

Core Matters

A Mining Industry Update for Marsh's Clients and Colleagues



Corporate Preparedness in the Mining Sector

BACKGROUND

The mining sector has experienced an unprecedented wave of crises issues. In the United States, the recent accidents in West Virginia have led to regulatory actions as well as political and community outrage. In Indonesia, several multinationals have experienced threats to their operations from terrorist groups as well as governmental lawsuits that allege local senior management has engaged in criminal activity. In Chile and the Philippines, community activists with the support of global NGOs (non-governmental organizations) have threatened to shut down a number of mine sites for alleged environmental practices.

The rise of global NGOs, continued political instability, and increased public and media scrutiny suggest that the mining sector should reexamine current corporate preparedness capabilities.

CORPORATE GOVERNANCE IS A CORPORATE PRIORITY

Effectively preparing companies to respond to and recover from emergencies, incidents (both real and emerging), as well as major crises is a defining test of corporate leadership. Recent studies from Oxford University found that in a crisis, companies with robust corporate preparedness plans effectively earned a 22 percent higher shareholder value after one year over those companies without these capabilities.

In an era where multinational companies are under increased scrutiny—particularly in the energy and mining sectors—crisis preparedness has now become a vital new standard of corporate governance.

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Core Matters is published by Marsh's Mining, Metals & Minerals Practice:
 Ken Sloan, Practice Leader
 9129 Cross Park Drive, Suite 101
 Knoxville, Tennessee 37923
 (869) 769-7717
Ken.L.Sloan@marsh.com

If you have topic suggestions for future newsletters or would like to receive *Core Matters* electronically, please contact Sooji Pak, industry development coordinator for Marsh's Mining, Metals & Minerals Practice, at (212) 345-1110 or e-mail at Sooji.Pak@marsh.com.

WHAT IS CORPORATE PREPAREDNESS

A strong corporate preparedness capability can dramatically improve a company's response capabilities—making it less likely that an incident will escalate into a crisis or, if one does occur, dramatically reducing the severity and duration of the impact. Corporate preparedness is a business process that elevates a company's ability to effectively manage and recover from any incident at the corporate, business unit, and site level—even those incidents whose nature was entirely unforeseen.

The most successful corporate preparedness programs are generally driven from the top of the organization. The board of directors and senior leadership must ensure that a coordinated programmatic and operational capability exists to manage any type of “hard” operational or “soft” reputational risk at any level of the organization. It takes analytical thought, imagination, resourcefulness, and training to develop confidence in a crisis management team.

A COMPREHENSIVE, INTEGRATED APPROACH

The following are proven methods across the spectrum

of corporate preparedness services:

- **Corporate Preparedness Review**
Assessing and reporting on a company's current capabilities and organizational issues.
 - **Facilitated Planning**
Developing customized plans, policies, and procedures that integrate multiple disciplines across an organization.
 - **Strategic Program Plans**
Establishing an integrated life-cycle schedule for implementation, maintenance and
- enhancement of a company's entire corporate preparedness program.
 - **Education and Training**
Introducing best practices and institutionalizing a crisis plans among employees and other key stakeholders.
 - **Exercising and Validating**
Verifying corporate preparedness through realistic test scenarios.
 - **Real-time Response**
Providing companies with immediate guidance and support to respond more effectively to an incident or emerging crisis.

Key Components of a Corporate Preparedness Program



Corporate preparedness programs must reflect each organization's culture, internal resources, concerns, and environment. The only way to assess a company's specific needs is through effective communication with company executives.

By Robert Perlman



Claims Preparation Related to Mining Losses

Mining incidents during the past few years have resulted in significant property damage, fire extinguishing and time element losses. In this environment, recouping lost revenues and costs can strongly impact a business's ability to compete, meet shareholder's expectations and maintain the confidence and support of a board of directors. With Mining Safety and Health Administration (MSHA), shareholders and the public scrutinizing business leaders have the ability to

manage an unforeseen event or crisis accurately quantifying losses and maximizing insurance recoveries which is increasingly important.

