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Minnesota Association of Farm Mutual Insurance Companies

Mutual LINK

The New “Bad Faith” Law in Minnesota

By Kirby Dahl, Attorney, Willenbring, Dahl, Wocken & Zimmerman, PLLC

It has been well publicized that a compromise “bad faith” bill was passed by the Minnesota legislature this legislative session and has since been signed into law by the Governor. What this “bad faith” bill does for the first time in Minnesota is to provide insureds the right to recover penalties and attorney’s fees if covered companies engage in certain prohibited practices while handling a claim.

The obvious immediate concern is how this new law affects MAFMIC member companies. If your company is incorporated and operating as a township mutual fire insurance company under the authority of Minnesota Statutes Chapter 67A, the answer to your concern is that the law does not apply to your company. Although the language of the Act does not specifically exclude township mutuals, the law that governs township mutuals (Minnesota Statutes Chapter 67A) does provide in part that “No law heretofore or hereafter passed shall apply to township mutual fire insurance companies unless it shall be expressly designated in that law that the law is applicable to township mutual fire insurance companies.” Since the authors of the current “bad faith” bill knowingly did not include language that said that the bill was to apply to township mutual fire insurance companies, any such company is, therefore, exempt from the law. Further, the Act applies only to insurance companies which engage in certain actions with regard to claims made on an “insurance policy”, as defined by the law. The law then goes on to state that written agreements issued pursuant to Minnesota Statutes 67A.191 are not “insurance policies” for the purposes of the Act. All combination policies issued in part by township mutual fire insurance companies are issued pursuant to the authority of Minnesota Statutes Chapter 67A.191 which law has two subdivisions. Subdivision 1 of that law addresses combination policies issued by statewide companies and township mutuals which policies are commonly referred to as “TP” or “farm policies.” Subdivision 2 of the law addresses “combination policies” issued by statewide companies and township mutuals which policies are commonly referred to as “PH” or “homeowner’s policies.” By excluding policies written pursuant to Minnesota Statutes 67A.191 from the new law, it is clear that the legislative intent was to specifically exclude any and all claims made against any and all such combination policies issued jointly by township mutuals and companies with statewide authority from the Act, regardless of which of the two companies is responsible for the peril at issue.

If your company is operating as an insurance company with statewide authority, then claims made against your company resulting from occurrences on a fire or related policy not issued in combination with a township mutual fire insurance company would be subject to the Act and, therefore, your conduct in dealing with an insured on any such claim would be subject to the provisions of the Act.

If your company is covered by the Act, your company may potentially be exposed to court-imposed penalties if it is shown to the court that:

1. your company denied a claim or any portion thereof without a “reasonable basis” for such denial **<u>and</u>**

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2. that your company actually knew of the lack of a "reasonable basis" for denying the claim or acted in "reckless disregard" of the lack of a reasonable basis for denying the claim.

Both elements are required in order for your company to be subject to the Act. In relation to other states, this is an extremely high standard for an insured to meet and if your company handles claims in a responsible, reasonable manner, you have little risk of being adversely affected by the new law. Nowhere in the new law is the term "bad faith" used nor is "bad faith" required in order for an insured to recover court-imposed penalties and/or attorney's fees. It is interesting to note that the legislature saw fit to exempt claims relating to your actions in conducting or cooperating with a timely investigation into an arson or fraud claim from the Act.

If a court finds that your company has engaged in the prohibited conduct described above, then the court has the authority not only to award the insured the actual amount of the covered loss, but to also impose a penalty and to order that the insured's attorney's fees are to be paid by your company. The penalty is an additional amount equal to 50% of the difference between the last amount you offered in settlement at least 10 days before the trial began and the amount in excess of that offer actually awarded by the court at trial, subject to a cap of $250,000.00 plus attorney's fees actually incurred by your insured in pursuing the claim, subject to an attorney fee cap of $100,000.00. By way of example, if you have denied a claim without a "reasonable basis" for denying the claim and are sued, but your company subsequently offers $25,000.00 to settle the claim at least 10 days before trial and, following trial, the court finds that your company in fact owed $50,000.00 on the claim, the court could then impose a penalty against your company of $12,500.00 (50% of the difference between the amount your company last offered and the amount actually awarded to your insured) plus reasonable attorney's fees not to exceed $100,000.00. Although the amount of the loss awarded by the court will be subject to the limits stated on your declarations page, any penalty and/or attorney's fees added to the amount of the actual loss pursuant to the provisions of this new law may cause your total payment to your insured to exceed the applicable policy limit.

