# THE INSURANCE PROCESS
## KEY ISSUES AND STRATEGIES IN COMPLEX PROPERTY RISKS FROM PROCUREMENT TO THE SUCCESSFUL RESOLUTION OF DISPUTED CLAIMS

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**TABLE OF CONTENTS**

**Page**

I. Risk Transfer for Complex Property Accounts………………………… 3

A. The Insurance Market and Driving Forces In Securing Optimum Risk Transfer……………………………. 3

1. Buying Team Roles……………………………………… 3
2. Market Cycle/Current Status Overview…………………. 3
3. Catastrophe vs. Non-CAT………………………..……… 4
4. Probable Maximum Loss Analysis and Relevance……… 4
5. Layer Structure Concepts and Issues………………. …… 5
6. Broker Manuscript vs. Insurer Form……………..……… 6

B. Common Coverage Issues……………………………….……. 6

1. Causation………………………………………………… 6

a. Basic Principles………………………………………. 6
b. Concurrent Causation………………………………… 8
c. "Anti-Concurrent Causation" Language: Can The The Insurer Contract Around Causation Principles?… 9

2. Progressive or Hidden Losses – Trigger of Coverage…… 9

3. Survey of First Party Causation and Trigger Case Law…. 10

4. Ensuing Loss Language…………………………………. 15

5. Known Loss……………………………………………… 16

6. Contractual Suit Limitations……………………………… 17

C. Coverage Differentiators Important to Hotel Risks………………. 18

1. Ingress/Egress Without Geographic Limitations………… 18

2. Interruption by Civil Authority or Military Authority……. 18

3. Business Interruption (Not Suspension) on Actual Loss…. 19

4. Extended Period of Indemnity……………………………. 20

5. Ordinance Coverage………………………………………. 21

6. Replacement Cost Coverage……………………………… 22

7. Landscaping……………………………………………… 23

8. Off-Premises Power Coverage…………………………… 24

9. Attraction Properties……………………………………… 25

10. Loss Adjusting Expenses…………………………………. 26

11. Designated Adjuster………………………………………. 26

II. Establishing a Team……………………………………………………. 26

A. The Role of the Designated and Named Adjuster………………… 26

B. The Role of the Coverage Attorney……………………………….. 27

C. Establishing and Maintaining Relationships……………………… 28

1. Circulate Policies…………………………………………. 28
2. Update Team on Business Matters……………………….. 28

III. The Claims Process…………………………………………………….. 28

A. Prepare for a Loss…………………………………………………. 28

B. Assume Nothing…………………………………………………… 28

C. Determine/Understand Roles of the Team………………………… 28

D. Seek High Level Underwriting/Claims Authority & Relationships 28

E. Set the Agenda……………………………………………………. 28

F. Loss Scenarios……………………………………………………. 28

# I. Risk Transfer for Complex Property Accounts

## A. The Insurance Market and Driving Forces in Securing Optimum Risk Transfer

### 1. Buying Team Roles

In the marketing of large and complex property accounts, an insured's first step is to select a retail insurance broker to handle their account. The role of the broker would encompass many areas of the insured's insurance program needs; however, in that portion specific to the marketing of large property accounts, the retail broker's role should focus principally on marketing to key insurance carriers represented by that broker as well as the coordination of an overall marketing strategy with any other marketing partners.

Other marketing partners often include a wholesale broker with significant property specialization. Another partner may or may not include a Lloyd's broker, depending on whether the Lloyd's market is to be coordinated through the wholesale broker or the retail broker. This may sound like a lot of "cooks in the kitchen"; however, each will play a significant role in maximizing the efficiency and quality of the placement and will, ultimately, more than offset any added cost through program savings. While some insureds and some retail brokers view the use of a wholesaler by the retail broker as a weakness in the retailer's marketing abilities, nothing could be further from reality. Even the very best and most knowledgeable retail brokers can benefit from the use of a wholesaler, principally in two areas:

A. <u>Expanded Market Access</u>: Many very key large account markets do business only through wholesale brokers. This is particularly true for risks that have significant catastrophe exposure.

B. <u>The Experience of Specialization</u>: A proficient large account wholesaler should be focused by product line – in other words, a large account property broker will work only on large property risks. By not diluting their time and experience in Casualty, Workers Compensation, and all of the other lines and issues that all retailers must be involved in, wholesale brokers are able to provide significant marketing specialization.

In short, an insured seeking the optimum outcome in the marketing of a large complex property program should build a coordinated team that will include a retail broker and a wholesale broker. Both the insured and the retail broker need to work closely in the coordination of that team's efforts.

### 2. Market Cycle/Current Status Overview

The property market, particularly for risks with either catastrophe exposure or loss experience problems, began a mild to moderate "firming up" in late 2000 and into early 2001, to include increases in rates, increases in deductibles, and reductions in coverages. September 11, 2001 acted as a catalyst to accelerate these trends already in motion. For larger property accounts, sometimes referred to as "two comma accounts," the trend is reversing.

In early 2003 there has been a leveling or slight reduction of rates, and a willingness of underwriters to consider some of the coverages that were completely out of reach over the past two years. From the second quarter forward there has been considerable acceleration in what the insurers would term "market deterioration". While most insurance companies are still far from financial health, most have also had extremely profitable property results for each of the last two years. The result is that insurance executives encourage increased property writings, which in turn direct us back into a more competitive state.

While most publications will point to current property premium reductions of 10% - 20%, large and more complex property risks that have had good loss experience are experiencing reductions, in the 20% - 30% range. Exceptions to this may include risks with high catastrophe exposures and high Probable Maximum Losses ("PML") - particularly in the "high demand areas" of tri-county Florida and the A/B quake zones of California. Even in those areas, however, there is a return of capacity available in the market at more reasonable terms.

We see this trend continuing throughout 2004, barring a large natural catastrophe.

### 3. Catastrophe vs. Non-CAT

While the markets are increasing their capacity as well as their premium/capital capacity for writing business, we see this on a more moderate scale for accounts that have a predominance of catastrophe exposed properties. We do not foresee large influxes of new capital available to support the writing of wind business in South Florida and certain parts of the Texas Coast, nor do we see a lot of new capacity available for zones A or B of California quake exposures. As the availability of these coverages has tended to remain fairly level, the reduction in prices has tended to be much more moderate than the reduction we are seeing for non-catastrophe exposures.

### 4. Probable Maximum Loss Analysis and Relevance

For risks with catastrophe exposures it is important to paint as accurate a picture as possible for underwriters. To this end it is very important that accurate modeling information be provided to carriers. Modeling information is not equivalent to traditional underwriting information. In this model, most traditional underwriting information would be considered the bare minimum for producing loss estimates. Additional data that can significantly affect the outcome of modeling is also contained in Appendix A and referred to as "Secondary Risk Characteristics". The more information entered into the model, the higher degree of resolution – or accuracy – of the model output. Lack of any information in most of these categories will generally default the model to the least favorable outcome.

There are several very significant implications to the modeling of catastrophe exposures on a complex property risk:

A. Pricing of your coverage - virtually every underwriter of catastrophe property coverage today uses some type of pricing factor or load based on modeling results.

B. Required use of PML limits for any given risk - the limits within a PML will cost significantly more than limits outside of a PML. Conversely, limits outside of the PML are much more readily available than limits inside of the PML.

C. Risk Management Planning - when done properly, modeling analysis can prove to be an extremely effective risk management tool for insureds. These models can illustrate:

- Average annual expected losses over time
- Insured's estimated retained loss at various deductible options
- Specific loss to actual past events
- Expected loss to specific potential event scenarios

- Changes in expected loss and retention scenarios based on risk changes (such as improvements in construction, safety glass, etc.).

In summary, it is vital that at least one member of your marketing team (either your retailer, your wholesaler, or some other third independent team member) be proficient in the use of catastrophe property modeling in order to achieve the best results in the marketing process, as well as to provide the information for risk management considerations. An example of a PML analysis is attached as **Appendix A**.

## 5. Layer Structure Concepts and Issues

In the wholesale market arena, it is common to use multiple carriers and/or multiple layers of limits in order to complete large property programs. The reasons include:

- **Carrier and Market Capacity Issues** - Occurrence limits capacity has always fluctuated significantly in catastrophe areas in an inverse relationship to the length of time from the most recent significant catastrophe event. In other words, immediately following any type of significant catastrophe event, total occurrence limits available in the market tend to reduce; the further away in time the market gets from a significant catastrophe event, the more total occurrence limits become available in the marketplace (and the less those limits cost). The same can be said for individual "risk" limits. This refers to the limits that are available on a "four walls basis". Obviously, the most recent example of a restriction in this area was caused by the loss to the World Trade Center; however, over history the most common event leading to this type of limit reduction is generally an extremely large warehouse or manufacturing operation fire. In either situation, the results are the same – a reduced amount of available limits in the marketplace.

- **Property Insurance Program Stability** - Because of the ease of entry and exit into the insurance business, markets come and go over time. We believe that a multiple carrier placement can increase the long-term stability of an insurance program by reducing the exposure if one or two carriers exit the market. When an existing carrier exits the market, replacing markets will view the risk as new business to them, and in a less favorable light than their existing accounts. In multiple carrier structures, the loss of one or even two carriers can often be offset by capacity elasticity of the other participating carriers.

- **Pricing** - Many less proficient brokers, both wholesale and retail, will create layers of limits on an arbitrary basis – most often breaking a layer at whatever number is offered by whomever they believe to be their lead carrier. To maximize the efficiency of layering, proper consideration should be given to various exposure factors such as fire PML, 100 year catastrophe event PML, 250 year catastrophe event PML, maximum values in one location, maximum values any one building. All of these factors are key in determining various pricing differentials of each layer. Significant savings can accrue beyond either a single carrier's accepting the entire risk or an improperly layered multiple carrier placement.

