Hurricanes, Sandy, and Business Interruption Insurance Policies

by Charles A. Yuen on November 6, 2012

Policyholders are likely to file many business interruption insurance claims as a result of the destruction associated with Sandy. They should try to understand the coverage and recognize how carriers will try to limit their recovery.

In order to incur a business interruption loss, an insured typically must suffer a loss of income from a disruption of business operations. This disruption may be from a physical loss or damage to the insured's own property, as a result of a covered cause of loss. Where an insured's operations are disrupted by a supplier, "contingent business interruption" provisions may provide additional coverage. Policies may also cover business interruption simply as a consequence of government action, or as a preventative measure.

Coverage typically begins following a waiting period, such as 72 hours. Coverage continues for the length of time it takes to repair, rebuild, or replace the damaged or destroyed property. Electrical outages, such as those caused by Sandy, may delay resumption of full business operations.

Before making payments, carriers will review their policy exclusions and causation provisions. Flood may be an excluded cause of loss, or recovery for flood damage may be subject to a low coverage limit. Insurers may try to characterize damage as resulting from flood. Policyholders may want to preserve evidence that damage resulted from another covered cause of loss, such as wind, or perhaps from wind-driven-rain.

While reviewing their physical losses, policyholders should be generally aware that case law typically supports a narrow construction of policy exclusions. For example, New Jersey courts have held that a peril-related exclusion may apply only if it is an "efficient proximate cause" of a loss. This may permit coverage where the exclusion may, at a first and limited glance, seem to apply.

"Thus, an insured is normally afforded coverage where an included cause of loss is either the first or last step in the chain of causation which leads to the loss." (*Puhlovsky v. Rutgers Cas. Ins. Co.* (N.J. App. Div. 2012)). Thus, even where water damage was excluded, New Jersey appellate courts have found flood damage covered (a) where vandals caused the flood and (b) where a sump pump hose broke and caused the flood. (*Id.*) Evidence concerning the chain of causation for items of physical loss should be reviewed in the context of any potentially applicable policy exclusions.

Carriers and their policyholders will also review the policy "triggering" requirements, such as whether suspension of the policyholder's business may be partial or must be total. They will also be looking for evidence of appropriate restoration periods, as well as appropriate historical and market evidence which may bear upon calculations of lost income. Many will promptly retain forensic accountants to analyze the expenses.

During the adjustment period, there exist competing goals. Businesses, of course, want their claims adjusted promptly and fully. Insurers want reasonably complete information from insureds prior to committing to payments. They also need to substantiate their payments in order to preserve their rights to recover from their reinsurers.

It is clear that as business interruption losses from Sandy are adjusted, many claims will be denied. Disappointed policyholders should not hesitate to review their policies -- and question any such denials.

If you would like to discuss anything further, please feel free to contact me.