There is a provision in the new law which prohibits the court from also awarding exemplary (punitive) damages, however, one could conclude that for the legislature to give the court the authority to award penalties and/or attorney's fees in addition to the actual losses that are covered by the policy is the equivalent of exemplary (punitive) damages even though those items are subject to the statutory formula and limits previously referenced.

If you are a licensed insurance agent for a member company governed by the Act, you are exempt from this law unless you actually participated in the conduct subsequently determined to be prohibited conduct.

Finally, the Act applies to company conduct that occurs on or after August 1, 2008.

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Team spirit is what gives so many companies an edge over their competitors

George L. Clements

Member Profile

Preble Farmers Mutual Insurance Company

Dale Krage, CPCU, Secretary/Treasurer

On June 28, 1880, 37 charter members met at the Preble Town Hall to form the Preble Fire Insurance Company, serving the eastern most townships of Fillmore County. Today the company serves the nine counties in southeastern Minnesota and is now called the Preble Farmers Mutual Fire Insurance Company.

Currently there are six employees working in the office for both Preble Farmers and their General Agency, as well as 35 agents from 18 agencies writing all lines authorized by MS 67A as needed by their members. Preble Farmers, however, currently does not write flood insurance.

As part of the mutual insurance profession in southeastern Minnesota, Preble Farmers' business philosophy is to help provide a strong, stable and service oriented market for the people of their area. "We are glad to be a part of a 'neighbor helping neighbor' tradition," commented Dale Krage, CPCU, Secretary/Treasurer.

As Preble Farmers continues to meet the challenges of educating their agents, policy owners and themselves, they also don't lose sight of helping their community. Here are a few examples:

- 100% of all fire department bills are paid by Preble Farmers to help support their local volunteer department.
- The children of the community are also an important part and Preble Farmers offers a $10 premium to each policyholder's child that exhibits at County Fairs - usually these children are 4-H members.
- Preble Farmers tries to do the majority of their investing in their area through CDs in local banks and buying bonds from local cities, etc.

To describe Preble Farmers Mutual Fire Insurance Company in one word, it would be "caring".

Preble Farmers Mutual is located in Lanesboro

> ***As long as you're going to think anyway—you might as well think BIG!***
> **Donald Trump**

Sarbanes - Oxley and the Minnesota Township Mutual Company

By Mike Kueffler, CPA

Sarbanes-Oxley Act of 2002 created the Public Company Accounting Oversight Board (PCAOB). The PCAOB has the authority to establish audit, attestation, quality control, ethics, independence and other standards relating to audits of publicly traded companies. It also has the authority to impose sanctions for violations of its standards and rules.

You may ask, "What does that have to do with Minnesota township mutual insurance companies, since they are not publicly traded companies?" Some of the rules and concepts imposed by the PCAOB have begun to be imbedded into the auditing standards issued by the Audit Standards Board (ASB). The ASB is the body charged with issuing auditing standards. These standards apply to the audits of all entities, and all industries. They are not limited to publicly traded companies.

Among the main topics addressed by the PCAOB and being emphasized in current audit standards is the focus on internal controls. In March 2006, the ASB issued eight auditing standards (SAS 104 through SAS 111), collectively referred to as the risk assessment standards. In addition, SAS 112 was issued requiring the communication of internal control related matters identified in an audit to those charged with the governance of an entity.

