

**MDD** FORENSIC ACCOUNTANTS

**Business Interruption: Beyond the Basics -  
What Every Adjuster Needs to Know**

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**ABOUT MDD FORENSIC ACCOUNTANTS**



- Tracing its roots back to 1933, MDD is one of the world's top forensic accounting firms specializing in economic damage quantification calculations.
- We regularly work with law firms, government entities, multi-national corporations, small businesses, insurance companies and independent adjustment firms to provide independent objective assessments that enable fair and equitable settlements.
- With forensic accounting professionals in over 40 offices on 5 continents, MDD has global resources to assist our clients with their forensic accounting needs. Our work spans more than 130 countries and 800 industries.

2

**BUSINESS INTERRUPTION IS NOT COMPLICATED**

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3

**AGENDA**



- Business Interruption Coverages and Basics
- Projecting Lost Sales and Case Studies
- Dependent Properties Coverages
- Extended Business Interruption
- Extra Expense
- Service Interruption Coverage
- Civil Authority

4

**BUSINESS INTERRUPTION**



- **Business Income**
  - Net Income Plus Continuing Expenses
  - Period of Restoration Typically Starting 72 Hours After Loss or Damage and Ends Upon Completion of Repairs
- **Gross Earnings**
  - Net Sales less Cost of Materials, Supplies and Outside Services
  - Ordinary Payroll May or May Not Be Covered
  - Period of Restoration Starts at Time of Damage and Ends When Repairs Are Complete
- **Gross Profits**
  - Reduction in Turnover (*Fancy Word For Revenue*) Times Rate of Gross Profit, Less Any Sum Saved During the Period of Restoration
  - Period of Restoration Starts at Time of Damage and Ends After a Defined Time Period (Often 12 Months)

5

**BUSINESS INTERRUPTION GOAL**



- The property insurance policy is one of indemnification.
- The "goal" of Business Interruption insurance is to follow the principle of **ACTUAL LOSS SUSTAINED**.
- In the event of a loss, the policy should financially do for the insured just what its business would have done for it if the loss had not occurred (i.e. "make the insured whole") – subject to policy terms, including deductibles, sub-limits, waiting periods, idle periods, etc.

6

**BUSINESS INTERRUPTION – CHAIN RULE**In the event of:

1. Physical damage
2. To covered property
3. By a covered cause of loss
4. Which causes a necessary suspension of operations

The policy indemnifies/covers:

5. The defined loss (Actual Loss Sustained)
6. For the defined indemnity period

7

**PROJECTING LOST SALES**

Projecting sales that would have occurred “but for” the tornado damage can be challenging.

- An amusement park sustained damage from a tornado that occurred at 7:30 pm on a Friday evening. The park re-opened the following morning.
- A home improvement store is damaged and closed for one month as a result of a tornado.
- A furniture store sustained damage as a result of a tornado and closed for one week.
- A fast food restaurant with multiple locations in the area suffered damage at one store that caused a one month closure.

8

**PROJECTING LOST SALES****Loss Determination**

- a. The amount of Business Income loss will be determined based on:
- (1) The Net Income of the business before the direct physical loss or damage occurred;
  - (2) The likely Net Income of the business if no physical loss or damage had occurred, but not including any Net Income that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses;

9

**CASE STUDY #1 – AMUSEMENT PARK**

An amusement park sustained damage from a tornado occurring at 7:30 pm on a Friday evening. The park re-opens the following morning.

- Normal Friday hours are noon to midnight
- Normal Friday admission revenue is \$32,000 and Concession revenue is \$12,000
- Park charges one-time admission that includes all rides
- 70% of Friday admission revenue is normally earned by 7:30 pm; 75% of concession revenue is earned between 7:30 pm and midnight.
- Park admission revenue for the day of loss was \$8,000 and concession revenue was \$2,000
- Customers who were at the park received free admission for a future visit (value of \$3,000) and credits for admission paid.

