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Covering Your Business Against Interruption

Even if a hurricane doesn't hit your company directly, it can still inflict lasting damage

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While the human suffering triggered by Hurricanes Harvey and Irma unfolded in real time on our TV screens, opening American hearts and wallets and triggering heroic volunteer rescue efforts, the full extent of the economic damage will not be evident for some time. That impact is likely to extend well beyond the Gulf states to the U.S. and even global economy.

Major refineries shut down in Harvey's wake, causing gasoline prices to spike. Many refineries sustained damage that led to chemical emissions. By August 31, the Texas Commission on Environmental Quality had received 56 preliminary emissions reports from petroleum and chemical companies, The Wall Street Journal reported. Production in many of those companies could be impaired for some time, affecting the supply chains of a wide range of products.

In the storms' aftermath, businesses in the affected areas of Texas, Louisiana and Florida should be vigilant about pursuing insurance recoveries. That entails assessing not only the physical damage to their property but also income losses stemming from such varied consequences as flooded and blocked roads and bridges, interruptions of shipping and air transport, evacuations and closures by civil authorities.

Beyond the area of immediate impact, businesses suffering from supply chain disruptions throughout the U.S. (and by extension, globally), should look to their property insurance policies for contingent business interruption coverage, triggered when policyholders do not themselves suffer physical damage but still lose revenue due to the effect of property damage to a supplier or customer. Contingent business interruption is a standard provision in many property insurance policies, though many businesses are not aware of it.

Below, we look more closely at a few key coverages that typically apply to losses from storms like Harvey and Irma – paying particular attention to the contingent coverages that may be accessed by businesses far from the direct impact of the storms. We also examine potential limitations on coverage, and counterarguments against such limitations, that have often led to coverage disputes and litigation.

Business Interruption

Business interruption (BI) insurance covers businesses for losses stemming from unavoidable interruptions in their regular operations. BI coverage may be triggered by circumstances including a forced shutdown, a downturn in business due to damage or a substantial impairment in access to a business's premises. Many property policies also provide extended business interruption coverage that begins when the property is fully repaired and ends when your operations are ramped up to their pre-disaster level – though that extension is typically limited to 60 days.

Storm-related disruptions can take many forms.

Contingent Business Interruption

This kind of coverage is triggered when policyholders lose revenue after a property loss impacts one or more suppliers or customers. For example, businesses that rely on specialty chemicals from the affected area may have to pay more for supplies, and companies that sell into the area, such as consumer products manufacturers, may suffer lost sales. While the business itself need not be physically damaged, it does need to have coverage for the type of damage that affected its suppliers, business partners or customers. For example, a business must have flood coverage to file a contingent business interruption claim for losses triggered when a supplier is incapacitated by a flood.

Whether the policyholder has the appropriate coverage for its own property can be a complicated issue. Many companies have earthquake coverage for their facilities in California, but not elsewhere in the country. Similarly, many have flood insurance for specifically designated flood zones. If the policyholder has substantial operations that are not included within those coverages, an insurance company might argue that it does not have the needed coverage to respond to a contingent business interruption loss stemming from floods in the Gulf. There is very little guidance from the courts on this issue, but it seems that the policyholder would have the better argument as long as it has flood insurance for facilities that are subject to those risks. The particular wording of the insurance policy is critical.

Another key condition of coverage that can be surprisingly ambiguous is whether the damage that triggers the loss has been suffered by a supplier or customer of the insured. Often it is clear whether this requirement has been met, but there are gray areas as well. For example, after flooding along the Mississippi River, Archer Daniel Midlands (ADM) suffered a loss because it could not move crops to its food processing plants by barge along the flooded waterways. It submitted a claim for contingent business interruption coverage, arguing that there had been damage to docks and dams operated by the United States Army Corps of Engineers, and that the Corps was a "supplier" of services to ADM. A federal court agreed, noting that ADM paid fees to government agency for using its facilities, which brought it within the insurance policy's coverage for losses resulting from physical damage suffered by a supplier.

