

The Journal of Insurance & Indemnity Law

A quarterly publication of the State Bar of Michigan's Insurance and Indemnity Law Section

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Opinions expressed herein are those of the authors or the editor and do not necessarily reflect the opinions of the section council or the membership.

From the Chair



Kathleen A. Lopilato,
Auto-Owners
Insurance Company

Greetings!

The section continues to grow and we are looking for ways to fulfill our strategic goals which include providing educational resources and programs. The quarterly *Journal* continues to be a mainstay of our mission of sharing information and opinions.

Beyond the *Journal*, we are always looking for ideas (and participation) on how our Section can share its expertise with our colleagues outside the Section. If you are aware of any other section, or any regional bar group that might be interested in a presentation on some aspect of insurance and indemnity law, please feel free to explore it with that group, and ask any of the Council members (listed on the inside back cover) to assist you.

Our hope is that each of our members will see himself or herself as an ambassador for our section's expertise. So if you are a member of another section that you think could benefit from a program or project, please take the initiative to explore the possibilities with them. Our Section's finances are strong, so we are able to set up and present programs, either on our own or jointly with other sections or groups.

Following up on that thought, we will be present at the Young Lawyers Greektown event on Saturday May 30, 2015, and we have agreed to provide a gold sponsorship.

Planning is also under way for the Annual Bar Meeting which will be held in Novi this year. The program this year will be "Effective Advocacy When Facilitating Insurance and Indemnity Issues." There is more information in the notice elsewhere in this issue. Save the date for October 8, 2015.

Welcome to our new members:

- Amallie de Fonseca defonse@cooley.edu
- Jessica Brigitte Hilliard jhilliard@setseg.org
- Elizabeth Ann Taylor Dornik eadornik@gmail.com

Thank you for joining!

—Kathleen A. Lopilato

Editor's Notes



By Hal O. Carroll
www.HalOCarrollEsq.com

The *Journal* – now in its seventh year – is a forum for the exchange of information, analysis and opinions concerning insurance and indemnity law and practice from all perspectives. All opinions expressed in contributions to the *Journal* are those of the author. We welcome all articles of analysis, opinion, or advocacy. The Section itself takes no position on issues.

Copies of the *Journal* are mailed to all state circuit court and appellate court judges, all federal district court judges, and the judges of the Sixth Circuit who are from Michigan. Copies are also sent to those legislators who are attorneys.

The *Journal* is published quarterly in January, April, July and October. Copy for each issue is due on the first of the preceding month (December 1, March 1, June 1 and September 1). Copy should be sent in editable format to the editor at HOC@HalOCarrollEsq.com. ■



Unmanned Aircraft Systems: The Wild Blue Yonder of Legal Uncertainty

By Mark Kelley Schwartz, *Driggers, Schultz and Herbst*

As a direct result of the increased popularity and corresponding decreased acquisition costs of Unmanned Aircraft Systems (“UAS”), commonly referred to as “drones,” media reports seemingly contain at least one sensational news item per week involving their operation or misuse. Not surprisingly, many of these stories highlight their unsafe operation, potential for endangerment of persons and property and issues relating to invasion of privacy.

As we enter the nascent stage of this new technology, or more simply put, as drones become cheaper, smaller and easier to operate, legal issues will arise with respect to their owners’ and operators’ liability for their operation, as well as the corresponding need for management of that risk, principally through insurance. Since this topic is so rapidly evolving and writing anything on this subject is somewhat akin to trying to throw a bulls-eye from a moving bullet-train – blindfolded, this article will only attempt to provide the reader with a fundamental understanding of the important differentiation between “Model Aircraft” and “Unmanned Aircraft” (a/k/a drones), a brief overview of the legal requirements for operation of Unmanned Aircraft and discuss the effect of recently proposed federal regulations for certification of their operators in the context of liability and insuring issues which may arise.

“Unmanned Aircraft Systems” are defined in federal regulations as the “unmanned aircraft” and the “associated elements (including communication links and components that control the unmanned aircraft).”¹ In this article, “Unmanned Aircraft System,” “UAS” and “Unmanned Aircraft” are used synonymously.

What Exactly Are You Flying?

“Model Aircraft,” “Small Unmanned Aircraft” and “Drones”

At the outset, the practitioner must make the initial determination of what the proposed or actual use involves. That is, is the Unmanned Aircraft a Model Aircraft, or not? Federal regulations distinguish between an Unmanned Aircraft and a “model aircraft.” An Unmanned Aircraft that falls into the classification of a Model Aircraft will continue to be largely unregulated – and therefore exempt from the proposed extensive regulatory scheme for the registration of the aircraft and licensure of its operators. This determination will be based

on both the “aircraft” itself as well as the facts surrounding its particular use.²

Model Aircraft. Historically, radio-controlled model aircraft have been used by hobbyists since the 1960’s and for the most part have peacefully co-existed with manned aircraft for many years. Up to a few short years ago, Model Aircraft remained largely off the radar of the Federal Aviation Administration (“FAA”), as they were generally operated responsibly and cooperatively by individuals and hobbyists groups. In 1981, the FAA issued Advisory Circular 91-57 “outlining and encouraging voluntary compliance with, safety standards for Model Aircraft operators,” which among other things provided for site selection recommendations for the use of Model Aircraft away from populated and noise sensitive areas, operations no higher than 400 feet above the surface and no closer than 3 miles from an airport unless certain notifications were provided to air traffic controllers.³

Drones. Fast forward twenty years, and military drones begin to be developed for surveillance and electronic warfare applications. These vehicles grafted existing mature aviation technology onto sophisticated telemetry systems. Later, these vehicles incorporated ground-operated airborne weapons platforms for warfighting purposes and were successfully integrated into the armed forces as they permitted extended mission duration at a significantly lower operational expense, without placing a highly trained pilot into unnecessary harm.

Just a few short years later, drone technology began being adapted for civilian use as manufacturing costs decreased and ease-of-use increased. The most common form is the quadcopter-type drone containing four vertical rotor blades shafts for increased stability; to the point that a child eight-years-of-age could easily operate one with only the most basic training.

Changes in Federal Regulations

Unmanned Aircraft. Recognizing the rapid development and propagation of these aircraft, Congress, as part of the FAA Modernization and Reform Act of 2012, mandated that the FAA undertake the regulation of Unmanned Aircraft Systems.⁴ Among many requirements, Congress directed the FAA to conduct studies and develop regulations and programs to integrate “Unmanned Aircraft” into the National Airspace System.⁵

Importantly, Congress provided a definition of Unmanned Aircraft as “an aircraft that is operated without the possibility of direct human intervention from within or on the aircraft” and set forth a classification scheme to shield the model aircraft community from many of the new regulations, provided that the Model Aircraft is flown for “hobby or recreational purposes.”

Small Unmanned Aircraft. Another subset of Unmanned Aircraft was also created by Congress, called Small Unmanned Aircraft, and being generally those Unmanned Aircraft with an operational weight (including all cameras, payload and sensors) of less than fifty-five pounds.⁶ This classification scheme becomes important as the proposed federal aviation regulations, discussed below, provide an entirely new operating and certification regimen for Small UAS.⁷

Model Aircraft. What distinguishes a Model Aircraft from its brother, the Small Unmanned Aircraft? The answer is generally contained within the touchstone phrase, “hobby or recreational purposes.” Exactly how far the FAA would go in deciding what uses constituted hobby or recreational uses was answered in 2014, when the FAA issued its “Interpretation of the Special Rule for Model Aircraft.” The FAA’s interpretation clearly states that for an Unmanned Aircraft to meet the definition of a Model Aircraft it must be *strictly* operated for hobby or recreational – as opposed to commercial – purposes. The FAA’s guidance is set forth in the chart below:⁸

Hobby or Recreation	Not Hobby or Recreation
Flying a model aircraft at a local model aircraft club.	Receiving money for demonstrating aerobatics with a model aircraft.
Taking photographs with a model aircraft for personal use.	A realtor using a model aircraft to photograph a property that he is trying to sell and using the photos in the property’s real estate listing. A person photographing a property or event and selling the photos to someone else.
Using a model aircraft to move a box from point to point without any kind of compensation.	Delivering packages to people for a fee.
Viewing field to determine whether crops need water when they are grown for personal enjoyment.	Determining whether crops need to be watered that are grown as part of commercial farming operation.

The common factor in the FAA-provided examples of operations which are neither strictly hobby nor recreational is that an Unmanned Aircraft is no longer a Model Aircraft if it is being used for the advancement of a commercial or monetary purpose, however incidental or remotely related to monetary

gain. As such, any analysis must begin with the purpose of use or proposed use. And, if the use is *strictly* hobby or recreational with no direct or indirect monetary gain, the aircraft will be considered a Model Aircraft and not subject to the comprehensive scheme of proposed regulations discussed below.⁹

Small Unmanned Aircraft and the Proposed Regulations

On February 23, 2015, the FAA released, through a Notice of Proposed Rulemaking, proposed regulations for the operation and registration of Small Unmanned Aircraft and the licensure of their operators.¹⁰ The proposal incorporates a new Part 107 to Title 14 Code of Federal Regulations.

