EDITOR'S NOTE

Welcome!
Nothing can damage a church like a sexual abuse allegation—except an abuse case that isn’t reported to the church’s insurance company immediately. In this month’s feature article, “Coverage Denied,” I recount the story of a church that waited 21 months before notifying one of its insurance companies of a sexual misconduct allegation. This mistake cost the church more than $2 million in settlement fees.

I’ll walk you through the five most important things every church leader needs to know in order to prevent making a similar mistake.

In our Financial Q&A, I tackle the question of what happens when donors want their money back. It’s a surprisingly complex issue.

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Blessings as you serve—Richard R. Hammar

facebook.com/ChurchFinanceToday
@RichardHammar
linkd.in/187SPcY
CFEditor@ChristianityToday.com

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COVERAGE DENIED

Failure to notify the insurance company of a claim cost one church $2.3 million. Five tips for avoiding a similar mistake.

By Richard R. Hammar

Church insurance policies generally require that a church notify its insurance company in writing, within a specified period of time, concerning any property damage or personal injury that occurs. Failure to do so can relieve the insurance company of any duty to defend the church in a lawsuit or pay a settlement or jury verdict as a result of the damage or injury. A recent case illustrates this point.

Facts. On April 6, 2006, a man (the "plaintiff") sued a church, claiming that he had been sexually molested by a church employee on numerous occasions between 1978 and 1982. The plaintiff claimed that the church had been negligent in hiring and retaining the perpetrator; that it was grossly negligent, and that it inflicted emotional distress. The church changed insurers during the time that the victim was being molested, so two insurance policies were implicated. The church only informed one of the two insurers of the claim, and this insurer retained an attorney who filed an answer to the lawsuit on May 12, 2006. The church did not notify the second insurer of the claim until 2008 because it had been unable to locate its nearly 30-year-old policy on molestation in the church until then.

In 2008, some 21 months after receiving the initial lawsuit, the church notified the second insurer of the claim. This insurer later informed the church that it was denying coverage as a result of the church’s failure to notify it of the claim in a timely manner. The church’s insurance policy imposed various duties upon the church, including a duty to notify the insurer of claims and lawsuits.

In the event of an occurrence, written notice containing particulars sufficient to identify the insured and also reasonably obtainable information with respect to the time, place, and circumstances thereof, and the names and addresses of the insured and of available witnesses, shall be given by or for the insured to the Company or any of its authorized agents as soon as practicable.

If a claim is made or a suit is brought against the insured, the insured shall immediately forward to the Company every demand, notice, summons, or other process received by him or his representative.

No action shall lie against the Company unless, as a condition precedent thereto, there shall have been full compliance with all of the terms of this policy.

As a result, the insurer refused to retain legal counsel or contribute toward any verdict or settlement. The second insurer later agreed
to provide a defense in the lawsuit but reserved its position on coverage.

The lawsuit was settled for $4.3 million during a court-ordered mediation in 2009. The first insurer paid $1.75 million of the settlement for the time period covered by its policy, while the second insurer contributed $175,000. The church paid the remaining $2.3 million. The church insisted that the second insurer was responsible for the full amount the church had paid, and the case was submitted to a federal district court in Georgia for a determination as to the second insurer’s obligations under the church’s policy.

In 2011 the court ruled that the second insurer’s duties under the policy were terminated by the church’s failure to provide timely notice of the claim. The fact that the church “couldn’t find” the relevant policy was no excuse, even though the policy was nearly 30 years old. The court also rejected the church’s argument that the insurer was required to show that it had been “prejudiced” by the church’s delay. The church appealed to a federal appeals court.

The court’s ruling. The court began its opinion by observing:

Notice provisions expressly made [are a] condition precedent to coverage. [They] are valid and must be complied with unless there is a showing of justification. If an insured unreasonably fails to comply with applicable notice provisions in a timely manner, the insurer is not obligated to provide either a defense or coverage. The insured has the burden of showing justification for a delay in providing notice.

The court concluded that the church failed to provide timely notice to the second insurer, and this relieved it of any duty under the policy to provide a defense or contribute any amount toward the settlement. OneBeacon America Insurance Co. v. Catholic Diocese, 477 Fed.Appx. 605 (11th Cir. 2012).

