A Common Experience from Hurricane Harvey

Current Issues Facing Businesses Damaged by Catastrophic Loss

By Scott E. Bushnell, CPA, CFF

Introduction

In the aftermath of Hurricane Harvey, the Texas Gulf Coast suffered an estimated $1.25 billion of damage. Much of the damage to businesses was subject to insurance coverage under hurricane coverage, which most Gulf Coast businesses purchase as part of their commercial insurance policies. Hurricane cover usually is adequate for most of the damage sustained in storms such as Hurricane Harvey. However, even though this cover is in place, it may not guarantee that the claim will be adequately adjusted and cover all the losses incurred by the policyholder.

In this article we will be discussing several situations with adjustment of claims and some of the lessons learned from Hurricane Harvey. These situations range from inadequate coverage to mistakes in the adjustment of claims. In order to illustrate these issues, I will use a client that has suffered damage from Hurricane Harvey as a case study.

Background

The subject business is located in Victoria Texas, which was in the direct path of Hurricane Harvey. The business is engaged in sales and distribution of plumbing, HVAC, and industrial safety products, as well as bathroom and kitchen fixtures. The plumbing, HVAC and industrial safety business are operated from a single location with corporate offices and a Warehouse. This location suffered significant damage from the hurricane.

The insurance policy in effect at the time of the hurricane is a commercial property Business Owners Policy which included Business Income and Extra Expense coverage. As part of the all-risk policy hurricane was a covered cause of loss. The limits of coverage were adequate for the loss sustained. So, the Policyholder was confident that the insurance policy would respond to the incident and damage incurred.

Shortly after Hurricane Harvey passed through the area, the adjuster for the insurance company conducted an initial site inspection with the Policyholder. During the site inspection damage to the facilities and inventory was identified as consistent with the hurricane. Business interruption losses were discussed in a general nature and the adjuster did agree that there would be some loss of sales from the hurricane.

Over the following months the adjuster sent his team to the policyholder's location to inspect the business and progress to repair of the facilities and resumption of operations. The policyholder solicited repair estimates from a couple of local contractors to repair the damage to their facilities. As is usual in the circumstances of major hurricane damage, the quotes were verbal and when pressed for a written quote the policyholder received an email with an approximate cost but no detail as to how the cost was determined. This information was sent to the adjuster to substantiate costs to repair the policyholder's facilities.

The policyholder engaged with the adjuster and the insurance company's forensic accountant for assistance with preparing their business income (BI) claim. To the dismay of the policyholder, the adjuster and forensic accountant did not give any assistance regarding the BI claim except to request the policyholder submit a substantial amount of information and the insurance company would prepare the claim.

In response to the adjuster, the policyholder researched how to prepare a BI claim. Although there is plenty of general information available about BI claims, the policyholder was unable to obtain detailed instruction on how to prepare their BI claim. They continued to prepare the BI claim as best as they could and submitted a $150,000 BI claim in November 2018 to the adjuster.

The insurance company's forensic accountant reviewed the BI claim submitted by the policyholder, requested additional information and assessed the claim. This process took the insurance company's forensic accountant approximately 6 months, during which the policyholder routinely asked for up-dates from the adjuster regarding the status of the claim. The insurance adjuster finally received the analysis from the forensic accountant and offered the policyholder $20,000 for their BI claim.

After the policyholder's initial shock, they contacted their insurance broker to discuss the offer and how best to respond to the adjuster. The policyholder and their broker were dismayed at the calculation presented by the insurance company's forensic accountant. The broker requested a review of the claim in order to make sense of it and determine if there were any reasonable critiques of the claim.

Claim Adjustment

The analysis performed by the insurance company's forensic accountant had several significant short comings.

· Period of Indemnity Not Defined

· Form of the Calculation

· Analysis of Lost Sales

· Overall Adjustment

In addition to these items, the overall adjustment of the loss was wrought with a lack of communication from the insurance adjuster. This is becoming all too familiar situation with the adjustment of claims, especially for small to medium sized businesses.

Indemnity Period

One of the most important aspects to BI claims is the period of indemnity. This is the period of time that the business interruption claim is calculated and generally is the period of restoration of the physical assets and resumption of full operations of the business. Additionally, there can be extended period of indemnity which begins at the end of the period of restoration and extends the recovery period for BI claims. Extended indemnity coverage is intended to allow a business to recover losses after the business has resumed operations.

