Your Coverage Advisor

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Insured's Response to Disaster Recovery: A Forensic Accountant's Perspective

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When Disaster Strikes

What do you do when you hear, "We had a fire."? Too often, businesses focus on insurance as their primary recovery option. However, as an insurance specialist, my advice is: *Don't* rely on insurance. Certainly, insurance coverage will be a critical component of the solution. However, an insured should always address their safety and other business issues *first.* In my experience, the businesses that attack the problem immediately *as if they had no insurance* achieve the best results both for long-term viability of the business **and** for procuring insurance recovery.

Teamwork in these situations is crucial. As a first step in the recovery process, assemble senior leadership and relevant personnel to implement your disaster recovery plan. If you are one of the many businesses without such a plan, this provides the impetus to create one. Together, brainstorm ways to minimize the loss of property and business income. Proactively consider every aspect of operations and identify steps to mitigate loss as quickly as possible at the impacted location, on overall production and sales, and for customer/supplier relations. Codify this into a solid response plan and clearly assign roles and responsibilities. Depending on the business/situation, your plan will likely include the following:

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- Precautions:
  - to ensure safety of personnel and others; and
  - to prevent further property damage.
- Assessment/quantification of options for:
  - moving operations and/or production to other locations;
  - depleting inventory to maintain sales; and
  - obtaining goods or materials from competitors.
- Procedures to communicate with customers, suppliers, and distributers.
- Steps to begin repair process as soon as possible.

This planning should include representatives from all facets of the business: manufacturing, supply-chain, management, sales/marketing, legal, and accounting. Each will have a valuable role to play. At this stage, the accounting role is to crunch numbers to inform decision-making on questions such as:

- How will moving production or operations impact sales?
- How can inventory best be utilized to minimize loss or expense?
- What are the costs and benefits of specific steps?
- Where can we save costs?
- And, last but not least, will our insurance policy pay for these recovery activities?

Working With Your Insurer

Unfortunately, insureds often discover at these crucial junctures that the insurance process may not be as they expected. On the one hand, insurance was purchased for just such circumstances, and the insurer is now a business partner and crucial member of your disaster recovery team. Insurance proceeds are often critical to funding property restoration and providing crucial cash-flow throughout the process. On the other hand, the insurer is a separate business entity, and adjusters represent the carrier, not the insured. As in any business relationship, there will be times when each party's interests are aligned, and times when they are not. Therefore, the claim process can be cooperative, or it can be contentious, and often it is both. So what steps can insureds take to make their carrier a partner, not an adversary, in this process?

The insured and insurer carry the same significant risk, and therefore the same common interest: helping the insured recover from the disaster as quickly and cost-effectively as possible. That is why a business response without consideration of insurance is essential: by overcoming the loss through planning and operations, the insured minimizes the dollars it risks in an insurance claim, while simultaneously minimizing the carrier's risk of shouldering that financial burden. Achieving a working partnership often makes the difference between a cooperative, successful process and a contentious, unsatisfying result.

The forensic accountant can assist in accomplishing the twin goals of minimizing risk while achieving a working partnership with its carrier as follows:

1. Understand the insured's policy. During the planning process, someone should review the policy carefully to inform decision making. For example, if the recovery plan involves shifting production/personnel to a temporary location, you should know if the corresponding expenses are covered while planning, not learn about coverage–or denial–during the claim process. Understanding coverage, limits/sublimits, deductibles, and exclusions for property repair, extra expense, and business income allows the insured to make savvy business decisions and avoid unwelcome surprises during the claim process.
2. Communicate with the carrier. The insured best knows its business and how to overcome disaster; the carrier best knows the policy coverage. Conflict can result if an important component of the recovery plan is not covered. While the carrier won't be included in initial planning discussions, informing the carrier of your recovery plans and confirming coverage is an extremely effective way to facilitate recovery and minimize claim issues. Also, proactive communication can prevent delays in obtaining needed proceeds to fund the restoration.
3. Submit a credible claim. A claim is a transaction; the insurer has the money and a contract (policy) obligating them to pay the insured *subject to the terms and conditions of that policy.* As in any transaction, the insurer will not pay unless

the policy terms are met. Therefore, the insured carries the burden of proving the loss under that policy. If the insured does so, the carrier will pay; if not, it will not.

