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K&L GATES

Superstorm Sandy: Are You Covered?

Insurance Coverage Issues in the Wake of the Superstorm

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Sandy's Economic Impact

Early Estimates

- **\$30 to \$50 billion in total economic damages**
- **\$10 to \$20 billion in insured losses**
- **Sandy likely among five most expensive storms**
- **Katrina: \$48 billion in insured losses**

Significant Business Interruptions

- **Business-dense areas**
- **Prolonged power outages**
- **Transportation disruptions**
- **Cell, internet, telephone also down**
- **Forced evacuations**
- **Gas line breakages and resulting fires**
- **Indirect impact on undamaged customers/suppliers**



Deductibles

Deductibles – Hurricane/Windstorm

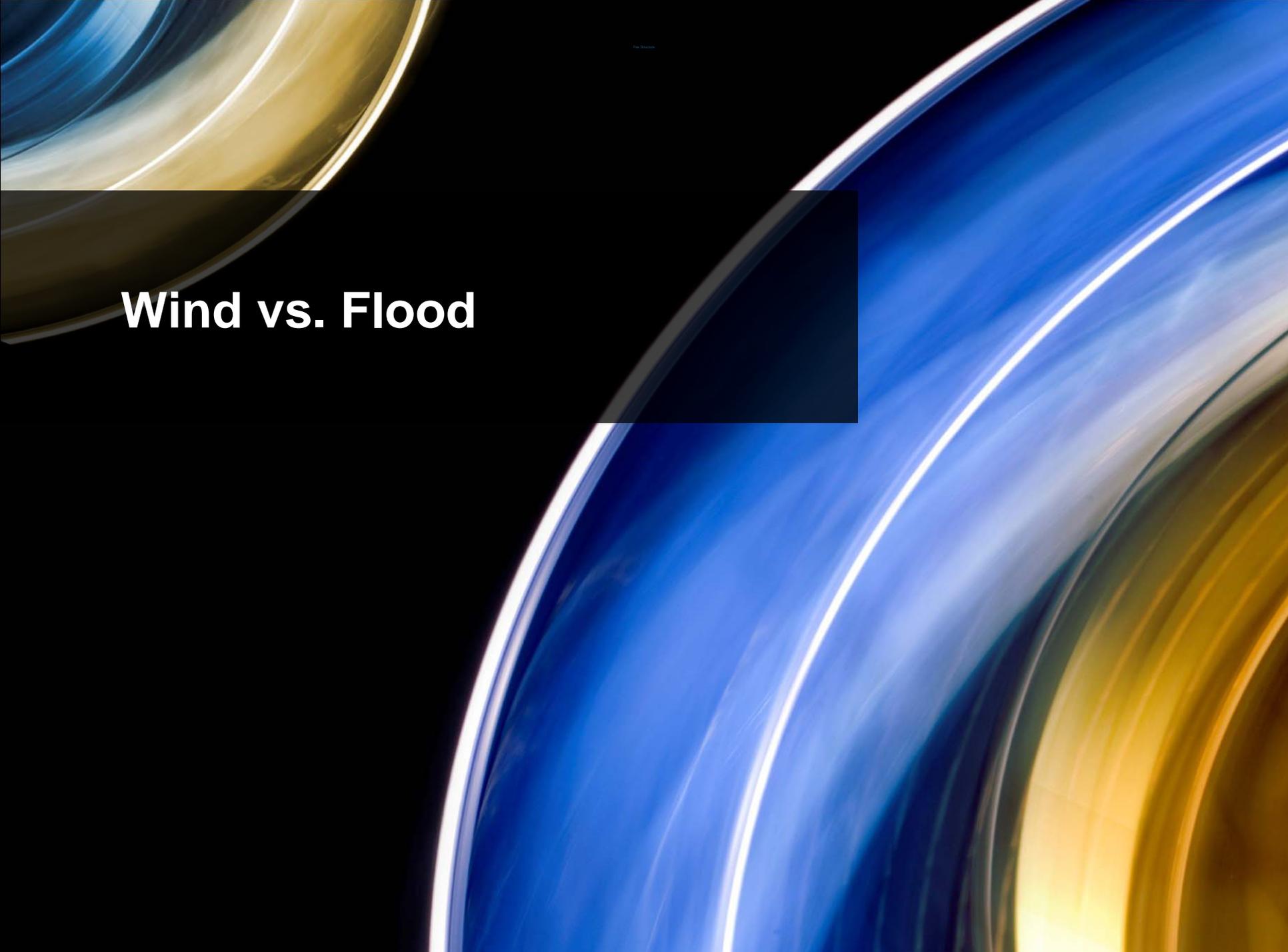
- Policies (home and commercial) often contain special deductibles for certain causes of loss
- Both home and commercial policies typically cover hurricanes, and carry special hurricane deductibles
- This “hurricane” deductible often is percentage of overall property value, e.g., varying from 1% to 5%
- Sandy had lost its hurricane status when it came on shore in NY and NJ
- In commercial policies (and some homeowner’s policies), Sandy’s “hurricane” status may not matter, because some policies carry “named windstorm” or “windstorm” rather than “hurricane” deductible, and Sandy remained a named windstorm (“post-tropical cyclone”)

