

California Insurance Law Coverage Newsletter for Attorneys

Bruce Cornblum - Insurance Coverage Scholar-Attorney-Litigator
11665 Avena Place, Suite 203A, San Diego CA 92128
858-485-8770 email cornblum@pacbell.net

December 27, 2010

website: brucecornblum.com

CALCULATION OF BUSINESS INTERRUPTION

Gross income

Policies define ‘gross income’ in varying ways in order to arrive at the business’s ‘net sales’ which would have been earned during the interrupted period. An exemplar definition is set forth in *Baxter Intern., Inc. v. American Guarantee and Liability Ins. Co.*, 369 Ill. App. 3d 700, 308 Ill. Dec. 198, 861 N.E.2d 263, 267 (1st Dist. 2006)] Gross earnings is defined as the sum of

- a. total net sales value of *production* (manufacturing operations);
- b. total net sales of merchandise (mercantile operations);
- c. other earnings derived from operations of the business, less the cost of
 - (1) raw stock from which production is derived;
 - (2) supplies consistent of materials consumed directly in the conversion of such raw stock into finished stock or in supplying the service sold by the insured;
 - (3) less cost of merchandise sold, including packaging materials thereof;
 - (4) less cost of services purchased from outsiders (not employees of the insured) for resale which do not continue under contract.

“Gross earnings” include all of the business’s earnings during the period of interruption including those earnings realized from the insurer’s indemnification of damaged *finished goods*. [*Baxter Intern., Inc. v. American Guarantee and Liability Ins. Co.*, 369 Ill. App. 3d 700, 308 Ill. Dec. 198, 861 N.E.2d 263, 268–269 (1st Dist. 2006)]

Valuation of finished goods

An insured is indemnified by an amount equal to what the insured would have realized had it been able

to sell the finished inventory in the open market. [*Baxter Intern., Inc. v. American Guarantee and Liability Ins. Co.*, 369 Ill. App. 3d 700, 308 Ill. Dec. 198, 861 N.E.2d 263, 269–270 (1st Dist. 2006)]

ILLUSTRATION: In *Baxter International Inc. v. American Guarantee & Liability Ins. Co.*, the insurer paid Baxter the amount Baxter would have received had Baxter been able to sell the inventory. Of the \$30.7 million the insurer paid in damages to Baxter’s inventory, *about \$15 million accounted for loss profit*. [861 N.E.2d 263, 266]

Upon payment of indemnity for the finished inventory, this amount is included in ‘gross earnings’ during the period of interruption.

Gross earnings definition that permits indemnity even in the absence of net profit

In *Washington Restaurant Corp. v. General Ins. Co. of America*, 64 Wash. 2d 150, 390 P.2d 970 (1964), the business interruption policy provided coverage for ‘actual loss sustained to gross earnings’ up to a monthly maximum of \$3,000. The policy contained no definition of gross earnings. The court held that the language permitted the insured to recover \$3000 in gross earnings in each month regardless of a lack of any net profit.

Where sales are made up at a later date

An issue that comes up with some frequency is whether there is actual loss sustained where the sales are made up at a later date. In *Finger Furniture Co. Inc. v. Commonwealth Ins. Co.*, 404 F.3d 312 (5th Cir. 2005), the furniture store was flooded. The store closed on June 9 and part of June 10. The following weekend, the insured discounted its prices and sales dramatically

increased. The insurer argued that the insured suffered no actual loss, as sales it lost on June 9-10 were made up the following weekend. This argument was rejected, as the court looked to policy language which calculated business interruption on historical sales figures and therefore the strongest, most reliable evidence of what the business would have done had the event not occurred was the period just before the interruption. There was nothing in the policy language that allowed the insurer to take into account post-damage sales when determining actual loss. See Brunner & O'Connor Construction Law § 11:116.48.

“Operating expenses” coverage; separate and distinct from business income calculations

When a catastrophic event causes damage to an insured’s business premises and prevents the insured from being able to operate, any business in that situation would face two distinct problems: (1) a loss of money coming into the business (loss of income) and (2) payment of ongoing *fixed expenses*, even though no money is coming in. A reasonable insured

would see that the definition of ‘*business income*’ has two distinct components (i) net income, and (ii) continuing normal expenses. Because the definition provides that ‘business income’ includes both items, a reasonable insured relying on the plain language of the clause would reasonably conclude that the policy covers *both items*. [*Amerigraphics Inc. v. Mercury Cas. Co.* (2010) 182 Cal.App.4th 1538, 1553, 107 Cal.Rptr.3d 307] Thus the policy protects *both* its lost income stream *and* as defraying the cost of ongoing expenses until operations are restored. [*Amerigraphics Inc. v. Mercury Cas. Co.* (2010) 182 Cal.App.4th 1538, 1554, 107 Cal.Rptr.3d 307 (holding that a business that is losing money at the time of the interruption can nonetheless be fully reimbursed for its ‘operating expenses’ incurred during the suspension of business)] *Amerigraphics Inc v. Mercury Cas. Co.* disapproved of the out-of-state cases of *Continental Ins. Co. v. VNE Corp.* (1992) 834 S.W.2d 930 (Tennessee) and *Dictiomatic Inc. v. US Fidelity & Guar.* (S.D. Fla 1996) 958 F.Supp. 594, holding that where there is a substantial loss of business income, operating expenses are reduced by the loss. [182 Cal.App.4th 1538, 1552]

The 2010 Two-Volume Edition of CALIFORNIA INSURANCE LAW DICTIONARY AND DESK REFERENCE (16th Edition – 4400 pages) authored by Attorney Cornblum is available through Thomson West.

To order this 2-Volume text call West (a Thomson Reuters business) at

1-800-344-5008.

Author BRUCE CORNBUM, Attorney at Law

Bruce Cornblum is an acknowledged expert in the field of insurance law. For 45 years Mr. Cornblum has specialized in proving to California courts that insurance companies do not understand the meaning of their own policies.

To obtain coverage opinions, preparation of pleadings, supervision of discovery, pre-trial conference, preparation of motions in liminae, preparation of appellate briefs if called for, contact Bruce Cornblum at **858-485-8770** or E-mail: cornblum@pacbell.net . Mr. Cornblum also offers a **FREE 45 minute** consultation to discuss any existing or new insurance case issue.

Mr. Cornblum has been appellate counsel for the Courts of Appeal and Supreme Court in over 100 litigated matters.

BRUCE CORNBUM
11665 Avena Place, Suite 202A
San Diego (Rancho Bernardo), California 92128
858-485-8770
Website: www.brucecornblum.com