In applying the risk assessment standards the auditor must assess the risk that a material error may reach the financial statement. According to SAS 106, *risk assessment procedures* are a defined category of audit procedures performed near the beginning of an audit to obtain an understanding of the entity and its environment, including its internal control, for the purpose of assessing the risk of material misstatements at the financial statement and relevant assertion levels. Naturally, a significant part of assessing the risk that a material error could reach the financial statement is the documentation and evaluation of the internal controls the entity has in place to prevent such an error. If your auditors have yet to spend time with you discussing internal controls, they will be.

An entity's internal controls encompass a wide variety of policies and procedures with the intent of preventing fraudulent activity and errors in financial reporting. Common activities like reconciling account balances, claims registers and statewide company statements; testing commission statements and policy rating, and authorizing vender payments, are all internal control activities. The segregation of duties where possible among staff members, as well as board oversight of disbursements and investment activity, are controls over fraudulent activity. In order for the auditor to adequately assess audit risk, these internal control procedures must be documented such that management can show the control is established, being implemented properly and monitored periodically. Inadequate controls or inadequate documentation that a control is being properly performed must be reported to those charged with governance (in most cases the board of directors) by the auditor. There are two types of control deficiencies that may be cited: a significant deficiency and a material weakness. Both are defined as when there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. The difference is the magnitude of the control deficiency, with a material weakness being more serious than a significant deficiency. Again, if your auditors have not yet discussed these terms with you, they will be.

I have yet to meet a manager or board of directors that want to be told they have a significant deficiency or material weakness in internal controls. However, as it is not uncommon for a Minnesota township mutual insurance company to operate with two and sometimes only one staff person, it may be very difficult to adequately segregate duties effectively to prevent the citing of a significant deficiency in internal control by the auditor. The auditor is required to do so under SAS 112 of the auditing standards. However, the governing body is not required to do anything about it. A board may for example consider the cost/benefit of hiring additional staff, and decide to acknowledge that a significant deficiency is present, but to not correct it. If this is the case however, the auditor is required to cite the deficiency again in subsequent audits until a correction is made.

So, while it is true that Sarbanes-Oxley does not directly affect Minnesota township mutual insurance companies, the influence that the PCAOB has on the drafting of new auditing standards indirectly impacts the operation of every audited company. The renewed focus on internal controls is likely to remain an area of emphasis with your auditor into the future. If you have not already done so, management should begin to formally document

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Key Federal Issues in Congress

By Marcus Marsh

There are several key federal issues before the Congress that have an impact on MAFMIC member companies.

Small Company Investment Income Election: Currently under Section 831(b) of the Internal Revenue Code small property casualty insurance companies with direct or net written premium of $1,200,000 or less can elect to be taxed on their net investment income. This premium amount has not changed since 1986, if adjusted for inflation the direct or net written premium dollar figure would be $1,971,000. MAFMIC supports legislation to raise this amount and index to inflation.

Restricting the use of Credit Based Insurance Scores: Legislation has been introduced to prohibit the use of consumer reports by Representatives Luis Gutierrez (D-Ill.), Barney Frank (D-Mass.) and Melvin Watt (D-N.C.). The bill number is H.R. 5633, which NAMIC and MAFMIC oppose.

Legislation has been introduced to prohibit the use of credit information or credit scores in underwriting homeowners and automobile insurance. The bill authors are Representatives Maxine Waters (D-Calif.) and Luis Gutierrez (D-Ill.). The bill number is H.R. 6062, NAMIC and MAFMIC oppose this legislation.

Insurance Regulation: We have a system that works very well with state regulation of the insurance industry. Once again members of Congress want to change the regulation and control of the insurance industry to the federal government. Legislation has been introduced to create an optional federal charter for property/casualty insurance and life insurance. The bills are S.2509 authors Senators Tim Johnson (D-SD) and John Sununu (R-NH.) and the companion bill in the US House is H.R. 6225 Representative Ed Royce (R-Calif.). This bill as introduced would completely pre-empt all state consumer protections, eliminate rate and form filings, and be exempt from any state licenses.

