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Preparing to Document and Mitigate Hurricane Losses Before the Storm: Lessons Learned from the Crisis in Puerto Rico and Steps to Help Avoid Uninsured Losses in 2018

Nearly a year after Hurricane Maria wreaked havoc on Puerto Rico, the Puerto Rico Electric Power Authority announced last month that power had finally been restored to all of the island's residents who lost power as a result of the storm. As has been widely reported, the state-owned utility has struggled over the last year to recover from the storm, which decimated the island's electrical grid and caused the largest blackout in U.S. history. Until very recently, many homes and businesses were still without power.

The unprecedented scope and duration of the disruption to Puerto Rico's infrastructure as a result of Hurricane Maria, and the threat posed this week by Hurricane Florence barreling towards the East Coast, underscores the increasing risks of catastrophic business interruption losses faced by businesses operating on the Atlantic and Gulf Coasts. The 2017 hurricane season (which also included Hurricane Irma in Florida and Tropical Storm Harvey in Texas) was one of the most destructive in history. Experts estimate the losses from weather-related disasters in 2017 collectively exceeded $344 billion.[1] Some experts predict that, due to the effects of climate change, the frequency and intensity of hurricanes like those seen in 2017 are the "new normal."

Unfortunately, many insurance companies faced with claims from policyholders for last year's extraordinary losses have denied or delayed payment, often in bad faith. In fact, earlier this year the Puerto Rico Insurance Commissioner issued a combined 2,587 fines to six insurers alone for their bad faith claims handling practices. As recently as June of this year, more than 270,000 insurance claims against insurers operating on the island were reported as still pending.[2] But this may be the tip of the iceberg as some of the more complex claims for significant business interruption losses from Hurricane Maria are still being evaluating and adjusted by insurers. In other words, another wave of denials or improperly discounted loss payments may be coming soon.

Under Puerto Rico's Insurance Code governing unfair claims handling practices, an insurer is required, among other things, to promptly respond to a claim notice within ninety (90) days, conduct a reasonable claim investigation before denying coverage, and "make a rapid, fair and equitable adjustment of a claim when responsibility is clearly present."[3] While Puerto Rico does not have a specific statute that provides a policyholder a right to pursue a claim against an insurer for such bad faith conduct, courts in Puerto Rico have recognized a bad faith claim against an insurer under Puerto Rico's Civil Code and the concept of "dolo"—*i.e.*, the malicious intent to do harm.[4] Thus, the standard for insurer bad faith in Puerto Rico is "either conscious wrongdoing, reckless indifference or the lack of a reasonable basis for denying a claim."[5] "Puerto Rico law provides that when a party acts with bad faith ('dolo') in breaching a contract, the aggrieved party may recover all damages that originate from the nonfulfillment of the obligation."[6] Notably, a policyholder is entitled to recover its reasonable attorneys' fees incurred in bringing a successful bad faith claim.[7] Many states along the Atlantic and Gulf Coasts have similar laws that allow policyholders to seek extra-contractual damages against insurers that deny or delay the payment of claims in bad faith.

If your company as a policyholder faces the situation where an insurer delays, refuses to pay, or refuses to fairly value a hurricane-related claim, it is important not to simply accept the insurer's coverage position before you have consulted with coverage counsel and determined whether a demand letter or potentially a lawsuit to secure full coverage may be necessary. In addition, if warranted, there may be damages available for the insurer's delay. Moreover, as the 2018 hurricane season nears its annual climax in the weeks ahead, businesses operating on the Atlantic and Gulf Coasts should review their insurance policies that might cover risks associated with a catastrophic storm, including those arising from a significant and prolonged disruption of critical infrastructure services, and be prepared to take action to maximum recovery for their potential losses.

REVIEW YOUR BUSINESS'S INSURANCE PROGRAM TO ENSURE NATURAL DISASTER COVERAGE IS ADEQUATE AND NOT INADVERTENTLY LIMITED BY NEW ENDORSEMENTS.

The greater frequency and severity of recent natural disasters, coupled with the potential for localized natural disasters to disrupt supply chains in today's globalized economy, increase the likelihood that your business may incur significant natural disaster losses in the future. At the same time, insurers may respond to the recent record property and casualty losses by quietly including endorsements with stricter policy terms at upcoming policy renewals, which could create unexpected gaps in coverage. To minimize the risk of future losses and to avoid gaps in coverage, all businesses should carefully review their insurance programs with experienced brokers and legal counsel to ensure coverages are adequate in the event of a catastrophic loss. Additionally, in light of the unprecedented duration of the disruptions to critical infrastructure in Puerto Rico and Houston following the 2017 hurricane season, businesses should consider seeking to extend the indemnity period for business interruption losses.

