A D J U S T I N G
TODAY
Adjusters International
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Providing Loss Consulting Services to the Insured

Editor's Note

Dealing with salvage after a loss can have a large impact on an insured's overall recovery. This issue of *Adjusting Today* provides a detailed look at the salvage process and how it applies to an insurance claim. Veteran professional loss consultant Robert Luongo takes an in-depth look at the salvage process and how its handling can affect the outcome of insurance claims.

For business owners of all types, this piece will enlighten anyone who has the potential for a salvage operation following an insured property loss.

Stephen J. Van Pelt, Editor

SALVAGE

Dealing with Damaged Inventory After a Loss

Robert Luongo – Adjusters International

Fire, flood, tornado, earthquake, hurricane. No matter what the cause of loss, most often there is property and inventory that is only partially damaged. While some policyholders may view the damaged property as useless, to others damaged property holds great value and opportunity. No matter how you look at it, if surviving property has some salvage value, that value will apply directly to that claim's loss adjustment calculation.

The value of salvage is considered by an insurer as a "credit" against what they owe you for an insured loss, based upon the terms and conditions of your policy. The calculation is simple:

Amount of recoverable insured loss - Salvage value = Net payment to policyholder.

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The more difficult part is establishing the accurate salvage value of the damaged goods.

Although typically not given much thought, salvage has a significant impact on a claim and the claim process. It can either be a means to be fully indemnified for a loss, or potentially impede the recovery. If there is sufficient insurance on the damaged goods, the insured still has the first choice in the handling of the goods whether they are salvageable or not. After all, it's his/her goods until paid for by the insurance company. If the owner of the damaged goods has no insurance for his/her loss, every penny that can be recouped from the pile of debris is even more critical for the owner.

The Basics of Salvage

The dictionary describes "salvage" as

a. The act of saving imperiled property from loss.

b. The property so saved.

c. Something saved from destruction or waste and put to further use.

The owner of damaged goods (insured or not) will always want to recover as much as possible for the salvageable items. How that is accomplished could fill volumes of books, as almost every salvage effort is unique. This is because the major factors that affect salvage value are market conditions, and time and place of loss. Each of these components is ever-changing.

The following scenarios provide a basic look at salvage principles.

1. Salvage Turned Over to the Insurance Company

Insured A has $100,000 in inventory value. They have $100,000 in coverage without a coinsurance clause or a deductible in the policy. In the event of a total loss to the insured property the insured would be paid the policy limits of $100,000 and surrender title and ownership of the damaged inventory. The inventory, now owned by the insurance company, would be removed by them and salvaged if possible.

2. Salvage Retained by the Insured

Insured A has $100,000 in inventory value. They have $100,000 in coverage without a coinsurance clause or a deductible in the policy. In the event of a loss to the insured property the insured decides to retain and attempt to salvage the inventory themselves. The insurance company places a salvage value of $30,000 on the damaged inventory. The $30,000 value is deducted from the policy limits of $100,000 and the insured would be paid $70,000. It is then up to the insured to salvage the inventory.

3. Salvage in an Underinsured Loss

Insured A has $100,000 in inventory value. They only have $50,000 in coverage and no coinsurance clause or a deductible in the policy. In the event of a total loss the insured is paid $50,000 — the limit of liability of their policy. The insured also retains the damaged inventory and, if salvageable, those monies contribute to the reduction of the policyholder's un-insured loss. Salvage becomes a means to become more fully indemnified. If the insured sells the salvage for $30,000, the insured would recover a total of $80,000 for their $100,000 inventory loss.

Note that sometimes time is of the essence and it may be necessary to salvage the inventory for the benefit of both the insured and the insurer. Proceeds are subsequently allocated once the claim is adjusted.