Generally, operators of Small Unmanned Aircraft will be limited to operating their aircraft in daylight hours with visibility greater than three miles and in visual line-of-sight conditions, where the operator or visual observer must be in a position to see the aircraft “unaided by any device” except corrective lenses.¹¹ Operations can only be conducted at less than five hundred feet above the surface, at airspeeds less than eighty-seven knots (100 miles per hour) and may not be conducted over persons who are not directly involved with the operation of the Small Unmanned Aircraft itself.¹²

Individuals operating Small Unmanned Aircraft would be required to be at least seventeen years of age, pass a written exam, be screened by the Transportation Security Administration and undergo a recurrent examination every twenty-four months to be issued an Unmanned Aircraft Certificate.¹³ Small UAS would have to be inspected prior to each flight, be registered with the FAA’s central registry and display, in a manner applicable to the aircraft itself, registration markings or a tail number.¹⁴ Just as with its cousin, the manned aircraft, the operator is directly responsible for and the final authority as to its operation, and careless and reckless operations which “endanger[s] the life or property of another” are expressly prohibited.¹⁵ In most other respects, the proposed regulations represent a simplified version of regulations for the operation of manned aircraft with the transparent intent to bring the commercial operation of UAS into the realm of manned flight.

Because the proposed regulations are still within the comment period and have not been adopted at the time of publication, any commercial operation of a Small Unmanned Aircraft, at present (without the authorization(s) discussed in the next section) are considered unlawful. The FAA is dealing with these violations on a case by case basis, with the issuance of cease and desist letters to operators being the primary enforcement mechanism. This will undoubtedly shift to more traditional enforcement methods upon the codification of the proposed regulations.

Interim Authority to Operate by the FAA

The FAA is providing certain approvals for commercial operations of UAS operators of those Small Unmanned Aircraft and Unmanned Aircraft through a Certificate of Waiver or Authorization or a Special Airworthiness Certificate. As of March 26, 2015, only sixty-nine petitions have been granted by the FAA, primarily to media outlets and motion picture companies. Referred to as Section 333 exemptions, these apply to those Unmanned Aircraft, without regard to weight, and as of publication, are the only manner in which any Unmanned Aircraft System (other than Model Aircraft) can legally operate.¹⁶

State Regulation

States are also anxious to enter the game of regulating Unmanned Aircraft Systems. As of December 29, 2014, some nineteen states have enacted laws relating to their operation.¹⁷ In Michigan, Governor Snyder will likely sign into law two bills to outlaw the use of Unmanned Aircraft to either assist or harass hunters.¹⁸

For purposes of state law relating to liability for operation of UAS, application of our present liability scheme for manned aircraft should be similarly applied to Unmanned Aircraft. Michigan has long recognized the vicarious liability of owners of "aircraft" for the negligent actions or omissions of the operator.¹⁹ The Michigan Aeronautics Code defines aircraft in almost identical terms to that used in the United States Code: "any contrivance used or designed for navigation of or flight in the air," thus extending notions of existing liability for negligent operation of an Unmanned Aircraft to both owner and operator.²⁰ As a result, those persons lending a UAS to another, or even letting another "take the controls" will remain responsible for its safe operation. The public policy behind the vicarious liability system ensures that the owner of a UAS retain individual responsibility for leasing or loaning an Unmanned Aircraft to those that meet the standards proposed in the regulations and are otherwise qualified to operate it responsibly.

Insurance Issues for Model Aircraft

Individuals operating Model Aircraft are routinely provided with coverage for bodily injury or property damage under either homeowners' insurance or through a separate policy issued by a hobbyist group or association. Although there is great variance and every insurance policy must be separately read, many homeowners' coverages which expressly exclude liability arising from use of an "aircraft" exclude from their definition of that term, any model or hobby aircraft not used or designed to carry people or cargo. Separately, aircraft model associations such as the Academy of Model Aeronautics ("AMA") provide insurance coverage as a benefit of member-

ship to its members, clubs and chapters. The insurance coverage offered must be closely examined as many of these hobbyist policies provide coverage only secondarily to a member's own homeowners' coverage. As of January, 2012, the AMA reported it receives approximately 35 claims annually of which about 20 are property damage and 15 are bodily injury.²¹ This number can be expected to increase as operators proliferate and the public becomes aware of their capabilities.

Insurance Issues for Unmanned Aircraft

Actual and proposed commercial uses of UAS are limitless and varied: pipeline patrol, environmental studies, commercial photography, news reporting, wedding and special event filming, crop and aerial surveying, real estate sales, aerial observation of production areas, mines, quarries and construction sites are some of the many possible uses of Unmanned Aircraft. Due to their mobility, when a UAS is fitted with specialty sensors and cameras, operators are able to detect potentially hazardous conditions long-before traditional fixed-systems can provide warning. Presently though, these commercial uses remain unlawful without the required Section 333 exemption issued by the FAA.

The commercial insurance industry, however, is not ignoring this emerging market segment. Insurers are beginning to provide coverage to operators of UAS, notwithstanding the fact that some of these commercial operators do not have the Section 333 exemption. As it stands now, if certain strict underwriting requirements are met, each of these stand-alone type of operations are insurable by a limited number of underwriters and insurance carriers willing to write coverage, even without certification.

According to aviation insurance executives interviewed for this article, there are a small number of underwriters writing primary liability coverage for professional UAS operators. In most cases, the underwriting criteria either mirror or go beyond the proposed regulations for operation of small UAS and include safety management systems and the requirement for the Unmanned Aircraft operator to possess at least a pilot certificate for manned operations. Typical coverages are for between one million and five million dollars. Although for certain types of operations, offshore oil platforms being just one example, the requirements for substantially higher limits are being met and coverage for losses as large as twenty-five million dollars has been bound.

However, absent this separate UAS policy or a special endorsement to either an existing Commercial General Liability ("CGL") policy or Aviation Commercial Liability policy, coverage for any loss involving a UAS is at risk for being declined as these operations involve the operation of an "aircraft," which is typically excluded in most forms of coverage. This leaves a significant number of insureds exposed in the event of a loss involving a UAS, whether for bodily injury, property loss

or even destruction of the UAS itself. Coverage for damage to the aircraft itself can be important as the loss of the unmanned “platforms” and associated components such as cameras, sensors, gimbals and ground-based control systems can easily run into the tens of thousands of dollars.

For those operators of UAS who are “going bare,” without primary UAS coverages, the Insurance Services Office has promulgated a liability extension endorsement, Form LD-41526, for standard Commercial General Liability policies, which provides for the removal of the coverage exclusion.²² It is at least arguable that such extensions of coverage may be illusory for the time being, because regardless of the UAS endorsement, other exclusions may well apply, such as exclusions for unlawful purpose, violation of federal or state laws and regulations, or illegal or wrongful acts. These other exclusions may well vitiate coverage.

With the proliferation of cheap Unmanned Aircraft being operated as either Model Aircraft or Small UAS we will likely begin to see claims alleging various common law torts under state law, including those for traditional bodily injury, property loss, as well as invasion of privacy or trespass claims

A simple hypothetical involving a small construction company using its senior executive’s personal Model Aircraft for site survey and photography may be instructive. The field superintendent operating the UAS (no longer a Model Aircraft, because now it is being used for a commercial purpose) flies it too close to an independently employed roofer, startling him and causing a fall from the ladder, resulting in the roofer becoming permanently paralyzed.

First, the Unmanned Aircraft’s use is neither hobby nor recreational (and thus not a Model Aircraft). Assuming no Section 333 Authorization, there is an unlawful operation. If there is no endorsement for UAS operation on the GCL policy there will be no coverage for the operation of the “aircraft.” Further, assuming that the new Part 107 has gone into effect, even with a UAS endorsement on the GCL policy; where the UAS is not registered, the operator not licensed, the carrier may be in a position to disclaim coverage through common GCL exclusions for violation of law or statutes.

Notwithstanding the uncovered loss for the construction company, both the field superintendent and the executive will have personal exposure as owner and operator of the UAS. Both may find their homeowners’ carriers denying coverage as the use at the time of the incident falls outside the Model Aircraft exception to aircraft exclusion in the policies. The net

result is significant individual and corporate exposure for a catastrophic uncovered loss.

State Law Torts

With the proliferation of cheap Unmanned Aircraft being operated as either Model Aircraft or Small UAS we will likely begin to see claims alleging various common law torts under state law, including those for traditional bodily injury, property loss, as well as invasion of privacy or trespass claims. These claims will not be limited to just Model Aircraft but will also involve small Unmanned Aircraft, and a thorough analysis must be made because the standards for each operation differ.²³

As to claims for bodily injury, the Michigan Aeronautics Code’s definition of an aircraft dovetails with the FAA’s definition and both the owner and operator of an Unmanned Aircraft (whether model or commercially-used) would be vicariously liable for the operator’s negligence and the resultant property damage and personal injury.²⁴ Care must be taken, therefore, with the registration and recordation of Unmanned Aircraft purchases and sales, so as to not gratuitously leave a client as the “paper owner,” despite having sold a UAS. Just as with manned aircraft, registration and recording of a UAS with the FAA is not evidence of ownership, so it’s advisable to maintain a clear chain of title.²⁵

Where the aircraft may have a dual use, such as a Model Aircraft and Small Unmanned Aircraft in the hypothetical above, the use of a purchase agreement (with appropriate disclaimers) in all circumstances may also serve to prevent any claim against the seller for any defect which served to injure person or property when operated by the purchaser.