The most common objections to layering and/or multi carrier placements revolve around insureds' concerns over the coordination of loss settlement in the event of loss. Pre-binding agreements by all carriers to use a common adjuster will generally resolve this concern. An example of a layered structure is attached as **Appendix B**.

### 6. Broker Manuscript vs. Insurer Form

Much has been made over the years about the value of “broker forms”. Post 9/11, very few carriers, if any, have been willing to support true broker forms. This is partially due to significant issues in the settlement of the 9/11 claims (for example the issue over the definition of occurrence); however, it has also evolved from the fact that many carriers have found a significant portion of their loss ratios have been developing over the past ten years out of expanded coverages in those broker forms that were not taken into consideration during the underwriting or pricing of the accounts. This is not to say that carriers will no longer provide many of the key coverage elements of the old broker manuscript forms. Today’s environment, however, tends to prefer to address extended coverage issues by specific endorsement to company tested (or at least developed) policy forms. This allows insurers to specifically acknowledge and consider the implications of each coverage extension.

The advantages of broker manuscript forms are, in concept, obvious; broader coverage’s and expanded coverage definitions. The drawbacks to these forms are, on the surface, not quite as apparent but every bit as real. The major drawbacks include 1) a lack of litigated coverage wordings and definitions that can lead to significant disagreements over “intent”, and 2) the inclusion of some coverages that underwriters had absolutely no intention of picking up, and therefore contest, vigorously at time of loss. Finally, these forms can be more difficult for adjusters if the extensions of coverage are not familiar to them.

A compromise can include carrier forms with extensions that specifically address needed and desired expansions of coverage. This approach demands a broker with coverage experience.

## B. Common Coverage Issues

While it is beyond the intent of this paper to address all of the potential coverage issues that may arise in connection with a hotel account, the following is designed to highlight several coverage issues that are common to most property policies and claims. The discussion is designed to illustrate some of the common issues surrounding first party property insurance which, next to worker’s compensation coverage, is the most expensive part of a hotel operation’s insurance program.

### 1. Causation

#### a. Basic Principles

The typical Commercial Property Form provides as follows:

> We will pay for direct physical loss of or damage to Covered Property at the premises described in the Declarations caused by or resulting from any covered cause of loss.[1]

Because the typical "all risk" language employs the concept of "causation" as a link to coverage, Insurers, policyholders, and courts, have been required to develop principles of causation that will provide the nexus between peril and indemnity.[2]

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[1]CP 00 10 06 95 (ISO 1994); FC and S Bulletin, "Forms, Commercial Property" FAY-1 (April 1997).

[2]Indeed, one court has gone so far as to explain that, whenever the term "cause" appears in exclusionary language, "it must be read as 'efficient proximate cause.'" *Safeco Insurance Co. v. Hirschmann*, 112 Wn.2d 621, 773 P.2d 413 (Wash. 1989).

Although the courts pay lip service to the notion that the tort and insurance concepts of causation are different, nonetheless, they have borrowed heavily from the tort notion of "proximate cause" to define the boundaries of insurance causation. For example, in an early Massachusetts case, *Lynn Gas & Electric Co. v. Meriden Fire Insurance Co.,* 158 Mass. 570, 33 N.E. 690 (Mass. 1893), the court outlined the causation principle as follows:

> The active, efficient cause that sets in motion a train of events which brings about a result without the intervention of any force started and working actively from a new and independent source is the direct and proximate cause referred to in the cases.

33 N.E. at 691.[3]

Another widely quoted passage is found in Couch on Insurance as follows:

> Where the peril specifically insured against sets other causes in motion which, in an unbroken sequence and connection between the act and the final injury, produced the final result for which the Insured seeks to recover under his or her policy, the peril insured against will be regarded as the proximate cause of the entire loss, so as to render the Insurer liable for the entire loss within the limits fixed by the policy.

Couch on Insurance (3d), ¶101.45 (1997).[4] From the foregoing, rather broad outline of "proximate cause," has come variations such as the "efficient cause," the "efficient proximate cause," the "efficient moving cause," or the efficient cause defined as the "predominant" cause.

Jurisdictions using a tort-based proximate cause analysis may be divided into either a "train of events" or "moving" cause jurisdiction, or a "predominant" jurisdiction. Under the former, it is the cause that sets other causes in motion that is deemed to be the "efficient proximate cause"; if the efficient proximate cause is a covered peril, then the risk is insured, regardless of any excluded perils in the chain of causation.[5]

On the other hand, the "predominant" theorists do not necessarily look to the triggering or moving cause, but rather to the "most important" cause.[6]

New York employs a different standard. Building upon Justice Cardozo's opinion in *Byrd v. St. Paul Fire & Marine Insurance Co.,* 223 N.Y. 47, 120 N.E. 86 (1918), New York does not trouble itself with "distant

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[3]*See, e.g., Jussim v. Massachusetts Bay Insurance Co.,* 415 Mass. 24, 610 N.E.2d 954 (Mass. 1993); *Naumes, Inc. v. Landmark Insurance Co.,* 119 Ore.App. 79, 849 P.2d 554 (Ore.App. 1993); *Frontis v. Milwaukee Insurance Co.,* 156 Conn. 492, 242 A.2d 749 (Conn. 1968); *Marshall Produce Co. v. St. Paul Fire & Marine Insurance Co.,* 256 Minn. 404, 98 N.W.2d 280 (Minn. 1959).

[4]*See, e.g., Graham v. PEMCO*, 98 Wn.2d 533, 656 P.2d 1077 (1983); *Bartholomew v. Cameron Country Mutual Insurance Co.*, 882 S.W.2d 173 (Miss.App. 1994); *Stone v. Royal Insurance Co.*, 211 N.J.Super. 246, 511 A.2d 717 (N.J.Super.App.Div. 1986); *Ariston Airline & Catering Supply Co., Inc. v. Forbes*, 211 N.J.Super. 472, 511 A.2d 1278 (N.J.Super. 1986); *Burgess Farms v. New Hampshire Insurance Group*, 108 Idaho 831, 702 P.2d 869 (Id.App. 1985).

[5]*See, for example, Graham v. PEMCO*, 98 Wn.2d 533, 656 P.2d 1077 (1983); *Griess & Sons, Inc. v. Farm Bureau Insurance Company of Nebraska*, 247 Neb. 526, 528 N.W.2d 329 (1995); *Kief Farmers Coop. v. Farmland Mutual Insurance Co.,* 534 N.W.2d 28 (N.D. 1995).

[6]*Garvey v. State Farm*, 48 Cal.3d 395, 257 Cal.Rptr. 292, 770 P.2d 704 (1989).

causes." Rather, New York courts look to the "causes nearest to the loss." *See, e.g., Pan American World Airways, Inc. v. Aetna Casualty & Surety Co.,* 505 F.2d 989 (2d Cir. 1974).

In the usual case, causation does not present much of a problem. However, where there is an intersection of two or more developed causes, the analysis becomes more complicated. Nonetheless, many courts have held principles of causation to deal with these situations of "concurrent causation."

### b. Concurrent Causation

Frequently, two or more causes, either independent of each other or following in sequence, "concur" to produce a loss. One of the causes may be covered, the other excluded, and hence the problem of "concurrent causation" and whether the policy will provide indemnity.[7]

In handling concurrent causation issues, courts have developed a number of approaches.

One approach is to determine the "moving" or "triggering" cause and assign that cause as the "efficient proximate cause." Thus, if both a covered and non-covered cause combine to produce a loss, the loss will be covered if the moving or triggering cause is a covered cause.[8]

A variation on the foregoing is to characterize the cause that is the "predominant" or most important cause in the chain of causation as the efficient proximate cause. Under this principle, where both a covered cause and an uncovered cause combine to produce a loss, if the predominant or most important cause is a covered peril, then the loss will be covered.[9]

Yet another formulation, having its roots in California in the early 1980's, states simply that, in the event covered and excluded causes or perils combine to produce a loss, there will always be coverage as long as one of the causes in the chain of causation is a covered cause.[10]

A final approach, which is the converse of the true "concurrent cause" approach outlined in the immediately preceding paragraph, is to foreclose coverage in those situations in which both covered and excluded perils or causes are present in the chain of causation. Thus, if anywhere in the chain of causation an excluded peril is present, the loss is excluded in its entirety.[11]

In response to the many judicial interpretations of policy language in the 1980's, particularly California, Insurers attempted to develop policy language designed to exclude coverage under those circumstances in

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[7] *See, e.g., Houser & Kent,* "Concurrent Causation and First Party Insurance Claims: Consumers Cannot Afford Concurrent Causation," 21 Tort & Insurance L.J. 573 (1986); Jerry, "Causation" in 3 Cozen "Insuring Real Property," Chpt. 48 (1998).

[8] Most jurisdictions employ an "efficient proximate cause" analysis defined as triggering or moving cause or one that sets other causes in motion as the defining principle where both a covered and non-covered peril event or cause concur to produce a loss. Examples of the application of this particular doctrine include *Frontis v. Milwaukee Insurance Co.*, 156 Conn. 492, 242 A.2d 749 (Conn. 1968); *Jussim v. Massachusetts Bay Insurance Co*., 415 Mass.2d 24, 610 N.E.2d 954 (Mass.App. 1993); *Kief Farmers Coop v. Farmland Mutual Insurance Co.*, 534 N.W.2d 28 (N.D. 1995); *Naumes, Inc. v. Landmark Insurance Co.,* 119 Ore.App. 79, 849 P.2d 545 (Ore.App. 1991); *Villella v. PEMCO*, 106 Wn.2d 806, 725 P.2d 957 (Wash. 1986).

