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The Business Interruption Claim

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Agenda

First Session

1. The BI claim – what to expect, what happens next
2. First things first - mitigating the loss
3. Identifying the reduction in turnover
 - Seasonality
 - Trends
 - Other circumstances

Second Session

1. Complexities in calculating the reduction in turnover
 - Make-up
 - Wide area damage
2. Increased Costs of Working/Additional Increased Costs of Working
3. Savings



A business interruption claim



- What are the expectations on an Insured ?
- What is the loss adjusters role ?
- What documentation will be sought from the Insured to quantify the loss ?
- What issues can arise in quantifying the loss ?



Mitigating the BI claim

Critical to identify and pursue opportunities to mitigate the business interruption loss.

- Identifying spare capacity at other sites
- Utilising spare equipment
- Temporary hire of equipment
- Temporary repair of equipment
- Fast-tracking replacement of key equipment
- Subcontracting of manufacturing
- Renting alternate premises
- Arrangements with competitors
- Paying overtime to staff
- Phone diversions, mobile phones and data for staff
- Ensuring as much stock as possible is saved in the property claim
- Advertising upon reopening or advising customers of other stores



How are loss mitigation strategies paid for ?





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Basic elements of a BI calculation

- Indemnity period
- Loss of turnover / sales
- Rate of gross profit
- Loss of gross profit
- Increased costs of working
- Savings
- Deductible



Basic elements of a BI calculation



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Detail	AU\$'000
Expected sales	100,000
Less: actual sales	(50,000)
Loss of sales	50,000
Rate of gross profit	40%
Loss of gross profit	20,000
Increased costs	3,000
Savings	(2,000)
Total	21,000



Loss of turnover / sales

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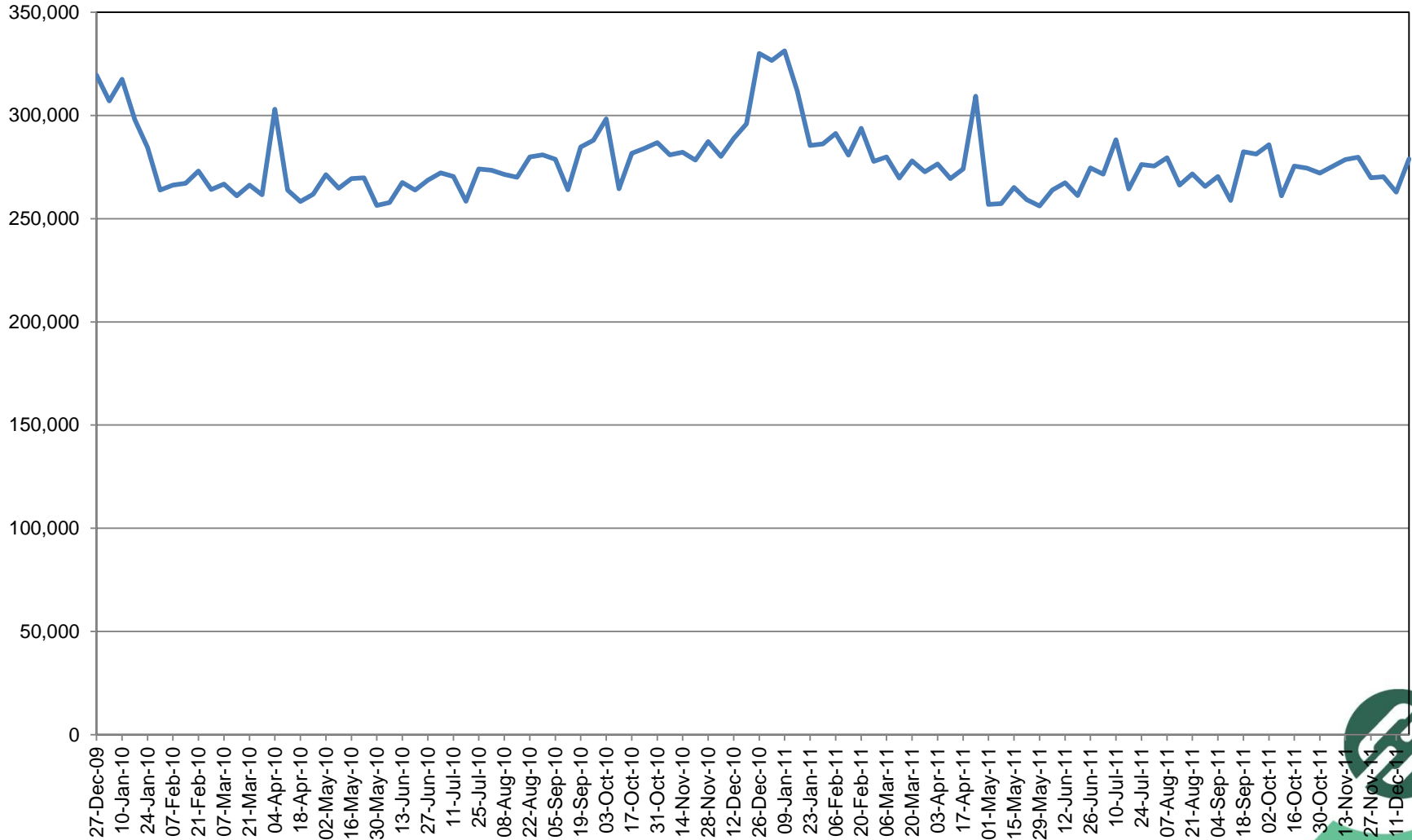
Identifying the reduction in turnover

- Policy refers to “Standard turnover” to estimate the expected sales of the business during the indemnity period:
“The revenue during the period in the twelve months immediately before the date of insured damage, that corresponds with the indemnity period, subject to any adjustments....”
- Why would the policy ask us to take this approach ?
- What sort of businesses would this type of approach suit?
- When might this approach not be valid?



