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TRIA Troubles: The Uncertain Future of Terrorism Coverage

by Tyrone R. Childress



Following the tragic events of September 11, 2001, concerns regarding the availability of terrorism insurance resulted in passage of the Terrorism Risk Insurance Act ("TRIA") in 2002. TRIA created a three year program by which the United States government effectively reinsures terrorism losses to a maximum of \$100 billion, with the federal government paying 90% of an insurer's TRIA-defined terrorism losses once such claims reach 15% of an insurer's earned premiums. In return for this financial protection, insurers are required to offer terrorism coverage.

With TRIA set to expire at the end of this year, speculation has been rampant regarding the future of TRIA. Proponents of extending TRIA argue that, absent federal financial backing, there will be insufficient, or at least not affordable, terrorism coverage available, leaving companies and the United States economy vulnerable to future terrorist acts. Further, TRIA proponents argue that certain infrastructure industries critical to the United States economy would be left, absent TRIA, with disproportionately shouldering the premium costs of protection that benefits all Americans. Opponents argue that TRIA was designed to be a temporary measure to allow United States companies to recover, while the insurance industry developed pricing and a market for terrorism coverage, and that extending TRIA would represent a thinly disguised insurance industry bailout. Numerous entities, including the Congressional Budget Office, the Rand Corporation, and, most recently, the Department of Treasury have issued reports discussing these issues at length.

Irrespective of the merits of the debate regarding TRIA's possible extension, it is likely that if TRIA is extended, it will only be done with significant modifications. Thus, corporate policyholders

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Insurance Coverage for MTBE Claims: *All is Not Lost*

by Mindy G. Davis and Arden B. Levy



Policyholders may be able to get insurance coverage for MTBE claims even if their policies contain the so-called “pollution exclusion.”



Members of the petroleum industry are struggling with the potentially staggering defense and indemnity costs of lawsuits

filed by various municipal water authorities concerning the gasoline additive methyl tertiary butyl ether (“MTBE”). The plaintiffs have filed dozens of suits against the petroleum industry and others alleging

General Liability (“CGL”) policies with product liability coverage to determine whether the policies provide coverage for defense and indemnity costs. Although other types of policies may afford coverage, this article focuses on only CGL policies with product liability coverage. From the CGL insurers reactions to these claims, it seems likely that insurance companies on these policies will try to deny coverage for various reasons, including the argument that the claims are pollution claims and a policy’s “pollution exclusion” clause precludes coverage for claims involving property damage caused by MTBE contamination.

defense costs because the duty to defend may be triggered by the defective product allegations in the complaint, not by a final determination as to coverage for indemnity costs. Thus, even if a carrier ultimately was justified in precluding coverage, it still may be obligated to pay defense costs.

MTBE Suits Are Defective Product Claims

In general, the MTBE suits allege wrongful conduct by the defendants related to their decision to use MTBE, not related to the individual spills or leaks of MTBE that caused the alleged contamination of groundwater. Plaintiffs typically

“The duty to defend is broader than the duty to indemnify as coverage for defence costs is triggered by the allegations of the complaint”

contamination of groundwater by MTBE that defendants added to gasoline to comply with the federal Reformulated Gasoline Program enacted by the 1990 Clean Air Act Amendments (“CAA”). See 42 U.S.C. § 7545 (k) and (m). Typically, the claims focus on the defendants’ alleged wrongful conduct in deciding to use MTBE – allegedly a defective product – rather than on allegations involving leaking underground storage tanks. These are defective product claims, not individual leak “pollution” claims.

As defendant companies face increasing defense costs and potentially enormous liabilities, they should take a hard look at their Commercial

However, the lawsuits at issue are product claims, not pollution claims, and therefore a “pollution exclusion” clause arguably would not preclude coverage and damages may be covered. Regardless, a policyholder may be entitled to

seek damages for property damage arising out of the defendants’ decision to develop and use MTBE as a gasoline additive and their failure to warn of dangers related to MTBE.



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Specifically, the MTBE complaints allege:

- ▶ Defendants should be held liable for contaminated groundwater resulting from the decision to use MTBE in order to boost the octane level in gasoline because their principal motivation for adding the oxygenate MTBE to gasoline was to increase their own profits, not to help fuel burn more efficiently or to reduce air pollution.
- ▶ Defendants chose to use MTBE rather than other oxygenates in gasoline even though a

choice of other safer oxygenates, allegedly such as ethanol, was available because MTBE was inexpensive and made from gasoline refining waste by-products.

- ▶ Defendants decided to develop and use MTBE despite having knowledge that MTBE has the propensity to contaminate groundwater by giving groundwater a foul taste and odor. As MTBE allegedly spreads faster and further in groundwater than other additives or other chemical components contained in gasoline and is slow to break

down, the MTBE inevitably contaminates wells and underground aquifers when gasoline leaks or spills. Thus, the MTBE allegedly contaminated groundwater by giving it a foul taste and odor.

