



LEXSTAT 1-13 NEW APPLEMAN NEW YORK INSURANCE LAW § 13.07

New Appleman New York Insurance Law, Second Edition

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PART III. TYPES OF INSURANCE COVERAGE
CHAPTER 13 PROPERTY INSURANCE

1-13 New Appleman New York Insurance Law § 13.07

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§ 13.07 Business Interruption Insurance

[1] Coverage Generally

As discussed in Section 13.03 *above*, the commercial fire and extended coverage policy covers "direct loss" by fire and the other perils named in the policy. "Direct loss" is understood to mean not only the damage actually inflicted by the fire or other named peril, but also any other damage of which that peril is the proximate cause.ⁿ¹ (*See* § 13.03[2][c] for discussion of proximate cause). Thus, in the absence of a rider or endorsement specifically providing such coverage, fire and extended policies do not cover "indirect" or "consequential" loss.ⁿ² In fact, the standard fire policy specifically excludes "compensation for loss resulting from interruption of business or manufacture."ⁿ³ Conversely, it has been observed, business interruption insurance policies do not ordinarily provide coverage of, or indemnify the insured against, loss or damage to physical property.ⁿ⁴

To obtain coverage for such indirect loss, an insured can procure business interruption insurance, which provides coverage for loss of earnings sustained by an insured due to the interruption of normal business operations by fire, lightning or other named perils.ⁿ⁵ In one case, the insuring agreement provided coverage for business interruption losses "when as a direct result of a peril insured against the premises in which the property is located is so damaged as to prevent access to such property." The policy covered the insured's data processing systems located on the fifth and sixth floors of a building. The insured suffered a loss when severe water damage in the basement of the building rendered its air-conditioning system inoperative, which in turn forced the shutdown of the insured's computers. The insured had no property located in the basement of the building and there was no "physical damage" to the insured's equipment on the upper floors. Moreover, physical access to the equipment was unimpeded. The insurer argued that it was not liable under the policy because there had been no direct physical damage to the insured's premises and physical access to the premises had not been impaired by the water damage in the basement. The court rejected this narrow interpretation of the policy provisions and held that the insured's loss was covered under the policy. The court reasoned:

[U]nder [the insurer's] construction of the word "premises," if an explosion or fire totally destroyed the first four floors of the building, without reaching the fifth floor, and thereby causing a total cessation of [the insured's] business, the loss would not be covered since the damage would not be to the "premises in which the property is located." [The insurer's] interpretation of the word "access" is equally strained.

Obviously, what was relevant and important to [the insured] when it bought the ... policy was the ability to utilize the computers in its business on a normal basis. [The insured] could not have been less interested in whether, following a peril insured against, it had the ability to physically touch a non-functioning mass of metal.ⁿ⁶

Business interruption coverage has been characterized this way:

The purpose of business interruption insurance is to indemnify the insured against losses arising from inability to continue normal business operation and functions due to the damage sustained as a result of the hazard insured against. In other words, the goal is to preserve the continuity of the insured's earnings.ⁿ⁷

Business interruption policies do not necessarily cover the entire period until the property is restored; the "suspension" or "restoration" period is limited to the period of time that repairs or replacement should *reasonably* take.ⁿ⁸ In ISO Form No. CP 00 30 04 02, the "Period of Restoration" means the period of time that:

Begins with the date of direct physical loss or damage caused by or resulting from any Covered Cause of Loss at the described premises; and

Ends on the date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality.

"Period of restoration" does not include an increased period required due to the enforcement of any law that regulates the construction, use or repair, or requires the tearing down of any property.

The expiration date of this policy will not cut short the "period of restoration."ⁿ⁹

The loss covered by a business interruption policy is typically defined as net income that would have been earned or incurred, plus continuing normal operating expenses (including payroll) actually incurred.ⁿ¹⁰ In other words, the items of recovery under a business interruption policy "consist of the profits that would have been earned if the business had not been interrupted and the expense of maintaining an organization during the interruption."ⁿ¹¹ In *King's Gym Complex, Inc. v. Philadelphia Indem. Ins. Co.*,ⁿ¹² there was no confusion regarding the proper submission of a claim because the insured had submitted property loss claims and provided sufficient proof of loss of those claims according to its policy with the insurer, but the insured failed to provide any documentation or other evidence of notice of a business loss claim and there was no reason to infer that the claim was filed in conjunction with the other property claims. Further, the insured failed to show that it had actually suffered any business losses at the time it filed suit against the insurer, and it was unnecessary to engage in an evaluation of the insurer's conduct under Ins. L. § 3407 because the insured failed to demonstrate that it filed a claim for business losses.

