

A Theater and a Fire Produce a Unique Insurance Claim

by Bruce Swerling

Anyone in the insurance industry will tell you there is no such thing as a "standard" claim. All losses are different and all claims are unique in some way. But the claim for damages caused by a fire in the North Shore Music Theatre in Beverly, MA two years ago was unlike anything I'd seen in my more than 40 years as a public adjuster. Three features in particular made this claim unusual:

- The nature of the building. "Theaters in the round" are unique; the building is circular, with all the seats surrounding the stage and the mechanical backbone of the operation located under it. That's where the fire began, leaving the structure intact, but damaging or destroying most of the equipment and reducing the theater's interior to a smoldering, soggy, smoky mess.
- The nature of the business. Theater companies are unlike other businesses. Business interruption has very different implications for a theater staging live performances than for a department store or a manufacturing facility.
- The nature of the insurance coverage. Few insurance policies are perfect, but North Shore's coverage had serious gaps in several key areas.

Components of the Claim

The claim had three components: Building, contents (a total of about \$1.9 million for the two combined), and business interruption and extra expense

coverage, at nearly about \$2.1 million, the largest portion of the claim.

Entering the process in the earliest stages (always the best time to bring in a public adjuster), we were able to influence the direction of the claim instead of allowing the insurance company alone to chart that course. This proved to be especially important in determining whether some building components and equipment should be cleaned and repaired, as the insurance company was inclined to conclude, or replaced entirely, which North Shore often preferred.

For the theater company, it was never a matter of trying to replace the Ford they had with the Cadillac they wanted. The goal, rather, was simply to recover what they had lost. But North Shore also had to be certain that any repairs would be effective and reliable; they couldn't have essential equipment malfunction in the middle of a performance, or worry constantly about that prospect.

Repair vs. Replace

This debate played out primarily in the building and contents coverage areas. Our job was to determine not just whether equipment and furnishings could be repaired, but whether they could be repaired acceptably and cost-effectively. And we had to support our recommendations with data the insurance company would accept.

The research effort involved was extensive and complicated. We were dealing, after all, with sophisticated

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A Letter From Bruce Swerling

Insurance Shortfalls Are Too Common, Too Costly, and Unnecessary

I hate insurance shortfalls. I see these problems all the time and hate them, not only because they are time-consuming, frustrating, and sometimes costly for our client, but also because many of the problems are unnecessary. The coverage gaps that leave companies without adequate insurance are invariably the result of policies that weren't written properly to begin with.

The case study on page 1 of this newsletter illustrates two areas in which policies often fall short: building and contents coverage and business interruption coverage.

In the first area (building and contents) many companies underestimate the value of their assets

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(equipment, furnishings, etc.), because they derive the estimates from their balance sheets. The problem is that balance sheet accounting reflects the original cost, minus depreciation, while the replacement cost coverage provided by an insurance policy reflects the current cost of replacing the assets, regardless of their age or any depreciation in their value.

If the values you estimate for your equipment and furnishings are too low, the reimbursement you receive for those items will probably also be inadequate. In the past, homeowners might have relied on “guaranteed replacement cost” protection to close those gaps, but most insurers no longer offer that pure coverage, making accurate cost estimates essential - for the building as well as for its contents.

Construction costs don't fall

There are few certainties in life, but one of them is that construction costs will rise. It will almost certainly cost more to replace or substantially renovate an office or office building next year or three years from now than it would cost to do so today. The automatic inflation adjustment formulas that insurers use don't accurately reflect all the factors (oil shocks and labor shortages, for example), that can affect construction costs. You want your estimates to come as close as possible to the real cost of replacing or renovating your property in the case of an extensive loss. So your calculations must be based on current conditions and real costs in the market in which you are located. There are three ways to obtain this information:

- Ask local architects or builders to develop the estimates for you.
- Retain a qualified insurance agent or an insurance consultant to design an appropriate coverage package for your business - the latter could be costly, but well worth the expense for companies that can afford it.
- Work with a capable, experienced insurance agent who is willing to go beyond insurance industry formulas and obtain the current, local replacement cost information you need.

High cost of compliance

Ordinance or Law coverage is another common and costly insurance oversight. This essential protection covers the cost of meeting code requirements that weren't in effect when the building was constructed, but that will apply if the structure is rebuilt or substantially renovated.

