SPECIAL REPORT

INSURANCE ROULETTE -- DON'T COUNT ON THE CAVALRY

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When you as a business owner or homeowner have a catastrophic event, **the expectation is that the insurance company will be like the cavalry and save the day**.

Actually, in order to achieve a satisfactory result in the event of a claim, the business owner or homeowner must have an insurance company that has:

- An **obligation** to pay (the terms and conditions of the insurance policy).
- The **ability** to pay (must be solvent).
- A **willingness** to pay promptly (without litigation).

This means that as a result of a catastrophe, such as a fire, people expect that the insurance carrier will be paying for:

- the rebuilding of their commercial building or their private home (wages of skilled workers; materials; equipment)
- any upgrades required by building codes [physical accessibility for disabled people (ramps, elevators, restrooms); plumbing or wiring; retaining walls; raising the building above flood level; fire-retardant roofing; insulation; higher-quality wallboard or flooring; asbestos removal; mold or pollutant remediation; safety code regulation (smoke detectors, carbon monoxide monitor, fire or intrusion alarms,

or fire sprinkler systems); ventilation; seismic systems; room height; space constraints; floor joists; boilers; leaks; real estate classification update (multi-family residential, commercial, industrial); inspections and more]

- all <u>losses of profits (due to physical loss of building or personal property, machinery and equipment, interruption of business)</u>

- all <u>continuing expenses</u> (normal expenses including salary, utilities, taxes), and

- all <u>extra expenses</u> (expenses that would not have been incurred otherwise; i.e., money spent to avoid or minimize a shutdown; demolition and cleanup; increase in cost to continue working reasonably to maintain the business to its normal level; rent and taxes for a temporary location.)

The homeowner or business owner believes that the insurance company <u>will quickly advance money</u> so that the repairs to their home or business will proceed without delay.

They hope, if it's a home, that the insurance company <u>will authorize rebuilding immediately</u> and pay all of the costs to rent another house they can temporarily live in during the rebuilding.

If the limit on the policy for home reconstruction cost is not enough, the insured may have been told they had a guaranteed replacement cost provision which requires the insurance company to pay <u>more</u> than the limit on the policy. This gives them reassurance.

The insured trusts that <u>in the event of a lawsuit for injury the carrier will immediately hire the best lawyers</u> to defend the insured and, in the event there is a judgment against the insured on the policy, the insurance carrier will pay the judgment without reservation.

While we hope that this happens, this is not typically what we see. The reality is that insurance disputes support attorneys, public adjusters, and insurance experts that sort out and typically litigate insurance disputes. These can be minimized by understanding the three elements of insurance roulette.

Let's Look At The Three Elements Of Insurance Roulette

1. Terms and Conditions: The Obligation to Pay

The first hurdle is that we hope the insurance company does not assert any terms and conditions of the insurance policy that would allow them to deny or limit your loss.

There is no obligation to pay unless the "four corners" of the policy itself create an obligation to pay. In other words, it is in your best interest to be sure your insurance policy **clearly states** exactly what the insurance company's **obligation** is to pay on your potential claim.

The following are a series of questions for first the business owner, then the homeowner.

For example, for your business:

- Did you have adequate limits in order to replace the building and your contents?

  Most insureds learn after a major loss that they did not have adequate limits because they confused market value with replacement cost or didn't otherwise take the time to evaluate the limits on the policy.

- Were you covered on a blanket basis if you have multiple locations? Or, if you have one location, did you have blanket building and contents?

  This is important because it could provide a safety net if you overinsured in one area and underinsured in another.

- Did you have an "open perils" policy or the limited "named perils" policy?

  Avoid a "named perils" policy because it limits significantly the damage covered by your policy.

- If you had blanket limits, was there a reasonable basis for the individual values used to make up the blanket limits?

  If not, the insurance company <u>can assert misrepresentation</u> and deny the loss.

- <u>Was the coinsurance clause waived</u> on the policy by way of an agreed value clause for both building, personal property, and business interruption?

  If not, the insurance company can test the values after a loss and reduce partial losses to the extent that you were underinsured.

- For business interruption to have agreed value coverage <u>you must also file a worksheet</u> with the insurance company.

  Was this done?

- Was business interruption limited to <u>12 months</u>?

  In a major loss it is highly unlikely that you could rebuild in 12 months.

- Was business interruption limited to the time <u>to *rebuild*</u> your building or was it the time <u>to *restore*</u> your business?

