

Anatomy of a Large Property/Business Interruption Claim

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I. SCOPE OF ARTICLE

When disasters strike, they may cause loss of life, destruction, and dislocation on a massive scale. Their economic impacts can be felt by businesses and individuals regionally and often nationally for long periods of time after the event. The hospitality industry businesses are almost always hit by those events. They may suffer direct damage to property and lost income due to the resulting interruption of their operations, and may also lose substantial income due to evacuation orders, disruption of utility service, disruption of mass transit on which their employees rely to get to and from work, and disruption of the operations of key suppliers or customers. As a customer-driven industry, the latter is of particular concern to hospitality businesses following a disaster. As the situation stabilizes after a large-scale loss and the focus turns to economic recovery, hospitality businesses will begin to examine their operations, assess their losses, and look to their insurance for compensation.

A hospitality business that faces losses from any major event should immediately consider how its insurance will respond, assess its insurance policies, and develop a plan to determine and document losses that were or will be sustained because of the disaster. Experience tells us that even sophisticated businesses unknowingly make errors in assessing and documenting their losses or interpreting their insurance policies that later limit or even bar potential insurance recovery, and that insurers frequently use initial characterizations as a basis to restrict or eliminate coverage. This paper discusses the steps that an insured should take following a major first-party loss to help maximize any insurance recovery and avoid any coverage limiting missteps.

II. APPLICABLE INSURANCE POLICIES AND COVERAGES

Several different types of insurance policies may provide insurance to hospitality industry businesses, but the most common are first-party property policies that protect an insured's place of operations and inventory and provide coverage for lost or damaged property. Many property insurance policies are sold on an "all risk" basis, meaning that they cover losses to insured property caused by any peril not expressly excluded. Once an insured shows that it has suffered a loss under a broad all-risk policy, the burden of proof shifts to the insurer to show that the loss is not covered. By comparison, a second type of property insurance—a "named perils" policy—covers only those perils expressly listed. Both types of policies may contain coverage

exclusions. It is important for an insured to carefully review its policies to determine if the specific loss is covered.

A. Additional Coverages, Including Business Interruption and Extra Expense

In addition to covering property damage, many property policies also provide some or all of the following coverages designed to recover non-property losses:

Business Interruption: reimburses the insured for the amount of gross earnings minus normal expenses (that is, its profits) that the insured would have earned but for the interruption to its business. Business interruption coverage sometimes, but not always, requires that “interruption” result from damage to covered real or personal property. Insureds, for example, have obtained reimbursement under such coverage when widespread disasters such as Hurricane Katrina and the 9/11 terrorist attacks caused business interruption even when they did not suffer direct damage. Business interruption coverage provisions typically apply even when an insured is forced to relocate in order to maintain business operations or to minimize its overall loss.

Service Interruption: provides coverage for losses that the insured incurs from interruption of utility services that result from physical damage to the property that supplies the utility. Property policies frequently provide this coverage, although they may require that the interruption of service last a minimum amount of time, after which coverage kicks in. The coverage may be subject to separate and lower limits of insurance than other business interruption coverages. Service Interruption coverage can vary widely with regard to what types of utilities are covered. Depending on the specific Service Interruption coverage purchased, it may apply to several services, including water, communications, and power supply. With no electricity, for example, there may be a significant gas shortage (even if stations have gas, with no power they could not pump it), preventing the delivery of goods and services and employees from getting to work.

Civil Authority: protects the insured from losses caused by the inability to access its premises when a civil authority denies such access because of covered damage to, or destruction of, property belonging to third parties. Some civil authority coverages require physical damage to the insured’s own premises; others do not. A “civil authority” for purposes of this coverage may extend beyond federal and state governments. For example, after the 9/11 terrorist attacks, some insureds successfully argued that the baseball commissioner’s cancellation of games constituted an order of a civil authority. Regardless of the “authority” involved, civil authority-related event cancellation may be a significant area of loss for hospitality industry businesses.

