

MORE THAN



Without Warning

Getting to grips with earthquake issues



Since the two devastating earthquakes in Canterbury, nothing has been the same. Our market has changed dramatically, particularly for brokers with customers directly affected by the quakes.

So we've decided to do things a bit differently too with this special edition of **More Than**, focusing our attention on the often misunderstood and complex topic of Business Interruption insurance. The earthquake events have had a profound impact on our industry. Issues such as the stability of market players, rising costs of reinsurance treaties, and what this will mean for future premiums have meant that businesses now look at their insurance cover in a whole new light, with far greater scrutiny and reliance on their broker for the best advice.

I have spent much of the last nine months talking to brokers, customers and people involved in these crisis situations. I'm pleased to say that as an industry I believe we have responded well under very difficult circumstances and most importantly, we continue to work extremely hard to put our customers' needs first.

The challenge for us all now is to ensure we keep our customers at the forefront of decision-making as the specifics of claims emerge, each with their own set of individual issues and interpretations.

The specific earthquake related issues in this edition are the ones we see as posing significant challenges to customers, and we would love to hear back from you about other issues you would like to discuss, and of course your thoughts on this publication. Please send your feedback to marketing@lumley.co.nz

While it's no secret that the insurance sector is seeing its share of problems from the Canterbury events, there are also many opportunities for us as an industry to step up to these challenges and work together to get the best result we can.

John Lyon
CEO

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No easy answers

The Canterbury earthquakes have had major repercussions for thousands of business owners, and not just those based in the affected areas. The economic issues that are emerging out of this disaster are without doubt wide-reaching.



This publication is not about trying to address every possible business interruption issue and policy application. Instead it is designed to simply raise awareness of the potential issues that we have identified at Lumley, for consideration and discussion with your clients.

The issues that appear to be most prominent in the market are strongly linked to business interruption insurance. That's why this edition of **More Than** focuses on a number of issues impacting on business interruption cover.

It has been done as a response to the plethora of complex business interruption issues that arise almost daily from the response to the Canterbury earthquakes. It's apparent there are no easy answers.


Even if you don't have clients who are directly affected, there are valuable lessons to be learnt with respect to how your clients' businesses would respond in the event of a natural disaster.

Business interruption is one of the least understood products in general insurance. It is becoming clear that many, mainly small to medium businesses, did not have sufficient business cover in place when the first earthquake occurred in September 2010. Consequent aftershocks and the large quake in February 2011

compounded the problem, highlighting concerns around adequate indemnity periods and sums insured.

With business interruption insurance, specifying an adequate indemnity period is critical. In Christchurch, it is now becoming clear that removing debris, obtaining council approval, rebuilding and regaining market share is going to be a lengthy process.

In the same regard, sums insured have proved less than adequate in the majority of cases. Demolition costs, demand surge and rebuilding structures to higher building codes, will all detract from the aggregate total amount clients will receive to reinstate their businesses.

Not surprisingly, business interruption insurance is going to come under scrutiny as never before. Accordingly, it is essential we keep our clients informed about the finer points of business interruption policies, while ensuring they have the most appropriate cover possible in place should a natural disaster strike. 

Wide area damage

Examining the depopulation issue

The word ‘depopulation’ has been bandied about with regard to the Canterbury events, and it’s become a negative word for the application of the adjustment clause in a business interruption claim.

For many clients, the word ‘depopulation’ simply means a lack of customers; the earthquake has taken them away for numerous reasons, so they want to be compensated for that.

However, following wide area damage the focus must be on the gross profit which would have been earned but for the insured physical damage. So an insured’s business would have been, in any event, interrupted because of the wide area damage or depopulation, but the insured may not have actually suffered any additional loss because of the physical damage.

For example, you may have planned to double your turnover because of the extra tourists arriving for the Rugby World Cup, but owing to AMI Stadium being out of action, there will be no RWC games in Christchurch. The reason for tourists not coming to Christchurch is not to do with damage to your property, but rather the RWC decision, so business interruption insurance is not going to pay for that.

