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Aftershock - Coverage Issues Post East Coast Quake

Law360

August 26, 2011

In a part of the country where earthquake insurance is an afterthought, insurance issues could get complicated following the 5.8 magnitude earthquake that shook the eastern seaboard this week. Businesses will be considering and reviewing whether there is available coverage and in many cases will find that coverage is barred or limited under widely used property insurance terms.

Because many property policies contain exclusions for "acts of God," earthquakes and land movement coverage may be excluded on one or more of these bases. However, insurers may face claims from a handful of affected policyholders that did purchase earthquake coverage by endorsement or otherwise.

To the extent any applicable coverage is in place, there are important insurance coverage issues, both with respect to any actual physical damage to buildings, and particularly with respect to any potential claims for recovery for business income losses from work stoppages. For any possible claim for recovery of lost business income, commercial policyholders would need to call on "business interruption" or "contingent business interruption" coverage. While business interruption coverage addresses lost profits caused by damage to the policyholder's own property, contingent business interruption coverage addresses a policyholder's losses resulting from interruption of suppliers' or customers' business due to damage to their property.

Insurers' exposure to claims for business interruption from the recent earthquake will be limited because, for coverage for business income loss to be triggered, courts across the country have consistently

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recognized that a covered damage to or loss of physical property is necessary. For business interruption coverage, the damage must be to the property of the insured, or for contingent business interruption coverage to the property of a supplier or customer.

Accordingly, it is important to carefully consider whether any interruption of a policyholder's business was caused by property damage–as is required in widely used insurance policy terms–or by some other circumstance or action associated with the earthquake that may or may not be insured; for example, a decision to close operations for a period of time as a precaution or for the safety of employees and customers.

Because of what some have termed an "evacuation" of buildings and offices, it's possible that some commercial policyholders might look to the civil authority provisions in their policies for lost income and extra expense coverage. Policyholders might further look to ingress and egress provisions for coverage. Civil authority provisions may cover loss of business income and necessary extra expenses caused by civil authorities prohibiting access to the insured premises, whereas an ingress/egress provision may cover loss of business income when access to the policyholder's premises is prevented. Both often afford any applicable coverage only for losses after a 24 or 48-hour period.

But that is a requirement unlikely to be met in the majority of situations here. Further, it does not appear that most private businesses faced any formal action by civil authorities at all. And, actions that have been referred to as "evacuations" would be unlikely to give rise to civil authority coverage unless they specifically barred access to the property. Similarly, an ingress/egress provision usually does not afford coverage if access to the insured premises is still possible.

Policy terms and case law also put important boundaries on the damages that are recoverable and the period of restoration of business operations in interruption coverages. Both policyholders and their insurers will need to consider these limitations.

It seems unlikely that there will be many viable insurance coverage claims stemming from the recent earthquake, since business income coverages are unlikely to apply and even coverage for direct physical damage is unlikely given the prevalence of earthquake and land movement exclusions. If a commercial property policy does not exclude losses due to earthquake or land movement, there are other important policy terms that will determine whether any insurance coverage would be available, especially for potential claims for business income losses. Contractual limitations on commercial insurance agreements generally have been upheld in the courts.