Uncertainty may also arise as to whether damage has been suffered by a customer. Many products are sold through distributors to retail establishments and then to end users. An argument could be made that anyone who receives the product along that chain is the manufacturer's customer. Some insurance policies limit the uncertainty by defining customers as "end users," but some do not. Even such a definition does not eliminate potential ambiguity – for instance, when a product is purchased and then incorporated into a larger product, such as a transmission for a car. Faced with uncertainty, policyholders should analyze their coverage in light of the legal rules of insurance policy interpretation, under which grants of coverage are interpreted broadly and exclusions are interpreted narrowly.

Civil Authority Coverage

This coverage is triggered when authorities limit or close off access to a damaged area. Ingress/egress coverage, which is related, insures lost profits due to difficulties in accessing the insured premises due to the storm. Here, too, damage to the insured's own property is not required to trigger coverage – though typically, the losses must result from property damage of a type covered by the insurance policy. Small businesses in particular may not even be aware of their civil authority or ingress/egress coverage, which can be valuable in situations like those surrounding Harvey and Irma.

Extra Expense Coverage

This applies to additional costs incurred by the policyholder as a result of damage to its property, and to costs incurred to mitigate economic losses. This coverage often is very broadly defined and can be extremely valuable to policyholders faced with sharp spikes in expenses needed to keep their businesses going.

Contingent Extra Expense Coverage

This is extra expense insurance that applies when costs are incurred as a result of a business interruption caused by damage to the property of a supplier or customer. Like ordinary extra expense coverage, contingent extra expense insurance may be issued in one of two basic forms: 1) for extra expense to reduce loss; and 2) for "pure" extra expense. The more common coverage insures only against extraordinary costs incurred to minimize or prevent a contingent business interruption loss. For instance, in the example given above involving the destruction of a chemical manufacturing plant, contingent extra expense to reduce loss insurance would cover expenses incurred while finding alternative ingredients at higher prices than the lost supply. Coverage for pure extra expense includes costs to minimize loss, but also insures against a wider scope of expenses incurred as a result of damage to the third party's property.

Policy Pitfalls: Sublimits and Concurrent Causes

Many commercial property insurance policies provide different sublimits for losses caused by "flood," "storm surge" and "named storms." How the policy defines these key terms can be critical in determining the amount recoverable for the policyholder's loss. For most businesses in the Houston area, Harvey wrought its worst damage under the aegis of "tropical storm" rather than "hurricane" – and that could affect coverage terms in some policies. Check your policy's definition of "named storm," and hold your insurance company to the terms of the contract.

In the aftermath of a major storm, damage caused by wind or wind-driven rain, storm surges or flooding can be difficult or impossible to distinguish. For policyholders lacking flood coverage, insurance companies often invoke "anti-concurrent causation clauses" to deny any coverage at all if flooding occurred. Many state courts, however, have held that if the "efficient proximate cause" of damage is covered – that is, the dominant cause – then the claim is covered. Denials based on anti-concurrent causation provisions should in many cases be contested – or at the very least, carefully scrutinized and analyzed in light of case law in the state in question.

Disaster Management Requires Vigilant Claims Management

Calculating the full range of business income loss from property damage, disruption of the surrounding area and closures by order of civil authorities is a complex task. The more thorough the documentation, the more likely the policyholder is to receive full or near-full acceptance of the claim from the insurance company – or, if necessary, to push back against the insurance company's lower loss estimates or even denial of the claim. To that purpose, the services of a public adjuster, skilled in the ways insurance companies calculate losses, can be invaluable. It's also vital to keep the pressure on your insurance company and demand partial payments if the claim resolution is delayed by disputes over the valuation of the loss or just by slow claims processing.

Coping with the aftermath of a disaster is trying under the best of circumstances. Insurance can be a vital lifeline – but it's not one that operates under its own power. Understanding your full range of coverage and thoroughly documenting your sources of loss are essential to maximizing recovery.

For additional information regarding hurricane recovery, property loss and business interruption coverage, visit Anderson Kill's website.

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