In 2010, Orient-Express Hotel group took their insurance company, Assicurazioni Generali to court to argue this very point. It was an appeal by Orient-Express, owners of the Windsor Court Hotel in New Orleans, of an arbitration award in favour of its insurer, Generali. The dispute was over an insurance claim for business interruption losses following the hurricanes Katrina and Rita in 2005 that devastated New Orleans.

The insuring clause in the policy provided cover for:

‘loss due to interruption or interference with the business directly arising from Damage’

The court held that this clause clearly provided that

Orient-Express was only entitled to recover business interruption losses that arose as a consequence of insured damage to the hotel. However, the hotel would not have been able to trade during September 2005 whether or not it had been damaged since the hurricanes had led to the centre of New Orleans being closed for that period.

The trend clause in the Orient-Express case stated:

‘adjustments shall be made as may be necessary to provide for the trend of the Business and for variations in or special circumstances affecting the business either before or after the Damage, or which would have affected the Business had the damage not occurred so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results but which for the Damage which would have been obtained during the relative period after the Damage.’

The two key aspects of this worth noting are: that the financial loss had to be in consequence of the insured property damage to the hotel; and that the insured items are adjusted to reflect the circumstances affecting the hotel’s business – which would have affected it regardless of the insured property damage. This means the financial results then reflect what would have been the case but for the damage to the insured property.

The insurer argued that the business interruption losses claimed by the insured did not arise from damage to the hotel, but rather from the damage to the surrounding area and its consequences (such as the mandatory evacuation) which had led to there being no customers for the hotel even if it had been open to trade. The ‘but for’ test was applied leading the court to find that the insured was only able to recover losses which, ‘but for’ the damage to the hotel would have been earned by the insured. The insurer was therefore entitled to exclude losses which would have been suffered by the insured in any event (i.e. loss of business attributable to damage in the vicinity of the hotel caused by the hurricanes).

Recoverable business interruption losses were severely restricted as the insured was unable to show that, if



the hotel had not been damaged, it would have had any customers anyway.

This case serves as a timely reminder of the issues that may arise when applying business interruption clauses to consequential loss claims in catastrophe scenarios where there is extensive damage to the surrounding area. However, given the complexity of the issues involved, each claim is being looked at on a case-by-case basis at Lumley, and unfortunately there is no 'one solution fits all' for this particular area of business interruption.

Many claimants are hoping that their insurance contract will reimburse them for their (totally genuine) losses even though their losses do not only arise from damage to their property, but also from the wide area damage effects of the earthquakes on the Canterbury region. Unfortunately that is not the case.

The aim of the insurer and the appointed loss adjusters is to take everything into account and to arrive at a settlement figure which represents as accurately as possible, the results which **but for the damage to their property**, the insured would have achieved.

The results from assessing the effects on one business, may not apply to another as they are very case specific and each case has to be analysed on its individual merits. This is why claims settlements take a great deal longer than a more common business interruption claim.

Some in the industry regard the word 'depopulation' as emotive and misleading. It has become entrenched and many claimants see the word as a literal emptying out of an area, when in fact it is simply a change of behaviour, i.e. a lack of customers, owing to the earthquake, not the condition of the building. The alternative description 'wide area damage' is a more accurate definition of what has happened.

The key thing to remember is that 'but for the damage to the building' would your client's business have been conducted as usual? **MT**

Repopulation



The opposite of depopulation. Imagine you own a reasonably priced motel in Christchurch. Prior to the quakes you were running at 60-70 percent occupancy. Suddenly post-quake, the city is flooded with insurance assessors and loss adjusters, not to mention people whose homes are uninhabitable. Now your motel has suddenly jumped to 100% occupancy of all available rooms, a figure you might not even

reach during your peak periods previously. But what if some of your rooms have been damaged? There is every chance you could fill those rooms too, but for the damage to the building. Your claim is damage driven, not peril driven, and you could make a business interruption claim because you cannot benefit from renting those damaged rooms which you would reasonably expect to be able to do.