Clients we have represented discovered the importance of this coverage the hard way when an old Vermont Inn burned down 30 days after they had purchased it. The \$25,000 in code coverage their insurance policy provided barely covered the cost of updating the sprinkler system; it didn't begin to approach the cost of upgrading electrical, plumbing, and heating systems and just about every other building component. Simply meeting the requirements for providing accessibility to handicapped individuals can cost thousands of dollars in some buildings.

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What's Happening

Wind damage.

Insurance companies, battered by a succession of hurricanes and other natural disasters, have become less willing to insure coastal properties, and real estate values in hurricane-prone regions may suffer as a result, according to Fitch Ratings. A recent research report notes that windstorm insurance premiums for commercial properties increased by between 25 percent and 400 percent last year, as risk-averse insurers braced for a repeat of the devastating 2005 hurricane season. Their fears didn't materialize; the 2006 season turned out to be light, with few storms reaching land. But insurers haven't shown any signs of reducing their premium prices, which could create serious financial binds for some owners, Fitch analysts warn. “If premiums and coverage do not return to more normal market levels, cash flow stress may be severe enough that a property can no longer support its full debt service, thus increasing the likelihood of payment default,” Joe Kelly, Fitch Senior director, said in a press statement.

Fitch also reported that policy deductibles have increased by 10 percent to 15 percent of replacement value for new policies, compared with the more “traditional” increases of 2 percent to 5 percent. As a result, some lenders and servicers are requiring borrowers to guarantee to cover the difference between the two deductibles, to mitigate the additional risks, Fitch reported.

Insurance fraud.

Insurance fraud is on the rise and state regulators are struggling to keep up with it. Most state insurance departments have established fraud bureaus to identify fraudulent activities and prosecute them, and a recent

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sound equipment, complicated hydraulic lifts, specialized insulation and wiring and high-tech console boards - not the sort of items you can find and price in a local Home Depot.

To obtain the information and expert evaluations we needed, we had to contact manufacturers and suppliers all over the country, synthesize their findings, and present them to the insurance company. When the company disagreed with our conclusions, as was often the case, we kept explaining our position and documenting, re-documenting and verifying our estimates of the repair and replacement costs. A few examples illustrate the give-and-take that continued throughout the nearly two years required to resolve the claim.

In one case, the insurer argued that surface cleaning of the spotlights would be sufficient, but we were able to demonstrate that while the equipment might be “clean,” when the high-intensity spotlights reached performance temperatures, they would emit the smell of smoke - not just unpleasant, but also the dangerous equivalent (almost) of “shouting fire in a crowded theater.”

In another case, the insurer determined that an electrical board could be cleaned by a local company. We questioned that conclusion and insisted on shipping the equipment to the manufacturer for an expert evaluation. The manufacturer agreed that the equipment could be cleaned (although only by specialists) and restored to perfect working order. But our research showed that North Shore could purchase a new unit for a lot less.

The evaluation of a key console board, controlling just about everything on and above the stage, produced a different conclusion. The manufacturer estimated



North Shore Music Theatre in Beverly, MA

the cleaning and repair costs at about \$100,000 - much less, we found, than the \$500,000 required to replace that equipment.

Closing the Gaps

We had to deal not only with the complexities of the theater's equipment, but also with serious deficiencies in the coverage for the equipment and other theater “contents.” North Shore had both blanket contents coverage and a scheduled contents “floater” listing estimated replacement values for approximately 700 individual items. There were two problems with this floater, however: Most of the listed items were seriously under-valued, and some of the scheduled items had no values attached to them at all.

The insurer insisted initially on sticking to the replacement values specified in the floater - a “what-you-have-is-what-you-get” insurance argument. But we were able to persuade the company to accept the blanket policy limit as the maximum coverage available for all contents, rather than setting item by

item replacement caps. As a result, we were able to offset shortfalls in the coverage for many individual items by rolling those deficiencies into the blanket coverage. And we were able to maximize the over-burdened contents coverage by arguing successfully that some building components -such as the lifts, cables connecting lighting equipment to the walls - were actually part of the building and could be classified under the building coverage portion of the policy instead, where there was room to pick up these items.

We actually found some good news in the building component of the coverage. The policy included “ordinance or law” coverage, which covers the cost of meeting building code requirements that were not in place when a structure was built. Many businesses overlook this essential protection, but North Shore's policy covered the cost of installing ramps and making other modifications required to meet state and federal handicapped accessibility requirements.