  To *rebuild* would typically mean to begin with a partially or totally destroyed structure occupying a building site where parts of the structure may still be standing but unusable, requiring demolition and removal. The foundation may also have been damaged beyond repair.

  To *restore* would generally mean to bring back to a former, original, or normal condition, to revive, or give new vigor, as in remodeling.
  <u>In either case, in the event of a major loss you will lose customers and it will take time after your building is repaired or rebuilt to restore your business.</u>

  Business interruption insurance covers the time to rebuild, or permanently relocate, plus only thirty (30) days to restore your business; however, an endorsement would provide for a longer period of time and extend the basic 30-day period of indemnity coverage up to 365 days, 730 days or with some insurance carriers an unlimited period of time. One caveat here is that extending the time to receive doesn't increase your limit, so consider this when you determine your business interruption limit.

- Was your building vacant or partially vacant?

  A building is considered "vacant" unless at least 31% of the total square footage <u>is rented and used</u> by a lessee or used by a building owner to conduct customary operations.

  If a building is deemed vacant, <u>there is no coverage at all for vandalism, sprinkler leakage, glass breakage, water damage, theft or attempted theft. All other losses, such as a fire, are reduced by 15%.</u>

- Did you have <u>replacement cost coverage</u> versus <u>actual cash value</u> coverage, which would contemplate depreciation?

  For example, if you had actual cash value coverage and the roof is old, you likely would not recover anything for the replacement of the roof.

- Did you have <u>a protective safeguards clause</u> that would require that your sprinkler or burglar alarm systems be maintained in <u>complete working order</u> at the time of the loss in order for the insurance company to pay the claim?

  This is not defined and gives the insurance company *wide latitude* to deny a total loss caused by a fire (if the sprinkler system was not adequate) or there was a theft loss (if the burglar alarm did not function properly).

- Did you have <u>ordinance or law coverage</u> that would pay the difference between the building as it was built versus how it would have to be rebuilt because of building code changes?

  If not, you will not be covered for building upgrades and this could be a substantial amount of money.

- Did you have an increase of hazard clause that would allow the insurance company to deny a loss if you did anything to increase the hazard of loss?

  What about office space heaters under a desk in the winter? This certainly increases the chance of a fire and the opportunity for an insurance carrier to deny your loss if an increase of hazard clause has been included in your insurance policy.

- Did you have a roof collapse that was caused by weight of ice, sleet, or snow but also because of wear and tear and deterioration of your roof joists?

  If so, the loss may not be covered if there is a concurrent loss provision in your policy.

- Did you have any environmental losses that would require cleanup of the land that you occupy or payment for injury to people who were injured because of this?

  Standard property and liability policies provide very limited environmental coverage.

- Did your liability policy have adequate limits? Did it have $100,000 in bodily injury liability when you should have had $10,000,000?

  Don't believe it when someone says the injured person can only sue for your liability insurance limits. Nothing can be further from the truth! All of your assets and future earnings are at stake in the event of serious injury and/or multiple injuries in a premises, products or auto accident.

- Did your liability policy have an absolute pollution exclusion?

  If so, injury arising out of fumes or other environmental matters is not covered (with limited exceptions). Examples of claims that would not be covered would be mold or fumes from a hi-lo or PCB leakage from a transformer.

- Were all locations listed?

  Every location you own, lease, or occupy must be listed on the liability policy as of the inception of your commercial liability policy each year or there will be no coverage for injury at the unscheduled location.

- Did you damage your landlord's building because of your negligence?

  Almost all liability policies exclude damage to a building you lease from others. A 50,000 sq. ft. building leased from another party could result in a $5,000,000 building damage claim by the landlord or the landlord's insurance company. This is not likely to be covered by an unmodified commercial liability policy except for a very low limit and, even then, water damage and many other perils are not covered.

- Was there an auto liability claim arising out of one of your employees who had a record of drunk driving violations?

  Did you know about the drunk driving violations?

  Was this driver declared on your list of principal drivers?

- Were you sued because of the disclosure of confidential information caused by cyber hackers?

  Standard liability policies exclude this type of claim.

- Were there any misrepresentations in any application for the coverage completed by you or your insurance agent?

  If so, the loss can be denied.

- Have you inflated or misrepresented any element of your claim?

  If so, the entire claim can be denied.

- Did you have a leased or long-term <u>temporary employee</u> that was injured? This is not covered under an unmodified commercial liability policy.

- Were you sued by an employee because of discrimination, sexual harassment or wrongful discharge?

