

1
2 **UNITED STATES DISTRICT COURT**
3 **EASTERN DISTRICT OF LOUISIANA**

4 LOUISIANA WORSHIP HOSPITALITY,
5 LLC.,

6 Plaintiff,

7 vs.

8
9 LEXINGTON INSURANCE COMPANY,
10 Defendant

) Case No.: 08-3740

) PRELIMINARY EXPERT REPORT OF
) CHARLES M. MILLER

11 **I. INTRODUCTION**

12
13 1. I have been retained by Louisiana Worship Hospitality, LLC (“Louisiana
14 Worship”) to provide my expert opinion on whether Lexington Insurance Company
15 (“Lexington”) complied with the practices and standards in the insurance industry for
16 claims handling in its handling of the Louisiana Worship claims, which are the subject
17 of this litigation.
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20 2. A copy of my CV is attached hereto as Exhibit A.

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22 3. My hourly rate is \$350.

23 **II. BASIS FOR OPINIONS**

24 4. I have been retained as an expert on insurance practices and standards
25 in over 100 cases, in both federal and state court, including Arizona, California,
26 Idaho, Nevada, New Mexico, South Carolina, Pennsylvania, Florida, the Virgin
27 Islands, Washington, Oregon, Utah, Arkansas, Texas, Missouri, Mississippi,
28

1 Louisiana, West Virginia, and Toronto, Ontario, Canada. I have been qualified as an
2 expert on insurance industry claims handling standards and practices and testified in
3 trial in Arizona, Nevada, Arkansas, Idaho, and California. Attached hereto as exhibit
4 B is a list of the cases in which I have been deposed and/or testified at trial in the
5 past five years.
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7 5. My opinions are based on my experience and training as an insurance
8 adjuster and manager at Fireman's Fund Insurance Company from 1972 to 1990, my
9 experience and training as a lawyer practicing insurance law, and my experience in
10 reviewing and analyzing the claims handling of other insurance companies. My
11 opinions are also based upon, among other sources, my review and knowledge of
12 insurance industry texts and articles concerning the handling of insurance claims,
13 and the statutory and regulatory standards for the handling of insurance claims, such
14 as National Association of Insurance Commissioner's Model Unfair Claim Settlement
15 Practices Act (hereinafter the "Act"), which has been adopted in Louisiana (LSA R.S.
16 22:1214(14)), and the National Association of Insurance Commissioner's Model
17 Unfair Claims Settlement Practices Regulations (hereinafter the "Regulations").
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21 6. The Act and the Regulations are one of many important sources of
22 information for insurance industry standards for the proper handling of claims.
23 Indeed, the Act and Regulations are often articulations of the general insurance
24 industry standards for claims handling.¹ As one well known author on insurance
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26
27 ¹ The Act and the Regulations are based upon the National Association of Insurance
28 Commissioner's Model Unfair Claims Practices Act and Model Unfair Claims Practices
Regulations. Over 45 states have adopted the Model Unfair Claims Practices Act either
in its original form or in a modified form. Likewise, many state insurance commissioners

1 claims handling has pointed out, insureds are frequently permitted to introduce
2 evidence of violations of the Model Unfair Claims Settlement Practices Act and Model
3 Unfair Claims Settlement Practices Regulations “because the model act is a
4 nationally recommended standard of care. It was developed [by the National
5 Association of Insurance Commissioners] as a guide for insurance regulators in every
6 state to establish reasonable claim practices. Since the NAIC [National Association
7 of Insurance Commissioners] is made up of insurance “experts,” juries should
8 consider their opinion of what constitutes unfair claim practices when evaluating the
9 behavior of an insurer in a bad faith case. Thus, although the model [Unfair Claims
10 Settlement Practices] act may not allow insureds or claimants who have been treated
11 unfairly by an insurer to file a private action, it has been used indirectly for the benefit
12 of many plaintiffs.” (Markham, James J. et al, ed., The Claims Environment (1st ed.
13 1993) Insurance Institute of America) Because the Act and Regulations constitute
14 accepted insurance industry practices and standards for claims handling, where
15 appropriate, sections of the Act and Regulations are referred to herein.
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19 7. In preparing my opinions I was provided with the following documents:

- 20 • The Petition for Damages;
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23 have adopted the Model Unfair Claims Settlement Practices Regulations. The Model
24 Unfair Claims Practices Act and Model Unfair Claims Practices Regulations are used by
25 insurance commissioners nationwide to conduct market conduct examinations of
26 insurance claims operations. Such examinations involve the review of hundreds of
27 claims files to determine if the insurer is complying with the standards set forth in the
28 Unfair Claims Settlement Practices Act and Unfair Claims Settlement Practices
Regulations. Further, many insurers have inserted either the Model Unfair Claims
Practices Act and/or Unfair Claims Settlement Practices Regulations, or versions
thereof, in their claims manuals and required their claims personnel to comply with
them.

- 1 • Defendant's Responses to Plaintiff's First Set of Requests for
Production of Documents;
- 2 • Defendant's Answer and Affirmative Defenses;
- 3 • Lexington policy 1115726 issued to Louisiana Hospitality, LLC for
4 the period of December 29, 2006 to December 29, 2007
(hereinafter, the "Policy");
- 5 • The depositions of Edward A. Mossien, Assistant Vice President
6 for AIG Commercial Insurance, Roger Sawyer of the General
Adjustment Bureau ("GAB"), Brent Barton of AIG, Jake Mello, and
7 Eddie Bhatt.
- 8 • The Examinations Under Oath ("EUO") of Ashok (Eddie) Bhatt,
and Daniel Adame;
- 9 • Plaintiff's Second Supplemental Response to Defendant's
10 Requests For Production of Documents;
- 11 • Documents produced by GAB;
- 12 • Documents produced by J.S. Held, and
- 13 • Lexington Documents produced, bates number 001-613.

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15 8. During my employment at Fireman's Fund I was responsible for the
16 handling of thousands of claims, either as an adjuster or supervisor, including claims
17 such as the one involved in this case. In many other similar claims it was necessary,
18 upon notice of an accident or occurrence, for me to thoroughly investigate the claim,
19 determine the scope and extent of damages as well as determine what coverages
20 applied to the loss. During my employment in the insurance industry, I not only had
21 the opportunity to learn about proper claims handling standards from my own
22 employer, but was also able to observe the claims handling procedures and
23 standards of well over one hundred other insurers. In addition, I attended numerous
24 classes, workshops, seminars or similar programs regarding the handling of
25 insurance claims.
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1 9. My experience with insurance industry claims handling standards
2 continued with my legal practice, which began in 1990. My legal practice, particularly
3 since 1992, has been substantially devoted to insurance matters. As a result, I have
4 been able to review claims files and manuals of many insurers as well as observe
5 their claims handling procedures and methods. I have also testified as an expert in
6 insurance matters since 1997. As a result I again have had the opportunity to review
7 numerous claims files, claims manuals, and other documents regarding insurance
8 company claims handling procedures.
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11 10. Insurance company claims representatives are routinely trained in the
12 standards of insurance claims handling. Claims personnel are expected to know
13 these standards and apply them in their work on a daily basis. This requirement is
14 underscored in a text on insurance claims, which is used nationwide to train
15 insurance claims personnel. In the book, The Claims Environment by Markham, et
16 al, the authors, all of whom are or were employed in the insurance industry, point out
17 that "claims representatives should have expert knowledge of insurance policy
18 coverages, the law, and determination of damages." (Markham, p. 12) Insurance
19 claims handling standards are national in scope, and do not differ substantially from
20 one state to another. These standards include the accepted standards for the
21 interpretation and application of insurance policies. Insurance claim professionals
22 are trained in the interpretation and application of insurance policies. Indeed, these
23 professionals, on nearly a daily basis, interpret and apply insurance policies sold by
24 their respective companies. In order to interpret and apply insurance policies fairly,
25 insurance claims professionals use insurance industry standards for the interpretation
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1 of insurance policies (see below) as well as many insurance industry resources which
2 provide guidance to insurance claims professionals on the interpretation and
3 application of insurance policies, some of which are referenced in this report.

