



A TERRORIST ATTACK COULD COST YOU MORE THAN YOU THINK

By Catherine A. Asaro

Corporations may find themselves facing liability in the event of a terrorist attack. The recent attacks in London serve as further notice that corporate preparedness remains a serious issue warranting immediate attention. The cumulative impact of terrorist attacks and natural disasters has raised the bar on corporate America's duty to provide a safe workplace. Directors and officers are under heightened scrutiny to anticipate, prepare for, and manage through catastrophic emergencies that can have a crippling effect on business. Directors and officers are charged with the duty to identify vulnerabilities and prepare flexible disaster recovery plans to protect corporate as well as personal assets. In short, directors and officers have the unenviable task of preparing for the unthinkable and ensuring safeguards are in place to minimize exposure should it happen.

Since good corporate governance imposes an obligation on every corporation to develop a comprehensive and effective emergency preparedness and management plan reflective of its unique circumstances and risk exposures, the government has offered aid to the private sector through the Terrorism Risk Insurance Act (TRIA) and guidelines to assist with risk management. Protecting employees, revenue, and assets are all components of a well thought out plan aimed at

minimizing loss and liability. A corporation's failure to identify its exposures and evaluate the impact of potential losses could be disruptive to the continuity of its business leaving its directors and officers open to severe legal and public criticism.

With the expiration of TRIA looming large at the end of this year, the private sector may no longer have federal protection to fall back on in the wake of a catastrophic terrorist attack. The current administration is looking to substantially scale back TRIA to force the private sector to play a greater role by bearing more risk. The administration contends that the government's role inhibits creative market solutions from the insurance industry which is capable of handling increased risk. More importantly, the administration argues that taxpayers should not have to bear the burden of such a large portion of terrorism risk when the insurance industry is operating at a profit.

After September 11, 2001, the market for terrorism insurance evaporated. It was reported that the insurance withdrawal caused approximately \$15 billion in real estate transactions to be put on hold and led to a slowdown in commercial construction. According to the White House, more than 300,000 jobs in construction were

lost and bond rating agencies downgraded \$12.5 billion worth of commercial mortgage-backed securities because of the lack of terrorism coverage.

When private insurers refused to insure terrorism-related losses in the wake of the September 11th attacks, the government stepped in and on November 26, 2002, enacted TRIA. Originally intended as a short-term measure set to expire on December 31, 2005, TRIA was enacted to afford the insurance market time to recover from the events of September 11, and develop new solutions. TRIA requires insurers to provide coverage for commercial risks and, in return, guarantees that the federal government will pay 90% of losses after an initial deductible, up to \$100 billion a year.¹

An extension of TRIA in its current form is opposed by the administration for fear that it may hinder further development of the insurance market by crowding out innovation and capacity building. A June 30, 2005 interim report on TRIA issued by the U.S. Treasury Department contained recommendations for restructuring TRIA to enable the reinsurance markets and the private capacity to provide insurance. Treasury Secretary John Snow stated that "TRIA has achieved its goals of supporting the industry during a transitional period and stabilizing the private insurance market...Extending TRIA would have little impact on the economy given its current strength."

At the present time the administration is exploring certain

modifications to TRIA that include increasing the size of the loss to \$500 million before TRIA coverage is triggered, requiring insurers to pay higher deductibles, and eliminating lines of coverage from TRIA's protection including commercial auto and general liability. Recent Congressional hearings subsequent to the issuance of the Treasury's report make it appear likely that an amended form of TRIA, including higher prices for terrorism coverage will appear by the end of this year.

Several insurance industry groups are of the opinion that the private sector is far from ready to replace the federal role. Without federal support, there are issues as to whether there is sufficient market capacity. A study by Reinsurance Association of America concluded that today there is only \$4 billion to \$6 billion in reinsurance capacity available for terrorism risks.

Advocates for renewal contend that the recent terrorist attacks in London prove that TRIA is still needed to ensure the American economy can recover in the event of another attack. In a recent Congressional hearing, Ranking Member Barney Frank (D-MA), a forceful advocate of extension, made a compelling argument that terrorism is an external threat against the United States and the government properly should bear a substantial proportion of financial responsibility for it. Without TRIA in place as a backstop, there is a real fear that we will revert back to that period after 9/11. With that in mind, directors and officers are going to be faced with the challenge of finding a new solution to ensure the integrity of their corporation's business continuity plans.

¹ Section 103(e)(1)(A) 'Terrorism Risk Act of 2002'

Corporate Preparedness Guidelines

With the insurance industry gearing up to bear more risk, insurers will be looking at corporations' emergency preparedness measures to minimize liability and loss in the event of a disaster. Based on the 9/11 commission's findings, the private sector which controls 85% of the nation's critical infrastructure is unprepared for a terrorist attack. One way for a corporation to differentiate itself in the market is by developing and implementing a comprehensive and effective emergency preparedness and management plan. These plans should comply with applicable regulations as well as be consistent with the corporation's mission, vision, management policy, and finances. Directors and officers would be wise to consider a risk assessment process that anticipates and aids in the development of a plan to mitigate perceived threats or hazards with significant impact potential. Aside from protecting against possible acts of terrorism, an all inclusive plan should address historical threats including natural disasters, infrastructure disruption, and reunification plans for employees' families.

In its final report published on July 22, 2004, the 9/11 Commission urged adoption of National Fire Protection Association Standard 1600 (NFPA 1600) by the private sector in an effort to provide some guidance in devising emergency preparedness plans. On December 17, 2004, President Bush signed the Intelligence Reform and Terrorism Prevention Act of 2004, Public Law 108-458 (IRTP Act)

supporting NFPA 1600 as a "voluntary" national preparedness standard.