Hurricane Deductibles

- **Seven states (and D.C.) have declared hurricane deductibles inapplicable**
 - **New York**
 - **New Jersey**
 - **Connecticut**
 - **Rhode Island**
 - **Delaware**
 - **Pennsylvania**
 - **Maryland**
 - **District of Columbia**
- **North Carolina allowing % deductibles**
- **Virginia not weighing in**

Deductibles – Flood

- **Most homeowners policies exclude “flood”, and therefore do not carry separate flood deductible**
- **Many commercial policies cover “flood”, but the type of deductible varies by policy**
 - **Some use flat amount for combined property damage (PD) and business interruption (BI) flood-related loss**
 - **Some use flat amount for PD and a separate amount for BI determined on the “Average Daily Value” (ADV) of the damaged facility (like a waiting period)**
- **Need to review specific policy language**

The background features a dynamic, abstract composition of curved, blurred lines in shades of blue and yellow/gold, set against a solid black background. The lines create a sense of motion and depth, resembling a stylized representation of a storm or a celestial body's surface.

Wind vs. Flood

Wind vs. Flood: Coverage

- **Most policies cover wind damage**
- **Homeowner policies generally do not cover flood**
- **Separate National Flood Insurance Program or private flood policy needed**
- **Commercial policies more likely to cover flood**
- **But, higher deductibles and lower sublimits may apply**

Wind vs. Flood: Allocation

- **Dispute: Whether wind or flood caused damage**
- **Especially where property completely destroyed**
- **Example: Pressure from wind and flood water lead to collapse of structure**
- **For business interruption, dispute over whether wind alone would have shutdown operations**

Wind vs. Flood: Burden of Proof

- Disputes often arise where losses are caused by multiple causes, some of which are covered and some of which are not
- Due to early policyholder successes in getting coverage where any contributing cause was covered, insurers added language to policies trying to exclude coverage where any non-covered cause contributed to loss (“anti-concurrent causation”)
- Courts split across country on how such policy language will be applied and when
- After Katrina, insurers in Gulf Coast argued *policyholder* had burden to prove wind damage, and courts typically held *insurer* had burden to prove flood exclusion applied

Storm Surge

- **Offshore water pushed by high wind**
- **Large cause of loss on Jersey Shore and New York**
- **After Katrina, policyholders without flood coverage argued storm surge was result of covered wind-related loss**
- **Courts generally deemed storm surge to be flood**
- **Many policies define “water damage” or “flood” to include “storm surge” or “overflow of a body of water” “whether driven by wind or not”**

COASTAL Act

- “Consumer Option for an Alternative System To Allocate Losses” Act
- Part of July 2012 reauthorization of NFIP
- Requires FEMA to develop standards for allocating between wind and flood for indeterminate loss
- Regulations not implemented
- Unlikely to affect most Sandy claims

Subsequent Damage

- **November 7 nor'easter**
- **Hindered recovery efforts**
- **Could raise problems separating damage**
- **Second “occurrence” could mean new deductibles (and perhaps new limit of liability)**

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Business Interruption Claims

Business Interruption: Five Basic Elements

1. A covered peril occurs (e.g., windstorm, flood)
2. The covered peril causes direct physical loss of or damage to covered property
3. The loss or damage to covered property results in a necessary interruption of the insured's business
4. The interruption of the insured's business results in a covered loss (e.g., lost "business income" or loss of "gross profits"), and
5. The covered loss occurs during the period of restoration (i.e., during the time the damaged property is being repaired or replaced and operations restarted)

Expenses to Reduce Loss

- **Policies allow recovery of expenses incurred to reduce covered business interruption loss**
- **Expenses not to exceed loss averted**
- **Most policies require the insured, where possible, to reduce the loss by complete or partial resumption of business**

Extra Expense

- **Provides coverage for expenses incurred during period of restoration that insured would not have incurred if there had been no physical loss or damage to its property**
- **Can include expenses to avoid or minimize suspension of business and continue operations, even at temporary or replacement locations**
- **Not usually limited by amount of BI loss averted**
- **Can have EE claim with no lost income**

Period of Restoration

- ***Begins:*** The date loss or damage insured by the policy occurs
- ***Ends:*** “When, with due diligence and dispatch, such lost or damaged property could be repaired or replaced and made ready for production or business operations or services under the same or equivalent physical operating conditions at the location that existed prior to such loss or damage.”
- If insured opts not to rebuild, then the claim is adjusted on a theoretical basis
- Includes not only repair time, but time to make facility ready for resumption of operations (testing, training, etc.)

