

## Ten Tips to Securing Insurance Coverage for a Business Interruption

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### INTRODUCTION

In the aftermath of Hurricane Floyd and the recent earthquakes in Europe and Asia, insurance for business interruptions has taken on renewed importance. That importance will increase exponentially if only a fraction of the widely anticipated Y2K calamities surface.

Business interruption insurance is typically sold as an endorsement to first-party property insurance policies. It promises to indemnify policyholders for losses associated with insured interruptions of their business. As one court concluded, business interruption insurance “is designed to do for the insured . . . just what the business itself would have done if no interruption had occurred . . .” Eastern Associated Coal Corp. v. Aetna Cas. & Sur. Co., 632 F.2d 1068, 1079 (3d Cir. 1980).

As with any insurance claim, however, securing full and timely payment requires a special mix of perseverance and ingenuity. Following the steps outlined below can enhance your business interruption insurance recovery.

1. Locate the Implicated Insurance Policies:

Treatises have been written on the appropriate “trigger of coverage” in third-party liability cases. While less has been written on the “trigger of coverage” in the context of first-party property losses, the issue remains important.

Most often, a property loss is caused and becomes manifest at the same time, as in the cases of fires or explosions. Some property losses, however, including

those that could arise in connection with Y2K, may be caused by events that take place well in advance of when any damage becomes manifest. For example, property damage may commence upon the installation of a defective computer chip, even though damage to the computer may not become manifest for many years. In those circumstances, careful consideration should be given to whether insurance policies in force prior to any actual manifestation of damage are triggered.

Moreover, large losses may also trigger coverage under excess insurance policies.

2. Give Timely Notice:

As with any insurance claim, prompt and timely notice can only aid recovery efforts. Property insurance policies typically require the submission of a signed and sworn proof of loss within a very short time frame, such as 90 days. Insurance companies are usually amenable to extending this period of time, but it is a good practice to secure such extensions in writing.

In addition, property insurance policies also require the filing of suit against the insurance company within a certain period of time, typically one to two years after the date of loss. Failure to file suit within the prescribed time period may result in the forfeiture of insurance.

3. Minimize the Loss:

Property insurance policies typically require a policyholder to minimize the loss through mitigation efforts. In the context of a business interruption, policyholders should promptly: (a) make temporary repairs to damaged property and equipment; (b) incur those expenses that will expedite the end of the interruption; (c)

secure alternate facilities or equipment; and (d) make use of available inventory. The unexcused failure to reasonably mitigate a loss could result in a loss of insurance.

Each of these activities should be undertaken in conjunction with the insurance company. Coordinating with, and seeking the assistance of, the insurance company will maximize the insurance recovery of these expediting and repair expenses. Obtaining the assistance of the insurance company makes sense for an additional reason - they are, or should be, expert in such repair and recovery efforts.

4. Document the Loss:

The better and more completely that a policyholder can document its loss, the quicker and more fully will it secure an insurance recovery. Supporting documentation for the following is prudent, if not, essential: (a) the reconstruction schedule; (b) the experience of the business prior to the interruption; (c) the production and sales forecasts for the interruption period; (d) the experience of the business during the interruption period; (e) the net sales value of the products or services lost as a result of the interruption; (f) the variable costs associated with involved products or services; (g) the expenses incurred in mitigating the loss; and (h) the value of production or sales made up through the mitigation efforts.

A professional, such as an accountant or public adjuster can be of immeasurable assistance in properly documenting a loss and preparing a business interruption claim. Often the fees charged by such professionals in providing claim documentation and preparation services are expressly covered under property insurance policies.

5. Determine the Period of Interruption:

Business interruption insurance policies insure losses occurring during a defined “period of interruption.” The “period of interruption” is typically defined to begin on the date when physical damage is sustained and end on the date when the damaged property could be repaired or replaced with due diligence or dispatch. As defined, the “period of interruption” refers to a “theoretical” period of time. The insurance industry desired the use of a theoretical period, because it:

wanted a standard of potential replacement time which was amenable to computation in advance and which was not subject to vagaries like owner indecision, strikes, or failure of lease negotiations which might affect the actual rebuilding time.

Beautytuft, Inc. v. Factory Ins. Assn., 431 F.2d 1122, 1125 (6<sup>th</sup> Cir. 1970).