The Canterbury Earthquake Recovery Act 2011

What you need to know

The Act sets up CERA (Canterbury Earthquake Recovery Authority) as a new government department based in Christchurch. It is dedicated to planning and executing a recovery strategy for greater Christchurch as quickly as possible.

For more information go to:

www.legislation.govt.nz/act/public/2011/0012/latest/whole.html

The Act provides CERA with wide powers, including the ability to relax or suspend normal regulatory procedures for earthquake recovery work. It came into law on April 18 2011. The Act gives the Minister of Earthquake Recovery (and CERA by delegation) the power to:

- obtain information from any source they have which is capable of being provided without unreasonable difficulty or expense. This does not include legally privileged information
- enter onto land and demolish any structure and to remove fixtures and fittings. It can also notify an owner to demolish a structure
- vary any building or resource consent matter by council order in relation to the demolition and carrying out of works
- order people to leave the land, restrict or prevent people from approaching a specified area
- close or stop roads and divert or control traffic
- acquire land through compulsory acquisition (with compensation) and to subdivide or develop the land
- erect temporary buildings anywhere (on any land including a street or reserve)
- direct a council to do or stop doing anything or to make or not make a decision
- direct any property owner to act for the benefit of his or her neighbour.

Brokers should note the following clause

Canterbury Earthquake Recovery Act 2011, Part 2 Functions and powers to assist recovery and rebuilding, Subpart 4 – Further provisions.

The Crown will not be liable to pay compensation for demolishing dangerous buildings.

Where a non-dangerous building must be demolished in order to remove a dangerous building, the Crown is liable to compensate the owner for a loss resulting from the demolition of the building whether or not the loss is insured in whole or in part. A claim for compensation must be made using a properly completed form and delivering it to CERA within two years of the exercise of the power to demolish.

News Update

In May it was announced that Roger Sutton had been appointed CEO of the Christchurch Earthquake Recovery Authority.



He will leave his role as CEO of Orion New Zealand to fill the post for a five year term.

In what is undoubtedly one of the key post-earthquake positions, Mr Sutton's main task will be to lead and manage recovery operations and develop a long-term recovery strategy in consultation with stakeholders. He has a high level of credibility across the Canterbury community, and has built effective relationships with stakeholders in central and local government and with community and business sector leaders.

He takes up his new role in mid-June.

Mud, mud inglorious mud

Liquefaction – the consequences

The two Canterbury events produced some of the most significant cases of liquefaction in New Zealand history, transforming whole streets from firm land to sludge. Liquefaction happens when silty, low-lying sandy soil is shaken violently, causing water to rise through its pores.

It's similar to jumping on wet sand at the beach – it soon turns to a murky soup. Large sections of Christchurch were built on soft sediments which remained saturated after a wet winter.

Roads, bridges and pipe infrastructure have been unsettled by the water squirting up through the soil during the two tremors. Much of this damage was superficial rather than structural, but many businesses were left unusable after silt, sewage and grey sludge cracked the roads and squeezed through floors. The worst affected areas were coastal spots such as New Brighton, and suburbs that skirted the lower reaches of the Avon and Heathcote Rivers, in particular Dallington. Homes and businesses in Kaiapoi, near the Waimakariri River, also sunk into the soil. This means that remedial work needs to be done before repair work can take place.

For insurers it has raised the issue of how to deal with a loss, given they do not insure the land on which a structure is located.

Each case has to be assessed on its individual merits, but any indemnity will be based on what is required to make the structure code compliant, but the land will not be remediated. For example, if the foundations need to be redesigned to make the building code compliant, then subject to the

maximum sum insured, the policy will respond.