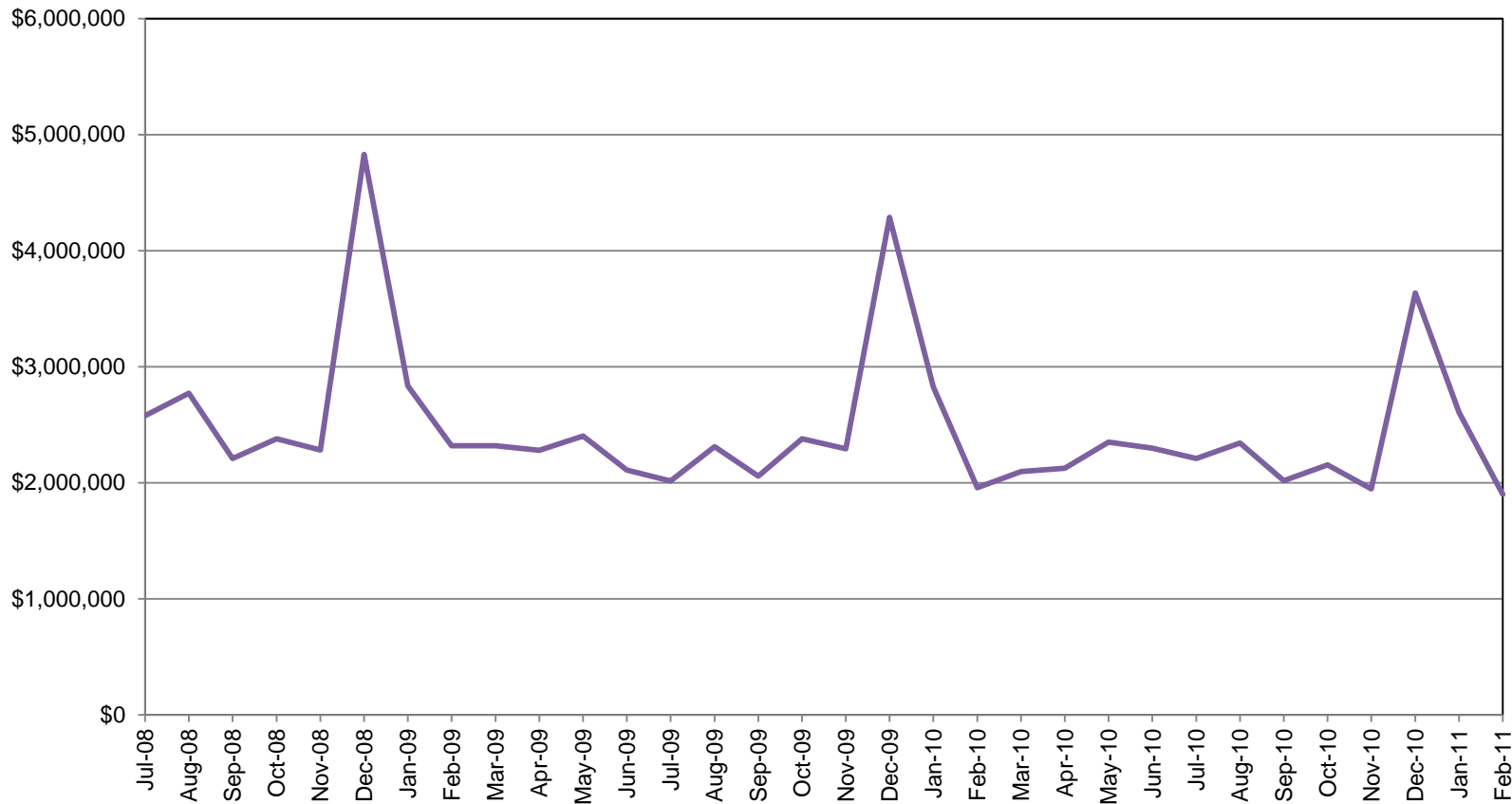
Annual seasonality

SUPERMARKET WEEKLY SALES



Annual seasonality

MONTHLY SALES - COMPUTER RETAILER



Adjusting turnover

- Policy allows “Standard Turnover” to be adjusted for other circumstances:
“The revenue during the period in the twelve months immediately before the date of insured damage, that corresponds with the indemnity period, subject to any adjustments....”
- Adjustments clause allows Standard turnover to be varied so as to reflect:
 - Trends in the business
 - Variations in the business
 - Other circumstances that occur both before or after damage
- When the adjustments clause is needed:
 - Business has undergone growth
 - New business
 - Short interruption
 - New/loss of major customer
 - New/loss of new product
 - Other factors affecting the business



Adjusting turnover for trend

TURNOVER

Financial Year	Month												Total \$ '000
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	
	\$ '000												
2005/6	30	32	30	32	37	42	30	32	32	36	39	40	412
2006/7	33	34	32	35	42	47	34	36	37	39	43	42	454
2007/8	36	38	36	38	46	52	38	40	40	42	48	46	500