Recovering lost revenues and costs requires a thoughtful and thorough approach. Unfortunately, the potential for an unsatisfactory recovery is high. Barriers include:

- Failure to communicate with the adjuster on planned procedures and proposed expenses
- Inability to establish the necessary accounting and technical protocols to measure and track the extent of loss amounts
- Lack of sufficient documentation
- Failure to demonstrate a true loss of business

Credibility of the claim is reduced if facts are incorrect, poorly stated, or the presentation is confused

SOLUTIONS

Given the complexity of the claims process and problems that may occur, businesses are choosing to better position themselves by retaining external loss consultants such as forensic accountants, insurance coverage

consultants, and project managers. These consultants should have coal mining technical expertise and complete knowledge and understanding of the entire claims process to achieve the best possible outcome.

Typically, adjusters assemble a claims team consisting of accountants and mining consultants. Many businesses choose to "level the playing field" by retaining their own consultants. Fortunately, most policies contain a claims preparation endorsement which reimburses the costs of claims preparation.

REVIEW POLICY

After a loss occurs, it is best practice to review the insurance policy with the assistance of a broker and coverage consultant. A review will identify insuring clauses, exclusions and sublimits. For instance, a sublimit related to fire brigade (fire extinguishing) expenses will require segregating these costs when submitting the claim.

ASSEMBLE CLAIMS TEAM

The next step in the claims process is to assemble an internal claims team that will gather information necessary to properly document the claim. The claims team should include personnel from risk

management, accounting/finance, operations, engineering, marketing, and possibly payroll. These individuals' roles are as follows:

- Risk manager – Liaison between adjuster and company personnel.
- Accounting/Finance – Track and gather supporting documentation for claim costs as well as relevant financial information to document the time element claim.
- Operations – Explain general operating conditions and pre-loss production and expected production during the loss period.
- Engineering – Individual who is knowledgeable of vendor's roles and can explain claim costs incurred.
- Marketing – Explain current and future market conditions and contracts in place at the time of the loss.
- Payroll – Track internal labor costs by employee such as mine rescue, property damage repairs, etc.

Identifying and training these individuals immediately after

the loss occurs will make the claim easier to document, substantiate, and collect. In addition, the claims team may include external consultants, including a forensic accountant to assist with the claims preparation. This claim team will work closely to strategize and present the claim to maximize recovery under the policy.



TRACKING CLAIMS COSTS

The assigned claims team will need to track costs for the particular claim submission. Establishing a loss account with special work orders, job numbers, and other accounting procedures will assist in identifying and capturing all costs of the claim. Examples of claims cost categories are:

- Protection and preservation of property
- Temporary and permanent repairs and replacement
- Extraordinary and expediting expenses

- Other expenses which may fall under policy limits such as fire brigade expenses

By establishing a loss account to capture all claim costs immediately after the loss, the claim will not only be easier to document and present but it will also make it easier for the adjusting team to review.

PROPERTY DAMAGE

Before seeking authorization for permanent repairs, attempt to obtain the adjuster's agreement on the full scope of repairs that is needed. In the absence of an agreement, disputes over the claim's monetary value are likely. Resolution of disagreements as to the extent of damage to buildings and other property may require an expert opinion from a contractor, architect, licensed structural engineer, and equipment manufacturer.

Most property insurance policies are written on a replacement cost basis, meaning the policy will pay to repair and replace damaged property with property of like kind and quality. If the property loss is partial, the claim will consist of repair costs. The claim will require invoices from contractors broken down by labor and material costs. If repairs are

extensive, further itemization may be required.

MACHINERY AND EQUIPMENT

The adjuster will request a listing of the machinery and equipment that is in the mine after a loss occurs to estimate the potential loss estimate for reserve purposes. Therefore, information required may include: detailed description of each machine in the mine; complete specifications about its manufacturer; age and cost; cost of freight; installation; accessories; attachments and modifications. Photos or videos of the equipment are extremely helpful when a loss occurs as well.

If equipment can be repaired, invoices are sufficient to present the claim. If it is replaced, the claim will contain actual replacement cost. Lastly, if items are not replaced, the equipment may be valued at actual cash value.

INTERNAL LABOR COSTS

Internal labor costs are another important aspect of the claim. If at all possible, segregate labor hours and costs by the specific task being performed such as firefighting, repairs to machinery and equipment, etc. The tracking of labor costs includes supporting

documentation of pay rates and applicable fringe benefits.

