

WHAT TO DO WHEN THE LIGHTS GO OUT

Introduction

Introduction

- ▣ The Panel
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Sandy's Impact

- ▣ 71% of businesses experienced power outages
- ▣ 56% of businesses experienced a loss of connectivity
- ▣ 52% of businesses experienced a sales or revenue loss
- ▣ 44% of businesses suffered supplier issues
- ▣ 44% of businesses closed their doors for at least 7 days

• The Harford 2013 Small Business Pulse: Storm Sandy

Business Interruption

- Off premises power interruption
- Ingress/ egress
- Order of civil authority
- Contingent Business Interruption

Overview of the Insuring Agreement

- ▣ Loss of net profit plus continuing expenses during a shutdown as the result of:
 - Damage
 - From a covered peril
 - To described property
 - During the period of indemnity

Off Premises Power Outage

- ▣ Cause must be from damage to utilities' property
- ▣ From a covered peril
- ▣ Leading to a shutdown of operations

Flood Coverage

- ▣ Damage to your property vs damage to property of others
- ▣ Your policy covers for flood
 - Off premises power outage
 - Contingent BI
- ▣ Sublimits
- ▣ Named storm

Civil Authority

- Prohibition of customers to gain access.
- Must be due to property damage from a covered peril
- Limitations

Ingress /Egress

- ▣ Inability of customers to access your premises
- ▣ As a result of property damage from a covered peril
- ▣ Limitations
 - Proximity
 - Time

Business Income Cover

- ▣ Gross earnings formula
- ▣ Net profit formula

Gross Earnings Formula

- ▣ Net sales
- ▣ Less cost of goods sold
- ▣ Less non continuing expenses
- ▣ Equals amount of loss for the period

Net Profit Formula

- ▣ Lost net profit
- ▣ Plus continuing expenses
- ▣ Equals loss for the period

Net Profit vs Gross Earnings

▣ Result is the same

Result is the same

- ▣ Profit and loss statement
 - Net sales
 - Cost of goods sold
 - Gross profit
 - Expenses
 - Net profit

Result is the same projected no loss

▣ Net sales	=	1,000,000
▣ COGS	=	500,000
▣ GROSS profit	=	500,000
▣ EXPENSES	=	400,000
▣ Net Profit	=	100,000

Result is the same projected LOSS PERIOD

- ▣ EXPENSES 400,000
- ▣ SAVED EXPENSES 150,000
- ▣ CONTINUED EXP 250,000

Result is the same GROSS EARNINGS FORM

- ▣ LOST GROSS EARN = 500,000
- ▣ LESS NON CONT EXP = 150,000
- ▣ LOSS = 350,000

Result is the same

Net profit form

- ▣ LOST NET PROFIT = 100,000
- ▣ CONT EXP = 250,000
- ▣ LOSS = 350,000

Result is the Same

	Actual	Gross Earnings	Net Profit
▣ Net Sales	\$1,000,000	\$1,000,000	
▣ <u>Cost of Goods Sold</u>	<u>(500,000)</u>	<u>(500,000)</u>	
▣ Gross Profit	500,000	500,000	
▣ <u>Expenses</u>	<u>400,000</u>	(150,000)	\$250,000
▣ <u>Net Profit</u>	<u>\$100,000</u>		<u>100,000</u>
▣ <u>LOSS</u>		<u>\$350,000</u>	<u>\$350,000</u>

Key Elements of Business Income Loss Measurements

- ▣ Period of Indemnity
- ▣ Sales Projection
- ▣ Mitigation Efforts
- ▣ Expense Analysis

Period of Indemnity

▣ Begins When?

- Event happens
- After waiting period
- Voluntary closure to secure premises

▣ Ends When?

- Event ends
- Repairs are completed
- Extended coverage

Sales Projections

- ▣ Forecasting Considerations
 - Seasonality
 - Averaging
 - Trending
 - Budgets/proformas
 - Best year syndrome
 - Market changes
 - Economic conditions
- ▣ Deferred Sales versus Lost Sales
- ▣ Lost Production versus Lost Sales

What Drives Sales?