Extended Period of Restoration

- **Provides BI coverage beyond standard period of restoration**
- ***Begins* on the date property is repaired and operations resume**
- **Ends when insured restores operations to the level of business that would have existed had no physical loss or damage occurred**
- **Usually limited to 30 to 365 days (specified in declarations)**

“Loss of Market” Defense

- **In area-wide catastrophes, insurers have asserted “loss of market” defense to BI claim**
- **Argue insured’s loss of business was result of loss of customers, not damage to insured’s property**
- **To extent possible, insured should document specific sales lost due to interruption**

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**Business Interruption:
What If the Insured's Property
Is Not Damaged?**

Insured's Property Not Damaged

- **Direct physical loss of, or damage to, insured property generally required to trigger your PD or BI coverage**
- **However, several common extensions of coverage in commercial policies do not require damage to insured's own property, and allow recovery for BI losses where some third-party suffered a PD loss or took a proscribed act**

“On Premises” Service Interruption

- **Covers business interruption and extra expense resulting from damage to utility *transmission lines* (e.g., electrical, fuel, gas, water, voice, data, video, etc.)**
- **May require that damage occur within fixed distance from the insured’s location (e.g., 1,000 feet)**
- **Also, damage must result from damage of the type insured (wind vs. flood issue)**
- **Burden may be on insured to establish**

Service Interruption

- **Similar to “on premises” but broader**
- **Covers BI and EE loss caused by interruption of incoming services (e.g., electricity, natural gas, water) resulting from “accidental event” at supplier’s facilities**
- **No distance requirement, no requirement of insured physical loss or damage**
- **Typically subject to “waiting period” (e.g., 3 days)**

Service Interruption (continued)

- **Insured may be required to notify supplier of service interruption**
- **Period of coverage ends when service could be wholly restored with the exercise of “due diligence and dispatch”**
- **These scenarios are ripe for disputes because the evidence of the existence and duration of a covered loss is tied to activities of third-party outside policyholder’s control**

Contingent Business Interruption

- **Covers loss of income due to physical loss or damage to another person's or company's property upon which the policyholder depends**
- **Applies even if policyholder's own property is not damaged**

Contingent Business Interruption (continued)

- Qualifying “contingent” properties may be scheduled in the policy or may be referred to in general terms
- May include:
 - Direct or indirect suppliers of goods and services to policyholder (transportation infrastructure?)
 - Direct or indirect customers of policyholder’s products or services
 - Properties that attract customers to policyholder’s business (e.g., convention centers, sports arenas)
- Utilities excluded

Ingress/Egress

- **Applies when closure of roads, airports, bridges, tunnels, etc. prevents access to premises**
- **Applies even if policyholder's property is not damaged (but may require damage to uninsured property of the type covered by the policy)**
- **May be subject to waiting period and separate sublimit**

Civil Authority

- **Covers loss if operations are suspended as a result of an order of a civil authority that prohibits access to covered premises**
- **May require that civil order be the result of direct physical loss or damage resulting from a covered peril (wind vs. flood)**
- **Often includes a waiting period (e.g., 72 hours) before coverage begins**
- **Period of coverage may be limited in time (i.e., 30 days or less)**

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Claim Adjustment Process

Claim Submission: Initial Steps

- **Carefully review all policy coverages, conditions and endorsements**
- **Provide immediate written notice under all potentially applicable policies**
- **Document all property damage (photos, videos, etc.)**
- **Track mitigation costs and extra expenses**
- **Identify impacts from supplier/customer interruptions**

Proving Loss

- **BI claims require projection of amount insured would have earned if not for the interruption**
- **Forensic accountant is often required to assist in documenting specifics of a BI and EE claim**
- **Market analysis may be required for CBI claims**
- **Insured may need to reach out to customers and suppliers**
- **Disputes as to amount of loss may be subject to mandatory appraisal proceeding upon demand of either insured or insurer**

“Proof of Loss” Submission

- **Policies typically require insured to submit signed, sworn “proof of loss” within fixed number of days (usually 60 or 90 days) from date of loss**
- **Typically required before insurer will make advance or partial payments**
- **If needed, extensions from insurer should be in writing**

Advanced Payments

- **Insureds can push for advanced or “partial” payments if magnitude of loss is obvious**
- **Not many policies include language mandating such payments**
- **Insured must press insurers for quick processing**

Claim Expense Coverage

- **Covers the costs the insured incurs in documenting and establishing covered claim**
- **Includes the significant costs incurred in retaining outside accounting experts**
- **Usually subject to sublimit**

Suit Limitation

- **Most policies require any suit under the policy to be filed within 1 to 2 years from date of loss**
- **Contractual limitations period**
- **Typically enforced even if claim adjustment process is continued**
- **Written extension or protective filing may be required**

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