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OUTSIDE COUNSEL

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Sept. 11: Risk Management Lessons Learned

There are valuable business management lessons to be learned from some of the companies affected by the Sept. 11 attacks. Financially, several of these firms are likely to make dramatic recoveries from their economic losses because of their executives' understanding of risk management and their foresight in taking appropriate steps to increase their firm's economic protection as their businesses grew. These executives understood that managing risk is part of managing their businesses, and all businesses can learn from their initiatives.

Many media outlets have reported gross estimates of insurance losses arising from the Sept. 11 attacks exceeding tens of billions of dollars, but these analyses are woefully simplified. Many different types of insurance and risks are implicated, each with their own unique issues. Much of the most severe economic losses will be minimized because many World Trade Center businesses took prudent risk management steps that did not involve insurance at all, such as using multiple suppliers and offsite backup storage of mission critical data.

In many cases, these risk management measures resulted from an analysis undertaken by the World Trade Center businesses after the 1993 bombing at the Twin Towers. A review of the various insurance and non-insurance risk management issues arising from the Sept. 11 attacks and the steps taken by the World Trade Center businesses is useful to businesses who want to know whether they are adequately managing their own risks.

The insurance issues should remind businesses to check their own policies. Each business changes and risks change. Just because coverage was adequate last year does not mean you should just renew and forget about it. The executive responsible for risk management issues should review the company's insurance coverage at least once a year with counsel and a professional commercial insurance broker. Many of the businesses affected by the Sept. 11 attack used the insurance market astutely after they received a wake up call from the 1993 attack.

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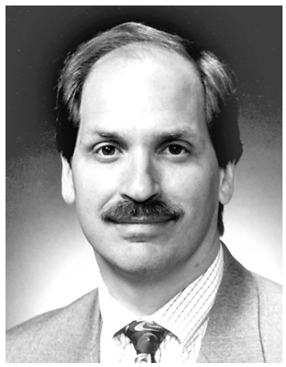

Coverage Exclusions

Most commercial property insurance policies contain a standard "war risk" exclusion. Cases interpreting this exclusion, mostly as a result of litigation ensuing from the 1993 attack on the Twin Towers, limits its applicability.

However, many recent polices contain a "terrorism" exclusion that expressly excludes or limits losses resulting from terrorist acts. These clauses are not uniform and are not routinely included by all commercial property insurers. Thus, it is important to review each insurance policy to see whether it provides reasonable coverage. If the policy includes a very broad exclusion, the insured should explore the possibility of purchasing coverage for terrorist acts.

The terrorist exclusion has not previously been widely examined by the courts but undoubtedly will be reviewed now as a result of the Sept. 11 attacks. One of the issues likely to be examined is whether the exclusion applies to a building that was not directly attacked but instead was damaged by falling debris. Many coverage attorneys believe that the exclusion will be read very narrowly by the courts but the result in any particular case will depend on the exact wording of the particular exclusion at issue.

Unquestionably, the extent of covered damages will be a hotly disputed issue, because most property policies do not cover consequential damages such as loss of use, business interruption or temporary relocation unless there are specific endorsements (and premiums paid) for such coverage. Usually, direct and tangible property damage loss for things such as business furniture, computers and supplies is comparatively minimal and relatively simple to calculate as opposed to intangible losses. In the case of the World Trade Center businesses, even the tangible loss issues may become very complex because of such considerations as the loss of telecommunications equipment and wiring.

It has been widely reported that the financial district in general, and the World Trade Center in particular, is one of the most densely "wired" places on earth, with some published estimates that some financial businesses may have losses of several hundred million dollars from telecommunications equipment and wiring alone. An interesting related issue regarding wiring is whether the wiring is the insured's covered property or a permanent improvement to the leasehold belonging to the landlord. Such damage considerations are novel, but may become routine in this era of highly evolved communications networks.

Tangible loss claims may also be complicated by loss of the actual insurance policies. Since the World Trade Center also housed one of the country's largest commercial insurance brokers, broker copies may also be unavailable. Insurance policies are important business assets but many companies often overlook the need to carefully store policies in a secure location.

The greatest economic loss will be intangible business interruption losses, which are among the most difficult insured losses to calculate even in a routine fire claim.

