

SPECIAL REPORT

25 CRITICAL CONSIDERATIONS IN BUSINESS PROPERTY INSURANCE PROGRAMS

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Over the past 41 years as insurance coverage attorneys, expert witnesses in property insurance claims, and insurance agents, we have been involved in over \$100,000,000 of major property claims. As a result, we have learned many lessons, and the purpose of this publication is to relate those lessons to you in hopes that in the event you do suffer a property insurance loss, the claims process will go smoothly.

Lesson 1: Bad Faith Causes Of Action Against Insurance Companies Are Generally Not Recognized In Michigan, But You Should Be Aware Of Your Remedies In The Event Of Nonpayment Of A Valid Claim.

Bad faith causes of action against an insurance company for failure to pay a claim have not been recognized by Michigan appellate courts to date. As a result, do not expect to be able to “punish” an insurance company for its failure to pay a claim by prevailing in a bad faith lawsuit.

Many property insurance policies contain limitations on the time in which you can sue an insurer for nonpayment of a claim, and these limitations have by-and-large been recognized by Michigan courts. Therefore, you should not delay seeking legal advice in the event of nonpayment of a claim. If an insurer does not pay a property insurance claim within 60 days of receipt of the proof of loss, you may be entitled to 12% interest on the claim pursuant to Michigan statute. It is surprising how many adjusters are unaware of these laws.

You should know that in the event of a breach of the policy contract, an insurer could be liable for the payment of damages flowing directly from the breach. For example, where an insurer refused to pay a claim on damage to a business use van, the policyholder was permitted to sue the insurer for lost profits after it failed to pay the claim.

Lesson 2: Just Because Your Agent Says It Is Covered Does Not Make It So.

In Michigan, the insurance agent represents the insured and not the insurance company and, therefore, statements of coverage made by the insurance agent do not necessarily bind the insurance company. Therefore, it is imperative that you rely on the policy language or endorsements issued by the insurance company. The insurance policy is nothing more than a contract that spells out the rules of the game. It is important to become familiar with those rules and to be certain that the contract itself is reflective of the understanding between the parties.

Of course, if your agent does make a misstatement regarding coverage, that agent could have liability to you and is hopefully covered under an Errors & Omissions insurance policy; however, obtaining payment under an agent's Errors & Omissions policy is usually a time consuming and expensive process. It is far better to be certain that the insurance policy itself is correctly negotiated.

Lesson 3: All Insurance Policies Are Not Alike.

If you count the words in property insurance policies from different insurance companies covering the exact same risk, you will find that there is a wide variance in the number of words used. These insurance policies are all different. Furthermore, they are all negotiable. Do not assume that purchasing a policy with the lowest price (or the highest price) necessarily makes a difference in coverage.

The negotiation, however, has to take place before the policy is placed. In order to accomplish this you must be certain that you have, as your negotiator, an insurance agent that is an expert in the negotiating process. This means that the agent must know how to negotiate with the insurance company underwriter and must know what items can be negotiated. This

varies with insurance companies; however, there is no substitute for a thorough knowledge of the policy provisions by your agent.

Insureds typically have agents worrying about the wrong thing and that is the premium level. The lowest premium level may not be the best in your particular situation. The agent should be obviously negotiating a competitive premium but also should be bullet-proofing your coverages so that the insurance company has less opportunity to avoid paying your entire loss.

Lesson 4: Coinsurance Will Ruin You.

If your insurance policy has any type of coinsurance clause, it could lead to disaster. Coinsurance, simply put, is a promise you make that you have insured adequately. For example, if a policy has a 100% coinsurance clause, you have made a promise that the value on the policy (let's say \$1,000,000 in building coverage) is equal to 100% of the replacement cost of the building.

The problem lies in the definition of replacement cost. What you may think is the replacement cost under non-emergency conditions using a non-union contractor can be totally different from an appraisal done by the insurance company that would indicate that the replacement cost of what you believe is \$1,000,000 is actually \$2,000,000 under emergency conditions using a union contractor. Clients usually underestimate the replacement cost of building and personal property items confusing replacement cost with market value. If a coinsurance clause exists, you will be penalized if you are wrong in your values. If the building is insured for \$1,000,000 and it should have been insured for \$2,000,000 and you have a \$100,000 roof damage claim, you will only receive \$50,000.