The church’s 21-month delay in notifying its insurer of the claim relieved the insurer of any legal duty to provide a legal defense or contribute toward the $4.3 million settlement. This left the church holding the bag for more than $2 million. The fact that the delay was caused, in part, by the church’s inability to quickly locate its 30-year-old policy was no excuse, according to the court.

**Importance to church leaders.** Most insurance policies impose on the insured a duty to promptly notify the insurance company of any potential claim. Failure to comply with this condition can result in a loss of coverage. Be sure you are familiar with the notice provisions in your church’s insurance policies and comply with all of the relevant requirements. Pay special attention to the following considerations:

1. **Timely notice.** Provide the insurer with notice of an accident or occurrence within the time limits specified by the relevant policy. It is common for policies to require the insured to notify the insurer of an accident or occurrence “as soon as practicable,” or “immediately.” Also, be alert to the possibility that more than one policy may be implicated, especially if the wrongful acts causing the claim occurred over an extended period of time.

2. **What triggers the notice requirement?** The duty to notify your insurer arises when you learn of an “occurrence” that, “from an objective standpoint, may potentially lead to a claim against the insured that might implicate the policy.” Note that the duty to notify an insurer is not triggered solely by the anticipation of valid claims that may be covered; instead, as one court noted, “the duty of notice extends to incidents sufficiently serious as to lead a person of ordinary intelligence and prudence to believe that any claim arguably covered by the policy may be brought, even claims that may ultimately fail or that the insured may believe are not valid in law or fact.”

**KEY POINT.** Church leaders should notify their insurer of a potential legal claim even when they are not certain that it is valid. Err on the side of caution. Remember, a failure to comply with the notice requirement can have disastrous financial consequences for the church.

3. **The content of a valid notice.** Your insurance policy will describe the information that needs to be communicated when notifying your insurer of a potential claim.

4. **Notifying your broker may not be enough.** Many churches purchase their insurance through a local broker. Church leaders naturally assume that in the event of an accident or injury they can simply call this individual and everything will be “taken care of.” This is not always the case. A broker may not be deemed an “agent” of the insurance companies he or she represents, so when a church provides its insurance broker with notice of an accident or loss, it is not necessarily notifying its insurance company.

Notify both your broker and insurance company. The insurance company’s address will be listed on your insurance policy. Ask the insurance company to provide you with written confirmation of receipt of your notice.

5. **Written rather than oral notice.** If your insurance policy requires written notice, be sure you provide written rather than oral notice of a loss.

**KEY POINT.** Church leaders should be familiar with the insurance policy’s provisions regarding notification of the insurance company. Is written notice required? If so, how soon after a loss? It is essential that these provisions be scrupulously followed in order to prevent a loss of coverage.
If you change insurance companies, carefully examine the new insurance policy. Do not assume that it will contain the same “notice” provisions as your previous policy.

**KEY POINT.** The duty to inform your insurance company of an accident or loss arises when the injury occurs, not when a lawsuit is filed. The purpose of the notice requirement is to give your insurance company sufficient time to investigate the incident and provide a defense.

**Example.** A pastor is informed by a parent that her minor child was molested by a church volunteer. The volunteer is questioned, and admits to molesting the child. This incident represents a potential “loss” under the church’s insurance policy. Triggering a duty to inform the church’s insurance company, the loss within the period of time specified in the insurance policy. It is very important that it not wait until a lawsuit is filed to notify its insurance company. Such a delay not only hinders the insurance company’s ability to investigate the incident and defend the case, but also may result in loss of coverage under the policy. This could have disastrous consequences for the church.

**Record Retention**
This case illustrates the importance of retaining church insurance policies permanently. In some cases, the deadline for filing a lawsuit (the so-called “statute of limitations”) does not expire for many years or even decades. This often is due to the application of the “discovery rule,” which suspends the statute of limitations until a victim “discovers” the connection between his or her injuries and the wrongful conduct. A church must be able to produce its insurance policy or policies in order to trigger coverage for any claim, including those from the distant past. Without a policy, the church will be “uninsured,” meaning that it will be responsible for retaining and compensating its own attorney, and paying any verdict or settlement. The takeaway point is this—safeguard your church. Retain your records.

**Resource.** To learn more on insurance reporting best practices, see these downloadable resources on YourChurchResources.com:
- Purchasing Church Insurance
- Your Helpful Guide to Church Insurance

The new limit does not affect the limitation on dependent care FSAs, health savings accounts, Archer Medical Savings Accounts, or an employee’s contribution for his or her share of health coverage premiums.

