

K&LNGAlert

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Insurance Coverage Katrina-Related Financial Losses: Insurance Coverage Considerations

The devastating hurricane that swept through the Gulf Coast region has caused widespread loss of life, suffering and damage to livelihood, and sympathies are extended to all those affected. The disaster also has caused substantial economic damage to various businesses, especially those with operations in the area and those that depend on the continuing operations of other businesses impacted by Katrina. Some early estimates of insured property losses approximate \$26 billion, which, if accurate, would make Katrina one of the most devastating hurricanes, in financial terms, in United States history. The total economic impact may well be much greater. Whatever the final tally in dollars, business losses will take myriad forms and, in many cases, will present complex challenges for businesses attempting to identify, document and recover insured losses. Indeed, in many cases, early identification, characterization and presentation of loss information in light of potentially applicable insurance policy provisions and insurance coverage law can make a substantial difference in a policyholder's ultimate recovery. Some policies may have purported procedural or timing requirements that, if not followed, could lead to coverage denials or forfeitures. Moreover, insurers and insurance adjusters are not necessarily motivated to evaluate potential claims and losses in the most coverage-enhancing manner. Accordingly, this Alert is designed to assist policyholders by providing a general overview of certain insurance considerations that may be relevant to many businesses; obviously, businesses should seek specific counsel regarding their specific situations.

Losses relating to Katrina are likely to arise in a variety of contexts, including for example: 1) destruction of insured property; 2) business interruptions caused by destruction of insured property; 3) extra expenses incurred to resume normal operations; 4) business interruptions caused by damage incurred by important suppliers or other business partners; 5) lack of water, power supply or sewer services; 6) lack of access to property or facilities because of, among other things, inaccessible entrances to buildings, inaccessible roads, airways and ports; 7) circumstances arising from civil orders or directives by governmental authorities; and 8) a variety of other circumstances depending on the particular business involved. For some businesses, the financial impact is indeed quite significant and will be felt not only in the Gulf Coast region but well beyond.

As noted below, the insurance instruments available to cover these losses may take a variety of different forms. Some of the relevant insurance policy provisions are relatively obscure, as they are not frequently implicated. In virtually all cases, in presenting a claim, the policy provisions should be considered against the backdrop of potentially applicable insurance coverage law to ensure that the insured is taking the steps necessary to maximize coverage.

Although, as noted, individual circumstances are likely to vary, the following considerations represent a general overview of selected issues that may be relevant to such claims:

IDENTIFYING POSSIBLE COVERAGE

The most common source of responsive coverage for most businesses is likely to be the first-party coverage insuring the assets of the insured entity. Such policies may be in the form of broadly worded “all risk,” “difference in conditions” or “inland marine” first-party property policies. In many cases, this insurance is supplemented by specialty coverages applicable to specific situations. While there are standard insurance industry forms for the coverage, some insurers have issued tailored policies to meet an insured’s particular risk scenarios. Evaluation of specific policy language in light of state law is critical. As a general matter, first-party coverage often includes the following specific elements:

- “property damage” coverage with respect to any property that may be classified as “insured property,” which often is broadly defined by the policy or applicable law;
- “business interruption” coverage, which generally covers the insured’s loss of earnings or revenue resulting from property damage caused by an insured peril;
- “contingent business interruption” coverage, which generally covers the insured with respect to losses, including lost earnings or revenue, as a result of damage to property of a supplier or some other business partner or entity;
- “extra expense” coverage, which generally covers the insured for certain extra expenses incurred by the insured as a result of an insured event and in order to resume normal operations and mitigate other losses;
- “civil authority” coverage, which generally covers the insured for losses arising from an order of a governmental authority that interferes with normal business operations;
- “defense” coverage, which generally covers the insured for defense costs incurred with respect to claims alleging that the insured is responsible for damage to covered property of others;
- “ingress and egress” coverage, which generally covers the insured when access to a business premises or location is blocked for a time;

- “service interruption” coverage, which generally covers the insured for losses related to electric or other power supply interruptions;
- “claim preparation” coverage, which generally covers the insured for the costs associated with compiling and certifying a claim.

As noted, in addition to these coverage features often set forth in general first-party property policies, many businesses may well have specialty policies potentially responsive to particular situations as well. Moreover, an insured must consider whether excess insurers should be involved. Thus, it is important for an insured to ensure that all potentially responsive insurance policies and policy provisions are considered and evaluated as a potential source of recovery.