Accordingly, the duration of any given “period of interruption” may be shorter or longer than the actual period of time it takes a policyholder to resume operations. No court, however, has found a period of interruption to be shorter than the actual repair or replacement time when a policyholder has acted diligently.

6. Determine the Loss Sustained:

The following multi-step formula serves as a useful guide in calculating a business interruption loss.

- a. Determine the “period of interruption.”
- b. Determine the quantity of lost production as reflected in inventory records, production records and sales records. Compute what the plant would have normally produced, had there been no loss, and then see how many units were actually produced. The difference is the gross lost production.
- c. Deduct any sales or production that can be continued or made up through the use of existing inventory, the

utilization of other plants, the utilization of overtime hours or other loss mitigation efforts. The difference is the net lost production.

- d. Multiply the net lost production by the marginal value of a single production unit.
- e. Add back the extra costs associated with replenishing inventory, and loss mitigation efforts.

The fundamental consideration in adjusting a business interruption loss is the actual experience of the policyholder's business during the "period of interruption."

Business interruption policies typically provide, in a provision entitled "experience of the business," that in determining the loss,

due consideration shall be given to the experience of the business before the date of damage . . . and to the probable experience thereafter, had not loss occurred.

Accordingly, if a policyholder's business would have operated at a loss during a period of interruption, it has been held that it suffers no compensable actual loss sustained. Berkeley Inn, Inc. v. Centennial Ins. Co., 422 A.2d 1078,1080 (Pa. Super 1980). On the other hand, a new business with no prior earnings can still collect under business interruption insurance, as long as it can demonstrate, through the use of accounting projections and other proofs, the requisite loss of profits during the period of interruption. Hutchings v. Caledonian Ins. Co. of Scotland, 52 F.2d 744 (E.D. SC 1931). Moreover, if a business' earnings are reduced as a result of a planned maintenance shutdown or another non-insured event during the "period of interruption," then the amount of actual loss sustained is reduced by a commensurate amount.

7. Seek Insurance Company Guidance on Non-covered Items or any Additionally Covered Items:

An insurance company's obligation to adjust insurance claims fairly and in good faith requires that it advise its policyholder promptly of: (a) any claim which is, in whole or in part, potentially not covered; (b) any differences over loss measurement or valuation; and (c) any covered items that have been left out of the claim. Moreover, as discussed above, an insurance company should be made an integral part of any mitigation efforts. In that way, the insurance company may be barred from complaining later about reimbursing the costs of those efforts.

8. Submit the Claim:

An insurance "claim" or "proof of loss" is a submission by a policyholder to the insurance company, which states and documents the amount of the policyholder's loss. It should be signed by an authorized representative of the policyholder and state the date and location of the loss as well as the amount claimed. With respect to a business interruption, it should summarize the claim components discussed above, including; (a) the period of interruption; (b) the production lost as result of the interruption; (c) the value of that lost production; and (d) the expenses incurred in mitigating the loss. The claim should also include all of the documentation supporting the claim components and values.

9. Seek Advances of Undisputed Portion of Claims:

Insurance companies will advance their policyholders' payments for those portions of an insurance claim over which there is no dispute. Accordingly, even if there is a dispute over a portion of a claim, press for payment of the undisputed portion. By pressing for and receiving advances, the insurance company may be precluded from

using those funds as leverage for resolving the disputed portion of the claim to its advantage.

10. Be Prepared to Appraise, Arbitrate and Litigate:

At times, the only way to secure a reasonable insurance recovery is to resort to some type of dispute resolution mechanism. The better prepared you are for that possibility, the more positive the outcome will be. By following the steps outlined above, you will be prepared to present your claim almost immediately to the arbiter, whether it be a judge, jury, arbitrator or appraiser.

Although property insurance policies typically contain appraisal clauses, appraisal is not appropriate in all circumstances. Rather, appraisal is appropriate only in disputes over the amount or value of a loss. Legal disputes, including policy interpretation issues, are typically not subject to appraisal.

Should litigation become necessary, make certain to select the most appropriate forum in which to litigate. Insurance law issues are governed by state law, which can vary dramatically on a state by state basis. To the extent that a choice is available, make sure you choose the most advantageous forum.

Conclusion

Like most important business matters, securing a full insurance recovery in response to a business interruption requires careful planning, the collection and presentation of detailed records, an awareness claim submission deadlines and requirements and the guidance of experienced professionals. Adherence to above-described steps should expedite and enhance any insurance recovery.