

CHAPTER SIX-B

Insurance/Financial Recovery

When Disaster Strikes

Considerations for Effective Claims Development

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by David M. Brenner

Riddell Williams P.S.

1001 Fourth Avenue, Suite 4500

Seattle, WA 98154-1192

(206) 624-3600

dbrenner@riddellwilliams.com

DAVID M. BRENNER heads the Insurance Coverage practice at Riddell Williams. Over the past 25 years, he has litigated numerous complex suits in the areas of insurance, antitrust, securities and corporate law. David was a member of the ABA Litigation Section Insurance Coverage Committee's Task Force on 9/11 claims and has co-chaired two national CLE's on Hurricane Katrina claims. He was named one of the Best Lawyers in America 2007 for insurance coverage and is a top 100 Super Lawyer® in this year's Washington Law & Politics survey.

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Introduction

Twice since 2000, the national economy has been significantly affected by a major regional disaster – once growing out of the World Trade Center attack on 9/11/01, and again when Hurricane’s Katrina and Rita caused unprecedented property damage on the Gulf Coast in 2005. Our own region experienced a substantial natural disaster in 1981 with the eruption of Mount St. Helens and more recently, property damage and business interruption from the WTO riots in 1999 and the Nisqually earthquake in 2001.

When a major regional disaster occurs, the effects ripple through the broader economy. Many businesses with plants, offices and retail stores in the region where the disaster happens will be directly affected by physical damage to their property or suspension of operations as a result of damage to their own facilities, lost utility supply, forced evacuation or other causes. Many other businesses in the region and around the country are likely to suffer indirect but nevertheless potentially crippling effects from loss of key suppliers or service partners in the location of the disaster. Deep in most commercial property policies are provisions intended to cover not only physical property damage but also economic loss suffered both directly as a result or damage to the insured’s own property and indirect loss from damage to the property of others.

I. Insurance for Physical Property Damage

The WTC and Katrina/Rita disasters suggest that the following physical property damage issues will be a key part of many disaster-caused property damage claims:

A. Key Coverage Related Questions:

1. Causation, Trigger and Exclusion Issues.

Most disasters cause damage by a combination of events. For example, many Katrina losses stemmed from a combination of the following:

- the hurricane itself
- flooding
- looting
- power disruption
- levee breaks
- civil authority

Property damage from earthquakes, tsunamis, fire, coastal and interior flooding and other types of disasters that we can expect in the Pacific Northwest are likely to have a similar combination of such causes. For example, physical damage in the event of a major earthquake could be caused by a combination of the earthquake itself, water damage or fire from broken

water, gas, and electrical lines, negligent design or construction of facilities, negligent operation of facilities in response to the earthquake, exposure to elements in the wake of the earthquake, looting, or loss of access. Earthquakes, resulting tsunamis, and flooding are frequently excluded from ordinary property coverages and require purchase of extended coverage through private or public programs. When property damage may result from a combination of covered and uncovered causes, the following essential trigger questions arise:

- a. What is the type of trigger in the policy?
 - (i) If it is “all risk” coverage:
 - (a) policyholder proves unintended physical loss to covered property occurred
 - (b) insurer proves loss falls within exclusion
 - (ii) If it is “named peril” coverage:
 - (a) policyholder proves specified risk caused loss
 - (b) insurer proves excluded risk caused loss
- b. Are there multiple causes?
 - (i) The cause that is the “efficient proximate cause,” i.e., the predominating cause that sets other causes into motion, will determine coverage.
 - (ii) Does the insurance policy language address losses with multiple causes? Note that it is against public policy to attempt to contract around efficient proximate cause doctrine in Washington, *Safeco Ins. Co. v. Hirschmann*, 112 Wn.2d 621 (1999).

2. Number of Occurrences:

Whether there is one loss or several will make a substantial difference in the application of deductibles and the available limits under a policy. Definitions for “loss” and “occurrence” usually will be found in the policy. Typical definitions refer to “the sum total of all loss or damage insured against arising out of or caused by one event” or “any one loss, disaster or casualty, or series of losses, disasters or casualties arising out of one event.” Some definitions may include a temporal element that includes all events within a specified time period as a single occurrence or loss for purposes of policy limits and deductibles. The biggest policy issue regarding WTC losses has concerned the question of whether the two planes constituted a single occurrence or two different occurrences – a question of potentially doubling the policy limits of \$3 billion. The resolution varies depending on the language of the specific policies under consideration. *E.g.*, *SR Intern. Business Ins. v. World Trade Center*, 467F. 3d 107 (2d Cir. 2006)

Washington follows the majority rule that the number of occurrences is determined by the nature of the cause or causes rather than the number of claims or injuries. *E.g., Pemco Mutual Ins. Co. v. Mitterbach*, 91 Wn. App.769 (Div. I, 1998) review denied, 137 Wn.2d 1009, (1999).