Insurance carriers do impose coinsurance penalties and courts recognize them. These penalties are not necessary and can be waived in many cases when you purchase the insurance policy. Of course, you may have to establish that you have insured to value, or you may have to insure in accordance with what the insurance company feels the value is. Also, look for hidden coinsurance clauses. Some companies will waive the coinsurance for building and personal property but not waive it for computer equipment or for mobile equipment. Similarly, a builder's risk policy may have a coinsurance clause that is termed a "100% completed value

clause.” This does the same thing and, again, should be waived. There are also “hidden” coinsurance clauses in some small business owner’s policies where certain replacement cost representations are made.

Lesson 5: If The Insurer Requests an Examination Under Oath, Obtain Legal Counsel.

Insurers reserve the right in property insurance policies to take examinations under oath. If one is requested of you or someone else in your business, obtain legal counsel to represent you. These examinations under oath are equivalent to depositions and can be used against you in subsequent litigation, if that arises. These examinations also serve as the basis from which many insurers will attempt to deny coverage.

Lesson 6: Don’t Assume That You Can Rebuild In Six Months.

Rebuilding a building is a time-consuming process. First, you have to negotiate with the insurance company to obtain the money necessary to rebuild. This process can be daunting. The insurance company will not agree to a settlement until their expert has reviewed the damages and computed the replacement cost. This is not done overnight on major building losses. In addition, you will have to obtain municipal permits to rebuild. This is not as easy as it sounds. Your building may not be up to code and, in fact, you may have to obtain a variance from the municipal authorities in order to rebuild. Any type of municipal delays because of this can cost you at least 120 days.

Next, you must negotiate with your own contractors to rebuild. Just because the insurance company obtains a replacement cost estimate from a contractor does not necessarily mean you have to use that contractor. As a matter of fact, in many cases you can settle with the insurance company based upon their contractor’s estimate and utilize your own contractor to do the rebuilding.

Ultimately, you are the one entering into the contract – not the insurance company. If the builder does a bad job or does not perform on time, it is your problem, not the insurance company’s problem. The insurance company is not obligated to repair or rebuild your building – you are. The insurance company will, hopefully, provide you with enough money to do so.

In any event, the minimum time you should be thinking about relative to the reconstruction period should be 12 months. To accomplish this you would have to move quickly and hope that your contractor can obtain the subcontractors necessary to rebuild.

Lesson 7: You Probably Cannot Restore Your Business In Six Months.

In discussing the limits that are necessary for business interruption, some insureds and agents will think in terms of being back in business in six months. Obviously, if you cannot rebuild the building in six months, you cannot be back in business in six months unless you have secured a replacement building elsewhere. Furthermore, just because you have rebuilt a building in 12 months does not necessarily mean that your customers will be waiting for you in 12 months. They most likely will have gone elsewhere, and it could take another 12 months to regain your customer base. This leads to problems from an insurance claims handling standpoint.

An insurance policy typically will provide for coverage for business interruption during the period of time it would take with due diligence to replace the building plus 30 days. (Some policies place a cap on this of 12 months. Do not accept this 12 month limitation unless you are a tenant that has the ability to move elsewhere quickly.) If the insurance company has an expert that indicated that the building can be rebuilt in 12 months your business interruption recovery will be limited to that period of time plus another 30 days. That 30-day period can and should be increased to 60, 90, 120, or even further. This allows you to recover your customer base and restore your income to the levels that existed prior to the loss. However, just because you negotiate with the insurance company an extension of the period of recovery does not necessarily mean that your limit of business interruption insurance will be adequate. Typically you will have negotiated a limit covering loss of business for one year and not for two years. Think in terms of at least a two-year recovery period under your loss of income coverage and be certain that your insurance policy is endorsed accordingly.

Lesson 8: Your Customers Will Enforce The Terms Of Contractual Penalties.

In the event you have a major fire or other casualty loss that disrupts your business, chances are you may disrupt someone else's business. For example, if you are a supplier to the automobile industry, you may shut down an assembly line. This can lead to massive penalties. As a matter of fact, a 24-hour shut down can result in penalties of \$720,000 from one major auto maker.