Ingress/Egress: similar to Civil Authority coverage, Ingress/Egress coverage may be available when access to (“ingress”) or from (“egress”) an insured’s premises has been prevented or made more difficult because of a disaster. Unlike Civil Authority coverage, no governmental act is required to trigger this coverage. Many policies cover losses when “ingress” to or “egress” from insured premises is “prevented” because of a covered peril. In the aftermath of a disaster, many businesses may be unable to operate because millions of employees cannot get to work. Many roads remain closed or otherwise blocked. The availability of Ingress/Egress coverage varies greatly from policy to policy. Frequently, a policy will cover the loss sustained by an insured “due to the necessary interruption of the Insured’s business due to prevention of ingress to or egress from the Insured’s property, whether or not the premises or property of the Insured shall

have been damaged” if the interruption resulted from damage of a type insured against by the policy.

Contingent Business Interruption: typically covers two types of business interruption. First, it protects against economic losses caused by a “direct” supplier’s inability to get its goods to the insured due to damage to, or destruction of, the supplier’s property by an insured peril. Second, it protects against economic losses caused by damage to or destruction of a customer’s property that prevents the customer from accepting the insured’s products or services. Accordingly, hotels located on the West Coast may still suffer insured losses resulting from storms in the Gulf Coast if a firm in the Gulf reserved the entire hotel for a firm retreat but was unable to attend at the very last minute because of physical damage sustained to the business located in the Gulf.

Extra Expense: indemnifies the insured for reasonable and necessary extra or increased costs of business operations above the norm because of a peril insured against. It may include coverage for, among other things, costs incurred for the insured to temporarily continue business operations “as normal as practicable,” such as the temporary use of the property or facilities of others.

B. Event Cancellation Coverage

Those hospitality industry entities with a financial stake in a sporting or entertainment event should consider all coverage options to ensure that the correct policy or policies are purchased. Hotels and casinos that host concerts and sporting events such as boxing matches face unique risks of economic loss if disaster strikes leading up to a scheduled event. Event cancellations, interruptions, and postponements can result in significant financial losses for hospitality industry insureds that are also in the event industry. For this reason, insureds with a stake in live entertainment and sporting events frequently purchase event cancellation insurance. This broad form of insurance can provide coverage for a wide variety of perils that can negatively impact live events, including: earthquakes, floods, fires, power failure, damage to the event’s venue, denial of access to the venue due to a failure of public transportation, or even the interruption of a live television broadcast for major breaking news.

The types of financial loss recoverable under an event cancellation policy will depend on the particular terms of the coverage purchased. At a minimum, most event cancellation policies will cover whatever marketing, organization, and other out-of-pocket expenses the insured incurred in the months and weeks leading up to the event. Insureds may also purchase, for an additional premium, event cancellation policies that cover the profits and revenues lost as a result of the covered event’s cancellation or postponement. Additionally, many event cancellation policies will cover any so-called “additional expenses” that the insured incurs to relocate or reschedule the event in order to avoid its cancellation. These covered “additional expenses” could, for instance, include amounts spent to rent an alternate venue and market the rescheduled or relocated event, and costs of transporting equipment to a new venue might also be covered.

C. Deductibles and Policy Limits

Experience tells us that when an insured makes a coverage claim, insurers may seek to reduce their exposure. In response to claims for disaster-related losses, insurers may rely on deductibles and policy limits to pay less.

A “deductible” is the amount that the insured must pay toward its losses before recovering from the insurance company. The deductible amount and whether it applies on a “per occurrence” basis may significantly impact an insured’s insurance recovery following a storm with many reported events (hurricane and tornados, for example). Also, some policies call for a complex calculation tied to a percentage of the value of the insured premises to determine an insured’s deductible. Insureds should pay particular attention to make certain that it is not paying a greater deductible than what the policy requires.

