Insurance Coverage for Losses Due to Hurricane Katrina: Practical Advice for Policyholders

Hurricane Katrina appears to be the most costly natural catastrophe in U.S. history. Estimates of insured losses prepared by the leading disaster modeling agencies in the first 48 hours after the hurricane hit the Mississippi Delta range from $9 billion to $26 billion, and losses from subsequently breached levees will add more damages. The previous record for insured losses is held by Hurricane Andrew, for which insured losses totaled $21 billion (in inflation adjusted dollars).

This disaster will have an enormous impact on insurers, who face far greater exposure from this loss than they have from any other natural disaster in history. Unlike Hurricane Andrew and the series of hurricanes that hit the Florida Panhandle in 2004, which primarily affected residential property, Hurricane Katrina has caused an unprecedented amount of damage to industrial (largely oil and chemical-related) and commercial property. That means impacted businesses will face longer and therefore more costly business interruption losses, complex contingent liability losses, and untold amounts of extra expenses incurred in an attempt to restore business operations. Insurers may also be further exposed due to the absence of state reinsurance programs, such as Florida's program that reportedly paid insurers $3 billion following last year's hurricane losses.

What this adds up to is heavy losses for insurers, and in such circumstances it can be expected that the insurers will seek every available avenue to limit their losses, including denial of potentially covered claims.

I. Coverage Issues Arising from Katrina

Damage caused by Hurricane Katrina raises a number of critical insurance coverage issues that should be addressed and evaluated for each claim. These include:

- Flood Damage vs. Wind Damage – Most “all risk” business insurance policies cover damage caused by wind and wind driven rain. Those same policies typically exclude damage caused by flood. Insurers may argue that properties damaged by wind, but later flooded, are not covered or are only partially covered.

- Business Interruption Losses – Coverage for lost income resulting from Hurricane Katrina will be afforded under most property policies. But business income losses, perhaps more than any other type of insured loss, take time to mature and require extensive documentation, leading inevitably to insurer delay and “negotiation.”

- Overlapping Coverage Grants – Business property policies contain numerous overlapping coverage grants often containing separate sublimits. The lines of coverage may include business interruption, contingent business interruption, extended business income, extra expense, civil authority, utility...
services, debris removal, expediting expenses, and preservation of property. Understanding these different coverages is essential. In the past, some insurers have categorized losses in a manner to minimize such coverage.

- Civil Authority – Most policies cover losses resulting from an evacuation order. Some of these policies provide set time limitations on how long such coverage is afforded. Insurers will likely argue that once a civil authority time limit is met covered damages cease, despite the fact that other overlapping coverage grants continue to provide coverage.

- Appraisal – Insurer delay is common with complex property loss claims. Many policies have provisions that allow the policyholder to force an appraisal to cut through disagreements on value related to both property damage and business interruption. Enforcing such obligations, however, may not be easy, given the overwhelming losses this catastrophe presents.

- Recovery of Attorneys’ Fees and Adjustment Costs – Some policies cover legal and accounting fees associated with presenting a loss to the insurance carrier, and even if such coverage is not afforded, many state laws mandate that recalcitrant insurers pay for a policyholder’s legal fees incurred to enforce coverage. Insurers often ignore such rights.

- Specific Legal Rights Under State Law - Louisiana, Mississippi and Alabama all impose penalties upon insurance companies for unfair or deceptive trade practices, triggered by an insurer’s improper handling of a claim. Claims handling requirements are a matter of state law. Louisiana, for example, requires that all insurers must make a written offer to settle a property damage claim within 30 days after receipt of a “satisfactory proof of loss” for that claim. LA. REV. STAT. ANN. § 22:658 (West 2005). The insurer’s failure to make the written offer to settle, if found to be arbitrary, capricious or without probable cause, entitles the insured to statutory penalties of up to twenty-five percent damages on the amount due. Id. A “satisfactory proof of loss” has been defined under Louisiana law as occurring when the insurer has adequate knowledge of the loss. Matter of Hannover Corp. of America, 67 F.3d 70, 73 (5th Cir. 1995).

