

# WHAT BUSINESSES CAN DO TO PREPARE FOR HURRICANE SEASON 2023 AND UNDERSTAND THEIR BUSINESS INTERRUPTION COVERAGE



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***The Colorado State University (CSU) Tropical Meteorology Project recently predicted “a slightly below average 2023 hurricane forecast.”<sup>1</sup> CSU forecast thirteen named storms, compared with an average of 14.4 for the period from 1991 through 2020.***

CSU’s report cited the “likely development of El Niño as a primary factor” but with “considerable uncertainty as to how strong El Niño would be if it does develop.”

“Given the conflicting signals between a potentially robust El Niño and an anomalously warm tropical and subtropical Atlantic, the team stresses that there is more uncertainty than normal with this outlook,” the CSU report summary said.

Most financial and risk managers are comfortable understanding and purchasing their property and liability insurance needs and limits to protect their companies from a loss due to an insured peril. However, their comfort level drops dramatically when it comes to business interruption coverage and limits. Due to this discomfort and unsurety surrounding business interruption coverage, extensions of coverage, and respective limits, many middle market organizations find themselves underinsured and short of cash when faced with a major loss.

When you met with your broker to review your insurance policy, you should focus on your reported or insured values for your business interruption coverage and the numerous extensions of coverage’s offered based on your organizations specific operations and needs. Calculating the appropriate business interruption values will help you select the proper coverage and respective limits and enable you to better manage—and more importantly—minimize your financial risk.

Unexpected occurrences can happen to any business, and a company may not be fully prepared when it is directly or indirectly affected by an outside event. Whether the event is a hurricane, flood, earthquake, or fire, the disaster can be catastrophic. Even when there is advanced warning for an event such as a hurricane, prudent companies prepare for the unexpected while also considering the safety of employees and customers. A catastrophic event can shut down a business for an extended period, dramatically affecting a company’s ability to generate future profits and pay employee wages.

<sup>1</sup> CSU Tropical Weather & Climate Research, “CSU researchers predicting slightly below-average 2023 Atlantic hurricane season,” Colorado State University (April 13, 2023). <https://tropical.colostate.edu/Forecast/2023-04-pressrelease.pdf>

## Action Steps to Respond to Disasters

Businesses can take several steps to respond to disasters:

1. The most important step is to protect employees' safety. Some service businesses, such as hotels or restaurants, also must consider the safety of guests. Protecting employees and guests and knowing how to evacuate them successfully is essential.
2. Losses related to physical property can be mitigated by boarding up windows, shutting down damaged utilities, and/or moving inventory and stock to a safer location.
3. Preserving financial records that are required for tax, operations, and insurance purposes is also critical. Historical records help a business demonstrate lost profits during a period in which it is completely or partially shut down.
4. A business must then put into action its disaster recovery team to assist with safety and property preservation.
5. If the damage is covered by the insurance policy, call the insurance broker. The broker will put the insurance company on notice, which will trigger the assignment of an adjuster. The adjuster should try to reach the physical location as quickly as possible and assess the extent of the damage to the property. A first-hand look by the adjuster is always better than taking photographs and conducting remote interviews. The adjuster's presence physically on site may speed up the recovery process, can facilitate obtaining an advance more quickly, and may result in a timelier resolution of the claim.

## Property Claims after a Disaster

The property loss aspect of a disaster often is most likely where a company will incur an immediate outflow of cash. The restoration process for an impacted facility requires immediate attention, whether it involves removing flooded property or drying out a building to avoid mold issues. Having an insurance company's adjuster assess damage in the immediate days following a loss can help a business obtain estimates from restoration companies more quickly to begin remediation or restoration work. An insurance company also can help to fund short-term cash outflows. Depending on the length of time a business is completely or partially shut down, an adjuster for the insurance company may consider providing a business an interim cash advance based on projected lost profits covered by the business interruption section of the policy.