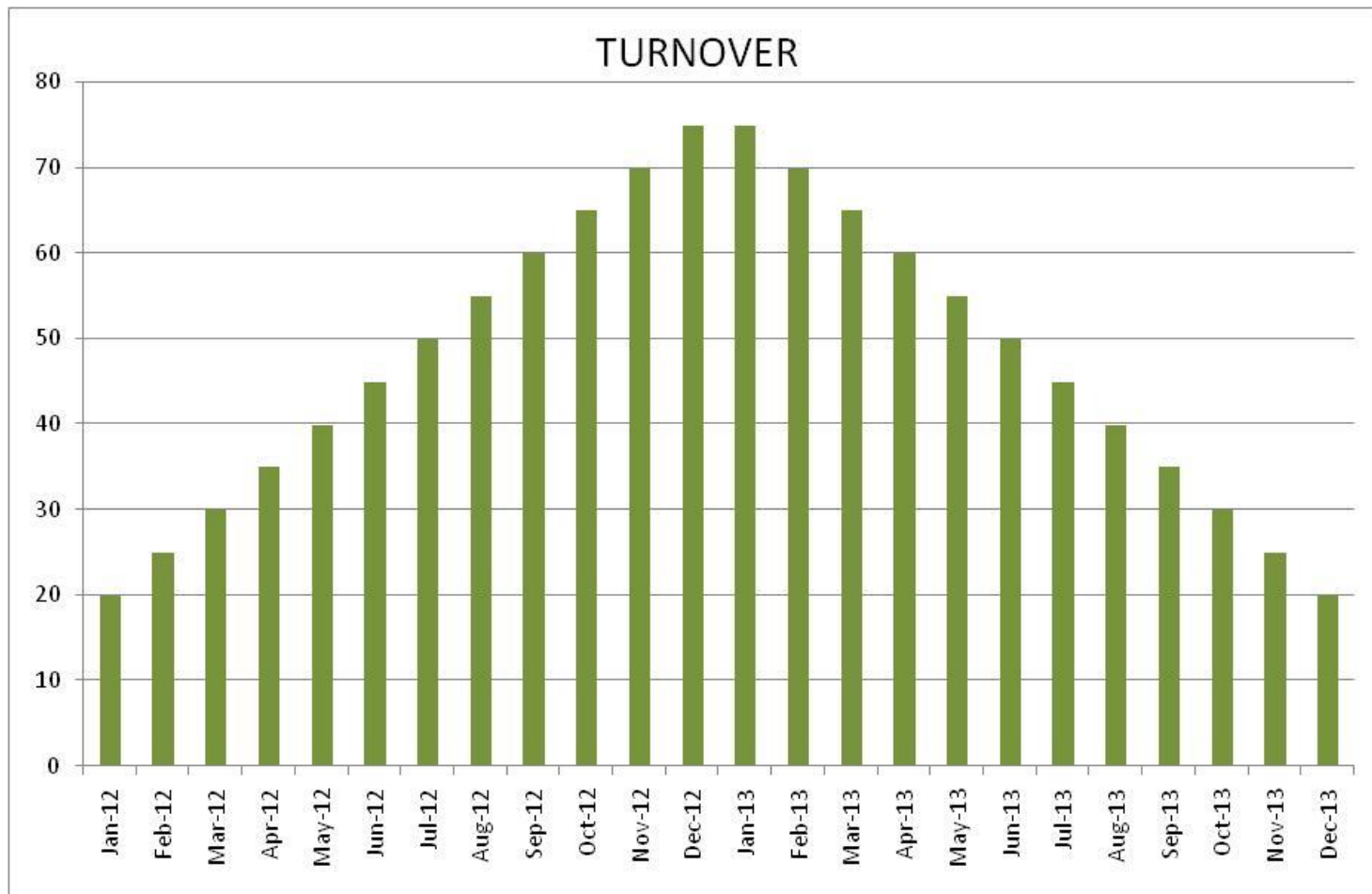


Adjusting turnover for trend

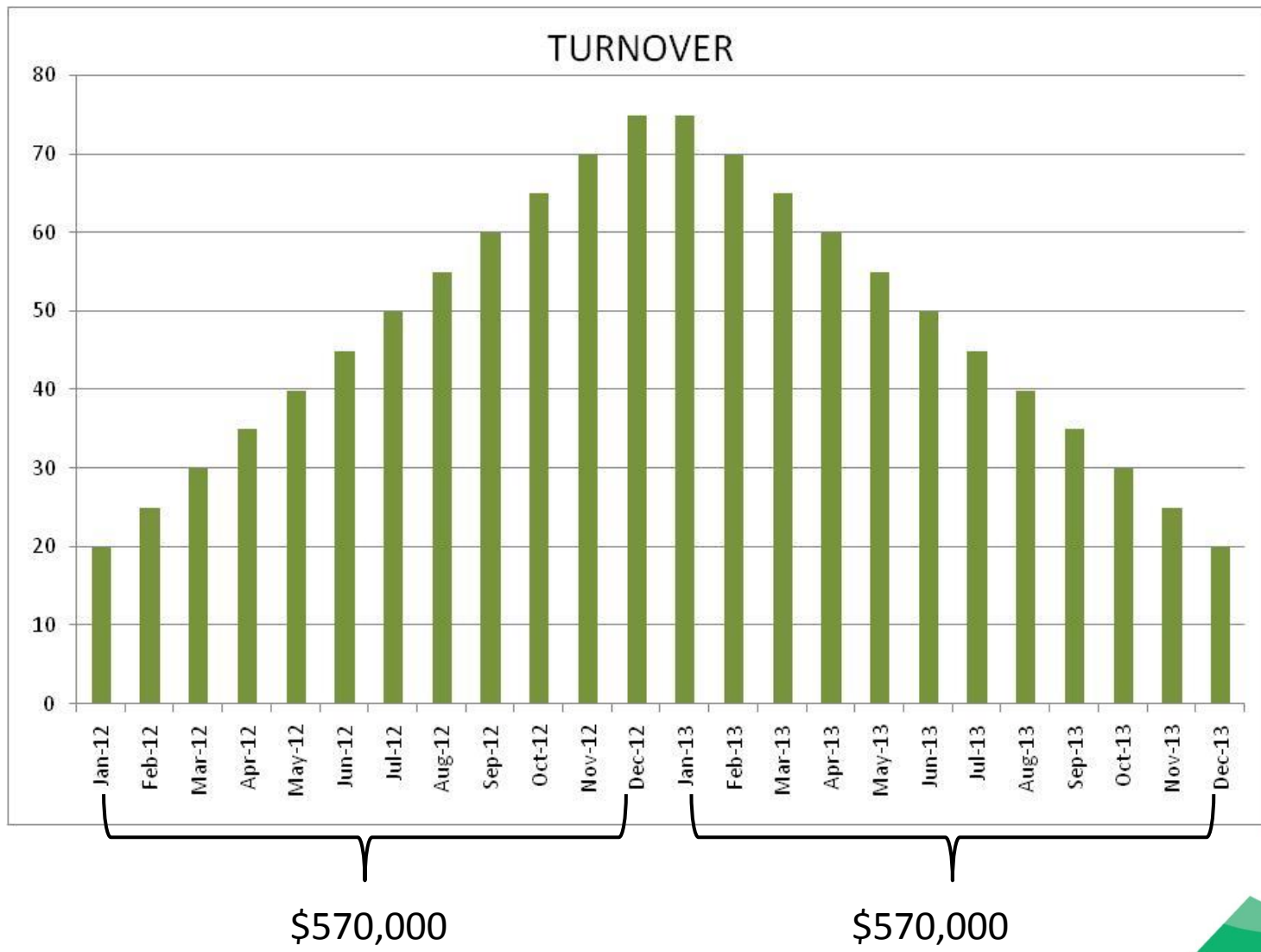
- Crucial to look at detailed information before deciding on trend
- Consider this example:
 - Fire occurs on 1 January 2014 and the business is unable to trade for 12 months
 - Sales for year to 31 December 2013 were \$570,000
 - Sales for the year to 31 December 2012 were \$570,000
 - What would sales have been in 2014 ?



Trends within historical sales...

