

COVERAGE AND VALUATION ISSUES FOR BUSINESS INCOME LOSSES IN CATASTROPHE CLAIMS IN THE POST-COVID ECONOMY

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The National Oceanic and Atmospheric Administration (NOAA) is predicting another active hurricane season. Setting aside the increased likelihood of hurricane-related claims, 2020 has already been a banner year for catastrophe claims, including tornados and riots. These claims are only being further complicated by the COVID-19 pandemic. More than ever, insurers need to plan ahead to ensure appropriate handling of hurricane and other catastrophe claims, consistent with social distancing guidelines and other restrictions/limitations put in place as a result of the pandemic.

COVID-related regulations are already affecting many businesses, which has resulted in a wave of claims and litigation centering on various business interruption coverages. The effects of these regulations will continue during hurricane season, compounding potential losses. In this white paper, we address coverage and valuation issues that insurance professionals should consider when handling business income losses related to hurricane and other catastrophe claims.

GENERAL PRINCIPLES OF BUSINESS INTERRUPTION INSURANCE

Business interruption insurance is intended to put a policyholder in same position if it was not for the property damage that led to the business interruption.¹ Conversely, it is equally well-recognized that business interruption insurance should not be used to put a policyholder in a better position than it would have occupied if the loss had never occurred.²

These general principles are of increased importance in this post-COVID world. In addition to the coverage issues that typically accompany catastrophe claims, challenges can arise when market conditions or generalized economic forces create a different landscape following the loss, but not resulted from any covered cause of loss. While the resolution of the issue may turn on the specific policy language at issue, courts are split as to whether such conditions are appropriately considered in the evaluation of a business income claim.³

BUSINESS INCOME COVERAGE ISSUES

Business income coverage applies to the actual loss of business income sustained by a policyholder where the policyholder's business operations have been necessarily suspended as a result of direct physical loss or damage to the insured location by a covered peril.

If a policyholder's business is damaged by a hurricane or other catastrophe, the direct physical loss requirement will, of course, be met. However, if the suspension of the policyholder's operations

did not result from that damage, but rather a pre-existing COVID-related restriction, there may be no compensable loss under the policy's business income coverage, or such loss may be reduced.⁴

CIVIL AUTHORITY COVERAGE ISSUES

Civil Authority Coverage applies to situations where access to a policyholder's property is prevented or prohibited by an action of a civil authority. A policyholder may be entitled to recover a loss of business income under these provisions if the business income loss is caused by (1) an action of civil authority; (2) prohibiting access to the policyholder's property; (3) caused by direct physical loss of or damage to property other than the policyholder's property; and (4) the loss or damage to property is caused by a covered cause under the policy.

Disputes frequently arise regarding whether an action of civil authority is the result of direct physical loss or damage to property. In the context of an evacuation order based on a hurricane that is actually occurring at the loss location, courts will generally find that the property damage requirement is satisfied. However, questions exist where orders are made in anticipation of a storm and/or to prevent potential injury/damage, with many courts ruling that no coverage exists where a civil authority order is anticipatory or preventative.⁵

This hurricane season, hurricane evacuation orders may be issued *on top of* existing COVID-related orders. In this regard, we expect that evacuation issues may be more readily issued in areas where emergency response systems and hospitals are already stressed, and, therefore, do not have the capacity to handle the increased strain caused by the hurricane.

Although the issue is presently being litigated, no Civil Authority Coverage exists for business interruptions caused by COVID-related shutdown orders, because such orders were not issued in response to any property damage, but rather to slow the spread of the COVID-19 pandemic. If a business is already closed by a COVID-related order, a subsequent hurricane evacuation order should not create coverage, as doing so would put the policyholder in a better position than he would have occupied had no loss occurred.

INGRESS/EGRESS COVERAGE ISSUES

In addition to Civil Authority Coverage, which applies where an order of civil authority prohibits or prevents access to an insured property, some commercial insurance policies also include an additional coverage for impairment or prohibition of ingress to or egress from an insured location. The key distinction between these two coverages is that Ingress/Egress Coverage is triggered without need for an order of civil authority.

One example of where Ingress/Egress Coverage may be implicated today is Seattle's Capitol Hill Autonomous Zone (CHAZ), where a group of peaceful protesters have cordoned off several city blocks, potentially limited access to business owners in the area.

