TRIGGERING COVERAGE UNDER A LIABILITY POLICY

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ABSTRACT

Two widely differing approaches are used by insurers to determine coverage when writing liability insurance. The difference centers upon the event that triggers coverage and is known as the coverage trigger. The two approaches are known as claims made and occurrence. This paper is an attempt to explain and investigate the relevancy of both mechanisms used in determining the question of coverage when a particular claim is made.

Keywords: liability insurance, long-tail liability, claims made, occurrence basis.

INTRODUCTION

A liability policy is nothing more than expensive paper until it responds to a claim. The policy rests in a filling cabinet or desk drawer until coverage is triggered. At that time, the policy comes to attention to provide the protection that has been promised. A critical question with all liability contracts is 'What triggers coverage?'. A significant amount of time can pass between the date the professional performs a service and the time when a problem arises or becomes apparent. During that time the professional may have moved the professional liability insurance to another company, increased the limits and made other changes. Therefore, it has become an important consideration in determining which policy is triggered by the claim.

A policy's trigger defines the events that must take place for the policy to be activated. This coverage trigger determines which policy, often in a series of policies, spanning a number of years, will respond to a particular liability claim. When a particular policy is triggered, we should not assume that the policy would cover the claim in question. One must still determine if the wrongful act is of the type covered under the contract, that the incident occurred in the coverage territory, and that it is not excluded. When coverage is triggered, we simply know we are reviewing the appropriate contract in our pursuit to find coverage.

There are a variety of coverage triggers that may be found in liability insurance. The trigger on a general liability policy is usually an occurrence. The coverage trigger on most professional liability policies is a claim made to the insured. Both of these applications will be thoroughly considered in the later section of this discussion paper.

THE OCCURRENCE TRIGGER

An occurrence policy usually provides cover for losses resulting from bodily injury or property damage that is neither expected nor intended by the policyholder. Under an occurence policy, an insurer may be called upon to defend or indemnify the insured for claims arising after the policy period has expired, the requirement for attachment

of cover being merely that the 'occurrence' took place during the policy period. When a liability policy contains an occurrence trigger, such as those found in Commercial General or Public Liability policy, there are two criteria that must be satisfied for coverage to be activated. What are these two criteria? The first one is what the literature referred to as the occurrence requirement. This implies that the incident must have occurred during the policy period. If an incident occurred on, let say, May 1 1998, it is the policy that was in force on that date that will respond. The incident may not materialize into a claim until years later but one must still go back to the policy in force when the incident occurred in order to find coverage.
The second requirement is known as the reporting requirement. This second condition must be fulfilled for coverage to be triggered under an occurrence policy. In this case, the insured must report the claim as required by the policy. In most standard liability contracts, the requirement is to report the claim as soon as practicable. This means that an insured should always report a claim as soon as he or she becomes aware of it.

Occurrence itself is a broad term that includes accidents as well as events that happen over an extended period, often due to exposure to harmful conditions. Another important point is that an occurrence need not be sudden. For example, gradual pollution would fit within the general definition of occurrence. However, liability insurance contracts providing coverage for occurrences attempt to exclude gradual pollution on other grounds. Coverage disputes relating to pollution claims generally arise because the pollution resulted from a gradual and cumulative process, typically lasting many years. For that reason, difficulties arise in determining when the offending occurrence took place. Liability policies written for industries known to have substantial exposure to environmental risks, such as petro-chemical industry, have for many years excluded losses arising from pollution, unless the occurrence giving rise to the pollution was sudden and accidental.

There are always confusions and difficulties in determining, first the event or the insured event that triggers coverage under an occurrence policy and second, how to precisely define what is sudden and accidental. Let us consider the case of Kelly v. Norwich Union (1990), as quoted by Mendelowitz (2000). In this case, the ultimate issue was whether the insured homeowner's property policy covered damage to the house caused by water entering the ground under the house and causing "heave", that is the expansion of the soil because of the entry of the water.

The fact in this case is that, Mr Kelly had purchased property policies covering the period from October 1977 to October 1981. Serious water leakage occurred in the summer of 1977, which was before coverage started, when pipes bringing water to the house became disconnected. In 1978, the pipes became disconnected again but the leakage was not that serious and quickly remedied. In 1980, a third leak occurred. From there onwards, hairline cracks began to appear in the walls. Finally, in March 1981, Mr. Kelly claimed against his insurer, when he returned to his home after having stayed with friends for some days and finding that the cracks had opened up and damaged the core structures of his house. Borne in mind that the policy insured Mr. Kelly against water damage but not against heave.