[9] *See, e.g., Garvey v. State Farm Fire & Casualty Co.,* 48 Cal.3d 395, 257 Cal.Rptr. 292, 770 P.2d 704 (1989).

[10] *See, e.g., Wallich v. Rosenburg*, 527 So.2d 1386 (Fla.App. 1988); *Witcher Constr. Co. v. St. Paul*, 550 N.W.2d 1 (Minn.App. 1996).

[11] Not surprisingly, most of the cases employing this approach are older ones and are set forth in Jerry, "Causation," n.73, found in 3 Cozen, "Insuring Real Property," p. 48-58.19 *et seq*. (1998).

which an excluded peril or cause was present in the chain of causation, even though it may not be the predominant, moving, or triggering cause.

### c. "Anti-Concurrent Causation" Language: Can The Insurer Contract Around Causation Principles?

In an effort to eliminate coverage whenever an excluded peril is in the chain of causation, and regardless of the principle of causation, Insurers developed certain "anti-concurrent causation" language as a lead-in to the exclusions. A typical "lead-in" formulation is as follows:

> We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

(Form CP 10 10 06 95 [ISO 1994]; Commercial Property Forms, FC and S Bulletin, FBY-1 [April 1997]).

The purpose of the foregoing lead-in language is to uniformly exclude losses in which an excluded peril is a concurrent, causal factor. Thus, for example, if the triggering cause of a loss is a covered peril, but an excluded peril concurs to produce the ultimate result, then, consistent with the anti-concurrent lead-in language, the loss will be excluded. Similarly, if the covered peril is the dominant, or predominant cause, but an excluded peril concurs to produce the loss, the loss and damage will nonetheless still be excluded.
The industry has been generally successful in upholding the effect of the anti-concurrent lead-in language. The accompanying chart illustrates those jurisdictions in which an Insurer is allowed to contract around causation principles. Only two states, California and Washington, have concluded that their respective doctrines of "efficient proximate cause" cannot be circumvented by the anti-concurrent lead-in language.[12]

### 2. Progressive or Hidden Losses - Trigger of Coverage

Circumstances may arise in which it is difficult to determine precisely when a loss has occurred for purposes of triggering a particular policy or policies. These circumstances may include occasions where a loss is progressive in nature or where it has remained hidden from discovery for an extended period of time. Although the issue has received considerable treatment under third party liability policies, particularly those relating to environmental losses, the issue has not been the focus of very many first party property cases. In fact, only a few such first party trigger cases are available as outlined in the accompanying chart.

Perhaps the leading first party property case is *Prudential-LMI Commercial Insurance Co. v. Superior Court (Lundberg),* 51 Cal.3d 674, 274 Cal.Rptr. 387, 798 P.2d 1230 (Cal. 1990). In *Prudential-LMI*, the California Supreme Court adopted the "manifestation" theory, defined as that point in time when appreciable damage occurs and is or should have been known to the insured such that a reasonable insured would be aware of his or her duty to notify the insurer of a loss. Only the insurer on the risk when the loss has manifested itself is liable to indemnify the insured. All other insurers will, both before and after manifestation, have no duty to indemnify.[13]

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[12]In California, *see, Howell v. State Farm*, 218 Cal.App.3d 1446, 267 Cal.Rptr. 708 (Cal.App. 3d 1990); and, in Washington, *Safeco v. Hirschmann*, 112 Wn.2d 621, 773 P.2d 413 (Wash. 1989).

[13]The manifestation theory has also been adopted by Colorado in *Western Fire Insurance Co. v. First Presbyterian Church*, 155 Colo. 34, 437 P.2d 52 (1968); and Nevada in *Jackson v. State Farm Fire & Casualty Co.,* 108 Nev. 504, 835 P.2d 786 (1992).

Washington State appears to have adopted the exposure theory in *Villella v. PEMCO*, 106 Wn.2d 806, 725 P.2d 957 (1986). In *Villella*, if at any point actual damage is occasioned to property, whether discovered or not, policies are triggered. Consequently, under Washington state law, multiple policies can be triggered in a progressive loss situation from that point in time in which injury, however minute, commences through the date of discovery.[14]

In *United Technologies Corp. v. American Home Assurance*, 989 F.Supp. 129 (D.Conn. 1997), a federal district court employing Connecticut law, determined that the appropriate trigger was "injury in fact." The court stated:

> In light of Connecticut's adoption of the "injury-in-fact trigger," the court believes that Connecticut would apply the multiple injury triggered in gradual environmental contamination cases. Interpreting the injury-in-fact approach has having multiple triggers reflects the reality that one contaminating event can result in several different losses after the date of its occurrence.

989 F.Supp. at 153.

In jurisdictions employing either a multiple trigger or an exposure type theory, the indemnity obligations of the insurers on the risk varies. For example, in Washington, all insurers on the risk whose policies are triggered are jointly and severally liable.[15] On the other hand, in Pennsylvania, under *PECO v. Boden*, 64 F.3d 852 (3d Cir. 1995), to the extent that multiple policies are triggered, the loss is prorated among all of the policies. The proration is based upon the amount of the total loss that occurs during each year, if that can be calculated, and, if not, then equally for each year.[16]

### 3. Survey of First Party Causation and Trigger Case Law

| STATE | CAUSATION PRINCIPLE | CAN INSURER CONTRACT AROUND? | TRIGGER OF COVERAGE |
| --- | --- | --- | --- |
| Alabama | | | |
| Alaska | May be efficient proximate cause<br>Bongen v. State Farm, 925 P.2d 1042 (1996) | Yes.<br>Bongen v. State Farm, 925 P.2d 1042 (1996) | |
| Arizona | Efficient proximate cause<br>Korry v. Western Casualty & Surety Co., 737 P.2d 388 (1987)<br>Millar v. State Farm, 804 P.2d 822 (Az.App. 1991) | Yes.<br>Millar v. State Farm, 804 P.2d 822 (Az.App. 1991) | |

[14]North Dakota appears also to have adopted a trigger position similar to Washington's in which actual injury, whether discovered or not, is the trigger point for coverage. *See, Kief Farmers Coop. v. Farmland Mutual Insurance Co.*, 534 N.W.2d 28 (1995).

[15]*See, e.g., Villella v. PEMCO, supra.*

[16]In *Alcoa v. Accident & Casualty Insurance Co.,* No. 92-228065-5 (Washington Superior Court, 1996), the court held that, where multiple policies are triggered, each policy was liable only for that damage that occurred during the policy period and that joint and several liability was not applicable under Pennsylvania law. The court found that the progressive environmental loss was divisible as a matter of law. The court divided the damage that took place over the length of time it was in existence by the policy periods. In addition, the court allocated a portion of the damage to Alcoa for those years in which it had no insurance coverage or was self-insured.

| STATE | CAUSATION PRINCIPLE | CAN INSURER CONTRACT AROUND? | TRIGGER OF COVERAGE |
|---|---|---|---|
| Arkansas | Efficient proximate cause noted; not necessarily adopted<br>Mercury Ins. Co. v. McClellan, 216 Ark. 410, 255 S.W.2d 921 (1950)<br>"Initiating cause" in "but for" analysis<br>New Hampshire Ins. Co. v. Frisby, 258 Ark. 39, 522 S.W.2d 418 (1975) | Maybe.<br>Shelter Ins. Co. v. Maples, 309 F.3d 1068 (Cal.App.8th 2002) | |
| California | Efficient proximate cause<br>EPC - "Predominant Cause"<br>Garvey v. State Farm, 48 Cal.3d 395, 257 Cal.Rptr. 292, 770 P.2d 704 (1989) | No.<br>California Insurance Code, §530.<br>Howell v. State Farm, 218 Cal.App.3d 1446, 267 Cal.Rptr. 708 (1990) | Manifestation (all risk)<br><br>Prudential-LMI Comm. Ins. Co. v. Supreme Court (Lundberg), 798 P.2d 1230, 57 Cal.App.3d 674 (1990)<br>Injury in fact (specified peril)<br>Central Nat'l Ins. Co. v. Superior Court (Spindt), 2 Cal.App.4th 926 (1992) |
| Colorado | Efficient moving cause<br>Koneilja v. Trinity Univ. Ins. Co., 35 Colo.App. 27, 528 P.2d 939 (1974)<br>Kane v. Royal Ins. Co., 768 P.2d 678, 78 ALR 4th 797 (1989) | Yes.<br>Kane v. Royal Ins. Co., 768 P.2d 678, 78 ALR 4th 797 (1989) | Manifestation<br><br>Western Fire Ins. Co. v. First Presbyterian Church, 165 Colo. 34, 437 P.2d 52 (1968) |
| Connecticut | Active efficient cause that sets in motion chain of events, without intervention of new independent force<br>Frontis v. Milwaukee Ins. Co., 156 Conn. 492, 242 A.2d 749 (1968) | | Multiple trigger based on "injury in fact."<br>United Technologies Corp. v. American Home Assurance, 989 F.Supp. 129 (D.Conn. 1997) |
| Delaware | Proximate cause, but if peril excluded, is cause in any sequence excluded?<br>Cavalier Group v. Strescon Industries, 782 F.Supp. 946 (D.C.Del. 1992)<br>Phillips Home Builders v. Travelers Ins. Co., 1996 WL 527237 (Superior Ct. 1996) | | |
| Florida | Efficient proximate cause - concurrent cause rule (adopting Partridge v. SF Mut. Auto, 10 Cal.3d 3094, 1090 AR 811, 514 P.2d 123 (1974)<br>Wallach v. Rosenberg, 527 So.2d 1386 (Fla.App. 1988) | Maybe.<br>Wallach v. Rosenberg, 527 So.2d 1386 (Fla.App. 1988) | |

