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Insurance for Business Interruption Losses Due To Damage Away from the Insured Premises: Lessons from 9/11 and Katrina, and Coverage for the Icelandic Volcanic Eruptions and the Gulf Oil Spill

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Business Income Coverage in the Post-9/11 World: How Insurance Companies Have Changed the Claims Handling Playbook Since 9/11 and Hurricane Katrina

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Introduction

The insurance claims that arose from the attacks of September 11, 2001 ("9/11") and Hurricane Katrina were a watershed for the way in which insurance companies handle Business Income insurance claims. Those events also set loose a spree of judicial opinions regarding the scope of coverage for Business Income and other time element losses. Indeed, although Business Income coverage has been around for more than a century, about *half* of the time-element cases have been decided since September 11, 2001.

Historically, Business Income and other time element insurance claims were resolved generally by negotiation or appraisal. There are many reasons why such claims increasingly are being litigated, but perhaps the primary reason is the circumstances surrounding 9/11 and, to a lesser extent, Hurricane Katrina. Those catastrophes gave rise to insurance claims that: (1) were often, individually, very large, a condition that by itself led to disputes; (2) were collectively massive, putting at least an initial strain on the industry and its individual players; (3) were quite similar to other policyholders' claims, which inclined claims handlers to be conservative, lest policyholders discover favorable claims positions and demand similar treatment;[1] (4) involved forms of recent vintage, with little or no case authority to provide guidance or constrain insurance company claims handlers; (5) involved broad coverage forms, a product of the "soft market" just beginning to lift in early 2001; and (6) arrived at a time when the financial markets, in which insurance companies are huge investors, were retrenching dramatically. The confluence of these factors, combined with the growing role of outside coverage attorneys in shaping the response to first-party claims, led insurance companies to take newly restrictive coverage positions on policyholders' time element claims.

This commentary will provide an overview of the issues that have been the focus of Business Income disputes between policyholders and their insurance companies since 9/11, with special attention paid to the ways in which insurance companies' claims

1. *See* Daniel T. Torpey & Jeffrey M. Phillips, "World Trade Center Terrorist Business Income Claims Will Challenge Policyholders" (Jan. 2002) ("Imagine yourself as an insurance executive with the knowledge that any decision you make on any one loss will impact multiple claims in multiple industries all for one event [the attack on the World Trade Center (the 'WTC')]. Accordingly, insurers will be very careful as to how they react to a variety of technical claim issues.").

handling approach has changed during that period. The article will also suggest how policyholders can avoid the traps recently laid by the insurance industry and its lawyers.

The Non-Existent *Daubert* Exclusion

As a practical matter, Business Income claims are calculated based on projections of what the policyholder's revenues would have been in a hypothetical universe where the loss event never occurred. By definition, this analysis represents what is, at best, a rough estimate of what probably would have happened had there been no loss. For most Business Income claims of even modest complexity, this analysis is typically done by separate forensic accountants retained by the policyholder and the insurance company. Although these accountants employ various mathematical and statistical techniques in their analysis, there in no one "correct" way to estimate any given loss, and no accountant's results can ever be said to be 100% accurate, or verifiable with scientific certainty. For exactly this reason, such claims historically have been resolved via give and take discussions between each side's accountants, until they are in substantial agreement on a methodology for estimating the loss – which typically yields a claim calculation somewhere in between the result initially obtained by each side.

In many 9/11 Business Income claims, and in some others stemming from the catastrophic hurricanes of 2004 and 2005, insurance companies took a much harder line in discussions over loss calculation methodologies. This forced many policyholders into litigation, where they were required to establish the amount of their damages predominantly through expert testimony by forensic accountants that worked up the Business Income loss projection models. Insurance companies argued that, in order to be admissible, such expert testimony had to meet the standards for reliability established in Federal Rule of Evidence 702, as well as Daubert v. Merrell Dow Pharms.[2] and its progeny. Thus, once the parties were in court, many insurance companies sought to disqualify the policyholder's forensic accountant – and thereby effectively undermine the policyholder's case – by challenging the reliability and accuracy of the accountant's Business Income loss calculation under *Daubert's* "junk science" standard. And in more than one case, insurance companies have succeeded in completely avoiding payment of claims simply by convincing the court that the forensic accountant's analysis or the data on which that analysis was based were unreliable under the *Daubert* standard.[3]

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2. 509 U.S. 579 (1993).

3. *See* Maher v. Continental Casualty Co., 76 F.3d 535 (4th Cir. 1996) (applying West Virginia law); Wyndham Int'l, Inc. v. Ace Am. Ins. Co., 186 S.W.3d 682 (Tex. App. 2006); Lava Trading, Inc. v. Hartford Fire Ins. Co., 2005 U.S. Dist. LEXIS 4566 (S.D.N.Y. 2005) (Dolinger, Mag. J.) (report and recommendation), adopted in an unreported order (S.D.N.Y. Apr. 8, 2005) (Castel, J.).

Business Income Coverage in the Post-9/11 World: How Insurance Companies Have Changed the Claims Handling Playbook Since 9/11 and Hurricane Katrina
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Such decisions effectively insert into the insurance policy a requirement that does not otherwise exist – a requirement that the accountant or loss adjustor and the data and other evidence relied on in calculating the Business Income loss meet the *Daubert* standard. The reasoning behind such decisions is questionable because the calculation of such losses, by definition, is counterfactual and essentially calls for estimates of revenues in purely hypothetical business environments. Ultimately, results such as these embolden some insurance companies to take a hard line in discussions with their policyholders over Business Income loss calculations, especially in cases where it is difficult to tie the loss-causing event to the policyholder's downturn in revenues with a great deal of precision, or where it is difficult to quantify the impact of potential alternate causes of the policyholder's decreased revenues on its covered Business Income loss. For example, when a jewelry store damaged in a hurricane suffers a 50% downturn in revenues for the month following the storm, the insurance company is likely to argue that some portion of those losses are attributable to people simply not shopping for luxury products because they were busy dealing with more pressing matters like repairing the roofs on their houses, which alternate cause might not be covered under the jewelry store's policy. So how is the policyholder's accountant expected to assess with mathematical reliability the extent to which earring buyers stayed home because they had leaky roofs versus the fact that the broken windows on the jeweler's storefront were boarded up?