Older ISO Forms: Prior to ISO's development of comprehensive policy forms, such as CP 00 30 (referred to in this note *above*), the following "Gross Earnings" forms were the basic forms used to provide business interruption coverage:

- ISO Form CF 15 03, "Business Interruption--Gross Earnings Form for Mercantile or Non-Manufacturing Risks" (often referred to as "Gross Earnings Form 3"); and
- ISO Form CF 15 04, "Business Interruption--Gross Earnings Form for Manufacturing or Mining Risks" (often referred to as "Gross Earnings Form 4").

While the loss covered is the loss of earnings during the period of suspension or restoration (that is, future earnings), the measure of loss is based on experience of the business before the loss and its "probable experience thereafter."ⁿ¹³ The

insured bears the burden of establishing the extent of the damage caused by the interruption, and the applicability of the policy to that damage.ⁿ¹⁴ In *Cosmetics Plus Group, Ltd. v. American International Group, Inc. (In re Cosmetics Plus Group, Ltd.)*, stores that were already going out of business and liquidating their inventory were not entitled to additional recovery under their business interruption coverage when the premises of their stores were rendered unusable by the September 11, 2001 terrorist attacks, because the stores could not show any likely lost future net income.ⁿ¹⁵

[2] Exclusions

The older ISO business interruption insurance policies typically exclude liability for loss resulting from electrical injury or disturbance to electrical appliances (unless fire ensues);ⁿ¹⁶ loss resulting from damage to finished stock;ⁿ¹⁷ and loss caused by nuclear reaction or radiation or radioactive contamination.ⁿ¹⁸ Loss to data processing equipment and to media is often limited.ⁿ¹⁹ Moreover, liability is also excluded "for any increase of loss resulting from" the following:

- (A) enforcement of any ordinance or law regulating the use, construction, repair or demolition of property; or
- (B) interference at the ... premises, by strikers or other persons, with rebuilding, repairing or replacing the property or with the resumption of business; or
- (C) the suspension, lapse or cancellation of any lease, license, contract or order, unless such suspension, lapse or cancellation results directly from the interruption of business, and then [the insurer] shall be liable for only such loss as affects the insured's earnings during, and limited to the period of indemnity covered under this policy.ⁿ²⁰

Finally, liability is also excluded for "any other consequential or remote loss."ⁿ²¹

Instead of enumerating the exclusions in the business income coverage form itself, the newer ISO policy forms refer to the "applicable Causes of Loss Form as shown in the Declarations" that serves as part of the comprehensive policy form set.ⁿ²² (See § 13.03).

[3] Coinsurance

The ISO business interruption policy forms contain a coinsurance clause pursuant to which the insured agrees to carry a minimum amount of insurance.ⁿ²³ Under this clause, the insured must bear a portion of any loss if less than the stipulated amount of insurance is carried. The insured typically has a choice of four coinsurance percentages: fifty percent, sixty percent, seventy percent or eighty percent. The insured elects which coinsurance percentage will be used in the policy. The insurer is liable for no greater percentage of loss than the amount of insurance carried bears to the stipulated coinsurance percentage of net income that would have been earned in the twelve-month period following the date of the loss.ⁿ²⁴

[4] Period of Indemnity

In the older ISO policies, the period of indemnity is defined as:

- [O]nly such length of time as would be required with the exercise of due diligence and dispatch to rebuild, repair or replace such part of the property herein described as has been damaged or destroyed, commencing with the date of such damage or destruction and not limited by the date of expiration of this policy.ⁿ²⁵

As stated in the foregoing excerpt, the period of indemnity is not limited by the expiration of the policy. If the fire or other insured peril occurs while the policy is in force, the insured is entitled to recover for the period it reasonably takes

to repair the damage or replace the damaged property, even though this could extend past the expiration of the policy. For example, assume that an insured is covered for business interruption loss under a policy that expired on January 1, 1990, and that the insured's plant burned to the ground on December 25, 1989. If a reasonable amount of time to rebuild the structure and replace the machinery was seven months, the insured would be entitled to indemnity throughout that time, even though the policy expired a week after the fire occurred.

In determining the period of restoration, the replacement building need not be required to be an exact duplicate of the damaged one.ⁿ²⁶ The rebuilding contemplated by the policy is the replacement that would actually follow after a disaster, not one that would ignore all progress in the art.ⁿ²⁷

[5] Extra Expense Coverage

"Extra expense" insurance covers the costs that are in addition to normal operating costs and that are needed to keep a business functioning while repairs are being carried out.ⁿ²⁸

Extra expense insurance is vital for those types of businesses that need to continue to operate normally despite physical losses. The types of businesses that need this insurance are either those whose customers are dependent on them (for example, hospitals and banks) or those businesses that would lose goodwill if even temporarily closed (for example, a dry-cleaning store).