Property insurance policies also limit the dollar amount that an insurer will pay for a covered loss (i.e., limit of liability). A “per occurrence” limit is the maximum amount that the insurance company will pay for one particular incident. An “aggregate limit” is the maximum amount the insurance company will pay for the entire policy period. A “sublimit” is any limit of insurance which exists within another limit. For example, the policy may have sublimits for “earthquake,” “flood,” or “windstorm” that may limit recovery for loss arising out of such events to a specified dollar limit per occurrence. Insureds should not necessarily accept an insurer’s determination of what policy limit applies. Frequently, insurers seek to reduce an insured’s claim for economic loss by improperly applying sublimits that are meant for physical damage losses.

III. MAKING A CLAIM FOR COVERAGE

Insurance policies typically impose on an insured obligations that must be satisfied to collect insurance. In seeking coverage, many businesses may overlook, or not be aware of, their duties. To preserve coverage, insureds should take care to identify and perform these duties. While an insurer may waive its right to insist on performance, insureds should proactively seek to comply with coverage obligations.

A. Provide Notice

Most insurance policies require that an insured notify the insurer “as soon as possible” or “as soon as practicable” after a loss or other insured event. This notice should be in writing for purposes of creating a record, although early oral notice may suffice, followed by written confirmation. An insured frequently must identify itself and provide information about the time, place, and circumstances of the loss. This notice requirement is intended to give an insurer a chance to investigate a loss or claim while the evidence is still fresh.

Courts frequently construe notice provisions to require that an insured provide notice within a reasonable time after an insured event occurs. The insurer may be excused from its obligations if the insured fails to exercise reasonable care in notifying the insurer of a claim within a reasonable time frame. However, many legitimate reasons may exist that justify not providing notice immediately after a loss, including the lack of power and telephone services, the lack of insurance information (because, for example, the information was destroyed or was kept in safe deposit boxes at banks that were closed) and the need to concentrate on efforts to protect life or

property. Many states require two conditions be satisfied before an insurer's duties can be discharged pursuant to the "notice" provision of a policy: (1) an unexcused, unreasonable delay in notification by the insured; and (2) resulting material prejudice to the insurer. Nonetheless, insureds should take immediate steps to provide notice. Notice to a broker alone may not be sufficient if the broker fails to give notice to the proper insurers. As a practical tip, the insured should be copied on all communications with the insurer—at least privately, to confirm that notice was given.

B. Cooperate

The duties outlined above may be set out specifically in an insurance policy. Moreover, almost all policies also contain a more general "cooperation" provision obligating the insured to cooperate with the insurer in its investigation of a loss and otherwise. This duty of cooperation obligates the insured to provide access to relevant books and records, provide the insurers with an opportunity to interview witnesses and employees, not commit fraud or perjury, not release claims against other parties to which the insurer may have a right of subrogation, not enter into unauthorized settlements with other parties, and assist the insurer in procuring evidence and securing the attendance of witnesses at depositions, hearings, and trial.

An insured's breach of its duty to cooperate could relieve an insurer of its policy obligations. However, most courts require that the insurer prove that it has been prejudiced by the breach. An insured should make a good faith effort to comply with its duty to cooperate and should honor reasonable requests from its insurer (requests for privileged information may not be reasonable) to facilitate reimbursement for its losses and not rely on the fact that it may be difficult for the insurer to prove that it has been prejudiced by the insured's non-compliance. Most provisions requiring the cooperation of the insured also provide that the insurer will pay for all additional costs the insured incurs complying with the insurer's requests.

C. File a Proof of Loss

Most first-party insurance policies require that an insured provide a "proof of loss, signed and sworn to by the insured," including statements of the time and origin of the loss; the interest of the insured and others in the property; the actual cash value of the property damaged; all encumbrances on the property; all other contracts of insurance potentially covering any of the property; all changes in the title, use, occupation, location, and possession of the property since the policy was issued; by whom and for what purpose any buildings were occupied at the time of the loss; and plans and specifications for all buildings, fixtures, and machinery destroyed or damaged.