2. Potential Avenues for Obtaining Coverage for Losses Due to Katrina

Many losses relating to Hurricane Katrina, by their nature, will raise complex issues involving the inter-relationship of property policy coverages and “legal causation.” Affected businesses are generally entitled to coverage when part of the loss was caused by a covered peril (wind damage), even if the loss was exacerbated by a non-covered peril (flooding). Hence, a business may be fully covered for all of its business interruption losses, despite widespread flooding. Also, additional coverages, such as contingent business interruption, dependent property coverage, and utility services coverage may broaden the scope of recovery for lost income if the loss of income results even in part from a covered peril. For example, contingent business interruption coverage pays for losses resulting from property loss at the location of a key vendor or supplier even in the absence of physical damage at the policyholder’s premises. Similarly, evacuation orders may trigger civil authority coverage, but any time or money limitations on that coverage should not interfere with coverage afforded under parallel lines of coverage provided for in the policies.
3. The Proof of Loss – Only a First Step but it is a Critical One

Most property policies put the initial burden of characterizing a claim on the policyholder. This is done through submission of a document known as a proof of loss. In its most basic form, the document must outline total damages that the policyholder believes are covered under the policy, and must be signed under oath. Insurers typically also require the attachment of relevant documentation evidencing the claim. Of course businesses cannot quantify the totality of a loss within the short periods of time typically required in the policy for submission (e.g., 30 days from loss). For this reason, it is often necessary to submit a series of “preliminary” or “partial” proofs of loss accumulating more damage information as the claim develops. In the end, a proof of loss can and will be used against the policyholder, so careful attention must be paid to every word prior to signing.

Recommendations

The property claims arising from Hurricane Katrina will present a minefield of insurance coverage issues. To minimize disputes with insurers and to maximize coverage, policyholders should consider the following steps:

Step 1: Preserve evidence of the damage immediately. Take videotapes (with sound), as well as photographs, of all property damage – ideally while damage is occurring, but certainly during initial cleanup efforts. Assign an internal account number to the loss and require use of that number so that all costs can be captured.

Step 2: Review all insurance policies for potential coverage with counsel before submitting any claim. The obvious coverages are property damage and business interruption, but scouring flood, automobile, comprehensive general liability, and other policies may turn up some potentially overlooked coverages.

Step 3: Notify the insurer and the broker of any property damage and business interruption immediately. (Often times the call can be to the broker, who will involve the insurer. Make sure that the broker does this immediately and obtain proof of such notice.) Schedule an initial conference with the insurer, ideally including the key members of the recovery team (risk manager, facility manager, financial officer, on-site response manager, counsel, accountants and other outside consultants).

Step 4: Demand written extension for any deadlines that might be missed. Policies may require that proofs of loss be submitted within 30 days of the start of damage, and that lawsuits must be filed within one year. Extensions are readily granted, especially for major losses. However, failure to comply with such deadlines, or to secure adequate extensions, can be fatal.

Step 5: Negotiate a funding arrangement with insurers to advance cash for business interruption losses or other partial payment of losses. Policies vary on this obligation, but insurers will generally agree to such an arrangement if reasonable under the circumstances. Do not negotiate any final settlement of claims before the loss is fully developed, however.
Step 6: Retain an accounting firm to work with your counsel and recovery team if the claim will be large or complex. Depending on the terms of the insurance policy, these costs may be recoverable. Consider all costs and benefits before retaining a public adjuster for large, complex claims.

Step 7: Thoroughly evaluate the insurance policy and potential coverage issues, including applicable deductibles and sublimits, early in the process, as an insurance company’s categorization and payment of certain types of expenses could compromise coverage. Again, retention of counsel possessing an intimate knowledge of how property policies work and the law governing the key issues is vital to protecting a policyholder’s rights.

Step 8: Gather all documentation in support of the business interruption claim and present that information in as coherent a fashion as possible to ease the burden on the insurer. Allocate costs to appropriate coverages, mindful of deductibles and sublimits. A well-presented claim, with complete backup documentation, will be paid faster than a disorganized or piecemeal claim.

Step 9: Identify the extra expenses that also may be recoverable. These could include the costs of continuing production at the current site, moving to a temporary location, using other company facilities, contracting out work, and paying overtime and bonuses. Understand the EE sublimit to establish a budget for recovery efforts.

Finally, here are a few practice suggestions:

1. Obtain approval from insurers before replacing damaged property. Insurance carriers may also have a right to physically take and sell damaged property. It is not uncommon for an insurance carrier to deny payment on otherwise useless property that was subsequently destroyed or discarded, if such action was taken without their knowledge or consent.

2. In securing interim funding for business interruption losses, present to the insurer as much documentation as possible demonstrating what must be done to get back into business, either at the current location or at a temporary location. Also, determine what products are most important to get back into production.

3. Communicate with the insurer as much as possible, but keep a log to document those communications. Continue to provide all necessary and relevant documentation to the insurer. Keep written documentation of when the claim was submitted, when adjusters viewed the damaged property, what they saw, what they asked for, and what was provided. It is common practice for insurance carriers to repeatedly ask for information that has already been provided, especially if there is no written evidence that there has been compliance with information requests.
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