[6] Contingent Coverage

Certain business enterprises are highly dependent on other firms for their supply of essential materials. For example, selling agencies like commission merchants, brokers, and mail-order houses are often dependent on an uninterrupted flow of products from other sources.

Conversely, the major output of some producers is marketed through one or two large outlets, or used in another commodity assembled elsewhere.

In all of these situations, interruption of activity at the other business will severely reduce or entirely eliminate the firm's earnings, even though its own premises are completely untouched by fire or other peril.

Contingent business interruption insurance is designed to protect an insured against losses of this kind. There are two forms of contingent coverage in wide use. "Contributing properties" insurance covers loss when the named peril strikes a supplier of material. "Recipient properties" insurance covers loss when the named peril strikes a recipient of material.ⁿ²⁹ In *ABM Indus.*, the court acknowledged the Contingent Business Interruption coverage in the relevant policy, but held that the insured was not entitled to Contingent Business Interruption coverage on the basis that the insured itself operated the building that was damaged.

[7] Agreed-Amount Endorsement

The coinsurance clause typically requires that the insured maintain insurance in an amount equal to a given percentage of the loss of earnings that would have been earned in the twelve-month period following the date of loss. This involves, of course, projecting earnings into the future. Certain types of business enterprises can obtain an "agreed amount" endorsement, which avoids the uncertainties associated with the coinsurance provision.

Under the agreed-amount endorsement, the amount of insurance required is a fixed, agreed dollar amount, rather than a percentage of prospective earnings for the twelve-month period following the date of loss. If the insured maintains the amount of insurance agreed upon in the endorsement, the coinsurance clause is waived.

Generally, this endorsement is available for use by all mercantile, non-manufacturing or manufacturing risks written under the gross earnings business forms, without restriction as to construction or fire-protection devices. Only risks that have been in business for at least one year qualify for the endorsement.

The insured must file a statement of earnings for the prior period and an estimate of earnings for the period covered by the endorsement.ⁿ³⁰

FOOTNOTES:

(n1)Footnote 1. Sorrentino v. Allcity Ins. Co., 229 A.D.2d 481 (N.Y. App. Div. 1996) (holding that damage to insured's building was proximately caused by windstorm).

(n2)Footnote 2. *See, e.g.*, Michael v. Prussian Nat'l Ins. Co., 63 N.E. 810 (N.Y. 1902) (loss of profits is not covered by a fire policy that merely insures the use and occupancy of a building); Tanenbaum v. Simon, 40 Misc. 174 (N.Y. Sup. App. Term) , *aff'd*, 84 A.D. 642 (N.Y. App. Div. 1903) ; Tanenbaum v. Freundlich, 39 Misc. 819 (N.Y. Sup. Ct. App. Term 1903) .

(n3)Footnote 3. Ins. L. § 3404(e) (first page of the standard fire policy).

(n4)Footnote 4. Citizens Savs. & Loan Ass'n v. Proprietors Ins. Co., 78 A.D.2d 377 (N.Y. App. Div. 1981) . *See also* Victory Container Corp. v. Sphere Ins. Co., 448 F. Supp. 1043, 1045 (S.D.N.Y. 1978) ("business interruption and property damage represent distinct forms of coverage ... [l]oss of use is a separate interest which may be specifically insured, but is not covered by a general property loss or damage, fire or marine insurance policy").

(n5)Footnote 5. *See, e.g.*, "Business Income (and Extra Expense) Coverage Form," ISO Form No. CP 00 30 04 02, which provides in part as follows:

We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration." The suspension must be caused by direct physical loss of or damage to property at the premises described in the Declarations, including personal property in the open (or in a vehicle) within 100 feet, caused by or resulting from any Covered Cause of Loss.

Copyright, ISO Properties, Inc., 2001.

(n6)Footnote 6. Datab, Inc. v. St. Paul Fire & Marine Ins. Co., 347 F. Supp. 36, 38 (S.D.N.Y. 1972) .

(n7)Footnote 7. Howard Stores Corp. v. Foremost Ins. Co., 82 A.D.2d 398, 400 (N.Y. App. Div. 1981) , *aff'd*, 439 N.E.2d 397 (N.Y. 1982) (citations omitted); *see also* Bi-Economy Market, Inc. v. Harleystown Ins. Co. of New York, 886 N.E.2d 127 (N.Y. 2008)

(n8)Footnote 8. *See, e.g.*, ISO Form No. CP 00 30 04 02.