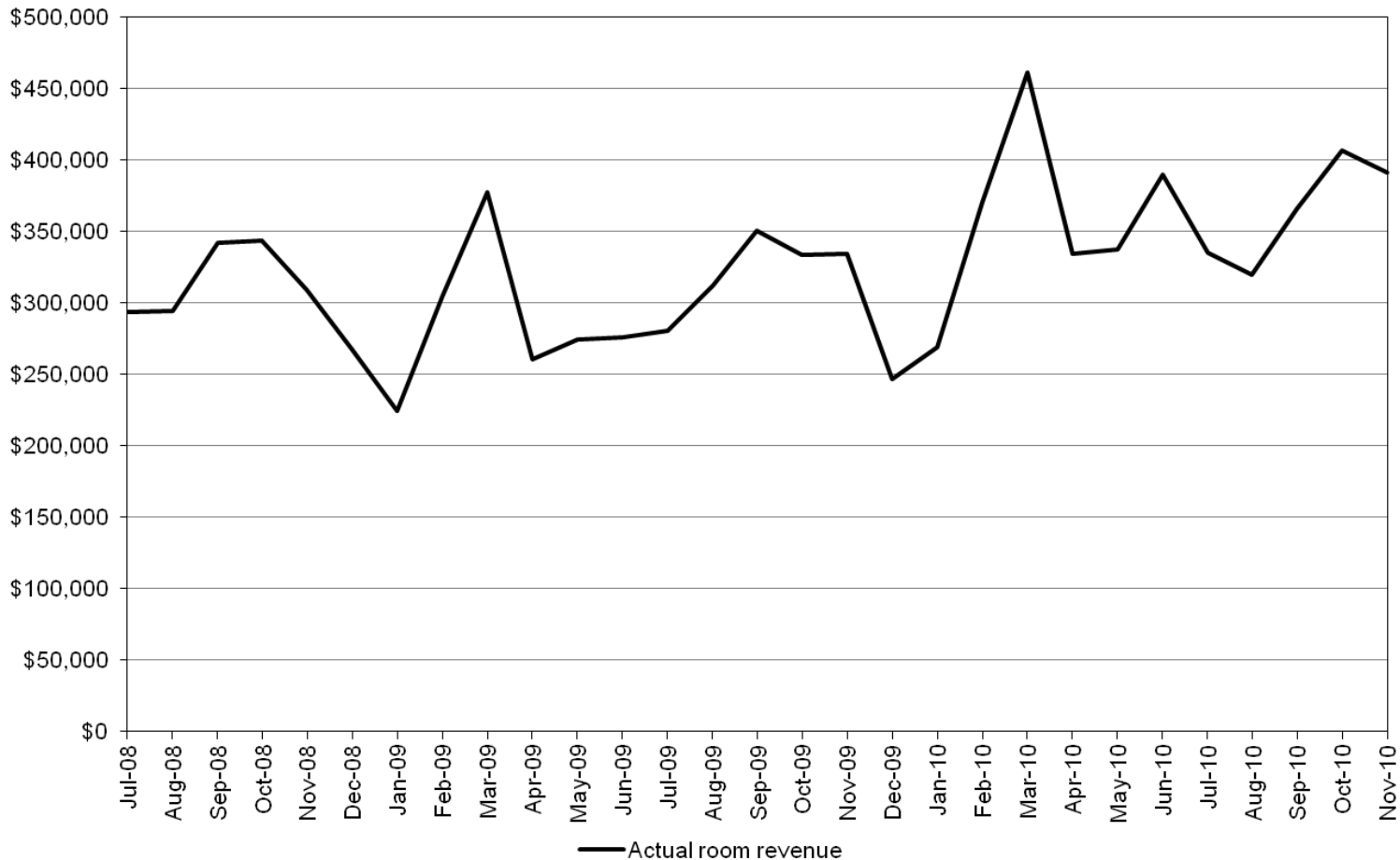


Trends within historical sales...