KEY INSURANCE COVERAGES FOR HURRICANE LOSSES FOR ALL TYPES OF BUSINESSES INCLUDE:

Business Interruption (BI) Insurance. Covers lost profits that a business would have earned but for the interruption of business caused by physical damage to, or loss of use of, property covered by the policy.

Contingent Business Interruption (CBI) Insurance. Even if your business did not experience *direct* property damage, your property policy may provide CBI coverage for economic losses arising from supply chain disruptions such as an inability to acquire goods or services from your suppliers, or an inability to deliver your products or services to customers.

Service Interruption Coverage. Covers any loss or expense caused by interruption of utility services resulting from damage to a utility's property.

Civil Authority Coverage. Protects businesses from losses resulting from a government order restricting access to a business's property or closing airports, roadways, bridges, or ports.

Extra Expense Coverage. Covers expenses necessary to resume normal business operations and mitigate losses.

Ingress/Egress Coverage. Pays for loss of business income caused by physical damage to property of others that prevents ingress/egress to your business.

Cyber / Data Security Insurance Coverage. Covers losses arising from a network security breach that results in the unauthorized disclosure of confidential data. A company's network security systems (or those of its vendors) may be impaired or disabled during a natural disaster, making the company more vulnerable to cyber attacks.

KEY EARLY STEPS TO AVOID MISHAPS THAT CAN DIMINISH OR PREVENT YOUR INSURANCE RECOVERY:

When making a claim following a natural disaster, businesses should promptly and proactively assess and document their losses, evaluate their insurance coverage, and act to comply with any contractual conditions that are necessary to obtain coverage. The following is a summary of some essential steps that your business should take to maximize the value of its insurance assets following a natural disaster.

Gather All Policies and Closely Review Their Terms. If your business has not done so already, it should gather and review all potentially applicable insurance policies, including excess and umbrella coverage. As policy terms vary and may be subject to different interpretations, consult with coverage counsel to assist in evaluating coverage. Even if your company is unsure of the full extent of its losses, it is vital to promptly locate all available insurance policies, assess the potential coverages available, and promptly notify the insurers to maximize the recovery available under your company's insurance program.

Give Prompt Notice. Policies frequently require that an insured notify the insurer "immediately," "as soon as possible," or "as soon as practicable" after the insured becomes aware of a potential claim. The effect of failure to provide notice in accordance with the policy terms varies among jurisdictions, but the consequences of failure to comply with notice provisions may be severe and preclude coverage. Property policies also often contain deadlines for providing a "sworn proof of loss" documenting the causes and value of the loss. It is important to know these deadlines from the outset and to seek extensions if necessary.

Collect and Preserve Evidence of Business Losses and Damages. It is important to record all costs, expenses, and damages for which you might seek coverage. If your business sustained direct property damage, take photos and videos of property damage and business interruptions to the extent possible and retain damaged property and equipment. To ensure full coverage under BI and CBI insurance for lost profits, businesses should document their losses by maintaining proof of business performance prior to, during, and following the disaster. Many policies also provide coverage for the expenses associated with such claim preparation-related activities. All such expenses should be tracked starting immediately after the hurricane event and even certain preparation expenses before the event.

Be Careful About Internal and External Communications Regarding the Loss. Businesses should be careful about what they say about insurance coverage in internal and external communications with brokers, insurers, and their adjusters / agents. If litigation over insurance coverage becomes necessary, insurers may gain access to internal communications such as emails and memoranda regarding a business's claims for insurance. How the loss is characterized in such communications may be used to deny coverage. Involving coverage counsel in these communications may ensure that they are protected as privileged in the event of litigation over coverage. Businesses also should identify a single point of contact or spokesperson for all communications with insurers.

Coordinate Mitigation Efforts With Insurers. While it is important to mitigate losses, it also is important to communicate with insurers regarding such efforts when possible. This will minimize the chance that the insurer will apply hind-sight to second-guess the reasonableness of the mitigation procedures that a business puts in place.

Engage Coverage Counsel. Claims from storm events are complex and may contain potential coverage defeating traps. Experienced coverage counsel is critical and will work with your brokers to ensure that you can maximize the insurance recovery for your loss.

COVERAGE ISSUES TO NAVIGATE BEFORE MAKING A CLAIM:

Policy Exclusions and Proximate Causation Issues. Property policies typically cover “all risks” or specified “named perils” that are not otherwise excluded. Exclusions generally target specific causes of loss. Flood, mold, bacteria, and pollution exclusions are some key exclusions insurers can be expected to assert for hurricane-related losses. It is critical to carefully identify the covered, non-excluded cause of loss from the beginning to avoid unwittingly providing the insurer unjustified grounds to deny your claim. As we have seen repeatedly after disasters like 9/11, Hurricane Katrina, the 2011 Japanese earthquake and tsunami, Superstorm Sandy, and the cluster of catastrophic storms last year, causation issues will be hotly contested in any claim that arguably involves more than one cause of loss (*i.e.*, wind and flood, or flood and mold). The law regarding concurrent causation differs across jurisdictions and continues to develop, so it is important to be cautious when asked by an insurance company to ascribe a specific cause to your loss. Moreover, recent state supreme court decisions in Texas and Florida confirm that policyholders should pay careful attention to anti-concurrent causation exclusions in their policies and attempt to remove them at annual renewals.[8]

Sub-Limits and Deductibles. Most policies contain varying sublimits and self-insured retentions depending on the cause of the loss. It is important to understand these limitations before making a claim. For example, some named-peril policies contain specific “Named Windstorm” or “Hurricane” coverage in addition to usual coverage for high winds. Such policies often contain sub-limits and deductibles for these perils that may limit the amount of coverage available.