(n9)Footnote 9. ISO Form No. CP 00 30 04 02. *See also* Lava Trading Inc. v. Hartford Fire Ins. Co., 365 F. Supp. 2d 434 (S.D.N.Y. 2005) (in suit by insured, whose business was located in World Trade Center, against insurer under business insurance policy, asserting coverage for certain losses resulting from terrorist attack of September 11, 2001, court determined that "period of restoration" provided for in policy ended on April 30, 2002, when property in insured's offices (and not entire World Trade Center complex or One World Trade Center building) should have been repaired, rebuilt, or replaced with reasonable speed and similar quality; time it took to rebuild off-site back up center was not included within "period of restoration").

Accord Retail Brand Alliance, Inc. v. Factory Mut. Ins. Co., 489 F. Supp. 2d 326, (S.D.N.Y. 2007) (insured sought declaratory judgment that business interruption insurance policy provided coverage for business income for period of

time it reasonably would take to replace insured's retail stores in rebuilt World Trade Center ("WTC") after stores were destroyed in terrorist attack on WTC; court held that period of liability clause extended time element coverage until insured could build reasonably equivalent stores in reasonably equivalent location but that period was not tied to hypothetical time it would take to rebuild stores in rebuilt WTC complex). *Cf. Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co.*, 411 F.3d 384 (2d Cir. 2005) (District Court erred in determining that business interruption (BI) coverage for losses arising from destruction of insured's drugstore in World Trade Center (WTC) by terrorist attack on September 11, 2001 would continue for hypothesized time reasonably necessary for insured to rebuild store at its former site and resume functionally equivalent operations; district court's phrase "functionally equivalent operations" effectively rewrote policy by superseding and enlarging on more limited coverage provided by policy's extended recovery period clause, and specific site of insured's former store at WTC was neither subject of insurance policy nor expressly provided for in calculus set forth in restoration period). Any discrepancies between a new location and the WTC were exclusively accounted for under the Leasehold Interest clause.

See also Broad St., LLC v. Gulf Ins. Co., 37 A.D.3d 126 (N.Y. App. Div. 2006) (in suit by building owner seeking coverage for business losses it sustained after WTC attacks of Sept. 11, 2001 plus declaratory judgment declaring that insurance company was obligated to pay owner's loss of business claims for entire period of restoration, record established that owner had resumed operations as of Sept. 18, 2001, in that it had cleaned most of debris from Sept. 11 attacks, changed building's air filters, re-established all utilities and allowed tenants to return, and that ongoing air testing was performed indicating quality was within acceptable Environmental Protection Agency levels; thus, owner was no longer suffering "necessary suspension" of its business operations).

(n10)Footnote 10. *See, e.g.*, the definition of "Business Income" in ISO Form No. CP 00 30 04 02.

(n11)Footnote 11. *Anchor Toy Corp. v. American Eagle Fire Ins. Co.*, 4 Misc. 2d 364, 365 (N.Y. Sup. Ct. N.Y. Co. 1956) .

(n12)Footnote 12. *King's Gym Complex, Inc. v. Philadelphia Indem. Ins. Co.*, 433 F. Supp. 2d 256 (N.D.N.Y. 2006) (in breach of contract action against insurer for allegedly breaching terms of its insurance policy concerning business loss claim, court held that it lacked subject matter jurisdiction because there was no justiciable controversy as insured failed to demonstrate that it submitted claim for business losses).

(n13)Footnote 13. *Howard Stores Corp. v. Foremost Ins. Co.*, 82 A.D.2d 398, 401 (N.Y. App. Div. 1981) , *aff'd*, 439 N.E.2d 397 (N.Y. 1982) .

(n14)Footnote 14. *Howard Stores Corp.*, 82 A.D.2d 398 . *See also United Air Lines v. Ins. Co. of Pa.*, 385 F. Supp. 2d 343 (S.D.N.Y. 2005) , *aff'd*, 439 F.3d 128 (2d Cir. 2006) (holding that plaintiff's business interruption insurance policy with defendant did not cover its lost gross earnings attributable to Sept. 11, 2001 terrorist attacks, other than those that may have resulted from destruction of its ticket office in WTC in New York, principally because those other losses were not direct result of physical damage to either insured's property at its "insured locations" or any "adjacent premises").

(n15)Footnote 15. *Cosmetics Plus Group, Ltd. v. Am. Int'l Group, Inc. (In re Cosmetics Plus Group, Ltd.)*, 379 B.R. 464 (Bankr. S.D.N.Y. 2007) .