Although they are problematic for policyholders, decisions such as those noted above are in conflict with a long line of cases holding that policyholders can prove their Business Income losses through various types of data and expert testimony[4] and do not

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4. *See* Diamond Shamrock Corp. v. Lumbermens Mut. Casualty Co., 466 F.2d 722, 728 (7th Cir. 1972) ("[The policyholder's] summary exhibits, together with the testimony of [the policyholder's] accountant … provide a detailed analysis of the method by which the total business loss figures were reached. Those exhibits were sufficient to establish a *prima facie* case of loss in the amount claimed. At that point it became incumbent upon [the insurance company] to prove that the losses claimed were excessive or unreasonable."); American Medical Imaging Corp. v. St. Paul Fire & Marine Ins. Co., 949 F.2d 690, 694 (3d Cir. 1991) ("Inherent in the concept of business interruption insurance is the necessity of [policyholders] making claims for lost earnings based in large part on estimates of things that have not happened, i.e., on estimates of what would have happened had there been no fire or other covered cause of loss. Moreover, throughout the world of business, such estimates are invariably based on the results of past performance projected and adjusted on the basis of present business conditions…. Unlike the district court, we find no fault with the character of [the policyholder's] tendered evidence on lost earnings. Indeed, the fact that [the policyholder's] projections were formulated in the regular course of business prior to the alleged loss may commend them to the trier of fact as more reliable than if they had been prepared after the fact for the purposes of litigation. Moreover, we know of no rule requiring that evidence of lost earnings identify the particular customers and hypothetical transactions that would have produced revenues but for the fire or other covered loss."); Net 2 Press, Inc. v. Employers Fire Ins. Co., 2004 U.S. Dist. LEXIS 18929 (D. Me. 2004) ("While some evidence of actual loss from interruption of business and extra expense to run the business is required in order to succeed on a claim that this portion of the insurance policy was breached, as well as proof that such evidence was provided to the [insurance company], the law does not require that such evidence be in documentary or any other particular form."); Gates v. State Auto. Mut. Ins. Co., 196 S.W.3d 761 (Tenn. Ct. App. 2005) ("while [the policyholder's] accounting practices are relevant, we must also consider "the nature of the business and the methods employed in its operation." We must conclude that the interpretation advocated by [the insurance company], given the nature of [the policyholder's] business and its method of operation, would defeat the essential purpose of business interruption insurance, that is, to place the insured "in the position it would have occupied if the interruption had not occurred." The interpretation adopted by the trial court is, under the circumstances of this case, more consonant with the language of the policy as well as the purpose of this type of insurance.").

need to be proved with mathematical precision.[5] When the shoe is on the other foot, insurance companies have lobbied hard for admission of their own forensic accountant evidence as "crucial" in Business Income cases.[6] Accordingly, there is ample ammunition to defend against improper attempts to inject the *Daubert* standard into the loss adjustment of Business Income claims, and policyholder advocates should be on the lookout for this unsavory insurance industry tactic. Finally, even where expert testimony is rejected under *Daubert*, it sill may be possible to present lay testimony from a policyholder's accountant to substantiate a Business Income claim.[7]

The Undefined Use of "Suspension" in Business Income Provisions

Most Business Income provisions promise to pay for loss resulting from a "suspension" of the policyholder's operations caused by damage or destruction of property at the premises. Historically, insurance companies have been somewhat successful in arguing to courts that the term "suspension" means "total cessation" and, thus, that a policyholder: (1) is entitled to Business Income coverage only during the period of time its operations are at a complete standstill; and (2) is entitled to no coverage if it is able to hobble along and continue operations despite property damage.

The "total cessation" argument is absurd for a number of reasons. First, the time during which coverage is owed is already measured by the Period of Restoration – generally

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5. *See* Springfield Fire & Marine Ins. Co. v. J. T. Wilson Co., 67 F.2d 426, 428 (6th Cir. 1933), 67 F.2d 426, 428 (6th Cir. 1933) ("it may be said that the amount of liability is not shown with mathematical precision, but there were sufficient proofs to take the case to the jury and justify the jury, if the evidence was believed, in rending a verdict in the amount returned"); Vinyl-Tech Corp. v. Cont'l Cas. Co., 2000 U.S. Dist. LEXIS 22507 (D. Kan. 2000) ("That the amount of lost profits may not be shown precisely will not prevent recovery if the [policyholder] makes the amount of its loss reasonably certain by competent evidence."); Lite v. Firemen's Ins. Co., 119 A.D. 410, 104 N.Y.S. 434, 436 (N.Y. App. Div. 1907) ("It is manifest that some loss of profit must have accrued from the inability to use or rent the 10 apartments, and, where there is an evident loss, the insured should not be deprived of indemnity merely because it may be difficult to fix the amount of the loss with absolute precision"); Anchor Toy Corp. v. American Eagle Fire Ins. Co., 4 Misc. 2d 364, 365-366 (N.Y. Sup. Ct. 1956) ("Such questions as the estimated amount of business during the period and the percentage of profit were not only of great complexity due, among many other factors, to the means of administering the corporate business, but also were at best matters of opinion."); Holt Atherton Industries, Inc. v. Heine, 835 S.W.2d 80, 84 (Tex. 1992) (noting that "[r]ecovery for lost profits does not require that the loss be susceptible of exact calculation"; "[t]he amount of the loss must be shown by competent evidence with reasonable certainty"; "[w]hat constitutes *reasonably* certain evidence of lost profits is a fact intensive determination"; and "opinions or estimates of lost profits must be based on objective facts, figures, or data from which the amount of lost profits can be ascertained"); State Farm Lloyd's Ins. Co. v. Ashby AAA Auto. Supply Co., 1995 Tex. App. LEXIS 3346, at *48-50 (Tex. App. 1995) ("'Recovery for lost profits does not require the loss to be susceptible of exact calculation.' However, the amount of the loss must be shown by competent evidence and with reasonable certainty. 'What constitutes reasonably certain evidence of lost profits is a fact intensive determination. As a minimum, opinions or estimates of lost profits must be based on objective facts, figures or data from which the amount of loss profits can be ascertained.' …. A party must show either a history of profitability or the actual existence of future contracts from which lost profits can be calculated with reasonable certainty.") (citations omitted).