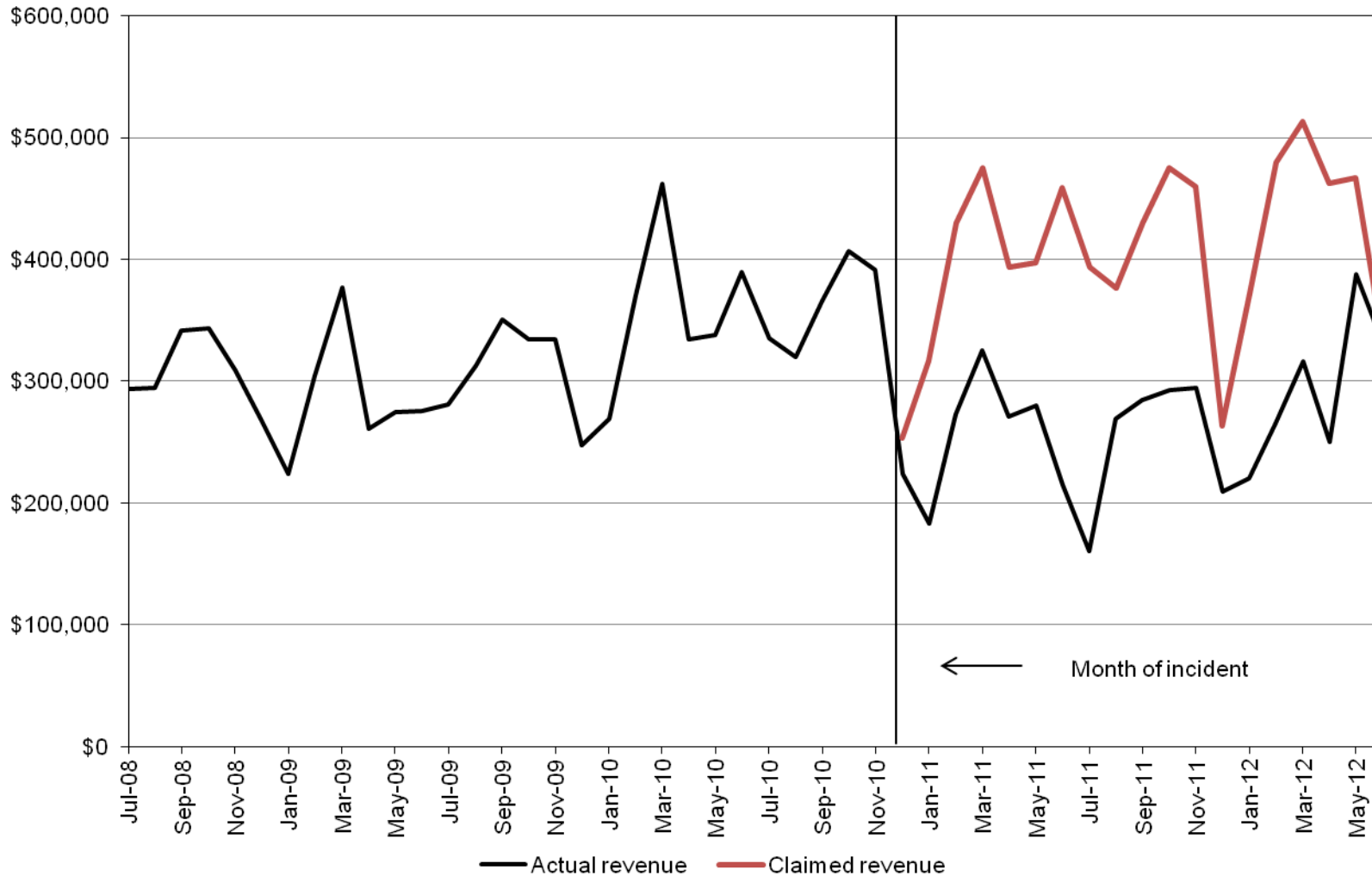
Trend - Hotel revenue

HOTEL ROOM REVENUE



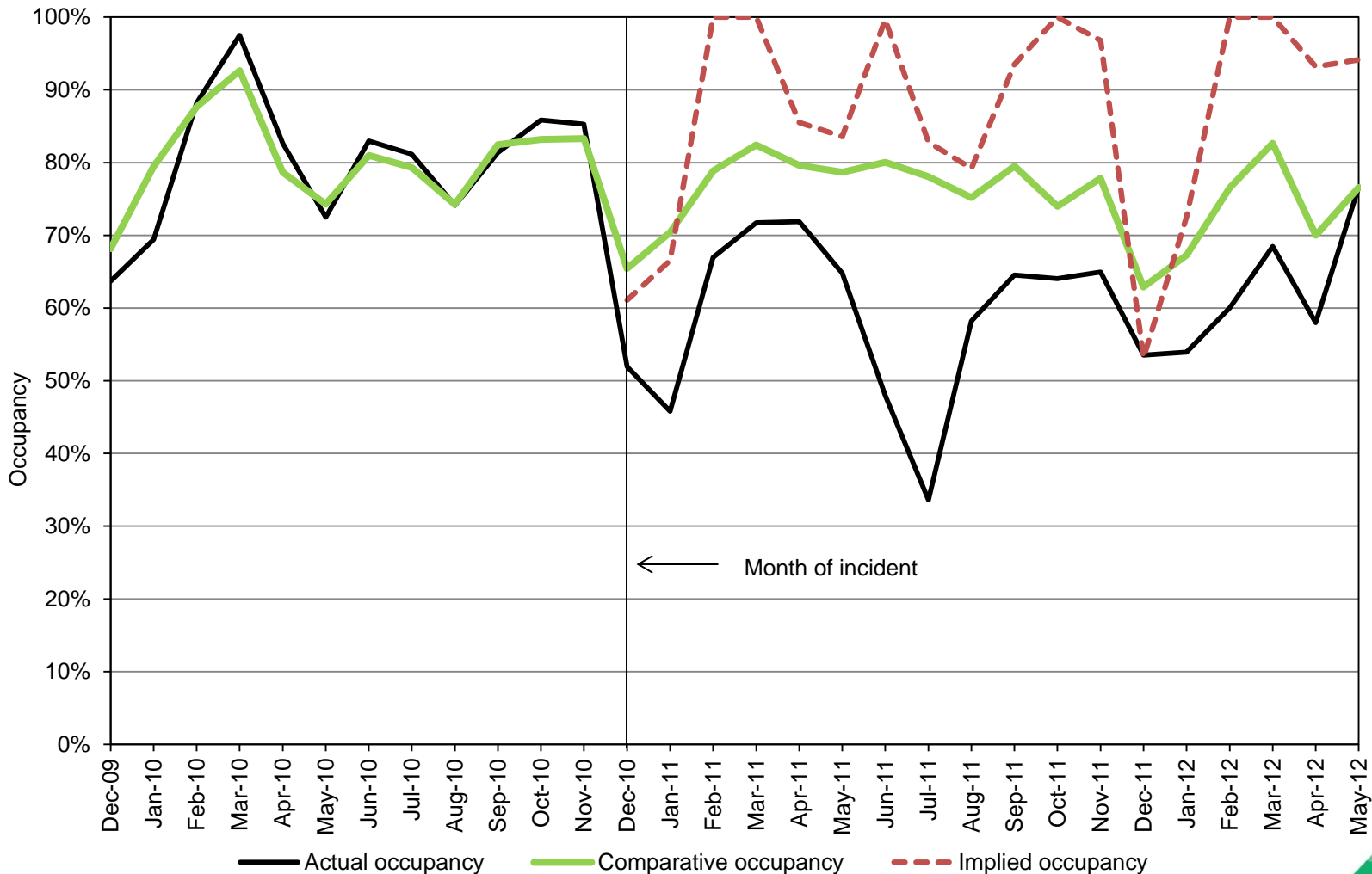
Applying trend – Hotel revenue

ACTUAL AND CLAIMED HOTEL ROOM REVENUE



Applying trend – Hotel revenue

ACTUAL AND EXPECTED HOTEL OCCUPANCY



Adjusting for “Other circumstances”



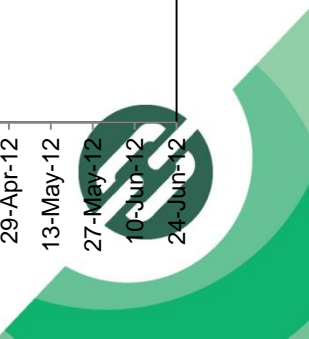
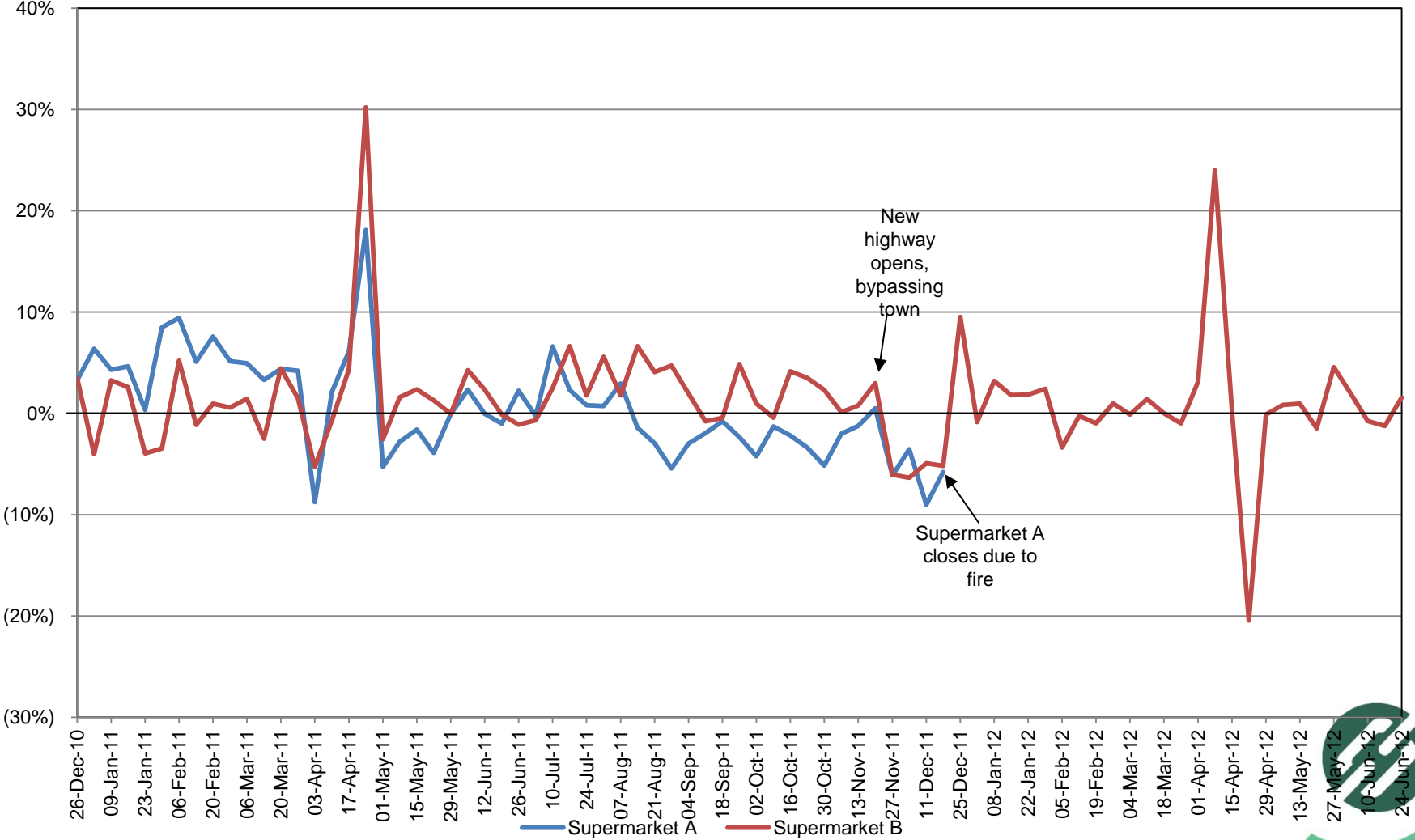
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Impact of "other circumstances"



YEAR-ON-YEAR WEEKLY SALES GROWTH - BOTH SUPERMARKETS



Adjusting for “other circumstances”

- Case study: Persian carpet store in Wellington
- Purchases of stock arrive via sea from Iran twice a year – November and May
- 1 October 2011 - fire destroys premises and stock
- Store re-opens on 15 November 2011 from alternative premises



HEADLINE NEWS – 15 NOVEMBER 2011

CONTAINER SHIP HITS REEF AFTER THE ITALIAN CAPTAIN MAKES AN UNAUTHORISED DIVERSION. THE PRESS ARE SPECULATING THE CAPTAIN WAS SAILING CLOSE TO THE SHORE TO GREET FRIENDS ON THEIR ARRIVAL INTO WELLINGTON





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How do we take this factor into account in the October fire claim ?