- ▶ Defendants conspired to mislead the EPA, downstream handlers, the public, and Congress about the risks of adding MTBE to gasoline in order to include certain oxygenate requirements in the CAAA that would allow for the use of MTBE.

These claims are defective product claims. A recent California trial reinforces the view that the MTBE claims should be viewed as defective products claims. *See South Tahoe Public Utility District v. Atlantic Richfield Co.*, No. 999128 (Cal. Super. Ct. Dept. No. 514, filed Nov. 10, 1998). In that case, the jury instructions focused on determining whether “gasoline containing MTBE manufactured, sold, or supplied by any of the following defendants [was] defective in design because the risk of harm inherent in its design outweighed the benefits of that design.” *See id.* (Special Verdict [Phase I] Mar. 4, 2002). Similarly, in the pending claims, the basis for the plaintiffs’ allegations and the defendants’ potential liability is clear – that defendants should be held liable for developing, marketing, producing and selling an allegedly defective product. Accordingly, defendants should look to their

CGL policies with coverage for product liability claims for coverage of the MTBE claims.

CGL Policies With Product Liability Coverage Provide Coverage for Defense and Indemnity Costs Arising From Defective Product Claims

A defendant determining whether it can obtain coverage for its defense costs and liabilities arising out of the MTBE claims should look to the product liability coverage in its CGL policies. These policies generally provide both a broad duty to defend and coverage for liabilities arising from defective product claims.

In a typical CGL policy, the insurer has a duty to defend a policyholder against suits seeking damages for bodily injury or property damage. The duty to defend is broader than the duty to indemnify as coverage

for defense costs is triggered by the allegations of the complaint. This duty is owed any time the allegations give rise to a potentially covered claim even if the claim ultimately is not covered. Thus, if a products policy arguably covers the underlying claims, the insurer must provide coverage for defense costs.

As to indemnity, “products-completed operations hazard” coverage for defective product claims may be available if the policy provides for coverage of property damage or personal injury arising out of a defendant’s “product.” The term “product” may be defined in a variety of ways, such as:

Any goods or products manufactured, sold, handled, distributed, or disposed of by you or others trading under your name, including warranties or representations

Business Interruption Insurance: An Overview

by Michael K. Obernesser



Business interruption insurance can be an invaluable asset that is overlooked by policyholders. For companies large and small, business interruption insurance can be the difference between life and death when dealing with a significant business interruption. Business interruption insurance has numerous potential applications including enabling a company to fund payroll, purchase materials, and arrange for an alternative location upon which to continue the business during the period of interruption. However, insurers often dispute business interruption claims and policyholders need to be aware of the coverage rights and their insurers' respective coverage obligations. Examining the needs and the nature of a business will

help a company to find the coverage it needs in the event of a disaster.

By way of background, business interruption insurance evolved from "use and occupancy" insurance. Historically, use and occupancy was generally a rider or endorsement to an insured's property insurance, and arose when business owners realized that even a small amount of

property damage to a vital piece of property or machinery could cause their operations to grind to a halt. Unlike insuring the specific property itself, for which a value could be immediately determined, the business owners sought to insure the profitability of the business. Today, this type of coverage is encompassed within what is now known as business interruption insurance.



"Business interruption insurance" is often included within broad first-party property policies, but can more broadly reflect a variety of specific types of insurance coverage that an insured can purchase as part of, in conjunction with, or separate from property policies in order to protect itself from economic losses. In brief, these types of insurance, among other things:

- (1) provide coverage for an insured's economic losses caused by its inability to operate its business due to damage to its property or surrounding property;
- (2) provide coverage for an insured's economic losses caused by the loss of another, such as the inability of an insured to get delivery of a supplier's goods, thereby preventing the insured from producing and then selling its product to the marketplace ("Contingent Business Interruption" coverage);
- (3) reimburse the insured for the amount of gross earnings minus normal expenses that the insured would have earned but for the interruption of the insured's business (i.e., profits) ("Gross Earnings" coverage);
- (4) provide coverage where the insured's inventory has been destroyed or damaged and, therefore, the insured has been deprived of the opportunity to sell that inventory to the public ("Profit and Commission" coverage);
- (5) indemnify the insured for any increased costs of business operations above the norm because of a peril insured against ("Extra Expense" coverage); and
- (6) provide coverage when an insured loses business income as a result of the issuance of an order of a civil authority, such as a public health authority, that prohibits or results in the prohibition of access to the insured's property ("Civil Authority" coverage).

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While property insurance indemnifies the insured for the value of the property that has been lost or damaged, business interruption coverage

be entitled to coverage, the covered event must cause the property damage, and the property damage must cause the interruption.

Cas. Co., 751 N.Y.2d 4 (2002). Using the hypothetical discussed above, imagine that the area between the plant and its access road is

In its most basic form, Business Interruption insurance generally does not provide coverage for the property of another. However, Contingent Business Interruption coverage applies to business interruption losses caused by physical loss or damage to property belonging to someone other than the insured."

indemnifies the insured for the income lost when the property lost or damaged disrupts the insured's business.

