

## What are Collateral Damages?

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Managers who have experienced a property loss know they need *at least 20%* more money than they will be paid by their traditional property insurance. Consider the following types of damages that routinely occur in conjunction with insured property losses but which are not paid by traditional property insurance.

- **Deductibles**  
Deductibles are much more financially painful after a loss. CAT deductibles and business interruption deductibles are often substantial.
- **Losses in excess of sub limits or policy limit**  
While one's policy limit may stand-out like a bright red line, it is easy to forget all of the other limitations specified by an insurance policy. For example, one may have some coverage for claim adjustment expenses, but for larger claims, the coverage is rarely sufficient.
- **Policy exclusions**  
Even when properties are covered against a specified peril, insurance policies have many other types of exclusions that prevent a full reimbursement for losses that the insured sustains.
- **Interest cost required to finance a loss until the insurance payment is received**  
Large losses are typically complicated and take many months, even years, to resolve. In the mean time, the insured must finance all of the cost associated with the loss. This cost is not reimbursed.
- **Amounts claimed but not paid by insurers**  
Large losses involve many people with different areas of expertise who are each applying their knowledge and best practices to the situation. The discretion they employ and the judgments they make are often second-guessed by claim adjusters working for insurers. Typically, claims made are 20% higher than the amounts for which the claims settle.
- **Ongoing lost revenue**  
Companies are often frustrated with business interruption coverage because these losses are difficult to prove and the coverage is determined off of an historical base. Also, companies may lose revenues without ever suffering a qualifying business interruption event. For example, several trucks filled with cosmetics were stolen en route to retailers during the holiday season. The company was reimbursed for the cost of the lost merchandise but not for their advertising expenses or for the lost sales that resulted.
- **Improvements, betterments, or rebuilding to a different standard**  
After a loss, companies typically want to rebuild to the current standard or to a future standard, but the upgraded equipment exceeds the replacement cost provisions of their property insurance policy. There may also be financial penalties for not rebuilding or not rebuilding at the same location.

- **Community impact costs**  
Companies must take care to maintain their relations with the communities around them. Actions must be taken for the sake of reassuring the community, even when it is obvious to insiders that there is no impact.
  - A fire at a manufacturing plant caused fears that ground water and air may have been contaminated. The company was confident that there was no contamination but hired a firm to test air and water samples to help reassure local officials and the community at large.
  - Historic buildings may have to pay large one-time assessments or incur other community fees and costs if they choose not to rebuild with the same materials or seek a different design.
  
- **Management and employee impact costs**  
Recovering from a substantial loss takes a toll on everyone affected by it and companies find it is in their interest to provide extra benefits and services to employees who must work substantial overtime to maintain and restore operations.
  - After hurricane Katrina, a large telecommunications company found it needed to set up tent cities for the families of its employees and provide free shelter, food, and healthcare, so that its employees could focus their attention on restoring the company's operations.
  
- **Impact on customers and suppliers**  
To maintain relations with their customers and suppliers after a large loss, companies often find that they need to make business arrangements that they would normally consider sub-optimal. In effect, the party that has suffered the loss finds it has the added burden of making its business counterparties whole.
  - A university found that it needed to provide extra services and benefits to student residents after a dormitory fire.
  - After a tornado destroyed a plant where a manufacturer had concentrated the production of a key component, it had to reveal trade secrets and enter into a long-term relationship with a new and unproven supplier at a higher per-unit cost so that it continue to supply product to its customers.
  
- **Fixing or improving risk management**  
Good risk management entails determining how a loss occurred and ensuring that procedures are implemented to ensure that similar losses do not happen again.
  - A storage company suffered a fire of suspicious origin at one of its warehouses. Its customers demanded that it increase security at all of its facilities, but its insurers were only willing to pay for increased security at the affected facility.
  - After a fire, a company learned of a design flaw in the construction of one of its components. Given that all of its locations were built to the same standard, it needed to make improvements at each location.
  - An oil refinery needed to undertake a long-term, independent investigation into its safety practices after an explosion killed several employees and destroyed its facility.

Although the types of Collateral Damage will vary from claim to claim, one can be confident that the amount of Collateral Damage will be at least 20% of whatever is recovered from their property insurance.