One issue that frequently arises in Ingress/Egress Coverage is whether the coverage requires physical damage to property to be triggered. The United States District Court for the Eastern District of North Carolina interpreted an Ingress/Egress Coverage provision in *Fountain Powerboat Indus. v. Reliance Ins. Co.*⁶ The provision read:

Loss of Ingress or Egress: This policy covers loss sustained during the period of time when, as a direct result of a peril not excluded, ingress to or egress from real and personal property not excluded hereunder, is thereby prevented.

The *Fountain Powerboat* court stated that the meaning of the ingress/egress provision was “exceedingly clear,” and held that the ingress/egress provision did not require physical damage to trigger coverage.

A small change in the ingress/egress provision can lead to a significantly different result. In *County of Clark v. Factory Mut. Ins. Co.*,⁷ the policy language at issue included a requirement that prevention of ingress/egress be the direct result of physical damage. Based on the use of the term “direct,” the court held that no coverage was provided for losses of business income sustained as a result of the mandatory ground stop order issued by the FAA following the September 11th attacks because prevention of ingress was, at best, an indirect result of the damage to the World Trade Center.

Insurance professions must analyze whether the impairment or prohibition of ingress/egress is a result of direct physical loss, or something else. In this regard, it will be important to understand any and all existing COVID-related restrictions and their impact on the policyholder’s business.

MARKET CONSIDERATIONS IN VALUING LOSS OF INCOME

Valuation of covered business income losses has become increasingly complicated in this post-COVID world. Businesses across the country are still being affected by COVID-related shutdown orders. What happens when a covered loss occurs during a period when the policyholder would not have been permitted to operate? Should the policyholder be put in a better position than it would have occupied had no loss occurred?

As discussed above, courts are split as to whether post-hurricane market conditions are appropriately considered in the evaluation of a business income claim. Courts that have held that the proper method for valuing a business income loss is to look at sales before, rather than after, the interruption have reasoned that “[t]he strongest and most reliable evidence of what a business would have done had no catastrophe occurred is what it had been doing in the period just before the interruption.”⁸ Courts that have taken the contrary position have based their decisions on the policy’s requirement for consideration of the probable future experience of the business.⁹

Determining whether market conditions, including COVID-related restrictions, are appropriately considered as part of a hurricane-related business income claim will depend on relevant policy language, as well as the applicable case law in that jurisdiction. Where the relevant policy language requires consideration of the probably experience of the business had no loss occurred, a strong argument can be made that it is reasonable for an insurer to consider COVID-related restrictions.¹⁰

VALUING BUSINESS INCOME LOSSES

To calculate the business interruption loss, we need to understand the business and how their operations were impacted. We need to understand the who, what, when, where, why and how. The initial phone call with the insured is one of the most important. In that call, we start to gather all of the facts. Once we have a general understanding of the operations and how they were impacted from the event, we can develop our request for information. These requests vary depending on the industry, the period of restoration and other facts surrounding the loss. In general, we request documentation to assist in quantifying the damages (tax returns, profit and loss statements, sales records, production records, inventory reports, payroll, etc.).

Once we have the necessary records, the next step is to project what the sales and expenses during the period of restoration. These projections can be based on a variety of methodologies; averages, trends, budgets, benchmarks from other locations and even post loss sales data. The methodology used depends on the specific business. Our goal is to use the methodology that would best represent what the sales would have been had no loss occurred.

In determining the best methodology, we consider a variety of conditions that may impact what the insured would have achieved during the period of restoration. These can include competition, the ability to make up the sales, holidays, normal shutdowns, introductions of new business lines or products, abnormal weather, new technology, elections, etc. We always have to consider the conditions surrounding this specific insured during this specific period of restoration. Therefore, we also have to consider a change in market conditions.

Specifically, in relation to COVID – 19 we need to consider what the insured would achieve throughout the COVID-19 related shutdowns. Again, this varies by each insured, where they are located, what local restrictions are and their reaction to COVID-19. We have three different scenarios where COVID – 19 will impact our analysis:

1. An insured sustained a loss prior to COVID-19 but the period of restoration continues throughout COVID -19. In this situation, the methodology that we used leading up to March 2020 may need to be adjusted to account for what the insured would have achieved had no loss occurred and they would have been open in March 2020.
2. An insured sustained a loss, such as physical damage from a fire from rioting, during the COVID-19 period. In this situation, we need to determine what the insured would have done within the current restrictions. For example, if an insured historically had their busiest month in June and in June 2020 they sustained a loss, would they have still had their busiest month or had they been shut down since March and actually had no sales planned in June?
3. An insured sustained a loss, such as a hurricane, in August 2020. Now we need to consider what the current restrictions are. We also need to remember that if operations are back to pre COVID-19 conditions, that we cannot use the COVID period as a basis in our projections.