Insurers often try to limit business interruption coverage even where a policy contains endorsements that are designed to enhance such coverage. What follows is a description of a basic claim made under a bare-bones business interruption policy, followed by a description of several oft-used endorsements and how they would provide coverage that a company may want or need. For purposes of illustration, presume an insured, Alpha Company, purchased a basic business interruption endorsement to its property insurance to cover its manufacturing plant in Florida. A hurricane lands near Alpha's plant, causing extensive damage to the plant and the surrounding area. Alpha seeks to file a claim under its business interruption policy.

Causal Chain

Generally, insurers contend that to make a claim under a business interruption policy, an insured must show physical damage to insured property, caused by a covered peril, which results in a loss to the insured. Thus, insurers often argue that these elements are not independent of one another; rather they are viewed as a causal chain. Under this theory, to

To recover under the insurers' standard argument, Alpha must first show that it suffered *physical damage* to the plant itself. Some damage must have occurred that results in a partial shutdown or stoppage of productivity for the plant. *See e.g., United Air Lines, Inc. v. Ins. Co. of the State of Pa.*, 2005 WL 786883 (S.D.N.Y. April 1, 2005) (Court held that airline could not recover for economic loss suffered as a result of the FAA-ordered grounding of all planes after the September 11, 2001 terrorist attacks because policy required a showing of physical damage.). While it is possible to recover where the insured retains some ability to operate after a loss, courts are oftentimes reluctant to grant coverage for mere slowdowns in productivity. *See Buxbaum v. Aetna Life & Cas. Co.*, 126 Cal. Rptr. 2d 682 (2002).

However, where an insured has suffered physical damage to limited portions of its property that affect operations, certain endorsements may impact an insurers' coverage obligations. For example, Ingress/ Egress or Civil Authority endorsements provide coverage for an insured when the business interruption is caused by its inability to access its property. *See Roundabout Theatre Co., Inc. v. Continental*

flooded, and state police will not allow anyone, including employees, to access the plant. In this hypothetical scenario, the loss to the company arises from the fact that no one can access the plant, not that the plant is unable to function. Nevertheless, pursuant to an Ingress/Egress or Civil Authority endorsement, Alpha may be able to recover for its losses sustained as a result of its inability to access its property.

Insured Property

Insurers also often contend that the damage must be to insured property. In its most basic form, business interruption insurance generally does not provide coverage for the property of another. However, Contingent Business Interruption coverage applies to business interruption losses caused by physical loss or damage to property belonging to someone *other* than the insured. In our scenario, assume that Alpha manufactured materials from items it purchased from its key supplier, Beta Corporation, which was destroyed by the hurricane. Until Alpha is able to purchase those materials from a third party, Alpha's plant will sit idle.

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Accounting for Business Interruption Claims

by John S. Wyckoff and Joseph T. Gardemal



Introduction

Business interruption claims (“BICs”) can play an important role in making a policyholder whole after it has suffered a significant loss. However, numerous issues may affect the complexity of a business interruption claim such as where:

(1) the claimant experiences no physical damage, (2) the claimant was geographically removed from the area where the damage occurred, and (3) the duration of the business interruption was limited. In order for an insured to maximize recovery prospects, there are a number of steps that should be taken both before and after any loss, as set forth below.



Figure 1- *General BIC Tasks To Conduct Before and After Disaster Strikes.*¹

Before Disaster Strikes

Prior to a loss, it is paramount that the risk manager completely understands the intricacies of the company’s insurance policies and has a disaster plan in place. This plan should be updated and reviewed periodically. Part of plan review should include analyzing the company’s insurance policies on an annual basis. Frequently when a loss occurs, few employees have reviewed the policies since the time that the policies were initially written. However, in order to act quickly in pursuing coverage, a risk manager should be familiar with the company’s insurance program in general and with key policy provisions such as notice requirements, time and coverage limits, exclusions, and significant endorsements. The risk manager should discuss any coverage issues with an insurance expert, clarifying the gray areas before a catastrophe can circumvent problems post-loss.

As part of a company’s disaster plan, the risk manager should build a team of experts (including outside advisors) to call upon in the event of a loss. The process of filing a claim is time-consuming and could divert the resources of management and staff. Thus, it is important to have an outside group of experts to assist in the business interruption claims process. The members of this team typically consist of the following members:

- 1) Company representatives (i.e. Risk Manager, Operations Managers)

- 2) Insurance company adjuster
- 3) Insurance company consultants
- 4) Company consultants (forensic engineers, accountants)
- 5) Insurance broker
- 6) Outside law firm

Having a disaster plan in place prior to an occurrence will enable the risk manager to expeditiously prepare a well-supported claim and assist in the company’s recovery efforts.

Documentation is the Key

The key to the successful outcome of a property and business interruption claim is a well-documented submission based on a thoughtful and logical analysis of the company’s loss. To begin the documentation process, the company should record the overall loss by taking photos, videotape, and employee testimony. The insurance company may find it difficult to deny a claim with a videotape showing an empty beach during the high season at a resort area or the company’s most important assembly machine in ruins.

