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The Insurance Industry's "Perfect Storm"

by Marvin Milton, FPPA

The tragedy of September 11, 2001 has coalesced many of the problems that have plagued insurance consumers over the past few years—hostile, recalcitrant claims processing by insurers; the constant attempts by insurance companies and the ISO to retool policy coverages, especially in the business income forms, to narrow the protection afforded; and the handling of even outsized claims by inexperienced adjusters with vastly limited dollar authority. Couple all of this with the beginnings of the hard market that started to show its face before September 11th and you have the insurance industry's "Perfect Storm".

As the claims from September 11th begin to hit the "wall" of insurance company intransigence, certain common patterns are emerging which highlight all of the changes both in insurance policy forms and the attitudes which have slowly been accruing. In the following paragraphs, we will comment on the positions now being espoused—almost uniformly—by insurers as they face the coverages brought into play by the events of September 11th. Just remember that most if not all of the recent policy changes have yet to have their first reading by courts so there promises to be much litigation in the offing.

Period Of Restoration and the Duty to Mitigate

Perhaps the cornerstone to the indemnity provided by the Business Income policy is the concept of the Period of Restoration for this sets out the period of time during which the coverage must respond to the damages. The classic definition of the Period of Restoration was from the date of physical loss or damage to the policyholder's real and personal property until the date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality.

Thus, the time to repair or replace the assets damaged or destroyed set the "theoretical period of indemnity" and this period continued even though the policyholder mounted temporary or interim operations after the loss and damage. The traditional concept of the period of restoration implicitly recognized the value of the policyholder's location and was consistent with the replacement cost valuation for that premises contained in the property policy.

Since 1995, the ISO, the organization that formulates and promulgates the standard property and business income policies, has been retooling the Business Income forms, to correct some of the abuses insurers perceived from Hurricane Andrew.

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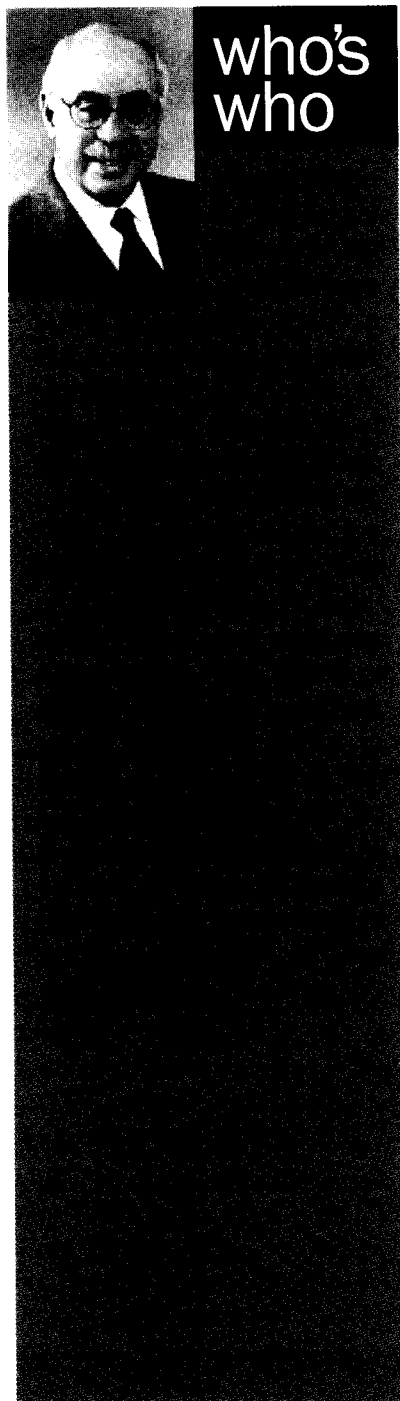
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One key definition added was to the Period of Restoration where now the period is the lesser of the time to repair or replace the physical damage or the date operations are resumed at a new permanent location. This modification of the Period of Restoration, in effect, devalues the advantage of the policyholder's pre-loss location. Assuredly, if the policyholder relocates and his business is service sensitive, it will take him longer to reestablish his revenue stream than if he resumed at his prior location but his coverage will be terminated under the revised definition. Under the classic definition, he still would have coverage even under a permanent relocation until the theoretical time expired to repair or replace although he would give the insurer credit for the operations set up at the permanent new location.

This alteration of the period of restoration could potentially engender a substantial shortfall in coverage under the World Trade Center scenario where the period of restoration for the tenants of the World Trade Center Towers and immediate surrounding buildings could be six or seven years but if they permanently relocate, the period of time and the business income coverage will come to a screeching halt.

The insurers of businesses at the World Trade Center Towers are actively attempting, in fact, to curtail their policyholders' period of restoration under the revised definition prevalent in the policies today by asserting that the policyholder has a duty to mitigate damages under their business income coverages and trying to force them into operations at another permanent location. The insurers are citing the resumption of operations clauses in the business income policies which clauses have received a mixed reception from the courts thus far.

But how much can the resumption of operations clause really mean in the context of the World Trade Center catastrophe since, with the businesses actually located there, the period of restoration could go on for six or seven years? Undoubtedly, these businesses will be vastly underinsured for their business income losses as the amounts of coverage are usually premised on a shutdown of only one year. Carrying out the losses for six or seven years, even factoring in some mitigation for interim operations, will nevertheless exhaust the coverage amounts.

That is, unless the insurers start insisting that the interim operations are not merely in mitigation but are actually permanent relocations thus terminating the period of restoration. The results will be fact driven. The subtext is how much risk can an insurer expect an insured to undertake in restarting its operations in a different location and, perhaps, with a different operating format just to reduce the loss for the benefit of the insurer.