The Show Can't Go On

Like all theater companies, North Shore derives virtually all of its revenue from box office receipts. No productions, no revenue. But the theater's operating expenses continued while its doors were closed; salaries, insurance, equipment rental costs, etc. all had to be paid. Business interruption coverage should have covered those

FAST FACTS:

Forty percent of fatal collisions involving drivers age 70 and older and other vehicles happen at intersections, according to a report released by the Insurance Institute for Highway Safety. That rate compared to 23 percent of fatal crashes involving those 35 to 54 years old.



costs, but this coverage, like the contents coverage, was inadequate.

The problem here was that North Shore's policy contained a coinsurance clause that required a specified amount of coverage in order to receive maximum reimbursement, and the theater did not meet that requirement. As a result, the company was entitled to reimbursement for less than half of its business interruption claim.

Theater officials were able to mitigate the box office losses (estimated at about \$2 million) by staging two productions in a downtown Boston theater. But that solution also entailed significant

additional costs - renting the downtown facility and special equipment, housing actors and stage hands (more expensive in Boston than in the suburbs), and providing transportation for audiences.

With the business interruption coverage severely limited, we reviewed the policy line by line and, wherever possible, moved expenses out of the interruption category and into the "extra expense" area where coinsurance was not applicable and dollar-for-dollar reimbursement could be achieved. We also worked closely with North Shore executives to identify expenditures that we thought the insurer would accept as "extra expenses." We didn't eliminate the shortfall entirely, but, as with the contents deficiency, we covered a significant portion of it, and North Shore appreciated the result.

In a letter written after the claim was resolved, Nancy Lewis, the theater's chief financial officer, said: "You safely walked us through a landmine of possible shortfalls in our coverage. While at the end of the day, we were undeniably underinsured, you maximized our coverage for us."

That is actually a good description of what we try to do on every claim we handle: Walk our clients through a very difficult, complicated, and time-consuming process, undertake the research and negotiations they don't have the time or expertise to handle themselves, and obtain the maximum benefits their policies provide. Although the North Shore claim was unique in many ways, I like to think we achieve the same positive outcomes for all the clients we represent. That, certainly, is always our goal.

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Keeping the business going

Many businesses also err - sometimes dramatically so - by either foregoing or (for those who purchase it) miscalculating business interruption coverage, which provides the cashflow a company needs to continue operating after a disaster when it may be unable to generate normal revenues or any revenues at all. One common mistake: Using net profit rather than gross profit (for manufacturers before manufacturing overhead) as the basis for the amount of coverage. If your business is unable to operate for a period of time, you will have to continue paying debt service, payroll, insurance, and other essential fixed expenses which the net profit figure does not reflect.

Errors of this kind occur in part because companies don't focus intently on the details of their insurance policies until after they suffer a loss. But some shortfalls result from intentional calculations, not erroneous ones. Because insurance represents one of the largest expense items for most businesses, it is also often the first place they look when they are trying to cut costs.

Insurance is the last area in which you want to be penny-wise and pound-foolish. No one will congratulate you for saving money on your insurance premiums if your policy doesn't provide essential coverage or adequately reimburse you for a disastrous loss.

While no company can count on escaping a disaster, all companies can make sure the insurance coverage that is supposed to help them recover from a disaster doesn't end up needlessly compounding the disaster instead.

Going Where No Public Adjuster Has Gone Before

When it comes to venturing into lions' dens, Daniel (of the bible) has nothing on Marvin Milton, the Milton in Swerling Milton Winnick. Daniel, after all, just faced lions; Marvin (senior vice president of the firm) spoke recently to an audience of insurance industry claims professionals, who are not typically huge fans of public adjusters. He appeared on a panel at a meeting of the Property Loss Research Bureau - the first time, in fact, that this national insurance industry organization has invited a public adjuster to participate in one of its programs.

The topic: Licensing of public adjusters. In his presentation, Marvin noted that the continuing licensing trend (42 states now license adjusters) underscores

the growing acceptance of adjusters by both consumers and businesses, and the recognition of the important role public adjusters play in resolving claims and securing adequate compensation for policy holders' losses.