McCarran-Ferguson Act: This act provides for a limited exemption of anti-trust laws to the insurance industry for certain activities. McCarran-Ferguson was passed in 1945 and has worked well for all these years with states enforcing the law. However, once again Congress wants the federal government to have greater control. Legislation pending before the Congress would grant authority to the Federal Trade Commission (FTC) and the Department of Justice (DOJ) to enforce antitrust laws and regulations. The Senate Bill is S618 with Senate authors, Patrick Leahy (D-Vt.), Arlen Specter (R-Penn.), Harry Reid (D-Nev,) Mary Landrieu (D-La.). In the House the bill is H.R. 1081 with Representatives Peter DeFazio (D-Ore.), Glen Taylor (D-Miss.), Bobby Jindal (R-La.) Charlie Melancon (D-La.). Once again NAMIC and MAFMIC strongly oppose this legislation that could create huge problems for our companies, our policyholders and states.

Sarbanes - Oxley

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the controls they have in place, evaluate their effectiveness, and establish a system to monitor that they are being properly performed.

Ask The Department

By Jaki Gardner, Assistant Commissioner,
Minnesota Department of Commerce

Q. How are the company meetings going that the Department is setting up with the member companies and what are topics of discussion?

A. We planned these meetings as “meet n’ greets” to give both the townships and the Department an opportunity to get to know each other and to learn more about the operations. It also gave the townships an opportunity to “put a face on” the Commerce Department. The discussions are relatively specific to the individual company based on what we already know and what they want to tell us.

The meetings have been very positive and we believe the companies, so far, have been pleased with the experience. However, in order to encourage open discussion, we are committed to keeping the discussion confidential.

Q. What kind of questions, concerns, or information are being requested by our member companies?

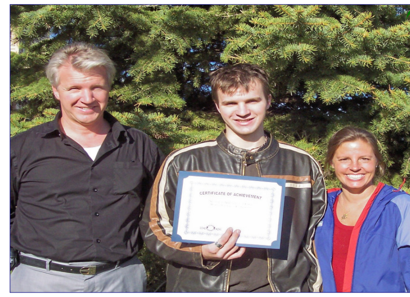
A. We really don’t want “prepared” responses or presentations, so we don’t have a list of questions that we would want to distribute.

2008 MAFMIC Educational Scholarship Winners

Congratulations and best wishes for a successful future to all of the recipients!

Foster Graif and his parents, Greg and Cindy Graif of Truman, received congratulations and his award from Paul Stueven, Manager of Fairmont Farmers Mutual.

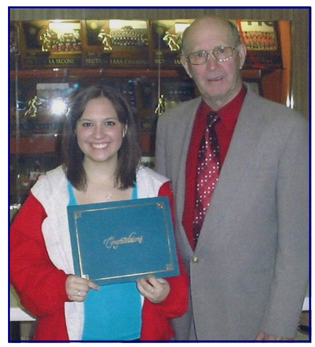
Mark Lynch of Pemberton received congratulations and his award from Dale Westphal, President, and Muggs Zabel, Manager of McPherson Minn Lake Mutual.



Spencer Dahlheimer and his parents, Jerry and Lynne Dahlheimer of Alexandria, received his award and congratulations from Edna Goracke, Manager of Holmes City Farmers Mutual.

Kalli Gilbertson of Mora received congratulations and her award from Tom Mrosla, Manager of Mid-Minnesota Mutual .

Ethan Scheck of Houston received congratulations and his award from Vicki Hongerholdt, Assistant Manager and Jerry Zenke, Manager of Mound Prairie



Lila Holst of Lake City, received congratulations and her award from her grandfather, Delmar Holst, President of Gillford Mutual

Johanna Hawkinson and her mother, Carol of Shafer, received her award and congratulations from Jim Froberg, President of Chisago Lakes Mutual. who also awarded her with an additional $500 scholarship from his company.

