



Cunningham 
& Lindsey

A presentation to...

New Zealand Insurance Law Association
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Christchurch Earthquakes and BI Claims

Two topics:

- Depopulation
- Practical calculation issues - Synergy

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Depopulation:

- Policy pays the loss arising from Damage:
- adjusted as may be necessary to provide for trend and any other circumstances affecting the Business before or after the Damage, or that would have affected the Business had the Damage not occurred, so that the result will represent, as nearly as practicable the results of the Business that would, but for the Damage, have been obtained during the relative period after the Damage

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Depopulation?

- Negative connotations
- “Repopulation”
- Market Effects Adjustment

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Market Effects:

- People move (demand changes)
- Other businesses move (supply changes)

“But for the damage” – both need to be taken into account.

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Demand changes:

- Depopulation, people move away (locally or regionally)
- People stay, but buy less
 - Why?
- Prevention of access
- Public authorities
- Customers' premises (houses?)

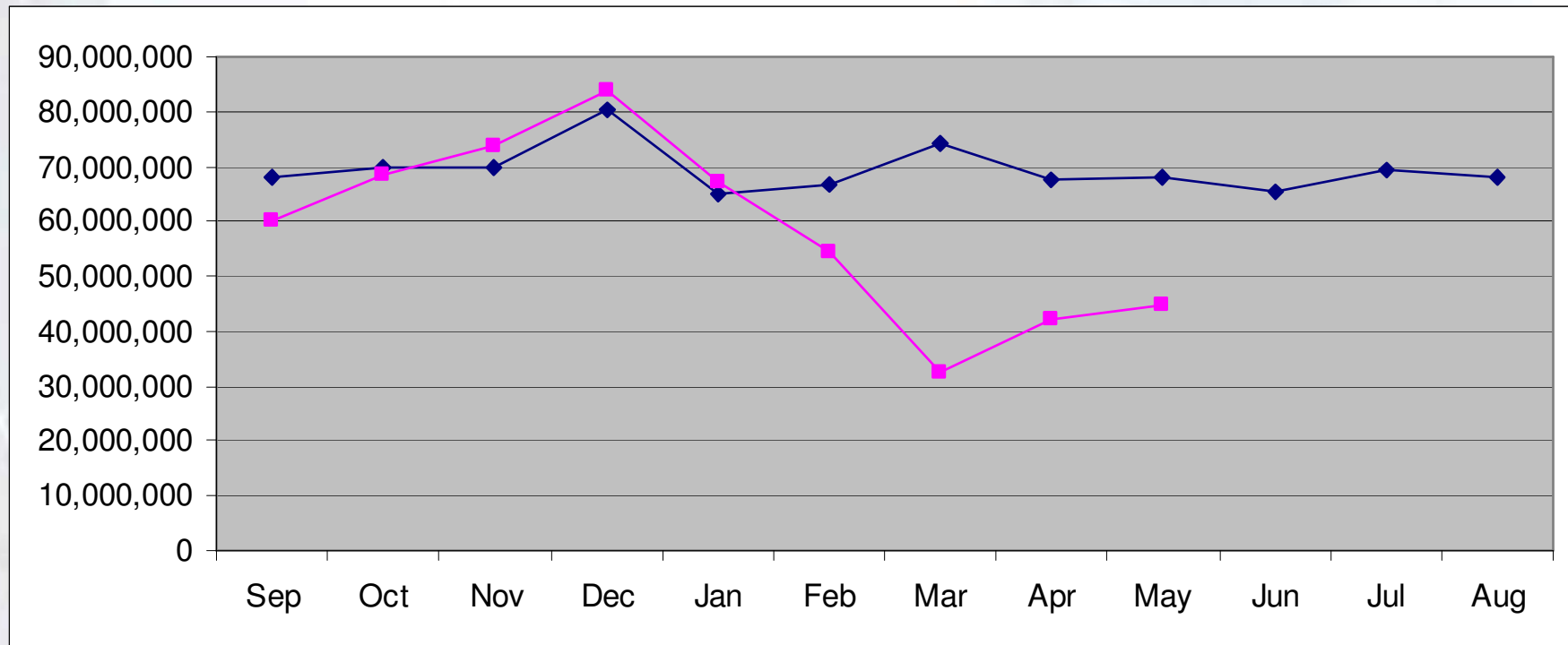
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Supply changes:

- Other businesses damaged, or within cordon

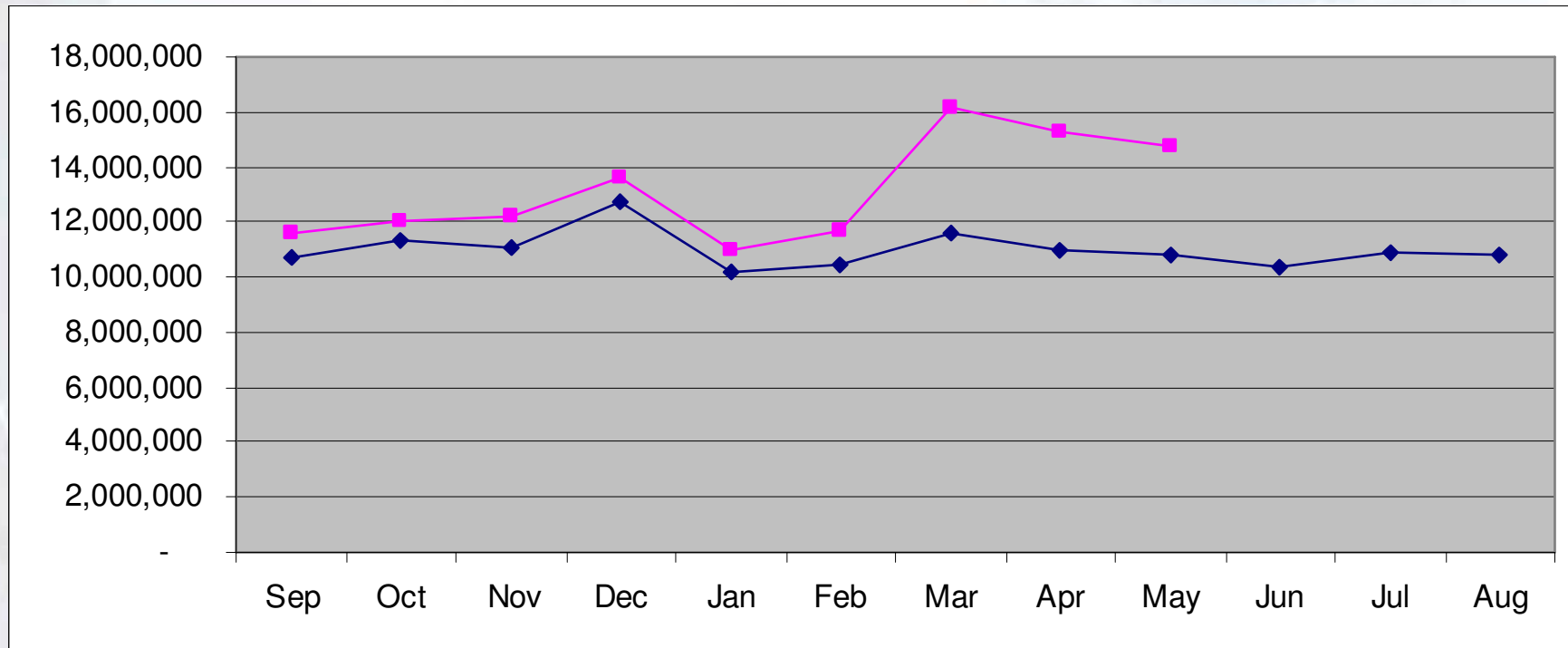
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Demand Changes – Christchurch Central:



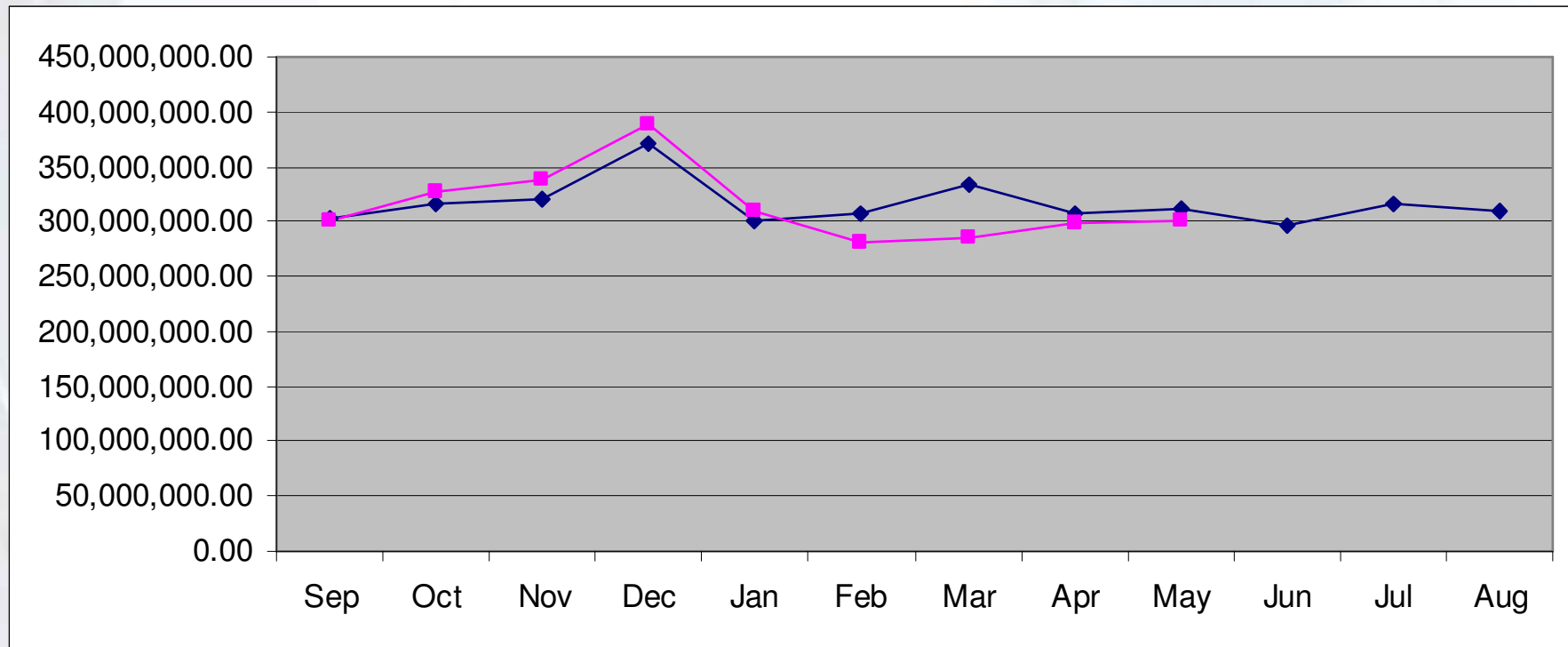
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Demand Changes – Addington:



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Demand Changes – Region:



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Example:

- *Pub*

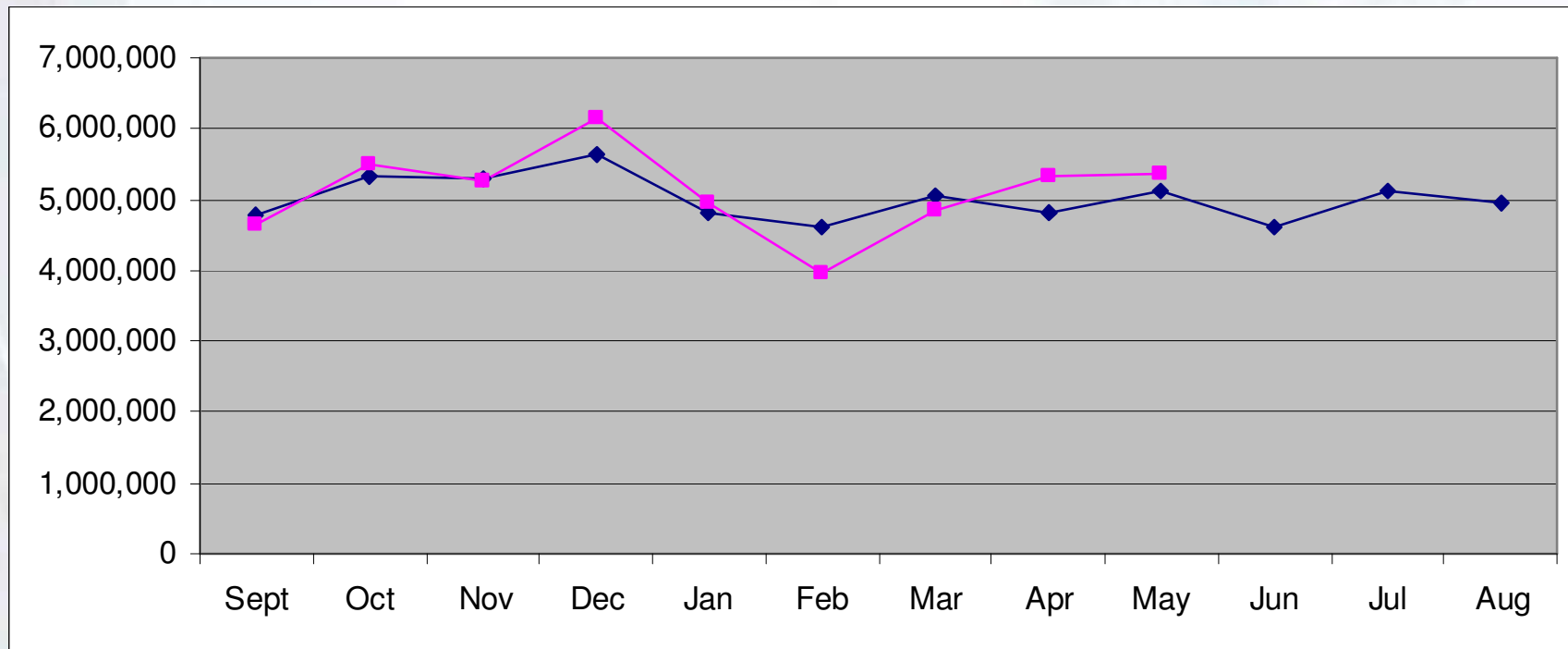
Christchurch residents spent \$22.8m on pokie machines between April and June, compared with \$19m from January to March. The city's share of national pokie revenue increased from 9.3 per cent to 10.4 per cent during the same period.

— *Press report*

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Example:

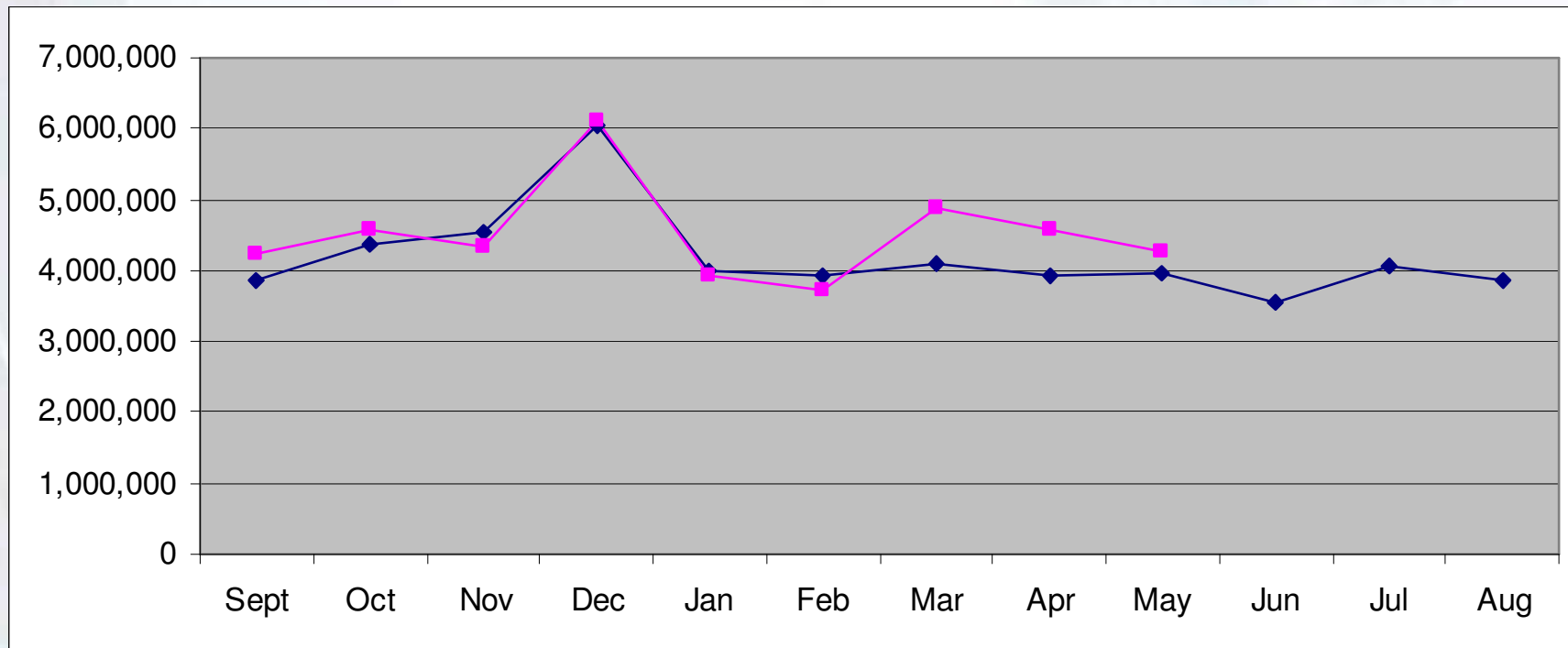
- *Pubs / Taverns / Bars*



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Example:

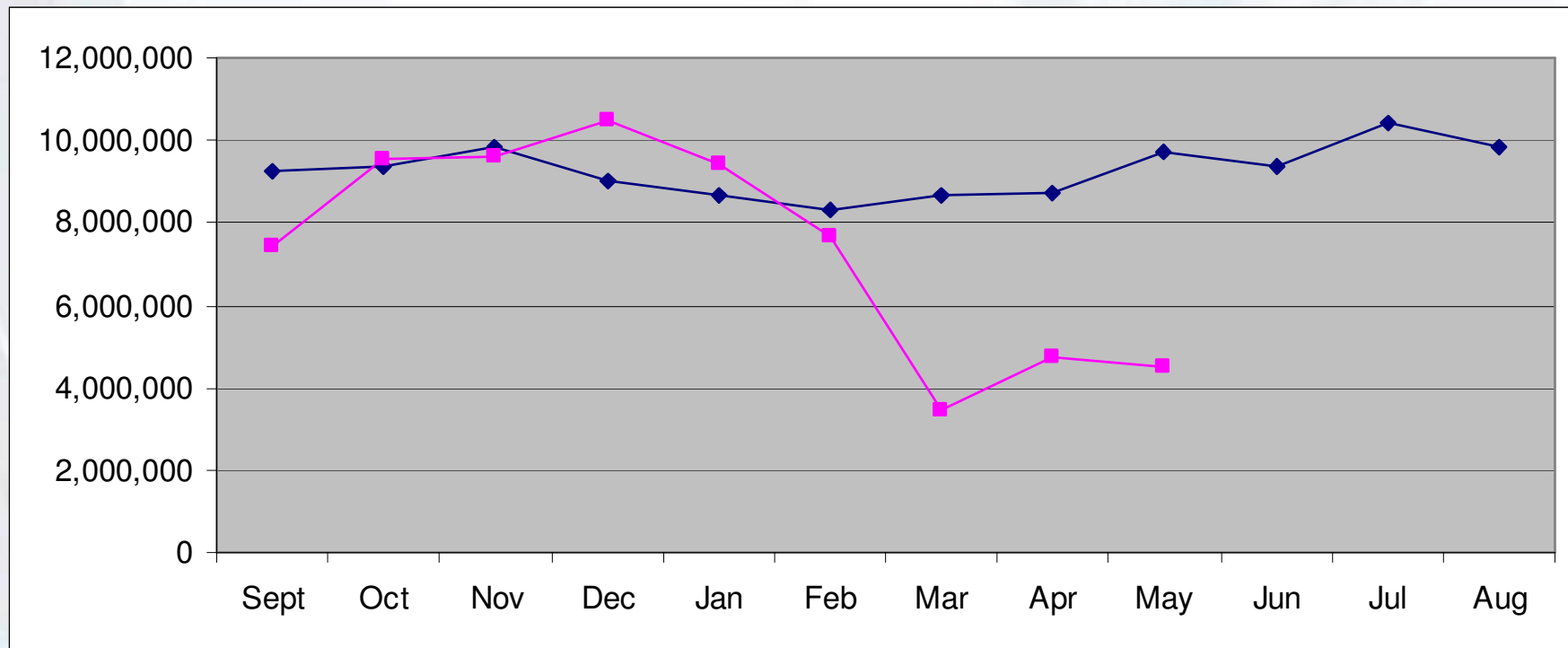
- *Liquor*



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Example:

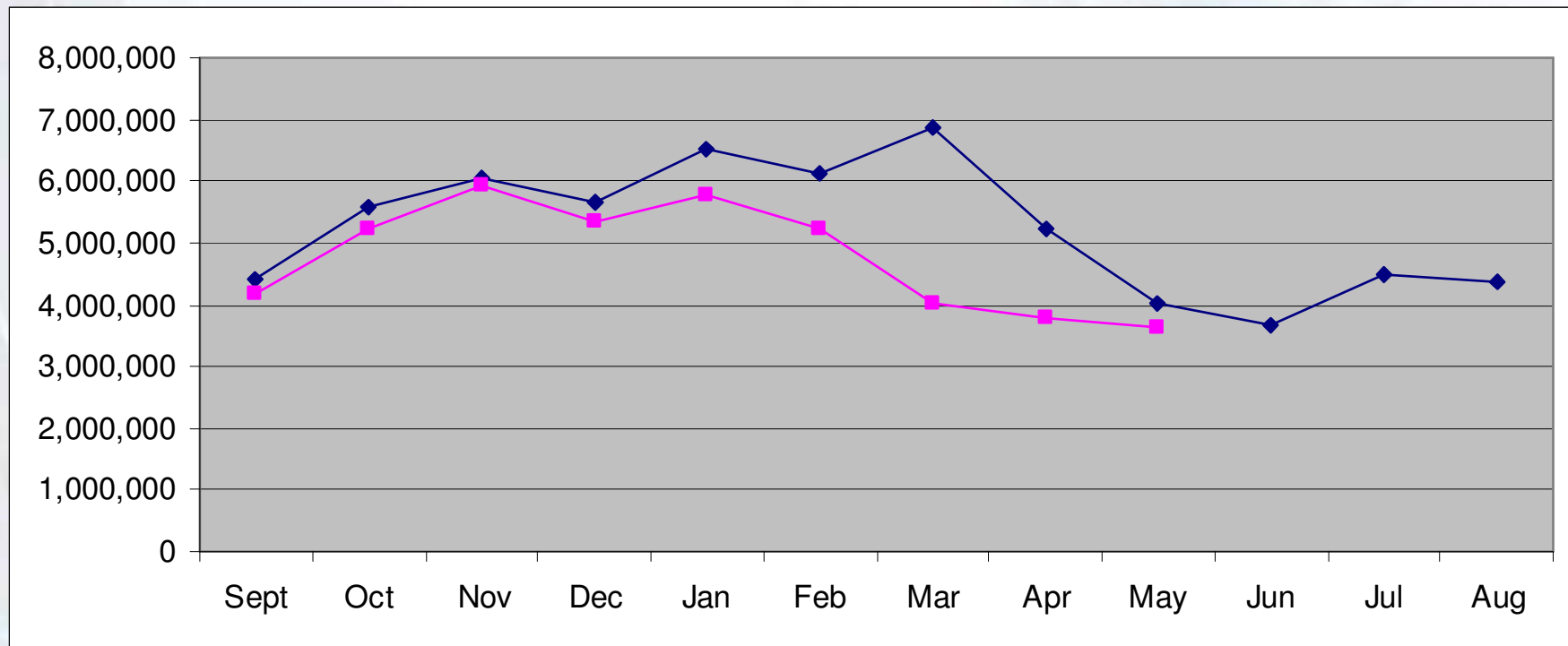
- *Retailing*



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Example:

- *Accommodation*



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Supply changes - *Hotel:*

- Statistics NZ said Canterbury's accommodation capacity was now 22 per cent lower, with many hotels and backpacker establishments put out of operation by the earthquakes.
- The Hotel Council's Canterbury regional chairman, Bruce Garrett, said a survey of council-affiliated hotel owners showed 875 rooms were available, down from 3717 before the September 4 quake.
- Hotels outside the inner-city cordon area and open were doing good business.
- His own hotel, The George, had occupancy in May and June about 20 percentage points higher than it normally would expect at this usually quiet time of year.