- ▣ Trending
 - Impulse
 - ▣ Restaurants
 - ▣ Retail Stores
- ▣ Seasonality
 - Special Times of Year
 - ▣ Bridal
 - ▣ Florist
 - ▣ Amusement Parks
 - ▣ UPS
- ▣ Monthly Averages
 - Constant Usage
 - ▣ Manufacturers
 - ▣ Doctors/Dentists
 - ▣ Janitorial
- ▣ Uniqueness
 - Driven by Market
 - ▣ Commodities

Mitigation Efforts

- ▣ What can be done to reduce the potential sales loss?
 - Working overtime or on weekends
 - Outsourcing (internally or externally)
 - Temporary location
 - Safety stock
 - Alternative product (will this affect the gross margin?)

Mitigation Continued

- ▣ How much might the expenses be and will they qualify as an extra expense?
 - This may require a test as to what the loss might be if they did nothing (maximum exposure)
- ▣ Is this a duty under the policy?

Analyzing Expenses

- ▣ What Type of Expense is it?
 - Fixed versus variable
 - Variable versus saved
 - Seasonal
- ▣ How will this Expense be Impacted?
 - Anticipated versus actual results
 - Extra costs
- ▣ What about Timing Issues
 - 30 day lag in recording/paying expenses
 - Short versus long loss periods

Typical Document Requests

- ▣ Tax Returns
- ▣ Monthly Profit & Loss Statements
- ▣ Sales Reports
- ▣ Payroll Reports
- ▣ Leases
- ▣ Cancelled Orders
- ▣ Extra Expenses

Industry Specific Requests

- Occupancy Reports
- Rent Rolls
- Billable Hours
- Collection Reports
- Orders Logs
- Customer Accounts
- Franchise Reports
- Z Tapes

Surprises

- ▣ Movie Theaters
- ▣ Casinos
- ▣ Plant Operating 24/7
- ▣ Apartments & Hotels

Sometimes the Most Difficult

- ▣ Small Mom & Pops
- ▣ Professional Service Firms
- ▣ Start Ups

CBI Wording

This policy is extended to insure the actual loss sustained by the Insured directly resulting from the interruption of the Insured's operations caused by physical loss or damage to real or personal property at any Direct Customer or Direct Supplier not operated by the Insured, subject to the limits of liability set forth herein.

Other wordings

- ▣ Damage to property of the type insured by this Policy
- ▣ Prevents a **direct** supplier of goods or services to the Insured from rendering their goods and/or services, or
- ▣ Prevents **direct** customers of goods and/or services from the Insured from accepting the Insured's goods and/or services.

Contingent Time Element Policy Provisions

- ▣ Results in Inability to Supply, Deliver or Accept Goods and/or Services
- ▣ And the Damage at the Dependent Property Interrupts the Insured's Business and Results in a Financial Loss

Contingent Time Element Policy Provisions

- ▣ Ends when . . .
 - Supplier is Back in Business
 - Insured's Inventory Levels are Back to Normal
 - Supplier's Property is Repaired
 - Does EPOI apply?

The Supply Chain

- Who is in the Supply Chain?
- Who is the Supplier? Who is the Customer?
 - Direct (tier 1) and Indirect (tier2)
 - Source suppliers, processor, manufacturer, packer, broker, transporter, distributor, retailer
- The Chain
 - Supplier to Supplier
 - Customer to Customer

Two Defining Cases

Where the term "supplier" is not modified by the term "direct," the court found that it includes suppliers in any tier, including the Army Corps of Engineers operating the locks on the Mississippi River.

Archer-Daniels-Midland (S.D. Ill. 1996)

A "supplier" must provide goods or services to the insured, directly or indirectly. A utility that supplied electrical power to a factory that, in turn, supplied products to the insured is not a "supplier" of the insured

Pentair (8th Cir. 2005)

Scenario

- ❑ The insured made a claim for lost income following a hurricane when its customer, a manufacturer, reduced orders
- ❑ Neither the insured nor its customer sustained damage as a result of the hurricane
- ❑ The only physical damage was to the another of the customer's suppliers, which limited the customer's production
- ❑ Is it covered?