With respect to the invasion of privacy type of claims arising from intentional or unintentional use, Michigan continues to recognize four distinct types of theories of invasion of privacy: intrusion upon seclusion, public disclosure of private facts, false-light publicity claims, and appropriation of another’s likeness.²⁶ Intrusion upon seclusion is likely the most applicable theory to advance a cause of action for the use of a Model Aircraft or UAS to “spy” on an individual.

A typical case may arise involving the use of a “drone” by an individual to view a neighbor sunbathing in her backyard. In this hypothetical, the operator of a Model Aircraft operates it purposefully using the onboard camera to capture images of the neighbor sunbathing in her enclosed backyard. First, in Michigan, the use of a Unmanned Aircraft (including a Model Aircraft) equipped with a camera to capture images of a sunbathing neighbor will likely constitute a felony if the neighbor had a reasonable expectation of privacy in her own backyard and the use of a Model Aircraft falls within the criminal statute’s broadly defined classification of “any device for observ-

ing, recording, transmitting, photographing, or eavesdropping.²⁷ A separate criminal violation under our anti-voyeur law could also be established.²⁸

In the ensuing civil action, both intrusion upon seclusion and intentional infliction of emotional distress counts would likely be pled. Would indemnification be provided by the homeowner's policy for these injuries without any accompanying bodily or physical injury? In Michigan, the carrier may file a declaratory judgment action to determine if coverage exists and might be successful in denying coverage, especially where criminal activity is involved.²⁹ But, what about the operator who merely transits the backyard of the sunbather, while piloting the Model Aircraft to another point? Or, the commercial operator who is flying the UAS to capture an image of a neighboring property being listed and inadvertently captures a shot of the sunbather and turns the ensuing photograph into a billboard? Think that is far-fetched? Not so, the last scenario is based on an actual event.³⁰

Possible Federal Preemption

With the proposed regulations for UAS, many traditional common law torts which relate to the operation of Unmanned Aircraft may be further significantly affected by implied federal preemption. While beyond the scope of this article, the Sixth Circuit has reasoned that the Federal Aviation Act of 1958, as amended, and its enabling regulations, implicitly preempt state common law remedies as they relate to aviation safety.³¹

Any cause of action may then have to include separate violations of the applicable federal aviation regulations in order to survive dismissal. As such, the practitioner in a matter involving an Unmanned Aircraft must exercise care to treat the suit in much the same manner as a traditional aviation case, with its ensuing reliance on a set of federal safety regulations and associated guidance. By contrast, in a common law tort such as invasion of privacy a court will likely not invoke federal preemption as the UAS was merely the instrumentality of the tort, viz., the method by which the invasion of privacy was accomplished.

Other Insurance Issues

Manufacturer Liability. At the manufacturing and distribution levels, insurance underwriting requirements will have to be developed to provide for insurance coverage in the event of a product defect or sale of same within the chain of commerce. With foreign manufacturers providing the bulk of these small Unmanned Aircraft, claims for design or manufacturing defect may not find an insured defendant. Liability based upon sale in the chain of commerce may still be viable outside Michigan.³²

Repair and Service Liability. Companies that repair, modify or resell UAS will also need to consider their insurance needs, as many owners and operators may find themselves uncovered for losses. Any claim of product malfunction or product defect will require a deep bench, composed of experts in fields of accident reconstruction, electrical engineering and piloting. Again, not at all dissimilar to traditional aviation accident litigation.

What the Future Holds

When the FAA adopts its proposed new regulations in Part 107 in Title 14 of the Code of Federal Regulations, and as UAS sales continue to explode, insurers should begin mandating compliance with the new regulations. This will permit certificated individuals to obtain insurance for their UAS and provide an underwriting comfort level for the carriers. Some remaining problems will include businesses and individuals who operate UAS ancillary to their principal lines of business and are not aware that these aircraft and their operators are now highly regulated. Part of the burden will fall on the insurance industry, which will need to educate the underwriters, brokers and agents, while also designing applications which ferret out the necessary information from the proposed applicant. Educating all users and having legal counsel who make inquiry into use of UAS will be paramount to preventing the uncovered loss.

As we have seen in the past with advances in the internet, mobile phone and GPS, the law oftentimes significantly lags behind new technology. Today, operation of Unmanned Aircraft by corporations and individuals is not far afield from the uncertainty plaguing many early participants in those areas. But, just as civilian UAS operations have been advanced as a result of the maturation of existing aviation technology; UAS policy and law will similarly follow, utilizing many aspects of existing aviation law to help configure itself in this new field. ■

About the Author

Mark Kelley Schwartz is partner at Driggers, Schultz and Herbst in Troy and practices nationwide and internationally in aviation, personal injury and wrongful death law. In 2014, Mark was recognized as a Board Certified Aviation Attorney, the highest level of evaluation and competency by The Florida Bar. A FAA certificated Commercial Pilot and Flight Instructor, Mark represents individuals and businesses in most aspects of aviation law, including aviation injury and wrongful death, Montreal Convention litigation, product liability, regulatory licensing and certification, enforcement and transactional matters. His email is MSchwartz@DriggersSchultz.com.

Endnotes

- 1 FAA Modernization and Reform Act of 2012, P.L. 112-95, Feb. 14, 2012; Title III, Section, Sec. 331(6).
- 2 The principal federal statute authorizing the Federal Aviation Administration to regulate aircraft, airspace and pilots, defines the word 'aircraft' in the broadest possible manner as "any contrivance invented, used or designed to navigate, or fly in, the air." 49 U.S.C. 40102(a)(6). Through adoption of its own regulations, the FAA similarly defines an aircraft as "a device that is used or intended to be used for flight in air." 14 CFR 1.1. Both Model Aircraft and Unmanned Aircraft are broadly considered aircraft.
- 3 Federal Aviation Administration, Advisory Circular 91-57, June 9, 1981.
- 4 FAA Modernization and Reform Act of 2012, P.L. 112-95, Feb. 14, 2012; Title III, Section 331, *et seq.*
- 5 *Id.*, Section 332.
- 6 *Id.*, Section 331 (6) and (8).
- 7 *Id.*, Section 336(c).
- 8 Department of Transportation, Federal Aviation Administration, *Interpretation of the Special Rule for Model Aircraft*, Docket No. FAA-2014-0396, issued June 18, 2014, p. 11.
- 9 *Id.*, p. 12. The Model Aircraft must still meet other requirements, including, operating with: 1) generally, a fifty-five pound weight limit (with any sensors, payload or equipment attached) at the time of operation, 2) in accordance with generally accepted community-based guidelines for Model Aircraft, 3) giving way to manned aircraft and, 4) flown outside a five mile perimeter of an airport, unless proper notice is provided. PL 112-95, Sec. 336(a)(1)-(5). The proposed regulations also codifies the FAA's authority to regulate Model Aircraft operators whom "endanger the safety of the national airspace system." 14 CFR 101.43 (*Proposed*).
- 10 Operation and Certification of Small Unmanned Aircraft Systems; Proposed Rule, Federal Register Vol. 80, No. 35, February 23, 2014.
- 11 Proposed 14 CFR 107.31; 107.32.
- 12 Proposed 14 CFR 107.30; 107.51.
- 13 Proposed 14 CFR 107.61 – 107.65.
- 14 Proposed 14 CFR 107.49; 107.89.
- 15 Proposed 14 CFR 107.19; 107.23.
- 16 FAA Modernization and Reform Act of 2012, P.L. 112-95, Feb. 14, 2012; Title III, Section 333. See also, Federal Aviation Administration, https://www.faa.gov/uas/legislative_programs/section_333 (accessed March 29, 2015).
- 17 National Conference of State Legislatures, Current Unmanned Aircraft Landscape, <<http://www.ncsl.org/research/civil-and-criminal-justice/current-uas-state-law-landscape.aspx>> (assessed March 31, 2015).
- 18 Senate Bill SB-0055, as Passed Senate, March 26, 2015; Senate Bill SB-0054, As Passed Senate, March 26, 2015;
- 19 MCL 259.180(a). *Woodworth v Gates Learjet Corp.*, 173 Mich App 480 (1988); *Storie v Southfield Leasing, Inc.*, 90 Mich App 612 (1979).
- 20 MCL 259.2(e)
- 21 Academy of Model Aeronautics, Annual Insurance Report; <http://www.modelaircraft.org/files/500-q.pdf>, last assessed March 31, 2015.
- 22 Wisconsin Office of the Commissioner of Insurance, <<https://ociaccess.oci.wi.gov/Companyfilings/document?docid=204467&fileid=220561>> (accessed, March 31, 2015).
- 23 The FAA is considering a separate classification for "Micro UAS," weighing less than 4.4 pounds, composed of frangible materials and operating at no more than 30 knots of airspeed below 400 above ground level. Operation and Certification of Small Unmanned Aircraft Systems; Proposed Rule, Federal Register Vol. 80, No. 35, p. 9557, February 23, 2014.
- 24 MCL 259.180a.
- 25 49 USC 44103(c)(2).
- 26 *Lewis v LeGrow*, 258 Mich. App. 175, 193 (2003).
- 27 MCL 750.539d.
- 28 MCL 750.539j.
- 29 *State Farm Fire and Casualty Company v Basham*, 206 Mich App 240 (1994).
- 30 Pinahi, *Mt Martha Woman Snapped Sunbaking in G-String by Real Estate Drone*, Herald Sun, (November 17, 2014).
- 31 *Greene v B.F. Goodrich Avionics Sys., Inc.*, 409 F.3d 784, 795 (2005).
- 32 MCL 600.2947(6).

