Disaster and Business Interruption Coverages in the Wake of the Earthquake and Tsunami

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Publication Date: March 15, 2011

The human toll from the catastrophes caused by earthquake and tsunami devastating the east coast of Japan has numbed the world. Obviously, the immediate collective focus must be on aiding the survivors and controlling the cascading damage. Indeed, given the scale of the destruction, attention to matters like insurance coverage for the widespread commercial destruction is largely impossible at present, as affected properties are still inundated with water or are otherwise too dangerous to access.

Nonetheless, as with the attacks of September 11, 2001 and the 2005 hurricanes in the Gulf of Mexico, the tragic events in Japan will spawn many commercial insurance claims. As with claims stemming from earlier disasters, many of the claims will be Business Income (or Business Interruption) claims, seeking loss of business profits arising from property damage or other commercial dislocations. Further, as with claims stemming from previous mass catastrophes, many of these claims-especially the large ones-will be strenuously resisted by insurance companies.

The following is a short treatment of Business Income insurance and the coverage issues that can arise under various Business Income provisions. The aim of this treatment is to make commercial policyholders aware of the types of coverage they may have purchased and that may apply to losses stemming from the events in Japan, so that they may give proper notice now and, later, at the appropriate time, pursue the coverage.

Business Income (or Business Interruption) Insurance

Business Income insurance is designed to cover a policyholder for profits lost, and unavoidable expenses incurred, during the hypothetical Period of Restoration needed to repair or replace damaged or destroyed property used by the policyholder in its operations.

The first coverage issue is the most fundamental: figuring the rate at which Business Income is lost during the Period of Restoration. Most policies provide little guidance as to how the amount of a Business

Income-loss is to be calculated: essentially, they state that Business Income is to be calculated from historical figures. This leads to many sources of potential conflict, for instance:

— What amount of historical data is looked at? The previous month? The previous year? The answer: this depends upon the type of business; for instance, seasonal businesses can establish loss through reference to previous seasons. In general, experience from the previous few years, along with projections for the Period of Restoration, may be used to establish loss.???

— What about new or unprofitable businesses? The answer: both types of businesses are permitted to attempt to establish that they would have enjoyed profits in the Period of Restoration. Further, unprofitable businesses are allowed to recover continuing expenses to the extent that revenues would have been sufficient to cover them.

Essentially, however, the language in most policy forms is so vague that it ensures that, if the claim is large enough, there will be a dispute.

Second, an insurance company may argue that, to the extent the policyholder's operations can limp along, there has been no "interruption." While insurance companies have had some success in pressing this argument in the United States, it misconceives the purpose of Business Income insurance, which is designed to do for the policyholder what it would have done had there been no damage. When damage impacts operations, the resulting loss is covered, regardless of whether operations totally shut down.

Third, issues typically arise regarding the length of the Period of Restoration. As normally written, this period, during which the loss of Business Income is covered, is bounded by the shorter of (i) the hypothetical time in which the destroyed property could be repaired, rebuilt or replaced "with due diligence and dispatch" or "reasonable speed," or (ii) the actual time it takes to repair, rebuild or replace the property. A number of issues can arise surrounding the former, "hypothetical" date. For instance, does it start during the period when authorities will not let the policyholder on site? Alternatively, is the Period of Restoration extended to account for the insurance company's delay in adjusting a claim? In general, delays occasioned by events out of the policyholder's control will serve to extend the Period of Restoration. Accordingly, if the insurance company delays in providing the policyholder sufficient money to get back into business, this delay will serve to extend the Period of Restoration.

Fourth, insurance companies-as they did both after the September 11, 2001 attacks and after the 2005 Gulf hurricanes-may seek to take advantage of the wider effects of the catastrophe, by arguing that Business Income recoveries of particular policyholders must be slashed because the widespread damage decreased customer demand. At its core, however, Business Income insurance is unlike most other insurance in that it is based on assumptions contrary to fact: it aims to do for the policyholder what the policyholder would have done **had there been no catastrophe**. Accordingly, in the absence of language permitting consideration of the wider effects of the loss, carriers should not be permitted to use those effects to decrease recovery.

Other Business Income Coverages

In addition to coverage for losses of Business Income stemming from the destruction of the policyholder's own property, a number of other coverages are available for losses of Business Income stemming from other events, including the following:

- ***Contingent Business Income*** coverage is designed to cover a policyholder for loss of income caused by damage to or destruction of property owned by others, usually identified as "contributing" or "recipient" locations (i.e., suppliers and customers). An example would be coverage purchased by a car maker to protect it if its sole supplier of a key component suffers destruction of its factory, and the car maker suffers a Business Income loss from its inability to complete manufacture of cars. Coverage under these provisions varies widely, with some provisions limiting coverage to "direct" customers or suppliers, and other provisions covering customers or suppliers "of any tier" (i.e., customers of customers). For most policies, one Period of Restoration definition controls evaluation of both Business Income and Contingent Business Income losses, but problems may arise in computing it because neither policyholder nor insurance company can monitor the "due diligence" of the third party. A policyholder should resist any argument that the Period of Restoration ends if the policyholder secures an alternative supplier or customer if any part of the loss continues; in other words, while obtaining an alternative supplier can mitigate the loss, it does not end the period in which loss is measured.

- ***Contingent Extra Expense*** coverage is designed to pay for increased costs incurred after the disaster to minimize or avoid a Contingent Business Income loss. Accordingly, if a business incurred additional expenses to avoid or minimize a Contingent Business Income loss, it may have coverage for those costs under Contingent Extra Expense coverage.

- ***Service Interruption*** coverage is designed to provide coverage for Business Income losses attributable to dislocation of utility or telecommunications service.

- ***Ingress/Egress*** coverage is designed to pay for the loss of Business Income caused by physical loss or damage to third-party property that prevents or hinders ingress to or egress from the policyholder's business.

Note that it is not unusual for a policyholder to have rights under multiple coverage provisions, each of which may have separate limits. The policyholder should be entitled to order its claim under these provisions to maximize recovery. For instance, if the policyholder has both a Business Income loss (capped by a 12-month maximum Period of Restoration) and a Contingent Business Income loss (capped by a $1 million sublimit), it should be able to recover Business Income for the first year and then an uneroded Contingent Business Income limit the next year.

Conclusion

It is still simply too early to shift focus from recovery efforts to mundane concerns like insurance coverage. Nonetheless, insurance coverage will be crucial to recovery. Further, insurance coverage can be voided if a policyholder does not give timely notice of its losses. Prudence should compel a policyholder to give a brief review of its first-party coverages and give appropriate notice of potentially covered losses, so that, at the appropriate time, it can pursue the coverage to which it is entitled.?