6. *See* Audubon Veterinary Hosp., Inc. v. U.S. Fid. & Guar. Co., 2007 U.S. Dist. LEXIS 46301 (E.D. La. 2007).

7. *See* La. Med. Mgmt. Corp. v. Bankers Ins. Co., 2007 U.S. Dist. LEXIS 59956 (E.D. La. 2007) (holding that a policyholder could call its accountant of 20 years to substantiate its Business Income claim as a lay witness because "[t]he Third Circuit has held that a company's accountant may offer lost business profits opinion testimony as a lay witness under Rule 701 because of his personal knowledge of the company's finances").

defined as the hypothetical period needed to repair or replace damaged property – which clause is rendered moot by the "total cessation" doctrine. Second, most modern businesses are fully capable of conducting some business – by fax, Blackberry, telephone, or laptop – despite catastrophic destruction of their premises. Third, most policies contain clauses contemplating partial operations (e.g., giving the insurance company credit for sales of existing stock), and promising Extra Expense coverage for the above-normal costs of engaging in partial operations *during the Period of Restoration*. Fourth, courts adopting the doctrine are not consistent as to whether cessation is a trigger (i.e., the policyholder gets coverage for all losses after an instant of cessation) or whether it relates to the Period of Restoration (i.e., the policyholder gets coverage only for losses during the cessation). Incredibly, some courts come to both conclusions at once.[8] Accordingly, several years ago, the Insurance Services Office ("ISO"), the insurance industry drafting arm responsible for much of the first-party language in commercial use, included a definition of "suspension" in its standard-form policy that expressly makes clear that Business Income coverage includes lost profits during slowdowns.

Many modern policies – based on broker, manuscript or insurance company forms – do not include the ISO definition of suspension. Thus, insurance companies repeatedly raised the "total cessation" argument in 9/11 Business Income claims,[9] and even obtained judgments in 9/11 claims based on the argument.[10] Insurance companies continue to make this argument and win.[11] Given this potential pitfall, policyholders, at the point of sale, should insist on a definition of "suspension" akin to that in ISO forms which make clear that partial suspensions of operations are covered.

"Location, Location, Location" Is Now Being Ignored by Business Income Claims Handlers

Historically, Business Income cases gave policyholders the benefit of location by setting the Period of Restoration – the period during which Business Income coverage is owed – as the hypothetical time needed to repair or replace damaged property at the original location. If the policyholder relocated during that period, the insurance company got the benefit of any income earned by the substitute operations, but relocation did not end the Period of Restoration.[12]

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8. *See* Broad St., LLC v. Gulf Ins. Co., 37 A.D.3d 126 (N.Y. App. Div. 2006).

9. *See, e.g.,* Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co., 279 F. Supp. 2d 235, 238-239 (S.D.N.Y. 2003), *aff'd in part, rev'd in part*, 411 F.3d 384 (2d Cir. 2005).

10. *See, e.g.,* Royal Indemnity Co. v. Retail Brand Alliance, Inc., No. 601164/04 (N.Y. Sup. Ct. Feb. 23, 2006).

11. *See, e.g.,* Madison Maidens, Inc. v. Am. Mfrs. Mut. Ins. Co., 2006 U.S. Dist. LEXIS 39633 (S.D.N.Y. 2006).

12. *See, e.g.,* Hawkinson Tread Tire Service Co. v. Indiana Lumbermens Mut. Ins. Co., 362 Mo. 823 (Mo. 1951).

Business Income Coverage in the Post-9/11 World: How Insurance Companies Have Changed the Claims Handling Playbook Since 9/11 and Hurricane Katrina
By Richard Lewis and Marshall Gilinsky

Since 1995, however, ISO's standard form has defined the Period of Restoration as the *lesser* of the time to repair or replace the physical damage at the original location or the time at which operations are resumed at a new permanent location. This modification devalues the policyholder's pre-loss location, capping the loss of many policyholders at the point of relocation, despite the fact that their loss will continue at an inferior replacement location. Obviously, if you purchase a policy with ISO language, this argument will be open to the insurance company, although one court has concluded that whether a policyholder has "permanently" relocated is viewed by the policyholder's subjective intent.[13]

But what about policies without ISO's restrictive language? In seven 9/11 cases, the insurance companies all argued that the Period of Restoration was not equivalent to the period needed to rebuild the World Trade Center ("WTC") where the policyholders had been located, but was the period needed to restart operations *anywhere*. These arguments had varying results:

In three involving firms with offices at the WTC, the courts concluded that the Period of Restoration was equivalent to the time needed to relocate the offices anywhere.[14] In two cases involving stores located in the mall in the concourse of the WTCenter, the courts concluded that the Period of Restoration was not the time needed to rebuild the WTC, but also rejected the insurance companies' arguments that the period was equivalent to the time needed to replace anywhere; rather, the court found the policyholders were entitled to coverage for the time needed to find a reasonably equivalent location.[15] Two other courts, however, found that the businesses at issue – a janitorial firm servicing the landlord and tenants at the WTC and a company providing temporary office space at the WTC, respectively – were entitled to coverage during the hypothetical period needed to rebuild the WTC, essentially because the WTC location was of overwhelming importance given the nature of their operations.[16]

Oddly enough, the only case of the above six to contain ISO's constriction of coverage was *International Office Centers*. The absence of such restriction should have been

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13. Shore Pointe Enterprises v. Michigan Millers Mut. Ins. Co., 2004 Mich. App. LEXIS 3486 (Mich. Ct. App. 2004).