10

**CASE STUDY #2 – HOME IMP. STORE**

A home improvement store is damaged and closed for one month as a result of a tornado.

- Normal monthly revenue is \$300,000
- Local home improvement stores that were not damaged saw a 30% increase in sales in the month after the loss
- How are sales projected; at the normal expected level or at the increased level??

11

**CASE STUDY #3 – FURNITURE STORE**

A furniture store sustained damage as a result of a tornado and closes for one week.

- Normal weekly revenue is \$50,000
- Local furniture stores that were not damaged saw a 50% decrease in sales in the week after the loss
- How are sales projected; at the normal expected level or at the decreased level??
- What if the loss period was longer, and all area stores saw an increase as local residents started to replace damaged furniture??

12

**CASE STUDY #4 – FAST FOOD REST.**

A fast food restaurant with multiple locations in the area (all insured under the same policy) suffered damage at one store that causes a one month closure.

- Normal monthly revenue for each store is \$50,000
- All stores that remained open saw an increase in monthly revenue to \$75,000
- Is some of the increase at non-damaged stores make-up??
- How should revenue for the damaged store be projected??

13

**DEPENDENT PROPERTIES COVERAGE**

We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your “operations” during the “period of restoration”. The suspension must be caused by direct physical loss of or damage to “dependent property” at a premises described in the Schedule caused by or resulting from a Covered Cause of Loss.

14

**DEPENDENT PROPERTIES COVERAGE (CONT.)**

“Dependent Property” means property operated by others whom you depend on to:

- a. Deliver materials or services to you, or to others for your account (Contributing Locations). With respect to Contributing Locations, services does not mean water, communication or power supply services;
- b. Accept your product or services (Recipient Locations);
- c. Manufacture products for delivery to your customers under contract of sale (Manufacturing Locations); or
- d. Attract customers to your business (Leader Locations).

“Dependent Property” coverage is similar to Contingent Business Interruption. Typically, contingent BI covers suppliers or customers of the non-damaged business.

15

**DEPENDENT PROPERTIES EXAMPLES**

- A company manufactures paint cans and ships them to a local paint store. The paint store sustains damage and is closed for one month (Recipient Location)
- A casino sustains tornado damage and is closed for one month. A neighboring hotel is undamaged but 80% of it's business comes from casino customers (Leader Location)
- A catering company provides the meal service to a local prison. Meals are prepared off-site and shipped to the prison on a daily basis. Damage to the prison causes all the prisoners to be transferred to other facilities. The catering company is no longer needed to provide the service (Contributing Location)
- Significant damage to a local housing community that is the customer base for many nearby businesses???

16

**EXTENDED BUSINESS INCOME**

If the necessary “suspension” of your “operations” produces a Business Income loss payable under this policy, we will pay for the actual loss of Business Income you incur during the period that:

- (a) Begins on the date the property (except “finished stock”) is actually repaired, rebuilt or replaced and “operations” are resumed; and
- (b) Ends on the earlier of:
  - (i) The date you could restore your “operations” with reasonable speed, to the level which would generate the business income amount that would have existed if no direct physical loss or damage had occurred; or
  - (ii) 30 consecutive days after the date determined in (1)(a) above.

17

**EXTENDED BUSINESS INCOME (CONT.)**

However, Extended Business Income does not apply to loss of Business Income incurred as a result of unfavorable business conditions caused by the impact of the Covered Cause of Loss in the area where the described premises are located.

Loss of Business Income must be caused by direct physical loss or damage at the described premises caused by or resulting from any Covered Cause of Loss.

18

**EXTENDED PERIOD DISCUSSION POINTS**

- Furniture store with depressed sales for several weeks after the damage
- Area wide increase in sales for home improvement stores
- Population decrease after significant tornado event

19

**EXTRA EXPENSE**

Extra Expense means necessary expenses you incur during the "period of restoration" that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss.

