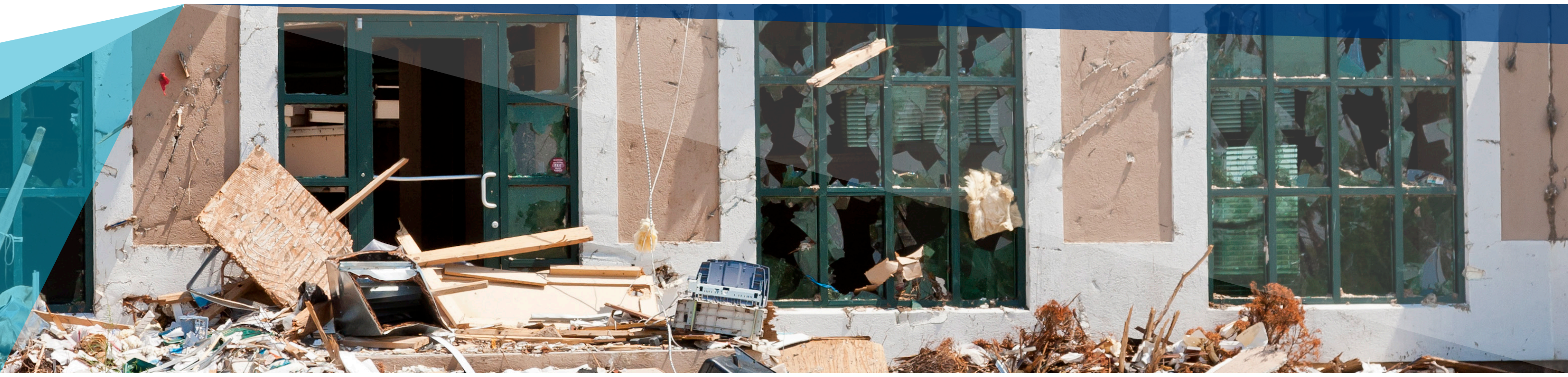
TAKING STOCK

TAKING INVENTORY OF SEVERE WEATHER EVENTS: LESSONS LEARNED



As the summer of 2017 was coming to a close, many retailers were bracing themselves for the usual back-to-school shopping rush — a significant factor in their third-quarter sales. However, the revenue tide quickly turned when Hurricane Harvey made landfall in Texas as a Category 4 hurricane just before Labor Day weekend. The storm stalled above the state and dumped an estimated 27 trillion gallons of rain water, leaving many retailers under water.

Thus kicked off a record-breaking number of severe weather events in Fall 2017, which left the US facing over $200 billion in hurricane damages alone—the second costliest mainland US hurricane season. The 2017 hurricane season was unique not only for the frequency of the hurricanes, but also the concurrent wildfires, mudslides, and earthquakes that added to resourcing challenges for insurance providers, recovery contractors, and federal aid in some areas. Many retailers' margins were impacted by these events either by the loss of product, compulsory discounts to move excess inventory, or supply chain issues.

RECOVERY

For some retail companies, the lost profits associated with these events may be partly recoverable via commercial property policies. The extent to which retailers will recover lost profits under their policies will depend on the amount of coverage provided and—more importantly—specific policy language.

Unfortunately, many retailers felt surprised by some of the terms and conditions of their policies, including sublimits, deductible applications, and definitions. While most of the 2017 claims are still in progress, it's clear that the retailers that are recovering the fastest and most completely are those who were prepared and thoroughly understood the four corners of their insurance programs.

THE ORIGIN OF LOSSES

In addition to damage sustained directly from wind, fire, and flood, retail businesses can also suffer from several indirect sources of loss. These can include:

- Loss of sales due to service interruption/lack of power.
- Loss of sales resulting from the inability to access retail establishments due to the flooding of roads and parking lots.
- Loss of sales due to orders from civil authorities, which may have closed retail shops during storms and other events.
- Loss of sales from customers that stayed home leading up to, during, and immediately following natural catastrophes.
- Reduced margins associated with discounts needed to move inventory buildup.
- Looting.

Given the unique nature of Hurricanes Harvey, Irma, Jose, and Maria, insureds will need to evaluate flood and wind insurance

TIPS TO HELP RETAILERS NAVIGATE CLAIMS CHALLENGES

- Retain building, construction, and accounting consultants to effectively work with insurers, who typically have these same experts on their teams.
- Define and calculate the scope of damage and timeline to repair/replace damaged property to help clarify the period of indemnity/closure.
- Understand the policy valuation (cost vs. selling price) and whether you have control over what happens to your damaged merchandise.
- Know how your policy will respond to the following components of business interruption:
  - Trending and projecting sales losses.
  - Inventory at selling price.
  - Expected turnover of damaged inventory v. the period of indemnity.
  - Multiple locations nearby loss location.
  - Website sales, loyalty card tracking, etc.

policies carefully to determine the predominant cause of loss. For most non-coastal locations, flood is likely to be the predominant cause, as most insurers define flood separately from named wind. If time element coverage is provided, extensions may exist to help recover lost profits from the indirect sources of loss listed above. Some key questions when evaluating storm loss recovery will include the following:

- How is “named storm” defined in the policy? Does the definition include minimum wind speeds in order for a storm to qualify as a named storm? What portion of the insured’s loss was caused by wind versus flood?
- How is storm surge treated by the insured’s policy?
- What deductible(s) will apply? Does the insured’s policy contain a stipulation about how the policy will respond when two or more deductibles apply to the same occurrence?
- Do affected locations reside in a known flood zone? Does any flood insurance exist through the National Flood Insurance Program?
- What qualifying periods or distance limitations associated with various time element extensions exist in the insured’s policy?
- What property and/or perils exclusions exist on the policy?