The typical insurance policy does not provide coverage for contractual penalties. You can anticipate that your customers will enforce their rights to sue you for their losses because of your disruption. Be certain that your insurance policy does cover contractual penalties with sufficient limits. See our separate report on contractual penalty legal issues and coverages.

Lesson 9: Document All Conversations.

When a major loss occurs you will be contacted by an insurance company adjuster early in the process. Document, in writing, all conversations you have with that adjuster. The adjustment process breaks down when the checks for payment must be written. This may not take place until six months after the loss occurs. The conversations you had with the adjuster after the loss will no longer be remembered by you (in most cases) but certainly will be remembered by the adjuster. The adjusters are documenting all conversations and you need to do the same. The loss negotiating process is a difficult one and needs to be handled in a diligent, logical, businesslike manner, just as if you were preparing for a lawsuit, because you may be.

Lesson 10: Many Losses Can Be Avoided.

All the problems you will suffer in negotiating a loss settlement with your insurance company can be avoided if you would avoid the loss to begin with. It is surprising how many clients do not have smoke detectors or alarm systems. These are simple and relatively inexpensive devices which, if connected to a central station, can provide a deterrent and also provide warning which may minimize the loss or avoid the loss. You do not want to suffer the time loss necessary to reach a successful settlement with your

insurance company if it can be avoided, and it can be avoided in many cases by simple loss prevention techniques.

Do not wait for your insurance company underwriter to require that you have a smoke detection system or burglar alarm system connected to a central station. Do it, because it may save your business. Even if you do reach a successful recovery with your insurance company, the business you have taken many years to build up may no longer have the vitality that it once had.

Lesson 11: Always Blanket Limits.

If you have two locations and let's say that each location has a building value of \$1,000,000, you may have a choice of writing these two locations separately with a limit of \$1,000,000 each or writing them together with a blanket limit of \$2,000,000 which would apply to each location. There is no significant difference in premium cost in doing so; however, if you have your agent worrying about the wrong thing, the agent will be searching for the cheapest insurance policy available and the cheapest policies, known as business owner policies, will typically not permit blanketing. Blanketing could save the day in the event that you inadvertently have underestimated the value of your building because a \$1,000,000 building that is insured for \$1,000,000 may cost \$1,500,000 to replace. Under the blanketing concept you would have \$2,000,000 in coverage.

Lesson 12: It Is Your Burden To Prove The Loss In Any Claim.

You must prove what you had in the building by way of personal property and what the replacement is of those items. If you have scheduled assets as part of your balance sheet and fail to have off-premises backup of those records, you may not be able to prove your loss. Always have off-premises backup and always be able to prove your loss. This requires discipline in maintaining not only asset records but in preserving those records in the event of a loss.

Lesson 13: New Municipal Ordinances Will Be A Problem.

We had a loss involving a 13,000 square foot building that was eight years old and that was insured for \$1,000,000. It turns out that the replacement cost of the building was approximately \$1,000,000; however, the

municipality involved required improvements in the building totaling \$156,464. These were items that were not part of the original building. The insurance company typically owes you the replacement cost of the building as it existed just before the fire. They do not owe you any improvements required by city ordinances. You must purchase ordinance or law coverage with a sufficient limit in order to accomplish this.

In this particular instance, the city required a full fire sprinkler system, wider interior doors, a larger parking lot, better building foundations, new curbing and new landscaping. Two story buildings most likely would also require elevators. Always negotiate a sufficient limit for ordinance or law and do not underestimate your need for this coverage. Remember -- most insurance carriers do not automatically provide it.

You also should note that under Michigan statute, an insurer is entitled to withhold 25% of an insurance settlement for a serious loss where required by a city, village or township.

Lesson 14: Ask About The Reputation Of The Insurance Company For Claims Paying.

Some insurance companies treat policyholders and claimants as heathens, scoundrels, and criminals. These insurance companies will deny coverage for claims knowing that most policyholders will not fight. Other insurance companies, on the other hand, will find a way to pay under their insurance policy if a claim is in a gray area and will expedite payments as quickly as possible. Most insurance brokers know the insurance companies that treat their insureds as heathens, scoundrels, and criminals and know the other companies that will deal with claims more favorably. The trick is getting the insured's broker to tell you about an insurance company's reputation.

