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ROANOKE TRADE
International Insurance Brokers Since 1935

E&O Review

Prior Acts Coverage—It's Essential

If you receive a quotation for Errors & Omissions Insurance and the price seems too good to be true, be sure to find out if it provides coverage for "prior acts." Prior acts are those transactions that took place prior to the inception of the policy you are purchasing. Often the lower priced policies fail to provide adequate coverage. In fact, some policies don't provide *any* coverage for prior acts...while others provide *limited* protection that may cover incidents that occurred one, two, or sometimes three years prior to inception of the policy. If the policy doesn't include prior acts coverage, errors committed in transactions that took place even one day prior to the inception of the policy will not be covered.

Since most claims involve mistakes that were made, or allegedly made, well before the claim is actually filed, it is a very risky decision to accept coverage with anything less than the longest prior acts period available. The potential claimants themselves may not be aware of a problem until some time after it happens. They may then spend time trying to resolve the problems themselves or simply be busy and distracted by other priorities and concerns. By the time they get around to making demands against you, or especially to filing suit against you, it's not uncommon for two or more years to elapse.

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While prior acts coverage is important for all, it is especially important for those of you with customs brokerage operations. Customs brokers know that liquidations are often suspended or withheld, that protests can take a long time to be acted upon, and that disputes in the Court of International Trade can drag on for extended periods. Similarly, 'old' entry files are re-opened during Customs' investigations of an importer's activities and dumping or countervailing duty investigations are often years in the making. In this environment, claims are frequently not discovered and brought against a customs broker until many years after a particular entry, or series of entries, were filed.

Any coverage with less than the longest prior acts period available is risky at best, and downright dangerous at worst. Many insureds mistakenly assume that their old expired policy, or policies, is where they will find coverage for prior incidents. Unfortunately, that is seldom the case. Almost all E&O policies are written on what is known as a "Claims Made" basis. Simply stated, Claims Made policies only cover claims made against the Insured (and reported to the insurance company) *during the policy period.*

Reporting a claim today, against a policy that 'was' in effect three years ago is *not* going to help. To have coverage, the claim must be made *during* the policy period. A claim made three years, or even three days, *after* an E&O policy has expired, is a claim made too late. That is why making certain that your *current* policy provides you with all the prior acts coverage for which you can qualify is essential.

If Policy X provides coverage for mistakes made on transactions dating back to September 1992 and Policy Y provides coverage for transactions dating back to September 2003, it's no mystery why Policy X costs more than Policy Y. What may at first glance appear to be a bargain, may in fact, be nothing more than a cheap and false sense of security.

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Suggestions?

Would you prefer to receive the E&O Review via email? Want to add someone to our reader list or make a change of address? Are there topics you'd like addressed in our next issue? Please send your comments and inquiries to: Bill Florio at bflorio@roanoketrade.com.

Did You Know?

Do you know why your E&O underwriters generally require financial statements when asked to provide coverage with deductible levels of $15,000 or more? The insurer wants to be certain that your company is financially able to meet its deductible payment obligations if called upon to do so. More importantly, the underwriter wants to be certain that if, in the insurer's judgment, a 'settlement' payment is required to resolve a claim your support or opposition to settling will not be influenced by the impact your deductible contribution will have on your company's overall financial results. Experience has shown that the higher an insured's deductible, the more reluctant an insured is to see a claim paid or settled. While the insurer is not required to seek your approval in a settlement decision, they want to avoid situations where financial considerations on your part become a major issue or concern.

About the Writers

Bill Florio is a Senior Vice President at Roanoke Trade Services, with over 25 years experience in providing insurance coverage for the international transportation industry. Among his responsibilities is the management of Roanoke Trade's Professional Liability (E&O) Insurance Program.

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Protecting Your Company When Presented with a Demand

It may come by telephone, fax, email or in person and it may be from the new, established, small or large customer — but when a demand is presented to your company, a clear response to the claimant followed by a coordinated defense is key to minimizing the exposure faced in such situations. Please keep the following guidelines in mind.

