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EDITOR'S NOTE

Windstorm losses, such as hurricanes, tornadoes, and thunderstorms, can create massive destruction over wide-spread areas. When these property losses occur, it opens the door to many complicated ambiguities with insurance during the adjustment process.

In this issue, veteran public adjuster Keith Hayman of Adjusters International analyzes several of the most common points of contention that arise regarding insurance coverage following a windstorm loss.

This article provides insights and case studies to help property owners better prepare themselves in the event of a major storm loss.

—Sheila E. Salvatore, Editor

Hurricanes and Windstorm Coverage

Case Studies and Explanations of Applicable Coverages

By Keith Hayman

The historic 2004 and 2005 hurricane seasons exposed many businesses and homeowners to the nuances and ambiguities of insurance coverage. Before 2004, it had been over 100 years since four hurricanes had impacted one state in a single year. Due to the widespread damage from the storms, interpretation of coverage became a major issue for policyholders seeking to recover all the monies due under their insurance contract. The insurance claim process was further complicated by multiple occurrences affecting the same insurable interest. In 2005 Hurricane Katrina highlighted issues involving flood versus windstorm coverage. In addition to coverage issues,

Case Study:

In 2001 the owners association of a Florida condominium complex comprising 20 buildings and 200 units purchased an insurance policy with a $20 million limit. To save money on the premium, they opted for a 5 percent windstorm deductible, and every year since, they had renewed the same policy.

In 2004 the condominium complex was directly hit by Hurricane Charley, and every building suffered major damage to the roofs and interiors of the individual units. With such excessive damages, the condominium board realized that with their overall deductible set at 5 percent of the policy limit, the first $1 million for mandatory repairs was expected to come from the coffers of the association. Saving a few thousand dollars in premiums over the past four years had resulted in more than a half million dollars in deductible costs.

The condominium board was then faced with the difficult task of assessing each unit owner for their share of the deductible.

reconstruction and mitigation became increasingly difficult when the resources of insurance companies, contractors, roofers, suppliers, and the government were spread thin.

Since hurricanes are largely unpredictable, policyholders along the coasts must always ready themselves for the possibility of future damaging storms. In the aftermath of a hurricane, many priorities come to mind, but primarily protecting your property, getting your business back up, and recovery in general are paramount. Just like boarding your windows before the hurricane, understanding your insurance policy long before a disaster strikes is essential to protecting your insurable interest and ensuring a fast recovery. Having contingency plans established in advance will help you weather the storm.

The case studies included in this issue provide examples of potential exposure insureds may discover. If any of this information raises a red flag in relation to your coverage or risk, call your insurance broker or consultant to determine how you can better insure your financial interests.

Windstorm Property Deductible

Is it 2, 3, or 5 percent of my policy limit?

When hurricanes make landfall and wind causes the initial structural damage to a property, such as blowing off the roof or knocking out windows, the cause of loss is classified as windstorm. Windstorm damage often opens the door for massive amounts of water and debris to cause further damage to a structure. Unlike other causes of loss, such as pipe breaks or fires, which have a preset, fixed deductible, the deductible for a windstorm loss amounts to a percentage of the overall policy limit. Even though these percentages may seem small — either 2, 3 or 5 percent — these percentage deductibles can add up quickly and put a serious strain on your financial recovery.

One way to mitigate such issues is for property owners to purchase a buy-back deductible. This is supplemental coverage that allows policyholders to forfeit paying a deductible by opting to pay an additional premium.

Mold

Is it covered? Is it excluded? Is it capped?

Any time water enters a building there is a potential for mold, whether it comes from a windstorm or from a simple pipe break. Regardless of your insurance coverage, the first step to containing a mold problem is to completely remove all wet carpet, drywall, and contents, and dry out the site immediately after exposure. This will reduce the potential for serious mold development — which has been proven to be capable of producing toxic effects in humans and animals — and mitigate further damages.

In recent years insurance carriers have expended extraordinary amounts of monies as a result of mold claims, and a majority of insurance policies have been rewritten to either include a mold exclusion or to cap the insurance available for mold remediation. At times, this cap is far below the true costs to remediate mold, so eliminating the potential for mold will help protect against an unexpected out-of-pocket expense.

Code or Ordinance Coverage

Do I have it? If so, is it enough?