  This is not covered by your commercial liability policy.

- Were you sued because of disputes related to your 401(k) plan or other employee benefits?

  If so, if you did not have <u>fiduciary liability coverage</u>, your personal liability as a fiduciary will not be covered.

  A 401(k) required ERISA bond does not provide any coverage in this area.

These are just a <u>few</u> of the issues and exclusions that can be asserted by the insurance company against business owners in order to allow them to deny, limit, or delay a claim.

<u>For personal insurance policies</u>:

- Did you have a <u>guaranteed replacement cost provision</u> on your homeowners policy which will pay a higher amount if the scheduled limit was not enough?

  If so, did you negate this coverage by making additions, alterations or renovations to your home and fail to inform the insurance company?

  Also, was it limited to 125% of the stated limit or was it “unlimited,” which is far better?

- Did you move out of your home and list it for sale or <u>rent it to others</u>, voiding the homeowners policy?

  For the homeowners policy to pay, <u>it must be occupied by the insured who is the owner</u>.

- Is your home owned by a marital trust, but you didn't list this on the policy?

  The policy only pays the losses of an <u>insured party</u>.

- Have you scheduled autos on your policy for children that actually live elsewhere?

  Losses will not be covered unless this is <u>disclosed and endorsed</u> on the policy.

- Are you listed as the titleholder on an auto insured by someone else?

  We see this happening when someone wants to receive employee discounts on an auto purchase or lease.

  Are you listed on that person's policy as an insured?

  Are the limits of liability sufficient?

- Have you been driving a borrowed car for more than 30 days?

  If so, has it been scheduled on your auto policy?

- Have you disclosed all of the people living in your residence?

  An undisclosed live-in boyfriend or girlfriend could result in the denial of a claim involving that person.

  An undisclosed youthful driver could also result in a claim denial.

- Has the usage of any automobile and its garaging territory been scheduled accurately?
  If not, this could be deemed a misrepresentation.

- Do you have a rental dwelling that has been vacant for 30 days or more?

If so, there is no coverage for many claims for damage such as theft or vandalism after 30 days, or there may be no coverage whatsoever for damage resulting from a fire, for example, after 60 days.

- Have you scheduled valuable jewelry items in order to override the small built-in theft of jewelry limit on the homeowners policy?

  If you did schedule these items, did you have “stated value” coverage which would pay the stated amount in the event of a total loss, rather than the wholesale replacement cost of the item?

- Did you tell the insurance company about your trampoline on your homeowner’s application?

  If not, and neighborhood kids are injured, you are likely not going to be covered.

- Did you have recreational vehicles such as dirt bikes, jet skis, or snowmobiles?

  Your homeowners and auto policies will not typically cover injury caused by these items or other losses, such as theft or physical damage.

- How about the small battery-powered riding “Barbie” or “Jeep” car you have for kids playing at your home?

  An injury claim is not likely covered unless you have modified your personal liability insurance policies.

Don’t get me wrong: Insurance companies are not in the business of unnecessarily denying claims in order to save themselves money. Insurance companies pay out billions of dollars in losses every year. However, claims departments of insurance companies are not in the business of paying claims that are not required to be paid under the four corners of the insurance policy. A claims adjuster can’t pay an uncovered loss because they feel sorry for you.

The problem is 99.9% of the business people or personal insurance buyers are amateurs when it comes to reading, understanding or modifying insurance policies.

Therefore, it is critical that you have an insurance advisor that will negotiate these terms and conditions or advise you of deficiencies in your insurance program to the greatest degree possible so that there is clarity in the obligations of both the insured and the insurance carrier.

Without terms and conditions that work in your favor, there is no need to go on to the last two elements of insurance roulette described below: solvency and willingness.

2. Ability to Pay: (Solvency)

Now, let's take a look at the second element of insurance roulette; that is, the insurance company's **ability** to pay.

- For the period between 1992 and 2012, 304 property and casualty insurance companies became insolvent in the United States. Think in terms of Kemper Insurance Company, or Reliance Insurance Company, for examples. These were at one time "A"-rated carriers that quickly became insolvent.

  Often these insolvencies occurred in short periods of time when insurance companies charged premiums that were too low in anticipation of investment income that never occurred. This results in a downward spiral causing a reduction in an A.M. Best rating and the loss of new and renewal business and the inability to pay claims.

