

WHEN IS FLOODING A FLOOD?

By Lee Lockrem

Having your business, property or home covered by water should reasonably be considered a flood. True or false? The answer is: it depends. And the answer may determine whether or not your insurance will cover you for your loss.

BACKGROUND

Since its completion in 1962, the Howard Hanson Dam, located in the Cascade foothills east of Seattle, has prevented major floods in the Green River Valley. That changed when 2009 winter's heavy rains weakened the hillside next to the dam. If heavy and prolonged rain occurs this season (roughly October through March), many businesses and homes in the valley that do not typically see flood water – including parts of Auburn, Kent, Renton, South Seattle and Tukwila – could again be flooded. As a temporary fix, the U.S. Army Corps of Engineers (the Corps) is spending \$8.9 million to inject grout into the abutment, forming a shield to lessen the seepage. (More information is available on this in a previous Willis publication, *You Should Know*, October, 2009.)

The Corps hopes to have a permanent fix – a concrete wall the length of the abutment and extending down to bedrock – but that could take three or more years to complete (at a cost of up to \$500 million).

Until the Corps can make permanent repairs, it must limit the amount of water stored behind the dam and has created several “inundation maps” showing possible areas of flooding and how much each area would be underwater if more water than usual must be released. Businesses below the Howard Hanson Dam should therefore prepare for a higher risk of flooding. In addition to homes and apartment complexes, the valley has hundreds of offices, including the headquarters for Boeing Commercial Airplanes, sprawling shopping malls, factories and what the Corps describes as the third-largest warehouse area in the nation.

The Corps, which earlier put the odds of severe flooding as high as 1 in 3, now says that extensive work to strengthen the abutment has



lowered the odds to 1 in 25. Although the risk of flood may be lower than it was, Washington State's Office of the Insurance Commissioner, the local city mayors, Metropolitan King County council members and the governor are still recommending property owners in the area secure flood insurance from the Federal Emergency Management Agency. Under the circumstances, federal flood insurance is very competitively priced and it is available to everyone, regardless of whether or not the party is located in a flood zone. However, there are a few snags.

FLOOD INSURANCE

THE GOOD NEWS Two types of flood insurance are available – structural and contents. The first covers damage to building foundations and walls. The second generally



includes anything that is not nailed down, as long as it is not in a basement. Only essential materials are covered if they are in a basement: such equipment as water heaters, sump pumps, furnaces and some drywall.

LESS GOOD NEWS Benefits are capped at \$500,000 for business structures plus another \$500,000 for business contents. Coverage is further limited to 10% of the business contents limit for Tenant's Improvements and Betterments and time element coverages are not available. This barely scratches the surface for many area businesses.

With some businesses in South King County finding it extremely difficult to buy enough flood coverage, Washington's Insurance Commissioner is calling for broader powers to intervene when a local insurance market collapses. "We keep hearing from businesses and brokers who say that the traditional market for flood coverage has dried up in parts of the Green River Valley," said state Insurance Commissioner Mike Kreidler. "Other than federal flood insurance, some say they cannot find additional coverage at any price." He's seeking broader powers to create a joint underwriting association (JUA) when critical coverage becomes all but impossible to find. On February 9, 2010, the Washington Senate passed the bill on a 30-18 vote and Senate Bill 6240 now heads to the House. The bill would give the state insurance commissioner the needed power to create the joint underwriting association.

THE BAD NEWS **Some policies that do exist have exclusions for actions taken by governments. Because flooding technically would be decided by the Army Corps, some carriers may try to deny coverage based on this exclusion.** Commissioner Kreidler urges business insurers to not use a common policy exclusion for "governmental actions" to deny claims if water releases from the dam. Many insurers use standardized policy language from the Insurance Services Office that typically excludes "seizure or destruction by order of governmental authority." In a letter sent to 200 business insurers, Kreidler wrote, "I strongly urge all companies to refrain from taking such a position." The commissioner "does not believe that a government order to release water to protect a dam constitutes the type of 'destruction of property by order of governmental authority' included in many insurers' commercial flood policies."

Some companies use different language. Therefore, READ YOUR PROPERTY INSURANCE POLICIES.

NOTE There is no such exclusion in policies from the National Flood Insurance Program. But since NFIP covers a maximum of \$500,000 for a building and \$500,000 for contents, many businesses below the dam have been seeking additional coverage from private insurance companies.

STATE OF THE MARKETPLACE

Flood exposures are being shed on a broad scale through non-renewals, reductions in renewal lines or declinations of new business. Insurers and reinsurers, whose capacity and capital are on the line in the Green River Valley, have called for flood rates and premium increases while substantially reducing flood limits.

The question is not only where to find coverage, but how much will it cost? There is one rather large patch of uncertainty for the insurance industry – and for the insurance buyers – and that patch is underwriting risk in the Green River Valley. We can safely predict capacity rationing and attempts to reduce limits and an increase in cost – because they are all happening now.

Property renewals to date in the first quarter have shown:

- FM Global and Affiliated FM have reduced flood limits in some cases from \$50,000,000 to \$2,500,000. If the buyer has an acceptable Flood Emergency

Response Plan (FERP), limits of \$15,000,000 may be achieved. While limits have been reduced, the rate for flood has increased and in some instances to \$2/\$100, increasing the annual premium by 400%.

- Commonwealth, Great America and CNA are not adding any new risks to their portfolio or, at a maximum, offering limits in the range of \$1,000,000.
- Allianz is excluding flood for any areas protected by dams, dikes and similar flood barriers.
- Zurich, Travelers, Chubb, Lexington, Ironshore and Swiss Re are looking at each risk on a case-by-case basis.

One of the biggest questions is whether or not the Difference in Condition markets will offset the capacity shortfall left by the standard property insurers. The answer is a solid “maybe.”

These insurers do not have the same capacity aggregation issues as the standard property markets, but they are commanding high levels of premium for limited deployment of capacity. Of more concern is the amount of total capacity available in this market sector. Will a billion dollars be available in the Green River Valley?

- Westchester, Global Excess Partners, Max Specialty, RSUI and Maximum continue to write new business with capacity lines in the range of \$2,500,000. If in an excess position, lines may be greater.
- Arrowhead and RLI are not deploying new capacity and, in some cases, have reduced renewal offerings.
- Aspen is writing new business in an excess position.
- Essex and remaining markets are underwriting on a case-by-case basis.

STRATEGIES

- Identify your Green River Valley flood exposures. This may not necessarily be your physical location; but may be the location of one of your major suppliers and/or vendors. Reduce your vulnerabilities by improving physical protection at your locations, establishing redundancy in capacity, or increasing the number of critical suppliers and/or customers. (Additional information can be found in our publication, *You Should Know*, October 2009.)

- Review current policies for limits, deductibles, coverages and exclusions.
- Use the time between now and the next renewal to develop an exceptional submission. Underwriters respond to a good story well told, and this will separate you from the pack.

Your renewal outcome can be influenced by the extent of your knowledge of the nature and behavior of your own flood risk, by how you manage that risk, by how you fund for it and by how you interact with the marketplace and present your story.

- Develop disaster recovery and business continuity plans – and test them! When they work, provide the plans to the underwriters. *Risk Management comes before risk transfer.*
- Have a face-to-face visit with your key underwriters several months before the renewal date.
- Have well informed and realistic expectations for the property insurance renewal and let everybody know what they are.
 - Be aware
 - Be prepared
 - Stay informed



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