| STATE | CAUSATION PRINCIPLE | CAN INSURER CONTRACT AROUND? | TRIGGER OF COVERAGE |
|---|---|---|---|
| Georgia | Efficient cause<br>Nationwide Mutual Fire Ins. Co. v. Tomlin, 181 Ga.App. 143, 352 S.E.2d 612 (Ga.App. 1986)<br>Bold Corp. v. Nat'l. Union Fire Ins. Co. of Pittsburgh, PA, 216 Ga.App. 382, 454 S.E.2d 582 (Ga. 1995) | No.<br>Cox v. State Farm, 459 S.E.2d 446 (1995) | Discovery of cause of loss |
| Hawaii | | | |
| Idaho | Efficient proximate cause<br>Burgess Farms v. New Hampshire Ins. Co., 108 Id. 831, 702 P.2d 869 (Id.App. 1985) | | |
| Illinois | Proximate cause<br>Mattis v. State Farm, 118 Ill.App.3d 612, 454 N.E.2d 1156 (1983)<br>General Acc'd Fire & Life v. Brown, 35 Ill.App.2d 43, 181 N.E.2d 191 (1962)<br>"Efficient and predominating." | | |
| Indiana | Proximate cause<br>Ramirez v. American Family Mut. Ins. Co., 652 N.E.2d 511 (Ind.App. 1995) | Yes. Ramirez v. American Family Mut. Ins. Co., 652 N.E.2d 511 (Ind.App. 1995) | |
| Iowa | Shinrone v. INA, 570 F.2d 715 (8th Cir. 1978)<br>"Efficient cause."<br>Bettis v. Wayne County Mutual Ins. Co., 447 N.W.2d 569 (Iowa App. 1989) | | |
| Kansas | Proximate cause - "sets in motion"<br>Dubuque Fire & Marine v. Caylon, 249 F.2d 162 (C.A.10 1957) | | |
| Kentucky | Proximate cause<br>State Farm v. Aylick, 781 S.W.2d 531 (1989) | | |
| Louisiana | Proximate or efficient cause<br>Rule v. State Farm, 356 S.W.2d 101 (La.App. 1978)<br>Roach-Strayhan-Holland v. Continental Ins. Co., 112 So.2d 680 (1959) | | |
| Maine | | | |
| Maryland | Lumbermans Mutual Casualty Co. v. Ely, 293 Md. 254, 252 A.2d 786 (1969)<br>"Efficient cause." | | |

| STATE | CAUSATION PRINCIPLE | CAN INSURER CONTRACT AROUND? | TRIGGER OF COVERAGE |
|---|---|---|---|
| Massachusetts | Efficient proximate cause<br>Jussim v. Massachusetts Bay Ins. Co., 415 Mass. 24, 610 N.E.2d 954 (1993)<br>DiCalogero v. Hingham Mutual Ins. Co., 1998 WL 164927 (Ma.App. 1998) | Maybe. Hanover New England Ins. Co. v. Smith, 35 Mass.App. 417, 621 N.E.2d 382 (Ma.App. 1993)<br>Yes. Preferred Mutual Ins. Co. v. The Travelers, 955 F.Supp. 9 (D.Mass. 1997) | |
| Michigan | Maybe efficient proximate cause, perhaps "substantial factor."<br>Michigan Sugar Co. v. Employers Mutual Liability Ins. Company of Wisconsin, 107 Mich.App. 9, 308 N.W.2d 684 (Mich.App. 1981) | Yes.<br>Sunshine Motors v. New Hampshire Ins. Co., 539 N.W.2d 102 (Mich.App. 1995) | |
| Minnesota | Efficient proximate cause employing "concurrent cause" analysis<br>Witcher Constr. Co. v. St. Paul, 550 N.W.2d 1 (Minn.App. 1996)<br>A covered cause must be a direct cause even though other excluded causes may exist. Causation is a jury question. | | |
| Mississippi | Efficient proximate cause -- "dominant cause?"<br>Grain Dealers Ins. Co. v. Belk, 269 So.2d 637 (1972)<br>Also, Kemp v. Amer. Universal Ins. Co., 391 F.2d 533 (5th Cir. 1968) | | |
| Missouri | Efficient proximate cause<br>Toumayan v. State Farm, 1998 WL 187403 (Mo.App. 1998) | Yes.<br>See, Toumayan v. State Farm; Pakmark Corp. v. Liberty Mutual Ins. Co., 943 S.W.2d 256 (Mo.App. 1997) | |
| Montana | | | |
| Nebraska | Efficient proximate cause -- "sets others in motion." Griess & Sons, Inc. v. Farm Bureau Ins. Co. of Nebraska, 247 Neb. 526, 528 N.W.2d 329 (1995) | | |
| Nevada | Efficient proximate cause<br>Schroeder v. State Farm, 770 F.Supp. 558 (Dist. Nev. 1991) | Yes.<br>Schroeder v. State Farm, supra | Manifestation, following Prudential LMI v. Lundberg (California); Jackson v. State Farm, 108 Nev. 504, 835 P.2d 786 (1992) |
| New Hampshire | Proximate cause.<br>Nassif Realty Corp. v. Nat'l Fire Ins. Co., 109 N.H. 117, 244 A.2d 194 (1968) | | |

| STATE | CAUSATION PRINCIPLE | CAN INSURER CONTRACT AROUND? | TRIGGER OF COVERAGE |
|---|---|---|---|
| New Jersey | Efficient proximate cause -- cause that set other causes in motion<br>Stone v. Royal Ins. Co., 211 N.J. Super. 246, 511 A.2d 717 (N.J.Super. App.Div. 1986) | | |
| New Mexico | | | |
| New York | "Most direct and obvious cause."<br>Kula v. State Farm, 628 NYS.2d 988 (N.J.App.Div. 1995)<br>"Cause nearest to the loss."<br>Pan American World Airways v. Aetna Casualty & Surety, 505 F.2d 989 (Cal.2d 1994) | Yes.<br>Great Northern Ins. Co. v. Dayco Corp., 637 F.Supp. 765 (S.D.N.Y. 1986)<br>Kula v. State Farm, 628 NYS.2d 988 (N.J.App.Div. 1995) | |
| North Carolina | Proximate cause<br>Concurrent cause principle<br>Avis v. Harford Ins. Co., 283 N.C. 142, 195 S.E.2d 545 (1973) | | |
| North Dakota | Efficient proximate cause<br>Kief Farmers Co-op. v. Farmland Mut. Ins. Co., 534 N.W.2d 28 (1995).<br>N.D. Cent. Code §26.1-32-01 | | Actual injury - commencement of damage whether or not discovered<br>Kief Farmers Co-op v. Farmland Mut. Ins. Co., 534 N.W.2d 28 (1995) |
| Ohio | Efficient proximate cause - "cause that sets others in motion."<br>Midwest Specialties, Inc. v. Westfield Ins. Co., 1994 WL 107192 (Oh.App. 1994) | Yes.<br>Front Row Theatre, Inc. v. Am. Mfg. Mut. Ins. Co., 18 F.3d 1343 (C.A.6 1994) (Ohio law) | |
| Oklahoma | | | |
| Oregon | Efficient proximate cause - "sets others in motion."<br>Naumes v. Landmark Ins. Co., 119 Or.App. 79, 849 P.2d 554 (1991) | | |
| Pennsylvania | Efficient and primary cause<br>Armon v. Aetna Casualty & Surety, 369 Pa. 465, 874 A.2d 302 (1952) | Yes.<br>Doylestown Elec. Supply Co. v. Maryland Casualty Ins. Co., 1997 WL 92110 (Pa. 1997) | Injury during policy period -- may be prorated for continuing loss.<br>Peco v. Boden, 64 F.3d 852 (3rd Cir. 1995) |
| Rhode Island | | | |
| South Carolina | Efficient cause<br>King v. North River Ins. Co., 297 S.E.2d 637 (1982) | | |
| South Dakota | | | |
| Tennessee | | | |

| STATE | CAUSATION PRINCIPLE | CAN INSURER CONTRACT AROUND? | TRIGGER OF COVERAGE |
|---|---|---|---|
| Texas | Proximate cause. If two concurring causes - one excluded, one covered - there is coverage only to extent of covered peril<br>Nat'l. Union Fire Ins. Co. of Pittsburgh, Pa. v. Valero, 777 S.W.2d 501 (Tex.App. 1989) | Yes, if event in the chain of causation is excluded, the loss is excluded.<br>Auten v. Employers Nat'l Ins. Co., 722 S.W.2d 468 (Tex.App. 1986) | |
| Utah | Efficient proximate cause<br>Alf v. State Farm, 850 P.2d 1272 (1993) | Yes.<br>See, Alf v. State Farm, 850 P.2d 1272 (1993) | |
| Vermont | | | |
| Virginia | | | |
| Washington | Efficient proximate cause<br>Triggering cause<br>Graham v. PEMCO, 98 Wn.2d 533, 656 P.2d 1077 (1983) | No.<br>Safeco v. Hirschmann, 112 Wn.2d 621, 773 P.2d 413 (1989) | Exposure<br>Villella v. Pemco, 106 Wn.2d 806, 725 P.2d 957 (1986) |
| West Virginia | Efficient proximate cause<br>Labris v. Western Nat'l Ins. Co., 133 W.Va. 731, 59 S.E.2d 236 (1950) | No.<br>Murray v. State Farm, 203 W.Va. 447, 509 S.E.2d 7 (1998) | |
| Wisconsin | Efficient proximate cause applying Wisconsin law<br>Arkwright- Boston Mfrs. Mutual Ins. Co. v. Wausau Paper Mills Co., 818 F.2d 591 (7th Cir. 1987) | | |
| Wyoming | Efficient proximate cause<br>Paulson v. State Farm, 756 P.2d 764 (1988) | Yes.<br>Paulson v. State Farm, 756 F.P.2d 764 (1988) | |

### 4. Ensuing Loss Language

Causation is at the heart of indemnity under an All Risk property insurance policy. Determination of "what caused" the loss is central to determining whether the policy will provide coverage. As discussed above, if the efficient proximate cause, triggering, initiating or predominant cause is a covered peril, the loss will be covered. If, on the other hand, the efficient proximate cause of the loss is an excluded peril, then generally there is no coverage.