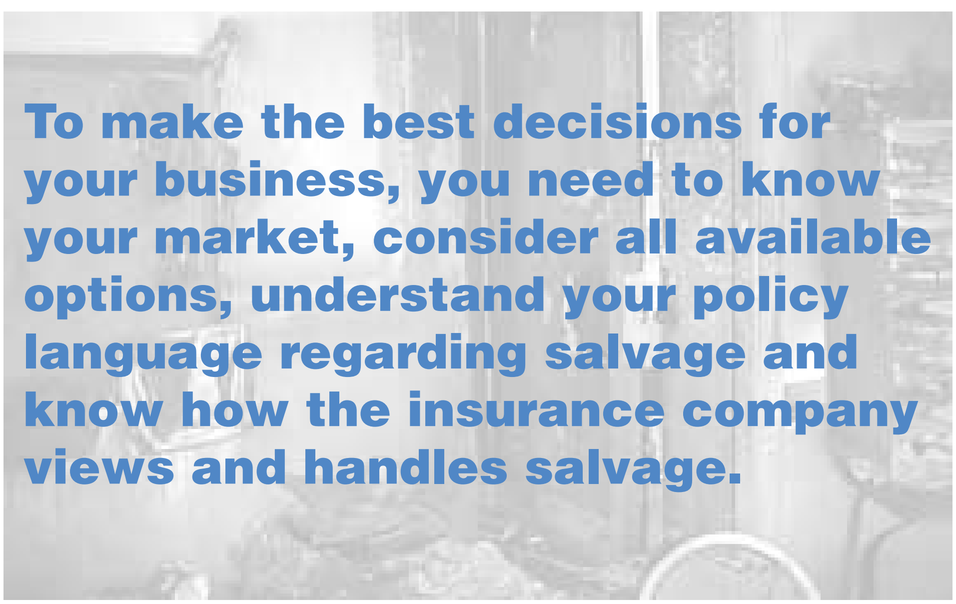
Unfortunately, dealing with salvage is not always a clear scenario. As stated above: "The difficult part is establishing the accurate salvage value of damaged goods." To make the best decisions for your business, you need to know your market, consider all available options, understand your policy language regarding salvage and know how the insurance company views and handles salvage.

The Professional Salvage Dealer

The handling of goods or salvage after a loss does not necessarily mean just the removal of the inventory from the damaged location. A professional salvage dealer (salvor) is usually hired by the insurance company and is paid a commission for their services. Salvors are used primarily on commercial losses where quantities are greater and higher values are involved. Salvors can also be hired by self-insureds as well as by underinsured owners. Therefore, salvors do not exclusively work for insurance companies and regardless of who hires them they attempt to be a neutral third party between the insurance company and the insured.

The salvor's job is to determine the value of the damaged property. They report their opinion of the property's "net value" after all handling and moving expenses are calculated. Additionally, a salvor's duties can be multifaceted and may include one or more of the following operations:

- Determine if the goods in question are in fact damaged, and if so, to what extent.
- Complete and/or verify the accuracy of an inventory.
- Move and/or remove equipment from a loss location to:
  - a restorer's premises
  - a storage facility
  - or directly to the salvage buyer's location.
- Sell the salvage at the loss site.
- A salvor may choose to hire an expert in a particular field to assist them in making a determination of "salvage value" of unique or specialty items.
- A salvor can be hired as a consultant by the insurance company to determine whether damaged goods can be cleaned and/or re-couped; and if so, at what cost. Re-couping damaged goods could preserve or even increase the value of damaged goods.



The Value of Salvage

At the time of the loss a salvor may or may not have an immediate buyer for the goods. That one factor will have a big impact on the salvage value of the goods to be considered in the loss claim adjustment.

Many things can affect the value of salvage. The following are some considerations an insured and an insurance company may have when observing damaged goods for the purpose of determining if there is any potential salvage value:

1. Insurable Interest

a. The first and most important consideration is the determination of "insurable interest" in the property involved. Are the damaged goods covered by insurance, and if so, to what extent?

b. Are the damaged goods being considered for salvage owned by the insured, under contract for purchase or sale, or are the goods "on consignment" from the owner(s) of the goods? If so, what are the

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terms of the consignment with respect to damage while the goods are in the "care, custody, and control" of the insured?

2. Location

a. Where, geographically, are the salvageable goods located in relation to where the salvage is going to be sold?

b. What special considerations will have to be made:

i. Are the salvageable goods hazardous? Will protective clothing be needed by the salvors?

ii. How difficult will it be to get access to the damaged inventory?

3. Handling

a. What size staff will be necessary to separate the salvageable goods from the non-salvageable goods, and prepare or verify an inventory? (Note: Separating damaged goods from undamaged goods is the policyholder's responsibility but a salvor may want or need to further separate goods for salvage and those costs are the salvor's responsibility.)

b. What special considerations will have to be made to obtain an accurate description of the goods, assign lot numbers to groups of salvage, and perform an accurate count?

c. What will be required to pack and "dig out" the salvage from the loss site? Just some cardboard boxes or multiple refrigerated containers?

d. Will it be necessary to transport the goods to the buyer or will the buyer pick up the salvage?

e. Will three men and a pickup truck be enough or will professional riggers, heavy equipment movers, or engineers be needed to properly transport the goods?