To summarise....

- In the event of a BI claim, it is critical to first focus on mitigation
- Quantifying the loss of turnover can be complicated
- Starting point is the turnover in the corresponding period of the prior year, but we then need to adjust for a range of factors
- Detailed financial data will be needed from Insured throughout the adjustment process





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Complexities in quantifying the loss of turnover



- Ability to “make-up” or mitigate the loss via:
 - trading from other locations
 - utilising spare capacity
 - increased sales after trading resumes
- Impact of Wide Area Damage



Make-up

- In the event of an interruption, some businesses are able to make-up the lost sales
- Strategies include:
 - Trading from other locations
 - Utilising spare capacity in the business
 - Deferring sales until after the business resumes (“claw-back”)
- What types of business might be able to make-up sales ?
- What types of businesses are unlikely to make-up sales ?



Make-up: Turnover from other locations

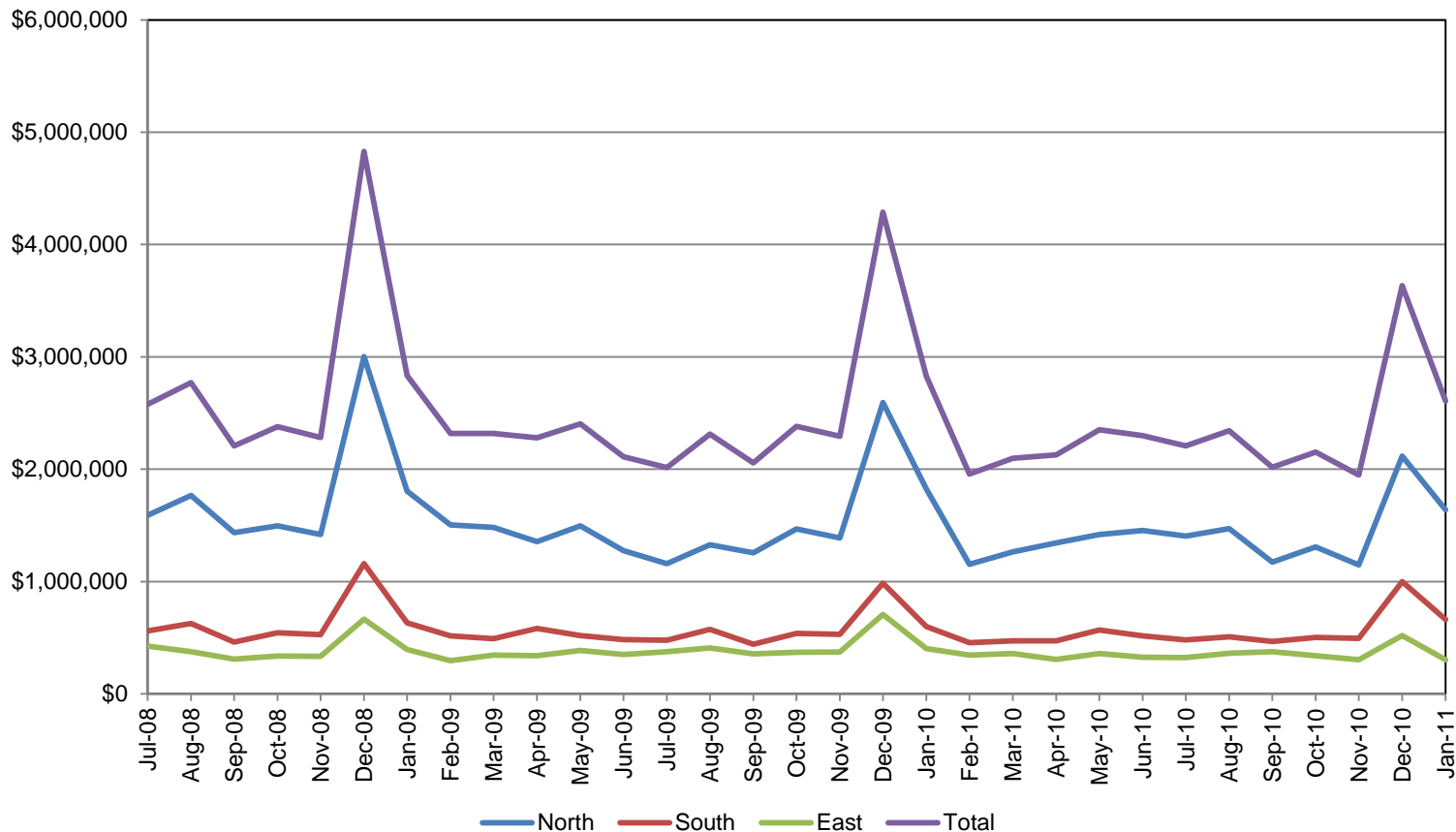


- Some businesses trade from multiple locations
- In the event of an interruption at one location, additional sales may be experienced at other locations.
- What types of businesses might this affect ?
- Any additional sales at other locations are taken into account in the loss quantification.