The limit on employee salary reduction contributions to a health FSA applies on an employee-by-employee basis. Therefore, $2,500 is the maximum that an employee may contribute, regardless of the number of individuals, such as spouse or dependents, whose medical expenses may be reimbursed under the plan. If two people are married, and each has the opportunity to participate in a health FSA, whether through the same employer or through different employers, each may contribute up to $2,500.

In the case of a plan providing a grace period, unused salary reduction contributions to the health FSA that are carried over into the grace period for that plan year will not count against the $2,500 limit for the subsequent plan year.

Employers may amend their plans to reflect the $2,500 limit at any time through the end of calendar year 2014, provided the health FSA does not exceed the limit in operations for plan years beginning after December 31, 2012. If an employer’s plan already has a limit in place before the plan year beginning in 2013 that does not exceed $2,500, the employer will not (generally) need to amend the plan to reflect the new $2,500 limit.

**RECAP OF NEW HEALTH FLEXIBLE SPENDING ACCOUNT RULES**

**Starting in 2013, health FSAs cap at $2,500.**

*By Richard R. Hammar*

A health flexible spending arrangement ("FSA") allows employees to pay for certain health care expenses on a tax-preferred basis. It is a benefit an employer may offer as part of a cafeteria plan, and it is usually funded through an employee’s salary reduction contributions. These contributions reduce the amount of wages subject to income and employment taxes. Employees can use the FSA funds to pay for certain health care expenses as they are incurred.

The Affordable Care Act (the healthcare reform legislation enacted by Congress in 2010) capped employee salary reduction contributions to health FSAs to $2,500 per year for plan years beginning after 2012. The $2,500 limit will be indexed for inflation for plan years beginning after 2013. As before, an employer may establish its own plan limitation, but an employer’s plan limit may not exceed the statutory limit.

**Tax Calendar Important Tax Deadlines in September 2013**

In addition to the regular semimonthly and monthly withholding requirements, church treasurers should note the following tax deadlines for next month.

**September 15**
- Ministers (who have not elected voluntary withholding) and self-employed workers must file their third quarter estimated federal tax payment for 2013 by this date (a similar rule applies in many states to payments of estimated state taxes).
- A church must make quarterly estimated tax payments if it expects an unrelated business income tax liability for the year to be $500 or more. Use IRS Form 990-W to figure your estimated taxes. Quarterly estimated tax payments of one-fourth of the total tax liability are due by April 15, June 17, September 16, and December 16, 2013, for churches on a calendar year basis. Deposit quarterly tax payments electronically using the EFTPS system.
REFUNDING A CONTRIBUTION

Is it legal (or moral) to give back a large financial gift at the donor’s request?

By Richard R. Hammar

Q: In 2012, one of our board members gave the church a gift of $10,000 with no strings attached (his words). The church provided him with a contribution receipt. We had hoped to put that money toward a building project. Recently, the donor asked if he could have the money back for three months, for an investment. Are we legally obligated to return his gift?

A: Most church leaders eventually are faced with a request from a member to have a charitable contribution refunded. Usually this occurs because of financial hardship. It is a surprisingly complex question, but here are two considerations to help guide you toward an appropriate response:

1. A charitable contribution is a gift of money or property to a charitable organization. Like any gift, a charitable contribution is an irrevocable transfer of a donor’s entire interest in the donated cash or property. Since the donor’s entire interest in the donated property is transferred, it generally is impossible for the donor to recover the donated property.

2. Most charitable contributions, like the one you described, are undesignated, meaning that the donor does not specify how the contribution is to be used. An example would be a church member’s weekly contributions to a church’s general fund. Undesignated contributions are unconditional gifts. A church has absolutely no legal obligation to return undesignated contributions to a donor under any circumstances. In fact, a number of problems are associated with the return of undesignated contributions to donors, which I cover in detail in the Church & Clergy Tax Guide. Churches should resist appeals from donors to return their undesignated contributions. No legal basis exists for doing so, even in emergencies. Churches should not honor such requests without legal counsel.

Resource. See Chapter 8 in Richard Hammar’s 2013 Church & Clergy Tax Guide for a full analysis on returning contributions to donors. To submit a question for consideration in a future Q&A, email: CFEditor@ChristianityToday.com.

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