A business interruption claim for lost profits takes a lengthy time to prepare and settle because lost profits cannot be determined until actual profits or losses during a period of interruption are known and quantified. Insureds can benefit from having an experienced forensic accountant included with their team of professionals during a loss to start calculating pro forma revenues as soon as possible. Pro forma revenues are the estimated/projected revenues the company would have earned "but for" the loss. The forensic accountant will then take the pro forma revenue and subtract the actual revenue recorded by the company during the period of interruption to derive the "lost revenue." Once the lost revenue is calculated, additional calculations are prepared to ultimately determine the estimated lost profits, which will be the amount of the business interruption claim submitted to the insurance company. This process can be one of the most challenging and complex coverage areas for insureds. In order to recover, it must be made clear during the claims process that coverage is for lost profits, not lost sales or revenues; insurance covers a loss to the bottom line, not the top line.

## Protection against Business Interruption

Business interruption insurance is a primary form of insurance that protects against disruption of operations and resulting lost profits. However, a company can purchase other extensions of coverage, which it should discuss with its broker. One extension of coverage, Extended Period of Interruption (EPI), protects a company against losses that extend past the actual period of interruption. For example, if a manufacturing business is shut down for four weeks (the period of interruption), and it takes an additional four weeks to restore manufacturing operations back to its pre-loss production, a business may purchase coverage for the period after repairs and restorations are complete. EPI provides coverage for lost profits during the “ramp-up period” following physical restoration and until a business is back to operating at pre-loss levels.

Contingent Business Interruption (CBI) coverage can enable the business to recoup lost profits as a result of the property damage at a supplier, customer, or feeder property even though the property may not have incurred damage or shutdown operations.

Another extension is for ordinary payroll. Management and salaried employees are covered as a continued expense in a loss, but hourly nonmanagerial employees are not. If you have hourly skilled labor or are located in a tight labor market and cannot afford to lose trained workers from not continuing to pay them during a shutdown, this extension of coverage will allow you to pay them while shut down for the period of time you purchase coverage (normally purchased in number of days from 30/60 up to 365 days).

Another important extension is claim preparation fee coverage. This enables the company to hire a forensic accounting firm to help them identify information needed for and prepare and present a claim to submit to the insurance company. With this coverage, the fees incurred to perform the work preparing the claim can be included in the claim submitted. This means that the claim preparation fees will be reimbursed by the insurance company even though the forensic accountant was engaged by the insured and worked for the insured.

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## Conclusion

Senior management must understand the impact and ramifications of a catastrophic event affecting their business now that we are in hurricane season. Management must simulate what would happen and how they would develop and quickly effectuate alternative suppliers, manufacturing operations, warehousing, distribution, technology, and other operational components to get back on their feet with minimal disruption to their supply chain, manufacturing, or distribution of their products or services. Executives must also understand and be able to quantify the amount of financial risk they want to transfer to the insurance company by purchasing the appropriate insurance coverages and limits of insurance, including their financial appetite for deductibles. Companies should consider having a coverage attorney review policy language to help an insured understand what it has purchased and agreed to in the language of a policy. Coverage and limits in a policy ultimately must provide the financial resources a company requires to repair, restore, and return to its operations as quickly as possible.

CFOs and CEOs should closely examine with their brokers their business interruption values, dollar limits, and available extension of coverages in their current policies. Insurance may not make your company whole in every loss scenario; however, it can be one of your most valuable assets, providing the critical working capital needed to survive during a catastrophic event.

## About the Author

Bob Glasser is a managing director in Berkeley Research Group's Business Interruption Claims practice, based in New York and Denver. He is a Certified Public Accountant, Certified Fraud Examiner, Certified in Financial Forensics, a Certified Insolvency and Reorganization Accountant, and a Chartered Global Management Accountant. He has over thirty-five years of diverse financial management and accounting experience at public and private companies. Mr. Glasser helps insured businesses prepare and substantiate business interruption and property damage claims resulting from physical damage due to hurricanes and other perils. His experience covers a wide range of industries, including hospitality, manufacturing, retail, and service organizations.



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