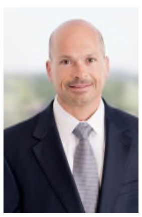
Lawyer Insights

September 14, 2017

Hurricanes Highlight Need for Contingent Business Interruption Insurance

by Syed S. Ahmad, Michael S. Levine and Katherine Miller

Published in Risk Management Magazine


As shown by the recent catastrophic impacts of Hurricane Harvey and Hurricane Irma, ensuring that your business is adequately covered for all potential storm risks is critical. But even if your business is not in the direct path of a hurricane, you still could suffer significant financial loss if another business you rely on is shut down or impacted by the storm. For this reason, contingent business interruption (CBI) insurance is (or should be) an important part of your insurance coverage portfolio.

What is CBI?

CBI typically provides coverage for loss of income due to physical loss or damage to property of a third party, such as a supplier, customer, transporter or other businesses that you rely on to operate your business. For example, if your sole supplier of materials is shut down because of a hurricane and subsequent cleanup, your business could suffer significant financial loss. CBI insurance provides coverage for this type of loss.

Unlike traditional business interruption insurance, which covers loss of your business income resulting from a physical loss or damage to your insured property, such "first-party" physical loss or damage is not needed to trigger CBI coverage. Rather, CBI is triggered when physical loss or damage occurs to property on which your business depends for its normal operation. This is why CBI coverage often is referred to as "dependent property" coverage. The term is born straight out of the standard policy language, which provides that the insurer will pay for loss the policyholder "sustains due to the necessary 'suspension of [its] operations' during the 'period of restoration.' The suspension must be caused by direct physical loss of or damage to 'dependent property.'"

What is Required to Trigger CBI?

As the policy language provides, the threshold inquiry is whether the third-party business's property is a "dependent property" under the policy. Some policies include a designated schedule of dependent properties while others define dependent property to include entities that deliver materials or services to the policyholder, customers that accept the policyholder's products or services, manufacturers of products and "leader locations" that attract customers to your business.

Additionally, some policies explicitly limit coverage to those businesses that are in a direct contractual relationship with the policyholder, whereas others employ broad language that triggers coverage after damage to "any supplier of goods or services." This broader language should not require a direct contractual relationship between the insured and the dependent property. Thus, if the policyholder relies on a supplier, and that supplier relies on another supplier that actually suffers the direct property damage, CBI still may be available for the policyholder's resulting financial loss.

But even under this broader language, the dependent property must function in a manner central to the policyholder's business. For instance, if a hurricane results in damage to power transmission lines that, in turn, causes a power outage that disrupts a dependent property's ability to produce goods for the policyholder, CBI would likely not be triggered because the party that suffered the physical loss (the power company) has no direct connection or relationship to the policyholder's business. This is distinguishable, however, from a situation where physical damage to a supplier's property directly results in a disruption of the policyholder's business.

Is Physical Injury to Dependent Property Required?

As discussed above, most first-party property policy CBI provisions require that the dependent property suffer some direct physical loss. Whether particular damage constitutes direct physical loss to dependent property sufficient to trigger CBI coverage will vary based on the circumstances, including in particular, the language of the insurance policy at issue. For instance, if a hurricane were to flood and disable a dependent property's computer systems, the flooded computers would likely constitute the requisite physical injury to tangible property needed to trigger CBI coverage. Of course, whether such flood damage could in fact trigger CBI would also depend on whether the policyholder's own policy included coverage for flood, since most policies require that the loss giving rise to the interruption be one that would otherwise be covered under the policyholder's own policy.

When Does CBI Begin, and When Does It End?

CBI is typically governed by time limitations, both for coverage inception and duration.

On the front end, CBI often does not incept until after a specified waiting period has elapsed. Such waiting periods often are between 48 and 72 hours. Think of this as a "time-element" deductible or retention. Once coverage has incepted, CBI will typically last until the dependent property is rebuilt, replaced or restored. This period is often referred to as the "period of restoration." Keep in mind, also, that like other coverages, CBI may be subject to a policy limit or sublimit.

Unlike an ordinary business interruption claim, however, CBI coverage typically does not require that the dependent property suffer a total cessation of operations. A slowdown will generally be enough to trigger this coverage. Thus, if an insured manufacturer sells a product to retailers nationwide, and a hurricane results in reduced sales to the manufacturer's buyers in the region affected by the hurricane, these reduced profits should be covered. This is especially important where businesses will likely have reduced hours leading up to and after the hurricane, such as when curfews are in effect after the storm hits.

Syed S. Ahmad and Michael S. Levine are partners at Hunton & Williams LLP in the Washington, DC office. Syed represents clients in connection with insurance coverage, reinsurance matters and other business litigation. He can be reached at (202) 955-1656 or sahmad@hunton.com. Michael practices nationally, focusing on insurance recovery, counseling and litigation. He can be reached at (202) 955-1857 or mlevine@hunton.com. Katherine Miller is an associate at the firm's Miami office. Her practice focuses on complex business litigation with an emphasis on insurance coverage counseling and litigation. She can be reached at (305) 810-2525 or kmiller@hunton.com.