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# Protecting the Lifeblood of Your Business—Its Income Stream: Insurance Coverage for Business Interruption Losses

By Finley T. Harckham

For companies that own, lease or manage real estate, having appropriate property insurance is essential. Most property policies insure not only buildings and their contents, but also the lost stream of income which results from damage to property. Often, lost profits are far greater than the loss from damage to property, and having adequate coverage for such business interruption claims may be essential to the company's survival, or continued profitability, after a catastrophic event. However, the scope of coverage provided for lost profits is far from clear in many respects, which leaves the policyholder with uncertain protection. This article discusses a number of the major areas of dispute between insurance companies and policyholders involving business income to demonstrate the need for the policyholder to focus with his or her insurance professional on minimizing the uncertainty surrounding this coverage.

## *Business Income (or Business Interruption) Insurance Coverage*

Most property policies promise to pay for losses of business income incurred in the wake of damage to covered property. Business income coverage is designed to pay the profits, including lost rents, and unavoidable continuing expenses caused by an interruption of the policyholder's business. Although many such provisions are in use, a typical one reads as follows:

> We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration." The suspension must be caused by direct physical loss of or damage to property. . . . The loss or damage must be caused by or result from a Covered Cause of Loss.

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

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## Tenants Who Holdover Should Think Twice—You Could be Subject to Increased Liability

By Jody Googel

On anuary 10, 2005, the Supreme Court, New York County, rocked the New York real estate community when it ruled that a tenant who holds over is liable to an incoming tenant in trespass. Such liability occurs when the tenant remains in occupancy after the expiration of its lease term and the tenant's holdover prevents the incoming tenant from taking its rightful possession of occupancy under its lease.

In *Kronish Lieb Wiener & Hellman LLP v. Tahari Ltd.*, Kronish Lieb Wiener & Hellman, LLP (Kronish) was the tenant of the 46th and 47th floors in an office building located at 1114 Avenue of the Americas in Manhattan, pursuant to a lease dated May 12, 1993. The terms of Kronish's lease provided them with the option to lease the 48th floor for a term beginning on June 1, 2003, and ending on April 30, 2014. Tahari Ltd., (Tahari) was in possession of the premises under the terms of a sublease which expired on May 31, 2003. Kronish exercised its option to lease the premises. However, Kronish was unable to take possession on June 1, 2003, because Tahari held over, remaining in possession of the premises.

In June 2003, Trizechahn-Swig, LLC (Trizec), the owner of the building,

*"Tenants Who Holdover" continued page 2*

*"Tenants Who Holdover" continued*

commenced an ejectment action against Tahari to recover possession of the premises. The Supreme Court, New York County, granted possession to Trizec based on the fact that Tahari's sublease had expired and Tahari had no written agreement granting it the right to remain in possession of the premises. On December 16, 2004, the Appellate Division unanimously affirmed the ejectment order holding that "[a]ll the written agreements clearly demonstrate that the defendant Tahari's right to sublet the [48th floor] expired when the master lease terminated and no triable issue has been raised as to whether Tahari reasonably relied on any contrary representation to its detriment."

In December 2004, Kronish commenced an action in the Supreme Court, New York County against Tahari. In this action, Kronish sought to recover damages from Tahari's failure to vacate the premises, when its sublease expired, based, among other things, on the theory that Tahari was liable to Kronish in trespass. Kronish moved for summary judgment based on the prior decisions of the Supreme Court and Appellate Division in the ejectment action. The Supreme Court granted Kronish's summary judgment on the issue of liability as to trespass. The Court stated that the amount of damages owed to Kronish by Tahari shall be determined in a separate trial along with any remaining issues of liability.

As a result of the Supreme Court's decision, a tenant is now open to liability in a holdover proceeding not only to the landlord under its lease but to the incoming tenant as well. Whether you are a landlord or a tenant, it is important to carefully examine your existing lease or carefully negotiate the provisions of a new lease regarding your rights and liabilities in a holdover situation.



*"Protecting the Lifeblood of Your Business" continued*

- **Contingent business income** coverage insures against loss of income caused by damage to or destruction of property owned by suppliers and customers.
- **Contingent extra expense** coverage is designed to pay for increased costs incurred after a disaster to minimize or avoid a contingent business income loss.
- **Leader property** coverage insures against losses of business income stemming from damage or destruction to a third-party property such as an "anchor" store that attracts customers or business to the policyholder.
- **Service interruption** coverage insures against business income losses attributable to dislocation of utility or telecommunications service.
- **Ingress/egress** coverage pays 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.

## *Be Prepared For Potential Hurdles*

There are a number of potential hurdles to recovery for business income losses.