That may mean a more complex (and expensive) foundation needs to be provided. This could potentially add a further 20–100% in repair costs.

The Department of Building and Housing recently issued a new set of rules in relation to 'seismicity and foundation details for Christchurch'. In summary, under the Structure Verification Method B1/VM1 and the Structure Acceptable Solutions B1/AS1 and B1/AS3, the immediate changes will:

- increase the seismic risk hazard factor for Christchurch from 0.22 to 0.3
- strengthen the definition of 'good ground' and require concrete-slab foundations to have reinforcing
- clarify that on-ground foundations that are prone either to liquefaction or lateral spread should be specially designed.

Subject to the policy limit and to the terms of the Reinstatement Clause, Lumley will meet its obligations under the policy to ensure that a reinstated structure is code compliant. However, as most valuations will not have included the significant extra costs required following the earthquake, there is a real risk of underinsurance as the sum insured is eroded by the unanticipated extra foundation costs.

Any discussion of this issue also has to take into account Christchurch City

Council's earthquake-prone, dangerous and insanitary buildings policy.

The initial policy required buildings to be strengthened to 33% of the building code as part of the repair process. The new policy will require earthquake prone buildings that were damaged in the quake to be strengthened to 67% of building code levels in any repair work.

Strengthening work involves seismic strengthening and compliance with other code requirements, such as fire escapes and disabled access.

Insurance issues are likely to arise where a building's strengthening is not completed within the specified time frame.

The Christchurch Earthquake Recovery Authority has the power to waive compliance with any provisions of the Building Act 2004. While wholesale waiver is unlikely, it is quite possible that, on a case by case basis, urgent remedial work could be undertaken without building consent, which along with code compliance, could be given retrospectively.

The three local councils (Christchurch, Selwyn and Waimakariri) can require repair work to be done on dangerous buildings if the property owner refuses to comply with a remedial works order.

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And the
walls came
tumblin' down...



Now the dust has settled and the bricks have stopped raining down, thoughts turn to cleaning up Christchurch. But as the many organisations behind this operation are discovering, the processes of demolition and removing debris can be challenging.

According to Roger Scholes, Technical Claims Manager – Broker Products, the costs of demolition and removal of debris are likely to be significantly higher than valuers had predicted, leading to a shortfall in the funds available to reinstate buildings.

“If a policy has a specific limit for demolition and removal of debris and that proves inadequate, the building owner immediately faces a potential uninsured loss, which may impact on his or her ability to reinstate the building.”

Where the demolition and removal of debris costs are included in the total sum insured, the balance left over to be applied to the reinstatement of the building is reduced.

Scholes says if there is not enough money to reinstate to an ‘as was’ condition, an owner might downsize or construct a building with different features.

“There is no doubt that the demolition of damaged buildings and the clearing of debris is a complicated and difficult process, when you consider that the earthquakes have given rise to the risk of neighbours’ demolition work causing damage to other premises.”

Under the policy the insured has a duty to take reasonable care to prevent loss to its property. Apart from the main cover for loss or damage, Lumley also covers the reasonable costs of controlling any cause of physical loss that threatens the property that is not otherwise covered under the policy.

Of course a neighbour or its insurers may well be liable if the loss or damage was avoidable; the neighbour cannot minimise its loss by causing further loss to its neighbour.

“Dropping a building onto your neighbour’s premises would not cut the mustard for example.”

Scholes says if you have a scenario where a neighbour’s building is going to be demolished by its owner (or its insurer) you should consider notifying the neighbour, in writing, that you expect them to take all reasonably practicable steps to minimise damage to your building.

If the Civil Authority undertakes demolition it is likely to have protection from negligence (but not from actions that are in bad faith or grossly negligent) according to the Civil Defence Emergency Management legislation.

Scholes says a good example of this in practice is the demolition of the Grand Chancellor hotel. Fletcher Construction have won the tender to demolish the building, a process which will take about 10 months.