STEP ONE – Do not hesitate to respond, but gauge your response. Silence in the face of demand can often be read by the claimant as a tacit admission of responsibility or a lack of concern about their claim. While it is important not to admit responsibility or to say, "My insurance will take care of it," a response should be given to the claimant. Examples of appropriate responses are "We understand your concern and we will assess your claim and respond shortly" or "We will let our insurance company know and you should hear from them or our counsel soon." This will put the claimant at ease and hopefully keep the situation from escalating.

STEP TWO – Report the claim. This applies not only internally within your organization, but also as between your company and your insurers. First and foremost, your employees must be assured that the only appropriate course of action when presented with a claim is to present it to management. The most difficult situations we face as counsel often begin when there is a lack of communication or fear of reporting claims within the organization. It is then the obligation of management to present the claim to your insurance broker, as they are your link with the insurer that will, if appropriate, appoint counsel to respond to the claim on behalf of your company.

STEP THREE – Gather and secure transaction documents. As counsel, we rely heavily on documents in assessing the claim presented and in formulating our response on your behalf. Why? Because documents "speak for themselves" and they are not open to interpretation by one side or the other and their memory does not fade. Not only will we need the actual transaction documents, but we'll also need to review file jackets, file notes, email and other correspondence, as well as any main customer file you keep apart from the transaction file. It is also important to have those employees that were involved in the transaction prepare a short written summary of the facts, as they know them. This summary is not a document you want to share with the claimant, but rather it is to be presented to your insurer or appointed counsel. The written summary often plays a key role in counsel's assessment of the claim, especially if the employee leaves the company or otherwise becomes difficult or impossible to contact.

STEP FOUR – Limit your communications. Often the claim will come from a customer with which your company is still doing business. Do not let the claim become the focus of an ongoing dialog with the customer. Business must go on, and just as you rely on other outside vendors to get a job done for you, let counsel handle the interaction with the claimant on issues pertaining to the claim. In order for counsel to do an effective job for you, it is important to let counsel take the lead on communication.

You and counsel have an attorney-client relationship that can be waived if you share counsel's communications with others or allow persons outside your organization to be privy to such communications. Therefore, it is imperative that you do not forward communications from your counsel to anyone else. Also, when sending any communications to counsel or your insurer, do not provide a copy to persons outside your organization.

The claim process can be demanding, but to minimize the impact the claim has on your company and the relationship with your customer, it is important to follow these basic guidelines in responding to the claim and in working with your counsel through the claim. As counsel, we are vested with the obligation of protecting your company's interests, and to do so, we need your help from start to finish.

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The E&O Review is a publication of Roanoke Trade Services, Inc. Articles contained in this newsletter are summaries of complicated issues, and are not intended to convey legal advice. Before acting on any information herein, it is recommended that you seek professional advice regarding its applicability to your specific circumstances.

Errors & Omissions

CLAIMS REVIEW

Through a periodic review of actual claims that have occurred, we hope to illustrate how valuable an E&O Policy is in managing your business risks. In each of the following cases, the settlement and the legal fees were the amounts paid by the insurance company. The insured paid their deductible on the settlement amount.

CLAIM: Misclassification

Customs Broker

An importer of cut fabric was issued penalties by U.S. Customs totaling $318,000 for “grossly negligent” violations under 19 U.S.C. 1592. The violations were for failure to disclose to Customs that fabric had been cut in Mexico. The importer stated that it had clearly supplied the customs broker with documentation stating that the fabric was cut in Mexico and argued that the Customs penalty against it should be cancelled because it had fully disclosed all the required information to the customs broker. At the same time the importer notified the customs broker that it would hold them responsible for any amount ultimately assessed against it. Customs ultimately mitigated its demand against the importer to $40,000. The importer paid that amount and demanded reimbursement from the broker.

Damages Sought:	$40,000
Settlement:	$40,000
Legal Fees:	$3,150
Insured’s Deductible Contribution:	$10,000

CLAIM: Failure to Obtain Quota Duty Refunds

Customs Broker

The customs broker was asked to clear two shipments of imported lamb from Australia. At the time of entry, lamb was subject to a tariff rate quota. A quota certificate was required to claim the reduced rate of 6%. As no quota certificates were provided, the broker filed the entries at the non-quota duty rate of 32%, billed the importer, and was paid in full. Quota certificates were later located for one of the shipments and Customs approved a refund request and issued refund in the amount of $3,052 to the importer of record. Quota certificates for the second shipment were never located. A year later, the food processor that had sold the meat to the broker’s import client claimed that duty refunds on both of the entries should have been obtained, and sent to *them*, rather than to the importer.