4 11. Because insurance industry claims handling standards are national in
5 scope they apply in all states. Although there may be some slight variations from
6 state to state, generally insurance claims handling standards do not differ from state
7 to state. Accordingly, a claims professional in Louisiana or one who handles claims
8 in Louisiana should be trained and knowledgeable in the standards of insurance
9 claims handling.
10

11 12. Insurance is defined as the “pooling of fortuitous losses by transfer of
12 such risk to insurers, who agree to indemnify insureds for such losses, to provide
13 other pecuniary benefits on their occurrence, or to render services connected with the
14 risk.” (Principles of Risk Management and Insurance, Rejda, George E., (Addison
15 Wesley, 8th ed., 2003) p. 18, quoting from the Commission on Insurance Terminology
16 of the American Risk and Insurance Association) As the definition reflects, a critical
17 component of the definition of insurance is the transfer of risk from the insured to the
18 insurer. If this transfer is interfered with so that the insured does not timely receive
19 the full benefits owed under the insurance policy then the purpose of insurance is
20 defeated. In order to avoid this outcome, the insurance industry has adopted various
21 standards and practices for the handling of insurance claims. The aim of these
22 standards and practices is to assure that the purpose of insurance and the insurance
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1 contract are fulfilled when the insured submits a claim. Among the standards for
2 claims handling are the following:²

- 3 a. The insurance company must treat its policyholder's interests with
4 equal regard as it does its own interests;
- 5 b. The insurance company must conduct a full, fair and prompt
6 investigation of the claim at its own expense;
- 7 c. The insurance company must fully, fairly and promptly evaluate
8 and adjust the claim;
- 9 d. The insurer should resolve any doubts regarding coverage in
10 favor of the policyholder;
- 11 e. The insurance company may not misrepresent facts or policy
12 provisions;
- 13 f. The insurance company must timely advise its insured of all policy
14 limitations or exclusions which may apply to a claim;
- 15 J. An insurance company must not assert coverage positions which
16 it knows are without merit;
- 17 k. An insurance company must look for coverage and not just ways
18 to deny a claim, and
- 19 l. An insurance company must interpret its policies reasonably,
20 pursuant to the well recognized insurance industry rules for
21 insurance policy construction.
- 22 m. An insurance company must interpret its policies reasonably,
23 pursuant to the well recognized insurance industry rules for
24 insurance policy construction, which include the following:

- exclusions are to be interpreted narrowly,³
- insuring agreements are to be interpreted broadly,⁴

25 ² Federated has also adopted these standards. (Sutton deposition, pp. 190-197)

26 ³ How to Draft and Interpret Insurance Policies, Wollner, Kenneth S. (Cas. Risk Pub, LLC 1999), p. 19 (hereinafter "Wollner") ("Exclusions and other limitations are strictly construed against the party seeking to impose the limitation.") All the insurance texts referenced in this declaration are either used in training insurance claims professionals or as reference materials for claims professionals.

27 ⁴ Insurance Contract Analysis, Wiening, Eric A., and Malecki, Donald S., (Am. Inst. for
28 CPCU, 1st Ed 1992) p. 76 ("[I]nsurance agreement provides a broad statement of coverage.")(hereinafter "Wiening")

- the insurance company must resolve doubts concerning coverage in favor of the policyholder,⁵
- policy language should be given its plain, ordinary and popular meaning;⁶
- ambiguous policy provisions should be interpreted against the insurer and in favor of coverage,⁷ and
- the insurance company has the burden of proving the application of an excluded peril.⁸

14. In arriving at my opinions in this case I have applied the standards for insurance claims handling.

III. OPINIONS

15. Based on my review of the available documents Lexington failed to comply with insurance industry claims handlings standards and practices in its handling of the Louisiana Hospitality claim by, among other things, the following:

- Failing to timely and thoroughly investigate the full scope of the loss;
- Failing to advise Louisiana Hospitality of all available coverages under the Policy;
- Improperly took depreciation;

⁵ Property Loss Adjusting, Popow, Donna J. (Am Inst. of CPCU, 3rd ed., 2004) § 5.34 (hereinafter "Popow")

⁶ Adjustment of Property Losses, Thomas, Paul & Reed, Prentiss, (McGraw Hill, 4th ed., 1977) p. 48 (hereinafter "Reed & Thomas")

⁷ *Id.*, p. 50.

