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Insurance and the Polar Vortex: Recovering Losses from the Big Chill of 2014

By Peter M. Gillon, David T. Dekker, Joseph D. Jean, Geoffrey J. Greeves, Vincent E. Morgan, James P. Bobotek and Matthew D. Stockwell

The first two weeks of 2014 ushered in an extraordinary weather disaster affecting most of the United States, causing extensive property damage and business interruption as a result of freezing temperatures. On January 3, 2014, a "Polar Vortex," a circulating pattern of cold air originating in the Arctic north, was drawn south into the United States, bringing with it unusual frigid conditions, ice storms and snow. The big chill froze pipes and sprinkler systems, interrupted chemical manufacturing and disrupted transportation systems. In fact, all 50 states experienced freezing temperatures – even Hawaii. Temperatures were so cold that a polar bear kept at Chicago's Lincoln Park Zoo was moved inside.

Preliminary estimates indicate that the Polar Vortex will cost the U.S. economy approximately $5 billion. As in any natural disaster, impacts varied by industry sector and location. Real estate assets were hit particularly hard. One of the most common impacts of the cold weather was freezing pipes. Pipe freeze-up and unfreezing damages were particularly severe in southern climes, where piping systems lack freeze protection more common in the north. Even in the northeast, property owners saw significant pipe failures. In some cases, fire sprinkler systems froze, allowing fire to spread due to the lack of fire protection. Malls, restaurants and other walk-in retail establishments suffered business interruption, and some lost power as well as other utility services. Travel-dependent businesses were also affected. Approximately 20,000 flights were reportedly cancelled. At JFK Airport in New York, a plane slid off a runway, causing the airport to close for almost two hours. Temperatures were reportedly cold enough in some places to render jet fuel unusable. Major airlines are expected to suffer approximately $50 to $100 million each in lost revenue, according to one report. Of course, the freeze had corresponding impacts on hotels and tourism, among other industries.

In response, insurers are already gearing up for anticipated Polar Vortex-related business interruption and property damage claims. From early responses, it is clear that numerous contentious issues will emerge from this event.

This preliminary guidance is intended to provide an overview of some of the key issues that commercial policyholders affected by the Polar Vortex are likely to face, as well as to assist with the initial insurance claims process.

Anticipated Coverage Issues

Even as affected businesses are completing repairs and returning to normal operation, their insurers are formulating arguments to minimize covered exposure. Here is a brief review of issues already emerging in the aftermath of the Polar Vortex.

I. Number of Occurrences

Some insurers have begun to assert that the Polar Vortex consisted of two or three separate “occurrences” rather than a single “occurrence” -- a transparent attempt to apply multiple deductibles, thus reducing (or in some cases, eliminating) policyholder recovery. Some have argued that the freeze was actually two occurrences, and that the subsequent thawing should constitute a third occurrence. Based upon standard policy language, however, policyholders should be in a strong position to treat this entire event as a single “occurrence,” as that term may be defined. Not every policy is the same, so policyholders should be sure to review their policy's definition of "occurrence," if there is one.

Insurers will look for support from an insurance industry group known as Property Claim Services (PCS), a division of Insurance Services Office, Inc. (ISO), which already has issued three catastrophe advisory notices as a result of this weather event: CAT 31, CAT 32 and CAT 31(A). CAT 31 was issued for the period of January 3 to January 5, 2014. CAT 32 covers January 5 to January 8. In response to inquiries concerning the difference between CAT 31 and 32, PCS issued CAT 31(A), asserting that “weather data” support treating the Polar Vortex as two events -- the first a weather front that ended on January 5, and the second a “Polar Vortex” that followed on January 5.

This is anything but conclusive, however. In fact, the available meteorological data supports the straightforward conclusion that this was a widespread freeze, all constituting a single weather event. More important, the typical “occurrence” definition in a property policy would treat any loss or series of losses arising out of a single weather event such as the Polar Vortex as a single “occurrence.”