The court had to define the term "events" in a policy provision stating that the insurer would "indemnify or pay insured in respect of events occurring during the period of insurance" referred to the events causing the insurer's liability, that is, the water seepage and not the occurrence of the damage. The court held that the damage to the house had begun in late 1979 or 1980, but could not allocate the damage between the events that may have caused it, that is, the summer 1979 leak and the 1980 leak. Although the cumulative policies (from October 1977 to October 1981) covered the entire period during which the damage occurred, the court ruled that the insured was not covered because the summer 1979 leakage began and ended before the policy period. The court ruled that the insured event might have taken place entirely outside the coverage period.

As mentioned earlier, there are also difficulties in precisely defining an occurrence giving rise to pollution which is sudden and accidental or as a result of gradual pollution (Mendelowitz, 2000). It has concerned insurers with regard to the interpretation of the trigger of cover under general liability policies covering gradual pollution. For example, consider a pollution caused by the escape of petrol and chemicals from a corroded underground storage tank. In this case, the process of corrosion may have been gradual, but it may be possible to identify the exact moment in time when the tank was finally breached or leaked. In this case, can we describe the breach as a sudden identifiable unintended incident which takes place in its entirely at a specific time and place during the period of insurance or the breach is the cause of the pollution through the gradual process of corrosion, which may have started long before inception of the policy, rather than the final rupture of the tank?

In the US, however, claims for bodily injury and property damage arising from asbestos and gradual pollution have been held to trigger all comprehensive liability policies purchased by an insured, from the time of initial exposure of persons or property to the asbestos or pollution, through to the discovery of the injury or damage or even later. Due to that, policies that were issued as early as the 1930s have been triggered. Can you imagine??

Irrespective of all confusions and difficulties surrounding the use of occurrence trigger, the occurrence based on coverage trigger offers a number of advantages to both the policyholder and the insurance carrier. What are these advantages? First, from the insurers' and their agent's point of views, the occurrence trigger is direct, straightforward and easy for an agent to explain and for the client to understand. Second, it involves uncomplicated underwriting. This implies that even an underwriter, who does not have a sophisticated degree of technical underwriting experience and knowledge, can write the occurrence policy. Last but not least, it increases mobility. When a policyholder, with an occurrence-based contract, changes carriers there are few potential coverage gaps.

On the other hand, the occurrance-based coverage trigger also carries with it certain disadvantages. First of all, it is about the policy retention. Since a policyholder may have to produce a contract to prove coverage that existed twenty years ago, record retention is essential with an occurrance-based policy. The second drawback in this type of trigger coverage concerns the old coverage limits. If a claim is made today for an incident that occurred twenty years ago, the policy limits available on the twenty-year-old policy will apply. Because of inflation, these limits may be inadequate. Moreover, there is no coverage for prior acts. With an occurrance-based policy, there is no way to obtain coverage for incidents that occurred prior to the inception date of the first policy. Furthermore, there are problems in determining the responsible insurer. If the act or acts leading to a claim took place over a period of time, spanning through several different policies, it may be difficult to determine which policy or policies will respond. There is also a problem related to long run pricing. With some liability claims there may be a significant time lag between the occurrance and the claim. This long-tail exposure can make it difficult to properly price and reserve a book of bussiness. In addition to all the above, the occurrance-based trigger coverage can also result in what is referred to in the literature as the stacking problem. In some cases, an insured has been able to activate several successive occurrance-based policies under the contention that the incident leading to the claim occurred over a long period of time and all policies in force during that time must respond.

In conclusion, insurers are very concern on the use of occurrence-based policies trigger, especially during the 1970s and early 1980s as a result of the increasing proportion of late claims, the higher awards late claimants tended to receive because of inflation and some others factors that increased insurer's pricing uncertainties and up to this point, insurers have sought to other alternative (Seaman, Scott M. et al, 1997).

A CLAIMS MADE TRIGGER

With some liability lines, the problems surrounding the occurrence-based contract are so significant that insurers are not willing to offer an occurrence contract. In those lines, the industry uses a policy with an alternative coverage trigger, that is, claims made, where a policy is written on a claims made basis. This means that the policy in force at the time a claim against the insured is made will pay for losses, regardless of when they occurred in the past. In other words, in claims made basis an insurer indemnifies the insured against claims made during a policy year, notwithstanding that the negligent act, error or omission may have occurred prior to the inception of the policy.

The sort of risk that should be written in claims made basis are such as products liability for manufacturers, medical malpractice or professional liability, all forms of pollution liability and employers liability claims (Bell, P., 1994). If an insured under a Professional Indemnity Contract becomes aware of a potential claim, he or she may notify the insurer accordingly within the current policy period. The result of this notification is that, any resulting claim will fall for indemnity under the policy in force at the time of notification, regardless that the negligence might have occurred before the policy came into force and the actual claim might be made after the policy expires.