SAVE THE DATE!

THE STATE BAR OF MICHIGAN
INSURANCE AND INDEMNITY SECTION

Annual Meeting and Program

October 8, 2015, 9:00 a.m.

Suburban Collection Showplace, Novi
46100 Grand River Ave, Novi, MI 48374

THE TOPIC

Effective Facilitation of Insurance and Indemnity Disputes

THE PANELISTS

Kevin S. Hendrick
Clark Hill, PLC

Martin G. Waldman
Martin G. Waldman, PC

Hon. James J. Rashid, Jr.
Judicial Resource Services, PC

THE PROGRAM

Please join the Insurance and Indemnity Section for a meaningful discussion of effective facilitation techniques with a panel of experienced facilitators.

The program will help you improve your advocacy skills in alternative dispute resolution, including valuable practice tips from the mediators.

There will be an opportunity to ask questions of the panel and other experienced practitioners concerning their experiences with alternative dispute resolution and in particular what they found to be effective and ineffective.

Please direct your inquiries concerning the program to the Insurance & Indemnity Section chair-elect Adam Kutinsky, at akutinsky@dmms.com or (248) 642-7835.



Fraud in Michigan's No-Fault Insurance Assigned Claims Plan: What Exactly Is a "Claim"?

By Andrea M. Symbal, *Kitch Drutchas Wagner Valitutti & Sherbrook*

Michigan's No-Fault Act provides for personal protection insurance (PIP) benefits to individuals that are injured in motor vehicle accidents. The Michigan Assigned Claims Plan (MACP) was created under the No-Fault Act to provide the same benefits to a person when there is no identifiable insurance company responsible for payment of the benefits. Recently, Michigan modified the No-Fault Act to bar payment of PIP benefits where the injured party submits a fraudulent claim under the MACP.

However, what if the fraud is not committed when the person makes the initial claim for MACP coverage, but when the person makes a later claim for a benefit under an open and otherwise legitimate MACP file? Does submission of that fraudulent claim for a single PIP benefit enable the insurer to deny all coverage under the MACP file that was initially legitimate?

This question requires a determination of what "claim" means under the No-Fault Act. Unfortunately, the law barring MACP benefits based upon a fraudulent claim does not clarify whether "claim" refers to the initial "claim" for MACP coverage or a subsequent "claim" for benefits under an open MACP case. This article discusses how this issue may be treated under Michigan law.

Michigan's No-Fault Act

Michigan's No-Fault Act was enacted in 1973 with the purpose of establishing a better system for compensating individuals injured in motor vehicle accidents.¹ The No-Fault Act was created to achieve three main goals: (1) to help injured persons achieve maximum recovery after accidents; (2) to ensure that auto accident victims were reimbursed promptly for costs related to their accidents; and (3) to reduce legal and administrative costs by avoiding time consuming and unnecessary lawsuits. It requires that every owner of a vehicle must maintain certain insurance coverage on the vehicle and, as a result, no-fault first-party PIP benefits are payable to anyone who suffers injury "arising out of the ownership, operation, maintenance or use of a motor vehicle."² Benefits for an injured person include medical and rehabilitative expenses, wage loss, and replacement services. Losses are recovered without regard to the injured person's fault or negligence.³ Unlike the handful of other states that follow the no-fault automobile insurance model, Michigan does not cap the amount of PIP

benefits an individual may receive.⁴

While individuals who purchase no-fault insurance policies are obviously eligible for PIP benefits for injuries arising out of motor vehicle accidents by way of their insurance contract, the No-Fault Act also carries out its purpose of providing PIP benefits to anyone who suffers an injury in a motor vehicle accident by establishing the MACP. The No-Fault Act requires that all self-insurers and insurers writing insurance in Michigan under the Act must participate in the MACP. The purpose of the MACP is to provide PIP benefits to persons injured in motor vehicle accidents where there is no identifiable or higher priority insurance available.⁵ The participating insurers of the MACP service the claims that are filed with the MACP. Therefore, those insurers, and to a larger extent the revenue generated by their policyholders and the public at large, fund the MACP and the provision of PIP benefits to individuals injured in motor vehicle accidents that do not have access to other no-fault insurance.

Fraud in Michigan's Assigned Claims

MCL §500.3173a clarifies the MACP's role in processing PIP claims. MCL §500.3173a(1) requires the MACP to make an initial review of the claims for eligibility and deny those that are obviously ineligible. In September 2012, MCL §500.3173a was amended with the addition of a second paragraph.⁶ That particular section of the No-Fault Act, MCL §500.3173a(2), attempts to control the potential for fraudulent claims within the MACP by stating (emphasis added):

A person who presents or causes to be presented an oral or written statement, including computer-generated information, as part of or in support of a claim to the Michigan automobile insurance placement facility for payment or another benefit knowing that the statement contains false information concerning a fact or thing material to the claim commits a fraudulent insurance act under section 4503 that is subject to the penalties imposed under section 4511. *A claim that contains or is supported by a fraudulent insurance act as described in this subsection is ineligible for payment or benefits under the assigned claims plan.*

As referenced in MCL §500.3173a, MCL §500.4503 defines fraudulent insurance acts and clarifies that a fraudulent insurance act includes, but is not limited to, acts or omissions committed by any person knowingly, and with intent to injure, defraud, or deceive. The commission of a fraudulent insurance act under MCL §500.4503 is a felony punishable by imprisonment for not more than four years or a fine of not more than \$50,000, or both, and payment of restitution shall be ordered.

As set forth above, MCL §500.3173a(2) provides that “A claim that contains or is supported by a fraudulent insurance act as described in this subsection is ineligible for payment or benefits under the assigned claims plan.” Despite what appears to be clear and unambiguous language, trial courts have not consistently applied MCL §500.3173a(2) to every case involving fraudulent PIP claims. Specifically, trial courts have rendered different decisions when an insurance company seeks to bar all benefits under an MACP file based upon a single fraudulent claim for a certain PIP benefit. Since the law is relatively new, its application begins with appropriate statutory interpretation.

Statutory Interpretation – What Is a Claim?

Although the No-Fault Act does not provide a definition for the word “claim,” the word is frequently used throughout the statute in the singular. The legislature’s use of the word “claim” is useful to determine whether “claim” encompasses all PIP benefits to which a person is entitled. For example, MCL §500.3172(1) states as follows:

A person entitled to claim because of accidental bodily injury arising out of the ownership, operation, maintenance, or use of a motor vehicle as a motor vehicle in this state may obtain personal protection insurance benefits through the assigned claims plan....

... In that case, unpaid benefits due or coming due may be collected under the assigned claims plan and the insurer to which **the claim** is assigned is entitled to reimbursement from the defaulting insurers to the extent of their financial responsibility. (Emphasis added)

The reference to “the claim” indicates that the injured person brings a single claim for all PIP benefits through the assigned claims program and the program then assigns that singular claim to a participating insurer. This singular use of the word “claim” is also seen in MCL §500.3172(3) addressing what is to happen when there is a dispute between two identified insurers. It states in part:

(b) **The claim** shall be assigned by the Michigan automobile insurance placement facility to an insurer

and the insurer shall immediately provide personal protection insurance benefits to the claimant or claimants entitled to benefits.

(c) An action shall be immediately commenced on behalf of the Michigan automobile insurance placement facility by the insurer to whom **the claim** is assigned in circuit court to declare the rights and duties of any interested party.

(d) The insurer to whom **the claim** is assigned shall join as parties defendant to the action commenced under subdivision (c) each insurer disputing either the obligation to provide personal protection insurance benefits or the equitable distribution of the loss among the insurers. (Emphasis added)

The principles of statutory interpretation also require the courts to give effect to the Legislature’s intent, which is determined by looking first to the language of the statute itself.⁷ In doing so, the courts are required to give effect to every word, phrase and clause, avoiding construction that would render part of the statute surplusage or nugatory.⁸ Undefined words are afforded their plain and ordinary meaning, and a dictionary may be consulted to ascertain the common meaning of a term.⁹ “When language of a statute is unambiguous, the Legislature’s intent is clear and judicial construction is neither necessary nor permitted.”¹⁰

In reviewing the use of the word “claim” versus the use of the word “benefits” within the No-Fault Act, it is clear that the “claim” is singular while “benefit” is plural; thus, the single claim encompasses the benefits within it. If the intent of the statute was to reflect that a person had a separate claim for each type of PIP benefit (e.g. a medical expense claim, an attendant care claim, a wage loss claim, and a replacement service claim), thereby requiring multiple claims to obtain all PIP benefits, the statute would have been worded to reflect an injured person’s multiple claims.