In order to document the expenses of the loss, the company should set up loss-related accounting procedures and establish a general ledger account that tracks expenses related to the loss. Using this account will allow a company to track purchases, internal and external labor, and other expenses related to the loss. In addition to a loss-related account, the company should maintain separate files for copies of invoices and receipts for the loss. This will help make the claims filing process more

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efficient because the company will not spend valuable employee time searching for lost or misfiled invoices. Company management



should also train employees to clearly and specifically document loss-related purchases (i.e. New 7.0 Computer replaces the 6.0 Computer in Room 112 damaged by the fire.)

Projected Sales and Expenses

With respect to the business interruption-specific portions of the claim, the company should begin collecting budgets, forecasts, financial statements, and strategic plans that existed *prior* to the company's loss. These items are critical for developing the company's projected sales and expenses had there not been a disaster. If possible, the company should try to locate these records for the past three to five years so that patterns of meeting (or not meeting) budgets can be established. If a company has met its forecasts for the past five years, it may be difficult for the

insurance company to deny that the company would have hit its target in the year of the loss. Some of the other factors to consider when developing projected financial statements are economic conditions, competitors, new customers, and product lines, as well as seasonality.

Once projected financial statements are developed, the projected net profit can be compared to the actual net profit of the company during the loss period. The extra expenses are added to this difference to determine the overall insurance loss for the company. While many policies refer to "reductions in gross earnings less non-continuing expenses" as the method for calculating the business interruption loss, the court in *Associated Photographers v. Aetna Cas. & Sur. Co.*, found that the language in the policy was equivalent to the difference in actual net profit and net profit the company would have earned but for the loss.²

The company should also document and collect information to support the preparation of the BIC. For example, the company's sales department should immediately begin documenting sales cancellations, deferred orders, and lost sales. In addition, the company's outside consultants (such as accountants) may be able to work with the insurer in determining the preliminary loss. Managing the expectations of the insurer at the outset of any claim is of paramount importance because insurers often set reserves based on the preliminary loss estimate. Once the insurer has established a preliminary

loss reserve, it may be difficult to get the insurer to budge from its original number. Therefore, the company should carefully calculate the preliminary loss as a range and include "to be determined" items. Once a preliminary loss has been determined, the company can request an advance in order to prevent cash flow problems.

Post-Loss Considerations

The company should act in its own best interests and not focus solely on the insurance claim. For example, an insurer should not force its policyholder to rebuild an obsolete factory when it is prudent to rebuild the factory in another location with the latest technology. While the company may face additional interruption, its BIC team should be able to calculate the effect of building in a new location.

Furthermore, company management must be proactive and take ownership of the business interruption claim. The company should assert that the claim is theirs to

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INSURANCE COVERAGE CASE HIGHLIGHTS



These summaries are not intended to be an exhaustive analysis of legal developments in the insurance field. Rather, they are an overview of recent “highlights” of developments in selected states. Should the need arise, Howrey is able to assist its clients in a more detailed analysis of recent legal developments pertaining to insurance coverage in any state. The following highlights have been provided by Averitt Buttry, an Associate in our Washington, D.C. office, and Kenneth A. Remson, a Senior Associate in our Los Angeles office.

NEW YORK

Business-Interruption Claim Denied for Policyholder that Suffered Gross-Earnings Loss After September 11 Attacks

United Air Lines, Inc. v. Ins. Co. of the State of Pa., 2005 WL 756883 (S.D.N.Y. April 1, 2005).

The Southern District of New York recently denied United Air Lines (“United”) business interruption claim for a system-wide loss of gross earnings that it suffered after the September 11, 2001 terrorist attacks. The business-interruption clause in the United policy sold by Insurance Company of the State of Pennsylvania (“ICOSP”) insured “against loss resulting directly from the necessary interruption of business caused by damage to or destruction of the Insured Locations, resulting from Terrorism” United argued that the word “damage” as used in the business-interruption clause included economic damage. ICOSP argued that the clause required a showing of actual physical damage at an insured location. The court found in favor of ICOSP, stating that the word “damage” was “susceptible of only one interpretation” and required a showing of physical

damage. Thus, the court held that United could not recover under this clause for the economic loss it suffered as a result of the FAA-ordered grounding of all airplanes.

United argued that if physical damage were found to be a prerequisite to coverage, the physical damage to a ticket counter at the World Trade Center and the accumulation of ash at a Reagan National Airport gate were sufficient grounds for recovery. The court rejected that argument and found that United was entitled only to indemnification for the loss identified as resulting directly from the destruction of the one ticket counter at the World Trade Center—not for its system-wide loss. Turning to the ash-accumulation argument, the court noted that the business-interruption coverage was limited to “such length of time as would be required . . . to rebuild, repair or replace” the insured location. Because the accumulation was minimal and, alone, would not have required any gate closure “to rebuild, repair, or replace” it, the court held that this did not trigger the business-interruption clause.