4. Market Value

The value of salvage is only as high as someone is willing to pay for it. It has a different value to different people and different industries located in different parts of the world. A Ralph Lauren business suit that retails in New York City for $1,000 may become "unsalable" by the business owner because it has smoke odor from a fire. This same suit with the smell of smoke may be very saleable in a special sale or distressed goods market.

5. Other Considerations

The value of the salvage also depends largely on the expertise of who is selling it. The larger your base of potential buyers, the higher the value the goods will have. An insured may be most in tune with their "niche" market or industry and thus be in a better position to handle his/her damaged inventory than a professional salvor. On many occasions salvors consult with other prior insureds as to the market value of goods.

A policyholder and their insurance company usually have some similar considerations when evaluating the salvage potential of damaged goods, however, the insured must also consider "tomorrow." The insurance company will also be more interested in the insured's future if there is Business Interruption or Loss of Earnings coverage in the applicable policy, but the insured needs to protect their business in the immediate future and in the long term.

Additional considerations:

- Is the inventory value of damaged goods accurate?
- How long will it take to make the premises tenantable again, or will relocation be necessary?
- How long will it take to replace the inventory?
- Can the damaged inventory be sold at a special sale to recoup more than the insurance company's salvor is offering?
- Should a "fire sale" be held and:
  - Have "some" inventory to sell
  - Maintain customer flow
  - Retain good employees
  - Not appear "out of business" to the neighborhood and competitors. (By doing so you may need to sell the salvage for less than the insurance company's valuation.)
- Should a portion of the salvage be kept, surrendering the remainder to the insurance company?
- What is the lead time to replace the inventory or equipment?

"Fire Sale" Considerations and Case Studies

A high-end, high-priced store (any kind of stock) has to take its "image" into consideration. One pricey boutique lost their clean, high-class business due to a fire sale. Their regular customers stayed away and did not return on re-opening, as they perceived the boutique to be a "discount liquidator." What took six years to build was lost in a 30-day fire sale.

Another example involves an appliance store in a small town. The salvor strongly suggested they remove the salvage and sell it to someone in the salvage selling business. The owner kept the salvage and held a fire sale, and made good money. The problem came when he re-opened for normal business. Business had slowed dramatically because high numbers of people in the small town took advantage of the fire sale and obtained their new appliance. Appliances typically last over 10 years and the owner had just "flooded his own market" with discount goods. Because of the small population, fewer people needed new appliances for years afterward.

A furniture store had scattered water damage to different areas of the showroom from a damaged roof from a storm. The salvor warned the owner about a "Storm Sale" but he thought it would be a good promotional event to increase business. The problem came when he was offering 50% discounts on only the one damaged piece of a set. The retail customer wanted the same 50% discount on whole five-piece furniture sets. It was also difficult to convince the customer that only parts of the store were damaged. The whole stock became suspect to customers.

Good practice following a commercial loss is to take pictures of the entire rebuilding process to display to your customers. Take pictures of the salvage dealer loading trucks. Take pictures of the empty store with all damaged stock removed. Take pictures of the contractors rebuilding the damaged areas. Take pictures of the new merchandise arriving in clean, factory sealed boxes. Then put up an "A" board at the front entrance to your store showing the rebuilding process. This helps rebuild the confidence of your customer base.

In some cases it may be necessary for the insured to sell their own goods rather than having the inventory removed for salvage.

A good example would be an insured that has a unique stock in a seasonal business. A swimsuit has a greater value to a retailer at a beach resort in the Caribbean in the winter than in the summer. Thus, a swimsuit retailer in the high season may not want slightly damaged inventory removed as salvage, as it would put them out of business until they could restock the store. It may be in the best interest of the retailer to keep the inventory and remain open for business, albeit holding a "fire sale." Along with retaining a customer flow, this also allows insureds to hold on to key employees and lessen the possibility of being forced out of business by a competitor.

There was an actual case where a retailer salvaged their inventory only to find it in a competitor's store holding a "distressed merchandise sale" down the block. Even if the damaged goods are sold at a loss by an insured sometimes it may be a better business decision not to salvage the damaged inventory.

Who's Salvage Is This Anyway?