14. Streamline Capital, L.L.C. v. Hartford Cas. Ins. Co., 2003 U.S. Dist. LEXIS 14677 (S.D.N.Y. 2003); Lava Trading, Inc. v. Hartford Fire Ins. Co., 365 F. Supp. 2d 434 (S.D.N.Y. 2005); Children's Place Retail Stores v. Fed. Ins. Co., 37 A.D.3d 343 (N.Y. App. Div. 2007).

15. Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co., 411 F.3d 384 (2d Cir. 2005); Retail Brand Alliance, Inc. v. Factory Mut. Ins. Co., 489 F. Supp. 2d 326, 334 (S.D.N.Y. 2007).

16. Zurich Am. Ins. Co. v. ABM Indus., 2006 U.S. Dist. LEXIS 28249 (S.D.N.Y. 2006); Int'l Office Ctrs. Corp. v. Providence Wash. Ins. Co., 2005 U.S. Dist. LEXIS 20494 (D. Conn. 2005).

sufficient for the above courts to conclude that the Period of Restoration should be metered by the time necessary to replace at the original location.

Nonetheless, insurance companies will press this point, and policyholders will succeed in avoiding a truncated Period of Restoration only to the degree they can demonstrate that their location was "of the essence" of their operations. In other words, policyholders must establish that the purpose of Business Income insurance – to do for the policyholder what it would have done absent the catastrophe – would not be served by basing the Period of Restoration on replacement anywhere, if losses would continue at the inferior replacement location.

Seemingly Illusory Coverage Provided by Civil Authority Clauses

Civil Authority coverage is a Business Income "coverage extension" that typically covers loss when, in the wake of a catastrophe, civil authorities take actions which affect customer access to a policyholder's property. Although the forms vary greatly, typical provisions require access (1) to be "prevented" or "prohibited" (2) as a result of property damage. Many policyholders made Civil Authority claims after 9/11, either for loss stemming from Mayor Giuliani's orders prohibiting traffic in lower Manhattan or for loss stemming from decreased customer demand in the wake of the order of the FAA.

The insurance industry, facing a vast number of such claims, strongly resisted them, urging two main defenses: (1) the orders were not as a result of the property damage on 9/11 but were issued to prevent further property damage;[17] and (2) access to premises such as hotels affected by the FAA order was not totally "prevented" or "prohibited."[18]

From a policyholder's perspective, the first argument is akin to asking: "which came first, the chicken or the egg?" Take, for instance, the prototypical Civil Authority situation, where the collapse of a building causes city authorities to bar access to adjoining buildings: is such an order because of the existing collapse or because of fear of future collapse? One could make a strong case for either point, but accepting the latter would essentially render Civil Authority coverage illusory.

The second argument was almost universally accepted by courts addressing 9/11 claims, which found that access was not "prohibited" or "prevented" – even if the policyholder's business was dramatically down – if it was possible for the customers, or even the policyholder itself, to physically reach the premises, regardless of whether

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17. *See, e.g.,* US Airways, Inc. v. Commonwealth Ins. Co., 64 Va. Cir. 408 (2004).

18. *See, e.g.,* Southern Hospitality, Inc. v. Zurich Am. Ins. Co., 393 F.3d 1137 (10th Cir. 2004).

commerce itself was feasible. This argument has also been accepted by one court addressing a Katrina claim.[19] Such holdings not only essentially render Civil Authority coverage illusory, they are often contrary to positions taken by the insurance industry in the press after a catastrophe, to the effect that delays in claims handling were attributable to the inability of claims handlers to reach affected property. The holdings are also contrary to decisions under a similar clause, covering loss caused by prevention of ingress or egress, which have taken a functional and realistic view of the term “prevent.”[20]

As currently construed by the insurance industry, and most courts, Civil Authority coverage is illusory unless the order totally bars access to the policyholder's property by any means. If possible, at the point of sale, policyholders should insist on the terms “hindered” or “impaired” in place of “prevented” or “prohibited.”

Beware of Arguments as to the Wider Effects of the Loss

A number of insurance companies sought to slash Business Income or Civil Authority recovery on the ground that business in New York was slow after 9/11. In other words, the insurance companies sought to take advantage of the wider effects of the loss, and argue that, because the catastrophe was so big, the recoverable loss for any particular policyholder should be smaller. Note that this issue may be the primary sticking point in Business Income claims stemming from Hurricane Katrina: insurance companies will argue that pre-loss projections of profit must be revised downward because of the decrease in population in New Orleans and along the Gulf Coast.

Historically, issues surrounding the wider effects of a catastrophe in the Business Income context have arisen in cases in which policyholders, whose businesses were destroyed by storm, argued that their lost profits should include the hypothetical increased sales levels they would have enjoyed had the storm at issue spared their business but still flattened neighboring property. Not surprisingly, insurance companies resist such claims on the ground that a policyholder cannot reap a “windfall” by factoring in the wider effects of the same catastrophe which caused the loss.[21] No doubt insurance companies will take similar positions in Katrina claims where policyholders seek to take advantage of the wider effects of the loss.

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19. Kean, Miller, Hawthorne, D'Armond McCowan & Jarman, LLP v. Nat'l Fire Ins. Co., 2007 U.S. Dist. LEXIS 64208 (M.D. La. 2007).

20. *See* Fountain Powerboat Indus. v. Reliance Ins. Co., 119 F. Supp. 2d 552 (E.D.N.C. 2000).

