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Coverage for Disrupted Business Relationships in the Storm Battered Gulf Coast

by Finley T. Harckham

Many companies have suffered losses from Hurricane Katrina, Hurricane Rita, or both, not because their own facilities were damaged, but because they do business with suppliers and customers in the Gulf region who were shut down by the storms. Collectively, these losses will amount to billions of dollars. Many affected businesses assume that they have no insurance coverage for the lost profits they have suffered and will suffer as a result of these catastrophes, and a good number of them are wrong.

Contingent Business Interruption Coverage

Many property insurance policies sold to businesses provide contingent business interruption coverage (sometimes called dependent time element coverage) for losses resulting from physical damage to the premises of suppliers and customers. There are significant limitations on this coverage, but its worth a careful examination of your policies to determine whether it applies to losses related to the hurricanes.

Insurance Coverage Provisions

There are numerous forms used to provide contingent time element coverage, and there can be significant differences among them. Typically, they provide coverage for lost profits and extra expense suffered as a result of physical loss or damage to the premises of a supplier or customer. For example, a commonly used wording provides:

> This Policy covers the Actual Loss Sustained and EXTRA EXPENSE incurred by the Insured during the PERIOD OF LIABILITY directly resulting from physical loss or damage of the type insured to property of the type insured at Dependent Time Element Locations located within the TERRITORY of this Policy.
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> Dependent Time Element Location means:
>
> (i) any location
>
> (a) of a direct customer, supplier, contract manufacturer or contract service provider of the insured;
>
> (b) of any company under a royalty, licensing fee or commission agreement with the Insured.

ANDERSON KILL LOSS ADVISORS
1251 Avenue of the Americas
New York, NY 10020-1182
(212) 278-1000 Fax: (212) 278-1733

1600 Market Street
Philadelphia, PA 19103
(215) 568-4202 Fax: (215) 568-4573

One Gateway Center
Suite 901 Newark, NJ 07102
(973) 642-5858 Fax: (973) 621-6361

2100 M Street, N.W.
Suite 650
Washington, DC 20037
(202) 218-0040 Fax: (202) 218-0055

230 West Monroe Street
Suite 2540
Chicago, IL
(312) 201-9516
Fax: (312) 201-9548

ANDERSON KILL & OLICK, P.C.
Two Sound View Drive
Suite 100
Greenwich, CT 06830
(203) 622-7668 Fax: (203) 622-0321

www.andersonkill-la.com

who's who

Finley T. Harckham is a senior stockholder in the law firm of Anderson Kill & Olick, P.C. Mr. Harckham regularly represents and advises corporate policyholders in insurance coverage matters and has successfully litigated, arbitrated and settled hundreds of complex coverage claims. Mr. Harckham's areas of particular expertise include property loss, business interruption and general liability claims. Mr.Harckham can be reached at (212) 278-1543 and fharckham@andersonkill.com.

This coverage may be limited by a maximum period of time, by a dollar limit, or both. Also, contingent business interruption coverages are subject to various exclusions.

Importantly, this policy wording and most others limit coverage to circumstances where the physical damage to the supplier or customer was caused by a peril that would give rise to coverage if it had resulted in loss to the policyholder's own property. Virtually all property policies provide coverage for wind damage and resulting rainwater damage. Moreover, many businesses have flood insurance. Even if that flood coverage is limited to certain regions—not including the Gulf coast —the policyholder will have a strong argument for contingent business interruption coverage. Coverage likely will be more problematic for companies that have flood exclusions in their policies.

Flood Exclusions May Not Bar Coverage

Even a company in Arizona with a flood exclusion in its insurance policy should carefully investigate the circumstances of the losses suffered by its suppliers or customers to determine whether the exclusion applies. Most flood exclusions are broadly written, but some may not apply to the unique events which resulted in the flooding of New Orleans, which centered around the failure of levees and not the typical scenario of a river overflowing its banks. The specific wording of a policy must be closely scrutinized with the particular facts of this tragedy in mind. Moreover, even if a flood exclusion applies to the circumstances of a supplier's or customer's property damage, the policyholder may nonetheless be entitled to recover at least part of its business income loss. Many businesses in the Gulf suffered both wind damage and flood damage. Any significant covered wind damage should trigger contingent business interruption coverage. At the very least, a proportion of the business income loss attributable to the wind damage should be recoverable. If the damage from covered and excluded causes, and the resulting contingent business interruption, cannot be segregated, the policyholder will have a reasonable argument for a full recovery. Likewise, the policyholder will have a strong argument for a full recovery if a covered cause of loss result in enough damage to cause the entire contingent business interruption loss, even if an excluded peril also created enough damage to result in the full income loss. Thus, the extent of coverage for these claims may be highly dependent upon the particular facts surrounding the loss suffered by the supplier or customer.