Over the years changes in your local building codes and ordinances have been enacted to reflect new standards for construction. If your older property suffers a substantial loss, fixing it may require higher construction standards. Simply replacing your property as it was may not be enough to meet these new laws and codes. Building ordinance or codes coverage, which pays to rebuild a structure

Building ordinance or codes coverage, which pays to rebuild a structure to comply with current building codes, can be added to your policy.

Case Study:

A major hurricane devastated parts of North Carolina on a Friday. An Ocean City mall was not spared, and major roof damage allowed water to soak a large percentage of the structure's drywall, carpeting, and ceiling tiles. After a quick clean-up, the owner of the shopping center waited for guidance from his insurance company.

By the time the insurance adjuster arrived, it was early afternoon on Tuesday. Both arrived to survey the damaged areas and found that mold had grown in the grocery store and four of the other occupied spaces on the premises. Because these areas had not been sufficiently cleaned and dried, the cost to remediate the mold was approximately $200,000. The insurance adjuster was quick to point out that there was a $15,000 cap for mold remediation in the policy. The additional $185,000 was to come out of the owner's pocket.

Case Study:

A business in Tennessee purchased a policy for a metal warehouse in Florida. Hurricane Jeanne hit the warehouse, and the building was destroyed. The warehouse was insured for $1 million, but with enhanced structural beams and concrete foundations being a requirement of the local building department, the cost for reconstruction to code increased to $1.75 million. The policyholder did not have any code or ordinance coverage and, as a result, was required to fund the additional $750,000.

Case Study:

Referencing the earlier case, the same Tennessee-based business believed that the language in their policy allowed for 10 percent in additional coverage for debris removal above the policy limit of $1 million. The insurance company's interpretation of the policy was that a maximum of 10 percent was payable for debris removal up to the policy limit of $1 million. This disagreement had the potential for a lawsuit, as the cost to remove the debris for the building damage was $140,000.

Case Study:

A popular beachside restaurant on the coast of South Carolina suffered major damage due to a windstorm that tore off the roof and flooded the interior. The restaurant was shut down for four months, and after rebuilding, it took several weeks to get the normal flow of customers back into the restaurant. The normal business interruption coverage indemnified the insured for the four months that they were out of business. But, as in most businesses, it took many weeks for customers to realize that the restaurant was again open.

Fortunately, the restaurant owner had an "extended period of indemnity" for 60 days built into the insurance policy, which allowed the business to continue to collect its lost profits until the customer base returned to a steady stream two months later. An extended period of indemnity begins the date a business returns to "normal business operations." In this case, the extended period of indemnity began the day the restaurant re-opened their doors for business after complete reconstruction.

to comply with current building codes, can be added to your policy. As building codes evolve each year, it is strongly recommended that you understand the exposure you could face if a major windstorm, or any type of loss — damaged your home or building, and what codes would be triggered upon reconstruction.

Debris Removal Coverage

How far does it go?

Debris removal is an expense often incurred in the aftermath of a windstorm. In the event of an extensive loss, some policy language for debris removal allows for an additional 5, 10 or 25 percent of debris removal coverage above the policy limit. Your policy language may clearly outline the additional coverage, or the wording may be ambiguous, causing a potential disagreement with the carrier over your payment. To avoid this problem, be certain of your coverage before you need it.

Business Interruption and Extended Period of Indemnity

Do I have enough?

How far does it go?

If you run a business, there is no greater life support to its survival than business interruption coverage. Having adequate coverage for the profits you would have earned had the disaster not occurred provides the support you need while rebuilding your business, a process that can take several months or longer. Business interruption coverage can also pay for continuing expenses, such as payroll, while your operations are down.

A business owner may choose coverage at a fixed dollar limit, or for the "actual loss sustained," which covers your loss from the date the coverage is triggered to the return to "normal business operations." In addition, an "Extended Period of Indemnity" is an endorsement option that will extend your business interruption claim beyond your return to

Case Study:

A retail store suffered major damage that would take eight months to restore. In order to mitigate their business interruption losses, the retail store opened a temporary location within a mile of the original location, with similar square footage and a six-month lease. The insured had extra expense costs to move equipment to the temporary location, rental of computers and furniture, installation of telephones and internet, and the cost of hiring hourly employees to prepare the temporary location for opening.

