

RISK & INSURANCE[®]

Emerging Strategies for Risk

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ETHANOL PRODUCERS need business income insurance that helps protect them against loss of income, but that also helps them meet payroll and absorb the extra expenses necessary for them to preserve critical operations while they rebuild property and production capabilities.

● PROPERTY-CATASTROPHE

Protection for E-85 Producers

Without adequate business income insurance, ethanol producers are at risk of significant losses that could put their operations in jeopardy. BY DARREN SMALL

As with any emerging industry, there is both promise and peril in the business of ethanol production.

Demand for alternative fuels has been growing in recent years in response to government mandates and increasing public concern about climate change.

The ethanol industry got a big boost when Congress mandated in 2005 that oil refiners blend 7.5 billion gallons of renewable fuel, such as ethanol, in the nation's gasoline supply by 2012.

This growing demand for alternative fuels has opened up a promising

opportunity for ethanol producers. With the government supporting demand for the product, there has been a rush of new entrants into the business. There are now some 125 plants in operation with 70 new ethanol plants under construction.

These endeavors are not without risk, however.

Ethanol plants are vulnerable to a number of perils that can damage or destroy critical business property and shut down operations for weeks, or even months, at a time. With operations at a standstill, ethanol producers face a loss of income as well as additional expenses as they try to get their plants up and running.

On top of that, it is a very volatile business, which puts producers at even more risk.

This volatility can be seen in the prices that producers pay for the feedstock and for their energy supply as well as the price they can charge for the finished ethanol product. U.S. corn prices, for instance, have increased sharply over the last year, making it more expensive for ethanol producers to buy the feedstock, while ethanol prices have fallen.

These pricing issues give ethanol producers little room for error and make them particularly vulnerable to losses that disrupt their normal operations.

Without adequate insurance, ethanol producers may suffer serious setbacks to

Summary

- In the ethanol industry annual income can vary greatly from one year to the next, making it difficult to determine how much business-income insurance limits to purchase.
- If a plant is damaged and out of operation, ethanol producers may be unable to meet payroll, unless they choose a business income policy with payroll protection lasting anywhere from 30 days to a year depending on their need to retain skilled workers.
- Ethanol producers should check to see how their policies define indemnity periods, how they value the finished stock, and how much insurance they provide in case of utility interruptions.

not take into consideration continuing expenses, such as ordinary payroll, and extra expenses incurred to continue operations while recovering from a property loss. In addition, the policy may include a very limited period of indemnity, 30 or 60 days, giving the producer a very short period of time to rebuild property and restore operations. With this type of limited business income insurance, ethanol producers could find themselves stuck with significant uninsured business income exposures.

Ethanol producers need business income insurance that helps protect them against loss of income, but that also helps them meet payroll and absorb the extra expenses necessary for them to preserve critical operations while they rebuild property and production capabilities.

This coverage needs to include limits of insurance reflective of the values at risk and a period of indemnity long enough to restore lost or damaged property and operations. In other words, ethanol producers need business income insurance designed to help get them back in business following a property loss.

One of the most important factors to consider when purchasing a business income policy is how much insurance limits should be purchased. Business income limits are typically based on an estimate of annual income. In the ethanol industry, however, annual income can vary greatly from one year to the next.

In a good year, ethanol producers could potentially earn more than they expect and find themselves with insufficient business income limits. In another year, producers may earn less than expected and find they have more insurance than they really need.

Some business income policies include an "annual income on reporting" feature that provides buyers with a refund if they overestimate their annual income. This allows producers to buy adequate limits without overpaying for the insurance.

A business income policy is designed to provide insurance under a wide range of scenarios.

If an ethanol plant is damaged due to a catastrophe or some other peril, for instance, the plant may be out of operation for months while it is being repaired.

Ethanol producers may experience a shortfall in income for other reasons as well. Small ethanol producers, for instance, qualify for a tax credit that is based on volume production. If a plant is damaged, the producer may be unable to meet that volume production target and lose the tax credit. A business income policy should contemplate loss of that tax credit in the business income calculation.

When a plant is damaged and out of operation, ethanol producers face not only the loss of their income stream, but additional, often unexpected expenses as well. Some policies will pay for expenses only to the extent they reduce a business income loss. But a more thorough business income policy will provide additional "extra expense" insurance for many of those unexpected expenses.

A business income policy should include insurance for extra expense under the following scenarios:

- An ethanol plant is damaged, leaving a producer unable to dry the distiller's grain.
- A burnout occurs in a fire tube, and the plant is no longer able to operate a coal-fired fluidized bed.
- An ethanol producer signs a contract to produce a certain amount of ethanol for a buyer. The plant is damaged and out of operation for several months. The only way the producer is able to meet the terms of the contract and avoid a contractual penalty is by subcontracting out the work to a third party, incurring extra expense.

If a plant is damaged and out of operation, there may be very little money coming in and ethanol producers may be unable to meet payroll and retain their trained workforce. A producer that loses its workforce then has to hire new employees and train them at a later date will find that cost is not included in many business income policies. With the right business income policy, however, producers can meet their payroll and retain their workforce.

Although many policies include ordinary payroll, some policies limit the duration for which they will include ordinary payroll insurance to a set number of days, such as 30. Others may insure ordinary payroll for as long as a year. Ethanol producers should assess their need to retain skilled workers and obtain business income insurance, including ordinary payroll, adequate to meet this need.

Typical business income policies also can offer a variety of endorsements.

Ethanol producers should check to see how their policies define items such as indemnity periods and idle periods, how they value the finished stock, and how much insurance they provide in case of utility interruptions.

Most basic policies will have a restricted indemnity period, for instance. With some policies, however, the indemnity period can be extended to a year or more.

The way a policy values finished stock is also an important factor. Some policies may value the finished stock by the cost of production while others may value the finished stock based on the market price.

Most policies also provide some business income insurance for utility interruptions. However, in many cases, those policies apply a separate limit for utility interruptions that is far below the policy's overall limit. For some ethanol producers, that lower limit for utility interruptions may be inadequate.

A business income policy will provide ethanol producers with important financial protection, but a business income policy alone is not enough.

Ethanol producers also should have a business recovery plan to help them reduce the severity of any loss they suffer. A business recovery plan should address disaster preparation, emergency response and should include a written business continuation plan. Ethanol producers should work with their insurance carrier's loss control department to help develop such a plan.

For ethanol producers seeking to meet the fast increasing demand for alternative fuels, the right insurance policy can be a critical factor in their success. Without business income insurance reflective of their exposures, ethanol producers are at risk of significant losses that could put their operations in jeopardy.

By carefully reviewing their policies and seeking broad, flexible insurance, ethanol producers can protect themselves from the risk of a disastrous loss and help to keep their operations running smoothly.

DARREN SMALL is assistant vice president of Chubb & Son and biofuel segment leader for Chubb Commercial Insurance. He is based in Chicago and can be reached at riskletters@lrp.com.