As policies state, the insurer has the right to verify coverage, loss measurement, *and that funds paid are used for business recovery.* The carrier will likely retain a forensic accountant to examine business records, perform interviews, and otherwise prove those facts. Inaccurate, poorly-documented claims only serve to raise carrier suspicions and harm the insured's credibility, undermining any goodwill. Therefore, the insured should take the following steps to make the carrier a partner in the recovery process:

- Establish accounting procedures to accurately capture loss activity, including supporting documentation;
- Bucket costs by coverage element and appropriately calculate and apply limits, deductibles, and exclusions;
- Provide contemporaneous support for the loss and recovery activities;
- Proactively address measurement issues that arise in virtually every business interruption claim: period of restoration, but-for revenue, saved expenses, market conditions, and make-up sales.

Jim Paskell is the founder and president of the national consulting firm Litigation and Liability Management, LLC, based in Cleveland, Ohio. ■

Policyholders May Forfeit Coverage by Failing to Allocate Between Covered and Uncovered Claims

By Caroline L. Marks
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Policyholders need to be aware of their obligations, at least in some jurisdictions, to allocate amounts between covered and uncovered claims, because, if they do not, they risk their insurers being relieved, entirely, from paying under their policies. A recent decision from the United States Second Circuit Court of Appeals demonstrates the potential peril of not allocating between covered and uncovered claims. *Uvino v. Harleysville Worcester Ins. Co.*, Nos. 16-3225-cv(L) & 16-3356-cv(XAP), 2017 WL 4127538 (2d Cir. Sept. 19, 2017).

Uvino v. Harleysville Worcester Ins. Co.

In this case, the Uvinos sued their construction manager, alleging that it had breached the parties' contract and negligently damaged their property. The construction manager's insurer, Harleysville, defended the construction manager under a reservation of rights. Before trial, Harleysville moved to intervene in that action in order to submit special interrogatories to the jury to allocate damages between the uncovered claims relating to the repair and replacement of the construction manager's own work and the covered claims involving damages to other property. The construction manager, however, successfully opposed Harleysville's motion to intervene, and special interrogatories were not submitted to the jury. The jury eventually entered a general verdict in the Uvinos' favor in an amount in excess of $400,000.

Thereafter, the Uvinos commenced a declaratory judgment action against Harleysville in an attempt to collect the judgment entered against its insured, the construction manager. The trial court, however, entered

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summary judgment in favor of Harleysville. On appeal, the Second Circuit affirmed, applying New York law and holding that the Uvinos failed to meet their burden to show which portions of the jury award were covered by the policy, and, therefore, Harleysville had no obligation to pay any portion of the judgment. In reaching its holding, the Second Circuit declined to shift the burden to the insurer because the Uvinos and the construction manager were fully aware of the allocation issue based on Harleysville's unsuccessful motion to intervene, and the Uvinos had ample opportunity in the underlying and coverage actions to allocate the damages, but failed to do so.

The *Uvino* decision itself leaves open the possibility that the Second Circuit would shift the burden of proof on allocation to the insurer had the facts of the case been different. For example, the Court arguably would have shifted the burden to Harleysville had it not attempted to intervene in the underlying case and had it otherwise failed to bring the allocation issue to the Uvinos' and the construction manager's attention.

Takeaways

Generally, it is important for policyholders to recognize that different jurisdictions decide the allocation issue differently. Some jurisdictions, for instance, shift the burden of proof to the insurer when the insurer wrongfully refuses to defend, or when the insurer, while providing a defense, fails to timely raise the allocation issue with its insured. If the insurer has the burden of proof and fails to satisfy it, the insurer would pay the entire unallocated amount of the judgment. Given the differences in the law on the allocation issue and its significant impact on coverage outcomes, policyholders would be well-advised to understand the law of their jurisdiction and to position themselves in a way to maximize recovery under the applicable law. ■

Can You Settle Your Third-Party Claim While in Coverage Purgatory?