United further sought coverage under a civil-authority clause for the ash accumulation. This clause

required damage to adjacent premises as a prerequisite to coverage. The court held that Reagan National Airport is not adjacent to the Pentagon, thus, no coverage existed under this clause. The court also noted that the grounding of airplanes was ordered to prevent further destruction, not because of any destruction that had already occurred.

ILLINOIS

Court Rules in Favor of Policyholder, Finding that the Clear Language in the Policy Overrides Relation-Back Provision

BSC Ins. Co. v. Wellmark, Inc., 2005 U.S. App. LEXIS (7th Cir. June 1, 2005).

The Seventh Circuit affirmed that a relation-back provision in an errors and omissions policy did not override the clear language to make arbitration optional even though policies issued previously contained mandatory arbitration clauses.

The insurer filed suit to compel what it believed was a mandatory arbitration clause in a policy that it

had issued after the policyholder sued the insurer for coverage. This policy was the most recent of four policies issued annually over a period of four years (1994-1997). Unlike the prior three policies that contained mandatory arbitration clauses, this last-issued policy (1997) stated that arbitration was optional.

The court held that the relation-back clause could not override the clear language of the 1997 policy's optional arbitration clause, which stated that "any controversy arising out of or relating to" the 1997 policy would be arbitrable only at the insured's request. The court noted that although the relation-back provision might affect coverage and limits of liability, it could not affect the policyholder's right to choose not to arbitrate. The court added that this clear language also overrode any presumption to arbitrate, as arbitration is a matter of consent.

CALIFORNIA

California Supreme Court Holds CGL Policies May Provide Coverage for Environmental Cleanup Costs Via Administrative Proceeding

Powerine Oil Co. v. Superior Court, S11329 (Cal. Aug. 29, 2005) ("Powerine II")

In a widely watched and anticipated decision, the California Supreme Court narrowed the effect of one of its more questionable coverage decisions in recent years. Specifically, the Court concluded

that some Powerine Oil Company's excess comprehensive general liability policies may provide coverage for the expenses of complying with environmental cleanup orders imposed by Regional Water Boards in administrative proceedings. The now defunct oil refiner faces costs arising from administratively imposed abatement orders related to soil and groundwater pollution related to past refining operations.

Earlier in *Certain Underwriters at Lloyd's of London v. Superior Court (Powerine Oil Company)*, 24 Cal.4th 945 (2001) ("*Powerine I*"), the Court had held that damages under Powerine's London Market standard primary CGL policies were limited to "damages" ordered by a court and did not include expenses paid in response to administrative agency orders. The court distinguished *Powerine I* and *Foster-Gardner, Inc. v. National Union Fire Ins. Co.*, 18 Cal.4th 857 (1998) (standard CGL policies' duty to defend a "suit" limited to actions prosecuted in a court) by analyzing the language in the nine standard form excess/umbrella policies sold by Central National Insurance Company of Omaha.

Unlike the primary policies at issue in *Powerine I*, the Central National policies agreed to indemnify the policyholder for "damages, direct or consequential and expenses, all as more fully defined in the term 'ultimate net loss.'" The court found the terms "damages" and "expenses" were not intended to be synonymous and, therefore, "expenses" had to provide something

more than court imposed "damages."

In addition, the definition of "ultimate net loss" included the total sum the policyholder was obligated to pay by reason of property damage "either through adjudication or compromise and shall also include . . . all sums . . . paid for litigation, settlement, adjustment and investigation of claims and suits." The Court concluded that obligations incurred through "compromise" or the "settlement, adjustment and investigation of claims" do not necessarily reflect an underlying court suit and could, for example, include a compromise designed to avoid litigation altogether.

Finally, the Court noted that the Central National policies were in part umbrella policies, intended to provide coverage in instances where primary policies did not provide coverage, thus their coverage should be broader than that of the London Market primary policies at issue in *Powerine I*. *Powerine II* calls into question the vitality of *Powerine I* and may lead to its reconsideration in the future once the Court returns to full strength after the appointment of a seventh justice.

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should be assessing their terrorism exposures and insurance alternatives now. Identifying and attempting to minimize terrorism exposures can be a mammoth undertaking, particularly for policyholders in the chemical, energy, utility, real estate and transportation industries. One national broker markets a proprietary database of more than 5,300 potential terrorism targets, and 24

primarily by offshore, financially questionable, insurers that may be unable to actually pay claims in the event of a massive terrorism loss. Others have predicted that market forces, and the insurance industry's desire for premiums, will result in the developments of an alternative, and financially robust, insurance market for terrorism exposures.

alter current coverage through the use of varying limits or contingent exclusions.

Gaps in TRIA

However, even if TRIA is extended in its entirety or on a modified basis, there are serious gaps in the terrorism coverage reinsured through TRIA which policyholders, depending on their exposures,

"If TRIA is extended, it will only be done with significant modifications. Thus, corporate policyholders should be assessing their terrorism exposures and insurance alternatives now."

different attack manuals to simulate 127,000 terrorism events. Given the sheer number of potential exposures, prudent measures such as relocating some activities, retrofitting existing structures, installing sophisticated security measures, and investing in disaster recovery programs still never fully eliminate the financial risks of terrorism. Thus, policyholders with terrorism exposures need to evaluate purchasing terrorism coverage to minimize the financial impact of any terrorist loss.