If contingent business interruption coverage is trigged, it typically applies to restore the policyholder's lost profits, just like regular business interruption coverage. Example of circumstances which may give rise to a covered contingent business interruption loss include:

- A manufacturing company cannot obtain a special petrochemical needed for the formulation of its products. As a result, it cannot fill orders or solicit new business, or

- The same company obtains substitute supplies of the petrochemical from alternative sources, but at a higher cost that it cannot pass on to its customers.

- A distributor of electronic products cannot sell to retail chains in the Gulf region because their stores have been destroyed. Those lost sales are not made up in other areas because the evacuees who left the affected areas lack disposable income to purchase the products.

Conclusion

Many other situations may also qualify for coverage. Policyholders must assess the impact of the hurricanes on their businesses and examine their coverage with that set of facts in mind.

As with any other type of insurance claim, the policyholder should give notice of a contingent business interruption loss to its carriers as soon as possible. Do not wait for the extent of the loss to become clear. Also, give notice even if it is unclear whether a covered loss will be suffered. Delaying notice, for even the seemingly most logical of reasons, creates the risk of a forfeiture of coverage.

Of course, a contingent business interruption claim must be fully substantiated, and a qualified public loss adjuster or accountant should be enlisted to quantify the loss. Do not rely upon the so-called independent adjuster retained by the insurance companies to properly adjust the loss. The "independent" in independent adjuster simply means he or she is not an in-house employee of an insurance company; it does not mean that they are neutral.

If the claim ends up in a protracted adjustment process, be mindful of policy provisions limiting the period in which the policyholder may sue the insurance company. Some policies provide that the period is as little as twelve months, although some state statutes enlarge the period. If the deadline is approaching and the claim has not been resolved, obtain a written extension of the time period from the insurance company. In all likelihood you will get the extension. If not, that may be a strong indication of the insurers intentions toward resolving your claim.

Check your policies for contingent business interruption coverage. You may find a silver lining to the storm clouds. ■

To learn more about the Loss Advisors Network Visit: www.andersonkill-la.com | Members List:

Marvin Milton, SPPA	Swerling Milton Winnick 36 Washington St., Suite 310 Wellesley Hills, MA 02481	(781) 416-1000 marvin@swerling.com www.swerling.com
Ronald J. Papa, SPPA President	National Fire Adjustment Company One NFA Park Amherst, NY 14228	(716) 632-7272 rpapa@nfa.com www.nfa.com
Charles (Dick) R. Tutwiler, CPCLA	Charles R. Tutwiler & Associates Inc. 5401 W. Kennedy Blvd., Suite 757 Tampa, Fl. 33609	(813) 287-8090 ext. 105 tutwiler@publicadjuster.com www.publicadjuster.com
John Apicella, SPPA	Apicella Adjusters, Inc. 284 S. Lambert Road Orange, CT 06477	(203) 795-3111 x314 John@ApicellaAdjusters.com www.apicellaadjusters.com
Jack H. Kunz President and Director	Alex N. Sill Company The Genesis Building 6000 Lombardo Ctr., Suite 600 Cleveland, OH 44131	(216) 524-9999 jkunz@sill.com www.sill.com
Richard Cohen	Clarke and Cohen 425 Belmont Avenue Bala Cynwyd, PA 19004	(610) 668-0144 rcohen@clarkeandcohen.com www.clarkeandcohen.com
Michael Rubin, SPPA	Rubin, Palache & Associates, LLC 16542 Ventura Blvd., Suite 310 Encino, CA 91436	(818) 728-0900 mrubin@9adjust.com www.9adjust.com
Finley T. Harckham President	Anderson Kill Insurance Services 1251 Avenue of the Americas New York, NY 10020-1182	(212) 278-1543 Fax: (212) 278-1733 fharckham@andersonkill.com www.andersonkill-la.com

Anderson Kill & Olick, P.C.
1251 Avenue of the Americas
New York, NY 10020