  We also see a significant number of insolvencies in the State of Florida where hurricanes can quickly destroy insurance companies and overwhelm the ability of claims adjusters to adjust their losses.

  As we said, some insurance companies (in order to remain viable) tend to underprice their policies in order to achieve greater market share. This is attractive to some insurance agents who sell accounts based upon the lowest price and, in fact, it is attractive to many insureds who choose to select from competing insurance carriers offering a lower price.

- Insurance carriers are rated by several rating organizations. The most common is A.M. Best Company.

  Their annual rating guide lists all insurance companies, many of which do not have any rating whatsoever, and the balance are rated between "E" (under regulatory supervision) and "A++" (superior).

  There is a critical difference between "A-" and "B+."

  While an "A-" (excellent) insurance company might be acceptable, that insurance company is one tick away from "B++" (good) which is unacceptable to most mortgage companies and to many insurance agents or brokers who place insurance. This often becomes a downward spiral to insurance carriers and could lead to insolvency, its being sold, and/or poor service including <u>delay</u> in claims payments.

3. <u>Willingness to Pay: (Without Delay or Litigation)</u>

Now, let's take a look at **<u>willingness</u>** to pay. Of all of the three elements of insurance roulette, this is the most illusory.

- Insurance carriers will delay payment of a claim simply by asking for the courts to make a coverage determination of an insured's claim. If there is any doubt as to the validity of a relevant term or condition of the insurance policy, the safest course of action for a claims adjuster is to let the court decide. Between the initial coverage determination by the courts and appeals, this can stonewall an insured and delay a claim payment <u>for years</u>. In the event of a large claim, t<u>his can be fatal</u> to other than the largest insureds with a great deal of liquidity.

  This, typically, is not because an insurance carrier wants to defraud you of your claim payment. It is because <u>they believe your claim is not covered based on their interpretation of the terms and conditions of the insurance policy</u>.
  <u>Again, this is why the four corners of the insurance policy as so important</u>.

- Insurance carriers can delay your claim while they wait for an investigation of your claim to be completed or in securing reconstruction cost estimates from subcontractors.

  This may not be intentional but is the result of having to obtain information from third parties.

- Insurance carriers can delay the claim process by having an attorney take your sworn statement if the claim is of a suspicious origin.

  The policy allows this; however, this results in a delay because now the insured must hire an attorney to represent his/her interests.

- Insurance carriers can offer an amount that is too low. When this happens, you have the right to invoke the appraisal remedy which is arbitration. This takes time.

- The failure of an insurance company to advance money in order to continue operations, could be fatal to an insured.

  There is nothing in the insurance policy that requires that an insurance company advance money or otherwise go out of its way to keep a client in business while a claim is being investigated.

  While many major insurance carriers will do this if there is business interruption coverage and the loss is clearly covered by the terms of the policy, there is no policy provision that specifies how much and when.

- The truth is that in almost all states the worst that could happen to an insurance company is that it may have to pay the claim that is in dispute plus, perhaps, some interest charges. Even if an insured wins in a lawsuit, it loses because an insured's legal fees and time loss are generally not recoverable.

- So, making a policy as bullet-proof as possible from a terms and conditions standpoint still will not solve the problem of this third element of insurance roulette because an insurance company simply chooses to dispute a claim, rightfully or wrongfully.

The trick is to try to ascertain the reputation of the insurance company in advance of placing the insurance and to have an insurance policy that is negotiated so that its terms and conditions are favorable to an insured, and an adjuster will think twice about spending the insurance carrier's money in disputing a claim if it is unlikely to win.

- Some insurance companies are more apt than others to see the coverage cup as half empty rather than half full.

  This could be ascertained by examining the complaint records with State insurance departments or getting your insurance advisor to discuss the reputation of various insurance carriers to pay claims promptly.

4. Will you win insurance roulette?

So, as you can see, insurance roulette is a challenging game because you have to win all three aspects of the game in order to win the prize; that is, the timely insurance payment that you counted on to begin with.

In casino roulette, you only have to pick one number. Insurance roulette requires 3 elements.

- You have to have **terms and conditions** that can be as bullet-proof as possible and designed for your particular business or personal endeavor.
- You must have insurance carriers that have the **ability to pay** and, equally as important,
- You must have insurance companies that are **willing to pay** without unnecessary stonewalling.

The Bottom Line

Here is the bottom line and the takeaway from all of this:

Although we hope that your insurance company will pay willingly and quickly, allowing you to stay in business or to rebuild your home, this is not always going to happen. There will always be claim situations that are not anticipated and fall between the lines of the policy or some other dispute that was not anticipated.