Policyholders should be concerned regarding the impact TRIA's expiration or modification could have on the availability of terrorism insurance. Some have predicted that it will become effectively unavailable or be offered

At the moment, the insurance industry is reacting in different ways to the uncertainty surrounding TRIA's future. For example, some property insurers are offering different limits (one limit until TRIA expires and another lower limit after TRIA expires), while other insurers are employing contingent absolute terrorism exclusions that go into effect immediately upon TRIA's expiration. The insurance regulators of a few states have not approved the use of these contingent endorsements and/or may be requiring

that terrorism coverage continue under policies irrespective of whether TRIA is renewed. Corporate policyholders should review carefully any attempt by insurers to

should consider filling with non-TRIA terrorism insurance. The most notable gap is that TRIA specifically provides that the terrorist act must be committed by someone acting on behalf of a foreign person or interest. This limitation would appear to exclude any domestic acts of terrorism (such as the Oklahoma City bombing). In light of recent news stories reporting the arrests of people living in the United States allegedly engaged in potential terrorist support or plots, ambiguities could arise as to whether a terrorist act committed by such people or an extremist group based in the United States were acting on behalf of a "foreign person or interest."

Similarly, TRIA limits its coverage to losses occurring in the United States (with the exception of U.S. based aircraft and vessels). The targeting in the past of American iconic "corporate symbols" and the potentially easier ability of terrorists to operate in

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foreign countries means U.S. corporate policyholders with significant foreign operations, personnel, or exposures should consider supplemental non-TRIA coverage.



Although TRIA does not mandate that the terrorism coverage offered by insurers include coverage for

nuclear, biological, chemical or radiation exposures, it does not reinsure it if an insurer offers NBCR coverage. According to the Treasury Department, only 3% of policyholders purchased NBCR coverage in 2002, 2003, and 2004. Policyholders with NBCR risks should evaluate whether to purchase such coverage irrespective of the future of TRIA.

Policyholders should certainly not wait until late December to start searching for TRIA-replacement coverage as the market capacity may not be sufficient and pricing may be extremely unfavorable. Even if TRIA continues, the existing gaps in coverage under TRIA may make it worthwhile for policyholders to consider buying supplementary terrorism coverage. Corporate policyholders with significant terrorism exposures should strongly consider purchasing separate stand-

alone terrorism coverage (with market capacity already existing in London and Bermuda for these risks) for non-TRIA-covered terrorism exposures (such as domestic terrorism) and securing options to extend such coverage to include terrorism coverage formerly encompassed by TRIA in the event TRIA is not renewed. While there are many creative and sophisticated ways to procure terrorism coverage, whether via traditional insurance or through captive programs, and whether relying upon TRIA or purchasing stand-alone coverage or some combination of both, there is no substitute for being aware of what your exposures are, and what your coverage provides, before a tragic event or loss occurs.

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present – it is not the insurance company’s claim. In doing so, the risk manager can be instrumental in the reserve-setting process, which does not allow the insurance company to set the loss reserve an unrealistically low amount. It is also important to maintain an open line of communication among all of the parties involved in the claims process. To avoid misunderstandings, it is important to keep the insurance adjuster aware of major decisions that relate to the approach of the claim. The

risk manager should discuss these with the claims adjuster and get them to “buy in” on these decisions. It is also a good idea to keep the adjuster aware of subsequent changes to the claims approach as well.

Following these procedures can greatly assist a company in its time of need and help the recovery process to proceed in an expeditious manner.

¹These general tasks should be conducted regardless of whether the BIC is resolved through litigation or approved for coverage. ²Litigation Services Handbook, 2 ed, (ch15, pg 10), John Wiley & Sons Inc., New York.

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made at any time with respect to the fitness, quality, durability performance, or use of your “product” and the providing of or failure to provide warnings or instructions.

Thus, a defendant’s claim for coverage of claims alleging that MTBE was a defective product potentially falls within “products-completed operations hazard” coverage.

Nevertheless, insurers may attempt to limit coverage for defective product claims in a variety of ways. One of the principal ways may be

or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water.

Thus, in order to obtain coverage for the MTBE suits under a typical CGL policy with product liability coverage, insurers may argue that a policyholder must prove that an “absolute pollution exclusion” does not preclude coverage for the defective product claims.

policies and an insured policyholder should be entitled to defense costs.