The statutory language is consistent and indicates that a person’s claim (singular) is for all PIP benefits of whatever type to which the person may be entitled, and that each benefit does not constitute a separate “claim.” The use of the singular word “claim” in MCL §500.3173a where it states, “A claim that contains or is supported by a fraudulent insurance act as described in this subsection is ineligible for payment of benefits under the assigned claims plan” means that a person’s request for all PIP benefits of any type become ineligible for payment where there is any fraud as to any benefit that is within the scope of the “claim.”

The singular use of the word “claim” to represent a claim for all PIP benefits to which a person is entitled is used consistently throughout the statute, and that serves to strengthen the assertion that the intent of MCL §500.3173a(2) is to deny

all PIP benefits in the event of a fraudulent insurance act regardless of whether the act only affects a particular subset of benefits.

Public Policy – Is This the Intended Result?

Further support that the use of the word “claim” encompasses all benefits to which an injured person is entitled may be found in public policy. One of the purposes of the No-Fault Act was to ensure prompt payment for costs associated with motor vehicle accidents, but certainly the purpose was not to freely provide funds to individuals who are knowingly intending to deceive the MACP. The continued payment of some types of PIP benefits to individuals that participated in fraudulent insurance acts would appear to be rewarding illegal behavior and would incentivize others to engage in fraud. It is a win-win situation. If fraud is perpetrated and the individual doesn’t get caught, full benefits in accordance with the Act are paid. On the other hand, if fraud is detected and only a portion of the claim is dismissed, the individual still receives payment of some benefits. It is unlikely that the courts would turn a blind eye to this activity especially as it pertains to assigned claims.

The public policy argument gets complicated, though. Nobody wants to reward an individual for fraudulent activity, but the question then becomes whether total denial of the claim satisfies the purpose of the Act, especially where the misrepresentation is relatively minor and confined to one specific category of benefit. For example, assume that a person has clearly been injured in a motor vehicle accident and requires continued and ongoing medical treatment. When submitting reasonable proof of his claims, the person for whatever reason intentionally exaggerates the days he or she required household replacement services and submits documentation seeking payment for the replacement service provider in the exaggerated amount and not the actual amount of the expense incurred.

In reviewing the use of the word “claim” versus the use of the word “benefits” within the No-Fault Act, it is clear that the “claim” is singular while “benefit” is plural; thus, the single claim encompasses the benefits within it.

In this situation it is questionable whether public policy supports the denial of all PIP benefits to an individual who continues to require medical treatment and the fraudulent activity only pertained to the replacement service benefits. It may be these competing public policy considerations that are driving the inconsistent opinions at the trial court level. And courts may find justification in denying the individual’s claim

for only a certain type of benefit rather than the whole claim because it will still ensure that two out of three of the purposes of the Act are being carried out: prompt payment and maximum recovery for the individual.

Conclusion

Now that there is a provision in place to combat fraudulent claims in the MACP, insurance companies will want to enforce that provision to prevent unnecessary payment of benefits in the presence of fraudulent insurance acts. As explained above, until further clarification is provided regarding the meaning of the word “claim” in the Michigan No-Fault Act the results of enforcement of MCL §500.3173a(2) will be inconsistent. This is an issue that will not be taken lightly by plaintiffs or defendants because it determines whether an individual that has committed a fraudulent insurance act will receive payment of any benefits at all. Until the Court of Appeals renders a published opinion on the issue, attorneys will find themselves arguing the meaning based on legislative history, statutory interpretation, and public policy. ■

About the Author

Andrea Symbal is an attorney at Kitch Drutchas Wagner Valitutti & Sherbrook and a member of its insurance and commercial litigation practice. Her practice focuses on insurance defense and insurance coverage with an emphasis on No-Fault Personal Injury Protection Insurance litigation. Ms. Symbal also represents commercial clients in complex disputes including real estate and banking litigation. She can be reached at (313) 965-2937 or andrea.symbal@kitch.com.

Endnotes

- 1 MCL §§500.3101 - .3179
- 2 MCL §500.3105
- 3 *Spencer v Citizens Ins Co*, 239 Mich App 291, 300; 608 NW2d 113 (2000).
- 4 The other No-Fault states are Florida, Hawaii, Kansas, Kentucky, Massachusetts, Minnesota, New Jersey, New York, North Dakota, Pennsylvania, and Utah.
- 5 MCL §500.3172
- 6 2012 PA 204; 2011 HB 4455
- 7 *Tellin v Forsyth Twp.*, 291 Mich App 692, 701; 806 NW2d 359 (2011).
- 8 *Book-Gilbert v Greenleaf*, 302 Mich App 538, 541 (2013) citing *Johnson v Recca*, 492 Mich 169, 177, 821 NW2d 520 (2012).
- 9 *Sands Appliance Servs, Inc v Wilson*, 463 Mich 231, 240; 615 NW2d 241 (2000).
- 10 *Lash v Traverse City*, 479 Mich 180, 187; 735 NW2d 628 (2007).

Business Court Report



By Kassem Dakhllallah, AT Law Group PLLC

Breach of Duty to Indemnify Creates Cause of Action Independent from Other Contractual Duties

Court: Oakland County, Hon. Wendy Potts

Case: Flagstar Bank, FSB v Integra Lending Group, LLC; Case No. 14-140051-CK

Date: November 21, 2014

Issue: Does a mortgage broker have a duty to indemnify a bank that purchases a mortgage loan from the broker pursuant to a mortgage loan broker agreement where (1) The breach of warranty claim arguably accrued prior to the six-year statute of limitation for breach of contract; and (2) The breach of duty to indemnify claim arose during the six year statute of limitation for breach of contract?

Ruling: Flagstar alleged that Integra breached its warranties for two loans: a 2006 loan and a 2007 loan. Integra transferred the notes and mortgages for these loans to Flagstar, who then sold them to Fannie Mae. In 2012, Fannie Mae demanded that Flagstar reimburse it for a loss incurred on the 2006 loan because the mortgage insurer rescinded the insurance based on several misrepresentations. In 2013, Fannie Mae demanded Flagstar reimburse the 2007 loan because the borrower misrepresented her income. Flagstar reimbursed Fannie Mae \$133,506.12 for the 2006 loan and \$108,715.59 for the 2007 loan. Flagstar claims that its total loss is \$248,236.99 plus attorney fees and costs.

Integra argued that Flagstar's claims are barred because it did not bring them within six years of its alleged breaches of the warranties. Integra claims that the breaches alleged by Flagstar occurred when Integra transferred the loans to Flagstar, which was more than six years before Flagstar filed the lawsuit. However, this argument misconstrued the nature of Flagstar's claims, which alleged that Integra breached its obligation to indemnify Flagstar. The indemnity provision in Integra's agreement creates an obligation to Flagstar independent of any other obligation. *Miller-Davis Co v Ahrens Construction, Inc*, 495 Mich 161, 173; 848 NW2d 95 (2014).

Flagstar alleged that Integra breached this duty to indemnify when Flagstar demanded indemnification and Integra failed or refused to do so. Because the duty to indemnify accrued when Flagstar demanded indemnification in 2012 and 2013, Flagstar filed its claims well within the six-year limitation period.

Note: A duty to indemnify is a duty separate and distinct from other contractual duties.

Business Court Jurisdiction Does Not Extend to Solely Declaratory Actions

Court: Ingham County, Hon. Joyce Draganchuk

Case: Peachtree Settlement Funding, LLC v The Lincoln National Life Insurance Co., No. 14-722-CZ

Date: June 17, 2014

Issue: Does a declaratory judgment action that does not seek any monetary damages brought by a lender against its insurer belong on the business court docket or the general civil docket?

Ruling: Business court jurisdiction is limited by statute to actions involving a "business or commercial dispute." MCL 600.8035(3). The statute defines a business or commercial dispute as, *inter alia*, "An action in which all of the parties are business enterprises." MCL 600.8035(3)(i).

The court held:

MCL 600.8035(1) provides that "[a] business court has jurisdiction over business and commercial disputes in which the amount in controversy exceeds \$25,000.00." As a court of general equity jurisdiction, circuit court has subject-matter jurisdiction to issue a declaratory ruling, an injunction, or a writ of mandamus. Had the Legislature intended business court jurisdiction to be concurrent with circuit court jurisdiction, it could have included actions for declaratory or injunctive relief to be within business court jurisdiction. Instead, the Legislature only provided for business court jurisdiction over cases where the amount in controversy exceeds \$25,000. This may have been an oversight.

Finding that the complaint does not allege a business dispute, the court ordered the case reassigned to the general civil docket.

Note: Practitioners are well-advised to determine prior to filing whether a case belongs in the business court. By statute, the business court has exclusive jurisdiction over business or commercial disputes. Thus, practitioners who cause or allow a case to be litigated to conclusion on the general civil docket rather than in the business court run the risk of obtaining a judgment that lacks finality.

continued on the next page

Franchise Termination: Injunction is Proper,
Receivership is not

Court: Oakland County, Hon. Wendy Potts

Case: Leo's Coney Island Franchising Company, v Milford Coney Prt, LLC, et al, Case No. 14-142622-CK

Date: September 24, 2014

Issue: Whether the franchisor is entitled to the entry of an injunction and/or receivership where it is undisputed that the franchisee has breached its obligation to pay royalties and franchise fees under the franchise agreement.