Throughout each of these scenarios, we have many nuances to consider and exactly how to calculate the loss may have some gray areas. Our job as the forensic accountant is to consider all

of the factors to properly quantify the loss during the period of restoration under the conditions of the policy.

¹ See *Berkeley Inn, Inc. v. Continental Ins. Co.*, 422 A.2d 1078, 1080 (Pa.Super. 1980); *Pennbarr Corp. Ins. Co. of N. Am.*, 976 F.2d 145 (3d Cir. 1992); *Dictiomatic, Inc. v. United States Fid. & Guar. Co.*, 958 F.Supp. 594 (S.D.Fla. 1997); *Amerigraphics, Inc. v. Mercury Cas. Co.*, 107 Cal. Rptr. 3d 307 (Cal.App. 2010).

² See *Eidelman v. State Farm Fire & Cas. Co.*, 2011 U.S. Dist. LEXIS 5395 (E.D.Pa. Jan. 19, 2011); See also *Am. Med. Imaging Corp. v. St. Paul Fire & Marine Ins. Co.*, 949 F.2d 690 (3d Cir. 1991); *Dictiomatic, Inc. v. United States Fid. & Guar. Co.*, 958 F.Supp. 594 (S.D.Fla. 1997); *Legier & Co., APAC v. Travelers Indem. Co.*, 2010 U.S. Dist. LEXIS 41554 (E.D.La. Apr. 28, 2010).

³ Compare *Catlin Syndicate Ltd. v. Imperial Palace of Miss., Inc.*, 600 F.3d 511 (5th Cir. 2010), with *Stamen v. Cigna Prop. & Cas. Ins. Co.*, 1994 U.S. Dist. LEXIS 21905 (S.D.Fla. June 13, 1994).

⁴ See e.g., *Celebrations Caterers, Inc. v. The Netherlands Ins. Co.*, 2008 U.S. Dist. LEXIS 7477 (E.D.Pa. Jan. 1, 2008)(granting summary judgment to the insurer on the issue of business income coverage because the policyholder could not prove that its lost rental income was related to the fire at its leased premises).

⁵ See *United Air Lines, Inc. v. Ins. Co. of the State of PA*, 439 F.3d 128 (2d Cir. 2006)(no coverage where civil authority order stopped flights due to 9/11 terrorist attacks, as order based on fear of future attacks); *S. Tex. Med. Clinics, P.A. v. CNA Fin. Corp.*, 2008 U.S. Dist. LEXIS 11460 (S.D.Tex. Feb. 15, 2008)(finding appropriate denial of coverage where evacuation order was due to anticipated threat of damage); *Two Caesars Corp. v. Jefferson Ins. Co.*, 280 A.2d 305 (D.C. App. 1971)(imposition of a curfew to facilitate movement of police and fire equipment was not due to property damage); *Syufy Enters. v. Home Ins. Co.*, 1995 U.S. Dist. LEXIS 3771 (N.D.Cal. March 21, 1995)(denying coverage because no property adjacent to the policyholder's premises sustained physical damage); *Dickie Brennan & Co. v. Lexington Ins. Co.*, 636 F.3d 683 (5th Cir. 2011)(mandatory evacuation order issued due to fear of future hurricane damage was not issued due to property damage in other locations).

⁶ 119 F.Supp.2d 552, 556 (E.D.N.C. 2000).

⁷ 2005 U.S. Dist. LEXIS 47574 (D.Nev. March 28, 2005).

⁸ See *Finger Furniture Co. v. Commonwealth Ins. Co.*, 404 F.3d 312, 314 (5th Cir. 2005); *Catlin Syndicate Ltd. v. Imperial Palace of Miss., Inc.*, 600 F.3d 511 (5th Cir. 2010).

⁹ See *Consol. Cos. v. Lexington Ins. Co.*, 2009 U.S. Dist. LEXIS 8542 (E.D. La. Jan. 23, 2009); *Stamen v. Cigna Prop. & Cas. Ins. Co.*, 1994 U.S. Dist. LEXIS 21905 (S.D.Fla. June 13, 1994); *Berkeley Inn, Inc. v. Continental Ins. Co.*, 422 A.2d 1078, 1080 (Pa. Super. 1980)(recognizing that an assessment of liability for a business interruption loss requires consideration of the probable future experience of the business after the loss).

¹⁰ See e.g., *Consol. Cos. v. Lexington Ins. Co.*, 2009 U.S. Dist. LEXIS 8542 (E.D. La. Jan. 23, 2009).