As to indemnity, an MTBE defendant may be entitled to coverage for its liabilities even if a product policy contains an “absolute pollution exclusion.” In typical pollution claims, these types of exclusions preclude coverage for claims alleging property damage caused by leaking underground storage tanks or other gasoline spills. The MTBE claims may be distinguishable, however, because the claims are product claims, not pollution claims. They are based principally on products

“Ultimately, the MTBE suits are unique in that they are product claims, not pollution claims. MTBE defendants, therefore, may be entitled to coverage for indemnity costs under product liability policies even if those policies contain an ‘absolute pollution exclusion’ clause.”

through a “pollution exclusion” clause. One of the more restrictive pollution exclusions is referred to as an “absolute pollution exclusion.” Insurers often included this type of exclusion in CGL policies issued in the late 1980’s and 1990’s, the time period associated with many of the allegations. Insurers may argue that this exclusion clause precludes coverage for all claims related to pollution accidents, including:

Bodily injury or property damage arising out of the discharge, dispersal, release

MTBE Defendants Should Consider Pursuing Defense and Indemnity Coverage Under CGL Policies with Product Liability Coverage

An MTBE defendant with product coverage could be entitled to coverage for its defense costs. This entitlement arises because so long as the allegations in the underlying suits potentially give rise to product coverage, the duty to defend is implicated. A product claim for coverage of the MTBE suits under a CGL policy arguably is covered because it would fall within a “products-completed operations hazard” provision. Moreover, that coverage would not necessarily be precluded by an “absolute pollution exclusion.” Accordingly, the allegations arguably give rise to a potentially covered claim under most CGL

liability, not on negligence. The plaintiffs’ claims rest primarily on their contention that industry defendants are liable for developing, marketing, manufacturing and selling a defective product by deciding to add MTBE to gasoline, not for leaking the MTBE into groundwater. Although courts sometimes have precluded coverage for product liability claims based on pollution exclusion clauses, they have not necessarily precluded coverage when the underlying claims relate to the policyholder’s distribution of a defective product rather than to traditional claims of environmental discharge. Coverage may be available to defendants because the underlying claims at issue focus on corporate decisions related to the manufacture of the product at issue.

Ultimately, the MTBE suits are unique in that they are product claims, not pollution claims. The underlying pollution-related property damage claims relate to the defendants' corporate decision to manufacture and use MTBE, not to leaking storage tanks or gasoline spills. MTBE defendants, therefore, may be entitled to coverage for indemnity costs under product

liability policies even if those policies contain an "absolute

"Business interruption policies generally provide that in determining a loss, consideration is given to the experience of the business before the loss and its probable experience thereafter."

pollution exclusion" clause. Certainly, any MTBE defendant should consider pursuing coverage under a CGL policy with product liability coverage.

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Here, if the policy contained a Contingent Business Interruption endorsement, there would be coverage for Alpha's business interruption, even though it was caused by damage to Beta's property and not to its own property. *See e.g., Pentair, Inc. v. American Guarantee & Liability Co.*, 400 F.3d 613 (9th Cir. 2005) (Court noted that "if the earthquake had damaged a substation directly serving Pentair, any resulting business interruption losses would be covered. . .").

Insured Peril

Further, insurers also argue that the damage must be caused by an insured peril. Where business interruption coverage is an endorsement to overall property insurance, the policyholder must look to see if the policy specifically excludes the peril causing the loss. Thus, our hypothetical policyholder, Alpha, would need to review its policy to determine whether hurricanes are excluded from coverage. Even if so, all of Alpha's business interruption losses that relate to the hurricane may not be

excluded depending upon the cause of the actual injury.

Actual Loss

Finally, insurers often argue that the insured must show that the interruption caused an actual loss as a result of the suspension of operations. *See Dictiomatic, Inc. v. USF&G*, 958 F.Supp. 594, 603-04 (S.D. Fla. 1997). Business interruption policies generally provide that in determining a loss, consideration is given to the experience of the business before the loss and its probable experience thereafter. The company's own records and financial projections will be very important in making the determination. *See American Med. Imaging Corp. v. St. Paul Fire & Marine Ins. Co.*, 949 F.2d 690, 694 (3d Cir. 1991). Where there is a loss to the insured, loss is computed from the time the damage occurred to the time when the property could be repaired, replaced, or returned to functionality. This is known as the "period of restoration." The Insurance Services Office has defined "period of restoration" as the period of time that begins 72 hours after the loss

and ends on the date when the property "should be repaired, rebuilt or replaced with reasonable speed and similar quality." Courts usually apply an objective, rather than a subjective, determination. For coverage beyond the period of restoration, an insured may purchase an Extended Period of Indemnity that would provide insurance for any unforeseen delays in the repair or replacement of its property.

As discussed briefly above, policyholders should review their business interruption insurance carefully to ensure they are getting the benefits of their bargain. Ideally, the time to conduct such a review is before disaster strikes. However, in the event of any type of business income loss, policyholders should check their insurance policies to determine whether valuable assistance can be obtained.

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Howrey In the News

What is the Fate of Terrorism Insurance?

