

Maximizing Protection Against Disruptions to Your Supply or Distribution Chain

Industry Week

Focus as soon as possible on establishing the extent and scope of your insurance coverage in order to be able to present an insurance claim that will maximize recovery for any losses. Calculating Loss: Calculating the total loss for an interruption claim is not as easy as calculating loss to real property. Most policies require that businesses calculate interruption losses in one of two ways: (1) the net reduction in gross earnings minus expenses that do not necessarily continue or (2) the net profit that is prevented from being earned plus necessary expenses that continue during the period of interruption. Establishing such a loss involves a complicated process of demonstrating how the policyholder would have performed had the event not occurred, and the nature of the market in general, potentially including the impact of the catastrophic event on that market. This may be especially difficult with new business enterprises or businesses in volatile markets. Any early assessment of loss, whether conducted by the policyholder or insurer, should make clear that the calculation of a business interruption or CBI loss is a complicated process, and it may take months, if not years, for a policyholder to realize the full impact of a catastrophe on its business. A policyholder suffering a CBI loss faces the additional hurdle of proving damage to a third party, i.e. a supplier or distributor. After an event, a policyholder should work closely with its suppliers or distributors to establish the extent of the damage suffered by that third party. Such evidence may be difficult to obtain during the claim adjustment process in the months and years following the loss. Loss of Market: Property and business interruption policies often contain an exclusion applying to claims for “delay or loss of market.” Insurers may argue that this exclusion precludes a policyholder’s loss, characterizing that loss as predicated on a change in demand or other market conditions. This exclusion, however, should not apply to preclude a business interruption or CBI claim, particularly when such a claim is based upon damage to the policyholder or the policyholder’s supplier or distributor that prevents the policyholder from getting goods to its customers. In a case arising out of Hurricane Katrina, the authors’ firm obtained a ruling that a loss of market exclusion did not preclude recovery for a CBI claim. Products could not be shipped because of a destroyed distribution. Moreover, while the specifics of

the insurance policy's provisions will determine whether a policyholder can calculate a business loss based upon the market existing after an insured event (i.e. taking advantage of any increase in demand or in the price of a product), insurers should not be permitted reduce a loss calculation based upon the absence of demand for a product in a market affected by a catastrophe. Insured Peril: Frequently, CBI losses are limited to damage to third parties caused by a peril of the type insured against under the policy. This provides another strong reason for policyholders to work closely with their suppliers or distributors in understanding the impact of a catastrophe on that third party's business. A policy may exclude flood coverage, but include coverage for earthquake, making it important for a policyholder to have good evidence of the cause of the damage to its supplier or distributor. Engage Experts Early: The insurance claim adjustment process requires a dialogue between policyholder and insurer. An insurer that receives notice of a significant claim immediately will hire experts to assist in adjusting the claim. Likewise, a policyholder would be wise to enlist the assistance of experts early in this process in order to protect its interests, as losses not readily apparent may become clear over time with close scrutiny and familiarity with a policyholder's business. A policyholder should consider retaining coverage counsel early to provide advice on the scope of the losses covered by the policy in an effort to maximize coverage. Retaining experts and coverage counsel early provides the policyholder with the best chance of maximizing coverage opportunities. Proper calculation of a business interruption or CBI claim takes time, and coordination with the adjustment team and counsel often are the most important steps. These steps should be taken at the beginning of the process to maximize potential recovery. Most companies whose business have been affected directly by the events in Japan understandably are focused on repairing damaged property and reestablishing supply chains. These companies and others that have close business relationships with companies in Japan would benefit from focusing as soon as possible on establishing the extent and scope of their insurance coverage, carefully tracking all costs being expended to rebuild the business or keep it running despite the losses caused by the earthquake, and determining how best to present an insurance claim that will maximize recovery for any losses.