“It is clear that the Grand Chancellor is leaning extremely close to the adjacent building, which is in turn almost touching another building. Because the hotel is so much taller than the adjacent building, there is an ‘overhang’ which appears to be about a metre, at the top of the Grand Chancellor.” Scholes says this strongly suggests that unless the hotel was very carefully demolished, debris may inevitably fall onto the adjacent building.

This could then affect other buildings in the vicinity, reminiscent of a house of cards or set of dominoes falling into one another.

The ‘drop zone’ of the Grand Chancellor is the area surrounding the hotel, allowing for dust and debris to spread outwards during the demolition process. All buildings in that zone are likely to be affected to a greater or lesser degree, including the potential for dust to enter buildings that are not weathertight.

Care has to be taken to determine if the dust might contain any hazardous substances such as asbestos, says Scholes.

There are usually three options when demolishing a building of this size and construction:

- careful deconstruction: minimises damage but can take a year or more
- careful demolition: floor by floor. Likely to cause more harm to adjacent property
- speedy demolition: will most likely cause extensive damage to adjacent premises.

Scholes says that he’s pleased a decision on the demolition process has been made.

“But really, you have to sympathise with those people who have to make the decision – whether to risk damaging other properties to speed up the process of rebuilding Christchurch, or to minimise damage to other property, thereby delaying the rebuild in a large area of the CBD.”

Demolition manager for Fletcher Construction, Adrian Jonkers, says a crane, parked in the hotel’s carpark, will be used to demolish the building from the top down, with the goal of bringing the building down to the 14th level within six months, making the building safe to the surrounding area.

High-reach diggers would then be used to complete the job, says Mr Jonkers. Before demolition work begins, some further work will be done to reinforce the interior of the hotel. This will allow guests to retrieve property they

CONTINUED >

were forced to leave behind on February 22.

Mr Jonkers could not guarantee surrounding buildings would not be damaged in the process.

Following demolition, hundreds of truck loads of rubble will have to be driven to a suitable dumping ground. The rubble will be a mixture of concrete, steel, glass, wood, plasterboard and all the other contents of a modern hotel, says Scholes.

“The hotel was a former Government building which was strongly built, so it will not be as easy to demolish as an early brick building or a wooden building,” says Scholes.


It has been reported that there are some extremely heavy panels of concrete – perhaps weighing many tonnes – which are in danger of falling in the event of another earthquake. Scholes expects this will be a significant consideration in the demolition process.

The Lumley policy states that reasonable demolition and other costs incurred will be covered for:

- demolition, dismantling, shoring or propping up the damaged property
- removal of stock, plant and other chattels whether damaged or undamaged
- disposal of debris (including any kind of solid, liquid or gaseous material) from the site of the damaged property and the area immediately adjacent to the site.

Liability for these costs will be tagged to any one event and will not exceed the limit shown in the schedule. If no such limit is shown the costs will be included in the sum insured on the affected property.

So are demolition costs always treated as having their own sub-limit – even if one is not provided in the policy schedule?

“No,” says Scholes. “If a separate limit has been agreed the policy schedule should set this out. If it doesn’t, the demolition costs form part of the sum insured.” 

On balance


Following the initial earthquake on September 4, Lumley made interim, non-specific payments to assist clients in their ‘hour of need’.