After a loss occurs it is the insured's decision whether or not to surrender their damaged property to the insurance company for salvage. Likewise, an insured cannot force their insurance company to take the salvage. The insurance company will only take damaged goods for salvage if it will reduce their total loss payout. Regardless of whether the insured chooses to retain their damaged goods or turn it over to the insurance company as salvage, the value established for the damaged goods will be applied in the claim adjustment.

The insured may know their market for the liquidation of salvageable goods better than the insurance company's salvor. An example would be a fire-damaged commercial sewing machine. A salvor may have several buyers for such damaged items and may be able to sell the machine for $10,000 to be used as spare parts. Thus at that moment the agreed salvage value of the sewing machine is $10,000 less handling charges and sales commissions.

However, the insured may consider the damaged machine as valuable spare parts as well and estimate the value of such to be more than the $10,000 as offered by the salvage dealer. In this case the insured could choose to retain the damaged sewing machine. The insurance claim payment would then be reduced by the $10,000 agreed salvage value as projected by the insurance company.

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Every Situation is Different

The case of the $90,000 oil painting

In the world and business of fine arts, perfection is paramount. The word salvage can have irreparable effects on not only the artist's particular work but also their career in general. Salvage can mean not perfect and that can mean a "loss in value" to the owner of the painting. Reputable art dealers usually must insure an artist's painting whether the gallery owns the work or the artist.

Several years ago there was a claim involving an oil painting on canvas at a prestigious New York art gallery/dealer. The painting was valued at $90,000, which was the dealer's selling price. The insurance policy covered the gallery inventory at full selling price. When the dealer received the painting it was in pristine condition having *never* had any prior damage.

Even in the most prestigious of art museums or galleries, accidents happen. The painting was leaning against a wall in the public area of the gallery waiting to be hung on display when one of the employees noticed a 2" x 2" right angle tear in the canvas. The cause and the responsible party were mysteries.

An art restorer was hired to first determine the repair cost to stitch up the canvas and retouch the painting. The artist in this case was not interested in repairing his painting. The restorer estimated the cost to repair the painting at $2,000. This was not much, considering the estimated 70% loss in value ($63,000) as a result of the tear. The repair cost and loss in value were covered by the insurance policy and included in the insured's claim. The underwriter's total exposure for this claim was $65,000.

Although the painting was restorable, the restored painting was considered to be a "total loss" to the art gallery. The gallery was paid $90,000 for the painting (the insured value), and the insurance company took possession and ownership of the painting as "salvage."

At the time of this claim a well-known New York City auction house was preparing an auction of similar works of art. The painting was entered in the auction and was sold for $60,000.00 net of sales commissions. So here's the math on this "salvage" operation:

Insurance company pay out to gallery	$90,000.00
Restoration cost	$ 2,000.00
Total outlay	$92,000.00
Net salvage return	$60,000.00
Net loss to insurer	$32,000.00

In this case the art dealer's loss was $90,000 and they were completely indemnified by their insurance policy and were not forced to deal with distressed goods. Heads up handling of the insurance claim, knowledge of the art market at the time, and proper handling of "salvage" reduced the insurance company's payout for this claim. The insurance company's loss was reduced by over $30,000. Everyone was satisfied as it was a win–win situation.

Expertise in Salvage

Journey of Canned Food

Another example of expertise in liquidating salvage can be colorfully illustrated with a loss involving canned foods. As stated earlier, someone with little knowledge of the potential market for damaged cans of food may view that type of salvage as worthless. However, to an expert salvor or experienced policyholder, distressed canned goods may have a variety of options open to them to recapture some of the goods' lost value.

For example, take a fire in a supermarket in the United States. Cans of food might smell like smoke, have some rust or most probably have been exposed to high temperatures. If the Food and Drug Administration (FDA), or your state, county or city agency health department condemns the stock it *must* be disposed of, with no option for salvage. The insured, insurance company, and salvors have nothing to say in that determination. However, if the agency issues an "Order of Embargo" the items can be salvaged but must be handled in accordance with the law as it pertains to the safe consumption guidelines. This means that the owner of the salvageable items has options for handling the food, but they must be supervised and/or approved by the embargoing agency. The handling of the damaged inventory now automatically becomes either a "salvage or debris removal operation."

