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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

How Insurance Can Help Businesses Rebuild

Law360, New York (June 13, 2011) -- As flood waters have threatened Missouri communities along the Mississippi river, and as the town of Joplin reels from the recent devastating tornado, the residents of these communities are quite appropriately absorbed with efforts to save lives and to regain some semblance of normal daily life. But, eventually, the flood waters will recede, the debris will be cleared, and business owners will turn their attention to repairing and rebuilding their businesses and recouping losses sustained.

Depending on the circumstances and the insurance purchased, insurance contracts may help businesses recover losses resulting from damaged buildings, vehicles, equipment and other property.[1] Some commercial insurance policies, for example, in addition to covering events like tornadoes and hurricanes, also expressly provide coverage for damage caused by floods.[2]

Moreover, beyond coverage for physical damage to property, businesses also may be able to recoup lost profits caused by an interruption of their business due to: property damage, an inability of people or materials to reach a business, or damage to key suppliers or customers.

This article briefly summarizes the main categories of losses that may be covered under typical property insurance policies, and it previews some of the disputes with insurance companies that may arise. The article also identifies steps that businesses should take now to preserve their right to pursue an insurance claim later if necessary.[3]

Types of Potentially Insured Business Losses

The most basic type of loss that may be covered by insurance is property damage. Buildings, equipment, records, vehicles and other property may sustain direct damage, or damage from events, such as fires, that may be precipitated by the recent flooding and/or tornado.[4] A typical property policy would cover the cost of rebuilding or repairing such property, if the property is “covered property” and if the cause of damage is a “covered cause of loss.”

Commercial property policies also often provide some protection for lost profits that result from damage to “covered property” based on a “covered event,” such as a flood, tornado or earthquake. These types of losses generally fall into one of two categories of coverage: coverage for “business interruption” losses and coverage for “contingent business interruption” losses.

“Business interruption” losses occur when a company loses profits due to damage to its own facilities. “Contingent business interruption” losses occur when a company loses profits due to the inability to get materials from a supplier or to sell its products to a customer, due to property damage sustained by that supplier or customer at its facilities.

A third category of loss that may be covered consists of additional expenses that businesses may incur in order to address the impact to their business of the flooding and/or tornado. These types of losses often fall under the “extra expense” coverage of a typical property policy.

For example, a business may incur expenses to shift production away from a damaged plant to other facilities. A business also may incur “extra expense” if, during the period that its normal suppliers cannot operate, the business has to use more expensive suppliers. Further, property policies also may cover costs and fees for professional services, e.g., from accounting firms and consultants, that are necessary to help a company address the impact of the tornado and/or flooding.

Potential Coverage Disputes

One dispute that often arises under property policies is whether there actually has been physical damage to insured property, which, as noted, typically is required for business interruption and contingent business interruption claims. For example, an insured company or its supplier may not have sustained physical damage to its factory, but because of a lack of power or an inability to get people and items in and out of the property, the company cannot use the facility.

Businesses have several tools at their disposal to address such disputes. For example, even if neither an insured company nor its direct suppliers have sustained physical property damage, some courts have interpreted the term “supplier,” for contingent business interruption purposes, to include more than direct suppliers, e.g., suppliers of direct suppliers, and those indirect suppliers may have sustained physical property damage.

Many property policies also provide types of coverage that may not require physical damage to the insured company’s own premises, such as “civil authority” coverage, “ingress/egress” coverage, and “service interruption” coverage. Civil authority provisions, for example, typically cover business interruption losses caused by an order, such as a curfew or road closure, that prevents use of insured facilities.[5]

Although such provisions often provide coverage only when the civil authority order results from property damage, civil authority provisions tend to vary materially between policies, and not always in obvious ways, so a careful examination of the precise language is critical.

For example, after the terrorist attacks of Sept. 11, 2001, U.S. Airways and United Airlines each litigated with their insurers over whether their civil authority coverage provisions applied to losses caused by the closure of Reagan National Airport. U.S. Airways won, and United lost, the merits of that coverage dispute, based on nuanced differences in the language of their civil authority provisions.[6] The same careful review of policy language is necessary for “ingress/egress” provisions and “service interruption” provisions.

Another potential dispute arises from the fact that some property policies contain flood exclusions, and insurers almost certainly will raise any such exclusions as a complete defense to claims based on the recent flooding. But, in instances where the flood waters themselves did not directly cause damage, but instead precipitated events, such as fires, that caused damage, businesses may have rights to coverage under insurance law concepts like the “efficient proximate cause” and “concurrent causation” doctrines.