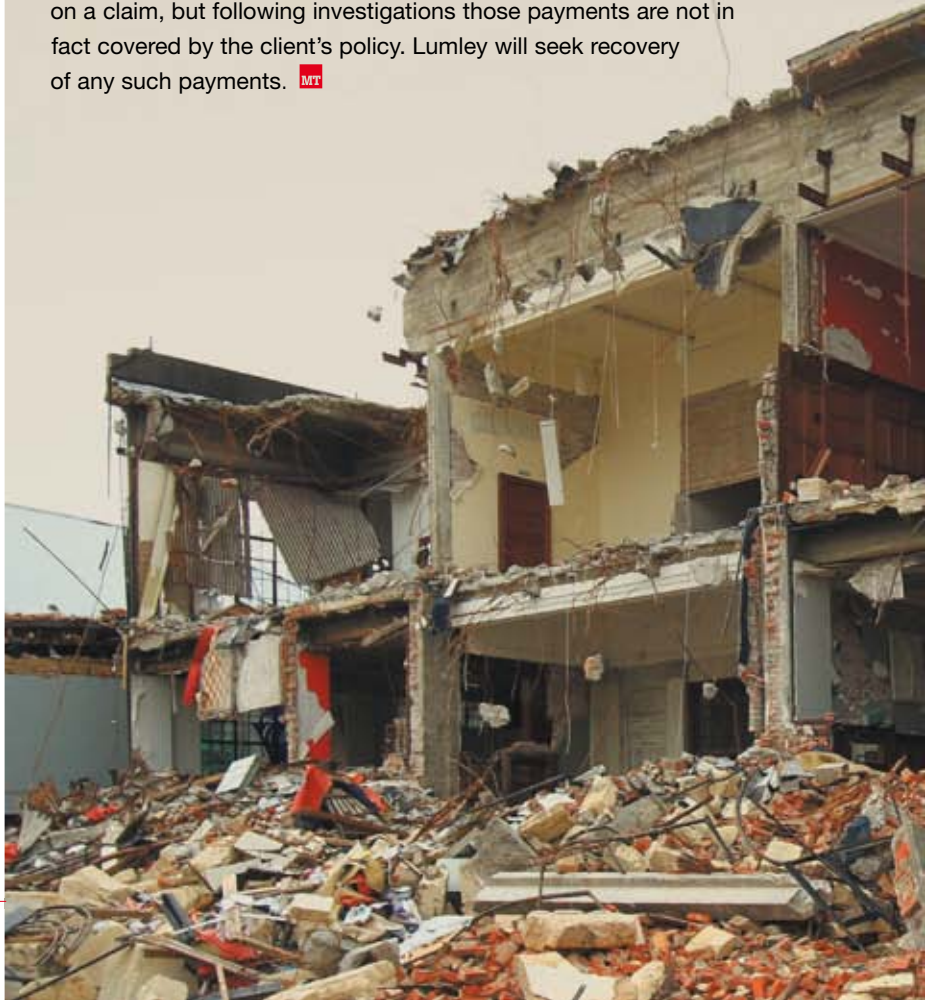
This gesture was made in good faith to support those affected customers with business interruption and material damage claims and had expenses that required cash reserves, such as the ongoing payment of wages and rent. Interim payments were generally made with immediate effect, and were often based on the amount requested from the client’s broker in respect to each claim.

However, it is possible that upon a full evaluation of the specific circumstances of a loss Lumley may have in some instances made ‘over-payments’, or indeed made payments when they were not warranted. An example of this is where a client suffered damage as a result of the earthquake and made a claim, but once Lumley’s appointed adjusters were able to access the site and talk to the client, the losses may not have been covered under their policy, or to a lower sum insured.

It’s worth checking with your clients to ensure any payments they have received were applicable under the details of their policy.

Interim payments were provided on the premise they would be deducted from the total amount of any business interruption or material damage payouts as a result of earthquake damage.

In the event that the aggregate total of the interim payments exceeds the total amount of the adjusted loss, the difference between the amount of the loss and the aggregate payments actually made is due to Lumley. This is also applicable in cases where interim payments have been made on a claim, but following investigations those payments are not in fact covered by the client’s policy. Lumley will seek recovery of any such payments. 



He's probably the busiest man in the country right now, apart from the PM, but EQC head Ian Simpson took some time out from his busy schedule to answer our questions.



Q&A with Ian Simpson

CEO of EQC

More Than The Canterbury Earthquakes are the fifth largest insurance disaster in world history. How do you deal with it?