We understand that some insurers have pointed to the “occurrence” language found in most ISO form policies, defining an “occurrence” in the case of flood, named windstorm, earthquake, or other sub-limited perils, as an event lasting no more than 72 hours. This may explain the attempt to split the Polar Vortex into two events. Of course, according to meteorologists (and common sense), the Polar Vortex was not a flood, named windstorm, earthquake, or other sub-limited peril; thus, the 72-hour limitation should have no bearing on coverage. At this stage, in the absence of compelling evidence that the weather events of January 3 to January 8 comprise two distinct, unrelated storm events, the Polar Vortex should be regarded for coverage purposes as a single “occurrence,” subject to only one deductible or waiting period. And this is true no matter the number of locations or damages (e.g., pipe bursts) experienced.

II. Specified Perils and Deductibles/Sublimits

The catastrophe notices referenced above identify flood, freezing, ice, snow and wind as the perils causing loss and classify the event as a "Winter Storm." We anticipate that insurers will attempt to fit this event into one of the named perils that are often subject to specific sub-limits and deductibles, waiting periods, or even exclusions, such as wind or flood. Some insurers have inserted anti-concurrent causation language into obscure policy locations, and have then argued for a broad interpretation of such language (for example, inserting anti-concurrent causation language into wind and flood definitions, and then arguing that a winter freeze event accompanied by wind could be treated entirely as a wind event). In fact, some of these insurers have contended that water damage as a result of a pipe freeze-up falls into the named peril of flood – a policy interpretation contrary to case law in much of the country (*see, e.g., Ariston Airline & Catering Supply Co. v. Forbes*, 211 N.J. Super. 472, 476 (N.J. Super. Ct. 1986); *see also Hernandez-Rodriguez v. A1 Sun Prot., Inc.*, 2010 U.S. Dist. LEXIS 32508 (S.D. Fla. Mar. 17, 2010) (observing that the common meaning of "surface water" does not include water from a burst pipe)) and common policy language.

A careful review by risk management and legal professionals of the insured's entire policy, as endorsed, along with the facts and circumstances surrounding the loss, is critical to ensuring that the loss is not incorrectly characterized as stemming from a named peril subject to onerous coverage restrictions.

III. Freezing as Property Damage

As noted, some property damage may be the direct result of freezing, such as the expansion and contraction of pipes as they are frozen and inexorably thaw, or the damage may be to product (personal property) conveyed in pipes, such as the jet fuel that became unusable as it changed physical state due to the cold temperatures. Insurers may question whether freezing itself is property damage. Freezing is an insured peril, and the consequent property damage caused by the expansion and contraction or other change of physical properties is covered property damage under all-risk policies. *See, e.g., Cavalier Group v. Strescon Industries, Inc.*, 782 F. Supp. 946, 956 (D. Del. 1992) (holding that freeze/thaw effect which exacerbated defects to balconies was not specifically excluded, and therefore was covered under an all-risk policy); *Harbor House Condominium Ass'n v. Massachusetts Bay Ins. Co.*, 703 F. Supp. 1313, 1317 (N.D. Ill 1988) (coverage for repair costs under an "all risk" insurance policy extends to a loss caused by a fortuitous freeze event; but since the insured could only show that freeze damage occurred to a small portion of pipes within a heating system, it could only recover for that specific location).

Under standard policy wording, damage to product, supplies, and other materials also triggers coverage. Fuel, chemicals, water and other "Personal Property" damaged (even temporarily) by the freeze may give rise to coverage for both direct physical loss (and/or loss of use) with respect to the frozen property, and resulting business income loss if the business is affected by such freezing damage.