21. *See, e.g.,* Prudential LMI Commercial Ins. Co. v. Colleton Enterprises, 1992 U.S. App. LEXIS 25719 (4th Cir. 1992).

Further, ISO's standard form already has two provisions addressing the wider effects of the loss: ISO's Business Income provisions state that favorable business conditions existing in the wake of a catastrophe do not affect the amount of loss, and ISO's Extended Business Income provision excludes loss "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." Accordingly, policyholders facing insurance company efforts to slash Business Income recovery on the basis of the wider effects of the loss can point out that the insurance industry knows how to draft policies, and the absence of any provision granting the insurance company the benefit of the wider effects of the loss means that the insurance company is not entitled to any such benefit.

Beware the Period of Restoration for Unusual Businesses

The Period of Restoration often has a poor fit to businesses with a substantial lag between the time they provide a service or sell a good and the time they get paid. Insurance companies will argue that only losses fully realized during the Period of Restoration may be recovered; under such an interpretation, a law firm out of business a couple of weeks will have no recoverable loss because it will not perform services, bill for them and receive payment during that period. This argument has been accepted by some courts,[22] while other courts have taken a more functional view of when income is earned.[23]

Policyholders can attempt to address this problem at the point of sale by purchasing a form which meters the loss in a manner more consistent with the nature of the business (i.e., billable hours lost for a law firm). Most forms, for instance, measure loss for manufacturing concerns in terms of the ultimate value of the product which cannot be manufactured, and not ultimate sales lost during the Period of Restoration. At a minimum, policyholders must resist insurance company efforts to have it both ways. For instance, many insurance companies seek to take advantage of "credits" for pent-up demand after the Period of Restoration; e.g., sales of eyeglasses to persons who had simply delayed purchase until after the neighborhood eyeglass shop reopens. An insurance company should not be permitted to confine "loss" to the Period of Restoration, but then seek "credits" for amounts earned afterward.

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22. *See, e.g.*, Pennbarr Corp. v. Insurance Co. of North America, 976 F.2d 145 (3d Cir. 1992).

23. *See, e.g.*, Vinyl-Tech Corp. v. Cont'l Cas. Co., 2000 U.S. Dist. LEXIS 22507 (D. Kan. 2000); Gates v. State Auto. Mut. Ins. Co., 2006 Tenn. LEXIS 502 (Tenn. 2006).

Beware of Insurance Company Arguments on Categories of Property Which Will Support a Business Income Loss

Historically, policyholders were entitled to make a Business Income claim when property at the insured premises – typically, the building at which the policyholder was located – was damaged, regardless of whether the policyholder owned or leased the specific property which was damaged.[24]

In 9/11 claims, however, insurance companies took very narrow views on the property which, when damaged, would support a Business Income claim. For instance, in Zurich Am. Ins. Co. v. ABM Indus Inc.,[25] which involved a Business Income claim by the firm providing janitorial services to the WTC landlord and tenants, the insurance company variously asserted: (1) the policyholder could not make a Business Income claim from the destruction of property unless it was also entitled to recover for the value of that property (which would have surprised most of the WTC's tenants); and (2) the policyholder could not recover for loss from leased premises unless the policyholder's lease required it to rebuild the leased premises if destroyed (ditto!). These positions failed, largely because of statutory law defining an insurable interest as any legitimate business interest in the continued survival of property.[26] Accordingly, an insurable interest in property employed in the operations of the policyholder is, under most forms, sufficient to support a Business Income claim if that property is destroyed.

Relatedly, as noted above, many policyholders in the WTC were surprised to find that their insurance company took the position that their Period of Restoration was the period needed to replace their particular office suite and not the entire WTC. Historically, the term "premises" has been broadly construed to include the entire building or complex in which a policyholder is located, and not a particular office suite. A number of insurance companies, however, have adopted a practice of listing a particular office suite – i.e., "WTC 1, Suite 7501" – as the "insured premises." Such practice may allow the insurance company to avoid paying Business Income losses caused by damage to the building which impacts the policyholder's operations if there is no damage in the policyholder's office suite. One should pay attention to this tack at the point of sale.

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24. *See, e.g.,* Datatab, Inc. v. St. Paul Fire & Marine Ins. Co., 347 F. Supp. 36 (D.N.Y. 1972).

25. 397 F.3d 158 (2d Cir. 2005).

26. Zurich Am. Ins. Co. v. ABM Indus., Inc., 397 F.3d 158, 167-168 (2d Cir. 2005) ("New York law embraces the *sui generis* nature of an 'insurable interest' and statutorily defines this term to include 'any lawful and substantial economic interest in the safety and preservation of property from loss, destruction or pecuniary damage.' N.Y. Ins. Law § 3401. [The policyholder's] income stream is dependent upon the common areas and leased premises in the WTC complex, and thus [the policyholder] meets New York's requirement of having an "insurable interest" in that property.").

Business Income Coverage in the Post-9/11 World: How Insurance Companies Have Changed the Claims Handling Playbook Since 9/11 and Hurricane Katrina
By Richard Lewis and Marshall Gilinsky

Conclusion

As noted above, Business Income claims which were once negotiated to resolution between "independent" adjusters (on the insurance company side) and loss adjusters or consultants (on the policyholder side) are now increasingly referred by insurance companies to coverage counsel. Unlike adjusters, coverage counsel are far less likely to be concerned about their relationships with the policyholder, and are far more likely to assume tenuous and highly restrictive coverage positions. Further, as a matter of ethics, attorneys retained by insurance companies owe <u>no</u> duties to policyholders and a duty of zealous advocacy to their client insurance companies; this is why hiring counsel to adjust claims is an act of bad faith. Many of the 9/11 and Katrina Business Income cases were handled by counsel, resulting in the various coverage-restricting positions outlined above. While such positions, if accepted by courts, dramatically restrict the coverage one would expect from a Business Income form, policyholders can expect insurance companies to take these positions in future claims, and should consider them in determining their appetite for Business Income coverage.