Ruling: Based on the evidence presented, plaintiff has a likelihood of success on the merits because there does not appear to be any factual dispute that defendants breached the franchise agreement. Plaintiff also demonstrated irreparable injury through loss of customer goodwill and possible damage to its brand and marks. The harm to plaintiff appears to outweigh any harm to defendants, and the public has no apparent interest in this private dispute. For all of these reasons, the court grants the request for injunctive relief and will enter plaintiff's proposed order.

Plaintiff also asks the Court to appoint a receiver to ensure that Defendants comply with the Court's injunction, cease operating the franchises, and do not violate their non-compete. However, appointing a receiver is a harsh remedy which should happen only in the face of strong evidence of harm. *Band v Livonia Associates*, 176 Mich App 95, 105; 439 NW2d 285 (1989). If defendants comply with the injunction, plaintiff will not suffer any further harm and a receiver is unnecessary. Thus, appointing a receiver is premature and the court denies the request without prejudice. If defendants fail to promptly comply with the injunctive order, plaintiff may renew its request for a receiver

Note: It appears that the plaintiff sought a receivership to continue uninterrupted the operation of the business as a franchise location. An injunction in this case means that the franchisee is prohibited from operating the business using the franchise name and marks. That effectively ends the franchisor's affiliation with the location. In some contexts, particularly cases involving waste to real estate, courts appear to liberally grant requests for receiverships. In the context of a franchise agreement where the franchisor's interest is to protect its brand, apparently courts are a little more reluctant to appoint a receiver. ■

About the Author

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Announcement

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ropolitan Bar Association Barristers. Kassem's practice focuses on business and commercial litigation, including commercial insurance litigation. His email address is kd@atlawgroup.com.

Additional Insureds and Contractual Indemnity

By James A. Johnson, johnsonjajmf@hotmail.com ©2015

Every general contractor wants to be an “additional insured” under its subcontractor’s policies. But even if an endorsement like the commonly-used Blanket Additional Insured Endorsement does confer additional insured status on the general contractor, the coverage that the endorsement grants may be so narrowly defined that the general may have trouble invoking it. Careful pleading may help the general in its quest for coverage, and as an alternative path to protection, the general will also want to invoke the subcontractor’s indemnity obligation. The rule is “tender early and often,” i.e. tender once to the subcontractors insurer for coverage under the policy and tender directly to the subcontractor itself for contractual indemnity.

The following are a few factual scenarios relating to the central question of defense. Under the ISO forms, fault is material to coverage for the general contractor as an additional insured. The operative coverage language affording coverage to the additional insured provides in pertinent part, “but only with respect to liability for bodily injury, property damage or personal and advertising injury caused in whole or in part, by your acts or omissions or acts or omissions of those acting on your [i.e., the subcontractor-named insured] behalf.”

even if an endorsement like the commonly-used Blanket Additional Insured Endorsement does confer additional insured status on the general contractor, the coverage that the endorsement grants may be so narrowly defined that the general may have trouble invoking it. Careful pleading may help the general in its quest for coverage, and as an alternative path to protection, the general will also want to invoke the subcontractor’s indemnity obligation

In one scenario, a subcontractor’s employee is injured at a construction site and sues the general contractor for failure to provide a safe workplace. The general contractor-additional insured will have to establish that its tort liability to the subcontractor’s employee arises out of the named insured-subcontractor’s acts or omissions. This is almost impossible for the additional insured general contractor to do because the named insured subcontractor is not a named defendant in the complaint. The employer of the injured employee cannot be a defendant because it is immune from suit by the exclusive

remedy provision of the workers compensation statute. The duty to defend in the above scenario is not triggered because there are no allegations in the complaint that the named insured employer was negligent.

The answer to whether and how the general contractor can establish that it is covered under the subcontractor’s policy is different in different jurisdictions.

In Michigan, the insurer has a duty to look behind the third party’s allegations to analyze whether coverage is possible.¹ The insurer has a duty to investigate known or readily ascertainable facts extrinsic to the complaint to determine if there is potential coverage.² The duty to defend is distinct from and broader than, the duty to indemnify for covered claims.³ So long as the complaint includes one count or claim for which there is a duty to defend, the duty extends to the defense of all claims in the suit, including those for which there is no coverage.⁴ Moreover, when an insurer is obligated to defend a suit that includes claims not covered by the policy, the defense obligation lasts until any possible recovery is definitively confined to the uncovered claims⁵

However, unlike the duty that Michigan imposes on insurer to look behind the allegations, in strict “eight-corners” jurisdictions, such as Texas, the court will not look beyond the four corners of the complaint and the four corners of the insurance policy. It is almost impossible for the additional insured-general contractor to obtain a defense from the subcontractor’s insurance carrier. But on June 13, 2008, the Texas Supreme Court in *Evanston Ins Co v Atofina Petrochem, Inc*⁶ departed from its “eight corners” rule and may have created a 12 corner or 16 corner rule for determining coverage for additional insureds. In this case, the plaintiff sued only the additional insured in which the sole-negligence exclusion applies automatically. Because the defendant alleged contributory negligence by the defendants who were earlier dismissed, the court remanded the case to the trial court for a determination of the respective liabilities of the parties. The catch-all provision of the excess policy defining “insured” to include any person or organization insured under the underlying insurance policy could extend coverage beyond what the underlying policy provided. The court may have given additional insureds a way to end-run the sole negligence exclusions found in most additional insured endorsements. This decision could mean that a sole defendant-additional insured need only counterclaim against the plaintiff for contribution or implead a third party to escape the sole negligence exclusion.

unlike the duty that Michigan imposes on insurer to look behind the allegations, in strict “eight-corners” jurisdictions, such as Texas, the court will not look beyond the four corners of the complaint and the four corners of the insurance policy ...

However, on January 1, 2012 the Texas Indemnity Act became effective codified in sections 151.001-151.151 of the Texas Insurance Code. In short, the Texas Indemnity Act prohibits in “construction contracts” clauses allowing indemnity for one’s own negligence void and unenforceable.

Jurisdictions such as Illinois follow the eight corners rule, but do not require the insurer to investigate. However, Illinois does require the insurer to defend if it knows of extrinsic facts creating a potential for coverage. The additional insured—general contractor can probably obtain a defense by providing information it has gleaned through investigation and discovery by the subcontractor-named insured’s insurance carrier.

Consider our previous example where the subcontractor’s employee sues the general contractor, but the additional insured endorsement contained exclusion for:

bodily injury or property damage arising out of any acts or omission of the additional insured-general contractor or any of its employees, other than general supervision of the work performed for the additional insured-general contractor by the named insured-subcontractor-employer.

Instructive is *Casualty Ins Co v Northbrook Prop & Cas Ins Co*,⁷ where the issue was whether the general contractor was entitled to a defense from the insurer of the subcontractor-employer despite the absence from the complaint of any allegation that the employer was negligent. The court held that the absence of such allegations did not negate the duty to defend because of the employer’s immunity under the Workers Compensation Act to a suit by its employee. The complaint’s silence as to any acts or omissions of the employer only indicates that the employer is statutorily immune to suit and not that it could not be held liable by virtue of its general supervision of subcontractor-employer.

Next is *BP Chemicals Inc v First State Ins Co*,⁸ decided by the 6th Circuit applying Texas law. This case involves an

A public entity cannot require any of the protected parties to assume any liability or indemnify the public entity or any other party for an amount greater than the protected party’s degree of fault.

underlying contract with an indemnification obligation and a hold harmless clause requiring the contractor to obtain an additional insured endorsement.

Plaintiff, BP Chemicals appealed from entry of judgment in favor of the defendant, First State Ins. Co in a breach of contract action for indemnification under an excess policy. Bath Electrical, the contractor was required to purchase liability insurance naming BP Chemical as additional insured. As part of the indemnification agreement in the underlying contract Bath agreed to indemnify BP against:

any and all losses, expenses, demands and claims” that may be claimed or for which suit is brought for any actual or alleged bodily injury or death occurring to any person whatsoever, “arising out of, in connection with, or resulting in whole or in part out of the acts or omissions of BES, INC., or any subcontractors employed by BES, Inc.

However, the indemnity obligation was limited in two ways. First it barred indemnity when the only negligence was that of the general contractor. Second, it provided for indemnity in proportion to the “actual percentage of comparative negligence” of the indemnitor:

“such obligation shall not apply when the liability arises solely from the negligence of Owner, its employees or agents. Such obligation shall also be limited, in a case involving or alleging joint negligence between BES, Inc., and Owner, its employees or agents, to BES, INC.’s actual percentage of comparative negligence, if any, found by the trier of fact in a cause of action brought against BES, INC. arising out of the performance of the work or alleged negligence in accordance with this Agreement.”

First State denied there was coverage under the excess policy and BP paid it from its own funds and brought this action. The Sixth Circuit concluded as did the District Court that BP was an additional insured under First State’s excess policy and that BP’s own negligence was excluded by the separate cross-liability exclusion. The Sixth Circuit further held that the question of whether BP was covered for its own negligence is determined from the scope of coverage provided by the underlying insurance policy. The underlying policy included a blanket endorsement (CG-4) for additional insureds which stated as follows:

“It is agreed that additional insureds are covered under this policy as required by written contract, but only with respect to liabilities arising out of their operations performed by or for the named insured, but excluding any negligent acts committed by such additional insured. (emphasis added)

The policy's CG-4 endorsement in *BP Chemicals v First State* defines the scope of BP's additional insured coverage in two relevant ways: (1) by providing coverage only with respect to liability arising out of BP's operations performed by Bath; and (2) by expressly excluding any negligent acts committed by the additional insured. Thus, the primary policy did not cover BP for its own negligence and the excess policy through its cross-liability exclusion followed the primary liability insurance and did not cover BP for its own negligence.