(n16)Footnote 16. ISO Form Nos. CF 15 03 (ed. 01/83) (Gross Earnings Form for Mercantile or Non-Manufacturing Risks), § IV, Clause 1; CF 15 04 (ed. 01/83) (Gross Earnings Form for Manufacturing or Mining Risks), § IV, Clause 1.

(n17)Footnote 17. ISO Form No. CF 15 04 (ed. 01/83) (Gross Earnings Form for Manufacturing or Mining Risks), § IV, Clause 2.

(n18)Footnote 18. ISO Form Nos. CF 15 03 (ed. 01/83) (Gross Earnings Form for Mercantile or

Non-Manufacturing Risks), § IV, Clause 4; CF 15 04 (ed. 01/83) (Gross Earnings Form for Manufacturing or Mining Risks), § IV, Clause 5. *See also* Parks Real Estate Purchasing Group v. St. Paul Fire & Marine Ins. Co., 472 F.3d 33 (2d Cir. 2006) (in action to recover under all-risk property insurance policy for building damage caused by cloud of noxious particulate matter emanating from collapse of WTC Twin Towers, as to efficient causation, while particulate matter caused damage to insured property, coverage depended on whether that damage was "contamination" within meaning of the policy; insofar as damage constituted contamination, it was excluded from coverage, but, insofar as damage was not contamination, it was covered).

(n19)Footnote 19. ISO Form Nos. CF 15 03 (ed. 01/83) (Gross Earnings Form for Mercantile or Non-Manufacturing Risks), § IV, Clause 2; CF 15 04 (ed. 01/83) (Gross Earnings Form for Manufacturing or Mining Risks), § IV, Clause 3.

(n20)Footnote 20. ISO Form Nos. CF 15 03 (ed. 01/83) (Gross Earnings Form for Mercantile or Non-Manufacturing Risks), § IV, Clause 5; CF 15 04 (ed. 01/83) (Gross Earnings Form for Manufacturing or Mining Risks), § IV, Clause 6. Copyright, Commercial Risk Services, Inc., 1982.

(n21)Footnote 21. ISO Form Nos. CF 15 03 (ed. 01/83) (Gross Earnings Form for Mercantile or Non-Manufacturing Risks), § IV, Clause 5; CF 15 04 (ed. 01/83) (Gross Earnings Form for Manufacturing or Mining Risks), § IV, Clause 6. Copyright, Commercial Risk Services, Inc., 1982.

(n22)Footnote 22. ISO Form No. CP 00 30 04 02 (Business Income (and Extra Expense) Coverage Form), § A.3. Copyright, ISO Properties, Inc., 2001. *See also* "Causes of Loss--Basic Form," ISO Form No. CP 10 10 04 02, Copyright, ISO Properties, Inc., 2001.

(n23)Footnote 23. ISO Form Nos. CP 00 30 04 02 (Business Income (and Extra Expense) Coverage Form), § D.

(n24)Footnote 24. ISO Form Nos. CP 00 30 04 02 (Business Income (and Extra Expense) Coverage Form), § D.

(n25)Footnote 25. ISO Form Nos. CF 15 03 (ed. 01/83) (Gross Earnings Form for Mercantile or Non-Manufacturing Risks), § I, clause 2; CF 15 04 (ed. 01/83) (Gross Earnings Form for Manufacturing or Mining Risks), § I, clause 2.

The definition of "period of restoration" determines the period of indemnity in the newer ISO form. *See* n.6 *above*.

(n26)Footnote 26. Anchor Toy Corp. v. American Eagle Fire Ins. Co., 4 Misc. 2d 364 (N.Y. Sup. Ct. N.Y. Co. 1956) .

(n27)Footnote 27. Anchor Toy Corp., 4 Misc. 2d 364 .

(n28)Footnote 28. *See* ISO Form No. CP 00 30 04 02, (Business Income (and Extra Expense) Coverage Form), § B. *See also* Systematic Control Corp. v. Liberty Mut. Ins. Group, No. 11147/05, slip op. 52455U (N.Y. N.Y. Sup. Ct. Nassau Co. 2006) ("Extra expense coverage insures the additional costs an insured incurs in the event one of its business locations suffers a covered loss and the insured cannot operate out of that location ... " and holding that no extra-expense coverage was included in the policy).

(n29)Footnote 29. *See, e.g.,* Zurich Am. Ins. Co. v. ABM Indus., Inc., 397 F.3d 158 (2d Cir. 2005) (holding that the CBI provision was inapplicable to a loss where the insured itself operated the building in question).

(n30)Footnote 30. *See, e.g.,* ISO Form EC 20 05 07 05, "Agreed Value Endorsement" (relating to Internet Liability and Network Protection Liability).