case study

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BY BILL KRAMER

How To Survive A $700 Million Property Loss

After Sept. 11, Lehman Brothers moved its headquarters north to a new building on New York's Seventh Ave.

You're in your $2.8 billion company world headquarters with some 6,000 other employees just 200 yards from New York City's World Trade Center on Sept.11, 2001.

When the terrorist attack causes the twin 110-story towers to fall, your building at 3 World Financial Center, including a $200 million data center, is evacuated and becomes totally inaccessible for months. Even so, your company is lucky. Its employees get out alive. But what about the property?

The collapse of the Trade Center towers spews a huge plume of debris that completely inundates your headquarters. Air conditioning equipment, operated during the evacuation, spreads the soot, debris, and contaminants throughout the building. As many as 24 floors—five through 29—in the southeast quadrant of the building experience direct collapse or damage. A power surge damages thousands of computers, facsimiles, printers, photocopy machines, etc. Later, your data center heats to nearly 180 degrees destroying virtually everything.

The damage goes beyond what's physically lost. You also suffer earnings losses (business interruption loss) for every day you can't do business. That's the situation. You're in charge. What do you do?

Lehman's Scenario

More than a hypothetical scenario, this situation was faced by Lehman Brothers, the Manhattan-based global institutional investment bank. Lehman's business interruption loss alone from Sept. 11, 2001 to Nov. 30, 2001 was $400 million.

The company couldn't reoccupy its headquarters until February 2002. Yet, Lehman not only survived, it finished 2001 with net revenues of $6.7 billion and net income of $1.3 billion. The company's $700 million insurance claim was paid months before any other of the eight or more mega-claims in New York City's Ground Zero area were even resolved.

Lehman's executives in risk and financial management reacted swiftly and decisively to the crisis. Reorganizing staff, relocating people, opening alternative offices, and working closely with the insurance adjuster helped keep the company operating. Perhaps most important was the commitment and intelligence of the staff.

Our team of four adjusters from William Kramer & Associates in Avon, Conn. worked full time on the Lehman Brothers Sept. 11 claim for a year representing Allianz, Chubb, Liberty Mutual, Royal & Sun Alliance, St. Paul and Zurich North America. In hindsight a big part of the success was that Lehman's people had such a personal ownership and commitment to the business.

Lehman Brothers took some especially intelligent actions. For example, one Lehman information technology staff member called a fiber optic supplier the day of the terrorist strike. He ordered 3 million feet of fiber optic cable and arranged for rapid delivery. By the following day no business could order the cable because the Pentagon secured all the existing supplies to deal with the terrorist attack at that site.

Fast action also saved millions of dollars by capturing proprietary data from Lehman's massive computers. The backup data center across the Hudson River in Jersey City was updated every night, but still the computers at 3 World Financial Center housed proprietary algorithms and financial models that couldn't be replaced or duplicated.

The Jersey City computer staff moved quickly the afternoon of Sept. 11 to electronically tap into the computers through a fiber optic network, saving data onto their servers before the raging 180-degree heat destroyed the hardware and software.

Reallocating People

Lehman no longer had their 27-floor, 1.6 million-square-foot headquarters, but they did have all of their staff and made use of them. On Oct. 3, 2001 Lehman representatives met with Kramer & Associates; Keith Meerholz, Lehman's Marsh USA insurance broker; and the insurance companies. Lehman offered a cadre of executives to Kramer & Associates to begin the claims adjustment process.

Phase one in the claims adjustment process was conducting a physical inventory. The adjustment team established a physical record of what was in the building, its replacement value and its condition was as of Sept. 11. The adjusters had to work quickly because Lehman needed to remove undamaged furniture and equipment so it could establish a base elsewhere.

Lehman assigned project leaders, each with a staff, to work on the ponderous, item-by-item, floor-by-floor inventory. The inventory teams included representatives of Lehman, Kramer & Associates, and Marsh's claim handling unit, CAPS. Everyone recognized some purchases had to be made immediately. Within a week of Sept. 11 the company replaced its lost computers, spending $150 million. The insurers stepped up by providing two substantial interim payments before the claim was completed—$100 million in October 2001 and $200 million the following April.