Considerations in this example may include:

- Is the container in good condition?
- Can it be wiped off and resold somewhere else?
- If the container has rust spots, local laws may prohibit it from being resold within that state. However, the inventory might be able to be sold to a supermarket or grocery store in another state.
- If the rusting is too extensive and not re-saleable in any U.S. state it could possibly be exportable to another coun

- try and sold as food. The Caribbean and South American countries have been big buyers of food salvage.
- If the damage is too severe and no country will be allowed to buy it as food, the inventory then might be sold to a pet food manufacturer.
- If the damaged goods are not acceptable for use in the pet food industry it may have a potential sale value to a fertilizer manufacturer.

The "food chain" in the salvage market for canned food is quite extensive. The salvage market for food items can pass through many different hands before being acquired by the final consumer.

Brands and Labels Endorsement

An insured that manufacturers or sells famous brand goods or highly recognized labels may not be able or even allowed to sell items that are marred, damaged or otherwise not in perfect condition. Such entities should consider a Brands and Labels endorsement to their insurance policy. Insurance policy terms and conditions for Brands and Labels will vary from one policy to the next, but basically Brands and Labels coverage is a means of protecting insured damaged goods bearing a particular name, brand, trademark, or marking, from being sold, distributed, or even given away. There may even be financial consequences of doing so.

A Brands and Labels endorsement can affect the value of salvageable goods directly and indirectly. A well-known brand item will generally have a higher salvage value than a lesser-known brand. The salvage value of that well-known brand will be considerably reduced if the labels or other markings have to be removed from the items before they can be salvaged or even disposed of.

The cost of removal of such brands and markings are generally covered in a Brands and Labels endorsement. The insured's claim should include the cost to remove the brand or label from the item in addition to any cost to repair it. The cost to obliterate such labels and markings is covered even if the damaged goods are worthless and must be disposed of.

A loss to designer suits presents a good example for this coverage. A large quantity of name brand suits with a value of $1,500 each were exposed to smoke as a result of a fire. Fortunately the suits were not burned but did retain an odor of smoke. The insured did not want smoke damaged suits with their brand name sold as distressed goods in the "salvage market." Their Brands and Labels endorsement covered the cost to have the labels removed.

Without the brand name the suit is less valuable, however, the insurance company's salvor found a buyer and sold them for $500 each. This situation again reduced the payout by the insurance company and, at the same time, removed the brand name off of the suits to protect the policyholder.

To make sure the label removing process is done satisfactory, the insured may choose to remove the labels themselves or supervise the insurance company's label removal operation as discussed above. The cost to do so is also usually covered by the Brands and Labels endorsement.

In instances where a label is cut out altogether, it is known to be a *damaged second*. If a label is simply cut through, but left on the article it is a *second*. If a label is blackened out as with a Sharpie, it is a *first quality item* that has suffered some sort of damage. There are also area restrictions with some national retail chains. Some retail stores only allow their salvage to be sold in certain states. Also, some labels can't be removed without damaging the item. Take a logo "service mark" on the front of men's polo shirts. It can't be cutout because it would leave a hole in the shirt. It can't be marked-out without blemishing the look while being worn.

Other Situations Affecting Salvage

An insured may have a pre-loss contractual agreement that addresses responsibility of goods not owned by the insured while in the possession of the insured. The insurance policy is usually bound to the terms of such a pre-loss agreement.

There is an ice cream company that now has wording on all its *bill of ladings* for all trucking companies shipping their product…"in the event of a claim resulting from temperature variances, a 20% salvage credit will be taken. Further, all damaged ice cream will be disposed of in an appropriate site. No product will be allowed to be sold elsewhere." This company had three freezer claims over a four-year period and in each case, the ice cream was resold, to their dislike. After going through the process, they changed their insurance policy and bill of ladings to restrict the distribution of salvage.

Inspect Your Policy

As with all contracts it is most important to read and understand its terms and conditions. We have seen terms and conditions in insurance policies include such caveats as an *Impairment of Recovery Rights Clause*. This clause protects the insurance company from paying on a loss if the policyholder impairs the rights of recovery from others by any act or agreement after such loss. Differences in wording can change the interpretation when it comes to your salvage and can lead to unexpected results in your insurance claim.

As every loss is unique, dealing with salvage will always be a case by case process. Be sure to carefully read your insurance policy and understand how, in the event of a loss, it addresses salvage and/or brands and labels.

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WEB SITE ADDRESSES
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PRINTED ON RECYCLED PAPER

AT03-1 3022