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BUSINESS INTERRUPTION INSURANCE
[INCLUDING BUSINESS INCOME]

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This discussion of Business Interruption insurance, including Business Income, is intended to point out some salient issues that need to be considered upon any review of a client's fire insurance policy. Preferably before a loss.

Business interruption insurance (BI) is an endorsement to a fire insurance policy which extends coverage to pay the insured for lost business income (as defined in the policy) and other specified expenses associated with closing as a result of the fire or other insured casualty (which we refer to herein as the "Event") and restoration of operations.

Typically [although not always] coverage is specified in the policy as payment for "*actual loss of business income you sustain due to the necessary suspension of your operations*" due to an insured event "*during the period of restoration.*" Some coverages include rental value of space occupied by the insured and sublease rents it would have received if there had not been an Event, and normal operating expenses including payroll. Some policies go on to state that "*suspension must be caused by direct physical loss of or damage to property at the described premises.*"

The basic rule of insurance is that the policy says what it means and means what it says. This leads to considerations which might not be obvious at first glance.

First, since the coverage is an extension of the fire policy, all exclusions to the basic fire policy will also apply. A "special form" policy, the kind formerly called all-risk, will cover all risks not excluded, and so will also cover all of the same risks in its BI coverage. But an exclusion in the basic policy, such as terrorism or flooding, will also be excluded in the BI. So the full policy must be reviewed when considering BI, not merely the BI section or endorsement.

The coverage described above includes a reference to "business income." This is defined in most policies as net income or loss before income tax that would have been earned or incurred if there had been no Event. It does not necessarily require that the pre-Event business was profitable, since the insured is entitled to recover for fixed costs which were paid during the suspension of operations, even without profits. "Suspension of your operations" also raises issues. Current policy forms usually provide that 'suspension' includes both slowdown and total cessation. But older forms, which are sometimes continued in renewals or used in custom prepared policies, do not define suspension. Insurers given that opportunity often claim that suspension means total cessation; if the insured suffers only partial cessation, this dispute must be resolved by negotiation during the insurance adjustment process, or litigation with typically unpredictable results.

Lost income is itself an imprecise determination, based upon historical data, requiring submission of records, lots of discretionary negotiating, recordkeeping. Some cases hold that the insured may claim that the loss includes improved conditions after the loss, such as the case of a motel in Louisiana claiming that the influx of insurance representatives after Katrina would have brought more business and that should be used to measure the loss, instead of the prior year's sales.

Policies requiring that there be 'loss or damage to property at the described premises,' which is not as universal as it once was, will not cover a situation where only surrounding buildings are damaged but not the insured's building, such as could occur in case of a flood or Katrina type occurrence. Even those clauses raise the question of what the "described premises" means. In case of a store in a shopping center, is it the center itself or only the insured store? If the center, a fire 500' away will nonetheless allow a claim to be made. This is often not clear in the policy language and, again, needs to be negotiated after the loss or settled in court.

Which leads to consideration of a further type coverage, contingent business interruption coverage (CBI).

CBI covers income loss when the damage is to other property than the described premises. The classic coverage is of damage to property that directly or indirectly prevents a supplier of goods or services to the insured, or a receiver of goods or services from the insured, from giving or getting the goods or services. That is, a supplier or a customer cannot fulfill its usual function due to a covered type loss and the insured is damaged and the insurance should pay the loss. Some examples follow.

There were numerous claims during the 1990's Midwestern floods. In one case, a grain farmer could not supply its grain to a consolidator which in turn sold the grain to Archer Daniels Midland. ADM was forced to obtain the grain elsewhere at greater cost. It claimed under its CBI and the District Court found that policy stated coverage for "necessary extra expense resulting from [business interruption caused by] damage to or destruction of real or personal property [by insured perils] of any supplier of goods or services [resulting in] inability of such supplier to supply" the insured's location. The insurer claimed that the farmer had no contract with ADM, only with the consolidator. The court found that although the grain farmer was not ADM's direct supplier, the policy referred to "any supplier" and so ADM was covered for the extra cost [its insurance did not exclude flood damage].