Many policies contain a provision in the Exclusions section of a policy providing coverage for an ensuing or resulting loss from an excluded peril. The exception to an otherwise excluded peril permits coverage for losses that flow independently from an excluded peril.

A typical Insurance Service Office provision providing coverage for an independent loss resulting from an excluded peril is as follows:

> We will not pay for loss or damage caused by or resulting from any of the following exclusions. But if an excluded cause of loss that is listed in the

> paragraphs below results in a "Covered Cause of Loss," we will pay for the loss or damage caused by the Covered Cause of Loss.

A typical provision in a Manuscript policy may provide as follows:

> This policy does not insure against loss or damage caused by or resulting from:
>
> (a) errors in design, faulty workmanship or faulty materials unless an occurrence not otherwise excluded ensues, and then only the ensuing loss or damage would be covered;

Ensuing Loss clauses are generally interpreted to provide coverage for independent losses that flow from an excluded loss so long as the "ensuing" or "resulting" loss is not itself excluded.[17]
A common formulation of the Ensuing Loss Doctrine is as follows:

> The Ensuing Loss clause may be confusing, but it is not ambiguous. Reasonably interpreted, the Ensuing Loss clause says that if one of the specified under-covered [excluded] events takes place, any ensuing loss which is otherwise covered by the policy will remain covered. The uncovered event itself, however, is never covered … the intent of the Ensuing Loss clause is not to enlarge the list of items covered under the policy.

*McDonald v. State Farm Fire & Cas. Co., supra*, at n.17.

### 5. Known Loss

Insurance is designed to transfer the risk of contingencies. If an event occurs that is not contingent, i.e., not an accident or fortuitous, then it may be excluded under the doctrine of "Known Loss."

The "Known Loss" doctrine is not an explicit exclusion under the policy, but rather a fundamental principle underlying the concept of insurance.

The Known Loss doctrine, which is similar to the Fortuity doctrine, provides that an insurer has no duty to indemnify an insured "where the insured is, or should be, aware of an ongoing progressive loss or known loss at the time the policy is purchased." *Two Pesos, Inc. v. Gulf Ins. Co.*, 901 S.W.2d 495 (Tex.App.-Houston 1995);[18] *Yale University v. CIGNA Ins. Co.*, 224 F.Supp.2d 402 (D. Conn. 2002) (the "known loss" defense is a variation on the fortuity theme. It holds that an insured may not obtain insurance to cover a loss that is known before the policy takes effect).

For hotel properties, the doctrine of Known Loss can arise under various circumstances. It may include a control agent of a hotel company guilty of embezzlement, known to the company before a fidelity policy is issued; a construction defect known before a policy is issued under which coverage is sought; an employee

[17] See, for example, *McDonald v. State Farm Fire & Cas. Co.*, 119 Wn.2d 724, 837 P.2d 1000 (1992); *American Concept Ins. Co. v. Jones*, 935 F.Supp. 1220 (D. Utah 1996).

[18] If an insured applies for and obtains an antedated policy knowing that a loss has already occurred … the failure to disclose that fact constitutes fraud that would enable the insurer to set aside the contract. *Birch v. Commonwealth County Mutual Ins. Co.*, 450 S.W.2d 838 (Tex. 1970).

harassment claim known by the company before a Claims Made Employee Practices liability insurance policy is received.

In today's marketplace, insurance coverage counsel are very quick to discover a known loss or a lack of fortuity. Fortuitous loss is one which is not certain to occur when a policy is issued. A non-fortuitous loss is one which, while it may not have occurred at the time the policy issued, is nonetheless a certainty.

A known loss, on the other hand, is a loss that has already occurred at the time the policy is issued. Both doctrines are implicit in the insurance contract and can preclude coverage.

### 6. Contractual Suit Limitations

Almost all property polices contain a "Suit Limitation Clause," i.e., a clause designed to shorten the period of time within which an action on or under the policy may be brought against the insurer by the policyholder. Typically, these time limits are from 12 months to 2 years. Most states, by statute, implicitly recognize the validity of Suit Limitation Clauses by prohibiting the use of such clauses in actions brought "less" than 12 months after the loss.

Except in a minority of jurisdictions, Suit Limitation Clauses have been upheld, even though they shorten the time within which a policyholder may be required to bring an action. In some jurisdictions, the nominal 12-month period has been extended to 2 (Oregon), 3 (Alaska), or even 6 (Kansas) years.

A common formulation of a suit limitation provision is that contained in the 1943 New York Standard Fire Insurance Policy. "No suit or action on this policy for the recovery of any claims shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with and unless commenced within 12 months next after inception of the loss."

A suit limitation provision is trap for the unwary. It operates for forfeit the policy if an action is not brought within the specified time period or the limitation period is tolled. It is generally enforced by all jurisdictions. Although the suit limitation rule is easy to state, it is often difficult to apply in practice. The application of a Suit Limitation Clause becomes more difficult when a loss incepts but is not discovered until after running of the limitation period. Some jurisdictions hold that the limitation period begins to run from the date the damage occurs regardless of when discovered, while others interpret the period to run when damage is sufficient to put a reasonable person on notice of the possibility of a property loss. *See, e.g., Prudential-LMI Commercial Ins. v. Superior Court*, 798 P.2d 1230 (Cal. 1990).

There are, of course, variations on the phrase "inception of the loss." For example, time period could be determined by "next after occurrence of the loss," "next after a loss occurs," or "next after happening of a loss." These are all common formulations of the suit limitation provision.
In *Panorama Village Condo. Owner's Assoc. Board of Directors v. Allstate Ins. Co.*, 144 Wn.2d 130, 26 P.3d 910 (2002), the Washington Supreme Court interpreted the provision "one year after a loss occurs," and held that the policyholder must bring an action for coverage within one year subsequent to or succeeding the loss. The *Panorama* court contrasted this with "after inception of the loss" language requiring the policyholder to bring an action for coverage within a time certain subsequent to the beginning of the loss.

Notwithstanding the difficulty in determining when the loss "occurs" or "incepts," sophisticated brokers have crafted suit limitation provisions that are either co-extensive with the statute of limitations for bringing an action under a written contract (generally 6 years), or upon an event whose certainty can be more easily determined.

For example, the following clause has been held to be co-extensive with the State of Washington's 6-year statute of limitations for the bringing of a contract action:

> No action or suit on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless the insured shall have fully complied with all the requirements of this policy. The Company agrees that any action or proceeding against it for recovery of any loss under this policy shall not be barred if commenced within the time prescribed therefore in the statutes of the State of Washington.[19]

### C. Coverage Differentiators Important to Hotel Risks

The words matter. Insurance coverage decisions are dependent on the language used by the parties whether the policy be an Insurance Service Office (ISO) form or a Broker's Manuscripted form. Large hotel risks with multiple properties in multiple states have traditionally been able to negotiate coverages through use of a manuscript policy. Even in instances in which an insurer refuses to write on a manuscript form, changes in ISO policy wording can be effected by endorsement. Where an ISO policy does not provide a particular coverage, that coverage can be added by endorsement.

The following represent some selected wording or phrasing of specific coverages that have been accepted by insurers, either by endorsement or in manuscripted policies.

#### 1. Ingress/Egress Without Geographic Limitations

These extensions of coverage provide payment for lost business revenues to a hotel due to lack of customer access caused by an insured peril. Property damage at the insured location is not required. Four weeks is the minimum desired time limit.

Some suggested wording:

##### a. Ingress/Egress

> (i) This policy is extended to coverage loss as insureds herein sustained during the period of time when ingress to or egress from real or personal property is impaired as a direct result of a peril insured hereunder.

An alternative would be:

> (ii) Loss sustained during the period of time when, as a result of a peril insured against, ingress to or egress from the real or personal property is prevented or hindered, irrespective of whether the property of the insured shall have been damaged.

#### 2. Interruption by Civil Authority or Military Authority

[19] *Port of Seattle v. Lexington Ins. Co., et al.,* 111 Wn.App. 901, 484 P.3d 334 (2002).

(i) This policy is extended to cover losses insured hereunder sustained during the period of time when access to real or personal property is impaired by order of action of civil or military authority as a direct result of a peril insured hereunder.

An alternative would be:

(ii) Actual loss as insured herein during the period of time when access to real or personal property is prohibited by order of civil or military authority.

### 3. Business Interruption (Not Suspension) on Actual Loss Sustained

Suggested wording:

This policy insures the interest of the insured in the following:

> LOSS OF EARNINGS resulting from the necessary interruption of business conducted by the insured, including all interdependencies between or among companies owned or operated by the insured resulting from physical loss or damage, insured herein and occurring during the term of this policy to real or personal property described [above].

For a hotel company, business interruption insurance is vital. Particularly vital is coverage for extra expenses.

Extra expense can come in two forms. It can be of a "pure" type in which extra expenses are defined as those "in excess of normal" and arising out of a covered peril. Extra expenses can also be tied to the extent to which such costs and expenses reduce the loss.