The National Fire Protection Association was founded in 1896 in the United States as a non-profit organization and has grown to an international organization with over 75,000 members in over 100 countries. It is recognized as a worldwide leading authoritative source of technical background, data, and consumer advice to deal with life safety issues. NFPA 1600 is a voluntary disaster management, emergency management, and business continuity standard developed in consensus with public and private sector organizations including the Federal Emergency Management Agency (FEMA), the National Emergency Management Association and the International Association of Emergency Managers and is approved by the American National Standards Institute (ANSI)². NFPA 1600 offers crisis management pointers to be used as guidelines in defining the standard of care owed by companies to its employees and the public at large.

The origins of NFPA 1600 date back to January, 1991, when the NFPA Standards Council established the Disaster Management Committee comprised of members of both the public and private sector. NFPA 1600 was presented to its membership at the 1995 Annual Meeting out of which the original version was published. It was then elevated from a recommended

² ANSI founded in 1918 is the official certification body for private, or non-governmental, standards making organizations in the U.S. and is the official U.S. representative to the International Organization for Standardization (ISO) in Geneva.

practice to a full national standard for the 2000 edition. In its revised form, the committee addressed the long-term business interruption and the additional affects of increasing natural, human and technological disasters.

NFPA 1600 can help guide corporations in developing a program that defines its policy, goals, objectives, plans, and procedures by taking a "total program approach" for disaster/emergency management and business continuity programs. It identifies key functional areas and overall strategy for disaster preparedness and business continuity for organizations in both the private and public sector. It requires appointment of a program coordinator to work in conjunction with an advisory committee to develop the program. Some specific program elements include:

- Hazard Identification
- Risk Assessment
- Impact Analysis
- Hazard Mitigation
- Resource Management
- Mutual Aid
- Planning and Direction
- Control and Coordination
- Communications & Warning
- Operations & Procedures
- Logistics & Facilities
- Crisis Communications & Public Information
- Training/Exercises/Evaluations & Corrective Actions
- Finance & Administration

Additionally, NFPA 1600 will enable a company to assess all of the hazards that might impact its people, property, operations, as well as the

environment and quantify the probability of occurrence and severity of consequences. It provides numerous methodologies for defining and identifying corporate risks and vulnerabilities. Through a business impact analysis, an organization can evaluate the cost-effectiveness of mitigation efforts and determine how much to invest in preparedness, response, and recovery plans.

"Voluntary standards can assist in protection of assets, disaster recovery, and emergency preparedness, and are critical to national economic and security interests" said Mark W. Hurwitz, ANSI President and CEO. NFPA 1600 is intended as a general strategic level reference that can serve as a guide in the development of an overall program. More detailed plans and operational level policies and procedures are best developed on a company-by-company basis. The standard is highly recommended because it forces companies to anticipate problems, update response plans, and train staff. It does so by outlining the management and elements that organizations should use to develop a program for mitigation, preparedness, response and recovery. The April 2004 edition is currently being revised and the latest edition is anticipated for release in the fall of 2006.

Although compliance with NFPA 1600 is still only voluntary, it is considered a significant resource outlining requirements and recommendations for private sector preparedness.

IT IS HIGHLY RECOMMENDED THAT CORPORATIONS ADOPT THESE STANDARDS AS THE PLAINTIFF'S BAR IS LIKELY TO ADOPT THEM AS THE GOVERNING STANDARD FOR EMERGENCY PREPAREDNESS IN ESTABLISHING AN EMPLOYER'S DUTY OF CARE TO ITS EMPLOYEES AND THE PUBLIC.

Additionally, it has also been recommended that insurance and credit-rating industries take a closer look at a company's compliance with this standard in assessing its insurability and creditworthiness.

In developing these plans, corporations should take into account a multitude of areas where liability exposure can arise leading to litigation. First, potential claims can arise from employees or others who suffered bodily injury, personal injury, property damage or economic loss. Shareholders may allege derivative claims for losses incurred by the company or securities claims for failure to disclose material information regarding the company's risk and level of preparedness. Creditors may allege claims resulting from a company's inability to pay debts or comply with its obligations. Any litigation resulting from such claims could focus on the extent to which the directors and officers adopted adequate precautions, implemented effective response plans and appropriately reacted to actual or threatened incidents.

Beecher Carlson has many resources available to help corporations in emergency preparedness planning. The first step to effective planning is to review your insurance coverage. Does

your company have sufficient coverage for replacement costs, business interruption, and extra expense coverage? Along with reviewing your coverages, we can conduct risk mapping to help build or revise continuity strategies, assist in formulating flexible disaster response strategies, and schedule annual reassessments of your coverages based on the objectives of your plan in this changing environment.

Additionally, as part of a plan to reduce the likelihood of a loss, the purchase of insurance from the marketplace and/or a captive insurance company should be evaluated. If TRIA is extended, coverage will be available from property and casualty insurers. A corporation may also insure the terrorism exposures in their own captive under certain conditions as determined by the Treasury department. A captive currently receives the same reinsurance support from the federal government as licensed carriers. The captive insurance company can also issue coverage for nuclear, biological and radiation exposures typically non-insurable in the traditional marketplace but covered by TRIA.

Given the strong support shown by the government, corporations should be aware that failing to comply with NFPA 1600 is likely to lead to protracted litigation or worse, force a company into bankruptcy. An ounce of prevention goes a long way, do not wait until disaster strikes before exploring your options.

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Catherine A. Asaro is an Assistant Vice President at Beecher Carlson's Executive Liability Practice in New York. Catherine holds a B.S. degree in

Business Management from St. John's University and a J.D. from New York Law School. Catherine is admitted to practice before the New York State and Federal Bar. She can be reached at casaro@bechercarlson.com

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