Ian Simpson EQC has been planning for some time for an event such as this, and what has happened over the last nine months has been a roll-out of those plans.

How are things progressing for EQC at the moment?

EQC has received more than 320,000 claims since September 4, including over 184,000 for September and more than 135,000 for February. So far EQC has paid out \$860 million in claims since the September quake.

What has been the biggest issue for you in sorting out claims?

The complexity of two big earthquakes hitting the same place so close to each other. This has involved having to determine separate quake damage for each event. Add in to that the numerous aftershocks that have struck Christchurch and it makes the assessments quite detailed.

Have you come across many people who are underinsured or have no insurance at all?

To be honest not that many. It has been gauged by the insurance industry that between 5-10% of New Zealanders are under or uninsured, but we have found that it hasn't been that high in Canterbury.

What lessons has EQC learnt from the event and how will you apply them for any future events?

The use of the Rapid Assessment which was put in place after the February earthquake has been a positive. It has allowed EQC to see every home in Christchurch and get a feel for the scale of the damage. Also the availability of skilled local people who have been used to help out in a multitude of areas. Our ability to quickly establish call centres has been a real positive.

EQC are an easy target for criticism obviously, how do your staff members cope with it and manage to carry on?

I think the people who are working for EQC can see the good work that has been, and is being, done. Of the 1200 staff we have at the moment at least 800 are based in Christchurch, so people directly affected by what has happened are actually heavily involved in trying to help.

What was it like when you first arrived in Christchurch after September and February – can you describe the difference?

They were two very different scenes. Of course the September earthquake involved no loss of life so it was a bricks and mortar operation. The damage was certainly more widespread after September than after February, which was more heavily felt in the eastern suburbs. In September all of Christchurch felt something. After the February quake there was a completely different atmosphere in the city with the loss of

so many lives, and there were multiple damages in the inner city.

Did September prepare EQC in lots of ways for February?

By the time the February earthquake hit, EQC was already fully operational and had many of the processes in place. We had also employed the assessors, and so they were on hand to start work assessing the damage as soon as was practicable. Also the Rapid Assessment process put in place after the February quake was to help us get an understanding of the scale of the damage as quickly as possible. All homes in Christchurch were initially assessed within two months, and those with severe damage were listed for full assessment prior to the middle of July.



your edge

Your Edge Liability Symposium Tuesday 16 August 2011

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Lumley 

In house

Your Edge

The countdown is on to this year's hotly anticipated 'Your Edge' Liability event.

This year's symposium promises to be the best yet, with a list of influential speakers and commentators. There will be discussion about the issues surrounding the Canterbury earthquakes, the lessons learnt so far and how they can be applied elsewhere. Other topics of interest include leaky buildings, professional indemnity and other engaging and helpful subjects.

Make sure you RSVP as numbers are strictly limited. To find out more visit lumley.co.nz/youredge

Policy System Improvements

In May we commenced rolling out the Guidewire suite of products for select lines of commercial business. The roll-out is on a product-by-product basis, and the first product that went live on our new policy system was Commercial Motor.

These new systems will mean great things for our customer service and claims management, providing you with quicker turnaround times and more efficient service. This move represents a significant investment from Lumley, and we are confident of the tangible benefits these system changes will offer you and your clients in the future.

For more information on this change and how it affects you, check out lumley.co.nz/policysystem

New COE Managers



In January Lumley welcomed Andrew Scrivens (left) as its new Marine COE Manager. Andrew joined Lumley from Associated Marine, and his knowledge of the marine sector, leadership skills and all-round insurance expertise have made him a valuable addition to the team.

Lumley has also appointed a new Liability COE Manager, Craig Kirk, who will be joining Lumley in August. His main focus will be the further development of Lumley's liability book, providing leadership to the Liability team and continually looking for ways to add value to both your business and our liability customers.

As this newsletter provides general information only, readers should not act on it without consulting with a legal expert.

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