⁸ Insurance claims handlers have testified that these standards are used in the insurance industry to interpret and apply insurance policies. For example, Stephan Hinkle, a State Farm Home Office Claim Consultant, was deposed in the matter of *Illing v. State Farm, So. Dist. Ms.*, Case No.: 1:06cv513-LG-RHW, and testified that it is a basic tenet of insurance claims handling that the insurer must prove the application of the exclusion. (See Hinkle Deposition, p. 166, and see Wollner, p. 46).

- Unreasonably denied coverage;
- Failed to adopt written standards for the handling of claims;
- Failure to pay all amounts due under the Policy, and
- Failed to pay timely all amounts due under the Policy.

By conducting itself in the foregoing manner Lexington demonstrated an intent to serve its own interests to the detriment of its policyholder. Indeed, Lexington's failure to investigate facts which supported coverage and advise its insured of potentially available coverages evidences Lexington's attempt to avoid payment of amounts due under the Policy.

A. Lexington Failed To Conduct A Timely and Thorough Investigation Of Louisiana Hospitality's Claims.

16. An insurer is obligated to thoroughly and timely investigate a loss, as well as accurately measure the amount of the loss and make timely payment. Investigation of a water loss, such as that sustained by Louisiana Hospitality at the Grand Hotel, involves not only an inspection of visible surfaces, but also of hidden surfaces which are likely to have been damaged by water. As Popow has pointed out: "Many times the problem is worse than it appears because mold can migrate through materials and affect both sides. The unexposed side of the material often reveals extensive mold growth and damage. Removal of a portion of the material for a visual inspection of the back might be appropriate. A boroscope can be used to view spaces in ductwork and behind walls to check for mold growth. The meter can help identify hidden mold growth, and aid in assessing the extent of water damage. Property loss adjusters should continue inspection, even after a source of the water has been found. More often than not, multiple sources will be found." (Popow, §6.15) Similarly, Popow

1 notes that tear out is often required in investigating the scope of a water loss. (Popow,
2 §6.11) Lexington, however, did not conduct inspection of water damage conditions
3 behind the walls.⁹ (Jake Mello deposition, pp. 88-89 (did not use moisture meters,
4 drills to look behind walls or conduct any destructive testing)

5 17. An insurer, during its investigation of the claim, must also look for
6 coverage for the policyholder. This often involves looking for other potential damages
7 that may be covered under the insurance policy that the insured may not have
8 included in its original claim assessment. The insurer has this obligation regardless of
9 the insurer's beliefs concerning the possible sophistication of the policyholder when it
10 comes to insurance claims. The insurance claims professional, not the insured, is
11 trained to evaluate and determine the scope and amount of a loss. Despite these well
12 recognized standards Lexington did not investigate and evaluate the acts of vandalism
13 that occurred after the February 10, 2007 incident despite the fact that Sawyer, who
14 represented Lexington, was aware of such damage. (Sawyer deposition, p. 92)
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19 ⁹ It is significant to note that Mello, who was in charge of the inspection of the hotel for
20 Lexington, was not aware of any standards that pertain to the inspection of a water loss.
21 (Mello deposition, p. 99) The leading standard for the inspection and remediation of
22 water damage is published by the Institute of Inspection Cleaning and Restoration, and
23 is Standard IICRC S500, "Standard and Reference Guide for Professional Water
24 Damage Restoration." This standard is recognized and used in the insurance industry
25 as well as with water remediation companies nation wide. The Standard provides that in
26 determining the extent of water damage the equipment to be used may include
27 "thermohygrometers and moisture meters." (S500, p. 34) Further, the Standard
28 provides that technicians "must use appropriate moisture detection equipment to
evaluate and record moisture intrusion in specific structural materials," which will include
"subfloor and underlays; above floor structural materials (e.g., walls, frames, ceilings,
fixtures, insulation...basements, crawlspaces and attics." (Id) It appears that Lexington
and its consultant did not comply with this standard. Accordingly, it would have been
improper for Lexington to rely upon the results of Mello's inspection to determine the
amount owed under the Policy.

1 Sawyer defends his failure to consider such damage by contending that Louisiana
2 Hospitality did not make a claim for the additional vandalism damage. (Id.) This
3 response ignores the insurer's obligation to fully investigate an insured's claim once it
4 is made, as was the case here, including items that the insured may not have included
5 in its original claim.(See RS 22-1964(14)(d) (It is unfair claims settlement practice to
6 refuse to pay claims without conducting a reasonable investigation based upon all
7 available information."))