B. Essential Steps in Preparing and Presenting the Property Damage Claim

Katrina and WTC claims have shown that causation and number of occurrence issues can become high profile questions that consume years of litigation and provide an overarching background to all other claims questions. Whether the issues arise or not, at a minimum the policyholder must present and prove up a property damage claim. Here are some essential and practical steps to do so, drawn in substantial part from the Checklists for Property Damage and Business Interruption Claims posted for broad use following 9/11 and Hurricanes Katrina and Rita by the ABA Litigation Section Insurance Coverage Committee Task Force on 9/11 Claims and for which I served as principal author. Of course, individual policies differ in their requirements and care should be taken to identify the particular requirements, restrictions and exclusions of the policy in question.

1. Gather insurance policies and related insurance records. If the policy was destroyed or is lost, contact the insurance company or insurance agent/broker to request a copy.
2. Contact other business partners, such as attorneys and accountants, who may have copies of the applicable insurance policies and records.
3. Give notice to the insured's insurance agent and company(ies) immediately, preferably in writing. Notice should provide the following basic information:
 - a. Name and address of insured
 - b. Location of loss
 - c. Date and time of loss
 - d. Contact name, phone, and fax number
 - e. Brief description of the loss
4. Prepare a Proof of Loss. A proof of loss provides details identifying the property destroyed or damaged, and documents the amount of loss incurred. Generally, any information substantiating the claim (photographs, receipts, records) can become part of the proof of loss. Check with the insurance company for the specific information required. Some companies may have a detailed list of documents they seek, or require the insured to fill out a particular form, such as a Proof of Loss. Check the policy for a time limitation requirement or trigger for preparing the Proof of Loss. Often policies provide that a Proof of Loss must be submitted within a set time, often 60 days, after one is requested by the Insurer.

5. Acquire copies of police or fire reports (if available).¹
6. Secure vital records and ledgers.
7. Collect photos or videos as proof of damage.
8. Consider whether to seek professional help in preparing and submitting a claim, including use of an engineer or consultant to address the extent of damage to property, and of appraisers and adjusters to value the damage.
9. Submit proof of loss, photos, and reports to insurance company.
10. Assist in insurance company's investigation. Property insurance policies typically allow an insurance company to conduct an investigation of the claim with the insured's cooperation. This may be in a provision entitled "Duties in the Event of Loss." This provision may allow the insurance company to interview the policyholder claimants in a process often called an "examination under oath" (EUO). The policy may also require the insured to exhibit the property, take reasonable steps to protect the property, and generally cooperate with the insurer's claim investigation.
11. Secure tolling agreements with the insurance company to deal with suit limitation clauses in the policies that may require suit within six months, one year or two years from the date of loss.

¹ Ask local police department. Obtain separate report or add information to original report if looting occurred.

II. Insurance for Business Interruption

A. Overview of Business Interruption Coverage

Even more important than insurance to repair physical losses may be coverage for lost income when businesses are shut down by physical damage. Most commercial property policies cover dollar losses as a result of loss of use or access to the property or suspension of the policyholder's business. This part of the policy is called "time element" or "business interruption" insurance. The term "time element" is used because this insurance will typically only kick in after the loss of use or business interruption exceeds a specified period of time. The time period is like a dollar deductible, except that it is measured in hours or days.

Business interruption coverage typically requires a "necessary interruption" or "necessary suspension" of operations during the "period of restoration" that follows a physical loss. Washington courts have interpreted such damage to require a complete cessation of operations rather than a mere reduction. *Keetch v. Mutual of Enumclaw Ins. Co.*, 66 Wn. App.208, 212 (1992). Post-2001 policies often define the "necessary suspension" as a "slowdown or cessation" of business, however, which should produce better results in the event of a reduction in business operations.

A business interruption claim predicts lost future business profits based on past operations. As a result, such claims are records-intensive and usually will benefit from the services of a good forensic accountant. Business interruption claims can also take many months to work through, raising important considerations as to the timing of interim payments.

Paired with "business interruption" insurance is "extra expense" coverage. Just like it sounds, this provides insurance for the extra costs a business incurs when it has to take extraordinary measures to get back in business. Insurers want their policyholders to get back on their feet so the insurers can stop paying for lost profits. Extra expense insurance helps the policyholder do that. A challenge for policyholders is to account for all extra expenses and make sure the insurer doesn't cut them off prematurely.