This case deserves reading in its entirety as does the Michigan statute providing that indemnification in a construction contract for sole negligence is against public policy and is void and unenforceable. On March 1, 2013 the amended version of MCL 691.991(Void Construction Contracts) became effective. In its original form enacted in 1966 it disallows construction industry contract terms that indemnify a party for its sole negligence. The statute was amended to cover in addition to structures, to apply to those who contract at the design phase. It now applies to construction, design, alteration, repair or maintenance of a "highway, road, bridge, water line, sewer line, or other infrastructure or any other improvement to real property."⁹ A contract provision executed in violation of this section is against public policy and is void and unenforceable.

Amended MCL 691.911 also includes "public entity" contracts by way of definition and what a public entity shall not require. A public entity cannot require any of the protected parties to assume any liability or indemnify the public entity or any other party for an amount greater than the protected party's degree of fault. An excellent discussion of this amendment can be found in the article "2013 Construction-Industry 'Anti-Indemnity' Amendments," Noreen L. Skank, Collins Einhorn Farrell PC, *The Journal of Insurance and Indemnity Law*, Vol 6 No 2, April 2013.

Also, take a look at Illinois¹⁰ Massachusetts,¹¹ Texas.¹² Ohio,¹³ and Indiana¹⁴ covering sole negligence.

It is interesting to note that the Supreme Court of Michigan on April 1, 2009 in *Zahn v Kroger Co of Michigan*¹⁵ affirmed the Court of Appeals in ruling that an employer may voluntarily subject itself to liability for damages to employees from which it would otherwise be insulated. Thus, MCL 600.2956 (several & joint liability-parties may only be liable for their own pro rata share of negligence actions) does not apply to contract actions – comparative fault contractual in-

demnity agreements and that the parties express contractual language controls. ■

About the Author

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Endnotes

- 1 *Shepard Marine Construction v Maryland Casualty*, 73 Mich App 62; 250 NW 2d 541 (1976); See *Euchner-USA, Inc. v Hartford Casualty Insurance Co.*, WL 2576348 (2d Cir. June 10, 2014) - the duty to defend under Commercial General Liability policies is "exceedingly broad." An insurance company has a duty to defend a claim even if there is only **a possibility of coverage** in light of how the underlying complaint against the insured has been pleaded. (emphasis added).
- 2 *American Bumper & Mfg. v Hartford Fire Ins Co*, 452 Mich 440; 550 NW2d 475 (1996).
- 3 *Allstate Ins Co v Freeman*, 443 NW 2d 734, 737 (Mich 1989).
- 4 *Dochod v Central Mutual Ins Co* 81 Mich App 63; 264 NW2d 122 (1978); *Parameter Driven Software, Inc v Massachusetts Bay Ins Co* 25 F 3d 332,336 (6th Cir 1994) - applying Michigan law.
- 5 *Ray Industries, Inc v Liberty Mutual Ins Co*, 974 F 2d 754, 769 (6th Cir 1992) – applying Michigan law.
- 6 256 SW3d 660 (Tex. 2008).
- 7 501 NE2d 812 (Ill App 1986).
- 8 226 F3d 420 (6th Cir 2000).
- 9 MCL 691.991(amended March 1, 2013); MSA 26.1146 (1); *Fishbach-Natkin v PPP Inc* 157 Mich App 448 (1987).
- 10 ILL Compiled Stat. 70 ILCS 35/1-3.
- 11 Mass Gen Laws Ann, ch 149, § 29C.; *RCS Group, Inc v Lamonica Constr. Co, Ins* 75 Mass App Ct 613 (2009).
- 12 Tx. Gov't Code 2252.902 (SB 311 @001), Tx. Civ. P. & R Code § 130.001-005 only prohibits indemnity of design professionals.
- 13 Ohio R C ch 2305.31
- 14 Ind. Code Ann. Sec 26-2-5-1
- 15 483 Mich 34 (2009).

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Location, Location, Location

Hal O. Carroll, *Law Office of Hal O. Carroll*

That's what they say about real estate in general and restaurants in particular.

The same is true of the words in contracts in general and insurance policies in particular.

"Location," here, is another word for context. When push comes to shove and coverage is disputed, the analysis often comes to a particular clause or phrase or word. The temptation is great to find the particular word that supports the desired result, point to it, ignore the others, and declare the analysis complete.

Simplicity is often a virtue (remember Occam's razor). But not always. Simplicity in the interpretation of an insurance policy can lead to taking words, or a single word, out of context, thereby giving it a meaning it would not have if it were read as a part of the whole.

Doing that violates the "prime directive" of insurance coverage analysis: read the document as a whole. "[W]e read the contract as a whole to effectuate the overall intent of the parties."¹

So any "analysis" that does not follow this precept cannot be described as analysis at all. Perhaps the fact that insurance policies are – let's all concede – tedious to read leads to a search for the easy way out. And finding a particular word or phrase that supports the desired result offers a simple solution to a complex problem.

Simplicity is often a virtue (remember Occam's razor). But not always. Simplicity in the interpretation of an insurance policy can lead to taking words, or a single word, out of context, thereby giving it a meaning it would not have if it were read as a part of the whole. The simple truth is that extracting a word from its context will almost always change its meaning.

The Michigan Supreme Court made this point in the context of a statute:

Rather, to read the law as a whole, it must, in fact, be read as a whole. The interpretative process does not . . . remove words and provisions from their *context*, infuse these words and provisions with *meanings* that are independent of such *context*, and then reimport these *context-free meanings* back into the law. The law is not properly read as a whole when its words and provisions are isolated and given meanings that are independent of the rest of its provisions.²

Substitute "insurance policy" in place of "law," and you have the principles enshrined in a principle with the grand Latin name of *noscitur a sociis*, which translates roughly as "known by its neighbors."

"[T]his Court applies the doctrine of *noscitur a sociis*, which 'stands for the principle that a word or phrase is given meaning by its context or setting.'"³

This principle is a specific expression of the general prime directive of reading the policy as a whole. A word is part of a phrase, a phrase is part of a sentence, a sentence may be part of a paragraph, the paragraph may be part of a clause and the clause is always a part of a policy.

So to predicate a decision on the meaning of a single word, without addressing the context, falls short of the standard that is required in analyzing a policy.

Too often overlooked in the search for context are the linking words and modifiers. The disjunctive "or" and conjunctive "and" are familiar to all of us, but even these simple words can have opposite effects. Consider "or." If I say "you can have cake or ice cream," you know you can't have both. They are separated. But if I put a negative in front of the "or," now it becomes conjunctive. "You cannot have cake or ice cream"

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means you cannot choose because *both* cake *and* ice cream are forbidden to you. Cake and ice cream are now joined.

So “or” can be disjunctive or conjunctive. To say the same thing: “or” can be disjunctive and it can also be conjunctive. It all depends on context.

Let’s expand the context a little. Consider the sentence “Coverage is excluded if the insured is employed or engaged in a business.” What is the relationship between “employed,” “engaged” and “business”? Does the “or” after “employed” separate “employed” from “business”? If so, then it means:

“Coverage is excluded if the insured is employed [i.e., whether employed by a business or not] and if the insured is engaged in a business”?

This means there are two separate and distinct bases for excluding coverage. Or does it mean

“Coverage is excluded if the insured is employed in a business or if the insured is engaged in a business”?

Under this version the exclusion becomes a business activity exclusion, and the words “employed and “engaged” serve the function of defining a broad relationship to a business. To put it succinctly, no business, no exclusion.

Again, context is critical. The word “business” is used to describe a type of activity. To treat the word “employed” as embracing every insured who gets a paycheck, irrespective of whether the employer has hired the insured to be a domestic worker or not, divides this clause into two distinct concepts. Part of it refers to business activity and part has nothing to do with business activities. The “policy as a whole” rule and *noscitur a sociis* both enjoin us to look at all the words.

The importance of context within a policy is that it reflects context outside the policy; insurance policies are practical documents, not philosophical treatises. There are many different – and distinct- types of liability policies. There are personal policies (homeowner and auto), professional policies, and general (*i.e.*, business) liability policies. They cover different areas of activity, so each is written to cover only its own area. Every general liability policy will exclude coverage for professional errors. Every personal liability policy will exclude coverage for business activities.

Recognizing this fact does not violate the “four corners” rule. Far from looking outside the policy, it looks at the words in the policy. But it looks at all of them.

Returning to the two ways to interpret the hypothetical clause, the structure of the exclusion is relevant. It is unlikely that a single clause would be written to exclude coverage on two unrelated bases. If coverage is to be excluded because someone is an employee, whether employed by a business or by an individual, that would normally be one exclusion, and “engaged in a business” would be separate. That would be easy to do.

