



Earthquake Insurance

Claim Denied!

As a prudent businessperson you recognize the greatest value of insurance is in protecting your business from a catastrophic loss. The definition of a catastrophic event may be different from one business to another. However, most people recognize that a significant earthquake has the potential to have a disastrous impact on a company's survival. Therefore, you decided to purchase insurance to protect your business from the potential of a "quake."

Unfortunately, that warm feeling you now have because you have protected your business from a "quake" may be premature.

Under what circumstances is a loss from an earthquake not insured by your earthquake insurance?

- Earth movement without an officially recognized seismic event may not be included in the definition of earthquake by your policy. Your policy may define earthquake so precisely that a landslide, sinkhole, or other earth movements are **not** covered. For little or no additional premium you might have been able to include this event simply by asking for it. (Of course, you would have had to ask before the loss occurred.)
- Adding the peril of an earthquake to the policy currently protecting you against fire and other perils isn't enough. Fire, windstorm, lightning and other perils do not endanger certain types, or parts of property and therefore those properties may not be included for coverage in your current policy.

Even if your policy responds to an earthquake, you may not be covered from loss to building foundations, underground parking structures, underground infrastructure, piers, docks, roadways, surface parking lots and other types of property that are not subject to loss, other than from an earthquake. If these types of property are not specifically insured for direct damage by the earthquake, the business interruption and extra expense insurance you purchased will not respond either.

O.K., now we have changed the definition of "quake" to include landslide and the insurance company has agreed to include "all" your insurable properties that may be damaged from all insured perils, including earthquake, are we done?

- The deductible on your policy is 2% with a minimum of \$100,000 per occurrence. Though a larger deductible than you are accustomed, you think you can manage this amount. After all this is expensive insurance and you are only buying it to protect against a catastrophic loss that would put you out of business.

Lets say you just had a \$5,000,000 earthquake loss at your location that has total insurable values of \$50,000,000. You are feeling good about your decision to buy earthquake insurance and having improved the policy to include the definitions and types of property you wanted protected. The loss is greater than the \$100,000 minimum deductible



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and 2% of \$5,000,000 is also \$100,000 so you approach the insurance adjuster expecting to recover \$4,900,000. Surprise! - the adjuster informs you that you are only entitled to \$4,000,000. Where is your other \$900,000? It turns out the 2% deductible is 2% of the total value of your property *at this location*, not 2% of the loss.

An earthquake deductible may be a percentage of total values per location, total values subject to loss, or some combination. Be sure you understand exactly how the deductible will be calculated.

A week has passed and suddenly you realize your loss isn't \$5,000,000, it is \$10,000,000. How could this be, you've added up all the costs of the loss to the damaged location.

- Unfortunately, you didn't take into consideration that the earthquake's damage was farther reaching than a fire or other localized loss. The quake also caused severe damage to facilities across town that you rely on for your daily operations. It may be a supplier/vendor, or even a utility. Without output from the facility, you cannot conduct business at your pre-quake level. The damage that they incurred is more extensive and will take time before they return to full capacity. And until they do, you must sit idle and your business interruption insurance does not extend to the loss of revenue created by the additional down time resulting from this unscheduled property. These properties end potential for loss required coverage for "contingent" business interruption.

When considering the potential for loss from an earthquake, or other hazards with a wide impact, you must include in your insurance those properties upon which you depend that

if damaged or destroyed will limit your ability to recover in a reasonable period of time.

O.K., we've fixed all the issues, right? We corrected the definition of earthquake to include landslide or other earth movements, included all properties with which we are concerned, negotiated an acceptable definition of deductible, added contingent coverage for loss of vendor property, utility services and any other property of concern, this must be everything.

- Unfortunately this was a truly regional disaster and impacted many properties resulting in a total loss to the insurance industry of \$10 billion. In fact, the small insurance company you chose that provided the broadest coverage, lowest deductible and most competitive premium was so attractive to so many customers in your area that they do not have the financial ability to pay all the claims for which they obligated themselves. They can't pay your entire claim and must file for bankruptcy and it will be several years before the bankruptcy court will be able to determine what is left over for you.

This is one risk management decision where you don't want to be on shaky ground.

There may be other unique needs specific to your business. For more information, contact a member of Parker, Smith & Feek's Real Estate Practice Group: Susan Stead, Dwight Jarvis or Katie Paul, at 425.709.3600.

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