The pure type of extra expense is exemplified by the following language:

**Extra Expense**

(i) Extra expense incurred by the insured following physical loss or damage insured herein and occurring during the term of this policy, to real and/or personal property.

(ii) The term Extra Expense as used in this policy is defined as the excess (if any) of the total costs chargeable to the operation of the insured's business over and above the total costs that would normally have been incurred to conduct the business had no loss or damage occurred.

Though not as common, another type of extra expense coverage, often subject to a sub-limit, is coverage for expenses that do not exceed the amount by which the loss otherwise payable under the policy is reduced. Typical phrasing of such an extra expense provision is as follows:

**Expenses Related to Reducing Loss –** This policy is extended to cover:

(1) such expenses as are necessarily incurred for the purpose of reducing loss under this policy; and

(2) such expenses in excess of normal, as would necessarily be incurred in replacing any finished stock used by the insured to reduce loss under this policy;

but in no event shall be the aggregate of such expenses exceed the amount by which the loss otherwise payable under the policy is thereby reduced.

The distinction between the two types of extra expense is quite simple. The first type of extra expense coverage applies to those expenses in excess of normal during the period of indemnity or restoration. There is no requirement that the incurred expenses served to reduce the loss otherwise payable under the policy.

The second type of Extra Expense coverage comes with a condition: that the incurred expenses serve to reduce the loss that otherwise would be payable under the policy. This type of coverage ties the incurrence of the expense to reduction of the loss thereby encouraging the duty to mitigate and penalizing those who engage in economic waste.

### 4. Extended Period of Indemnity

An Extended Period of Indemnity clause allows a hotelier to be compensated for that period of time necessary to ramp back up to the revenue level existing immediately prior to the loss or casualty. The provision is usually crafted as an extension of the time within which business interruption coverage is payable by an insurer to a maximum of 180 to 365 days. A common formulation of an extended period of indemnity provision is as follows:

**Period of Recovery**

The length of time for which loss may be claimed is referred to as the recovery period and:

1. shall commence with the date of such loss or damage and shall not be limited by the date of expiration of this policy;
2. shall not exceed such length of time as would be required with the exercise of due diligence and dispatch to rebuild, repair or replace such part of the property that has been destroyed or damaged; and
3. such additional length of time to restore the insured's business to the condition that would have existed had no loss occurred, commencing with the later of the following dates:
   (a) the date on which the liability of the insured for loss or damage would otherwise termi-nate; or
   (b) the date on which repair, replacement or rebuilding of such part of the property that has been damaged is actually completed and the insured has resumed normal operations,

   but in no event for more than three hundred sixty-five (365) days thereafter from said later commencement date.

The above clause sets forth the usual "due diligence and dispatch" period within which business interruption and extra expense is payable. In addition, it allows the insured to regain and restore the insured's business to a condition that existed immediately prior to the loss and grants a maximum 365-day period within which additional business interruption/extra expense payments will be made.

### 5. Ordinance Coverage

One of the most important coverages any hotel operation can acquire is code upgrade coverage, sometimes called "Demolition and Increased Cost of Construction" coverage. The purpose of the coverage is to allow a hotel company to take advantage of changes in building codes between the time a hotel is built and when a loss occurs requiring repairs or reconstruction. This type of coverage is particularly important to hoteliers in areas in which hurricanes or earthquakes are common occurrences. Often this extension of coverage contains a sub-limit.

While there are many variations of wording, most insurers include wording that only requires them to compensate the policyholder to comply with the "minimum" requirements of the jurisdiction having authority. A common clause will look like the following:

> In the event of loss or damage under this policy that causes the enforcement of any law or ordinance regulating the construction, repair, or use of property, the insurer shall be liable for:
>
> (a) the cost of demolishing the undamaged property, including the cost of clearing the site;
>
> (b) the proportion that the value of the undamaged part of the property bore to the value of the entire property prior to the loss;
>
> (c) increased cost of repair or reconstruction of the damaged and undamaged property on the same or another site and limited to the costs that would have been incurred in order to comply with the minimum requirements of such law or ordinance regulating the repair or reconstruction of the damaged property on the same site. However, the insurer shall not be liable for any increased cost of construction loss unless the damaged property is actually rebuilt or replaced;
>
> (d) any increase in the Business Interruption, Extra Expense, Rental Value, Royalties, and/or any time element loss arising out of the additional time required to comply with said law or ordinance.

A couple of items in the above language are important. *First*, the code upgrade coverage does not require the policyholder to rebuild the property on the same site; rather, the amount payable is limited to that which would have been payable had the money been used to reconstruct or repair the property on the site at which damage occurred.

*Second*, in order to compensate it for the cost of code upgrades, the policyholder must actually rebuild the property. *Third*, if code requirements require a longer construction period than would have been required

had the code restrictions not been applied, the coverage will allow for the additional business interruption loss or extra expenses.

### 6. Replacement Cost Coverage

Most modern policies are issued with Replacement Cost coverage. Replacement Cost insurance is designed to provide for the full cost to repair or replace damaged property. While the concept of Replacement Cost insurance has been the subject of numerous articles and treatises, the disputes that generally arise between a policyholder and its insurer revolve around the extent of replacement, whether replacement must be on the "same site" or can be on "any site;" whether the replacement must be identical to that damaged or destroyed or may be a "functional" equivalent. Other less troublesome issues relate to whether the policy has a time period, usually 180 days, within which replacement must occur.

It is gainsaid that, absent replacement, Replacement Cost insurance is not triggered.[20]

Replacement Cost coverage is generally found under that part of the policy dealing with "valuation."

An Insurance Service Office Valuation Replacement clause provides:

> For property valued on a replacement cost basis, we will determine the value of covered property in the event of loss or damage at the cost to replace the lost or damaged property with new property:
>
> (a) of comparable kind and quality;
>
> (b) on the same premises (regardless of whether rebuilding actually occurs); and
>
> (c) intended for the same occupancy or use;
>
> without deduction for depreciation. But if the damaged or destroyed property is not repaired or replaced, we will not pay more than its actual cash value at the time of loss or damage.

Under this particular ISO provision, the calculation of the Replacement Cost is based on replacing the damaged or destroyed property with property of like kind and quality on the same premises and intended for the same use and occupancy. This does not mean the property must be reconstructed on the same site, but rather the amount of money that will be allowed for Replacement Cost will be calculated as if the property was repaired or replaced on the same site.

Manuscript policies have an advantage in that they have the opportunity to broaden the Replacement Cost coverage. A couple of examples of broader Replacement Cost coverage are as follows:

a. At the time of loss, the basis of adjustment, unless otherwise endorsed hereon, shall be as follows:

> Real and personal property not otherwise valued below, shall be valued at the Replacement Cost determined as of the date of replacement, if actually

[20] There have been one or two anomalous cases in which actual replacement was not required. *National Fire Ins. Co. of Hartford v. Solomon,* 96 Wn.2d 763, 638 P.2d 1259 (1982).

replaced, and if not replaced, at the Actual Cash Value as of the date of the loss.[21]

b. At time of loss, the basis of adjustment shall be as follows:

1. On buildings and structures, at the replacement cost new.[22]

Each of the above two Replacement Cost provisions contained in Manuscripted policies would provide for replacement of one facility with its "functional equivalent."[23] Nor do either of the above two replacement cost provisions require that property be built on the same site or with like kind and quality materials.

### 7. Landscaping

For resort hotel properties, coverage for landscaping is essential. This is particularly true for those properties subject to wind loss or tidal surge. It is not uncommon to find landscaping coverage subject to a sub-limit. This is an area that should be carefully assessed by a hotel owner as a wind loss can result in a significant landscape claim without sufficient coverage.

Landscaping coverage can be rescinded in a couple of different ways. *First*, landscaping being the earthwork and whatever trees, shrubs and flowers might be adorning the earthwork, is clearly real property, and therefore is generally covered under the Insuring clause of an All Risk policy.[24]

*Second*, most often land and land value are excluded. An exclusion may except "landscaping" thereby indicating that landscaping is covered as "real property."

Another way of handling landscaping is to provide specific landscape coverage. This additional coverage can take the form of "outdoor trees, shrubs, plants and lawns, for losses caused by a specified peril (such as fire, lightning, etc.).

Similar coverage without restriction to a specified peril has been offered in the following terms:

> We will pay for direct physical loss of or damage to outdoor trees, shrubs, plants and lawns if the loss or damage is caused by or results from a Covered Cause of Loss.

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[21] This particular provision allowed an Alaska fish processing company to replace its destroyed shore-based fish processing plant with a fish processing vessel that could ply the oceans from the Bering Sea to southeast Alaska.

[22] This particular provision, contained in a hotel policy, also provided that if the insured elected not to replace the lost or damaged property, it could nonetheless still obtain loss settlement on a replacement cost basis if the proceeds of the loss settlement were expended for other capital items related to the insured's business. This is an extraordinary advantage for any insured.

[23] One court has noted the term "replacement" includes the notion of substituting for an original item another item which serves the same function as the original, but is different in nature from the original. *Conway v. Farmer's Home Mutual Ins. Co.*, 26 Cal.App.4th 1185, 31 Cal.Rptr.2d 883 (Cal.App.4th 1984).

[24] Under the coverage section of a policy, defining "Covered Property," provision is usually made to cover "all real and personal property owned, used or intended for use by the insured, acquired by the insured, property of others in the insured's care, custody or control, including the insured's liability for such property, and including the cost to defend any allocations of liability for loss or damage to such property including, but not limited to [named] items of property.