Multiple Occurrences vs. Single Occurrences. Insurance policies typically provide for a deductible for each “occurrence” that results in a loss, as well as a per-occurrence limit below the total aggregate limit of the policy. Because storms can cause damage to an extremely wide area, many businesses incurred damage to more than one facility in different locations and at different times – sometimes several days apart. Consequently, the resulting losses potentially may be considered one occurrence (*i.e.*, one storm) or multiple occurrences (*i.e.*, numerous locations separately damaged, or damaged by multiple storms) depending on the specific facts involved and policy language. Businesses should consult with coverage counsel before making a claim in anticipation of disputes over the number of occurrences to maximize coverage in view of the specific deductibles, per-occurrence limits, and language of the policy.

Loss Valuation Issues. Many policies contain information about how losses should be accounted (*i.e.*, actual cash value, replacement cost value, or functional replacement cost value) which can have a dramatic impact on the value of an insured loss. It is important to understand these provisions before making a claim, and for complicated losses, it may be advisable to seek the advice of a forensic accountant before submitting a proof of loss. Furthermore, when rebuilding / refurbishing properties after a disaster, businesses generally must comply with building code regulations currently in force, which may be more onerous than code requirements in place when a building was originally constructed. Some policies will cover additional costs to bring a property up to current code regulations, while others may not.

Acts of God / External Infrastructure Exclusions in Cyber Policies. Many cyber policies include exclusions for security breaches arising out of failures of external infrastructure, such as power failures. Some cyber policy forms also include "acts of god" exclusions for breaches arising out of floods, fires or other natural disasters. In other words, coverage may be excluded if an external cause disables the policyholder's network security defenses, leading to a data breach. Cyber policies and the cyber extensions now included in many commercial property policies are relatively new to the market and it is unclear to what extent insurers will rely on these types of exclusions in the wake of a natural disaster. However, it is important to coordinate the communications with the cyber insurers with experienced data security and coverage counsel to minimize the risk of the application of these exclusions.

We work closely with our clients and their risk managers to collect from their insurers for losses arising from property damage, business interruption, and supply chain disruption caused by catastrophic events, and have obtained billions of dollars in insurance recoveries for our policyholder clients.

[1] Aon Benfield Weather, Climate & Catastrophe Insight 2017 Annual Report.
[2] http://caribbeanbusiness.com/puerto-rico-insurance-industry-hinders-recovery-with-unsettled-claims/.
[3] § 2716a Unfair claim adjustment practices or actions, 26 L.P.R.A. § 2716a.
[4] *See Event Producers, Inc. v. Tyser & Co.*, 854 F. Supp. 35, 38-39 (D.P.R. 1993), *aff'd sub nom. Event Producers, Inc. v. Tyser & Co. N. Am.*, 37 F.3d 1484 (1st Cir. 1994) ("The field of insurance is governed by the Insurance Code, which has no direct provision for such an action. . . [But] given the trend in other states and the general tendency in Puerto Rico to protect consumers, we find that there can be a bad faith action against an insurer. . .")
[5] *Id.*
[6] *Oriental Fin. Grp., Inc. v. Fed. Ins. Co.*, 598 F. Supp. 2d 199, 224 (D.P.R. 2008) (citing P.R. Laws Ann. Tit. 31 § 3024).
[7] *See QBE Seguros v. Morales-Vazquez, No. CV 15-2091 (BJM),* 2018 WL 3763305, at *6 (D.P.R. Aug. 7, 2018) ("QBE delayed the adjustment of his claim in violation of the Puerto Rico Insurance Code and engaged in bad faith post claim underwriting, both of which entitle him to reasonable attorneys' fees.")
[8] *See Sebo v. American Home Assurance Co., Inc.*, 208 So.3d 694 (Fla. 2016) (holding that where there are covered and non-covered causes of a loss, and the "efficient proximate cause" cannot be determined, the loss is generally covered, but noting that insurers can contract around this doctrine); *JAW The Pointe, LLC v. Lexington Insurance Co.*, 460 S.W.3d 597 (Tex. 2015) (enforcing anti-concurrent causation flood exclusion where wind and flood were contributing causes of the loss).