Proofs of loss usually must be submitted within a relatively short time—often within 60 days after the loss incepts or within 60 days after the insurer requests a proof of loss. However, if an insured does not fully comply, it still may be entitled to coverage if it substantially complied with the requirement. At least one recent decision applied the "notice-prejudice" rule to a proof of loss in a first-party coverage case in California. These deadlines are typically extended where needed, but such extensions should always be secured in writing before the deadline passes. Most insurance companies will cooperate with such a request.

D. Submit to Examinations Under Oath

Most first-party insurance policies give the insurer the right to conduct, by any person it names (including outside counsel), an examination under oath “as often as may be reasonably required” about any matter relating to the insurance or the loss and require that the insured produce relevant books and records for examination. An insured’s failure to submit to an examination under oath may be enough to excuse an insurer from performing its duties under a policy. The circumstances giving rise to the failure to submit an examination must be reviewed and an insurer must exercise its rights to an examination in a reasonable manner

E. Abide by Contractual Limitations Periods

Many property insurance policies contain a contractual limitations period (that is, a contractual statute of limitations). A California court explained that “the purpose behind the shortened limitations period . . . is to relieve insurance companies of the burden imposed by defending old, stale claims.” However, some states, including Mississippi, prohibit contractual clauses purporting to shorten the time otherwise available to bring suit to less than the regular three-year statute of limitations, and, states may enact similar statutes applying to specific named storms if they are particularly devastating. For example, Louisiana enacted a statute that provided insureds until September 1, 2007, to file claims regarding Hurricane Katrina and until October 1, 2007, to file claims regarding Hurricane Rita regardless of any contractual limitations in their policies. Therefore, insureds must be careful to commence suit in a timely fashion or obtain an agreement with the insurer tolling the running of the limitations period.

The limitations period typically commences running on the “inception of the loss.” In many states, the running of the limitations period may be tolled from the date that the insured gives notice until the insurer communicates its coverage position “clearly and unequivocally in writing.

It is thus extremely important that insureds take all appropriate steps to ensure that suits, if necessary, are filed in a timely fashion. Unfortunately, insureds may not find clear answers and may have to initiate litigation to preserve their rights given possible disputes over which law controls (e.g., the law of the jurisdiction where the insured is headquartered and the policy was brokered, or the law of the jurisdiction where the loss was suffered).

IV. A ROADMAP TO SUCCESSFUL CLAIM RESOLUTION

For a Hospitably company or any organization dealing with a major loss, the process of filing timely, comprehensive and accurate insurance claims must be elevated to a top priority. While the insurance claims process associated with a major loss may seem overwhelming at first, there are several steps business owners and leaders can take, above and beyond what they are obligated to do under their policy, to mitigate the difficulties, issues and challenges that can arise when dealing with such a claim.

A. Assemble a Claims Team

The claims process tends to go smoother when the insured designates a senior-level manager within the organization to lead the claim. In larger organizations this role is typically filled by

the Risk Manager but in smaller companies that do not have a Risk & Insurance group, it might fall to the CFO or another senior resource within Finance, Accounting or Legal. The team lead should be responsible for championing the collection and compilation of data required to develop and support the claim, controlling the flow of information to insurer, brokers, claim consultants and adjusters; and for coordinating internal communication of important claim information to the executive management team.

Regardless of the size of loss, property and business interruption claims can be quite complex and require a substantial investment of time and resources to yield positive results. One of first things that the team lead should do is assemble a cross-functional team to assist with the evaluation, analysis, preparation and resolution of the claim. A typical team may include internal personnel from various departments, including finance and accounting, operations, legal and risk, and outside professionals, including brokers, forensic claim accountants, coverage counsel and technical experts. Bringing in outside expertise enables the insured's employees to remain focused on operational recovery efforts and core business functions.

B. Timely and Strategic Communication

It is critical for the insured to maintain regular communication with the claim adjusters and insurers. Keeping the adjusters and insurers apprised of your plans and restoration efforts will help to eliminate surprises and lead to a less contentious claims process. Disputes are bound to occur during the adjustment process; however, the insured should not be quick to let such disagreements derail settlement discussions. Rather the insured should strive to resolve as many claim items as it can and table the disputed items for a narrowly focused final claim negotiation.