In addition, the extra expense coverage absorbed the cost differential between the normal rent at the original location and the increased rent at the temporary location with the six-month lease. The extra expense coverage also covered the costs of moving back into the original location after reconstruction.

"normal business operations." This endorsement can be 30 days, 60 days, 90 days, and so on, and provides a cushion as you return to your pre-loss sales volume. Understanding your potential losses and having an idea about how long it will take to regain a steady flow of business after rebuilding is key to properly insuring against your potential business interruption exposure.

Note: Business interruption calculations are never cut-and-dried. Determining your business interruption claim will vary greatly depending on the forecasts that you use.

Make sure an accountant or public adjuster with experience in the valuation of business interruption claims assists you in the claim process.

Extra Expense
What does it cover?
How can it help me?

Extra expense insurance covers expenditures over and above your normal expenses following a covered insurance loss, to continue the operation of the business. The intent of extra expense coverage is to have monies available to pay for reasonable expenses required to mitigate any further exposure to a business interruption claim. When it comes to windstorm, businesses sometimes need to cover extraordinary costs associated with massive cleanup, e.g., rental equipment; relocating to a temporary location while they rebuild the space; distributing goods from a different warehouse with an associated increase in shipping costs; or paying overtime for employees. These extra costs

> *"The intent of extra expense coverage is to have monies available to pay for reasonable expenses required to mitigate any further exposure to a business interruption claim. When it comes to windstorm, businesses sometimes need to cover extraordinary costs associated with massive cleanup."*

Case Study:

A medical group had 37 offices throughout Florida. A hurricane was approaching the coast, and there were mandatory evacuations in various parts of the state. After a mandatory evacuation, the anticipated hurricane slowed down and did not hit until 18 hours after the anticipated landfall. After the hurricane hit, three coastal towns were inaccessible for several days, and residents were unable to return. Several doctors appointments were cancelled and postponed. As a result of the evacuations, the medical group made a claim for business interruption losses for 16 locations. Of the 16 locations that suffered business interruption losses due to the windstorm, only five locations actually triggered coverage because of the language in their policy. For these, the lost profits (in excess of the deductible) from the cancelled and postponed appointments were paid by the insurance carrier.

Case Study:

A furniture manufacturer in North Carolina had a supplier that provided upholstery for a majority of their products. The upholstery supplier suffered a total loss due to a Category 4 windstorm that destroyed their building and inventory. As a result, the furniture manufacturer had their operations stopped on five major products for several months, and the major back order caused an additional loss of existing customers. Fortunately, the contingent business interruption coverage paid for the extra expenses necessary to get materials from another manufacturer and covered the business interruption loss.

fall under extra expense coverage. This is complementary to business interruption coverage, but some policies are written for business interruption without extra expense. If you don't have extra expense coverage, consider talking with your broker about obtaining it.

Contingent Business Interruption

What is it? Do I need it?

Contingent business interruption insurance and contingent extra expense coverage reimburse lost profits and extra expenses resulting from an interruption of business at the premises of a customer or supplier. For instance, if a supplier provides an important component for your manufacturing process, a severe insurance loss to that supplier could result in a shutdown of your manufacturing operations when that part becomes unavailable. This coverage can be purchased as an extension of your standard property insurance, and it only applies if the dependent property sustains a loss caused by a "causes of loss" stated in your policy.

There are three situations in which this coverage is most widely used:

1. *When the insured depends heavily on a single supplier or a few suppliers for materials or merchandise.*

2. *When the insured depends heavily on one or a few major customers to purchase the bulk of the insured's products.*

3. *When the insured counts heavily on a neighboring business to help attract customers (known as a leader property).*[1]

Civil Authority

When and how does it trigger my policy?

All policies have language for civil authority, but some policyholders do not understand how it can work in their favor. When a windstorm causes a massive mandatory evacuation and a coastal area is extensively damaged, residents and business owners are often not allowed to return for several days or weeks due to safety concerns. In these cases, civil authority can trigger coverage for business interruption for a specified limited period. Most civil authority language requires that the situation extend beyond 72 hours in order for the coverage to come into effect.