Although the insurance industry has attempted to contract around these causation doctrines through the use of so-called “anti-concurrent causation clauses,” courts have taken differing approaches to the scope and enforceability of these clauses; thus, as in many insurance disputes, the issue of which jurisdiction’s law applies to these issues will be important.

Insurers also may challenge the efficacy of loss mitigation measures that businesses adopt to address the effects of the recent tornado and/or flooding. Typical property policies require business owners to take reasonable steps to minimize losses, and insurers often question, after the fact, the measures that businesses take to do that.

Businesses should be prepared to rebut any such hindsight-based arguments, and to defend their business decisions. Further, under many property policies, businesses may be able to recover expenses incurred in order to mitigate loss.

Practical Pointers for Preserving Insurance Rights

There are steps that businesses can and should take now to put themselves in the best possible position to secure coverage if and when the need arises.

First, businesses should collect, organize and review their insurance policies. This process should include an effort to identify and obtain policies issued to other businesses, such as current and former affiliates, that may also provide coverage.

Second, most property policies require policyholders to provide notice of potential claims and to submit “proofs of loss” quickly, and these policies also often have express deadlines for when any lawsuit against the insurer must be brought if there is a dispute. For example, many property policies require that businesses “immediately” give notice of a loss that may give rise to a claim, and policies often further require that a policyholder submit a “proof of loss,” documenting the insured damage, business losses, and expenses, within 60-90 days. These policies often also require that any lawsuit against the insurer be brought within one or two years.

It is critical that businesses act proactively to protect their rights by promptly giving at least precautionary notice, absent business reasons to refrain from doing so. Business owners should also keep their insurers informed of their efforts to mitigate their damages and to reopen their businesses, in order to limit future disputes.

Moreover, businesses should consider approaching their insurers about postponing, or “tolling,” the referenced proof of loss and lawsuit deadlines, by agreement. Insurance companies often are

willing to do so in situations that involve widespread losses, like those that can be anticipated with the recent tornado and flooding. Note, however, that some jurisdictions differ in their rules regarding the extent to which parties can enter into such “tolling” agreements, and thus an examination of the applicable law is necessary.

Third, businesses should carefully document their property damage, lost revenues, and additional expenses, and they also should set up protocols for communicating both internally and externally about any losses and insurance issues. Because of the nuances in the coverage issues raised, such protocols are important to help protect against inadvertent characterizations regarding the nature or cause of losses, for example, that insurers might use later if a coverage dispute arises. Thus, businesses should consider involving their legal departments and/or insurance lawyers in such communications.

Finally, because of the complicated coverage questions and potential procedural traps previewed here, businesses should consider consulting with experienced professionals, such as insurance brokers, accounting consultants, and coverage counsel, who can help prepare for a potential coverage claim.

Conclusion

The coverage provided by a business’s insurance policies can be an extremely valuable business asset. Business owners can maximize the benefits of insurance, and minimize the chances of protracted disputes later, by acting proactively now to assess and preserve their rights.

--By Barry I. Buchman (pictured) and Benjamin R. Davidson, Gilbert LLP

Barry Buchman is a partner, and Benjamin Davidson is an associate, in the Washington, D.C. office of Gilbert LLP. Buchman and Davidson represent companies on a wide variety of insurance issues.

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[1] See, e.g., Joplin Tornado May Cost Insurers Up To \$3 Billion, Dow Jones News Service, May 24, 2011.

[2] Homeowners also often have insurance to protect from flood losses. That protection, however, usually is provided through specific insurance issued under the federal flood insurance program, which is beyond the scope of this article.

[3] This article provides an overview of general principles, and non-exhaustive examples of the issues and arguments that may arise. Actual legal advice should be based upon an evaluation of all facts and circumstances, including specific policy language and the law of the pertinent jurisdiction(s).

[4] As illustrated in connection with the recent tsunami in Japan, flood waters can precipitate other, potentially insured events, such as fires.

[5] See, e.g., Casinos Ordered to Shut Down After Mississippi River Flooding, Travel Insurance Center, Apr. 28, 2011, available at <http://www.worldtravelcenter.com/eng/news/article.cfm?aid=846>; see also Coast Guard Partially Reopens Mississippi, Reuters, May 23, 2011.

[6] U.S. Airway's victory was later vacated on appeal, on grounds independent of the merits of the policy interpretation dispute between U.S. Airways and its insurer.

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