Setting Up New Offices

With Manhattan office space at a premium, Lehman knew they couldn't go out and replace all 1.6 million square feet of space they had lost at one location. Within a few weeks of the disaster they located about 400,000 square feet at the Citicorp Building on Park Avenue. Lehman also realized that after Sept. 11 the tourist trade in New York City was going to suffer greatly in the short term. Lehman approached two hotels, the Sheraton New York and Sheraton Towers in Midtown. Company representatives pitched the idea that because New York hotels would attract few tourists during the months after Sept. 11 the Sheraton should rent space to Lehman. The hotels agreed, removed and stored hotel furniture, and for three months rented space to Lehman employees.

By late October 2001 the company had an investment banking operation with about 600 bankers in the two Sheratons. The banker had phone service, fiber optic cable, and copy centers in the hotel ballrooms. Employees sat, row upon row, at portable card tables with phone and internet lines running down the middle of the floor doing research, calling clients, and keeping the business up and running.

Another 1,000 employees moved into the Operations Center in Jersey City. Twice that number worked from home. Key executives, including risk managers and lawyers, took up temporary housing in Manhattan law firms that had existing business relationships with Lehman.

Help From the Competition

Assistance also came from one of Lehman's competitors, New York City-based Morgan Stanley & Co. Construction on Morgan's new headquarters at 745 Seventh Avenue was nearly complete. But since construction had begun more than three years earlier, Morgan's priorities had changed so much that it decided it didn't need the facility. Morgan's chairman offered Lehman the 32-floor, 1 million-square-foot building to Lehman Brothers and they bought the building for $750 million. It came furnished, only needing some final touches like a security system and lobby construction. In early January 2002 Lehman began to occupy that site.

Inventory Count Critical

The decision to conduct a complete physical inventory was an expensive and time-consuming proposition but proved to be critical.

Most if not all of the other Sept. 11 megaclaims relied solely on existing corporate records to determine what was lost. But relying on existing corporate records assumed those records were complete and accurate.

Throughout the inventory phase of the claim adjustment conflicting numbers and costs arose between existing records and the inventory. For example, the asset ledger indicated the company had more equipment than what the inventory teams counted. Lehman was able to reconcile the physical counts with their corporate asset records, thereby eliminated a potential discrepancy in the claim.

Conducting the inventory took from Thanksgiving until the end of January 2002. The final inventory reached 64,000 lines of data on an Excel spreadsheet. The 29th floor alone required 4,000 lines of data.

Damage Assessment Difficult

Once the inventory was complete, phase two of the adjustment process began. In February 2002, Lehman began the damage assessment and assigning values to what the company had lost. This phase required the adjuster to understand Lehman's technology, what each piece of equipment did, and what it would take to replace the damaged or destroyed pieces.

One of the biggest challenges was to accurately value the data center equipment. To the untrained eye, one server looks much like the next. But, some of the Lehman's data center computers contained several cards worth $50,000 each. We brought in a computer hardware expert who could speak on a technical level with the Lehman computer experts.

Cooperation Speeds The Process

Good working relationships enabled the company, the adjuster, and the insurers to reach a resolution much more easily. Lehman worked closely with the adjusters ironing out differences on a daily or weekly basis.

This joint effort eliminated any last minute surprises and any need for further research by the adjuster after Lehman submitted the claim. The insurers also helped by reviewing updates of the project about every two months.

To be accurate, a claims adjuster must ask for lots of information—asset lists, building specifications, invoices, plans, blueprints, and more.

It usually takes the insured a lot of time to gather all these facts. Lehman was great. They said to us, 'What do we need to get you so you can do your job?' They had that kind of spirit. For an adjuster, this is the best possible working environment.

After a large loss, the company with the claim makes a big push for payment and generally receives an advanced payment. But, once the insured has that advance oftentimes the motivation to settle the remainder of the claim gets lost in the flood of everyday work. The people asked to settle the claim already have a full-time job that may demand long hours, and they aren't enthusiastic about adding more hours to settle the claim.

Even without losing a single employee, the survival of many companies was threatened by property damage and business interruption losses caused by Sept. 11. In Lehman's case, the company found a way to weather the storm.

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