We will pay Extra Expense (other than the expense to repair or replace property) to:

- (1) Avoid or minimize the "suspension of business and to continue operations at the described premises or at replacement premises or temporary locations, including relocation expenses and costs to equip and operate the replacement location or temporary location.
- (2) Minimize the "suspension" of business if you cannot continue "operations".

20

**EXTRA EXPENSE (CONT.)****Loss Determination**

The amount of Extra Expense will be determined based on:

(1) All expenses that exceed the normal operating expenses that would have been incurred by "operations" during the "period of restoration" if no direct physical loss or damage had occurred. We will deduct from the total of such expenses:

(2) Necessary expenses that reduce the Business Income loss that otherwise would have been incurred.

21

**EXTRA EXPENSE EXAMPLES**

- Generator rentals due to damage to on-site electrical equipment, which allow a business to continue to operate (don't forget about saved utility expense!)
- Outsource production due to damage to building and production equipment
- Increased cost of raw materials due to damage to a key supplier (contingent EE)
- Rental equipment to make repairs and security services to protect a building which is partially exposed??

22

**CASE STUDY #5 – EMPLOYEE BONUS PAYMENTS**

- A fast food restaurant sustained damage as a result of a tornado. They were closed for three weeks to make repairs and all hourly employees were either laid off or voluntarily left.
- The restaurant paid new hires \$6,000 each as a signing bonus after they re-opened. Insured claimed this as an Extra Expense.
- Why was expense incurred? Was it a result of damage to property?
- What if the restaurant was undamaged, would this change anything?
- Would Extended Business Income apply if new hires were not available to re-open the store?

23

**UTILITY SERVICE INTERRUPTION**

- A. We will pay for loss of Business Income or Extra Expense at the described premises caused by the interruption of service to the described premises. The interruption must result from direct physical loss or damage by a Covered Cause of Loss to the property described in paragraph B.
- B. Utility Services
  1. Water Supply Services
  2. Communication Supply Services
  3. Power Supply Services

24

**COMMON ISSUES WITH UTILITY SERVICES**

- Loss to insured must be a result of service interruption from a Covered Cause of Loss.
- Rolling brown-outs are not a result of a Covered Cause of Loss.
- Special limits apply to this coverage (sublimits, waiting period).
- Service interruption caused by damage to overhead transmission lines may not be covered.
- Utility company voluntarily shuts off power to a section of town that had damage, even though certain customer still had power???

25

**CIVIL AUTHORITY**

When a Covered Cause of Loss causes damage to property other than property at the described premises, we will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises, provided that both of the following apply:

- (1) Access to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the described premises are within that area but are not more than one mile from the damaged property;  
and
- (2) The action of civil authority is taken in response to dangerous physical conditions resulting from the damage or continuation of the Covered Cause of Loss that caused the damage, or the action is taken to enable a civil authority to have unimpeded access to the damaged property.

26

**CIVIL AUTHORITY**

Civil Authority Coverage for Business Income will begin 72 hours after the time of the first action of civil authority that prohibits access to the described premises and will apply for a period of up to four consecutive weeks from the date on which such coverage began.

Civil Authority Coverage for Extra Expense will begin immediately after the time of the first action of civil authority that prohibits access to the described premises and will end:

- (1) Four consecutive weeks after the date of that action; or
- (2) When your Civil Authority Coverage for Business Income ends; whichever is later.

27

**CIVIL AUTHORITY DISCUSSION POINTS**

Local government closes early and recommends local businesses do so as well in light of a high risk tornado forecast issued by the Storm Prediction Center.

- Do businesses that close early have coverage for this closure under Civil Authority??
- What if a tornado later causes damage to a business, how does Civil Authority then apply?? Is there now consideration for the early closure as well??
- What if a business is undamaged, but a tornado causes nearby damage and government restricts access to the area in which the business is located??

28

**QUESTIONS???**

**THANK YOU FOR  
YOUR TIME**

29