haynesboone

September 27, 2019

A Guide to Business Interruption Insurance for the Energy Industry

By: David P. Bender, Jr. and Caroline Hurtado Ford

When a company incurs financial loss due to an interruption of its business, it should look to its property policy to provide coverage for all or a portion of the loss. The aim of this article is to give an overview of business interruption coverage from authors with decades of experience representing insureds in the energy sector who face property loss and business interruption issues.

Business interruption coverage issues arise when the company is purchased, enters into transactions with third parties and when it sustains an interruption of its business operations because of damage to property.

Key Issues at Point of Purchase

Like all insurance policies, a property policy that includes coverage for business interruption loss is simply a risk-transfer contract from the purchaser (the insured) to the insurance company (the insurer). Therefore, our starting point is: What risks does the company wish to transfer to its insurance company and does the policy language in fact transfer those risks?

A. Named Perils vs. All-Risk Coverage

First-party property/business interruption coverages are generally written in two different ways: named perils or all-risk. Under a named perils policy, the policy sets forth specific perils that are covered. If the cause of loss is not included in one of those enumerated perils, there is likely no coverage unless another part of the policy can be triggered. Under a named perils policy, the company has the burden of proof to establish that the cause of the loss was a named peril.

In contrast, an all-risk policy covers all perils except for any perils that are specifically excluded. Therefore, with an all-risk policy, the company need only establish that physical damage (or the other requirements necessary to trigger a loss) occurred and the loss was not caused by an excluded peril. The insurer then bears the burden of proof to establish that the cause of loss was excluded under the policy.

B. Various Types of Time Element Loss

Business interruption policies cover various types of losses defined as “time element losses.” The following chart summarizes these coverages:

Type of Coverage	Description/Notes	Energy Industry Examples
Business Interruption	This coverage provides for the lost income sustained as a result of the need to shut down operations because of physical damage to insured property.	An oil refinery is damaged as a result of flood and wind damage due to a hurricane. The refinery must suspend operations and faces a disruption in production. The oil refinery’s business interruption policy will cover the lost

Type of Coverage	Description/Notes	Energy Industry Examples
	An issue to be considered is whether “interruption” is defined in the policy. Some policies require a complete shutdown of operations. However, other policies only require a partial shutdown. In most jurisdictions, if the policy is ambiguous regarding a term or definition, any ambiguity is to be construed against the insurer. Litigating ambiguity is not simple, however, and can be costly. It is therefore a best practice to define, when purchasing the insurance at the outset, what constitutes an “interruption” for purposes of triggering coverage.	income sustained during the shutdown due to the hurricane damage.
Extra Expense	Extra expense is the extra cost of conducting the company’s business during the period of restoration. It can include, for example, the cost of operating at a different location, increased costs of production, or any other additional costs incurred by the company that would not ordinarily have incurred that is needed to conduct the business due to the property damage.	The same oil refinery that was forced to suspend operations as a result of the flood and wind damage due to the hurricane must now transport its product from a different, more costly location in order to meet its production demand or face more significant losses under its contractual obligations to purchasers. This extra expense should be covered by the oil refinery’s property policy.
Contingent Business Interruption/Extra Expense	Contingent business interruption and extra expense does not require any physical damage to the company’s property. Instead, it is triggered when there is physical damage to the property of a supplier, a distributor/customer, or a transporter. The benefit of this coverage is that it provides coverage for situations which interrupt operations even though the insured property itself did not suffer any damage.	An oil refinery depends on a single supplier for most of the steel used in its production and processing operations. The steel manufacturer’s production was affected by a hurricane. Contingent business interruption would protect the oil refinery from the impact to its main steel supplier’s production.
Civil/Military Authority	This coverage extension also does not require actual damage to the property. However, if there is nearby damage	The federal agency responsible for pipeline safety shuts down an oil refinery following a nearby pipeline

Type of Coverage	Description/Notes	Energy Industry Examples
	(usually limited to within a specific geographic area like a mile, for example) and civil or military authorities refuse to allow the company to access its property, the policy will provide coverage. This coverage only applies if the civil/military authority prevents access to the site. If the company's employees are allowed at the site but civil/military orders refuse to allow operations, this coverage is likely not triggered.	rupture and barricades the five-mile radius surrounding the oil refinery, prohibiting access. This shutdown is required while the agency investigates and tests for the integrity of the structures. The oil refinery's property insurer should provide coverage for the time during which it could not carry out its business operations because of the federal agency's forced shutdown and related inability to access the refinery.
Off-Premises Services	If utility service to the property is interrupted offsite and the property cannot operate as a result, this coverage extension will apply.	The off-site power generating station that supplies electricity to an oil refinery is damaged as a result of a hurricane. As a result, the oil refinery cannot function.

C. Calculating Loss

The following terms are part of business interruption coverage and should be understood by the company before purchasing the policy:

- Waiting Period: What is the waiting period? That is, how many days of interruption must have passed before business interruption coverage kicks in? Policies can identify a variety of waiting periods.

- Calculating Lost Income: Does the policy clearly define how lost income is calculated? Ambiguities in this regard could lead to disputes, even litigation, at a time when an insured is simply trying to have its claim paid.

- Period of Indemnity: The policies usually have caps that state that the period of indemnity begins to run on the date the damage occurred until the property is rebuilt (or could have reasonably been rebuilt) but no longer than a certain date.

Key Issues Related to Making a Claim

When making a claim on its property policy, an insured should anticipate the following issues:

- How will the company ensure its proof of loss complies with the policy's requirements?

- How soon will the policy make payments upon submission of a satisfactory proof of loss?

- Will the insurer make agreed-upon advance payments subject to a final proof of loss?
- Does the company allocate how the recovery is apportioned and to which categories of damages (which is relevant in claims that exceed policy limits)?
- How are disputes over the amount of loss resolved?
- Which state's law applies to the policy? There are states with laws more favorable to the policyholder that can provide the company with important leverage towards resolving the claim quickly.

The company should insist on having the policy pay its claim preparation expenses and ensure that the limits for this purpose are high enough to cover the experts needed to compile a strong proof of loss. The company should always prepare its own proof of loss, with its own experts (accountants, etc.) and not rely on the insurance company's team for this purpose.