MAINTAIN DAILY REPORT

Maintain a log or daily report during the loss period which documents the status of the loss and major milestones. This report should be shared with the adjuster on a regular basis.



TIME ELEMENT

The most difficult and subjective aspect of the claim is the time element loss. The purpose of time element insurance is to put an organization in the same financial position as if no loss had occurred. The coverage includes damage to insured property caused by a covered peril and its reimbursements for loss of earnings during the period of interruption. The profit and continuing expenses that would have been earned, had no loss occurred, will be recoverable as well as any expense to reduce the loss and extra expenses.

Documenting and calculating a time element claim is

difficult and time consuming. Therefore, a forensic accountant can provide tremendous value in preparing and calculating the time element loss. If the claim is not prepared correctly, the adjuster's accountant could take months to complete the review of the claim. This means valuable time is lost in securing advance payments, receiving total damage recovery dollars, and/or concluding the claim.

PERIOD OF INTERRUPTION

The first step in determining a time element claim is to establish the period of interruption. Most policies state, "...the time required with the exercise of due diligence and dispatch to rebuild, repair or replace the damage or destroyed property." Note that the policy only provides coverage until the property is restored or replaced. Additional time required to get operations to the same level as if no loss had occurred can be purchased in increments of time, as an extended period of indemnity coverage.

PROVIDING INFORMATION

The data required to document a time element claim can be voluminous since the coverage is for what *would*

have occurred rather than what *actually happened* (as under a property damage claim). Historical information of up to three years pre-loss will be requested to prepare the claim. To quantify a loss, the following information is required:

- Monthly detailed profit and loss statements
- Monthly (and potentially daily) production records
- Monthly sales by customer
- Contracts in place at the time of the loss
- Monthly inventory
- Budgeted/forecasted/planned sales and production
- Copies of union contracts if a union mine
- Planned maintenance or any other planned outage during the loss period



FACTORS TO CONSIDER

When preparing a time element claim most policies

state, “Due consideration shall be given to the experience of the business before the date of damage or destruction and to the probable experience thereafter had no loss occurred.” Therefore, a time element claim considers the following:

- Balancing prior period production rates with forecasted/budgeted production rates and any changes in operation scheduled to occur
- Selling price fluctuations (contract and spot)
- Anticipated increase or decrease in expenses

By taking these and any other relevant factors into account, a solid foundation to support the time element claim is established.

DEDUCTIBLE

Determining the deductible related to the time element portion of the claim can be complex. Most often, deductibles are defined in two ways: 1) a waiting period expressed in the number of days; and 2) an average daily value expressed in the number of days.

A 45-day waiting period essentially means loss recovery occurs after the loss

exceeds 45 days. On the other hand, a 45-day average daily value is based on the average daily time element value beginning with the date of the loss through a point in time (for instance up to a year from the date of the loss) multiplied by 45 days. Therefore, if tonnage and selling price are higher at the end of the loss or even after the loss is over, the average daily value for deductible purposes may be higher than the average value during the loss period. As a result, a 45-day average daily value deductible may equate to more than the first 45 days of the loss period.

SUMMARY

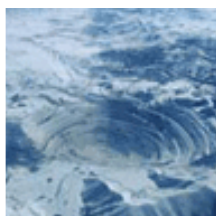
A thorough approach to submitting a large claim is difficult. A successful claim outcome is dependent upon a number of factors. Many companies experience negative outcomes due to the following:

- The entire claims process takes too long.
- The claims process is too expensive.
- There is limited expertise and capacity “in house.”
- The insurer’s information requests are overwhelming.
- The insurer does not understand the client’s business.

- The company is unable to respond to the insurer's accountant.

If an organization has experienced these issues, or it does not have the resources and expertise to present a claim properly, the retention of a forensic accountant and other loss consultants would be beneficial to accurately quantify the loss and maximize the recovery.

By John R. Kopfer



Ken Sloan, ARM, CIC, CRM is the global leader of Marsh's Mining, Metals, & Minerals Practice. He has provided risk and insurance management consulting service to mining, metals, and minerals companies for more than 20 years. Based in Knoxville, Tennessee, he reports to Marsh's Industry Practices based in New York.

Contributors:

Robert Perlman, SVP
Kroll Inc.
New York City, New York

John R. Kopfer, SVP
Marsh USA Inc.
Minneapolis, Minnesota

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