The insurer in overcoming all the disadvantages under an occurrence basis policy has introduced claims made policies.These dis advantages are outlined earlier but worth mentioning again. Claims - made policies offer a number of advantages to both the insurance company and the insured. First, there are no problems concerning coverage limits. Limits can be predicted on today's exposur es more accurately than with 'occurrence' policies, so there is less likelihood of being underinsured. In addition, most policies contain annual aggregate limits which protect the insured from having prior claims reduce the coverage available for the insured prior acts exposure. Second, claims made policy offer prior acts coverage. Claims made policy may reach backwards in time and provide coverage for claims made today from negligent acts errors or omissions that occurred years before the policy was purch ased. Third claims made policy will solve the problems or difficulties in determining the exact date of loss. This is especially true in liability lines such as product liability and professional indemnity. Fourth, there is no problem in retaining old policy under claims made basis. The insured will not have to maintain a record retention with their old insurer in order to activate coverage for an event that could happen many years before that. Fifth, claims made policy will also solve the problem in determining the responsible insurer. This type of problem exists under occurrence basis where the act or acts leading to a claim took place over a period of time and with several different policies. Sixth, the insurer can get away with problem such as long run pricing. This is the most acute problem faced by the insurers, especially for long -tail risks. Some liability claims might involve a significant time lag between the occurrence and the claim. This long tail exposure can make it difficult to properly price and reserve a book of business. Lastly, claims made policy will solve the problem of long tail claims. As mentioned earlier, insurers are very concern about the increasing proportion of late claims such as those of long tail risks (pollution, product liability, employers disease liability etc.). Shortly after the expiration of claims made policy, an insurer can close their book and determine the year profit or loss. This is not possible under an occurrence basis where an insurer cannot determine their profit or loss for decades because of possible incurred but not reported (IBNR) claims.

Besides all of the above advantages of claims made policy, the primary disadvantage of claims made policy is its complexity. This complexity presents challenges for the underwriters especially in the underwriting process and in explaining its mechanism to the potential insured. Moreover, another problem with claims made basis is for the insured to follow precisely the notification procedures for claims and potential claims situations. Since coverage is triggered by the insured awareness and notification of a claim or potential claim situation, failure to properly provide notification to the insurer will eliminate coverage.

RETROACTIVE DATE AND THE REPORTING REQUIREMENTS. TWO ESSENTIAL ELEMENTS IN CLAIMS MADE POLICY

Prior act or retroactive date is an essential element in claims made policy. Claims resulting from services rendered or liabilities incurred before the prior acts date are not covered. The retroactive date determines the cut-off date for claims. If the incident occurred before the retroactive date, the insurer has no obligation and the insured has no coverage. The prior acts date is a critical item for negotiation and discussion at the time the insured purchase his or her coverage. For example, professionals such as lawyers, brokers, architects, doctors etc. need to negotiate a prior acts date that match with the first date the insured and his predecessors provided services. The insurer might be reluctant to provide the insured with extensive prior acts coverage, especially if the insured is presently uninsured or has gaps in his/her past insurance cover. Moreover, the provision of the retroactive date will be influenced very much by the statute of limitations that prohibits claims after certain years. In Malaysia, the time limit in which action may be brought by a potential plaintiff is governed under Section 6(1) of the Limitation Act 1953 and it serves well as a defense mechanism for both the tortfeasor and their insurer.

Furthermore, the reporting requirements in claims made policy are also important factors in determining coverage. Most claims made policies include a provision that allows the insured to notify his/her insurer of a potential claim situation and requires the insurer to accept this notification as the coverage trigger for any future claims (Hewitt, C. Markby, 1997). These notifications or reporting requirements are important since many claims begin as complaints or controversies that take months and sometimes years to develop into actual claims. Failure by the insured to comply with the policy conditions concerning time and manner of notification may entitle insurers to reject a claim which would otherwise be covered under the policy.

CONCLUSION

The notion that liability insurance may be written on an occurrence basis seems to be a good idea. Indeed, occurrence based coverage does have its advantages. For example, under claims made policies, the limit of liability may be more prone to exhaustion. Because a claims made policy may cover prior acts, the limit of liability may be spread over many years. It may be necessary to increase the limit over what might be considered sufficient under an occurrence policy. Another drawback of claims made coverage is that as soon as the policy is cancelled or expires, coverage ceases. This may require the purchase of tail coverage and there may be no guarantee that such coverage will be available. Tail coverage is usually restricted to cover acts occurring during the policy period or retroactive period. There is usually no coverage for claims based on covered acts taking place after the policy expiration. Insurance written on a claims made basis generally offers the broadest coverage available, pricing remains competitive and high limits of liability are available for most insureds. The widespread availability of prior acts coverage represents an important feature that may be missing under the occurrence based policy.

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