If you have your agent worry about the wrong thing, such as price, that agent, in order to save your account, may place you with one of the insurance companies that have a bad reputation in this area. Discuss this openly with your agent and be certain to worry about the right thing, and that is the ability and reputation of your insurance company to keep you in business in the event that you suffer a disaster.

Lesson 15: Spend The Time On Your Insurance Program Before The Loss.

Do not buy insurance the way you buy janitorial supplies. Buying insurance the right way takes time, understanding the policy provisions takes time, making your policy bullet-proof takes time, selecting the proper agent takes time. Spend quality time on your insurance program and do it every year.

Lesson 16: Use An Expert.

In the event you suffer a major loss, the insurance company will be represented by an expert, an adjuster, who is an expert in policy coverages and in negotiating losses. Do not expect that you will ever have the knowledge that your insurance company has. You need to be represented in the initial stages of a claim by an insurance attorney, an insurance agent that is an expert or by a public adjuster.

When these losses occur, public adjusters attempting to represent you for a percentage of the loss settlement may contact you. Do not make a decision immediately regarding a public adjuster but within a few days select either an attorney, an agent that is an expert, or a public adjuster and negotiate the appropriate fees. Usually, if your insurance agent is an expert, they should be able to represent you at no cost or at least at a cost that is less than that charged by public adjusters or by attorneys; however, that is not to say that attorneys or public adjusters should be ruled out. The key is to be represented and to not try to do it by yourself.

When you consider the selection of an expert to assist you in the process of loss adjustment, you may need more than one expert. For example, if you select an expert insurance agent or an attorney you will also need to select an expert CPA in the event of a business interruption loss. The insurance companies utilize forensic CPA's that do nothing but determine the amount of business interruption losses. These are experts representing the insurance company. You will need an expert CPA on your side. A business CPA is not necessarily qualified to negotiate business interruption claims. These are expert CPA's that specialize in business interruption claims.

Lesson 17: Do Not Reward Poor Performance.

The typical insured will do business with an insurance agent or company for a long period of time. This is because it is difficult to change relationships and can entail some work because of the fact that new insurance companies will want inspections, and going from a known relationship to an unknown relationship can be difficult.

If you have your insurance program analyzed by an attorney or other expert and you determine that there are serious deficiencies (deficiencies that can destroy the assets of your company in the event of an uncovered loss) do not reward bad performance by allowing your current agent to correct mistakes that were discovered by your expert. This rewards bad performance and leaves you in a situation where, after the initial corrections are made, you may be in the same jeopardy again in the future as your business changes and the insurance program does not keep pace with those changes or with market conditions.

So often insureds will accept proposals from other agents or reviews from insurance experts and the recommendations that are made by those individuals are turned over to the existing agent to incorporate into the current insurance program. Unless the expert is a fee-based expert, it is unlikely that the expert will be reviewing your insurance again only to be not rewarded with the business.

If someone is trying to sell you insurance this is not necessarily in your best interest. Find out whether your insurance agent is an expert and, if that person is an expert, whether they will continue to service your account after you placed the responsibility for your assets in their hands. With many insurance firms, the initial account executive that may have the expertise to put together your account properly and to make it bulletproof from insurance company issues, is not necessarily the person that will continue to service your account. Usually those agencies will place the service responsibility with people who are not as experienced. This is not the scenario that you want. In other situations, the so-called insurance representative is a sales person that works directly for the insurance company. These are known as direct writers. This is about the worse scenario because they have absolutely no clout with the insurance adjuster given that they are employees of that insurance company and you likely will be on your own in the event of a major loss.

Lesson 18: Have A Disaster Plan.

Fires and tornadoes happen to the nicest people in the nicest buildings in the nicest areas all the time. You need to give some thought before the disaster hits as to what you would do in order to stay in business.

Lesson 19: Always Insure Replacement Cost.

There is a big difference between actual cash value and replacement cost coverage under an insurance policy. Actual cash value is not defined in the insurance policy; however, traditionally it is a loss adjustment based upon the replacement cost of the building less physical depreciation. As an example, if you have a substantial roof damage claim and the roof is let's say 30 years old, it probably has no value and the insurance company under the actual cash value concept would not owe you any money.