In the case of our client, the week after the hurricane the facility was mucked out and damaged merchandise and fixtures were identified and moved to a staging area. There was damage to the facility itself, but the policyholder was able to resume partial operations at the damaged location. The policyholder sought three estimates to repair the damage to the facility.

The estimate that was accepted by the policyholder would have required approximately 3 weeks to affect the repairs. The estimate was submitted to the insurance company, but it was rejected due to insufficient detail for the scope of work. In any event, the adjuster had an estimate prepared for repair of the damage.

The insurance company's forensic accountant did not appropriately assess the period of indemnity for their calculation of the claim. In that analysis, he timed the period of indemnity from the date of loss to the resumption of partial operations. Additionally, the forensic accountant ended the period of indemnity just 11 days after the resumption of operations. The reason the period ended so soon after partial operations, according to the forensic accountant, is that sales had in a single week exceeded the pre-loss sales. To say the least, this is not consistent with policy wording nor did it fit the reality of the post loss situation.

The rebuttal to this situation was an explanation of the how the period of restoration was developed and the reality of what the business experienced during that period of time. Although the actual construction period was 15 days, crews needed to be assembled, materials needed to be ordered and delivered to the site and all of this during a period of time where resources are scarce due to Hurricane Harvey. The actual period of restoration was determined to be 57 days or approximately 8 weeks. In addition, the insurance policy included coverage for 60 day of extended indemnity. During this entire 117-day period, the policy holder continued to sustain a loss of sales as a result of the damage incurred due to the hurricane.

Practically, the end of the extended indemnity period is either the expiration of the 60 days or the point at which sales returned to the level they would have been had no loss occurred. This language allows for the post loss expected sales to reflect where the market would have been post loss. So, the determination of the end of the period could be a date short of the 60 days stated in the policy. Policyholders should work closely with their claim preparers so that the indemnity period can be adequately analyzed and understood.

Form of the Calculation

The Business Income coverage is a Net Profits form which means the loss is based on the Net Income plus continuing expenses of the business. The calculation prepared by the insurance company's forensic accountant did not adequately address the BI losses incurred by the policyholder.

Firstly, the actual form of the calculation that was prepared by the insurance company's forensic accountant did not adequately assess the continuing the expenses of the business. In most BI calculations the losses incurred are determined by applying a BI rate to total lost sales. This BI rate is the Net Income plus Continuing Expenses expressed as a percentage of sales. In the case of the insurance company's forensic accountant, the continuing expenses were calculated in such a way as to under calculate the losses.

Secondly, the insurance company's forensic accountants did not appropriately analyze historical sales to determine the anticipated sales during the period of indemnity. This analysis is usually done monthly looking back at the 12 to 36 months preceding the loss period. In the case of this claim, which is a common occurrence, the forensic accountant analyzed sales on a weekly basis and adjusted the previous year's weekly sales in order to "correct" the expected sales in month following the loss incident. This correction then led to the forensic accountant to ending the period of indemnity early because one week's sales in the indemnity period was greater than the pre-loss period.

Our rebuttal to this issue in the claim was to prepare a proper analysis which considered the historical sales trends of the business and the likely market conditions had no loss occurred. This analysis considered sales contribution of larger customers as well as the overall value of sales on a monthly basis. This form of the analysis gave a better base line of anticipated post loss sales during the indemnity period. Ultimately on rebuttal the adjuster accepted our form of this analysis as a more realistic picture of expected post loss sales.

Adjustment of the Loss

This is a good point to discuss the overall adjustment of the BI claim. The policyholder early in the claim process went to the adjuster and their forensic accountant for information regarding how to prepare the claim. Neither the adjuster nor their forensic accountant gave the policyholder any constructive information or help. On the contrary, the policyholder was told to submit requested information and that the insurer would calculate the loss.

One of the most frequent comments that policyholders make is the lack of information they are getting from adjusters. In this case the adjuster was not explaining how the claim was being adjusted and the information required for the adjustment. Many times, the first order of business with my client is explaining as much as I can about the claim, generally how they are adjusted and interpreting what little analysis I may have received from my client. Time and again the claims process would have moved much smoother if the adjuster and policyholder had more open communication.

Many times, when policyholders have a major catastrophe they will look to their insurance broker for guidance and direction. As this article has shown, sometimes the best assistance a broker can give their clients is introducing experts that can assist with documenting their claims. When it comes to BI claims this is even more important that policyholders hire a forensic accountant to assist them with preparing their BI claim and rebutting the analysis of the adjuster.