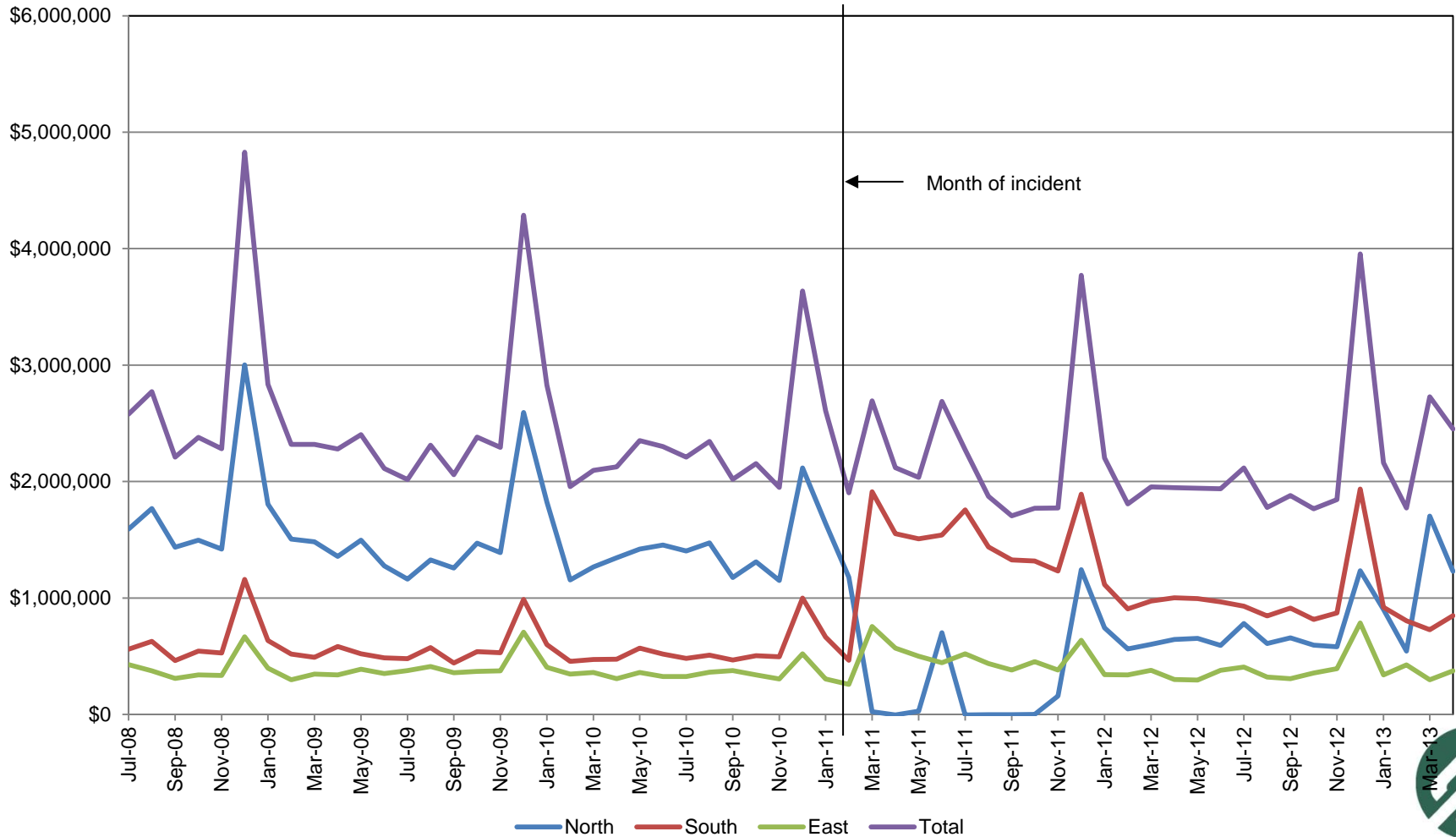
Case study: Computer retailer

MONTHLY SALES - COMPUTER RETAILER (3 STORES)



Case study: Computer retailer

MONTHLY SALES - COMPUTER RETAILER (3 STORES)



Make-up: Utilising spare capacity

- The income-producing assets of a business are not always fully utilised
- In the event of a loss, the impact may be mitigated via the use of spare capacity
- What types of businesses might this affect ?
- Need to measure the extent to which the business has utilised spare capacity in quantifying the loss



Case study - hotel

An 80-room hotel has a fire – hotel operator claimed business interruption as follows:

- 8 rooms smoke damaged
- Repairs take 6 weeks
- Average rate per room - \$180 per night
- Insured claims a loss of revenue of \$60,480
(8 rooms * 42 days* \$180)

What issues might we have with this approach ?



Case study - mine

Dump truck destroyed by fire - Mine claimed business interruption as follows:
Truck replacement repair period - 12 weeks
Truck utilisation 8hrs/day, 7 days per week
Truck Capacity – 22 tonnes - 10 loads per day
Gross Profit per tonne - \$185
Claimed loss of Gross Profit - \$3.4 million

What issues might we have with this approach ?



Make-up: Additional sales upon reopening



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- In the event of an interruption, some businesses are able to defer sales and make them up at a later date (sometimes referred to as “claw-back”).
- What types of business may have claw-back ?
- Indemnity period does not end when the damage is repaired, but when the results of the business are no longer affected (subject to maximum indemnity period).
- Additional sales need to be taken into account in the calculation of lost sales.