When an electric power source was put out of commission by an earthquake and the plant it powered was thereby unable to manufacture its supplies, the user of the manufactured supplies was injured. But the court noted that there was no direct physical loss or damage to the manufacturer, only to the power plant, and the power plant was not the insured's direct or indirect supplier, so the CBI coverage did not apply.

Another case found recovery when a factory's by-product was steam which it sold to a neighboring plant. An explosion closed the neighboring plant, which was found to be a covered loss under a policy providing coverage for an event which "wholly or partially prevents the acceptance of products produced by the insured and results directly in the necessary business interruption of the insured's business."

An interesting unreported case involved a loss to a supplier. The operating personnel at the insured company made added-cost emergency arrangements to replace the interrupted supplies but appropriate claims persons didn't find out for quite some time which exceeded the usual time limit on reporting claims and insurer refused to pay. But the policy fortunately, and unusually, provided that notice to the insurer was required as soon as practicable after the risk management department (and not just any employee or department or some deemed notice to the insured) learned of the Event, and so the day was saved for the insured. Good risk management people somewhere in that story.

One other interesting sub-type of coverage is for an attraction, or "leader", property in the vicinity. So, if you are a motel across the street from Stapleton Airport in Denver and the airport closes for all traffic for a week, the motel would have a basis for a CBI claim. Provided the event closing the airport was a covered event (e.g. a fire).

A final topic is a brief listing of some available coverage extensions which could be considered for a business' policy. We do not mean to imply that all are cost efficient, or even needed, but only that they are may be available and so considered.

- (a) Extra expense – expenses to remain open for business that wouldn't have been incurred if there was no Event. Such as generators rented to overcome a fire burning out the electrical system.
- (b) Civil Authority – denial of access to insured's premises by direction of government authorities after a loss at a non-owned location. One reason why there was some dismay, it was reported, when New Orleans declared the City reopened.
- (c) Extended period of indemnity – extends the basic coverage period, which is generally one year or sooner reopening, often after a deductible period.
- (d) Ingress-Egress – loss of access otherwise than by government action.
- (e) Building ordinances – extra reconstruction costs due to change in law since original construction
- (f) Leasehold coverage – extra rent cost if business relocates temporarily to another location

Business interruption coverage is very valuable, but the actual wording of the policy is vital and the extensions of coverage show the need for an informed insurance broker or risk department or attorney. [Two timely articles concerning business interruption insurance, as well as seven! other articles on hurricane losses and liability, are in the ABA Tort Trial & Insurance Practice Law Journal, Spring 2006 (Vol.41, No.3)].

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New York, New York ©

FORMS

The following is a fairly typical form of business income endorsement.

BUSINESS INCOME COVERAGE FORM AMENDATORY ENDORSEMENT

A. COVERAGE

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 insured by this policy at the premises described in the Declarations, resulting from any Covered Causes of Loss.

1. Business Income

Business Income means the:

- a. Net income (Net Profit or Loss before income taxes) that would have been earned or incurred;
- b. Continuing normal operating expenses incurred, including payroll; and
- c. Actual “rental value,” if applicable.

2. Covered Causes of Loss

See Covered Causes of Loss Section.

3. Expenses to Reduce Loss

We will pay any necessary expenses you incur to reduce the amount of loss under this Coverage Form. We will pay for such expenses to the extent that they do not exceed the amount of loss that otherwise would have been payable under this Coverage Form.

B. LIMITS OF INSURANCE

The most we will pay for loss in any one occurrence is the applicable Limit of Insurance shown in the Declarations.

Payments under expenses to reduce loss will not increase the applicable Limit of Insurance.

The most we will pay for loss of Business Income in each period of 30 consecutive days after the direct physical loss or damage is:

1. The Limit of Insurance, multiplied by
2. The fraction shown in the Declarations for this Optional Coverage.

The first 30 day period begins after the deductible period specified in Declarations. Co-insurance does not apply to this coverage.

C. EXCLUSIONS

We will not pay for:

- a. Any increase of loss caused by or resulting from:
 - a. Delay in rebuilding, repairing, or replacing the property or resuming “operations,” due to interference at the location of the rebuilding, repair, or replacement by strikers or other persons; or
 - b. Suspension, lapse, or cancellation of any license, lease, or contract. But if the suspension, lapse, or cancellation is directly caused by the suspension of “operations,” we will cover such loss that affect Business Income during the “period of restoration.”
- b. Any Extra Expense caused by or resulting from suspension, lapse, or cancellation of any license, lease, or contract beyond the “period of restoration.”
- c. Any other consequential loss.