Scenario (Continued)

- ❑ The supplier of a customer is neither an indirect supplier of the insured nor an indirect customer of the insured.
- ❑ Would the term "any customer or supplier" affect your analysis?
- ❑ How is your analysis affected by the terms:
 - "caused by physical loss or damage to property of the type insured that directly prevents a supplier from rendering their goods and/or services to the insured, or that prevents a customer from accepting the insured's goods or services"
- ❑ Was the insured's customer "prevented" from accepting goods due to property damage?

**Business
Interruption/EBI**

Contingent BI

**Interdependency
Coverage**

Recent cases: No Contingent Coverage

- ▣ *DiLeonardo v. Hartford Cas. Ins. Co.* 2012 WL 1074290 (D.R.I. 2012): no coverage for affiliate's income loss caused by power interruption and damage at insured's location

▣ *Lightfoot v. Hartford Ins. Co.* 2012 WL 6161796 (E.D. La., 2012): no coverage for “indirect” income losses due to interruption of affiliated/subsidiary company’s business following Hurricane Katrina

- ▣ *WMS Industries, Inc. v. Federal Ins. Co.* 2010 WL 2711084 (5th Cir. 2010):
dependent property sublimit
enforced

▣ *Metawave Communications Corp.*
v. St. Paul Fire & Marine Ins. Co.
(Cal. App. Unreported 2006):
geographic limitation enforced
to restrict coverage for income
loss resulting from fire in
Singapore plant

CBI/IC Decisions:

- ▣ *Park Electrochemical Corp. v. Continental Casualty Co.* 2011 WL 703945 (S.D.N.Y. 2011): a subsidiary can be a “supplier” for purposes of CBI coverage

▣ Millenium Inorganic
Chemicals, Ltd. v. National
Union Fire Ins. Co. 2012 WL
4480708 (D. Md. 2012):
disregarded the “middle
man” in identifying “direct
contributing property”

▣ *Weirton Steel Corp. Liq. Trust v. Zurich Specialties London, Ltd.*
2008 WL 2945493 (N.D.W.V. 2008): recognized that damage at supplier's premises must be to property *of the type insured*, so no coverage for loss traceable to fire at an underground mine

- ▣ *Penton Media v. Affiliated FM Ins. Co.*, 245 Fed. Appx. 495 (6th Cir., 2007): civil authority and CBI coverage are separate, not additive

▣ *Arthur Anderson LLP v. Federal Ins. Co.* 416 N.J.Super. 334, 3 A.3d 1279 (2010): no coverage for reduced income following 9/11 attacks

Other recent cases of interest:

- ▣ *James E. Berwick Assoc. v. Hartford Fire Ins. Co.* 2012 WL 4097306 (D. Col. 2012): dispute whether losses after re-occupancy of premises were caused by the fire, or by “market forces”

- ▣ *Commstop, Inc. v. Travelers Indem. Co. of Conn.* 2012 WL 1883461 (W.D.La., 2012):
diminution in traffic due to road replacement doesn't trigger BI coverage

- ▣ *Coupled Products LLC v. Harleysville Ins. Co.* 2011 WL 3101357 (N.D. Ind. 2011): theft of custom made parts and trade secrets, and resultant loss of competitive advantage, did not interrupt business to trigger BI coverage

Actual Loss Sustained – Measurement Issues

- ▣ *B.F. Carvin Constr. Co. v. CNA Ins. Co.*, 2008 WL 5784516 (E.D. La., 2008): **add together** net profit/loss that would have been earned **and** continuing operating expenses

- ▣ *Consolidated Companies, Inc. v. Lexington Ins. Co.*, 616 F.3d 422 (5th Cir. 2010): same result

- ▣ *HTI Holdings, Inc. v. Hartford Cas. Ins. Co.*, 2011 WL 4595799 (D. Or., 2011): same result

▣ *Amerigraphics v. Mercury Casualty Co.*, 182 Cal.App.4th 1538 (2010): contra, holding that insured could recover **both** (1) reduction in profit (if it sustains any) **and** (2) continuing operating expenses

Actual Loss Sustained – Causation Issues

- ▣ Mirlan, dba Vinyard Valley Center v. Affiliated FM Ins. Co. and Axis Specialty US Services, Inc., 2010 WL 4462728 (9th Cir. 2010): no coverage where landlord voluntarily abated rent

▣ *Tower Automotive Inc. v. American Protection Insurance Company*, 266 F. Supp. 664 (W.D. Mich. 2003):
rejecting coverage for extra expense claim for auto parts manufacturer's concessions to major customer for delay following fire in manufacturer's facility.