> The most we will pay under this additional coverage is $500 for loss (including debris removal) to any single tree, shrub or plant not to exceed $25,000 for all losses from any one occurrence unless a higher limit is shown in the Declarations or Schedules.[25]

Apart from direct loss to landscaping by a covered peril, landscaping can be damaged indirectly as result of repair work to a building or facility. In this case, policyholders have attempted to circumvent a sub-limit by arguing that the landscaping did not suffer a "direct" loss from a covered peril but were damaged as part of the overall repair of a covered building and therefore should be included within the broad and more extensive building coverage. The argument has not as yet been successful.

### 8. Off-Premises Power Coverage

Hotel operations are energy dependent. Most policies will provide some coverage for failures on or near the premises. The preferred policy extension will provide coverage for a resulting loss due to property damage at a supplier or distribution site up to 5 miles away.

Quite frequently, particularly with respect to ISO policy forms, loss or damage from failure of utilities is an **Exclusion**. Exclusion precludes coverage for: "the failure of power or other utility service supplied to the Described Premises, however caused, if the failure occurs away from the Described Premises.

In light of exclusionary language which is fairly common in policies, it is important for the hotel owner to secure utility or offsite premises coverage. Coverage can be worded as follows:

> This policy, subject to all its provisions and without increasing the amount of the policy, also insures against loss resulting from, damage to or destruction by the perils insured against to:
>
> Any electrical equipment and systems, fuel, water, gas, sewage, steam, telephone, telecommunications, heating refrigeration and/or air conditioning systems, or their respective transmission lines or utility plants, situated on or outside of the premises, when used for the incoming service of the insured.

Another formulation of off-premises service coverage as follows:

> We will pay for loss of business earnings or extra expense at insured's premises and locations caused by the interruption of services to insured premises and locations. The interruption must result from direct physical loss or damage by a covered cause of loss to the following property not on insured premises and locations: (1) water supply services; (2) communications supply services; and (3) power supply services.

Offsite utility coverage usually does not require any physical loss or damage to the real or personal property of an insured. The need for the coverage is found in the significant business interruption and extra expense loss that may be occasioned by loss of onsite power as the result of an offsite utility failure resulting in

[25] This is a typical ISO policy coverage for landscaping subject to a sub-limit unless premium is paid for a higher limit.

significant income losses. The hotel can go dark and require the hotelier to move all of the customers to different properties, refund payments and, in some cases, advance deposits.

Under some policies, failure of an offsite utility can be covered under "contingent business interruption" coverage. Under Contingent Business Interruption coverage, the failure of a supplier of a service (utility) which results in business income loss, will be covered. For example, the following language, even in the absence of an offsite utility premises coverage, would likely be sufficient to provide business interruption coverage for a utility failure:

> This policy also insures against loss resulting from, damage to or destruction by the perils insured against to:
>
>> Property that directly or indirectly prevents a supplier of goods and/or services to the insured from rendering their goods and/or services, or property that prevents customers of goods and/or services from the insured from accepting the insured's goods and/or services.

The "supplier" is broad enough to include a supplier of utility services, whether it be electrical, gas or communications.

### 9. Attraction Properties

Hotels are often near attractors of business such as theme parks, convention centers, or other sources of visitor attractions. This extension provides for lost hotel revenues should an attraction property suffer a property loss by an insured peril. Similarly, property policies can extend coverage for event cancellations.

Coverage for Attraction Properties is akin to Contingent Business Interruption coverage. Again, the anticipated loss is one of income, not physical damage. In one policy, "Attraction Property" was defined as:

> properties, not operated by the insured, which attracts potential customers to the vicinity of the insured's location.

A typical formulation for coverage for Attraction Properties provides as follows:

> This policy insures against loss sustained by the insured resulting from cancellation of or inability to accept bookings for accommodations as the direct result of loss or damage as insured hereunder to Attraction Properties.

[With Attraction Properties defined as above].

### 10. Loss Adjusting Expenses

ISO policies almost uniformly fail to provide coverage for loss adjustment expenses. These are expenses incurred after a loss in order for the policyholder to work through the claim. Normally, expenses for accountants, engineers, architects and, on occasion, attorneys, are covered subject to a sub-limit.

Loss Adjustment Expense coverage wording is as follows:

> This policy is extended to insure reasonable expenses incurred by the insured, or by the insured's representative, for assessing, for preparing and/or certifying

details of the claim resulting from a loss which would be payable under this policy. However, this policy does not insure the expenses of Public Adjusters.

A policy coverage for loss of adjustment expenses issued to one of the panel member's clients included attorney's fees for preparing the claim and a proof of loss, but excluded those attorney's fees incurred in prosecuting a civil action against the insurer for coverage.

For a hotel property, the preparation and processing of a large claim, particularly a claim which is the result of a natural casualty such as a wind loss or earthquake, is complicated, detailed and costly. This particular coverage is one of the most often over-looked coverages that are available for little or no extra charge. Because the insurer provides the coverage under a sub-limit, and within the overall policy limits, there is probably no additional premium.

**11. Designated Adjuster**

It is important for an insured to assign property loss adjustment responsibilities to a competent adjuster familiar with the insured's operations and business. Though paid by the insurers, the named adjuster develops a business relationship with the insured, thereby enhancing the loss settlement process.

An adjuster may be designated by use of the following language:

> It is hereby understood and agreed that each and every loss will be adjusted by [name] unless otherwise agreed by the insured and the insurer.

## II. Establishing a Team

### A. The Role of the Designated and Named Adjuster

**The Opportunity**

Your firm has large real estate holdings and other hotel operational risks that are subject to physical damage and loss of business income. To protect against such losses, you have purchased property insurance with limits, coverage's, and deductibles consistent with your firm's tolerance for risk and insurance market availability.

When a loss occurs, your insurer will assign a claims adjuster to evaluate, adjust, and settle the loss. The assigned adjuster is either an employee of the insurer or an independent adjuster having a business relationship with the insurer. In both cases, the adjusting services are paid by the insurer. When multiple insurers (layered or quota share programs) exist, there is the likelihood of multiple adjusters representing the several insurer interests -- so it is apparent why many large or complex property claims become one-sided, are subject to the interpretation of the insurers and their representatives, become time consuming for your key executives, and are often needlessly protracted.

**The Solution**

Your firm can purchase property insurance that specifically names an independent property adjuster of your choice, with whom you have established a business relationship. You select the adjuster based upon the firm's and individual's reputation in the industry, familiarity with your potential loss exposures, and the adjuster's ability and willingness to understand your company and philosophy. Your broker will include the

adjuster's name as part of the policy wording, prior to any losses, and subject to insurer approval. While it is likely your firm will change insurers over time due to market conditions or changes in your risk, you will continue to retain your designated adjuster, assuming on-going satisfactory results. (Typically, insurers will not withhold approval of reputable adjusters.)

**Advantages to You**

- Although costs are paid by the insurer, the designated adjuster will have a solid business relationship with your firm.
- Over time and with satisfactory loss settlements, the loss settlement process becomes more predictable and less time-consuming.
- Your adjuster will know your coverage, having received and reviewed your policy in advance of a loss.
- In difficult negotiations, you will be able to anticipate winning strategies.

In the event of large catastrophic losses, your adjuster will be available when you need him most (large losses such as hurricanes or earthquakes draw on the most competent adjusters from around the country, draining available resources).

### B. The Role of the Coverage Attorney

**The Opportunity**

A complex loss occurs and you are faced with potential disputes over interpretation of coverage wording, loss calculations, periods of indemnity, etc. Your insurer issues a reservation of rights, or otherwise informs you of a position inconsistent with your understanding of the coverages that you purchased. Although you may have in-house counsel and outside counsel relationships, it is unlikely that either specializes in insurance law.

**The Solution**

Your firm establishes a relationship with a coverage attorney specializing in insurance matters. The attorney reviews your insurance policies prior to a loss and provides advice on potential legal interpretation and may offer advice where coverage wording could be improved. At the time of a large or complex loss, you consult with your broker and attorney to anticipate problematic issues in the adjusting process, such as:

- Sections of policy wording in which you intend to seek coverage
- Analysis of the factual and legal cause of loss
- Selection and direction of experts
- Coverage analysis based upon case history
- Dealing with and responding to insurer's coverage attorneys
- Working together with your insurance broker to craft settlement strategies to present to the senior business people of the insurer.

**Advantages to You**

- You will better understand the legal issues of your insurance contracts.

- You will have the opportunity to take the offensive in presenting a coverage position, rather than responding to a denial based on underwriters' evaluation of cause, or interpretation of exclusionary language.

- Your experts will understand and help formulate your position, not simply respond to insurance company questions.
- The insurer will understand early on that there will be close scrutiny and diligence in the adjustment process and outcome.

- Your firm's recovery from insurers is maximized.

**C. Establishing and Maintaining Relationships**

**1. Circulate Policies**

**2. Update Team on Business Matters**

## III. The Claims Process

**A. Prepare for a Loss**

**B. Assume Nothing**

**C. Determine/Understand Roles of the Team**

**D. Seek High Level Underwriting/Claims Authority and Relationships**

**E. Set the Agenda**

**F. Loss Scenarios**

**<u>Loss Scenario No. 1</u>**

The first scenario involves a total fire loss to a hotel located in a beach community. Structure is two stories, with 22 guest rooms consisting of efficiencies with kitchen facilities. Policy inception date was 1-13-01. Loss was the result of a fire on 5-23-01 in which the building and contents were a constructive total loss.

The application signed by the insured requested:

| | |
|---|---|
| $1,000,000.00 | building |
| $ 50,000.00 | contents |
| $ 100,000.00 | business interruption |

Application stated the building square footage was 24,352. Actual square footage was half that or approx. 12,150. Retail agent reviewed property records and doubled the footage area thinking the property appraisers calculations were only addressing the footprint of the building. Being two stories, he doubled the square footage.

