

# Commercial Coverage Conundrums — Property Appraisals and Theft Coverage Problems

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**Editor's note:** At the 2010 CPCU Society Annual Meeting and Seminars in Orlando, the Risk Management Interest Group, together with the Underwriting Interest Group and the Claims Interest Group, presented an interactive discussion of 10 coverage problems. Here are discussions of two of them prepared by one of the panelists and an associate. (Additional problems will be discussed in future issues.)

## Appraisal Argument

**P**roblem: Fire damaged a building and its contents. The building is occupied as a knick-knack store operated by the insureds. The insured submits claims for total loss of \$750,000 on building and \$320,000 on contents. The carrier offers \$550,000 on the building claim, asserting that the rear of the building is salvageable. This accounts for \$100,000 of the difference. Differences in unit costs and labor allowances account for the other \$100,000 difference.

On the contents, the carrier offers a replacement cost of \$208,000 settlement subject to a 50 percent depreciation holdback. (The insurer doubts that the elderly insureds will replace a lifetime accumulation of knick-knacks). The insureds demand appraisal, which the carrier rejects claiming that the issues are coverage issues. The insureds delay re-building, stating that they do not have funds pending outcome of appraisal.

### Discussion:

(1) *Are the insureds entitled to appraisal? If so, on what claims?*

Yes. The policy provides coverage for the damage to the building as well as for the loss of the contents that, given the function of the store, could fall under the business personal property coverage as "stock." CP 00100607§§A.1.a-b.

The policy further provides, in relevant part, that "[i]f we and you disagree on the value of the property or the amount of loss, either may make written demand for an appraisal of the loss." CP 00100607§E.2.

The problem suggests that the difference between the carrier's offer and the policyholder's submission, with regard to the building, is that the carrier views the building as salvageable. Although salvage is often undefined in a policy, it can mean, for example, "a state of damage or disrepair such that the [building] is rendered unsuitable for its originally intended use in the absence of major alteration or repair and is in such condition that it is usable only for scrap value or secondary purposes." See *Vanguard Ins. Co. v. McWilliams*, 680 S.W.2d 5052 (Tx. Ct. App. 1984) (holding that "salvage" was an ambiguous term and therefore construing the term to provide coverage). Although a dispute over whether the building is salvageable would arguably fall within the realm of a disagreement as to the value of the property, and thus within the appraisal provision, the question of salvage can implicate a blend of legal and valuation issues, and thus a case could be made that appraisal is not warranted until disputes over salvage are resolved. See *Duane Reade, Inc. St. Paul Fire & Marine Ins. Co.*, 261 F. Supp. 2d 293, 296 (S.D.N.Y. 2003); *Indian Chef, Inc. v. Fire & Cas. Ins. Co. of Connecticut*, No. 02 Civ. 3401, 2003 WL 329054, at \*3 (S.D.N.Y. Feb. 13, 2003) (denying motion to compel appraisal on the grounds that it was premature because a dispute between the parties "that goes to coverage under the policy can only be resolved by analysis

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and application of the policy.”). However, the question of salvage only comprises \$100,000 of the difference. The remaining basis for the difference, unit costs and labor would likely be subject to appraisal, as would differences in the valuation of the contents claim.

- (2) If the insured is entitled to appraisal, assume that it takes months to resolve these various issues and that, by the time the repairs are completed, the rental value loss exceeds the policy limit. What time limit applies to the rental value claim? Can the insureds recover in excess of their rental value limit?

The Business Income Coverage includes coverage for the actual loss of Business Income (rental value) that is sustained due to the necessary suspension of operations during the “period of restoration.” CP00300607, §A.1. The period of restoration is the period of time which begins 72 hours after the time of direct physical loss or damage for Business Income Coverage. CP00300607, §F.3.a. The period of restoration ends on the earlier of (1) the date when the property at the described premises could be repaired, rebuilt or replaced with reasonable speed and similar quality; or (2) the date when business is resumed at a new permanent location. CP00300607, §F.3.b.