Actual Loss Sustained and Wide Area Damage

Windfall Profits / Offset

- ▣ Courts will allow a credit for make-up if the interruption was merely a delay in sales.
- ▣ If that delay would have affected the number or price of the goods sold, the court will likely not grant a credit
 - Finger Furniture Co. Inc. v. Commonwealth Ins. Co., 404 F.3d 312 (5th Cir. 2005) (holding that insurers were not entitled to offset losses sustained by insured during the two days its furniture stores were closed as a result of flooding with increased sales the weekend following the flood, observing that "[t]he policy indicates that a business-interruption loss will be based on the historical sales figures," and "says nothing about taking into account actual post-damage sales to determine what the insured would have experienced had the storm not occurred.")

Actual Loss Sustained and Wide Area Damage

Orient-Express Hotels Ltd. v. Assicurazioni Gen. S.p.a. (U.K.), (2010)

- ▣ A Katrina case from the U.K. courts
- ▣ Insurer contended it was only required to put the insured in the position it would have been “but for” the damage to its hotel.
- ▣ Insurer maintained it was not required to pay the insured a loss the insured would have sustained, with or without damage, due to the Wide Area Damage as a result of Hurricane Katrina
- ▣ The policy's trends provision read as follows:

In respect of definitions under 3, 4, 5 and 6 above for Gross Revenue and Standard Revenue adjustments shall be made as may be necessary to provide for the trend of the Business and for variations in or special circumstances affecting the Business either before or after the Damage or which would have affected the Business had the Damage not occurred so that the figures thus adjusted shall represent as nearly as may be reasonably practicable the results which but for the Damage would have been obtained during the relative period after the Damage.

Actual Loss Sustained and Wide Area Damage

Orient-Express Hotels (cont.)

- ▣ The High Court of Justice stated " the 'but for' test is a necessary condition for establishing causation in fact."
- ▣ The court concluded that "the application of the 'but for' test means that the loss claimed was not caused in fact by physical damage **to the insured property.**" (Our emphasis)
- ▣ The court then addressed the meaning of "special circumstance" with respect to the Trends provision and concluded that losses resulting from WAD were not a "special circumstance."
- ▣ The court concluded that allowing the insured to recover gross operating profit suffered as a result of WAD would be inconsistent with the requirement that the losses were caused by damage to the insured's own property.

Appraisal

- ▣ *Amerex Group, Inc. v. Lexington Ins. Co.*, 678 F.3d 193 (2nd Cir. 2012): appraisers of business interruption claim were properly permitted to decide the period of restoration

Case Study #1

- ▣ DINE AROUND TOWN BAR & GRILL
 - Hundreds of Locations with Varying Impacts
 - ▣ Property Damage
 - ▣ Power Outage
 - ▣ Civil Authority/Ingress Egress Issues
 - ▣ Remained Open
 - Policy Provisions
 - ▣ Blanket Policy
 - ▣ 24 Hour Qualification for Power Outage
 - ▣ No Ordinary Payroll Coverage
 - ▣ 30 Day Extended Period of Indemnity

Case Study #2

- ▣ TOES UP HOTEL
- ▣ Franchise hotel was forced to close for 3 months due to damage from the hurricane
- ▣ Policy Provisions
 - 12 Months Actual Loss Sustained
 - 30 Days Ordinary Payroll Coverage
 - 60 Day Extended Period of Indemnity

Case Study #3

- ▣ TOAST OF THE TOWN EVENT PLANNERS
- ▣ No damage to this audio visual company that supports conferences and meetings.
- ▣ Many of their customer's properties were affected by the hurricane to varying degrees by:
 - Physical Damage
 - Power Outage
 - Civil Authority & Ingress/Egress