8
9 **B. Lexington Improperly Took Depreciation From Louisiana**
10 **Hospitality's Loss.**

11 18. The Policy follows the format of commercial first party property policies
12 commonly used in the insurance industry. Most of the provisions in the Policy likewise
13 are common to insurance industry first party property policies. Generally, the purpose
14 of the Policy is to put the insured back into the position they were in prior to a covered
15 loss. This is the insurer's obligation. In order to fulfill its indemnity obligation, the
16 insurer must pay not only for the direct costs to perform the actual repairs, but also the
17 cost of additional indirect repair items. These include building permits, security costs
18 for the building and materials during the course of construction, subcontractor's
19 overhead and profit, and similar costs. Indeed, insurers commonly pay overhead and
20 profit that is incurred by a single subcontractor (where no general contractor is
21 required) whose unit costs include the subcontractor's overhead and profit. (See How
22 To Estimate Building Losses and Construction Costs, Thomas, Paul I., (4th ed.
23 Prentice-Hall Inc., 1983) p. 18 ("Subcontractors generally add their own overhead and
24 profit to their figures.")) Where general contractors are required insurers commonly
25 pay, in addition to the subcontractor's overhead and profit, an allowance for the general
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1 contractor's overhead and profit. This allowance is commonly a minimum of 10% each
2 for overhead and profit. (See "Overhead & Profit/ Its Place in a Property Insurance
3 Claim, by Edward Eshoo, FC&S Bulletins ("there is an existing industry standard that
4 provides for GCO&P [General Contractor Overhead & Profit] at 20% of a
5 repair/replacement estimate."))¹⁰ Like the subcontractor's overhead and profit, or other
6 indirect repair costs, the general contractor's overhead and profit is paid in order to
7 fulfill the insurer's indemnity obligation, and, therefore, is a policy benefit. Absent
8 payment of this policy benefit where it is owed the insurer fails to fulfill its indemnity
9 obligation under the policy and the insured is thereby deprived of a policy benefit. Any
10 overhead and profit that is owed must be paid to the insured at the time of the Actual
11 Cash Value ("ACV") payment. The difference between the Replacement Cost Value
12 ("RCV") and the ACV, which is called the hold back, is determined by subtracting any
13 applicable depreciation from the RCV. Depreciation, in the insurance industry, is
14 understood to apply where the property is subject to wear, tear or obsolesce. (See
15 Property Loss Adjusting Volume I, Markham, James J., ed. (IIA 2nd ed., 1995) pp. 93-
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20 ¹⁰ The FC&S Bulletins have been published by the National Underwriter for over 50
21 years to assist insurance companies in the interpretation and application of a wide
22 variety of insurance policy provisions. The FC&S Bulletins are used frequently by
23 insurance industry claims professionals to interpret and apply insurance policy
24 provisions. As one Court has noted: "The FC & S bulletin, which is published by the
25 National Underwriters Association, is used by insurance agents and brokers to interpret
26 standard insurance policy provisions. (citation omitted) "[R]eliance on [an] FC & S
27 bulletin is appropriate under Civil Code section 1645 which provides: 'Technical words
28 are to be interpreted as usually understood by persons in the profession or business to
which they relate, unless clearly used in a different sense.' (citations omitted)
"[I]nsurance industry publications are particularly persuasive as interpretive aids where
they support coverage on behalf of the insured. Ultimately, the test is whether coverage
is 'consistent with the insured's objectively reasonable expectations.' [Citation omitted.]"
Golden Eagle Insurance Co. v. Ins. Co. of the West, 99 Cal.App.4th 837, 838 (Cal. App.
2002)

1 94) Not all items in a loss are subject to depreciation. For example, the cost of debris
2 removal is not subject to depreciation because it is not subject to wear, tear or
3 obsolesce, or any other factor which would cause depreciation. Debris removal is
4 simply a labor cost that is required in order to perform the necessary repairs.¹¹