If you have replacement cost coverage, however, they will owe you the cost of a new roof. The insurance policy must indicate that replacement cost coverage is provided or the policy will be settled on an actual cash value basis. Remember, however, that your values should also represent replacement values. Replacement values do not, in the case of machinery and equipment, necessarily mean that you will obtain cost new but the insurance company will replace with some equivalent property that is available.

A related issue with replacement cost is a policy requirement that you make a replacement cost claim within 180 days even if you have replacement cost coverage. Let's say that you have a building that is insured for \$1,000,000 and the agreed replacement cost of that building after the loss is \$1,000,000 and that the agreed actual cash value amount is \$500,000.

After the loss is negotiated, the insurance company will pay you \$500,000 and after you have spent the money to replace the building, the insurance company will pay you an additional \$500,000. In other words, you have to replace to obtain replacement cost; however, in order to obtain replacement cost coverage, you must actually make a claim for this within six months of the loss date. Many insureds forget to do this and the insurance company could deny the replacement cost difference at a later date. Make your replacement cost claim from Day 1 so that this item is not forgotten.

Lesson 20: When Developing Building Insurance Values, Always Add The Estimated Cost Of Debris Removal.

In a major building loss, debris removal can be a substantial expense in the several hundred thousand dollar range. If you have a building that has a \$1,000,000 replacement cost you will want to be certain that you factor in the debris removal expense and insure up to \$1,250,000. Debris removal is not in addition to the policy limit but is included within the limit and must be factored into your values.

Lesson 21: Be Aware Of Your Rights To Appraisal Under The Insurance Policy.

In the event you have a fire insurance loss and cannot agree on a settlement value (either for building, personal property, or business interruption) you have the right to engage in the appraisal process with the insurance company, which means that you will have an expert, the insurance company will have an expert, they both will select a third expert, and they will arbitrate the loss. The result is binding on you and on the insurance company. This is required before you can sue your insurance company for breach of contract. For this reason, you need to start off the loss adjustment process by building a legal file and assembling experts that can represent you in the appraisal process.

Lesson 22: Report The Loss Immediately And Take Action To Protect Your Property.

This is required by the insurance policies. You must make temporary repairs and to prevent further loss. There are major fire insurance company repair contracts that will respond immediately to assist you. Have the home number of your insurance agent and let your agent select a fire insurance company contractor that they do business with that can respond immediately to assist you. Be certain that the agent reports the loss immediately to the insurance company and attempt to meet with the adjuster that day to embark upon an initial strategy with that adjuster to expedite the resumption of your operations and the repair process.

Lesson 23: Your Expenses In Settling The Loss May Not Be Covered.

The expenses that you incur in documenting, negotiating and submitting your claim is usually not covered by your insurance policy unless the insurance company has requested that you perform certain inventories and appraisals, and even then, all policies do not cover that cost.

Lesson 24: You Can Rebuild Elsewhere.

You do not have to replace your building on the site of the original building unless the building is seriously damaged and the municipality requires the insurer to withhold 25% payment unless you do rebuild. You can replace in another location; however, you must replace in order to obtain replacement cost and the insurance company will not pay more than what it would cost to replace the building on the original site.

Lesson 25: Major Fires Can Cause Major Environmental Damage.

Your policy may not provide coverage for asbestos cleanup and may limit coverage to \$10,000 for cleanup for environmental damage as a result of a fire to the land that you occupy. Because of the water necessary to extinguish a fire and the pollutants that may be inside a building or that may be developed because of the fire itself, your possibility of environmental damage is substantial.

Many insurance carriers offer higher limits.

You should also consider securing a pollution legal liability policy that covers on-site cleanup triggered by the insured to cover this exposure. In addition, the environmental damage that affects your site may affect adjacent sites, leaving you open to litigation from neighboring landowners for damage to their property or even injury to their employees. This may not be covered by standard liability policies.

Pollution liability policies covering on-site cleanup and liability for bodily injury or property damage to other people or property are available at low cost. Contact us for a copy of our special report on pollution legal liability.

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