My grandfather once told me that there are two kinds of people: those who do the work and those who take the credit. He told me to try to be in the first group; there was less competition there.
Indira Gandhi

Matthew Lageveen 2008 Memorial Scholarship Award

The Matthew Lageveen 2008 Memorial Scholarship Award was presented on behalf of the MAFMIC organization to Cale Puls on Saturday, May 24th at the Grinnell High School Honors Night. Cale is a 2008 graduate and aspires to be a U.S. Marshall. He will be attending Marshalltown Community College for 2 years and will then transfer to a state school to pursue a degree in criminal justice. Cale's parents are Kathy and Dale Puls of Grinnell, Iowa. The Lageveen family would like to thank the members of MAFMIC for their contributions that made this scholarship possible and for investing in the future of our young people.

The "Buck and a Quarter" Club

Celebrating 125 Years

We would like to take the time to recognize all of the companies that are celebrating 125 years or more. Congratulations!

- Vasa-Spring Garden Mutual, Cannon Falls (1860)
- Chisago Lakes Mutual, Scandia (1867)
- German Farmers Mutual, Stillwater (1867)
- Has San Lake Mutual, Buffalo (1867)
- Young America Mutual, Glencoe (1869)
- Vernon Edda Mutual, Sargeant (1874)
- Kenyon-Holden-Warsaw Mutual, Wanamingo (1875)
- Farmers Mutual Insurance of Manchester (1876)
- Leon Mutual, Cannon Falls (1876)
- Wanamingo Mutual, Wanamingo (1876)
- Wilmington Mutual, Spring Grove (1876)
- Unity-Gordon-Hartford Mutual, Cold Spring (1878)
- Norwegian Mutual, Cottonwood (1879)
- Sumter Mutual, Silver Lake (1879)
- Hay Creek Mutual, Goodhue (1879)
- Crow River Mutual, Hutchinson (1880)
- Preble Farmers Mutual, Lanesboro (1880)
- Arctander & Lake Andrew Mutual, New London (1881)
- Lake Park & Cuba Mutual, Lake Park (1881)
- McPherson Minn Lake Mutual, St. Clair (1881)
- Owatonna Mutual, Owatonna (1881)
- New Prague-Ceska-Louisville Mutual, New Prague (1882)
- New Sweden Mutual, Nicollet (1882)
- North Fork Mutual, Belgrade (1882)
- Kelso & Shelby Farmers Mutual, Amboy (1883)
- Moe-Urness-Lund Mutual, Brandon (1883)
- Southeast Mutual, St. Charles (1883)
- Sverdrup Mutual, Underwood (1883)
- White Bear Lake Insurance, Starbuck (1883)

Company News & Notes

MAFMIC 2008 Calendar of Events

July	16	**Manager & Directors Seminar** St. Cloud Civic Center, St. Cloud
	17	**Educational Scholarship Golf Outing** Little Crow Country Club, Spicer
Aug,	5-7	**Farm Fest 2008** Gilfillan Estates, Redwood County
	7	**Mutual Support Staff Seminar** Holiday Inn, St. Cloud
	12	**Adjuster & Inspector Seminar** Holiday Inn, St. Cloud
Sept. Oct.	28 - 1	**NAMIC National Convention** Philadelphia, Pennsylvania
Nov.	5-6	**Short Course** St. Cloud Civic Center, St. Cloud
Feb.	1-3	**2009 Convention** Sheraton, Bloomington

To submit an article to be published in the Mutual Link, please send them to: Mutual Link, PO Box 880, St. Joseph, MN 56374, or email them to info@mafmic.org.

IN SYMPATHY

George Saukkola, 81, of Kimball, passed away on May 11, 2008. George enlisted in the Army during World War II and was a paratrooper with the 11th Airborne Division where he received a Bronze Star. Besides his military service, George was also an auctioneer for 55 years and farmed from 1946 until 1978. George will be remembered for his love of his family, fishing, threshing shows, collecting antique cars and tractors, as well as his sense of humor and his love of a good story or joke. George served on the Board of Directors for Cokato Mutual from 1978 to 2008.

MAFMIC wishes to express its sympathy to the family and friends of George.

Thank you to our 2008 Education Partners!

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