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6 19. Lexington improperly applied depreciation to its loss payments. Pursuant
7 to the Policy, Lexington is obligated to pay for the loss of "Real and/or Personal
8 Property at replacement cost without deduction for depreciation except as provided
9 below or by endorsement (3) If the property is not repaired or replaced within a
10 reasonable period from the date of loss, the valuation is to be on an Actual Cash Value
11 basis measured at the time of loss. Actual Cash Value shall mean the less of (i)
12 replacement cost less depreciation or (ii) market value." Lexington paid the February
13 10, 2007 on an ACV basis.¹² Further, J.S. Held Inc. ("Held"), in its October 5, 2007
14 report and estimate of the May 27, 2007 loss and vandalism losses recommended to
15 Lexington that the May 27, 2007 loss be paid on a similar basis. This was improper.
16 Unlike other first party policies,¹³ Lexington is only permitted to pay the ACV of the loss
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20 ¹¹ First party property policies, such as the Policy, expressly provide coverage for debris
21 removal.

22 ¹² Lexington's hold back on the February 10, 2007 loss was \$395,058.00. It is unknown
23 if this hold back has ever been paid to the insured. Nonetheless, Lexington should not
24 have taken a hold back.

25 ¹³ First party property policies often provide that the insurer will pay the insured the ACV
26 of the loss, and then, if the insured repairs or replaces the loss within a certain period of
27 time, the insurer will then pay the full RCV of the loss. The ACV payment is due at the
28 time of loss whereas the RCV payment is due at the time repairs or replacement are
completed. (See Popow, §2.5 ("Until insureds have replaced the property, they are
entitled to, and receive, only an ACV settlement.))(emphasis added) This, however,
was not the case with Lexington's policy, which contained no provision that permitted
Lexington to withhold the difference between the ACV and RCV until repairs were
completed within a specified time in the policy.

1 if the repair or replacement is not completed within a reasonable period. When
2 Lexington made its May 2007 claim payment for the February 10, 2007 loss that
3 condition had not been met, because by May 2007 it could not be determined if the
4 repair had not been completed within a reasonable period of time, nor is there is
5 evidence in the material reviewed that Lexington ever took that position. Similarly,
6 Lexington apparently proposed to pay the second loss also on an ACV basis. For the
7 same reason as its first payment (assuming that was paid on an ACV basis) this
8 proposal was also improper. Absent evidence that the repairs were unreasonably
9 delayed, Lexington owed the full RCV, which it apparently did not pay.
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11 20. Similarly, in its October 5, 2007 report, Held also recommended that
12 various items in the estimate be depreciated. These included several items that are
13 known to be subject to wear, tear and obsolescence, and therefore subject to
14 depreciation, such as painting and wallpaper. In recognition that some repair items are
15 not subject to depreciation, Held did not depreciate such as cleaning and contents
16 manipulation. Nonetheless, Held did apply depreciation to many other items which are
17 not subject to depreciation and should not have been depreciated. These included the
18 labor costs incurred in the work to be performed. Only materials, and not labor, are
19 subject to depreciation. Indeed, Held recognized this when it did not apply depreciation
20 to such categories as "labor." Nonetheless, Held, apparently with Lexington's approval,
21 depreciates labor in other categories, such as painting, and so forth. Although the
22 material costs in those categories are clearly subject to depreciation the labor is not.
23 Similarly, Held applies a depreciation rate to overhead and profit. Overhead and profit
24 are clearly not subject to depreciation and should not be depreciated. The full amount
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1 of the overhead and profit is owed at the time of the ACV payment, or in this case at
2 the time of the RCV payment. Assuming that Lexington followed these practices when
3 it made its May 2007 payment then Lexington withheld Policy benefits by depreciating
4 non-depreciable items such as labor and overhead and profit.

5 **C. Lexington Unreasonably Denied Coverage.**
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7 21. On September 19, 2007, Lexington denied coverage for Louisiana
8 Hospitality's vandalism claims.¹⁴ Lexington based its denial on the vacancy and/or
9 Unoccupancy exclusion, the condition in the standard New York Standard Fire
10 Insurance policy, which is made part of the Policy by statute, regarding increase in
11 hazard, that the losses were not fortuitous, and the mold exclusion. At no time prior to
12 its denial did Lexington advise Louisiana Hospitality in writing that it was reserving its
13 rights under the Policy with regard to these specific Policy provisions.¹⁵(See Sawyer
14 deposition, p. 101 (not asked to tell Bhatt that policy would be suspended because no
15 one was living in the hotel) This was contrary to insurance industry claims handling
16 standards and practices, in that an insurer must advise its insured timely of potential
17 policy defenses. In order to effectively advise the insured of such policy defenses the
18 insurer, at the outset of the claim, should send the insured a reservation of rights letter
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22 ¹⁴ This does not appear to be entirely accurate, as Lexington appears to have paid for
23 vandalism claims in its May 2007 claim payment. Rather, it appears that Lexington was
24 only denying coverage for the vandalism claims that arose after February 10, 2007.