*(a) What Is the Rate of Business Income Loss?*

The first coverage issue is the most fundamental: figuring the rate at which business income is lost during the period of restoration. Property policies typically 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:

- What is looked at, the business as a whole or a small sector of the business?
- What amount of historical data is looked at? The previous month? The previous year?
- What about cyclical businesses, like resort properties, does one look at the year as a whole or just the high season?
- What about new or unprofitable businesses?

Essentially, the policy language is so vague that it ensures that, if the claim is large enough, there will be a dispute. For such losses, a loss adjuster or an accountant versed in property insurance should be engaged early in the process.

*(b) Has There Been an "Interruption"?*

Insurance companies often deny business income coverage on the ground that the policyholders have not suffered a total "suspension" of all their operations, and thus that business income coverage was not triggered. For large businesses with many properties in different locations this argument is simply not accurate: no catastrophe, short of nuclear annihilation, could totally halt every facet of the operations of such a company. Although there is some unfavorable law on this subject, the more prevalent and better-reasoned authority has recognized that an interruption does not require a total halt to all operations, but includes adverse effects on performance. However, the suspension of operations is less clear when damage causes a potential disruption of operations at a single location, resulting in a slowdown, rather than a cessation, of the business there. Some insurance policy forms specify that partial disruptions of a business are covered.

### *Length of the Period of Restoration*

Issues often arise regarding the length of the period of interruption or period of restoration. As typically 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 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 due to ongoing investigation, e.g., by environmental authorities? Further, disputes often arise over whether the policyholder could relocate to an alternative site and thereby end its period of loss, particularly where the location of business is important to its success.

### *Permanent Replacement*

Historically, a policyholder was entitled to its loss of business income under business interruption coverage for the period from the destruction of property until the property at the described premises should have been repaired, rebuilt or replaced with reasonable speed and similar quality. This "theoretical" period continued even if the policyholder mounted temporary or interim operations after the loss and damage, thereby recognizing the value of the policyholder's location. Since 1995, however, the Insurance Services Office standard form has defined the period of restoration as the lesser of the time to repair or replace the physical damage or the time at which operations are resumed at a new permanent location.

Some insurance companies have argued that policyholders, forced by destruction of their premises to move their operations elsewhere on a temporary basis, have in fact permanently relocated, thereby terminating the period of restoration. Such a result may not seem unfair for office operations, which likely can relocate in fungible space, but what about retailers and restaurants which rely upon their locations to provide access to a steady stream of customers? The courts have been inconsistent in their treatment of this issue.

### *Can the Business Income Loss Be Reduced by the Wider Effects of the Catastrophe?*

In response to claims for losses resulting from 9/11 and recent hurricanes, some property insurance companies have argued that business interruption recovery is diminished by the wider economic effects of the catastrophe. Historically,

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**Effective October 1, 2006, recordation and transfer taxes were increased in the District of Columbia for most real property transactions.**

The recordation tax rate for deeds to residential property (in excess of $400,000), and commercial property (regardless of amount) increased from 1.1% to 1.45%. The separate transfer tax rate for such transfers also increased from 1.1% to 1.45%. Leases for terms of longer than 35 years are also subject to both taxes at the increased rates. Transfers of economic interests in real property are subject to recordation and transfer taxes in the District of Columbia; however, the tax rates for economic interest transfers will continue to be 1.1%. Deeds of trust are subject only to recordation tax in the District of Columbia. The recordation tax rate for deeds of trust also will continue to be 1.1%.

For further information about how the tax increase may affect you, or about tax exemptions, please contact Thomas R. Petty, a partner in our Washington, D.C. office, at tpetty@andersonkill.com or (202) 218-0041.

there was no policy provision permitting insurance companies to reduce estimates of their policyholder's lost business income on account of generalized lack of consumer demand which follows a catastrophic loss. Nonetheless, this is what insurance companies attempted to do. Courts, however, consistently found that business income losses must be computed based on net profit expectancies as they existed prior to the loss. In response, some insurance policies now provide that the business income recovery must be based upon the business environment that existed after the loss.

## *Conclusion*

Avoiding all of the issues discussed above may be impossible. Nonetheless, the policyholder can reduce the likelihood of encountering some of these problems by carefully selecting the business interruption coverage form to be used in its policies. This requires the assistance of an insurance professional who is not just concerned about obtaining high limits of coverage (which may be worthless) or the best rates, but is also well versed in the significance of the different wordings in the various policy forms in the marketplace. Other problems can only be addressed after the loss is suffered, with the assistance of a claim specialist such as a public loss adjuster. It is a shame that a policyholder should need a cadre of consultants in order to secure business interruption coverage that fills its needs, but the stakes are often too high to minimize the risks associated with this insurance.


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