IV. Business Interruption Deductibles/Waiting Periods

Business interruption policies are similar in substance, but vary greatly in coverage terms. Many policies include, in addition to monetary deductibles, "waiting periods" that limit coverage to the loss occurring after a waiting period – typically presented as a number of hours, e.g., 72 hours. Sometimes deductibles are also expressed in terms of days, hours, or even production equivalents, and although insurers and adjusters like to treat them as the same, they are sometimes very different. For example, if a loss continues for 10 days, and is subject to a 24-hour waiting period, there is coverage only for the 9 days after the first 24 hours, typically eliminating the largest day of loss. Some policies even define if the days are

business days or calendar days. If the loss is subject to a 24-hour deductible, the insured is entitled to deduct an amount representing 1/10 of the loss, which is typically less. This simple calculation could have a major impact on claims relating to the Polar Vortex.

Another point of tension may be proving and measuring contingent business interruption (CBI) losses. Policyholders with CBI coverage, whose own businesses suffered losses as a result of interruption to a customer or supplier's business, may be entitled to their resulting loss of gross earnings or gross revenue and contingent extra expense losses. There are, however, challenges in presenting such claims. First, the CBI location must have suffered a loss that is covered under the policyholder's policy. Second, the policyholder must prove that the CBI location's losses impacted the policyholder's business. This is often difficult as the insured has little or no control over, or access to, the facts and circumstances of the supplier/customer's property damage and the reasons behind consumer behavior. A strong argument can be made that requiring such proof exceeds an insured's reasonable expectations when such coverage was purchased. Finally, BI -- and especially CBI claims -- are often the most highly contested insurance claims.

Critical to presentation of any BI claim involving this freeze will be whether the insured has put the right team of specialists in place, including forensic accountants, coverage attorneys, and other consultants who specialize in assessing, quantifying and maximizing the extent of coverage. These professionals interact with management to help document the loss, including both financial and physical damages, and, when properly retained by counsel, may be subject to the attorney-client privilege such that their communications and advice are protected.

V. Other Potential Coverages

Depending upon an insured's particular circumstances, a number of coverage extensions may provide a basis for recovering some or all of the loss caused by the Polar Vortex. For example, Loss of Ingress/Egress coverage typically indemnifies an insured when access to the insured's property is impaired as a result of road closures, flood, ice and snow, although proof of physical obstruction is usually required. Under this coverage, an insured may recover if access to its property is restricted due to physical damage such as impassable roads, and/or property damage within a certain perimeter of the insured's premises. Similarly, Civil Authority coverage may apply where a governmental order impairing access to the insured's premises was issued, typically as a result of physical damage of the type insured by the policy. These are often additional coverages, so a careful review of the policy is necessary before the claim is submitted.

What you should do:

- Obtain and Evaluate Policies

As a first step to recouping the losses, it is critical to obtain, review and evaluate all potentially applicable insurance policies for coverage. Understanding your rights and obligations requires a thorough review of all policies to determine what coverages may apply. Property insurance policies are more likely to cover damages sustained as a result of the Polar Vortex. Liability policies generally will cover claims brought by third parties as a result of the weather, such as slip and fall accidents.

- Place All Insurers on Notice

In order to preserve all rights under your insurance policies, it is critically important to notify each insurer (including excess insurers) of potential losses as soon as possible. Any instructions for providing notice to the insurer should be carefully followed. Brokers generally notify the insurance carrier on the policyholder's

behalf, but it is important to verify that the notice is accurate, in written form, and is actually sent to the correct parties in such a manner that the recipient has actual knowledge of the communication. Even if you have not yet identified all of your losses, or determined conclusively that a policy might respond, make sure to notify all insurers that may provide coverage, including excess participants on your property program. If you use your broker to provide notice, be sure to get confirmation of delivery and acknowledgement of receipt. Late notices can prejudice your ability to secure coverage in many states.

