An unwelcome interruption

Will business interruption insurance be the answer to all your woes? Helen Smith, of Duncan Cotterill, looks at the fine print.

Some Christchurch companies are discovering that their business interruption policy is not all they thought it was.

Many are shocked to find that there is no cover for lost profits as a result of the general economic downturn caused by people no longer frequenting a certain area of the city (commonly referred to as "loss of attraction" or "depopulation"). Some suggest insurers are reneging on their obligations and looking for ways to avoid paying out. But is it so?

Insurers don't provide cover for all losses. The losses which are covered are set out clearly in the policy so understanding your policy is key. Businesses can suffer a loss of turnover or an increase in expenses for many reasons but not all of these will be insured. It is important to read the policy to see what cover is actually provided and to get advice early.

Business interruption insurance used to be called loss of profits or consequential loss insurance. While the name has changed, the principles remain the same. What is covered is lost profit (that is, reduced turnover or an increase in expenses) caused by a business interruption. However, not all business interruptions result in cover under the policy. As always with insurance, the terms of the policy determine what is covered.

Trading for many Christchurch businesses has dropped dramatically since the earthquake. In some areas that is set to continue for some time. However, the fact that many businesses will have suffered reduced turnover or increased costs in the weeks since the earthquake is not, in of itself, enough. The reduction in turnover or increased costs must arise because of damage to insured physical property. If there is no damage to insured physical property, or there is but the loss of profit arises because of other reasons, there is no cover. The damage has to be an effective cause of the business interruption - not just coincidental to it.

So what does all of this mean? You need to look carefully at the cause of the reduced turnover or increased costs and then look to your policy to see whether the circumstances fall within one of the insuring clauses. Some policies include extensions that provide cover for damage at suppliers' or customers' premises or for prevention of access to your premises so be sure to check whether any of the extensions apply. Sadly, however, it is beyond the scope of a business interruption policy to provide cover for the effects of the earthquake on the local economy. Is that fair? Many would say 'no' but if that's what your policy says, then it's fair. The nature of the cover is set out clearly in the policy and the extent of cover dictates the premiums that we have been paying for years. If we wanted more far reaching cover (assuming we could get it and cover for loss of attraction is not common) then the premiums payable would have been significant and likely out of reach for most businesses.

Cover is also available for some business interruptions where they arise from physical damage somewhere other than property of the insured. The most common are where the business interruption is caused by damage to customer's and supplier's premises, prevention of access or closure of premises by authorities. As the cordon is still in place preventing access to those buildings in the red zone understanding the cover provided by the last two extensions referred to is important. As with all policies, the specific terms of the policy need to be analysed carefully to determine whether there is cover and if so, to what extent.

Your business interruption policy will include an indemnity period, normally around 12 months but sometimes up to 24 months. Businesses might still be suffering lost profits after the indemnity period has expired but this is not covered by insurance.

Businesses need to be close to their key advisors to ensure that they are making the most of the opportunities that are available - both from an insurance, tax, employment and commercial perspective. As business interruption policies do not cover losses that arise from a general economic downturn, understanding your rights and obligations and making decisions early to ensure the viability of your business is fundamental. Make sure you review your policy. Talk with your insurer either directly or through the appointed loss assessor. Clarify any areas of uncertainty with the scope or meaning of the policy, or what is required of you. Ask about a progress payment on your claim to ease cashflow. If you are not satisfied with the response, seek legal advice.

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