The policyholder may be able to recover in excess of the rental value limit under two related theories. The first theory imposes consequential loss on an insurance company, where the insurance company withholds coverage benefits needed by the policyholder. In *Bi-Economy Market, Inc. v. Harleyville Ins. Co. of New York*, 10 N.Y. 3d 187 (N.Y. 2008), New York’s highest court determined that the time element coverage period of liability is extended where an insurance company withholds



payments that are needed by a policyholder to re-establish business operations. See *Bi-Economy*, 10 N.Y. 3d at 195-96. Under such a scenario, the improper denial or withholding of payment of all or part of an insurance claim (including time element insurance coverage) will result in the insurance company being liable for all consequential damages.

Under the second theory, time element insurance coverage may be extended while coverage issues are adjusted and resolved. Case law under this theory deals with the issue more specifically. In one such case, *Vermont Mutual Insurance Co. v. Petit*, 613 F.Supp.2d 154 (D.Mass. 2009), the policyholders’ rental property was destroyed by fire, and at issue was the rate of lost income, the length of the Period of Restoration, and the proper classification of continuing expenses. Richard Lewis, *Business Income Insurance Disputes*, § 5.02[F]. The Period of Restoration was held to be a “theoretical replacement time,” which included

“any delay attributable to [the insurance company’s] failure to perform its duties under the policy,” or “failure to adjust [a] loss within a reasonable time,” along with “[a] reasonable extension in the adjustment period [to] include foreseeable delays in negotiating losses.” *Id.* The court therefore extended the Period of Restoration to include the entire period taken to adjust and pay the loss. *Id.* Accordingly, the policyholder has an argument here that their time element insurance coverage is extended while the coverage issues are adjusted and resolved. Forms used in discussion: CP 00 10 06 07, CP 10 30 06 07, and CP 00 30 06 07.

## Theft from Storage Shed

**Problem:** Insured put a \$3,000 storage shed on the premises. It was placed 20 or so feet behind the sales office. The client did not want coverage for the shed itself. One night, the shed was broken into and more than \$50,000 worth of business personal property (BPP) items were stolen.

The carrier denied the claim because the BPP was not in or on a building listed in the declarations. The insured pointed to the policy wording of “ ... located in or on the buildings or ‘mobile homes’ at the described premises ... ” which, he argued, did not state that the building had to be specifically listed on the policy to trigger coverage for BPP stored inside.

The adjuster responded that the shed is not considered to be part of the “described premises.” He referred us to the Description of Premises on the dec page which lists Prem #1 and Bldg #1, along with the address. He said that since the shed was not Bldg #1, it was not part of the premises.

**Discussion:** Is the insured covered for the loss of the BPP in the shed? Policy forms CP 00 10 06 07 and CP 10 30 06 07 plus declarations page CP DS 00 10 00.

There are a number of arguments that the insured may be able to make in favor of coverage for the loss of the BPP in the shed. According to the Building and Personal Property Coverage Form, the insurance company “will pay for direct physical loss or damage to Covered

Property at the premises described in the Declarations caused by or resulting from any Covered Cause of Loss.” CP00100607, §A.

Obtaining coverage under the policy may depend upon what items constituted the BPP. For instance, coverage is available for the following Covered Property: “materials, equipment, supplies and temporary structures, on or within 100 feet of the described premises, *used for making additions, alterations or repairs to the building or structure.*” CP00100607, §A.1.a.(5)(b) (emphasis added). The BPP was clearly close enough to the building to obtain coverage but coverage may only be available if the BPP, for example, consisted of tools and supplies used to repair the building.

In addition, the insured might also argue that the BPP is covered under the Business Personal Property Coverage. This coverage extends to property within 100 feet of the described premises, including furniture and fixtures, machinery and equipment and all other personal property owned by you and used in your business. CP00100607, §A.1.a.(5)(b). If the insured can establish that the materials in the shed and the

BPP housed in the shed constitute “all other personal property owned by you and used in your business” or any of the other enumerated categories, the insured will be entitled to coverage.

Another basis for coverage is that fact that the shed is covered because it is only 20 feet from the sales office and thus comprises part of the Description of Premises since it shares the same address with Prem #1 and/or Bldg #1. ■