Miscommunication can derail an otherwise smooth claim process. Disjointed communication, internally or externally, may lead to misunderstandings, which will take time and resources to overcome. Companies need to be open about the importance of establishing and working through a set communication protocol. This typically works best when the team lead is responsible for controlling the flow of all information related to the claim. Every analysis, email, memo and press release could be used in the context of a dispute. In the event of a potentially difficult claim, consider channeling communications through counsel to establish legal privilege.

C. Be Proactive About Managing the Claim Process

It is important to understand that the insured owns the claim and should drive the claims process. Be proactive, not reactive. Do not rely on the insurance company's adjusters to look out for your company's best interest. It is the adjuster's job to adjust the claim presented by the insured, not to assist in preparing it. The insured has the burden of proving and documenting the claim.

The insured should establish early on that it is carefully and fully preparing a fair, credible claim for all losses it may be entitled under its policies. It usually a good idea to implement critical path milestones to keep the claim process moving forward.

D. Fully and Fairly Respond to Insurer Requests

The insured has an obligation to deal with insurers in good faith and respond to all reasonable requests in a timely manner, to the extent possible. However, this does not mean that the insured should haphazardly rush to supply every piece of information the adjuster or forensic accountant requests. The insured should take a deliberate approach to responding to such requests and seek to understand why a particular piece of information has been requested and determine its potential relevance to the claim. It is common practice for adjusters and claim accountants to recycle boilerplate information requests that may include information (i.e. historical production data) that is completely irrelevant to your Hospitality business. If you don't understand why certain data is relevant to your claim, you should ask for clarification. If you believe that certain information requests are overly burdensome, you should propose alternatives (i.e. sampling) that might be acceptable to the adjuster.

Documenting and supporting a large insurance claim is a data intensive process. It can be a challenge to transmit large amounts of data over email and inefficient to burn information to CDs that then has to be sent to multiple parties. A web-based file share site can be an effective tool for sharing invoice and other claim related information. File share sites are relatively inexpensive and can easily be set up to provide different levels of access and permissions for internal and external users. File share systems speed the transmission of data and ensure that everyone is working from the same set of information.

E. Prepare and Periodically Submit Claim Summaries and Support Packages

Depending on the nature and extent of damage, it can take anywhere from a few months to more than a year to repair a damaged hospitality property and even longer for business to be restored to pre-loss levels. Moreover, insurance recovery tends to lag behind the physical and operational recovery because it takes time for the final repair costs to be processed and for the insured to have enough post-loss operating data to verify that the recovery period has truly ended. However, this does not mean that the insured should wait until the loss is over to prepare its claim. Rather the insured should prepare preliminary estimates of both their property and business interruption claims as soon as they have a general understanding of the scope of the loss and estimate of potential restoration period. Preliminary claim estimates should be communicated to the Insurer as soon as practicable so that this information can be factored in the claim reserve.

Over time additional restoration costs will be incurred and business income losses will be realized. The insured should periodically update claim estimate and distinguish incurred costs and realized losses from estimated future costs and losses. Organizing the claim materials in this manner will help the Insurer to keep track of the loss. Insurers will and in some cases have an obligation to make interim payments based on the agreed amount of a claim. The insured should begin requesting interim payments once the agreed claim amounts exceed the applicable deductibles.

F. Prepare for Settlement Meetings

One of most common mistakes insureds make is to enter settlement meetings with the simple goal of getting “as much as they can!” The insured is bound to leave money on the table or walk away with an unresolved claim if they fail to understand the value their claim in light of both its strengths and weaknesses. Resolving a claim is not just about getting the most money possible from the insurance company, the insured needs to consider all relevant factors, not just coverage, legal, technical, but also relationships, market factors, renewals in the process of settling the claim.

G. Be Flexible

In any complex claim, there are inevitably new, unexpected issues that arise or your perspective on things changes as more information about claim is developed. Be prepared to walk away and come back to table at later time.