Business Interrupted?

Good Record-Keeping Should Be Part of the Recovery Plan

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Decisions made by a hospitality business in the days following an accident or disaster causing a loss of business can have a large impact on the ease with which it is able to recover on its insurance claim for business interruption (BI) losses.

Business interruption insurance, included in most first party commercial property insurance policies, typically covers loss of income due to the interruption of operations, and cover such losses throughout the ensuing period of restoration. Under many policies, the interruption must be caused by direct physical loss of or damage to property, although some forms provide coverage despite the absence of physical damage to any property.

This past January, a federal court decision reminded policyholders to be careful and proactive when documenting the losses related to a business interruption loss.

Metro Hospitality Partners Ltd. v. Lexington Ins. Co. (S.D. Texas Jan. 25, 2015) concerned BI coverage for a loss that occurred when a Texas hotel's air conditioning unit failed. Lexington accepted the loss under the equipment-breakdown coverage in the hotel's commercial property policy and requested repair or replacement quotes, invoices and contracts. The hotel forwarded an initial estimate but did not provide additional information or documents for another nine months — at which point it demanded over $600,000 for repair costs and unquantified "reputation" damages.

The hotel sued for coverage under the business interruption part of its insurance policy, but Lexington prevailed on summary judgment. The court agreed that a spreadsheet produced during the corporate designee's deposition did not satisfy the requirement that losses be supported by "financial records and accounting procedures, bills, invoices and other vouchers, and deeds, liens or contracts." The court took issue with the designee's lack of knowledge about the data underlying losses related to meal vouchers, canceled reservations and room discounts purportedly caused by the outage.

Metro Hospitality is a lesson in how not to document a business income loss. Such losses can be calculated with reasonable certainty in many ways, including from historical data such as:

- Income statements, balance sheets and cash flow statement for the loss year and prior years.
- Inventories and records of sales volume.
- Budget projections and marketing plans.

Establishing an income history requires maintaining financial records in advance of a loss. The insurance company (and later,

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the court) might view post-loss attempts to reconstruct financial figures with suspicion or even disregard them altogether.

Policyholders should take reasonable steps to document the economic impact of the interruption. Vendors should be directed to describe interruption-related services thoroughly in invoices. The policyholder should look beyond lost sales or other typical balance-sheet indicators of profit and loss by asking questions such as:

- How long will it be necessary to continue paying salaried employees until the business is restored?
- Can those employees assist with restoration of the premises and business operation?
- Are long-term contracts at risk? Can customers be supplied from pre-existing inventory during the interruption? How long will it take to restore inventory to pre-loss levels?
- If limited operations can be sustained during the interruption, what will be necessary to keep running and to serve our clientele? What are the extra expenses to do so?
- Are the services of an attorney and/or public adjuster needed?

The policyholder should document its efforts to resume operations quickly. Many BI policies limit interruption losses to those incurred during the "period of restoration." If that period exceeds a reasonable time to repair, the policyholder may be asked to explain delays, supported by construction contracts, schedules, invoices and change orders.

Many BI policies include coverage for "loss preparation fees," which may also be referred to as "claim preparation expenses." This benefit provides for fees to hire an independent, skilled financial professional, typically a forensic accountant, to help prepare the policyholder's business interruption claim. The insurance company benefits from a clearer claim presentation, but policyholders should beware that the professional fees to be paid under this benefit are sometimes subject to a cap.

Fastidious record-keeping may not rank as a high priority when faced with a flooded warehouse, tons of rotting produce or a broken air conditioner in midsummer. But the policyholder's ability to document its losses and its efforts to mitigate those losses will make recovering on its business interruption claim much easier.

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State Approves 5.9% Average Increase In Workers' Comp Loss Costs

The New York State Department of Financial Services (NYDFS) has approved an overall increase in workers compensation Loss Cost rates to take effect on policies renewing on or after October 1, 2015. In May 2015, the New York Compensation Insurance Rating Board (NYCIRB) filed a request for a 6.9% increase. According to NYCIRB's Actuarial Committee, the indicated increase was 15.8%, so, in the end, the insurance carriers were granted approximately one-third of the indicated increase.

The increase in the Loss Costs reflects the last two policy years of experience, as well as an estimate of the latest increase in the maximum weekly benefits. This increased from $808.65 to $844.29 per week, effective July 1, 2015. Additional costs associated with the increase in the minimum benefit, as well as the elimination of the Reopened Case Fund, as part of the 2013 Business Relief Act, were also taken into account. The overall increase includes a change in the Loss Cost provision for terrorism from 0/38 to 0.45 per $100.00 of payroll.

The State Insurance Fund has not made any changes in its Loss Cost Multiplier concurrent with the October 1, 2015 Loss Cost revisions, so that the calculation of renewal rates for State Insurance Fund policies renewing on or after October 1, 2015, has been done based on the new Loss Costs only. We will keep you advised of any subsequent changes in the State Fund Loss Cost Multiplier, should they occur.