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March 2011

Business Interruption Insurance

Introduction

Recent extreme weather events and other natural disasters across Australia, New Zealand and South East Asia have caused an unprecedented amount of damage, causing severe disruption not only to individuals, but also to the commercial and industrial sectors, with many businesses experiencing significant interruption, and in the most extreme cases, total collapse.

While many businesses are insured against property damage, many suffer from loss of profits as a result of their inability to quickly resume normal business operations.

With the volume of claims now at over a billion dollars in Queensland alone, protracted litigation is a possibility in relation to disputes over exclusions and business interruption losses.

This article discusses the purpose of a business interruption policy ("BIP"), how BIP policies are quantified and some of the issues arising out of the interpretation of BIPs.

Business Interruption Insurance

Most commonly incorporated in Industrial Special Risk Policies (ISRs), business interruption insurance is designed to cover the shortfall in a business's gross profits caused by an interruption to the business following an insured loss. The policies often also provide cover for overheads such as mortgage payments, rent, salaries, and the costs incurred during relocation.

The purpose of business interruption insurance is to assist businesses to resume normal operation so that they can generate the same profits enjoyed before the event, thereby returning the business to the position it would have been in had the event not occurred.

For an insurer to indemnify an insured under a BIP, the insured bears the onus of establishing that, on the balance of probabilities, its loss was caused by an insured peril. Three requirements must usually be satisfied:

1. The insured must sustain some sort of "*physical damage*" as a result of an insured peril;
2. There must be an interruption to the insured's business as a result of that physical damage; and
3. The damage must have resulted in a measurable business interruption loss.

Each of these can often be a vexed question, depending on the strength of the definitions in the BIP. As with many types of policies of insurance, the words chosen in the insurance clauses, extensions and exclusions will be critical, such as "occasioned by", "indirectly or directly arising out of", "in connection with", "caused by" and "relating to".

Where there are two concurrent causes of loss, the Wayne Tank principle[1] will require careful consideration. That well known English case is authority for the proposition that where loss arises by reason of two or more causes that can both be considered 'proximate' causes of loss, where one of those causes of loss is excluded under the policy, the policy will not respond to the entirety of the claim. Although that decision was not followed in *McCarthy v St Paul International Insurance Co Ltd,*[2] it is still regarded as applicable in Australia, and is a potential area of difficulty for insureds.

Prior to obtaining a BIP, insureds must first provide insurers with an estimate of the time it would take for their business to resume normal operation following damage from an insured peril. Commonly known as the "*business interruption period*", insureds will often be brought to task for providing insurers with false information with respect to their expected period of restoration.

The same applies when disclosing to insurers a business's turnover. Failure to provide insurers with an accurate estimate in an attempt to reduce premiums can lead to difficulty for the insured, should the need arise to make a claim.

Under insurance arises when the sum insured is less than the amount required to fully indemnify against the resulting loss. When an insured attempts to claim under the policy, they will not receive full compensation for an insured event, but proportionately share in any loss. Most commonly, this will be expressed in an "*averaging clause*", meaning that an insured may be required to bear part of the loss itself if the business is under insured.[3]

It is important to remember that pursuant to s 44(1) of the *Insurance Contracts Act 1984* (Cth), insurers cannot rely on an averaging provision included in a contract of general insurance unless, before the contract was entered into, the insurer informed the insured in writing of the nature and effect of the provision.

Policy Interpretation

In the wake of the recent floods, a key issue facing insurers is determining the cause or causes of loss and deciding the extent of loss attributable to each cause, for example where loss is attributable to both river flood and water escaping stormwater drains.[4]

In the event insurers agree to provide cover against floods, it is often only against flash floods or flooding resulting from a storm, but not flooding from a river.

It can be difficult in practice differentiating between flash flooding and storm damage caused by run off.

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In light of these difficulties, it is perhaps no surprise flood affected policy holders are being urged by plaintiff lawyers to submit claims despite being told by insurers that they are not covered. There are rumours of class actions against insurers, alleging misinformation about policies, contrary to the provisions of the *Trade Practices* legislation.

In a recent decision[5] by the Financial Ombudsman Service ("FOS"), FOS found an insurer liable to indemnify an insured because the insurer could not establish that the insured was provided with a product disclosure statement. Since "*floods*" were covered as a prescribed event under the *Insurance Contracts Regulations 1985*, the insurer was ordered to indemnify the insured.

Calculating Claims

BIPs can be one of the more contentious insurance policies, because there are numerous factors that impact the calculation of an insured's loss, including consideration of actual profits over gross profit speculation. In quantifying expected profits, the insured bears the onus of establishing the revenue it would have earned had the interruption to the business not occurred. In the event the business was not profitable at the time the event occurred, the insured will be required to establish that the business had an improved expectation of profit during the business interruption period.

To determine an insured's actual loss, it is also important to pay close attention to whether the insured has attempted to mitigate its loss, for example by selling existing stock or partially resuming operations in an attempt to reduce their loss of profits during the business interruption period.

Regardless of whether there is more than one cause of loss, cover will only extend to expenses that are incurred as a result of physical damage, arising from an insured peril and not from an insured's attempt to minimise the risk of a similar occurrence in the future.[6] Where there is more than one cause of loss following a business interruption, it is important for insureds to implement systems that ensure the losses attributable to each cause are separately identified. The insured bears the onus to establish that the loss was proximately caused by an insured event.

In the event that a business was interrupted due to a lack of accessibility, and not a result of damage to the insured's property, a decision made by a public authority in the interest of public safety may preclude cover, unless a selected extension to the policy provides cover for loss of access.

Moving Forward

While many businesses hold a BIP, a significant number are coming to the realisation that they are either underinsured or precluded from making claims due to certain policy exclusions. Nonetheless, plaintiff law firms and consumer protections groups seem committed to pursuing claims through the courts and lobbying the legislature.

In response to the potential ambiguity or confusion surrounding the term "flood", the Australian insurance industry has recently announced its decision to establish a standard "flood" definition in an attempt to simplify policies and provide clarity to policy holders.

Insurers that write flood protection / or exclusions into BIPs should be mindful of developments in this area.

1 *Wayne Tank & Pump Co Ltd v Employers Liability Assurance Corporation Ltd* [1974] 1 QB 57.
2 [2007] FCAFC 28.
3 *J'O Conner and Sons Pty Ltd v Spunfine Pty Ltd, Macaray Pty Ltd and MMI General Insurance Limited* [1998] ACTSC 69.
4 See for example *Peterson v Union des Assurance de Paris IARD* (1995) 8 ANZ Insurance cases.
5 Case 213228.
6 *PMB Australia Ltd v MMI Insurance Ltd & Ors* (2002) ANZ Insurance Cases, 61-537 per Jersey CJ, Jerrard JA & White J.

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