- Document Your Losses

Next, properly documenting the loss or damage to property is crucial. This includes not only property that was damaged as a result of the weather, but also any property rendered damaged or unusable in the following days, such as inventory that was frozen/thawed, or exposed to water as a result of burst pipes. Contamination, spoilage or latent moisture infiltration are among other sources of loss which must be considered when standing water and sediment is released due to a burst pipe. It is important to document all damage and premises/locations with photographic evidence and, in some cases, give the insurer a right to inspect before discarding or replacing any damaged items. Keep a log of all actions taken. Save all repair receipts and other records of additional expenses made necessary by weather-related damage. Aside from taking steps to mitigate losses and prevent further damage to insured property, insureds should consult with coverage counsel before taking any action or agreeing to be interviewed by adjusters regarding the destruction of insured property as the insurer may have rights to that property under the policy's salvage provisions.

- Consider Engaging Experts

Third, it is wise to engage professional claim consultants, such as forensic accountants, particularly where there are business interruption losses. Their professional fees and other mitigation expenses are sometimes covered under property policies, subject to sub-limits. Usually, fees of attorneys and public adjusters are not covered. It is also advisable to engage an experienced insurance coverage lawyer, not just when you need an advocate, but to help you protect the privileged nature of your communications, and also to assist in avoiding many common problems inherent in presenting your insurance claim submissions. Counsel may work in the background, without revealing their involvement to insurers. Insurers routinely do this. A prudent business owner who has to answer to shareholders is wise to have a policyholder team with equivalent expertise. Cooperate with the insurance company adjuster, but don't forget that he or she works for your insurer, not for you. If you need an advocate, hire your own.

- Follow the Policy to Preserve the Claim

After initially notifying the insurer of the loss, most property policies require a sworn proof of loss, itemizing the damages. Sometimes, policies require proofs of loss to be submitted within a certain number of days or months after the loss. Although insurers are usually amenable to an extension of time to do so, any such extension should be confirmed in writing. In addition to notice and proof of loss, insureds must also preserve and protect property from further losses, including taking any and all steps necessary to mitigate (or minimize) additional damage, including business interruption. Because such steps are required to be taken, mitigation expenses are covered under property insurance policies. For example, if a building is flooded, most policies require the insured to take necessary steps to dry out flooded areas and, accordingly, provide reimbursement of such mitigation expenses, subject to certain sub-limits. Keep in mind that all damaged property must be preserved, since the insurer may have salvage rights to such items.

- Assess all Potential Coverages

With respect to weather-related damages, “first-party” policies such as commercial property policies are the most likely to provide coverage for an insured's own losses. As set forth above, in addition to providing coverage for physical damage to an insured’s property, many commercial property policies also include coverage for losses due to the interruption of the insured’s normal business activity as a result of damage to utilities, customers, suppliers, infrastructure and other critical, or dependent, properties. These extended coverages may apply, even if the insured’s own property was not physically damaged. This may be critical to businesses whose supply and customer chains were disrupted as a result of supply issues, closure of roads, grounding of flights, and other transportation-dependent issues. A thorough review of the policy’s coverage and application to one’s knowledge of the policyholder’s business process is critical to determining whether, and the extent to which, coverages may apply.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or one of the following members of the Insurance Recovery & Advisory practice section:

Peter M. Gillon (bio)
Washington, DC
+1.202.663.9249
peter.gillon@pillsburylaw.com

David T. Dekker (bio)
Washington, DC
+1.202.663.9384
david.dekker@pillsburylaw.com

Joseph D. Jean (bio)
New York
+1.212.858.1038
joseph.jean@pillsburylaw.com

Geoffrey J. Greeves (bio)
Washington, DC
+1.202.663.9228
geoffrey.greeves@pillsburylaw.com

Vincent E. Morgan (bio)
Houston
+1.713.276.7625
vince.morgan@pillsburylaw.com

James P. Bobotek (bio)
Washington, DC
+1.202.663.8930
james.bobotek@pillsburylaw.com

Matthew D. Stockwell (bio)
New York
+1.212.858.1075
matthew.stockwell@pillsburylaw.com