Business interruption coverage usually is available only if the policyholder has suffered covered physical property damage. However, three types of coverages can apply even if the policyholder's own property has not been physically damaged. Two of these are related to loss of access. If access to property is blocked by decisions of "civil authorities" or by physical damage that prevents "ingress or egress", specific policy provisions likely exist and may apply. There are often geographic limits on distance from property that is physically damaged. The third type of coverage that does not require direct physical damage to the insured's own property is "contingent business interruption" coverage. This is specifically intended to insure business interruption when the physical property damage happens to a *different* business on which the policyholder is dependent such as a key supplier. In the era of "just in time" inventory, this coverage is more important than ever. Sometimes, however, contingent business interruption coverage may apply only to damage at specific premises named in the policy.

B. Essential Steps in Preparing a Business Interruption Claim

Most of the steps discussed above with respect to direct physical loss apply equally to business interruption claims, which are really just an addition part of the claim but aimed at economic loss rather than physical property loss. Here are some specific steps that are particularly important for business interruption claims, again drawn from the ABA Litigation Section Insurance Coverage Checklists for 9/11 and Katrina Claims.

1. Determine what general coverages are available.

The basic types of policy coverages identified under time element coverage in a policy are likely to be:

a. Business Income. Designed to replace income that would otherwise have been earned by the business had no loss occurred. Business income is generally defined as the net profit or loss before taxes, plus continuing normal operating expenses, including payroll. Note that the usual insurance definition of net profit is the net profit (or loss) before taxes, in contrast to the accounting definition of net profit (or loss), which is the net profit after taxes. Coverage is often limited to the loss of income sustained until the property is restored, or for 12 months following the physical loss or damage. Other limitations may apply to the period for which “ordinary payroll” coverage is included. “Ordinary payroll” generally means payroll for employees other than officers, executives, department managers, or employees under contract.

b. Extra Expense. Designed to pay for necessary expenses incurred during the period of restoration of the property, that would not have been incurred if there had been no physical loss or damage to the property. Extra expenses include those necessary to continue operating the business at its original location, or at a temporary replacement location until the original location is repaired. Extra expenses may also include expenses that minimize the time the business is unable to operate. Further, coverage generally applies to extra expenses made to repair or replace damaged property, or to restore or replace valuable papers and records, but only to the extent that the extra expenses actually reduce the amount of loss.

c. Contingent Business Interruption. An extension of coverage designed to cover loss of income incurred by the business due to a property loss at a key supplier or customer location. For example, if a key supplier experiences a fire at its plant and is unable to deliver parts or goods necessary for the continuation of business operations, the business may have a claim for a contingent business interruption loss.

d. Civil Authority. Coverage may also be available for loss of business income and extra expense sustained as a result of government denial of access to the business premises, due to a covered loss at a location not owned by the insured. There may be a 2 or 3 day waiting period before coverage begins, and coverage generally only applies for a few weeks.

2. Identify other possible coverage adjustments.

Other policy terms may apply to limit or extend coverage beyond the specific categories of time element coverage discussed above. Major ones include:

- a. Extended Period of Indemnity: May extend period for loss of income coverage for a specified time beyond completion of repairs.
- b. Requirement of a Business “Suspension”: As noted above, the policy language may determine whether a complete or partial cessation of business is needed to trigger coverage.
- c. Resumption of Operations: May limit business interruption loss to the point at which operations can be even partially resumed, even though the business may not be able to fully sustain itself.
- d. Coinsurance Provision: Requires that a policyholder pay a share of business income loss if the actual loss sustained is substantially higher than the estimated income established at the time insurance was purchased.
- e. Agreed Value: Establishes in advance a maximum for recovery in any given month.
- f. Covered Locations: Identifies what locations are covered. There may be extensions of coverage for “newly acquired locations” to cover property recently acquired, and for property at locations not owned by the insured.
- g. Ingress/Egress: Coverage may be provided for loss of business income and extra expense when the policyholder cannot gain access to its property without the government action required under the coverage for closure by a civil authority.
- h. Building Ordinances: May provide coverage for the additional time required to rebuild due to compliance with building ordinances.
- i. Electronic Media and Records Limitation: May limit replacement period for such data and documents.