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Market effects adjustment summary:

- “Depopulation” may be occurring, but
- For some industries the reduction in demand is less than the reduction in supply
 - Average revenue per operating business
- Policy requires overall market effect adjustment
 - Suburb specific
 - Industry specific
 - Month specific

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Market effects adjustment summary:

- The unpalatable end conclusion of this line of logic, is that everyone in an industry could claim an increase

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Market effects adjustment summary:

- Once the adjustment identifies all of the market issues, then the claim is overlaid with the potential extension coverages:
 - Prevention of Access
 - Public Authorities
 - Customers' Premises

Which may cover some of the losses that would otherwise be considered “depopulation”

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Calculation issues:

- Synergy Health (UK) Ltd v CGU Insurance & ors
 - Increased Costs and the Indemnity Period
 - Depreciation

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Increased Costs:

- Although ruled against the insured on the basis of quantum, agreed with their argument

Example:

- 12 month Maximum Indemnity Period
 - Out of premises for 9 months
 - Have to lease a building for 24 months at \$10,000/mth
- In the case of Christchurch, lease could be 6-8 years

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Increased Costs:

- Although costs are for longer than the maximum indemnity period, this is not a problem
- Provided exercise is economic
- Effectively paid 24 months rent for 9 usable months
- Alternative would have been to not do it, and lose a greater amount of gross profit

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Increased Costs:

- Caveats:
 - Would expect insured to have exhausted all other options
 - Would expect insured to try and sub-let the unused period to mitigate the loss
 - Assumes that the insured had no benefit for the 2nd year. If the loss lasted 24 months, then an apportionment would be usual

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Depreciation:

- Insured buys an asset for \$1,000,000
- It is used over 20 years,
- And makes a gross profit of \$100,000 per year
- In simplistic terms, rather than making a \$900,000 loss in year 1 and \$100,000 profit from years 2 to 20,
- Depreciation allocates \$50,000 per year over the lifespan so every year shares equally in the cost of the asset.

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Depreciation:

- If on 4 September 2010 the asset is destroyed in an earthquake,
- Then it is written down immediately, and no more depreciation is allocated to the profit and loss account
- If the BI policy pays a gross profit claim of \$100,000 per year,
- Then is the \$50,000 that is no longer allocated, a saving of the “*charges and expenses of the business payable out of the gross profit...*”?

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Depreciation:

- There are at least a dozen technical and philosophical arguments for and against, such as:
 - Is it an expense?
 - Is it payable out of gross profit?
 - If the asset is replaced, then how can you deduct a saving for (say) 6 months, but not pay the extra expense of higher depreciation on the new asset for the remaining 6 months?

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Depreciation:

- For buildings, the Depreciation rate for tax is now 0% from 1 April 2011.
 - Most companies would follow tax depreciation, but they don't have to in their accounts, only in their tax return
 - For most companies the question is a moot point for the future, but
- It is still an issue for:
 - Companies with a higher depreciation rate than tax rates
 - For losses before 1 April 2011
 - For non-building assets

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Depreciation:

- The judgement in Synergy is:
 - Depreciation reduces profit
 - If you don't deduct depreciation as a saving the insured ends up with more profit
 - The policy is one of indemnity so paying more than the profit the insured would have earned is to be avoided
 - Therefore depreciation should be deducted as a saving
- The word “payable” is problematic, so interpret it liberally to give effect to the principle of indemnity

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Depreciation:

- The question of any increased depreciation charge didn't arise
- Issues for New Zealand insurers:
 - Do they agree? Currently each insurer forms their own view on a case by case basis
 - Even if insurers agree, would a New Zealand judge?
 - It would be easier if the policy dealt with the issue

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Questions?



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