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Insuring Businesses Against Catastrophic Losses

With super storms growing more frequent, adequate protection is vital

By DAVID G. JORDAN

Erratic weather patterns brought about by global climate change, along with natural disasters unrelated to climate issues, have become prevalent over the last decade. The tornadoes, wildfires, earthquakes, tsunamis and hurricanes that have made international headlines during this time period suggest that catastrophic losses are no longer a question of "if," but are more appropriately viewed as a question of "when." "Superstorm Sandy," the combination hurricane-nor'easter anomaly that slammed the Northeast and parts of the Midwest, is only the most recent example of Mother Nature's indiscriminate devastation.

When natural disaster strikes, an insurance policy can be the single most important document to the economic future of a business. Adequate protection against the potential (or likelihood) of catastrophic losses is not simply a matter of purchasing an insurance policy and stowing it away in a drawer or filing cabinet, only to pull it out and dust it off when a loss occurs. Rather, sound risk-management and loss mitigation protocol requires a thorough examination of the insurance program, an understanding of the scope and limitations of such coverage, and periodic assessments of whether the acquired insurance sufficiently meets the needs of the particular business (or whether there is a better coverage available in the market at a realistic price).

First-party policies in particular, including commercial property policies and builders risk policies (arguably the most pertinent to natural disasters), require thorough review. Unlike other types of insurance that include standard-form language, such as most general liability policies, commercial property and builders risk policies can vary dramatically between insurance companies. Some policies limit coverage to direct-physical loss to the covered property, while others, to varying degrees, may include coverage from other types of losses that result from physical loss, such as: 1) carrying costs, known as "soft costs" (extended insurance, extended security, additional loan interest, etc.), 2) business interruption losses (extra expenses and lost revenues), 3) law and ordinance expenses (higher costs due to building code changes since the time the property was originally constructed), and 4) protection from economic losses caused by damage to property other than the insured premises. The 2011 tsunami in Japan, spurning a nuclear power-plant crisis that caused a cut-off of needed supplies to U.S companies, is one example. Loss of a business's utilities caused by damage to a power station located miles away from the insured premises is another.

Higher Upfront Payments

David G. Jordan

Apart from the coverage scope differences mentioned above, there are several categories of restrictions that policyholders should be aware of, including specified peril deductibles, sub-limits, and, of course, exclusions. All insurance policies contain limitations upon the coverage afforded, and losses stemming from natural disasters are seldom, if ever, covered 100 percent. There can be significant differences between policies, however, as to the breadth of these restrictions. Some polices completely exclude certain natural disaster causes, while others do not; the wake of a devastating loss is not the time to learn that the insurance purchased affords little or no protection. The first restriction mentioned, specified peril deductibles, imposes higher up-front payment requirements upon the insured for losses involving riskier types of causes. Thus, for example, a policy containing a general deductible of $25,000 that is applicable to the majority of covered risks may also contain a specified peril deductible of $100,000 when a loss is caused by windstorm. Percentage deductibles, which are often based upon a certain percentage of the property (or project) value, can be particu-

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larly onerous because they can effectively result in no payable insurance if the value against which the percentage is calculated is substantial. (e.g. a $10 million project, insured under a policy with a named-storm deductible of 10 percent of the project value can render any loss under $1 million unrecoverable).

Another type of deductible, a waiting period deductible (associated with business interruption coverage), can also dramatically curtail the amount of insurance provided. To illustrate, if a business was shut down for four days due to a storm-caused power outage, a policy with a three-day waiting period deductible would limit business interruption coverage to only one day of economic losses.

The second type of restriction, sub-limits, can likewise place substantial limitations upon coverage. Sub-limits reduce the maximum recovery to an amount below the general policy limits for specific causes of loss. To illustrate, a policy may contain general limits of $10 million or more, but may otherwise cap limits for storm or earthquake caused damage at $500,000. Other categories of losses that can be subject to sub-limits include debris removal, loss of valuable papers and records, storage costs and preservation of property (a/k/a "sue and labor") costs. Insurance companies, being no stranger to natural disaster losses, typically place storm caused damage into these low-sublimit (and aforementioned high deductible) categories, if they are covered at all, given both the likelihood of the risk and the amount of damage often associated with severe weather; especially for policies issued in coastal and fault-line locations.

Circumventing Proximate Cause

Finally, there are exclusions. As mentioned, some first party policies outright preclude coverage for weather-caused damage, including flood and rain-caused losses. The exclusions pertaining to these losses may further contain "anti-concurrent" language, which can avoid coverage even when the excluded cause is not the predominant factor causing the loss.

One such anti-concurrent causation (ACC) clause states: "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." Another, more stringent provision, states: "We do not insure for such loss regardless of: (a) the cause of the excluded event; or (b) other cause of the loss; or (c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss; or (d) whether the event occurs suddenly or gradually, involves isolated or widespread damage, arises from natural or external forces, or occurs as a result of any combination of these . . ."

The effect of these exclusions is to circumvent the general rule of proximate cause applied in most legal jurisdictions, by eliminating coverage even when the excluded peril is a small contributor to the loss. Some states, including California, Washington and West Virginia, prohibit the application of ACC provisions, either on public-policy or statutory grounds. Most states, however, do not have such preclusions, leaving it to the courts to interpret their application and meaning.

Several courts confronted this exclusion following the Hurricane Katrina tragedy on the Gulf Coast. The findings have been divided, with several courts upholding their application and thus excluding losses involving excluded flood and/or rain damage, even when wind (a covered cause) may have been the most significant factor in driving the waters onto the damaged properties. For example, the U.S. Court of Appeals for the Fifth Circuit in *ARM Properties Management Group v. RSUI Indemnity Co.,* 400 F. App'x 938 (5th Cir. 2010) discussed the exclusion under Texas law, finding that its purpose to exclude any losses involving water was clear: "The plain language of the ACC Clause and Water Exclusion, read together, exclude from coverage any damage caused by a combination of wind and water. Thus, the combined wind-water damage at issue here is a peril expressly excluded from coverage."

In comparison, the Supreme Court of Mississippi adopted a restrictive view of the ACC clause in *Corban v. United Services Automobile Ass'n*, 20 So.3d 601, 609 (Miss.2009), finding that the excluded clause must occur simultaneously with the covered cause in order to apply, as a covered event cannot become uncovered by an excluded clause that occurs even just a few moments later: "No reasonable person can seriously dispute that if a loss occurs, caused by either a covered peril (wind) or an excluded peril (water), that particular loss is not changed by any subsequent cause or event. Nor can the loss be excluded after it has been suffered, as the right to be indemnified for a loss caused by a covered peril attaches at that point in time when the insured suffers deprivation of, physical damage to, or destruction of the property insured."

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These decisions suggest that ACC provisions present considerable challenges to coverage, but that some courts and jurisdictions are more favorable to insureds than others.

Conclusion

While no business is immune to the potential travesty of a natural disaster, and no policy of insurance will ever render an insured entirely whole after such an unfortunate experience, an assessment of the business' insurance program (and understanding the limitations) and some familiarity with how the courts of relevant jurisdiction have interpreted the pertinent provision, before a loss occurs, can put the business in the best position to prepare for a catastrophic loss, and continue on in spite of adversity should it experience such a loss. Thus, in matters of insurance policy procurement, knowledge and awareness can go a long way.