3. Identify possible policy exclusions.

Policy provisions may specifically exclude certain causes or aspects of a loss, including:

- a. Property exclusions. Since there typically must be a covered loss to covered property for business income coverage to apply, all of the exclusions in the property section of the policy are generally relevant.
- b. Idle periods: Coverage is generally excluded for periods when operations would normally have been idle.
- c. Interference: Additional costs with rebuilding due to labor unrest may be excluded.

d. Loss of contracts: Income loss on long-term contracts may be limited to period ending with completion of repair or replacement.

e. Consequential losses: Coverage for consequential losses is generally excluded, unless the policy contains an extension of coverage for such losses.

f. Utility service interruption: Coverage may not extend to loss caused by utility service interruption.

4. Identify special Conditions for Submitting and Resolving Claims.

Some policy terms may apply to deal with the policyholder's obligations in presenting the claim and determine how disputes over claim values will be resolved. These include:

a. Duties in the Event of a Loss. Typically, business income coverage is subject to the policy conditions, including the "Duties After Loss" discussed above. Thus, the policyholder may be required to substantiate the claim by making available the company's books and records, financial statements, income and expense reports, and the like. If those original records have been destroyed or otherwise no longer exist, they should be recreated from other sources, such as documents maintained by the policyholder's accountant, or business partners.

b. Appraisal: Many policies provide that if there is a disagreement as to value of the loss, the policyholder can state a demand, then two party appraisers will be selected to determine if they can agree on value. If they cannot, they will select an umpire, and the decision by two will be binding on the claim. Appraisal applies to valuation, not to disputes over whether the claim is covered or not.

c. Loss Determination. Business interruption coverage may include specific provisions for valuing the loss of income and extra expenses. Policies often contain examples and descriptions of how to calculate business income loss and extra expense incurred. However, you may need to engage the assistance of your agent/broker, accountant, or attorney to provide clarification of some provisions.

5. Calculating the Business Interruption Loss.

The following list sets forth some representative questions that should be reviewed in calculating the extent of a business interruption loss. This list is not necessarily exclusive, nor do each of the items necessarily apply to every claim.

a. What type of operation is affected (office, store, restaurant, plant)?

b. Is there interdependency with other operations?

c. Is operation partially or totally disrupted?

(i) What is the normal operation capacity of the operation that was damaged?

- (ii) At what percent of capacity was the business operating just prior to the loss?
 - (iii) At what rate did the business expect to operate during the loss period?
 - (iv) How many shifts a day did the business operate? How many does it operate after the loss?
 - (v) How many shifts a day, week, or month does the business dedicate to maintenance?
 - (vi) What is expected downtime?
 - (vii) Can the business add shifts to reduce potential operation loss?
 - (viii) Can the business operate temporarily at another site to reduce the loss?
- d. Are sales affected? Partially? Totally?
- e. How long will the business need to continue paying salaried employees until the business is restored? Can they assist with restoration of the premises and business operation?
- f. Does the business need to pay hourly employees to retain them during the time the business is not operating? Can they help with clean-up and repair during restoration?

6. Mitigation and Recovery.

Policies generally require a policyholder to mitigate its losses. Following is a list of questions that pertain to the duty to mitigate.

- a. Is the business able to access alternative facilities?
- b. Could sales or service be conducted elsewhere?
- c. Can rental equipment, overtime or additional shift work be used?
At what added cost?
- d. How much production can be made up with overtime and how long will it take?
- e. Will the business be able to supply customers from inventory during loss period?

- f. If the business has to draw down on inventory to meet orders, how long will it take to replenish inventories to the quantities before the loss?
- g. Are there limited markets or major suppliers?
- h. How much production can be deferred?
- i. Are long-term contracts at risk?
- j. Potential Claim Items for Extra Expense.

Some of the following cost categories may be recoverable as “Extra Expenses,” depending upon the coverage provided.

- Depreciation
- Advertising
- Repairs and maintenance
- Real and personal property tax
- Rent
- Other taxes
- Postage
- Claim preparation expense
- Telephone
- Corporate charges
- Utilities
- Experimental expenses
- Supplies
- Recruiting
- Dues and subscriptions
- Bad debts
- Travel
- Discounts
- Vehicle usage
- Interest on loans
- Labor (direct and indirect)
- Profit on loans
- Overtime
- Tooling
- Payroll tax
- Bonuses
- Unemployment compensation
- Sales department
- Holiday, sick and vacation time
- Research and development
- Workers’ compensation
- Engineering service

- Insurance and benefit cost
- Consulting fees
- Legal fees
- Other outside fees
- General/administration expenses
- Commissions
- Licenses
- Tax penalties