About the Authors. Richard Lewis and Marshall Gilinsky have worked as litigators at Anderson Kill & Olick, P.C. since 1992 and 1996, respectively, and specialize in representing policyholders in insurance coverage actions.

GULF OIL SPILL INSURANCE COVERAGE ISSUES FOR THE HOTEL AND GAMING INDUSTRIES

By Joshua Gold and Marshall Gilinsky

The underwater oil spill in the Gulf of Mexico is catastrophic in every sense: loss of life, loss of livelihoods, and unprecedented environmental damage to a huge swath of coastal areas bordering several states. The oil spill also spells potential disaster for hospitality and gaming businesses on or near the Gulf Coast (and perhaps beyond). It does not take a great deal of insight to realize that during the summer vacation season, many travelers and businesses will avoid the areas affected by the oil spill. Indeed, significant cancellations of existing hotel and event reservations are occurring and are likely to get worse as the damage from the spill spreads.

Most hospitality and gaming businesses affected by the oil spill probably have so-called “time-element” insurance coverage that protects them from the perils and losses occurring as a result of the oil spill tragedy. For example, some of the better forms of property insurance policies will provide some degree of insurance coverage for losses stemming from environmental damage to either their own property or some other property (whether privately owned or public). Other policyholders have insurance coverage for business income losses which result from pollution by oil, chemical or other substance of any beach, river or waterway within a certain distance of the policyholder’s operations. For those policyholders that are located on or close to the beach, this coverage may prove tremendously valuable.

Other common time element coverages that might respond to oil spill-related losses are “business interruption” and “contingent business interruption” coverage. Business interruption and contingent business interruption coverage are designed to protect businesses from losses stemming from unavoidable interruptions in their daily operations, and may apply in a variety of circumstances, such as a shutdown or downturn in business due to the damage from the oil spill. Business interruption losses typically occur where the policyholder’s downturn in business is due to property damage at or near the policyholder’s own property. Contingent business interruption losses typically occur where the downturn is due to property damage at customer’s or supplier’s property. Thus, a hotel suffering business income losses due to the presence of oil on or near its beaches may have coverage for those losses under its property insurance policy.

Many policyholders also purchase a form of time element insurance coverage known as civil authority insurance coverage, which protects against loss of business income when a civil authority prohibits access to the policyholder’s premises due to loss or damage within a certain distance of the policyholder’s operations. There are already ever-expanding bans on fishing activities in the Gulf and it may be a matter of time before beaches and other areas along the Gulf are restricted due to contamination with oil and chemical dispersants.

Many businesses hurt by the oil spill are planning on pursuing remedies from BP, Transocean, and others alleged to be responsible for the spill – via complicated dispute resolution procedures being set up to resolve such claims. But those businesses should consider the benefits of going directly to their property insurance companies to obtain the coverage provided under their property insurance, and then leave the task of pursuing those responsible for the spill to the insurance company and its team of subrogation experts.

Even if these favorable insurance coverages are purchased, there can be obstacles to insurance recovery that thwart even some of the most sophisticated businesses and risk management professionals. Some prudent steps that hotel and gaming companies can take to best protect themselves when it comes to pursuing their insurance coverage are set forth below.

1. Policyholders Should Take an Inventory of Their Insurance Coverage

Policyholders should be diligent in trying to identify potentially relevant insurance coverage that can respond to the Gulf oil spill. Some of this coverage is custom tailored to protect against risks unique to the gaming and hospitality businesses. As noted above, a number of specialized insurance products have been developed by the insurance industry under so-called "all-risk manuscript" property insurance policies to protect against risks to hotels and resorts.

Some manuscript insurance policies also protect against the loss of business income due to damage away from the premises which the policyholder is nevertheless reliant upon, such as conference centers, sports complexes, stadiums, convention centers, and amusement parks. In addition to "time element” insurance coverage for pollution risks are time element insurance coverages for losses caused by an interruption in operations due to infectious or contagious disease, food or drink poisoning, vermin or pests. Furthermore, insurance coverage may be available to cover the costs of relocating guests as a result of a loss.

2. Beware of Misapplication of Exclusions and Other Limiting Policy Terms

Despite some of the good insurance coverage provisions that exist, it is important to be wary of the escape clauses that the insurance company might try to exploit to avoid coverage for a large claim. For example, insurance companies sometimes argue that their policies require a “complete and total” cessation of business for time element insurance coverage to be triggered. This can be a devastating position when a policyholder operates numerous business activities at a location and an insured peril only affects a portion of the operations. Even a partial interruption of business activities can have dire consequences for the hotel’s profitability.

Insurance companies might also argue that damage by oil and chemicals to a resort’s beach does not trigger business interruption coverage, since it merely is damage to “land,” which is excluded under many property insurance policies, as opposed to damage to “property” that is insured under the policy. But this argument ignores that fact that resort beaches rarely are in their natural state, and that the improvements and maintenance that go into such amenities are as much “property” as the establishment’s pools or patios. Insurance policy traps such as these should be contested as they are counter to the purpose of purchasing the insurance in the first place.

3. Keep Good Records to Support Your Insurance Claim and Give Prompt Notice of All Claims Under All Potentially Applicable Policies

Many hotel and resort operators maintain large insurance programs with scores of different insurance companies because the property values they are insuring and the significant risks of catastrophe in certain locations (Caribbean hurricanes, California earthquakes). While it can be painstaking, policyholders should ask their broker to make sure that excess insurance companies also have notice of claims filed with the primary insurance companies – even if the loss is not presently expected to reach a certain claim threshold which would trigger some or all of the excess layers of coverage. This is because insurance companies routinely argue for a forfeiture of all insurance coverage where they do not receive immediate notice.