PRESENTING A CLAIM

Most policies purport to identify specific procedures that should be followed in presenting a claim (notice, proof of loss, suit limitation, etc.), and some of these procedures may have timing deadlines associated with them. Moreover, the manner in which a claim is presented can sometimes have an impact on the ultimate recovery. For example, policies may have different deductibles depending on the particular peril causing the loss (whether wind, flood, or some other direct circumstance), and the policyholder’s presentation of the claim could impact the deductible applied. Deductibles (and limits) may also be expressed “per occurrence” or “per loss” or in other ways, and, again, presentation of the claim could affect the number of deductibles applied or the amount of the limits available. Policies may also have specific exclusions applicable to certain perils or circumstances that the insured should take into account in presenting its claim. In all cases, an insured should promptly collect and document its loss information, evaluate the information in light of the policy wording and, applicable law, and present it to the appropriate insurer or insurers in a timely and coverage-promoting manner. It is sometimes advisable or necessary to retain forensic accountants to assist in preparing and certifying a claim, and the costs associated with such an effort often are covered. If purported deadlines have passed, the insured’s pursuit of an insurance claim is not necessarily foreclosed. It may be that the insurer must show that it was

prejudiced by an insured's failure to meet a timing deadline before coverage will be forfeited on this basis.

COMMON INSURER RESPONSES

Insurers may raise any number of issues in response to a business interruption claim submitted by a policyholder. Issues raised by insurers may include the following:

- Did the alleged loss of income or extra expense arise out of damage to "insured property"? It is not always necessary that the relevant "property damage" occurred to property owned by the insured. "Insured property" is sometimes broadly defined by policy language or law to include other property in which the insured may be said to have an "insurable interest." Many policies explicitly or implicitly also promise coverage when a supplier or, depending on the policy language, some other entity incurs property damage that results in an interruption of the insured's business. Such coverage is sometimes known as "contingent business interruption" coverage and is often very broad. Similarly, there may be arguments for coverage where anticipated business was foreclosed in light of circumstances created by civil orders or inaccessible ports, roads and closed airports.
- Was the damage to insured property caused by an "insured peril"? Many first-party property policies are written on an "all risk" basis, meaning that virtually any cause of property damage is within the scope of the policy except those causes that are specifically and unambiguously enumerated in exclusions. Accordingly, although some policies may expressly exclude or limit coverage for damage caused by "flood" or "windstorm," this fact is not necessarily determinative when damage or loss may be the result of multiple causes. As noted, policies also sometimes contain particular provisions promising coverage for losses resulting from particular specified events such as orders of a "civil authority" or lack of ingress or egress. A policyholder's particular loss circumstances and policy language should be evaluated in considering whether coverage may be available even if an exclusion may appear to apply to certain aspects of the loss.
- Did an "interruption" of business result? While insurers sometimes take a narrow view of what may constitute an "interruption," generally an insured may have a claim, depending on the circumstances, any time its income is adversely affected by an insured event.
- Was the interruption necessary? In many cases, this is not a controversial issue. In some cases, the insurer could question whether the claimed interruption is the result of a routine business decision as opposed to a "necessary" interruption under the circumstances.
- Does the loss meet any requirements the policy may have regarding duration of the interruption? Some policies have language limiting coverage to interruptions that extend for longer than a specified period of time.
- How long is the allowed "recovery period"? Policies sometimes include provisions specifying that the policy will only cover loss of income and related expenses for a specified period of time after an insured event occurs. This time frame frequently is tied to the time it would take the insured, employing reasonable mitigation efforts, to resume normal business operations under the circumstances.
- How many "occurrences" are implicated by the alleged loss? As noted, many policies have "per occurrence" deductibles or other self-insurance features that may reduce the amount of coverage available depending on how the "number of occurrences" issue is addressed. This issue can also impact the amount of per-occurrence policy limits that may be available to the insured.
- In the case of a claim resulting from loss of income or extra expenses associated with loss of electrical power or other service, did the interruption result from damage by an insured peril to property of the provider of the service? Some policies purport to exclude business interruption coverage arising from interruptions in electrical service (assuming the interruption is the controlling "cause" of the loss). Other policies have language explicitly promising time element coverage for losses arising out of service interruptions (including service interruptions to suppliers of the insured) but purport to require that the interruption resulted

from damage to property of the service provider. In such a case, the circumstances and cause of the interruption, including whether the circumstances and cause can be characterized as resulting from damage to property of the service provider, may be critical to the availability of coverage. Policy language in this context varies considerably, however, and an insured must review carefully its own policy to assess the availability of time element coverage arising out of service interruption.

law will apply to a coverage dispute (in the absence of a specific choice-of-law provision, possibilities include, among other locations, the headquarters location of the insured or the insurer, the place where the insurance contract was issued or delivered, or the location of the damaged property or losses). Moreover, the applicability of these potential defenses will also depend a great deal on the specific language used in the policy. Experienced insurance coverage counsel may be able to assist an insured in assessing the viability and strength of its potential claim and in maximizing the insured's potential insurance recovery.

EVALUATING AND CHALLENGING INSURER POSITIONS

The validity of any defenses or limitations to coverage raised by insurers may well vary from state to state as the courts of each state have developed differing approaches to coverage issues presented by business interruption claims. It is not always clear which state's

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