By P. Wesley Lambert
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Most commercial general liability (CGL) policies grant control over the defense and settlement of third party claims to the insurer. Thus, the right to settle, or not settle, a third-party claim against the policyholder resides with the insurer. However, when an insurance company breaches its policy, for example by wrongfully refusing its duty to provide a defense to its policyholder, the policyholder may settle the claim against it without securing the insurer's consent. *Sanderson v. Ohio Edison Co.*, 69 Ohio St. 3d 582, 635 N.E.2d 19 (1994). Conversely, when the insurance company is honoring its defense obligation, even under a reservation of rights to later contest coverage, the policyholder must respect the policy's grant of control of the settlement process to the insurer or risk losing coverage for any settlement reached without the insurer's consent.

But, what happens when the insurer is providing a defense to the insured, and thus technically complying with the policy's terms, yet has made it clear that it will not actually indemnify the policyholder for any settlement or judgment? These situations leave the policyholder in a sort of coverage purgatory – it is receiving the defense coverage it bargained for, but not the indemnity coverage. Policyholders may want to resolve the claims against them in order to limit their liability, but may also be afraid that doing so will result in a forfeiture of coverage for the settlement amount.

Fortunately, courts have constructed an alternative path for policyholders stuck in these situations, holding that insures may not leave their policyholders in limbo by controlling

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the policyholder's defense but unequivocally refusing to indemnify the policyholder for any settlement or judgment. In *Ward v. Custom Glass & Frame, Inc.*, 105 Ohio App.3d 131 (8th Dist. 1995) and *Patterson v. Cincinnati Ins. Cos.*, 2017-Ohio-2981, 2017 WL 2291605 (8th Dist. Aug. 22, 2017), the Eighth District Court of Appeals held that when an insurer clearly indicates that it will not indemnify the policyholder, the policyholder is relieved from the obligation to secure the insurer's consent prior to settling the claim against it.

In both cases, the policyholder was subject to a third-party claim that the insurer had agreed to defend. However, the insurer in both cases stated, in no uncertain terms, that it would not indemnify the policyholder if there were a judgment against it. Thus, the insurance companies maintained that they had the right to control the policyholder's defense, and its ability to settle the claim, but that it would not actually fund any settlement or ultimate judgment. The policyholder, left with no other option, settled the claim itself, while at the same time keeping the insurer apprised of the settlement negotiations.

The insurers in both cases argued that the policyholder's disregard of the policy's consent to settle provision relieved the insurers from the obligation to cover the settlements. Both courts disagreed. The *Ward* court was particularly critical of the insurer's conduct, holding that "[w]hen an insurance company refuses to provide coverage and at the same time seeks to maintain control of the same litigation, it . . . creates a frustration of purpose. Such conduct would compel a person of reasonable faculties to cut his costs and settle a lawsuit to avoid the possibility of a higher judgment." *Ward*, 105 Ohio App.3d at 137. Thus, when an insurance company maintains that coverage does not exist, it "must make a clean break from the case and should not subject the insured to a guessing game or by its conduct cause the insured to incur more expenses than necessary." *Id.* The *Patterson* similarly noted the "frustration of purpose" created when the insurer controls the defense of an action while at the same time disclaiming its duty to indemnify. *Patterson*, 2017-Ohio-2981 at ¶30.

> {[There is a]} "frustration of purpose" created when the insurer controls the defense of an action while at the same time disclaiming its duty to indemnify.

Thus, policyholders trapped in coverage purgatory may look to *Ward* and *Patterson* for support when deciding whether they may settle a case against them without violating their policy's consent to settle provision. It is important to note, however, that in both cases the policyholder kept the insurer apprised of the settlement negotiations and offered them the opportunity to remain involved in the process. While it is unclear whether this impacted the courts' analysis of the case, policyholders would be well-advised to keep the lines of communication open with their insurer despite the ostensible breach of the policy's indemnification obligation. ■

Q&A: Additional Insured Coverage

By Gabrielle T. Kelly
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Question: My contract has a provision requiring the other party to include me as an additional insured on its policies. Do I need to do anything else to ensure that I have coverage if a claim arises?