This brings us to risk management.

What you need to do is operate your business or personal life on the basis that a loss to your property or injury to others is the absolute last thing you want to happen. If you don't have a loss, you're not going to lose your business (or home) because you failed insurance roulette and the cavalry didn't save your business or personal assets.

Operate your business or home on the basis that there is no insurance and that you will have to pay every damage to property loss, every crime loss, and every lawsuit that might be brought against you.

Avoiding a Loss – Risk Management

There are several practical things you can do to avoid losses.

1. The first one is to listen to the experts and do what they say.

   - For example, if you have an automatic fire sprinkler system you will want to be certain that you do more than just "go through the motions" of an annual sprinkler inspection report by your sprinkler contractor.

   - You need to ask for a complete assessment of the sprinkler system to be certain that it is in compliance with National Fire Protective Association Standards for your particular business. If they say that your sprinkler system is not in good working order, take steps to bring it into good working order immediately. This accomplishes two things:

     First, it will be a defense if the insurance company claims that your system was not in good working order and they want to deny the fire claim because of a protective safeguards clause that requires this.

     Secondly, it will help avoid a catastrophic loss.

- Listen to your insurance carrier loss control experts. Insurance companies typically will inspect a business account and inspect large homes owned by personal insurance clients. These inspections are typically viewed as an irritation by many insureds and they try to argue with the insurance company that certain recommendations are not necessary or they attempt to compromise with the insurance company on what they are willing to do.

  We suggest that you listen to these experts and follow their recommendations because they are based upon national standards and also based upon the losses that the insurance companies have paid over the years.

- With respect to management practices-type losses (such as wrongful discharge or discrimination) be certain that you have a good human resources attorney who specializes in these types of claims.

- Have safety, fire, and other loss prevention be a key management initiative. This starts at the top of an organization by demanding that property protection and safety be a top priority.

  This standard needs to be adopted by your plant manager or maintenance people because the bottom line is you cannot afford to have a property insurance loss, an unnecessary liability loss, or an unnecessary employment practices loss, to give you three examples.

  When we say that you cannot afford to have this type of loss, we say this because it can put you out of business. Even if you win insurance roulette and eventually do collect 100% from your insurance company, you will never be reimbursed by your insurance company for your loss of time and business productivity because of the amount of time you spent in rebuilding or negotiating with the insurance company, and so forth. Furthermore, you will not collect your legal fees.

2. Here is a little known secret: Most of us in the insurance and risk management business know which clients and prospects are more likely to have a loss than others.

This is simply because we can see the signs of weak or bad management in the operation of the business. A company with strong management and controls is less likely to have a catastrophic loss.

- Strong management will have cash reserves to allow its company to survive the inevitable delay in the event of a major disruption caused by a fire and other catastrophic loss.

- Strong management will spend money on property preservation, safety and risk management.

- Strong management will take the time to understand the terms and conditions of its insurance policies and will make insurance decisions based on quality, and not strictly price.

- Strong management will seek an insurance advisor rather than an insurance agent that acts as an order taker.

- The weak managers, because they don't have the money or time or because they want to maximize profits, avoid doing what is necessary to prevent or minimize losses and buy the cheapest insurance rather than the insurance that is the most appropriate for their needs, hoping for the best.

  In other words, these managers are the most likely to have a loss and the most likely to be unable to survive a loss.

3. Don't engage in wishful thinking such as:

- It won't happen – it's never happened.

- If it does happen, the insurance policy will pay. After all, that's why I bought insurance.

UNFORTUNATELY, INSURANCE ROULETTE IS NOT A GAME.

IT IS THE <u>REALITY</u> THAT REVOLVES AROUND WHAT HAPPENS AFTER THERE IS A CATASTROPHIC EVENT.

A CATASTROPHIC EVENT COULD:

- **COST MILLIONS OF DOLLARS IN UNCOVERED CLAIMS**
- **CAUSE LOSS OF EMPLOYEES' LIVELIHOODS**
- **JEOPARDIZE THE ASSETS OF THE BUSINESS OWNER**
- **JEOPARDIZE THE PERSONAL ASSETS OF AN INDIVIDUAL OR FAMILY**

DON'T "GAMBLE" WITH YOUR BUSINESS OR YOUR HOME!

MAKE SURE YOU HAVE THE RIGHT INSURANCE ADVISOR TO HELP YOU.