D. LOSS CONDITIONS

Duties in the Event of Loss

- a. In case of a loss to covered property, we have no duty to provide coverage under this policy if the failure to comply with the following duties is prejudicial to us. These duties must be performed by you, or your representative.
 - (1) Give us prompt notice, through your broker, of the direct physical loss or damage. Include a description of the property involved.
 - (2) As soon as possible, give us a description of how, when, and where the direct physical loss or damage occurred.

- (3) Take all reasonable steps to protect the Covered Property from further damage by a Covered Cause of Loss. If feasible, set the damaged property aside and in the best possible order for examination. Also, keep a record of your expenses for emergency and temporary repairs, for consideration in the settlement of the claim. This will not increase the Limit of Insurance.
 - (4) As often as may be reasonably required, permit us to inspect the property proving the loss or damage and examine your books and records. Also, permit us to take samples of damaged and undamaged property for inspection, testing and analysis, and permit us to make copies from your books and records.
 - (5) Send us a signed sworn proof of loss containing the information we request to investigate the claim. You must do this within xx days after our request.
 - (6) Cooperate with us in the investigation or settlement of the claim.
 - (7) If you intend to continue your business, you must resume all or part of your "operations" as quickly as possible.
- b. We may examine any insured under oath, while not in the presence of any other insured and at such times as may be reasonably required, about any matter relating to this insurance or the claim, including an insured's books and records. In the event of an examination, an insured's answers must be signed.

Loss Determination

- a. The amount of Business Income loss will be determined based on:
 - (1) The Net Income of the business before the direct physical loss or damage occurred;
 - (2) The likely Net Income of the business if no physical loss or damage had occurred, but not including any Net Income that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of Covered Causes of Loss on customers or on other businesses:

(3) The operating expenses, including payroll expenses, necessary to resume “operations” with the same quality of service that existed just before the direct physical loss or damage; and

(4) Other relevant sources of information, including:

(a) Your financial records and accounting procedures;

(b) Bills, invoices, and other vouchers; and

(c) Deeds, liens, or contracts.

b. Resumption of Operations

We will reduce the amount of your Business Income loss to the extent you can resume your “operations,” in whole or in part, by using damaged or undamaged property (including merchandise or stock) at the described premises or elsewhere.

c. If you do not resume “operations,” or do not resume “operations” as quickly as possible, we will pay based on the length of time it would have taken to resume “operations” as quickly as possible.

E. DEFINITIONS

1. “Operations” means:

a. Your business activities occurring at the described premises; and

b. The tenantability of the described premises.

2. “Period of Restoration” means the period of time that:

a. Begins with the date of direct physical loss or damage caused by or resulting from any Covered Cause of Loss at the described premises; and

b. Ends on the date when the property at the described premises should be repaired, rebuilt, or replaced with reasonable speed and similar quality.

“Period of restoration” does not include any increased period required due to the enforcement of any ordinance or law that:

a. Regulates the construction, use or repair, or requires the tearing down of any property; or

- b. Requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify, or neutralize, or in any way respond to, or assess the effect of "pollutants"; or
 - c. The requirements of which result in a loss in value to covered property; or
 - d. Requiring any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify, or neutralize, or in any way respond to, or assess the effects of, "pollutants".
-

Another somewhat more coherent form of Business Income:

3. Business Income

a. Business Income means the:

- (1) Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred;
- (2) Continuing normal operating expenses incurred, including payroll;
- (3) Includes "Rental Value"; and
- (4) Includes "Maintenance Fees" if you are a condominium association.

b. If the necessary "suspension" of your "operations" produces a Business Income loss payable under this policy, we will also pay for the actual loss of Business Income you sustain during the period that:

- (1) Begins on the date property is actually repaired, rebuilt or replaced and "operations" are resumed; and
- (2) Ends on the earlier of:
 - (a) The date you could restore your "operations" with reasonable speed, to the level which would generate the Business Income amount that would have existed if no direct physical loss or damage occurred; or
 - (b) Sixty consecutive days after the date determined in b.(1) above.

