

Introduction to Business Interruption Insurance

Module 2: Which Interruptions are Insured?

Insurers do not intend to provide cover for all financial losses. Not even for all business interruption losses! Businesses can suffer loss of sales or increased expenses for many reasons, typically the normal commercial risks of supply and demand, competitors' activities, buoyancy of national or world economies, ill health of the proprietor, scarcity of raw materials, labour disputes, cold weather, or hot weather.

What insurers do provide cover for is:

**BI policies insure:
loss of profit
consequent upon
a business interruption**

These few words include the three labels that the insurance industry has given to this type of insurance;

Historically it was called **Loss of Profits** insurance.

It then acquired the "**Consequential Loss**" label,

and most now call it **Business Interruption** insurance or "BI" insurance.

It is the **loss of profit**

consequent upon

a business interruption.

But it is not every business interruption that is insured.

**A basic BI policy only insures the business interruption that
results from damage to property used by the insured at the
premises.**

And it is not all types of damage that are insured.

BI policies only insure the loss resulting from damage caused by an insured peril.

Nothing I say on this subject has authority unless I can justify it with reference to the policy document. I therefore back up my comments by quoting from several Contractual Clauses as follows:

“Insurer will indemnify the Insured in respect of each item in the Schedule the amount of loss resulting from interruption or interference to the Business if during the period of insurance any building or other property or part thereof used by the Insured at the premises for the purpose of the Business be destroyed or damaged by:

(a) such risks as are covered under Part 1 Material Damage”

Alternatively, a slightly less formal expression of the same -

“If property used by you at your business premises is accidentally lost or damaged during your period of insurance with us, and your business activity is interrupted or interfered with because of that accidental loss or damage then we will pay you for your lost business profit. ...

If we have agreed to pay your claim for the accidental loss or damage under the property section of this policy then we will pay your lost business profit.”

Both policies restrict cover to the loss (of profit) consequent upon an interruption to or interference with the business caused by damage to property used by the insured business.

The first limits the perils by referring to the risks covered by its Material Damage Section. The second achieves a similar result by requiring that a claim has been accepted under the property damage section of the policy.

This is subtly more restrictive.

If it is a pre-requisite that a claim has been accepted under the property section of the insured's policy, then obviously the damage must have occurred to the insured's property. But what about an interruption that results from damage to property that the insured uses but does not own? The most common example is a business that occupies premises that it does not own. If the critical factor in the interruption is damage to the building, for which there is no claim under the Material Damage Section of the tenant's insurance policy, then the interruption loss of the tenant would not be covered.

I should express this more precisely by saying that the additional interruption resulting from the building damage, that is additional to the interruption attributed to the damage to the tenant's property (i.e. contents of the building such as plant and stock) is not covered.

Obviously this is a very important issue for all businesses that are in leased premises.

You may hear the term "Material Damage Proviso" in this context. This comes from the older style policies that listed the perils (fire, lightning, explosion) and then stated:

"..... the Company will not be liable for any loss under this Policy unless the Insured's property destroyed or damaged at the premises is insured against such damage and the Company by which such property is insured shall have paid for or admitted liability in respect of such damage."

Material Damage Proviso

The damaged property must, itself, be insured and a claim accepted for the damage.

The purpose of the Material Damage Proviso was twofold.

- 1 It intended to ensure that the business could reinstate the damage by using its insurance claim proceeds. This was not effective, however, unless the sums insured were adequate and replacement conditions applied.
- 2 It avoided the need to include all the conditions and warranties both in the material damage policy and the business interruption policy. A breach of warranty under the former also precluded a claim under the latter.

You will see that the material damage proviso only refers to the Insured's property and has no application to property the insured uses but does not own such as the building, or leased plant.

The first policy from which I quoted above includes the following material damage proviso:

“Provided that:

.... The insurer will not be liable under Part 2 (i.e. the business interruption section of the combined property and BI policy) unless the insured’s property destroyed or damaged is insured against such insured Damage under Part 1 Material Damage..... and the insurer shall have (or would have, but for the application of an excess or deductible) paid for or admitted liability in respect of the Insured Damage.”

It requires not only that liability has been accepted for a claim for the insured’s property damage but more specifically, that the claim under the material damage section of the combined Material Damage and Business Interruption Policy.

This gives the insurer control of the claim process for the material damage enabling it to avoid delays, which might impact the BI claim. It has no relevance to an interruption caused by damage to property that the insured does not own (and therefore cannot insure).

Perhaps the more restricted version of the contractual clause in the 2nd example is an unintended result of the drive to create a material damage proviso with more user-friendly language.

(i.e. “If we have agreed to pay your claim for the accidental loss or damage under the property section of this policy then we will pay your lost business profit.” What about damage to the landlord’s building?)

I will recap on the circumstances that give rise to a claim.

- 1 There must be damage to property used by the insured for the business.**
- 2 The damage must result from an insured peril.**
- 3 The business must be interrupted.**
- 4 A loss must result.**
- 5 Damage to the insured’s property must be insured.
(There are slight variations on this requirement.)**

There are a couple of further elements that don’t need elaboration.

- 1 The damage must occur within the period of insurance.
- 2 It must occur at the business premises (i.e. as defined in the Schedule of the policy).

In today's complex economic environment no business can operate in isolation. Because there are many inter-dependencies damage elsewhere than at the insured's premises can interrupt the insured's business. BI policies are frequently extended to insure some of these interdependencies and the policy clauses that provide cover for a wider range of business interruptions will be explained in a later module in this series. (Module 3.1 – "Widening the Definition of Damage")

Brett Fawcett
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