The fact that the drafters did not do that requires that the analysis must move in a different direction. That direction is reading the exclusion clause “as a whole.” Doing that leads to the conclusion that “employed” and “engaged” share a relationship to “business.”

The importance of context within a policy is that it reflects context outside the policy; insurance policies are practical documents, not philosophical treatises.

But it’s better to write a clause that makes this kind of parsing unnecessary. So let’s tweak the clause a little. Let’s add the phrase “or otherwise.”

“Coverage is excluded if the insured is employed or otherwise engaged in a business.”

“Otherwise” is an adverb. It modifies “engaged,” and it means “in another way.”⁴ For purposes of analysis we can use simple algebraic substitution, substituting “in another way” for “otherwise.”

“Coverage is excluded if the insured is employed *or in another way* engaged in a business.”

Now the meaning is clear. Being “employed in a business” is one thing that will exclude coverage, and being “engaged in a business in another way” will also exclude coverage. The important converse is that the mere fact of employment does not trigger the exclusion.

All of this is the sort of green-eyeshade stuff that makes lawyers outside our charming field of practice run for the exits. Yes, it can be tedious, and it always requires careful attention to words, their “location,” their neighbors and their neighborhood. But clients and litigants deserve it.

Conclusion

Interpreting a policy based on a single word taken out of context is a per se violation of the principles of insurance coverage analysis. By the same token, omitting an inconvenient word is also a violation. Actually, neither can be called analysis at all. It is word mining, and it is always wrong. ■

Endnotes

- 1 *Hayley v Allstate Ins Co*, 262 Mich App 571, 575; 686 NW2d 273 (2004).
- 2 *Mayor of City of Lansing v Michigan Public Service Commission*, 470 Mich 154, 168; 680 NW2d 840 (2004).
- 3 *In re complaint of Rovas against SBC Mich*, 482 Mich 90, 114; 754 NW2d 259 (2008) (citations omitted).
- 4 American Heritage Dictionary, 3d Ed., p 1283

**Insurance
Case
Summary**



Selected Insurance Decisions

By Deborah A. Hebert, *Collins, Einhorn, Farrell; Deborah.hebert@ceflawyers.com*

Michigan Court of Appeals – Unpublished

Auto policy exclusion upheld for non-owned vehicle used in the course of employment

Meyer v Hunt and Farm Bureau Ins Co of Michigan

Unpublished Court of Appeals opinion of January 15, 2015
(Docket No. 318074)

Plaintiff was injured in an accident caused by a vehicle insured by State Farm. The owner of that vehicle employed a nanny to care for her children and the nanny was operating the vehicle in the course of her employment when the accident occurred. State Farm settled with plaintiff on behalf of the owner and the nanny, but the settlement agreement allowed plaintiff to recover additional sums against the nanny to the extent coverage was available under her personal auto policy with Farm Bureau. That policy, however, excluded coverage for liability arising out of the insured's operation of an employer-owned vehicle operated in the course of employment. No further coverage was available.

Serving alcohol to minors in not an occurrence under this homeowners policy

Depositors Ins Co v Luera-Harris

Unpublished Court of Appeals opinion of January 13, 2015
(Docket No. 318269)

Homeowner sought coverage under his homeowners policy in connection with wrongful death claims against his son, who hosted a party at which alcohol was served to minors. One of the underage guests became intoxicated and caused an auto accident on his drive home, resulting in the death of his three passengers. Depositors denied coverage on several grounds, including the lack of an occurrence and the auto exclusion. The Court of Appeals agreed that coverage was never triggered due to the lack of an occurrence. Relying on *Allstate Ins Co v Morton*, 254 Mich App 418 (2002), the court concluded that there was no "occurrence" because serving alcohol to minors is not an accident and that injuries caused by the minor's operation of a motor vehicle while intoxicated are reasonably expected.

Motorcycle policy does not provide medical benefits

Maley v AAA

Unpublished Court of Appeals opinion of January 20, 2015
(Docket No. 318669)

Plaintiff purchased a motorcycle policy from AAA with the following language: "Medical Benefits - Not Included." In addition, no premium was charged for medical benefits. Plaintiff later sustained injuries while operating his motorcycle and looked to AAA to pay his medical bills. The Court of Appeals upheld AAA's denial of benefits, holding that plaintiff had a duty to read his insurance contract, which clearly announced the lack of coverage for medical bills, and plaintiff failed to produce sufficient evidence of a special relationship with the AAA agent who sold him the policy.

Owner of uninsured vehicle barred from tort recovery

Lanter v Stephens

Unpublished Court of Appeals opinion of January 29, 2015
(Docket No. 318358)

Claimant agreed to assume ownership of his mother's vehicle with the understanding that he would transfer title to his name and purchase insurance. Claimant took possession of the car but failed to purchase insurance before being injured in an accident while operating that vehicle. Claimant attempted to recover against the owner of the other vehicle but the Court of Appeals determined that he was the constructive owner of an uninsured vehicle involved in the accident and was therefore barred from suing for residual liability under MCL 500.3135.

Question of fact as to proper cancellation of policy for non-payment of premium

Reed v Star Indemnity & Liability Ins Co

Unpublished Court of Appeals opinion of January 29, 2015
(Docket No. 317813)

Plaintiff paid the full premium for her Ford Explorer, which was involved in an accident. Shortly before that accident, she added two other vehicles to her policy and paid some of the additional premium charged for those vehicles. Plaintiff, however, cancelled the coverage for the additional vehicles soon afterward and thus did not submit any addition-

al premium. The insurer canceled the policy for non-payment, after which the accident occurred involving the Ford Explorer. The Court of Appeals found a question of fact as to whether coverage was properly canceled for the Explorer, and remanded for further proceedings on that issue. It also addressed a PIP claim for wage loss presented by the Explorer's operator, who was unemployed at the time of the accident. Because the operator failed to produce sufficient evidence that he would have become reemployed but for his injuries, he did not have a PIP claim for lost wages.

WCA's Form 400 does not determine coverage

Ace American Ins Co v

Worker's Compensation Agency/Director

Unpublished Court of Appeals opinion of February 17, 2015
(Docket No. 317501)

Two workers compensation insurers failed to properly identify the insured employers on the Form 400 notices required of insurers by the Workers Compensation Agency (WCA). Instead of naming the Delphi subsidiaries that were covered by the policies, the insurers identified parent company Delphi, which was self-insured. After considering several procedural issues concerning jurisdiction and the propriety of a declaratory judgment action to resolve this dispute, the Court of Appeals determined that the function of WCA Form 400 is to provide notice of the existence of the underlying insurance but not to create that insurance obligation. Form 400 did not determine the actual coverage provided by the insurer.

**Published Michigan Federal District Court
Opinions**

"Horsepower" exclusion in boatowner's policy upheld
Boating exclusion in homeowner's policy upheld

Scott v State Farm Fire & Casualty Co

___ F Supp 3d ___ (2015)

Case No. 13-cv-13287

The insured's boatowners policy covered him for liability arising out of the use of the boat identified in his policy, as well as for any new boats acquired by him, but only for the first 30 days after delivery. The insured's homeowners policy expressly excluded coverage for liability arising out of the use of any boat with more than 50 horsepower. More than 30 days after taking delivery of his new 170 horsepower boat,

the insured was involved in an accident when the tube he was towing with his new boat collided with a boat hoist and caused injury to one of the individuals on the tube. The court found no coverage under the boatowners policy because the insured had taken delivery of the new boat more than 30 days prior to the accident. And the +50 horsepower boat exclusion in the homeowner's policy applied.

Business/employment exclusion upheld
for non-owned vehicle

Allstate Ins Co v Das

___ F Supp 3d ___ (2015)

Case No. 13-cv-13177

Allstate's insured, operator of a small transportation business, rented a van and hired a driver to transport passengers to the Palace of Auburn Hills for a fee. The Allstate auto policy did not cover liability for the insured's use of any vehicle to carry persons or property for compensation. The federal court accepted jurisdiction primarily because the underlying state tort case was on appeal and determined that the exclusion applied.

Another claim for hidden fees charged by third-party
administrator

Dykema Excavators v BCBSM

___ F Supp 3d ___ (2015)

Case No. 13-cv-12151

This is yet another successful claim against Blue Cross and Blue Shield of Michigan to recoup administrative fees charged to self-insureds using BCBSM as the third-party administrator for claims. Several courts have determined that BCBSM violated fiduciary obligations owed its customers in charging more than what was charged by the health care provider for the services rendered. This opinion also addresses the ERISA statute of limitations for bringing these claims.

Insurance and Indemnity Law Section Calendar of Section Events

2015

- May 30** Young Lawyers event at Greektown Casino. The Insurance and Indemnity Law Section is a sponsor and will be present with promotional materials.
- June 1** Due date for articles for the July issue of the *Journal*
- June 16** Council meeting at 4:00 in Lansing
All members are welcome to attend
- September 1** Due date for articles for the September issue of the *Journal*
- September 15** Due date for members to declare candidacy for Council seats
- October 8** Annual meeting and program
9:00 Business meeting – election of council members and officers
9:30 Program – Effective Facilitation of Insurance and Indemnity Disputes
- December 1** Due date for articles for the January 2016 issue of the *Journal*



Insurance & Indemnity Law Section 2014-2015 Officers and Council



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