For example, a retail business involved in a fire will typically estimate its business interruption losses based upon historic sales patterns if it was charged an insurance premium based upon sales. Such calculations are difficult because the insured must convince the court that its estimates are reasonable and not mere speculation.

In the case of the World Trade Center businesses, the business interruption estimates will be even more difficult than normal because most of these businesses were financial firms, law firms or insurance brokers. These businesses engage in speculative trading and/or provide professional services, where revenues are very difficult to predict. Moreover, many businesses do not have business interruption coverage because the premiums are typically very large, reflecting the huge risk that is insured in the case of a catastrophe.

Intangible Losses

Other intangible losses raised by the Sept. 11 attacks include the loss of files, data and telephone service. The scope of covered economic damage will likely hinge on dueling expert testimony; that is, if the court determines that any of these losses are covered. Relocation insurance losses will also be very difficult to agree upon, because the Manhattan real estate market and the locations of these businesses are unique. Relocating a high tech brokerage operation from lower Manhattan is not the same thing as relocating a warehouse.

The life insurance losses are not likely to be as significant to the insurance industry as may appear at first blush, but unique issues will be raised because of the difficulty in obtaining death certificates. The death certificate is a necessary bureaucratic requirement because of the danger of fraud. The State of New York and the court system have taken steps to expedite the legal process, but some surviving families may face temporary economic hardship due to the delay in paying benefits. The economic losses from medical and disability insurance claims may be far more significant to the industry because of the likelihood of continuing psychological claims.

Liability insurance issues will surely be tested, but Congress has quickly moved to limit the liability of the airlines which are the most obvious target of lawsuits. The Port Authority is also likely to be sued as a result of evacuation procedures: in particular, plaintiffs' firms have already cited the World Trade Center announcement to South Tower tenants to stay in their offices after the initial North Tower attack. Liability claims do not presently appear to be a major issue for most of the affected businesses.

Some of the affected businesses planned effectively and expended significant resources to minimize the potential damages if they suffered a catastrophic loss of their offices. Some telecommunications-intensive businesses purposely installed telephone systems from several different vendors; thus, if one system went down, they could still talk to the outside world via the other carrier's equipment. Quite a few companies utilized outside contractors to back up their most significant files and data in an offsite location, in some cases paying these contractors to back up their systems several times a day. Some businesses, such as the New York Board of Trade (which trades cotton futures and other commodities), retained an outside contractor to provide them with an immediate temporary location. The Board of Trade was able to move within days into a facility in Long Island City that was prepared to handle its complex operations. Other businesses had agreements with computer vendors and telecommunication providers to supply replacement laptops, personal computers and cell telephones within 48 hours.

Both the tenants and management of the World Trade Center also utilized classic risk management safety evaluations to prepare for a disaster. The Port Authority took steps to improve evacuation routes as best it could. Survivors of both the 1993 attack and the Sept. 11 attacks reported that the evacuation was more orderly this time, the stairwells better lit, and the tenants and staff better trained for emergency procedures.

As with insurance policy reviews, business managers should meet with their counsel at least once per year to review non-insurance risk management. This could potentially encompass the aforementioned safety evaluations as well as a review of business forms, contracts, strategic partnerships and vendors. Are the fire exits adequately marked and lit?

For retailers, are the goods on the display shelves arranged so that they will not fall off and injure a customer? Is the parking lot full of potholes and cracks that will invite injuries and attract slip and fall lawsuits? Are sales forms up to date so that they state all applicable UCC defenses? Are vendors and contractors adequately insured and indemnification agreements executed?

Conclusion

There is no question that the 1993 attack forced many of the businesses affected by the Sept. 11 attacks to focus on risk management issues resulting from a terrorist act or other catastrophic loss. In particular, the financial industry met, consulted and agreed on a risk management strategy which may well have saved this country from an economic disaster.

Clearly, the horrific events of Sept. 11 should serve as a wake-up call to all Americans on a number of issues which make the economic issues minor considerations, but we should not forget that the one of the terrorists' apparent goals was to disrupt the financial system. All businessmen can learn from the foresight of these industry leaders and take appropriate risk management steps to protect the economic health of their businesses and this country.

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