Hurricane Harvey Alert

Understanding insurance coverage and the immediate steps Risk Managers must take to mitigate a loss and prepare a claim.

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Hurricane Harvey will test many risk managers' insurance programs and response plans as it's been over 10 years since a major hurricane made landfall in the U.S. Many risk managers have yet to experience a hurricane caused area wide disaster that can devastate multiple properties across many miles. Such disasters are often complex and require decisive decision making that could mean the difference of continuation or cessation of your business. When property and business interruption insurance is in place, such losses require significant documentation and data to substantiate the loss and prove covered damages.

I. Review your policies closely

Many businesses have coverage gaps that leave them with exposure to catastrophic losses. To make matters worse, insurers often restrict the coverage available for catastrophic damages, particularly those caused by natural disasters, through the use of exclusions and sublimits. In addition, when there are large-scale losses, insurers may try to liberally apply exclusions and sublimits, or categorize the losses in ways that reduce the available coverage.

The Business Interruption Coverage Grant

Disruption to business operations can cause enormous losses as a company struggles to get back on its feet. Business interruption insurance, also known as business income insurance or "time element" coverage, generally covers lost earnings that result from disruption to the insured's business. Business interruption policies have many more variations in coverage terms and conditions relative to other types of insurance policies. Since one business interruption policy can differ significantly from another, policyholders should always review the specific language of their policies at both renewal and at the onset of any potential insurance claim.

Despite the variety in business interruption policies, the following coverage grant is oftentimes part of a commercial property policy:

We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your operations . . . caused by direct physical loss of or damage to property.

Such coverage can be extremely valuable to companies suffering a suspension of operations after a catastrophic loss. However, ambiguous policy language and a lack of uniform policy interpretation by the courts can lead to otherwise avoidable denials of claims.

The Shifting Identity of "Direct Physical Loss"

Business interruption coverage often requires that the insured suffer "physical loss," "physical damage," or "direct physical loss or damage," but lacks definitions for these terms. A business might suffer interruption without any direct physical loss to its products in a traditional sense. For example, if an oil refinery suffers a power outage during a hurricane, there may not be any direct physical damage to the oil or petroleum products within the plant, but there is almost certainly a cessation of business due to the loss of power. The issue then becomes whether loss of power at the plant constitutes a direct physical loss.

Over time, some courts have been expanding their interpretation of "direct physical loss" to include events such as power outages that render the insured physically incapable of continuing its business operations. The outcome of this issue varies by jurisdiction.

Furthermore, some business interruption policies require only “direct physical loss to Covered Property,” as opposed to “direct physical loss to Covered Property at an Insured Location.” The former language may provide better coverage in instances such as power outages, since the policy does not specify where the property must be located. For example, if insured business personal property such as machinery or equipment is located off-premises, coverage for any business interruption resulting from damage to such machinery is unlikely if the policy requires that the loss occur “at an Insured Location.”

Placing a Value on Lost Business Income

After Hurricane Katrina, many refineries were forced to suspend their operations, some for extended periods of time. Gas prices went up as much as fifty percent, but an out-of-operations refinery would obviously be unable to profit from the increase in prices the same way an unaffected refinery would profit. This raises the issue of compensation under business interruption insurance. Should the refinery be compensated in the amount it would have earned had there been no hurricane at all? Or should the measure of damages be the amount that would have been earned if the hurricane occurred and this particular company was unaffected?

The valuation clause of business interruption policies typically sets forth the manner for calculating the amount of reimbursement for a claim. In valuing claims where the policy is silent as to changes in profit opportunities following a catastrophic loss, courts often hold that the policyholder must be compensated as though the loss never occurred.

Monitor Contingent Business Interruption exposures

Sometimes, a single catastrophic event can impact the entire supply chain. When a disruption to the supply chain occurs, contingent business interruption insurance, also known as dependent property insurance, can cover earnings lost because of damage to facilities that are not owned, operated or controlled by the insured, but upon which the insured depends to conduct its own business. Dependent properties include properties the insured depends upon to deliver materials or services, accept products or services, manufacture products for delivery to the insured's customers, or attract customers to the insured's business.

II. Take immediate action to mitigate, document and set the tone for a claim submission

As the storm moves on and damages are initially investigated, the first hours and days after a loss are paramount to setting a tone in the insurance adjustment process that will help the recovery go as smooth as possible. Below are five key steps to follow when beginning the recovery and claim process on a large loss:

Document all the damage

Photographs and video footage of the loss are key to memorializing the damages. At some point, these documents will help you settle potential disagreements on items such as scope, quantity, and pricing. Be sure to include pictures of any identifying information such as serial numbers of damaged equipment.

Mitigate the loss and initiate your recovery

After the damage has been memorialized, it is important to focus on decisions that get your business up and running as quickly as possible. Sometimes there is confusion on whether or not to act to mitigate the loss prior to the first adjuster site inspection. While you don't need to ask for permission from your adjuster before you act, it helps to keep him or her in the loop as you move to mitigate your loss. More often than not, any decision made by a prudent business person to mitigate a loss is considered favorably by the insurance community. Be decisive.

Survey the damage with your insurance adjuster

When you have a date set for the adjuster to view the damage, make every effort to be there in person. Risk managers often rely on facility staff for this inspection. Being there sets the tone and working relationship for the entire adjustment process. In a large, area-wide disaster, adjusters are typically spread thin and likely do not have unlimited time to spend at your loss. Be prepared to walk the adjuster through the loss and focus the discussion on your business operations. Explain your recovery efforts and your timeline to document the loss

Provide a preliminary loss estimate/order of magnitude

As your adjuster begins to review the parameters of your loss, he or she will look to recommend a loss reserve to the insurer(s) for accounting purposes. Prepare a short summary identifying all areas of your loss with associated estimated costs. For example, if there is building damage, obtain estimates for repair to demonstrate the ultimate costs. If claim items are too early to quantify, such as business interruption, include the item as “to be determined” or “TBD.” This will help the adjuster consider the worst-case scenario including potential future claim items as he or she sets the reserve.

Request partial payments

Remember that the claim doesn't have to be paid only at the end of the process. The adjuster can release funds as items are agreed to and supported. As you prove damages through the adjustment process, ask for partial payments. This will help you maintain cash flow for your business during the recovery.

Assemble your team, be prepared and vigilant

Risk managers should work with a good team of sophisticated claim preparers, brokers and legal counsel to increase the likelihood of mitigating catastrophic losses. They should establish a) proper business interruption values, b) favorable policy language, and c) adequate coverage limits, all in advance of a loss. Policyholders can also increase recoveries from insurers post-loss by (a) assembling the claim preparation team early, (b) thoroughly reviewing the relevant coverage, sub-limits and exclusions before presenting the claim, and (c) being realistic, yet zealous in pursuit of insurance recoveries.

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SDV Law is a national law firm exclusively representing policyholders in insurance recovery matters, with regional offices around the country.