Also, it is important for policyholders preserve as much documentation as possible to support their losses claimed under their insurance policies. Insurance companies often attack the documentation used to support time-element insurance claims. Accordingly, it is important to keep close track of cancellations (including the reason for the cancellation, where available) as well as records of budgets and projections (and all versions of same) to help refute such insurance company assaults on the policyholder's damage or loss calculations.

Conclusion

Policyholders need to be thinking about their insurance coverage in dealing with the disaster in the Gulf. There are time-sensitive provisions in the policies regarding notice, proofs of loss and suit limitations that could be at issue if the insurance company ends up denying insurance coverage. The extent of coverage will depend heavily on the quality of the insurance product purchased: some policyholders in the hotel and gaming industries may have tailor-made insurance coverage that will defray a significant portion of the losses being experienced (or soon to be experienced) as a result of the oil spill. Often, the key provisions that provide this valuable coverage are missed by employees or even brokers who are asked to determine whether coverage for such losses exists, and it pays to have an experienced eye review your policy to see if your property insurance will help you deal with the impact of this disaster on your business.

***About the Authors*:**

Joshua Gold and Marshall Gilinsky are both shareholders in the New York office of Anderson Kill & Olick, P.C. Mr. Gold represents and counsels a number of gaming and hospitality clients with regard to insurance coverage matters, risk management issues, disputes, lawsuits, captive insurance companies and international arbitrations. Mr. Gilinsky represents a number of hotels, resorts and retailers in connection with property damage and business interruptions claims. Mr. Gold can be reached at (212) 278-1886 or mgold@andersonkill.com and Mr. Gilinsky can be reached at (212) 278-1513 or mgilinsky@andersonkill.com.

About Anderson Kill & Olick, P.C.

Anderson Kill practices law in the areas of Insurance Recovery, Anti-Counterfeiting, Antitrust, Bankruptcy, Commercial Litigation, Corporate & Securities, Employment & Labor Law, Real Estate & Construction, Tax, and Trusts & Estates. Best-known for its work in insurance recovery, the firm represents policyholders only in insurance coverage disputes, with no ties to insurance companies and no conflicts of interest. Clients include Fortune 1000 companies, small and medium-sized businesses, governmental entities, and nonprofits as well as personal estates. Based in New York City, the firm also has offices in Greenwich, CT, Newark, NJ, Philadelphia, PA, Ventura, CA and Washington, DC. For companies seeking to do business internationally, Anderson Kill, through its membership in Interleges, a consortium of similar law firms in some 20 countries, assures the same high quality of service throughout the world that it provides itself here in the United States.

Industry News

When Far Away Problems Hurt your Business, Look to Insurance

By Marshall Gilinsky

Marshall Gilinsky
Anderson Kill & Olick, P.C.

The massive travel disruptions caused by the 9/11 attacks, the Deepwater Horizon oil spill and the volcanic eruptions in Iceland - ***all of which severely impacted businesses in the hotel and hospitality industry far from the place where the disaster originated – should serve as a wake up call to hoteliers to make sure that their property insurance program covers business income losses resulting from such faraway occurrences.*** In the wake of the eruptions in Iceland and Gulf oil spill, insurance industry spokespeople and some insurance advisers immediately were on the airwaves to tamp down policyholders' expectations of coverage, usually on the grounds that such losses were not covered since there was no damage to the policyholder's own property.

But many commercial property insurance policies do not contain such a requirement in order to trigger coverage, and many policies cover business interruption losses caused by damage that occurs away from the insured premises – or even where there has not been any physical damage anywhere. Accordingly, savvy policyholders can and should ensure that they have express coverage for highly disruptive faraway events like terrorist attacks, volcanic eruptions or the recent Gulf oil spill (and many others).

Many standard property insurance policies provide coverage for losses caused by damage away from the insured premises. For example, in addition to business interruption ("BI") coverage designed to protect businesses from losses stemming from interruptions in their daily operations when there is damage on the property, many policies include contingent business interruption ("CBI") coverage, which covers losses in business income due to property damage that occurs at a supplier's or customer's business, or damage even further up the chain of suppliers or customers. Another important and fairly common coverage is dependent property or attraction property insurance, which covers losses of business income caused by damage to a remote business that attracts or supplies customers to your business. For example, if an amusement park or convention center that draws guests to your hotel is damaged, or an airport or other transportation hub that brings customers to your business is damaged, this "dependent property" coverage insures the resulting downturn in your profits.

Although these standard types of coverage usually require property damage somewhere to trigger coverage, there is no reason why the trigger has to be tied to damage to your or someone else's property. As we saw with the eruptions in Iceland, hospitality businesses can be severely affected by travel disruptions even where there is no damage to anyone's private property, and there is no reason why hoteliers should not consider what similar types of exposures they face and seek to have such risks expressly covered under their property programs. In the end, a day or two spent carefully going over your policy wording with your broker, insurance consultant or lawyer can pay big dividends when claims arise – not only in avoiding frustration in the claims process, but also in terms of the size of the ultimate payment of your claim.

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Understanding Your Property Insurance: ACV and Replacement Cost Coverage

By Marshall Gilinsky, Esq.

Marshall Gilinsky, Esq.

Your property insurance policy covers the cost "to repair or replace damaged property with property of like kind and quality." But if a fire destroys your hotel, your insurance company might refuse to pay the cost to replace it.

I. ACV vs. Replacement Cost

Historically, insurance generally did not cover the full cost necessary to replace damaged property since doing so violated the principle of indemnity by putting the policyholder in a better position by providing new property in place of old. Accordingly, depreciation generally was deducted during the adjustment of losses covered under Actual Cash Value ("ACV") insurance policies.

Because many policyholders preferred insurance that provided complete coverage from a loss, insurance companies began offering Replacement Cost coverage. This innovation expanded the basic ACV coverage and meant that policyholders who had a loss did not need to bear any cost in replacing depreciated property.