On June 17, *CBS Marketwatch* contacted Ty Childress (Howrey Los Angeles) to explain how a U.S. Treasury report on terrorism could impact the renewal of the multibillion dollar Terrorism Risk Insurance Act. As Ty noted, the Act is scheduled to expire at the end of 2005 so “[t]he Treasury report could be a political document advocating a particular course strongly or just something that provides more information. Everyone is waiting to see. Ultimately, it will be up to Congress to decide whether to end the program or extend it.” Ty was paraphrased as explaining that the main concern is, without federal backstop, terrorism insurance will not be available in the private market or will only be available at very high premiums. In a June 2 article in the *Property Protection Report*, Ty advised companies to investigate the standalone insurance market as a fallback option because “[t]here are risks that TRIA does not cover,” such as domestic terrorism (e.g. the Oklahoma bombing) and biological and nuclear attacks.

Hurricane Katrina Causes Business Interruption Claims

On August 31, A.M. Best Company, Inc.’s *BestWire* interviewed Dave Steuber (Howrey Los Angeles) about the state of business-interruption claims in the aftermath of Hurricane Katrina.

“This impacts not only the general area of New Orleans itself, or even Louisiana itself, but contingent business-interruption effects could be felt nationwide, if not internationally,” Dave explained. “There may well be companies and business elsewhere who might have coverage claims under their own policies far away from that port. I think you’re going to see trade disruption claims, maybe hinging upon a civil authority or contingent business type of analysis, and many types of claims that often have not been fully vetted in courts before,” said Dave.

MTA’s Record Settlement of Metro Construction Lawsuit

On August 22, the *Los Angeles Business Journal* reported that the LA Metropolitan Transportation Authority plans to pay \$40 million to \$60 million to settle a nine-year dispute with its primary insurer for claims brought against the agency during construction of the Metro Rail line system. The dispute is similar to an increasing number of lawsuits involving policies for large property damages that have unclear terms and ambiguous language. As Dave Steuber (Howrey Los Angeles) explained in the news article, “in the past, they used to be resolved on an amicable basis. As the dollars are increasing, they are becoming more and more contentious and more and more resolved by the courts.”

How to Select a Law Firm’s Homeland Security Practice?

On June 2nd, the *Property Protection Report* published an article about how to evaluate a law firm’s homeland security practice. As Ty Childress (Howrey Los Angeles) explained, it must be determined, for instance, that the group is well-coordinated with a tight communication and collaboration structure. As was reported in the article, “the best way to determine this is through the interview process, says Ty

Childress, an attorney with Howrey LLP in Los Angeles, who represents New York City developer Larry Silverstein in this capacity. Ask them to put together representatives from the team that would represent you and give you a presentation on the issues that affect your business...because homeland security does affect a cross-section of areas—from insurance to real estate to finance—you want to make sure that the attorney in question has background in that area prior to 9/11.”

As Ty further explained, companies need an expert in the field who is able to integrate this knowledge into the growing number of homeland security regulations and case law.

Have We Uncovered All Questionable Broker Compensation Methods?

According to a May 27 *Associated Press* article, the latest allegations in the already scandal-plagued insurance industry may lead investigators in a new direction – some insurers may have concealed bonus commissions in premiums. As Ty Childress (Howrey Los Angeles) explained, the exchange of money between insurance companies, brokers and prospective policyholders offers a broad array of compensation methods. “There’s obviously all kinds of ways these issues have come up. I’m not sure anyone has uncovered all the ways brokers and insurers have paid each other.” At a minimum, full disclosure is necessary, Childress said.

Howrey’s Honors & Awards

“Super Lawyers” and “Rising Stars”

In September 2005, the publisher of *Law & Politics* magazine and *Super Lawyers* magazine announced its selection of “*Rising Stars*” – “the best up-and-coming attorneys” in Southern California. In the field of Insurance Coverage, William Um, a partner in our Los Angeles office, was included in the prestigious “*Rising Stars*” list. William joins many of our Insurance Recovery Group partners who were recently named as 2005 “*Super Lawyers*” – Lester Brown (LA), Mary Craig Calkins (LA), Joanne Caruso (LA), Tyrone Childress (LA), Amy Fink (LA), Thomas McMahon (LA), Curtis Porterfield (LA), and David Steuber (LA).

“A Go-To Firm On All Counts”

In June 2005, *Chambers USA* published its annual “America’s Leading Lawyers for Business” directory and Howrey’s Insurance Recovery Group received top recognition. According to Chambers USA’s research, “Howrey is noted by market sources for its policy-

holder practice. Its great national reputation attracts considerable work to the California office. Its high points usually involve acting for policyholders in insurance recovery disputes, though the team also offers counseling on various insurance products.” *David Steuber* is described as “highly skilled and considered an excellent opponent.” *Robert Shulman* “has all the skills and is an excellent attorney who is recommended as a fantastic strategic thinker with experience in complex disputes.” Overall, Howrey’s Insurance Recovery Group is described as “a full-service group with respected market presence and a large, talented team of attorneys. The diverse array of expertise and responsive, well-researched approach make this a go-to firm on all counts. The proactive team leads forays into some of the most current areas of market concern.

It is advising clients concerned about their interests following the Spitzer allegations against Marsh, AIG and Aon. Other areas of experience include D&O and products liability.”

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