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How to Get More from Your Superstorm Coverage

Two case studies highlight the need to challenge how your company's property insurer measures losses in the wake of a disaster like Sandy.

Pamela Hans, Michael LoGiudice

For a business to recover from a disaster like superstorm Sandy — and get the most benefit from its insurance coverage — it's important to understand property insurance policies and the business-income coverage they provide. Companies need to know what triggers coverage, and the methods insurers use to value business-income losses.

It is generally accepted that to measure the impact of an event on a business, the business income is measured with and without the impact of the event. The loss is the difference between the business income the company would have earned without the event versus what the business actually earned.

While this principle may suffice for isolated events, like a fire to an individual store, what happens when the impact of the event is so widespread that its impact is felt throughout the entire economy, or the entire regional economy — as with superstorm Sandy?

OPINION

Two case studies highlight the importance of understanding policy language, carefully documenting the business loss, and understanding and questioning the insurance company's coverage determination and loss calculation.

In the first case, a national supplier of major household appliances had its regional distribution center destroyed by a hurricane. The hurricane devastated the entire region; thousands of homes needed to be rebuilt — and those homes needed new household appliances. The demand for appliances was unprecedented. Without its distribution center, however, the supplier had to cancel or was unable to fulfill thousands of orders generated by the same hurricane that destroyed the distribution center. The supplier wanted its insurance to pay for the lost profit on the cancelled orders, and the insurance company balked. Refusing to consider the actual loss in sales because the distribution center was not able to operate, the insurer considered only the supplier's prior performance when calculating the business-income loss.

In the second case, the same hurricane destroyed a fast-food chain outlet that could not start its rebuilding efforts until about six months after the storm because of delays in restoring power to the region. As a result, there were no customers in the area for the first several months after the storm.

Because there was ample evidence that rebuilding an outlet such as the one damaged, under normal circumstances, should take about four months, the insurer used four months as the period of interruption. The business asserted that, in calculating its business-income loss, its actual performance in the prior year should be considered.

The insurance company refused to pay for a business income loss. It said that since there were few people around the restaurant during the period of interruption, there would have been little business during the first four months after the hurricane and therefore the fast-food company sustained no loss. Even if the six-month delay to restore power was added to the four months to rebuild the outlet, the insurer could still demonstrate that there was little economic activity in the damaged outlet's area to back its assertion that no loss was sustained.

These implicitly contradictory coverage defenses were invoked in response to the same hurricane. Two insurance companies employed two different ways of calculating the loss of business income — including or excluding the hurricane's impact on the region.

Forewarned is forearmed: knowing that the method of calculating business-income loss may be a source of conflict puts you ahead of the curve. To maximize the chances that the loss will be calculated to reflect your actual losses, it is essential to engage the issue proactively and keep the lines of communication open between you and your insurance company. Tell it how you believe your loss should be measured and ask the company to tell you explicitly if it agrees. Answers may vary according to individual circumstances. Depending on the dollars in question, it may be helpful to obtain professional help. Once again, taking the initiative and raising the issue puts you ahead of the curve.

The Policies and the Coverage

The most common place to find "business income" or "business interruption" coverage is in a first- party property-insurance policy. In such policies, the insurance company typically promises to pay business-income loss caused by loss or damage to covered property.

Many policies also cover business-income losses sustained by the policyholder caused by things like service interruption, acts of civil authority (such as mandatory evacuation or mass-transit shutdowns), or damage to others' property (such as suppliers, customers, or other businesses that attract customers to the policyholder's business). Generally, business-income coverage will do three things.

• Protect policyholders unable to operate because of damage to their property.

• Protect those policyholders prevented from accessing their property because of an order by government or other civil authority.

• Reimburse policyholders for continuing expenses — expenses that continue even though the business cannot operate. Continuing expenses may include payroll for key employees and other "soft costs." Insurance policies typically list the types of soft costs that are covered as part of business-interruption coverage. In general, business-interruption coverage is designed to do for the policyholder what its business would have done if the loss had not occurred.

In addition to covering business-income losses because of damage to your own property, you may also have the coverage for impact of damage to property that is owned by others, but that you depend on for your business.

To be covered, the damage to the third-party property must typically be caused by a peril or risk that is insured by the property policy and would be covered if it happened to the policyholder's property. Business-income coverage for those losses is typically referred to as "contingent" business-income coverage. The locations are generally referred to as "dependent" locations.

Coverage for business-income losses is not necessarily limited to the time period during which your business is not operating. When a policy includes coverage for an extended period of liability or extended period of restoration, a business may be entitled to coverage for the additional time that is needed to return to preloss production or business levels. Different from the period of interruption, the extended period of restoration may cover losses that continue even after the business has resumed operations.

Pamela Hans (phans@andersonkill.com) is a managing shareholder in the Philadelphia office of Anderson Kill & Olick. She regularly represents policyholders in insurance coverage matters. Michael LoGiudice (mLoGiudice@CBIZ.com) is managing director of CBIZ Valuation Group's Chicago Office, specializing in litigated valuations, construction disputes, insurance, and damage measurement. Darin J. McMullen (dmcmullen@andersonkill.com) also contributed to this article. He is of counsel in Anderson Kill's Philadelphia office.