Answer: Having an agreement that details the other party's obligation is a great start, but it does not guarantee that the insurance will be available and contain the terms that you requested. The first step to ensuring that you have the coverage that you bargained for is to obtain a copy of the policy containing the additional insured (AI) endorsement or broad coverage language.

Certificates of Insurance

It is not advisable to settle for receiving a Certificate of Insurance. The Certificate does not guarantee that the insurance company has added you as an additional insured; only that the broker intended to add you to the policy. Further, if there are any discrepancies between the coverage listed on the Certificate and the terms of the policy, the latter will control. In fact, Ohio Revised Code section 3938.02 explicitly states, "A certificate of insurance is not a policy of insurance and . . . shall not confer to any person new or additional rights beyond what the referenced policy of insurance expressly provides." Accordingly, an AI cannot rely on a Certificate of Insurance as evidence of coverage for a claim.

Additional Insured Endorsements

The next step is to review the policies. Additional insured endorsements vary greatly and it is imperative to confirm that the language provides the coverage that the parties intended. The endorsement may be very specific, and explicitly state that it provides coverage only to the person or company listed. The endorsement could specify a category of persons that is added as additional insureds (e.g. managers of premises), and contain a test for determining if a party falls within the AI endorsement. Lastly, the policy endorsement may be a "blanket additional insured" endorsement that provides coverage to any party to whom the named insured is contractually required to provide coverage. As long a party falls into one of these three categories, it will be recognized as an AI under the policy.

Coverage Limitations

However, the examination is not complete even when a policy provides AI status. Insurers have attempted to narrow the coverage provided to additional insureds with various restrictions, such as time limits and causation requirements. Some policies contain provisions stating that the AI benefits will exist only for the time specified in the contract. Insurers write these provisions in such a manner that they can avoid providing coverage after a project is completed.

Insurers also attempt to restrict coverage to the AI only if the bodily injury or property damage results from the negligence of the named insured. Courts have interpreted this language as precluding coverage to an AI except when the evidence establishes that the named insured acted negligently and caused the loss. This may be contrary to the requesting party's understanding of its AI coverage. Therefore, it is important to review the policy to determine whether there are any limitations to the AI status or insurer's defense obligation.

Lastly, if the project or relationship spans longer than the initial policy period, confirm with the other party that you are an AI on subsequent policies. The last thing you want to do is wait until after a loss has occurred to determine the availability of insurance. If you are unsure about your AI status or the level of coverage you are receiving, contact coverage counsel for a policy review and recommendation. ■

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Attorney Highlights

Kerri L. Keller was appointed to the board of directors of the Federal Bar Association, Northern District of Ohio Chapter.

Amanda M. Leffler was appointed for a second-term as an editor of the IRMI CGL Reporter.

Kerri L. Keller has been named co-chair of the Civil Rules Committee of the Advisory Group for the U.S. District Court for the Northern District of Ohio.

Gabrielle T. Kelly was selected as a trustee for the Cleveland Metropolitan Bar Association.

Bridget Franklin and **Lucas Blower** spoke at the OSBA's Insurance Law seminar on October 17, 2017, on Recovery for Non-Policyholder: Insured Contracts, Additional Insured, Assignments, and Judgment Creditors.

Amanda M. Leffler spoke on construction-related insurance issues at Cleveland Metropolitan Bar Association's Real Estate Law Institute on November 10, 2017.

Upcoming Events

Gabrielle T. Kelly and **P. Wesley Lambert** are presenting at the NBI seminar titled "Construction Law: Advanced Issues and Answers" on December 5, 2017 (Cleveland) and December 8, 2017 (Akron).

Meagan L. Moore and **Alexandra V. Dattilo** are presenting "Environmental Liability Insurance: The Risks You Never Considered" and **Anastasia J. Wade** is presenting "IC for IP: Insurance Coverage Issues for Intellectual Property Cases" on December 15, 2017, at the Akron Bar Association's Annual Advanced Issues in Insurance Law seminar.

Gabrielle T. Kelly is speaking at the NBI seminar titled "Negotiating Claims with Insurance Companies" on December 20, 2017.