25 ¹⁵ Curiously, Sawyer testifies that he was not retained to investigate coverage. (Sawyer
26 deposition, pp. 46-47) Further, Sawyer never discussed coverage with Louisiana
27 Hospitality. (Sawyer deposition, p. 47) Nonetheless, Barton testifies that he is pretty
28 sure that he had conversations with Sawyer about the facts of the case before he sent
out the denial letter. (Barton deposition, p. 44) In order for Barton to rely upon Sawyer's
understanding of the facts for the purpose of denying the claim, it would have been
necessary for Barton to have instructed Sawyer to conduct a coverage investigation,
which he did not do.

1 which, among other things, contains a reference “to each policy provision that might
2 preclude coverage, with an explanation of why such a provision may result in a
3 coverage denial.” (Liability Claim Practices, Jones, James R. (IIA, 1st ed. 2001) §4.8)

4 As Markham has pointed out: “The insurance company’s failure to advise the insured of
5 the coverage problem at the beginning of the claim adjustment process will most likely
6 prevent the company from latter denying coverage to the insured.” (Markham, p. 31)

7 Lexington failed to comply with this standard because in its non-waiver agreement it
8 only generally referred to the insured’s possible failure to protect the property without
9 citing to any specific provision in the Policy. Further, at no time prior to its denial did
10 Lexington advise Louisiana Hospitality that Lexington may deny coverage based on the

11 Vacancy and/or Unoccupancy Exclusion, even though Lexington was aware that the
12 hotel was evacuated on or around February 10, 2007, and that the tenants did not
13 return to the hotel after the evacuation.(Bhatt EUO, p. 127) Lexington’s failure in this

14 regard precluded Louisiana Hospitality from taking any steps to preclude the
15 application of the Vacancy and/or Unoccupancy Exclusion. An important reason
16 behind the insurer’s obligation to timely and completely advise its insured of all the

17 basis’ for its reservation of rights is to allow the insured the opportunity to respond to
18 the reservation and protect its rights under the applicable policy. Here, Lexington
19 denied Louisiana Hospitality the ability to protect its interests because of its failure to

20 timely and completely advise Louisiana Hospitality that Lexington may assert the
21 Vacancy and/or Unoccupancy Exclusion. Similarly, Lexington failed to specifically
22 advise Louisiana Hospitality that it may deny coverage because the losses were not

23 fortuitous or that there was an increase in hazard even though Lexington knew, well
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1 before its denial, that there was continuing vandalism.¹⁶ Again, Louisiana Hospitality
2 was denied the opportunity to take whatever steps it could have taken to address this
3 concern of Lexington's.¹⁷

4 22. Lexington's denial of coverage was also contrary to the accepted and
5 recognized standards in the insurance industry for insurance policy interpretation and
6 application. Lexington first denied coverage based on the Vacancy and/or
7 Unoccupancy Exclusion in the Policy, which provides: "Unless otherwise endorsed
8 hereto, this Company shall not be liable for loss or damage to any property that has
9 remained vacant or unoccupied for a period of sixty (60) or more days." Lexington
10 contended that the Grand Hotel was "not renting rooms to guests" from February 10,
11 2007 to May 25, 2007, and that the utilities were shut off during that period. According
12 to Lexington, these facts supported its position that the hotel was unoccupied for a
13 period of sixty or more days. In essence, Lexington interprets the exclusion to apply
14 regardless of the reason for any vacancy or unoccupancy. Lexington's interpretation is
15 contrary to the insurance industry's interpretation of the exclusion. As noted in the
16 insurance text, Adjustment of Property Losses, which has been used in the insurance
17 industry to train insurance claims professionals on the handling of first party property
18 claims such as Louisiana Hospitality's, this "provision must be construed reasonably,
19 giving full consideration to the type of building, the circumstances of the temporary
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24 ¹⁶ This is not to suggest that there was merit to Lexington's Policy defenses. As
25 discussed *supra*, those defenses are without merit.