Spoilage Endorsement

Protecting perishables

Because a windstorm can cause massive power failures or mechanical breakdowns, perishables need to be insured with spoilage coverage. Prescription drugs and

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[1] Daniel T. Torpey - Ernst & Young, LLP, May 2003, www.irmi.com, ***Contingent Business Interruption: Getting all the Facts.***

Case Study:

A grocery store lost power for six days after a major windstorm near the coast of Georgia. Due to the loss of power, all refrigerated goods on the premises spoiled and had to be disposed of. The spoilage endorsement allowed for all stock losses to be reimbursed. In addition, the business interruption insurance and extra expense coverage were triggered to pay for the lost business and additional shipping costs while the grocery store restocked their inventory.

Case Study:

A motel on the coast suffered a major power outage due to severe damage at the local power plant, and the power was out for two weeks. Their service interruption coverage had a 72-hour deductible, which triggered the business interruption coverage after three days without electrical power. The motel was able to collect for the lost business due to the power outage on all collectible days until the power returned.

other pharmaceuticals, fruits, meats, miscellaneous foods and beverages, etc., need to be protected in case of a failure to maintain required refrigeration, cooling or humidity levels. These are common losses resulting from windstorms, especially if there is not a generator or other backup equipment in immediate operation to help protect perishable inventories.

Utility Service Interruption

Service interruption and off-premises power failure coverage

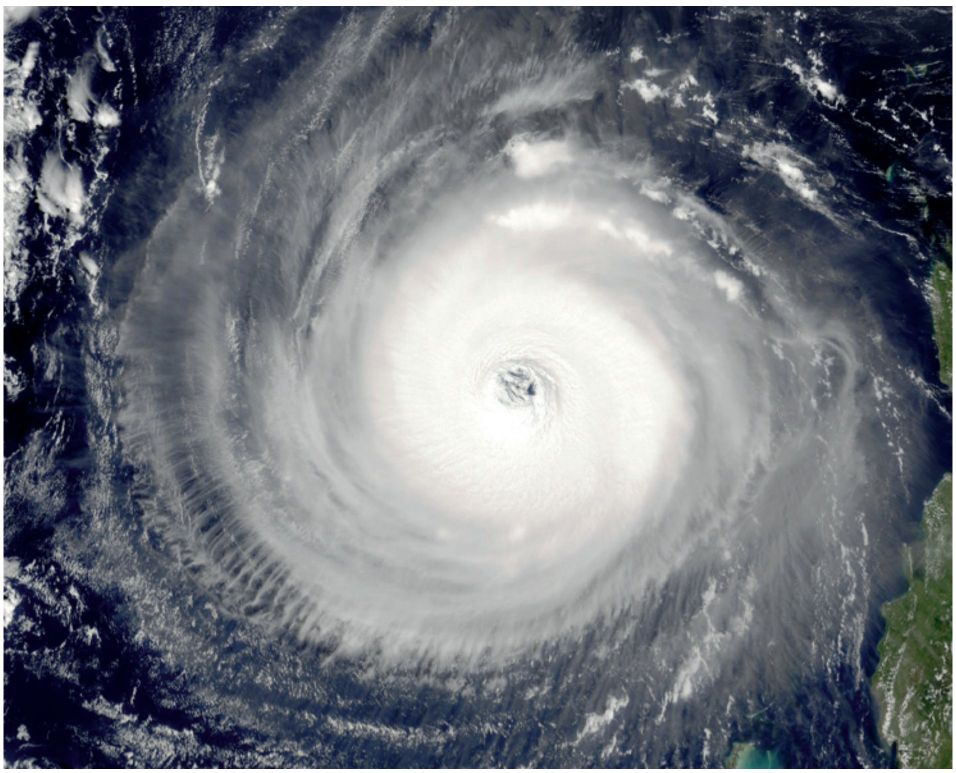
Windstorms make businesses highly vulnerable to utility service interruption losses such as electricity, gas, water and telecommunications. Vulnerable businesses may be able to buy insurance coverage for losses resulting from this "service interruption" or "off-premises power failure." The service interruption must result from a covered peril. Be aware that some

policy language excludes coverage for damage to overhead power lines. When the power goes out, deductibles may vary from four hours up to 72 hours of service interruption before coverage kicks in. Review your coverage to assess whether you are adequately insured in case of a service interruption.

Conclusion

There has been a spike in the number and severity of hurricanes in recent years. In the aftermath of these storms, there have been too many occasions where businesses were not adequately covered due to the complexities of the loss and inadequacy of coverage.

Understanding your full exposure and minimizing your risks can help you financially survive the next major hurricane that comes your way.



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