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ALERT

Is There Insurance Coverage for Losses Stemming from Government Shutdown or Default?

By Mark Garbowski

At the time of this writing, the federal government is in a partial shutdown. Essential functions are operating, but certain areas such as national parks are completely closed. While this partial shutdown does not threaten the validity of federal debt, some fear that a similar impasse regarding the debt ceiling could trigger a partial or full federal default. These events pose varied risks for businesses. A variety of insurance and other risk mitigation products may cover some losses.

Government Contractors

Depending on the nature of the services that a company performs for the government, it may be possible and indeed necessary for government contractors to buy special policies that cover the potential elimination or disruption of an underlying government project. For example, if a company is going to spend significant sums for a project whose only potential client is the government — building, for example, an aerospace vehicle — it may be possible to purchase a specialized policy that would protect the company in the event that the government cancels the program.

Whether a presumably temporary, partial shutdown would trigger coverage under any such policies currently in force of course depends upon the specific coverage grant, terms and conditions of each policy. By their nature such policies tend to be specifically written for particular risks, so there is very limited precedent and experience. In addition, insurance companies are usually reluctant to insure against ordinary business risks such as the loss of a client or the cancellation of a project. Absent compelling circumstance such as the development costs for a space exploration or military project, it might be difficult to purchase such coverage, but when available in the appropriate situation it can save a company.

Contingent Business Interruption

Companies that do not directly contract with the government can still suffer a loss due to a shutdown. For example, the closing of National Parks will affect tour companies, hotels and other travel businesses. The most likely source of coverage here would be contingent business interruption insurance, but again, there are obstacles to coverage.

Business interruption coverage is normally triggered by property damage to the policyholder's own property, and that is unlikely to be applicable here. Contingent business interruption coverage can provide

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coverage without physical damage to your own property, but almost always requires physical damage to a third party whose operations are necessary to your business, such as an entity in your supply chain. Typically, that party must suffer a physical loss that would be covered if it happened to your business. For example, if an earthquake incapacitates a company's key supplier, contingent business interruption may kick in if the company in question itself has earthquake coverage. In the current impasse, the government is not shutting down operations because of a physical loss but because of a political stand-off, an occurrence not covered by most business income provisions. Still, it is worth checking your coverage, as policies vary.

Political Risk Insurance

Since this is a political event, it is natural to consider whether political risk coverage might apply. Most companies in the United States that purchase political risk insurance do so to cover foreign political risks. In fact, the US Government has an agency that sells insurance to US businesses and other entities covering investments and activities in 150 developing countries. These overseas political risk policies, whether sold by this government agency or in the private insurance market, usually cover risks such as limits on currency conversion, appropriation of cash or assets, and political violence.

There is no reason why a US business could not purchase political risk insurance for domestic contingencies. In fact, the aerospace example discussed above is a form of political risk insurance. Policyholders should be aware, however, that such policies usually require a waiting period, often as long as 90 days, before coverage is triggered. If the government action or political situation does not last that long, there will often be no coverage.

Other Insurance Possibilities

Other connections between insurance coverage and the shutdown are perhaps more attenuated. A company that suffers significant losses due to the shutdown could face investor suits and should make sure its D&O coverage is adequate for such a possibility. A federal contractor that loses government funding may be forced to lay off or furlough employees. Any such measure could give rise to a variety of employment-related claims, to which Employment Practice Liability Insurance (EPLI) may respond. Delayed EPA approvals could increase the costs of ongoing environmental remediation, which could lead to faster erosion of CGL limits for environmental claims. Finally, regarding the possibility of a federal debt default, the loss mitigation tool most likely to address such a possibility, however remote, is probably a credit default swap. Those instruments would typically pay after any failure to make a single due payment that lasts only three business days.

While insurance is far from certain to cover the negative consequences of a federal government shutdown, now is the time to review your policies and find out, and to plan ahead for the next potential stand-off.

who's who

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