Damages Sought:	$8,726
Settlement:	$0
Legal Fees:	$900
Insured’s Deductible Contribution:	$0

CLAIM: Improper Release of Cargo

Customs Broker

The customs broker, handling a shipment of cargo from Italy, to the U.S., had been given written instructions by the shipper to “release cargo only against collection of original house B/L and receipt of USD $2,640.” The broker did not follow those instructions and instead simply released the goods to the consignee. The consignee failed to pay the shipper for the merchandise and the shipper held the broker responsible for the full value of the merchandise on which it had not received payment.

Damages Sought:	$18,900
Settlement:	$18,900
Legal Fees:	$1,270
Insured’s Deductible Contribution:	$2,500

CLAIM: Failure to Respond to Information Requests

Freight Forwarder

The freight forwarder was asked by its overseas agent to handle the paperwork pertaining to the receiving of an ocean shipment of scissors from Hong Kong. The overseas agent sent several emails to the forwarder requesting information that it required prior to export. The forwarder’s employee never answered those emails. As a result of the forwarder’s failure to respond it became necessary to ship via airfreight to ensure that the product would be received in a timely manner.

Damages Sought:	$20,435
Settlement:	$0
Legal Fees:	$660
Insured’s Deductible Contribution:	$0

CLAIM: Damage to Cargo

Freight Forwarder

The freight forwarder arranged transportation on an import shipment of solvents, in plastic bottles, from Hong Kong to California. The cargo arrived damaged and leaking. The importer, who had no cargo insurance, sued the carrier and the forwarder for the value of the damaged product.

Damages Sought:	$10,000
Settlement:	$0
Legal Fees:	$2,250
Insured’s Deductible Contribution:	$0

Improper Release of Merchandise Against Documents

Over half of the E&O claims paid and submitted involve improper release of merchandise. We wrote about this problem in some detail in the Spring 2001 E&O Review (Volume 3. Issue 4). Unfortunately, both the dollar amounts paid as well as the volume of claims surrounding this issue has only become worse since then. When cargo is released in the absence of original bills of lading or in contravention of L/C instructions, shippers are often unable to collect payment from their consignees. The shipper or supplier then typically makes a large claim against the freight forwarder, customs broker or receiving agent, depending upon who made the error that enabled the consignee to take possession of the merchandise *without having paid for it*.

Claims for improper release of merchandise are large because the entire value of the shipment is usually at issue. These claims are difficult to favorably resolve because the consignee who took the merchandise is usually financially insolvent, or already out of business. These claims are difficult to defend because generally, there is no justifiable excuse or mitigating circumstance for the improper release. These claims are frequently caused by blatant errors. Sometimes they result from carelessness, while other times they result from trusting or relying on past experience with a consignee. More often than not though, these claims are a result of a combination of a*ll of the above*.

The more the global economy worsens and the more competitive business becomes, the more 'mistakes' of this nature seem to occur. We urge you to implement strict procedures of checks and balances within your operations to avoid the improper release of merchandise against documents. Closely review your internal procedures to be certain this does not happen to you.

Be alert to the existence of 'house' waybills when you receive instructions to release only against original documents. While you may have an original 'master' waybill in your possession, it might be insufficient if a 'house' waybill is also involved. Release instructions may be silent or unclear in this regard, but that does not relieve you from responsibility. If you are told not to release in the absence of original bills of lading, you want to be certain that you have *all* that are applicable.

More than one prominent E&O insurer has already eliminated coverage for claims involving the improper release of merchandise against documents. If the loss trend continues, it will only be a matter of time before all E&O insurers exclude coverage for these losses.

The good news though is that with the proper safeguards in place, claims of this nature can be avoided. They are preventable errors. With rare exceptions, these losses are usually the result of bad judgment and/or poor decisions. Even in the case of outright fraud, knowing who is the rightful owner of the goods and having evidence of ownership before releasing anything can protect you. If you are not sure who the rightful owner is, or if you do not have adequate proof, do not authorize release unless or until you have formal permission, in writing, from the seller to do so.

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