So this interplay between the classic period of restoration, the resumption of operations clause and any interim or permanent relocations will determine the outcome of many business income claims. Given the present inclination of most insurers to take extreme, hard-nosed positions, it will be difficult to see any uniform early resolution of these issues without the imprimatur of some widespread principles laid down by court decisions.

Extended Business Income Coverage

Most Business Income policies today have Extended Business Income protection for an additional thirty, or sixty, or one hundred eighty days, even two years or, perhaps, until operations return to normal. Since the classic period of restoration only covers from the date of the physical loss or damage to the repair or replacement of those physical damages, there still exists a gap in coverage for the time that it takes the policyholder to recapture its market position after the repairs or replacements are completed. That is the purpose of the Extended Business Income coverage: it begins on the date the property is "actually repaired, rebuilt or replaced and business operations are resumed" and ends on "the date you could restore your business operations with reasonable speed, to the level which would generate the Business Income amount that would have existed if no direct physical loss or damage had occurred; or the number of days stated in the Declarations...."

Back a few years ago, the ISO inserted language in the Extended Business Income coverage to essentially narrow those provisions by excluding "loss of Business Income incurred as a result of unfavorable business conditions caused by the impact of the Covered Cause of Loss in the area where the described premises are located." Thus, apparently, as the loss becomes bigger, the coverage becomes less. This language will receive its first reading from the courts in the events following the World Trade Center tragedy.

Peculiarly, at least as far as the ISO is concerned, the new language did not decrease coverage and, therefore, required no adjustment of premium. Clearly, that is just not credible. What exactly does it all mean? If landlords and business owners of property in the World Trade Center area have difficulty in re-renting their property after repairs are completed, is that due to "unfavorable business conditions" or rather is that due to reports of poor air quality, disruption of transportation and pedestrian walkways and bridges surrounding the WTC area? Is "unfavorable business conditions" too broad and amorphous an exclusion basically removing the essential coverage provisions of the Extended Business Income endorsement as well as being just plain ambiguous? The best is yet to come!!!

The Civil Authority Clause

Under the basic business income coverage, in order to trigger a compensable loss, there first has to be physical damage by a covered peril to the building or personal property of the policyholder causing an interruption of operations. This is not so with the civil authority clause of the Business Income policy. As long as there is physical damage to other property in the area from a covered peril that results in an order from a civil authority precluding access to the policyholder's premises, the coverage is activated for "up to" a period of time depending on the wording of the particular policy.

The civil authority clause has received but minor attention from the courts thus far and mostly related to curfews imposed after the riots following the assassination of Martin Luther King and the acquittal of the assailants of Rodney King. The facts of September 11th promise to flesh out the full scope of this policy coverage.

For instance, access has to be precluded to whom? Personnel of the policyholder? Customers and business invitees of the policyholder? Vendors who supply goods and services to the policyholder? What is the exact definition of premises? The building itself? The streets and byways adjacent to and surrounding the premises? Any areas within a 100 feet or 1000 feet of the building?

All of these questions will arise because the orders of civil authority issued by the City of New York starting on September 11th and followed by orders on each succeeding week altering the areas and streets that were off limits to either personnel, general pedestrian or vehicular traffic, and public transportation or any combination thereof will have to be analyzed in light of what is determined to be within the ambit of coverage of the civil authority clause. The analysis will not be easy for the United States District Court for the Southern District of New York decided in an insurance case some thirty years ago that the words "access" and "premises" were ambiguous. This holding was just recently cited by the Supreme Court of New York (the trial court) in another insurance case involving "access to premises" which was decided in favor of the policyholder.

Yet with this adverse legal backdrop as precedent, virtually all of the insurance carriers faced with an interpretation of the civil authority clause have opted to take the narrowest stance possible—"access" is only related to the personnel of the particular business insured even if customers or business invitees and service vehicles are precluded from entering and "premises" are confined to the four walls of the particular building.

Another interesting application of the Civil Authority clause will be for those businesses operating at the nation's airports where the orders of the FAA after September 11th restricted many flights and, in effect, shut down certain airports but, perhaps, pedestrian traffic was still possible.

General Comments

We have attempted to delineate some of the battle lines that are being drawn in the context of the World Trade Center claims between policyholders and their insurers. It is sure to be a long, contentious path. This will not be the insurance industry's finest hour but rather its "Perfect Storm".

There are many more issues and questions out there that will surely come to the fore: the recovery of expenses in mounting interim operations and extra expenses to reduce the loss; the potential stacking of coverages like those for dependent properties or utility interruption with the traditional Business Income base line reimbursement; the problem of interpretation arising from those policies that insure against the "suspension" of business operations—does this require a total cessation of operations or does a partial shutdown qualify?—for the new definition of "suspension" inserted by the ISO specifically includes a slowdown; and the question of whether or not policyholders were notified by their insurers on renewal of the diminution in coverage relating to the period of restoration and to the terms of the extended business income policy relating to "unfavorable business conditions" as New York statutory law requires. Let's hope that all of the changes introduced by the ISO in reducing the coverages afforded without notifying their policyholders will be placed in the "no fly zone" by the New York courts.

All of these issues highlight and validate the crucial multidisciplinary approach to claims processing advocated by the policyholder law firm of Anderson Kill & Olick, P.C. and its Anderson Kill Loss Advisors Network—Loss Advisors on the ground capturing the evidence of the losses and damages sustained operating in close co-operation with the legal professionals at Anderson Kill & Olick, P.C. who marry those losses and damages to the policy provisions in effect to maximize the recoveries for the policyholder.

If you are encountering difficulties in advancing your WTC claims, please check us out at our website at www.andersonkill-la.com. ■

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