II. ACV Holdback

Under many policies, Replacement Cost coverage does not kick in until the damaged property is actually replaced, and insurance companies typically withhold depreciation until the property is actually replaced. The depreciation "held back" should be kept to a minimum. Doing so leaves fewer points open for discussion or to develop into problems. Moreover funds that are withheld are not available to assist in the policyholder's recovery.

Sometimes the insurance company and policyholder will agree to a "walk-away" settlement for figure that is somewhere between ACV and Replacement Cost. This can be a win-win situation, with the insurance company paying less than the full replacement cost owed, and the policyholder getting most (if not all) of its money up-front, as well as the choice not to replace certain property and use the money on types of property not owned at the time of the loss.

III. Replacing Elsewhere or with Non-Identical Property

Many policyholders believe – incorrectly – that they must restore the property to its exact condition prior to the loss or replace the property with exactly the same property. Generally, as long as the replacement dollars are spent, the depreciation will be recoverable, but the amount of the claim will be determined based on the cost to replace the property that actually suffered the loss.

Marshall Gilinsky, Esq. is a shareholder at Anderson Kill & Olick, P.C. with extensive experience in insurance coverage analysis, litigation, and dispute resolution.

Insurance Coverage for Gulf Oil Spill Losses

by Robert M. Horkovich, John G. Nevius and Marshall Gilinsky

The size of the Gulf of Mexico oil spill is hard to conceive. Just one reported oil slick is 10 miles long and 4 miles wide. That single oil slick is bigger than many Caribbean islands. It now has been reported that a million gallons of oil have been released each day for the past several weeks. Fishing areas off the Louisiana coast already have been affected. Louisiana's shrimp industry already is shut down. As of May 18, fishing has been banned in 19% of the Gulf of Mexico due to the oil spill. The whitest sand beaches in the world already are lined with oil balls. Some predict that the oil slick will make its way into the Gulf Stream and then impact the East Coast. The initial explosion itself caused a massive loss with the loss of numerous lives, dozens injured, and the total loss of a major oil drilling platform.

Swiss Re Insurance Company has estimated insurance coverage for the loss to exceed $3.6 billion. J.P. Morgan estimated a $1.6 billion insurance loss but noted that its estimate does not include the impact of the oil coming ashore. The owner of the oil rig that blew up already has received over $481 million in insurance recoveries.

The massive losses are covered by a variety of insurance policies already purchased by those being harmed. First party property and business interruption (BI) insurance certainly will provide coverage for certain losses. Liability insurance, both general liability and pollution liability policies, will provide defense and indemnity for lawsuits. Directors and officers insurance also will provide coverage for derivative lawsuits against directors and officers.

What Types of Losses are Covered?

Liability Insurance

As of May 10, 2010, over 70 lawsuits related to the oil spill already had been filed in courts. Companies facing liabilities due to property damage from spoiled beaches or closed fishing areas or due to bodily injury from deaths and injuries on the oil platform itself can look for defense and indemnity from their liability insurance coverage. Both general liability insurance policies and pollution liability insurance policies will come into play.

Companies facing lawsuits should give notice to all liability insurance companies in their insurance program (including any captive insurance companies) all the way up to the top of their coverage charts despite a present $75 million cap on liability. Legislation has been proposed eliminating caps on liability. A prudent policyholder facing oil spill liability claims ought to provide notice now rather than waiting to see what happens with such legislative initiatives.

Directors & Officers Insurance

Derivative actions already have been filed in court against directors and officers of companies involved in the Gulf of Mexico oil spill. Dozens of such lawsuits are sure to follow. D&O insurance should be tapped to provide defense and indemnity of directors and officers facing such claims.

First Property and Business Interruption Insurance

The massive Gulf Coast oil spill will cause extensive property damage and business interruption losses to businesses all along the Gulf Coast from fisheries in Louisiana to beachfront hotels in Florida and all kinds of business around the Gulf. There are also businesses away from the coastline, such as shipping lanes on the Mississippi River, whose property is safe, but that might suffer business income losses anyway. While such businesses are looking first at responsible parties to cover their losses, over 70 lawsuits already have been filed and hundreds more will likely ensue, they also should start thinking now about their own insurance coverage.

In addition to coverage for damage to tangible property such as ports, marine equipment or beachfronts, affected business owners should look to the business interruption coverage included in most business property policies. BI coverage is designed to protect businesses from losses stemming from unavoidable interruptions in their daily operations. BI coverage may apply in a variety of circumstances, such as a forced shutdown, a downturn in business due to the damage from the oil spill, or a substantial impairment in access to products, services, a business? physical plant or premises.

Because the economic effects of the spill likely are to extend well beyond the Gulf region, businesses nationwide may be eligible to file contingent business interruption claims -- a standard coverage grant in many property insurance policies, though many small businesses are not aware of it. Contingent BI covers policyholders that did not suffer physical damage but still lost revenue after a property loss crippled a major supplier or customer. For example, a manufacturer in St. Louis will be safe from the oil slick, but nevertheless may suffer losses because of problems shipping its product down the Mississippi River or receiving material from suppliers shipped via the Mississippi.

Steps to Take

If you are facing any of these types of losses, consider taking the following steps:

- Locate all of your insurance policies
- Look to liability, D&O or first-party property insurance
- Remember that property damage, business income, contingent business income and extra expense coverage may be available
- Remember that coverage may be available even without direct physical loss or damage
- Give notice to all levels of coverage
- Secure tolling agreements with your insurance company to protect your rights
- Understand thorough emergency responses and preservation of property
- Consider help in submitting your claim, including your broker, public adjuster and attorney
- Consider whether insurance coverage may be available under other insurance policies
- Taking these steps now will help prudent policyholders secure the insurance coverage for which they paid precious premium dollars and to which they are due for this enormous and tragic loss.

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