Application was sent to US Broker who has a practice of combining the Building and Contents into a single limit. In doing so they transposed a zero and a five and instead of writing a policy for $1,050,000.00 they wrote the combined limits as $1,500,0000.00. A premium was paid for the lesser amount. Agent received the policy and noted discrepancy but did not act. He provided insured with a copy of the policy pointing out the increased limits.

Immediately after fire, which was attributed to improper storage of gasoline by a neighboring establishment, the insured hired a Public Adjuster. Agent, insured and public adjuster meet day of fire and agent tries to talk insured out of using a PA and backtracks on the amount of coverage. PA wants to know where the Business Personal Property coverage is that was requested by the insured in the amount of $300,000.00. This is news to the agent but sets the tone for the adjustment process. Accusations begin to abound.

The adjuster notifies US and London Broker of problems. The adjuster took R/S of retail agent and asked for authority to hire a General Contractor to assist in estimating damage to building and Attorney to represent Lloyds on the coverage issue. The attorney assures London and US Broker that in view of the obvious transposition of the two numbers, policy limits would revert back to $1,050,000.00 for both building and Business Personal Property.

The US Broker then issues an endorsement with an effective date of 1-13-01 (policy inception date) to correct the policy limits to $1,050,000.00. Adjuster issued a Reservation of Rights letter to insured outlining coverage's, premium for $1, 050,000, and reminds insured he signed the application requesting that amount of coverage.

Insured responds denying he ever reached an agreement with the agent for $1,050,000.00. Insured hires an attorney and the battle begins. Problems further escalate when a defense attorney starts to place the fault with US Broker, who is taken out of the loop.

The adjuster completes an estimate on Building in the ACV amount of 917,962.70, Business Personal Property in the amount of $51,258.63 and Coverage Extension of $11,160.00, and makes offer of settlement of $979,381.33. Offer rejected by insured and his counsel.

**Outcome of Claim:**

Four months later after legal posturing payment is made too insured for Policy limits of $1,500,000.00 for building and contents, $10,000.00 for additional debris removal and Earnings limits of $100,000.00. Plaintiff attorney is paid $25,000.00 in legal fees. Then both attorneys join together and proceed to seek recovery from the at fault establishment that improperly stored the gasoline. Insured claimed additional damage for Business Personal Property and London Defense Attorney also seeks recovery from US Broker and Retail Agent for errors made in issuing policy. The adjuster concludes the loss.

This is an example on how a small transposition of two numbers can escalate, and become a $475,000.00 mistake.

## Loss Scenario No. 2

This Hurricane Floyd loss involved a beach resort hotel and occurred on September 14, 1999. This was a monster storm that threatened the entire state of Florida but veered to the north and caused severe damage in the Carolina's. The beaches sustained wind gust approaching 80 MPH.

The policy on this risk was an all risk manuscript, providing $2,500,000.00 primary coverage on a blanket basis for real and personal property and business income with extra expense. There was a $250,000.00 wind deductible. This manuscript policy included coverage for a leaky roof. There was no requirement that the building first sustain damage too exterior from an insured peril.

The risk was an eight story, 194-guest room resort hotel with banquet facilities plus a lounge and restaurant. It is located on the Atlantic Ocean. This is a 4 Star hotel. The building was 35 years old. It was in average condition with what appeared to be good maintenance.

Assignment received 9-21-99.

The damage scope included notable wind damage to roof coping over the first level restaurant area and minor damage to the exterior. There was no visible wind damage to the roof over the 8th floor which covered the guest rooms. There was, however, some interior water damage to guest rooms on the upper floors. The damages to these rooms were not uniform but scattered. After initial inspection, the insured started to notice additional damage to lower level rooms. We ended up with damage to 50% of the rooms.

Reserves were revised to reflect the added exposure with the additional water damage. The revised building reserve was $1,000,000.00, contents $50,000.00, and business income $300,000.00.

This was 1999. Mold was not a major issue in Jacksonville at that time. Guest rooms appeared to have no damage but the manager would pull back wallpaper and we would find major problems with mildew. Agreement was reached to clean and spray walls with mildecide or bleach and replace wallpaper in those rooms. Today, just a few years later, there would have been people in moon suits inspecting these rooms. The remediation cost plus pre and post loss testing would have resulted in major dollars. Instead of about $2,000.00 loss per room, we would have been looking at about $15,000.00 per room.

There was no visual wind damage to the 8th floor membrane roof. An expert was called in to inspect the roof for any damage. He advised there was no noted wind damage to the roof but the roof insulation was soaked and the roof cover would require replacement. This was approximately $100,000.00.

About a month after the loss, the adjuster received a call from another independent adjuster indicating that he had a claim on the same building. He represented a cell phone company and the insured had filed a 3rd party claim for improper installation of a cell phone tower on the building which contributed to the water intrusion. This was news to the adjuster. He confronted the insured who acknowledge the situation. In short, there was subrogation potential.

The cell phone tower was attached to the 8th level of the hotel building. The adjuster was not aware of the problem with the tower until January 2000. By then the roof had been repaired and the base of the antenna repaired. When the antenna was originally attached, apparently a small opening was left which resulted in water entering during the storm. The cell tower was not damaged in the storm.

The bottom line on this claim is as follows. The building loss settled for just less than $700,000.00 less the $250,000.00 deductible. The contents claim for $6,200.00. The non-disputed business income claim paid was $337,013.00.

After the storm, the insured decided to completely renovate the hotel. The adjusted BI claim was based on damages related to the storm. The insured claimed his damages were more severe but the adjuster believed this was due to the major remodel.

The insured did not agree to the business income claim as adjusted. A trip was made to Chicago, the insured home office to meet with the CFO of the insured and broker.

Insured filed for appraisal. The appraisal process at that time was formal and after a 2-day hearing, the insured were awarded business income claim of $796,000.00.

## Loss Scenario No. 3

This loss was sustained by a large resort hotel with golf, tennis and convention facilities. Ownership is a large national corporation with corporate headquarters in Atlanta, GA. Coverage is all risk replacement cost with $27,567,645 on the building and $1,235,350.00 on business personal property. Earnings coverage is $2,700,000.00. We had the first layer for $5,000,000.00 with a $10,000.00 deductible.

The loss was a guest room fire that took place on 4-28-02 at 1:20 a.m. This resort and spa hotel was built in 1897. It is of frame construction with 244 guest rooms. It is on the National Registry of Historic Places, and reported to be the world's largest wooden occupied structure. It is equipped with smoke alarms and sprinkler system. It has through the wall HVAC system. The HVAC system was a constant problem and was repaired or replaced as needed.

Assignment received late in the day on 4-30-02 and inspection made on 5-01-02. Copy of policy was requested from the broker but never received.

Fire started in wall A/C unit in unoccupied guest room which consists of a suite with a separate living room and bedroom. Two guest rooms on the second floor were fire damaged and the sprinkler head activated causing damage to the administrative offices and ballroom on the first floor.

Upon inspection adjuster found the A/C unit removed from the wall and hole boarded up. All furnishings were removed as well as carpet. Damaged furniture discarded. A/C unit was placed in a storage room with about 10 other units and was already cannibalized for parts.

Adjuster received authority for C & O who inspected on 5-14-02 and again on 5-20-02. Scene had been repaired and renovated except for carpet before his arrival in spite of adjusters' request to refrain from further demo.

The C & O investigator found that the compressor, capacitor and other components had been removed from the air conditioner and installed in other pieces of equipment. Basically only the chassis remained along with wiring harness. Subrogation possibilities faded even though the
building had gone through an electrical retrofit several years earlier.

Adjuster completed building estimate for approx. $20,000.00. Inventory of business personal property was discussed with assistant general manager. Inventory sheets were provided with instruction for completion. Contents inventory returned with $4,000.00 in damages. Computer equipment included on inventory that had gotten wet was still being used. No restoration of equipment undertaken by insured and all furniture was discarded.

Insured presented claim for $10,000.00 for guest compensation. Occupancy was about 50%. However, 61 guests were reimbursed for their stay. Most guests remained in their rooms but were compensated for all three days even though they were scheduled to checkout the day of the fire. Insured only provided an inventory type list of those guests' revenues. These charges were added to the claim in spite of the fact that the fire was isolated to two rooms. Insured maintained that the fire alarm required all guest to be evacuated and for goodwill purposes he comped every guest to preclude complaints.

Adjuster attempted to justify this income claim by stating it was an extra expense to reduce loss. The problem encountered was that most of the guests were there for a three-day convention that ended the day of the fire. The insured were therefore unable to justify that the compensation would have actually reduced his loss. We were unable to verify that the insured would have actually sustained a loss if they had not refunded these funds to the hotel guests. Entire extra expense claim was denied by the carrier.

Claim was finally settled October 28, 2002 or almost six months after the date of loss for $19,557 less a $10,000 deductible for a net claim of $9,557.

Factors that affected damages, recovery and length of time to reach settlement.

1. Fire occurred at time when no maintenance personnel were available and sprinkler system ran for inordinate length of time before water supply line could be found and shut off. Night auditor was not properly trained in emergency procedures.

2. Evidence was spoiled by in-house cleanup and demo.

3. Local management did not have authority to reach agreement with on site adjuster.

4. Insured could not readily provide invoices and documentation for valuation of inventory.

5. Insured could not provide any financial documents to verify loss of revenue.

6. BI coverage does not address goodwill.

7. Insured experiencing constant maintenance problems in plumbing and mechanical equipment which results in an unusual high rate of compensation to hotel guests.