KEY INSURANCE CLAUSES

Once the above questions have been addressed and discussed, there are several key clauses in commercial property insurance policies that will determine the extent to which losses are recovered.

VALUATION — LOSS OF FINISHED STOCK INVENTORY

Retail companies can benefit from valuing finished stock on a selling price basis at the time of loss as opposed to a replacement cost basis. This supports recovery of the anticipated profit associated with damaged or destroyed inventory without having to prove that it would have been sold. Retailers that value stock at cost and then seek recovery as part of standard business interruption coverage often find this more complex since recovery is based upon the insured’s ability to demonstrate that such inventory would have been sold.

Additionally, replacement cost basis policies allow carriers’ adjusters to consider the likely experience of the business following the loss. In the case of the recent natural disasters, adjusters may conclude that retailers were forced to discount prices to clear out inventory post storm and factor those lower selling prices into the loss adjustment.

SERVICE INTERRUPTION (OFF PREMISES POWER)

A property damage extension is intended to cover spoilage loss to inventory resulting from the interruption of power, while a time element extension is intended to cover any business interruption loss resulting from the interruption of power. This coverage often carries a waiting period of 24 to 48 hours.

Some policy forms may limit the damage to the premises of the utility supplier only and not extend to power interruption losses caused by damage to transmission and distribution (T&D) lines. Some forms may also contain a distance limitation stipulating that the utility suffering insured physical damage must be within a certain distance of the insured's retail location that suffered the service interruption loss in order for coverage to be triggered. Both of these limits may be negotiable.

INGRESS/EGRESS

This time element extension may indemnify the insured for its time element loss during the period of time when—in connection with or resulting from an insured peril—access to real or personal property (i.e., a retail store) is impaired. While some policy forms require that access be completely denied in order for this extension to respond, insurers may allow for coverage to respond once access is partially impaired. In addition, some forms require that access be prevented due to an insured peril that causes physical damage to property of the type insured by the policy.

CIVIL OR MILITARY AUTHORITY

When access to retail property is prevented or impaired by order of civil or military authority issued in connection with or following an insured peril, this time element extension may indemnify the insured for time element losses resulting from an interruption of business. Some carriers require that actual physical loss by a named peril be the cause of the civil authority order and that access be completely denied. Similar to ingress/egress, the policy may be negotiated to respond if the order of civil authority is given in connection with or resulting from an insured peril versus damage to property of the type covered by the policy. Additionally, the policy may be expanded to also respond during a partial impairment of access as opposed to complete denial of access. This coverage extension is typically subject to both a sublimit and time limit of 30 to 60 days.

VISUAL INTELLIGENCE

Given the billions of dollars in losses from severe weather events last year, the ability to gather information under difficult conditions at an early stage was vital to recovery. Visual intelligence technologies are being developed at a rapid pace and are making a difference in managing catastrophic disaster response and claims assessment for insureds and insurers. In 2017, Marsh combined expert analysis with images from drones, fixed-wing aircraft, helicopters, satellites, and open source intelligence — such as traffic cameras, YouTube, Facebook and Twitter — to provide our clients with real-time insights for initial loss projections.

These technologies and analyses provided [many of] our clients with many layers of data, helping their claims processes move swiftly and effectively. In fact, we brought to the attention of a car part retailer that they had in fact incurred storm damage at a location they thought had been unaffected by the storm. The value of this data is clear and many clients have asked that their

retail locations be added to our system in advance of next year's hurricane season.

TAKING CARE OF YOUR PEOPLE

As retail companies began their 2017 recovery efforts, they needed to focus their attention on their most valuable asset: their employees. Some retail companies have helped their employees through such difficult times by providing them with the tools and advice to navigate unfamiliar claims processes. Marsh Risk Consulting (MRC) and Marsh's Claims Advocacy Practice joined together to provide employees of our retail clients with access to our deep expertise in claims issues and catastrophic event crisis management. During their time of need, we were able to provide the support these retail employees needed to recover as quickly as possible and return to their normal lives.

LOOKING TO THE FUTURE

It is common for insureds to review their insurance policies in the wake of a loss. However, the most important time to review policies and understand the scope of coverage is before a loss happens. The words matter.

By taking the above actions, retailers can help mitigate the impact of severe weather related disruptions on their inventory and bottom line.

This briefing was prepared by Marsh's Retail/Wholesale Practice, in conjunction with Marsh's Property Practice and Marsh Risk Consulting.

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