However, this extended Business Income does not apply to loss of Business Income incurred as a result of unfavorable business conditions caused by the impact of the Covered Cause of Loss in the area where the described premises are located.

Loss of Business Income must be caused by direct physical loss or damage at the described premises caused by or resulting from a Covered Cause of Loss.

c. We will only pay for loss of Business Income that occurs within 12 consecutive months immediately following the date of direct physical loss or damage.

4. Covered Causes of Loss

RISKS OF DIRECT PHYSICAL LOSS unless the loss is:

- a. Limited in Paragraph A.5., Limitations; or

- b. Excluded in Section B., Exclusions.

6. Additional Coverages

Unless otherwise stated, payments made under the following Additional Coverages will not increase the applicable Limits of Insurance.

b. Civil Authority

We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the de-scribed premises due to direct physical loss of or damage to property within the jurisdiction invoking the civil authority. Such loss or damage must be caused by or resulting from a Covered Cause of Loss.

This coverage will apply for a period of up to two consecutive weeks from the date of that action of civil authority.

c. Debris Removal

(1) Subject to Paragraphs (3) and (4), we will pay your necessary and reason-able expense to remove debris of Covered Property caused by or resulting from a Covered Cause of Loss that occurs during the policy period. The expenses will be paid only if they are reported to us in writing within 180 days of the date of direct physical loss or damage.

(2) Debris Removal does not apply to costs to:

- (a) Extract "pollutants" from land or water; or
- (b) Remove, restore or replace polluted land or water.

(3) Subject to the exceptions in Para-graph (4), the following provisions apply:

(a) The most we will pay for the total of direct physical loss or damage plus debris removal expense is the Limit of Insurance applicable to the Covered Property that has sustained loss or damage.

(b) Subject to (a) above, the amount we will pay for debris removal expense is limited to 25% of the sum of the deductible plus the amount that we pay for direct physical loss or damage to the Covered Property that has sustained loss or damage.

(4) We will pay up to an additional \$25,000 for debris removal expense, for each location, in any one occurrence of physical loss or damage to Covered Property, if one or both of the following circumstances apply:

- (a) The total of the actual debris removal expense plus the amount we pay for direct physical loss or damage exceeds the Limit of Insurance on the Covered Property that has sustained loss or dam-age.
- (b) The actual debris removal expense exceeds 25% of the sum of the deductible plus the amount that we pay for direct physical loss or damage to the Covered Property that has sustained loss or damage.

Therefore, if (4)(a) and/or (4)(b) apply, our total payment for direct physical loss or damage and debris removal expense may reach but will never exceed the Limit of Insurance on the Covered Property that has sustained loss or damage, plus \$25,000.

e. Expediting Expenses

In the event of covered ' loss or damage, we will pay for the reasonable and necessary additional expenses you incur to make temporary repairs, expedite permanent repairs, or expedite permanent re-placement at the premises sustaining loss or damage. Expediting expenses include overtime wages and the extra cost of ex-press or other rapid means of transportation. Expediting expenses do not include expenses you incur for the temporary rental of property or temporary replacement of damaged property.

The most we will pay under this Additional Coverage is \$10,000 in any one occurrence.

f. Extra Expense

(1) We will pay the necessary and reasonable Extra Expenses you incur during the "period

of restoration" that you would not have incurred if there had been no direct physical loss of or damage to property at the premises described in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss. With respect to loss of or damage to personal property in the open or personal property in a vehicle, the de-scribed premises include the area within 1,000 feet of the site at which the described premises are located.

With respect to the requirements set forth in the preceding paragraph, if you occupy only part of the site at which the described are located, your premises means:

- (a) The portion of the building which you rent, lease or occupy; and
- (b) Any area within the building or on the site at which the described premises are located, if that area services, or is used to gain access to, the described premises.

(2) Extra Expense means expense incurred:

- (a)** To avoid or minimize the "sus-pension" of business and to continue "operations":
 - (i) At the described premises; or
 - (ii) At replacement premises or at temporary locations, including relocating expenses, and costs to equip and operate the replacement or temporary locations.
- (b)** To minimize the "suspension" of business if you cannot continue "operations".
- (c)** To repair or replace any property.