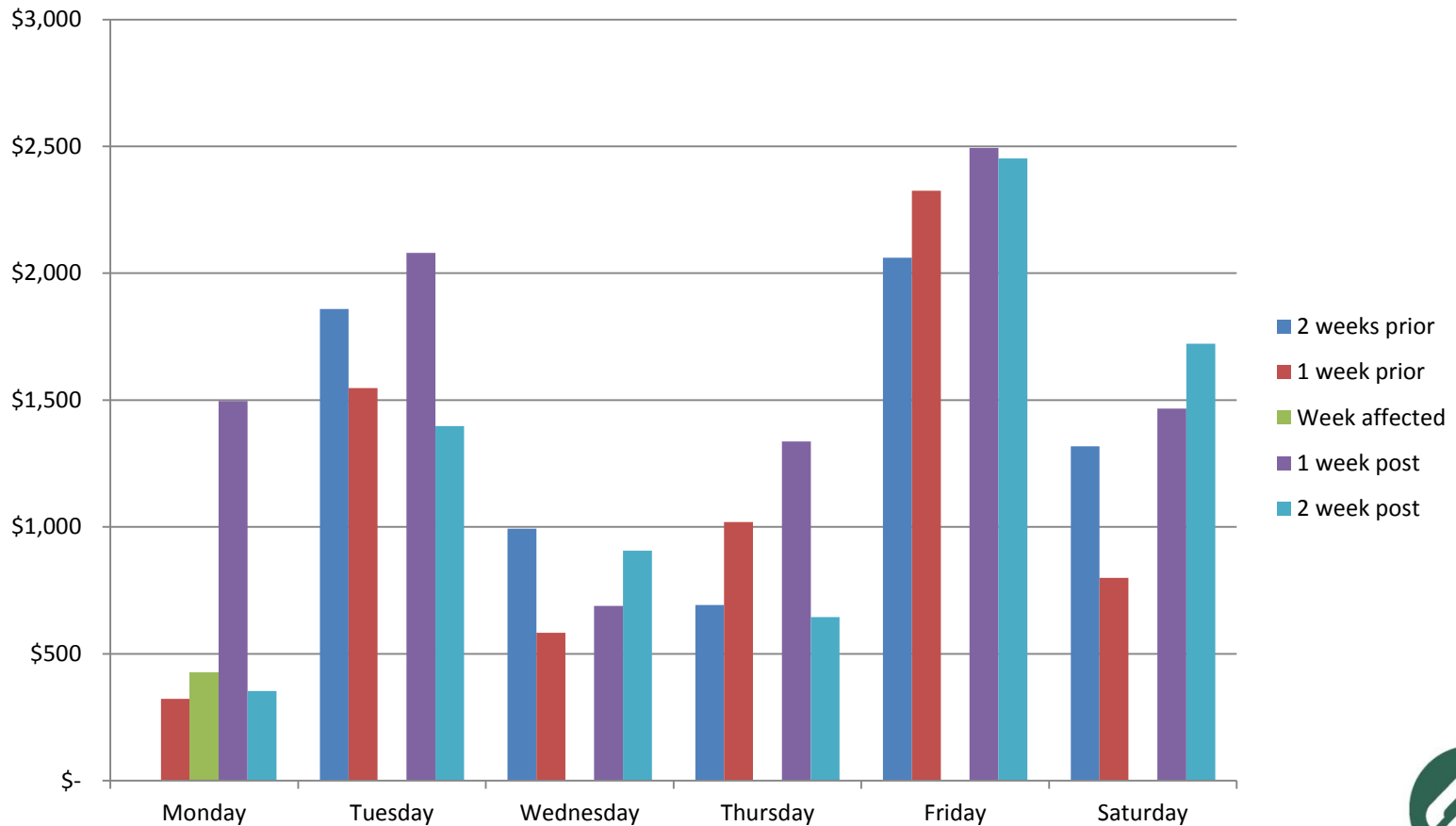
Case study: Hairdresser



Turnover (\$)								
Period	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Total
2 weeks prior	-	1,859.45	993.00	692.50	2,061.45	1,317.80	-	6,924.20
1 week prior	321.95	1,547.95	583.45	1,019.45	2,325.45	798.85	-	6,597.10
Average	160.98	1,703.70	788.23	855.98	2,193.45	1,058.33	-	6,760.65
Week affected	424.50						-	424.50
1 week post	1,495.95	2,079.80	688.90	1,336.90	2,493.60	1,465.95	-	9,561.10
2 week post	353.50	1,397.30	905.95	645.00	2,452.30	1,721.95	-	7,476.00
Average	924.73	1,738.55	797.43	990.95	2,472.95	1,593.95	-	8,518.55



Case study: Hairdresser

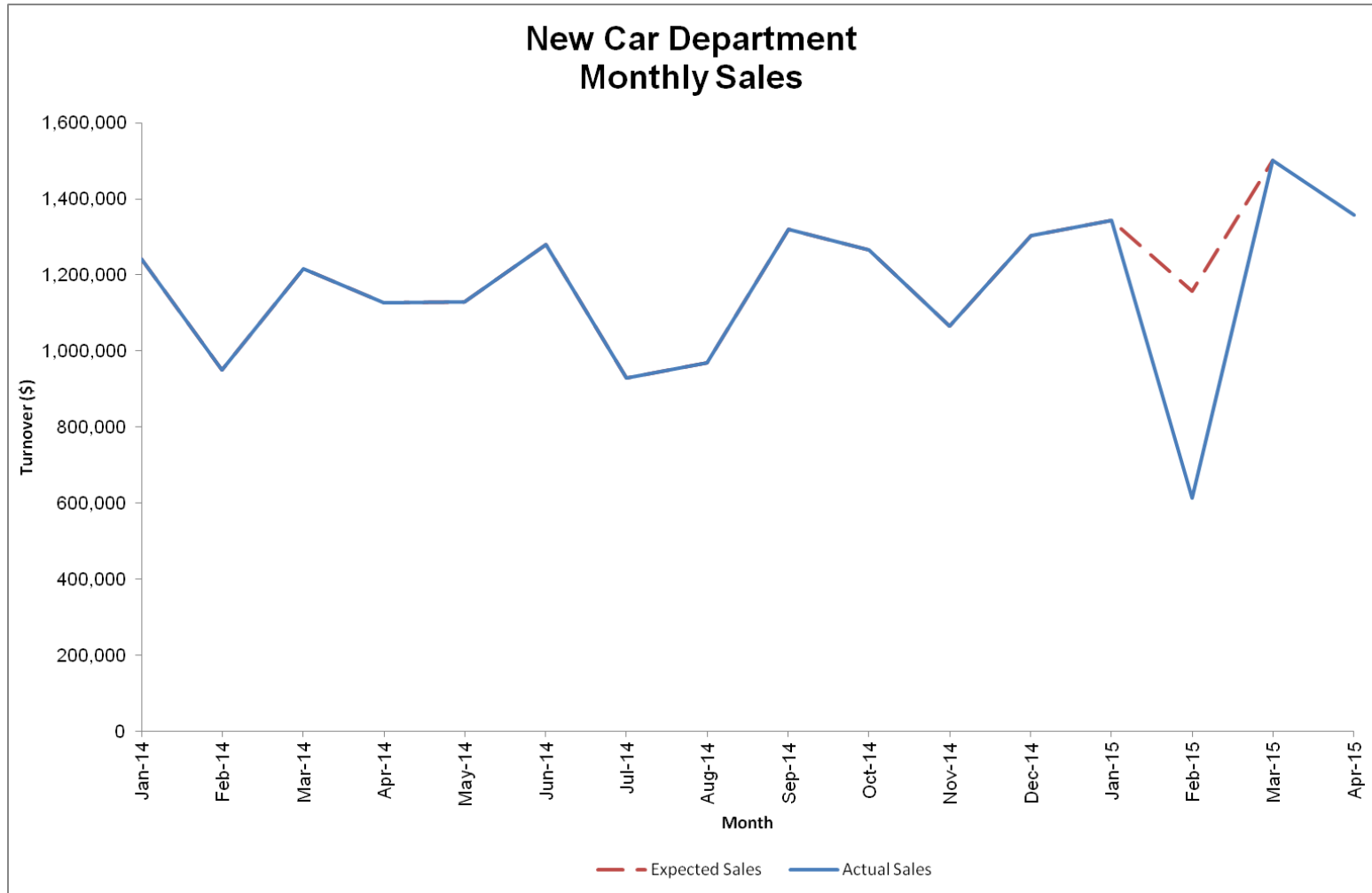


Impact of wide area damage

- The business interruption policy responds to insured damage, not the wide area damage seen after a CAT.
- Adjustments clause means that the impact of the natural disaster should be excluded from standard sales – both the positive and negative impact.
- Disparity between Insured's expectations and policy response on this issue.
- Some NZ policies have optional cover for losses following a natural disaster.



Cyclone Marcia - Rockhampton car dealerships



Increased Costs of Working/ Additional Increased Costs of Working



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Increased Costs (part of Gross Profit cover)

‘The additional expenditure necessarily and reasonably incurred for the sole purpose of avoiding or diminishing the reduction in Turnover which, but for that expenditure, would have taken place during the Indemnity Period in consequence of the Damage, but not exceeding the sum produced by applying the Rate of Gross Profit to the amount of the reduction thereby avoided’

Additional Increased Costs (no economic limit test)

‘The insurance under this item is limited to Increase in Cost of Working (not otherwise recoverable hereunder) necessarily and reasonably incurred during the Indemnity Period in consequence of the Damage for the purpose of avoiding or diminishing reduction in Turnover and/or resuming and/or maintain normal business operations and/or services’



Savings

- Most policies specify that saved expenses will be deducted from the claim:

“We will deduct from your claim any sum saved during the indemnity period for costs and expenses of your business operations that cease or reduce because of the insured damage.”

- Typical savings
 - Utilities
 - Rent and rates
 - Labour
 - Maintenance costs



Questions