Marvin also explained details of the Model Public Adjuster Licensing Act endorsed recently by the National Association of Insurance Commissioners. Other panelists included Phil Silverberg, an insurance industry defense attorney with Mound Cotton in New York, and Robert Keegan, Regional Administrator of the Bureau of Investigation of the Florida Department of Financial Services, the agency that licenses and regulates insurance adjusters.

Approximately 2,200 claims executives attended the PLRB meeting, held March 18-22 in Orlando, FL. The insurance industry's leading claims organization, PLRB writes legal opinions on coverage issues and provides training and educational seminars for the claims professionals who serve insurance companies.

"Claims adjusters generally view public adjusters as adversaries rather than colleagues, and my appearance at the PLRB meeting didn't change that view," Marvin said. "But in the post-meeting evaluations, many attendees said they appreciated having a public adjuster on the panel to provide a counterbalance to the insurance company's perspective."

WORTH QUOTING

"We believe the private insurance, reinsurance, and capital markets can serve as the predominant source of risk management for natural disasters, unless it's a mega disaster."

- Chuck Chamness, president and chief executive officer of the National Association of Mutual Insurers, in Congressional testimony arguing against the development of a national disaster insurance plan.

FAST FACTS:

Of the \$48 billion in catastrophe-related losses in 2006, only \$15.9 billion were covered by insurance.



Sixty-seven percent of households have a disaster-preparedness kit, according to the Insurance Research Council, which means that 33 percent do not have them.





For over 100 years, Swerling Milton Winnick has worked on behalf of owners of property and businesses to secure responsive and satisfactory settlements of their insurance claims. The firm's mission has been and continues to be the delivery of consistently superior client service while developing the respect of insurance company personnel and obtaining fair settlements which enable insurance consumers to resume their normal business operations or lifestyle.

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study found that many of them are reporting record numbers of convictions. But the study, by the Coalition Against Insurance Fraud, also found that 18 of the 47 agencies surveyed reported a decline in convictions between 2004 and 2005.

“For the most part, fraud fighters are priming the pipelines with fresh cases that could create a new generation of convictions in the years ahead,” the report noted. “Still, the lack of growth in convictions and cases opened is cause for concern.”

Congressional attention.

Insurance issues are finding a place on the Congressional agenda this year, as legislators wrestle with, among other questions:

- How, or whether, to provide insurance to the more than 47 million Americans who lack health coverage; and
- Whether to establish a national reinsurance fund to stabilize insurance markets and prevent the premium cost increases and coverage restrictions that often follow natural disasters.

On the latter question, Massachusetts Congressman Barney Frank, chairman of the House Financial Services Committee, has indicated his support for government action. “It is clear that government has got to step in,” he told reporters recently. “I very much see that some federal backup is necessary, and I am optimistic that we'll be able to come together [in Congress]” and approve legislation.”

On the other side of Capitol Hill, Senators Max Baucus (a Democrat from Alabama) and Charles Grassley (a Republican from Iowa), the chairman and ranking member, respectively of the Senate Finance Committee, are looking

for ways to close a widening insurance coverage gap that has left 16 percent of the U.S. population without health coverage, and businesses struggling to afford the risking cost of offering insurance to their employees.

Democrats have long supported government initiatives to broaden health coverage, but Republicans have not generally embraced the idea. So Grassley's support has attracted attention and led some analysts to predict that legislation might have a chance of moving in the Senate this year.

“Moving major legislation during a presidential election cycle is extraordinarily difficult, but not impossible,” Grassley said during the recent hearing. But he noted that “welfare reform and the Medicare drug benefit moved in a presidential cycle.” Grassley called for an end to “rigid ideology” and political “standoffs,” and the beginning of a serious effort to build consensus on the health care issue.

They're ok - really!

What's the matter with kids today? Not nearly as much as media horror stories about “children of privilege” and “teens gone wild” would seem to suggest. A survey of teenagers from high net worth families and wealthy parents of children under the age of 18 found that these affluent young people see themselves as caretakers rather than spenders of the wealth their parents have amassed and will be passing on to them. Only 25 percent of the 210 teens responding to the survey, commissioned by PNC Financial Service Group Inc., agreed with the statement, “I should be able to buy anything I want.” By contrast, 73 percent said they feel an obligation to manage the money they will inherit wisely. Only 10 percent said they intend to live off the money they inherit for as long as possible and 70 percent disagreed with the suggestion that they don't have to worry about earning a living because their families will always provide the money they need.