26 ¹⁷ This assumes that Louisiana Hospitality would have had the financial means to
27 protect the property, which appears unlikely because of the bankruptcy. As discussed
28 *supra*, Louisiana Hospitality was deprived of funds to protect the property because of
Lexington's failure to advise its insured of policy provisions which would have provided
coverage for such protection and then to make payment under the policy provisions.

1 vacancy, and the customary occupation or lack of occupation incidental to its use. The
2 courts distinguish between temporary absence and unoccupancy. Where the occupant
3 is temporarily away for reasons of health, pleasure or business, and such absence is
4 not for an unreasonable length of time, the premises would not be considered
5 unoccupied." (Reed & Thomas, pp. 37-38) Lexington failed to take into consideration
6 the circumstances of the unoccupancy, which, in my opinion, would have precluded the
7 application of the Vacancy and/or Unoccupancy Exclusion. This was clearly contrary to
8 insurance industry claims handling standards. (RS 22:1964(14)(n)(It is an unfair claims
9 settlement practice to fail to promptly provide a reasonable explanation of the basis in
10 the insurance policy in relation to the facts or applicable law for denial of a claim.)))

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13 23. The most significant circumstance is that on February 10, 2007, the fire
14 department ordered the hotel evacuated and the guests were removed. No guests
15 could return to the hotel until the hotel was repaired. The damages were obviously
16 extensive, consisting mostly of water damage to several floors. As a result of this
17 damage Louisiana Hospitality submitted a business interruption claim to Lexington, and
18 Lexington paid approximately \$200,000 on this claim in May 2007. Further, Lexington
19 did not pay for the repairs, based on Lexington's loss estimate, also until May 2007.
20 Accordingly, Louisiana Hospitality's period of restoration, as defined in the Policy,
21 would continue from the date of the loss until Louisiana Hospitality received sufficient
22 funds from Lexington to complete the repairs, and then for an additional period of time
23 to actually complete the repairs. The period of restoration would have encompassed
24 the period of February 10, 2007 to May 25, 2007, or the same period that Lexington
25 contended the building was unoccupied and therefore subject to the exclusion. Indeed,
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1 in Gab's Statement of Loss for the February 10, 2007 loss, GAB estimated that the
2 period of restoration would be 10.65 months, or well beyond May 2007. Lexington's
3 interpretation of the exclusion is patently unreasonable, because the exclusion is being
4 used to vitiate the business interruption coverage, which Lexington admitted was owed.
5 Indeed, the unoccupancy was not within Louisiana Hospitality's control; rather, it was
6 within Lexington's control because repairs could not be commenced, let alone
7 completed, until Lexington made full payment on the claim. (Sawyer deposition, p. 95
8 ("You would think they [Louisiana Hospitality) needed the insurance money to pay for
9 repairs.")) It was entirely improper for Lexington to assert the exclusion as a basis for
10 its denial when Lexington, and not the insured, controlled the length of time that the
11 hotel would be unoccupied.
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14 24. Lexington's denial also requires consideration of the purpose of the
15 Vacancy and/or Unoccupancy exclusion. The purpose of the exclusion is to address a
16 potential moral hazard. A moral hazard is the "chance that the existence of insurance
17 will increase the likelihood of the insured event." (Fidelity, Casualty & Surety Bulletin,
18 "Additional Insureds Coverage and Legislative Changes on the Horizon." Also see
19 FC&S Bulletin, "Overtime Pay and Employment Practices Liability" (moral hazard "is
20 the temptation of an insured to precipitate the event insured against"). Here, the moral
21 hazard is the risk that the insured will abandon his/her property, thereby, increasing the
22 risk of loss, as it is generally believed that a building that is vacant or unoccupied for an
23 extended period of time is more likely to be subject to loss due to vandalism, theft and
24 similar risks of loss. Here, however, there is no moral hazard because the insured did
25 not abandon the property for an extended period of time. Indeed, the insured
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