

Stop And Read Your Slowdown Insurance Policy

Law360, New York (April 16, 2014, 4:45 PM ET) -- What happens when a hotel suffers property damage, whether by natural disaster or man-made accident, and is forced to close some or all of its rooms, amenities or services? It is important to understand how insurance can protect you from the resulting financial loss. In addition to potential recovery for property damage from your property/casualty policy, you may be able to recover lost revenue from your business interruption coverage. If your operations are disrupted, whether completely or partially, the language of your policy will determine if — and for how long — your insurance company will cover such a loss.

Your insurance should cover income loss not only when operations are completely shuttered, but also when your business is partially suspended. The distinction is important to hotel owners and operators, especially those with amenities or services like restaurants, spas and seasonal activities, which are more likely to operate on a reduced level after a loss. Historically, many business interruption provisions required a “necessary suspension” of operations. These older policies and forms did not define “suspension” or state whether complete shutdown was necessary.

To understand the likelihood and extent of business income loss recovery, policyholders should be aware of the actual terms provided under their business interruption coverage and should recognize that there are some differences between jurisdictions in how they approach this issue.

Must There be a Complete Cessation of Operations?

In New York, if a policy requires a “necessary suspension” of operations, where the term “suspension” is not defined, the courts have held that the policyholder’s business must have experienced a “total interruption or cessation” of operations. See, e.g., *Broad Street LLC v. Gulf Insurance Co.* (2006), where, after loss on 9/11, a building owner could recoup lost business income from insurance, but only up to the point where tenants were again allowed to reside in building.

The result is similar in California, where courts have held that a “necessary suspension” of operations “connotes a temporary, but complete, cessation of activity.” See, e.g., *Buxbaum v. AETNA Life & Casualty Co.* (2002), where a law firm did not trigger business interruption coverage because there was no complete cessation of operations when evidence showed that attorneys continued to bill hours following incident of water damage in office building.

Policyholders should therefore note that if “suspension” is not defined in the policy, some jurisdictions have followed a narrow interpretation of coverage — thereby preventing policyholders from recovering income loss where there is only a partial cessation or a slowdown of business. See, e.g., *Keetch v. Mutual of Enumclaw Insurance Co.* (1992), where a motel remained partially open, the policyholder

could not recover under business interruption coverage, despite dramatic decrease in occupancy caused by ash from volcanic eruption. See also *Apartment Movers of American Inc. v. One Beacon Lloyds of Texas* (2006), where a slowdown was not a necessary suspension of operations to trigger coverage for loss of business income. This narrow interpretation of coverage often conflicts with the obligation to mitigate losses that is sometimes imposed on the policyholder by the insurance policy.

Fortunately, some jurisdictions, like Pennsylvania, have taken a more reasonable approach and have not required a complete cessation of operations. In *American Medical Imaging Corp. v. St. Paul Fire and Marine Insurance Co.* (1991), the court examined a policyholder's claim for business interruption coverage after a fire incident that damaged its headquarter offices. The policyholder was able to resume operations in a temporary location, but at a reduced level due to an interruption in its telephone system. The policyholder, a provider of ultrasound testing services to physicians and health care institutions, depended on the telephone system for orders, scheduling and preparation of written test reports for existing and new business. The policyholder sought business interruption coverage for the lost earnings and extra expenses caused by the incident and relocation, particularly the disruption of the telephone system. The trial court ruled in favor of the insurance company. On appeal, however, the result was different and the appellate court rejected the insurance company's suggestion that coverage was precluded because the policyholder "would be carrying on the same kind of activities [elsewhere] that occurred at the covered location."

The appellate court held that under the trial court's decision "the insured would have no motivation to mitigate its losses" as "[c]ontinuing in business at any level would bar recovery because the insured would be carrying on the same kind of activities that occurred at the covered location." Moreover, the appellate court noted that the policy imposed "an affirmative duty [on the policyholder] to mitigate its losses."

The court ruled that the insurance company's "obligation to indemnify continues until the resumption of 'normal business operations,'" and as such, "the obligation to indemnify can arise while business continues, albeit at a less than normal level." The case confirms that a policyholder can still recover lost income under its business interruption policy when it operates in a partial or reduced mode.

More recently, in *iCue Corp. v. USF&G* (2008), an unpublished case, the federal court in Pennsylvania held that "suspension," as used in the insurance policy, included both partial and total cessations. In that case, the court also allowed lost business income covered by insurance to include the time period when the insurance company delayed making payments to fully restore the policyholder's operations.

New Forms Cover Slowdowns

In recent years, the insurance market has responded to the need for coverage of a partial cessation or slowdown in business operations. For example, in 1999, the Insurance Service Office Business Income (and Extra Expense) Coverage Form, a standard form often used in insurance policies, was updated to add a specific definition of "suspension" as "[t]he slowdown or cessation of your business activities."

Today, most brokers and insurance companies covering the hospitality industry have access to forms that affirmatively state the policy "shall cover the loss resulting from complete or partial interruption of business." The use of such updated forms can avoid many of the problems created by court decisions that narrowly interpret the coverage extended under older policy forms.

Policyholders experiencing a partial interruption, such as closure of some, but not all, rooms, amenities

or services, should review the terms of their policies and become familiar with the rules that apply in their jurisdiction. In planning for the future, policyholders should confirm that their policy covers both complete and partial interruptions. If appropriate, policyholders should ensure that they have other beneficial coverage, such as reimbursement for expenses associated with professional services needed to prepare a business interruption claim.

Professional services are becoming increasingly necessary to calculate and recover insurance for business interruptions, especially when a policyholder is seeking recovery due to lost patrons or the need to discount rates because amenities or services are unavailable. This consideration can be particularly important for destination hotels where patrons visit with the expectation of using many amenities and services. The policyholder may need to hire a forensic accountant to calculate the amount of business income loss sustained. These costs can be expensive and might be covered under a professional fees or "LOSS ADJUSTMENT EXPENSE" provision. Work with a knowledgeable broker to get the coverage that suits your business.

When claims arise, insurance companies will often look for ways to deny coverage or diminish their exposure to the loss. After charging you premiums based on the entirety of your business operations, these insurance companies should not be so quick to deny coverage to you on the grounds that you merely suffered a slowdown or partial interruption. If your insurance company is not fully cooperating, you should engage the services of an insurance recovery attorney who can assist you in getting the insurance company to honor its obligations under the policy.

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