A Potentially Costly Interruption in Business-Interruption Insurance

Restoration-Period Language Punctuates Coverage Gap

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How would you feel if your client asked you to secure business-interruption coverage, and you obtained a policy that provided your client with coverage for only 25 percent of such risks? How would you feel if the business-interruption policy you obtained provided no coverage for losses caused by computer viruses?

The problem centers around two important issues, only one of which recently has received much attention, thanks to society's growing reliance on the use of computers. First, some policy forms provide business-interruption coverage only for loss of income sustained and extra expense incurred during the "period of restoration." That's a problem

Second, most policy forms do not expressly address the question of whether, for example, loss of data on a computer caused by a virus is "direct physical loss or damage" to property that triggers business-interruption coverage. That's a problem, too.

When business-interruption forms were created decades ago, most limited coverage in a very important way. The policy allowed the insured to capture loss of income and recoup increased expenses *only* for the period of time starting with the date covered property sustained "direct physical loss or damage" and ending when such lost or damaged property was repaired or replaced, or when such property would have been repaired or replaced if the insured had been acting with reasonable diligence.

Although this was a good start, it did not really provide the insured with complete protection. Most businesses continue to suffer loss of income and sustain extra expenses long after the repair and/or replacement of lost or damaged property that causes the business-interruption loss (i.e., long after the "period of restoration").

Extended Indemnity Period

When the shortcomings of standard business-interruption coverage limited to the "period of restoration" (the time to repair or replace lost or damaged property) came to light, the insurance industry responded by offering an "extended period of indemnity." This enhancement entitles the insured to claim coverage for all loss of income and extra expense sustained during a certain time ***after*** the lost or damaged property at issue is repaired or replaced.

In today's insurance market, such an extension varies widely from one form to the next. Some forms provide for a fixed amount of time, such as 30 days, as the "extended period of indemnity." One form of "extended period of indemnity" provision reads as follows:

> d. Extended Business Income. We will pay for the actual loss of Business Income you incur during the period that:
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> 1) Begins on the date property (except "finished stock") is actually repaired, rebuilt or replaced and "operations" are resumed; and
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> 2) Ends on the earlier of:
>
> a) The date you could restore your "operations" with reasonable speed to the condition that would have existed if no direct physical loss or damage occurred; or
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> b) 30 consecutive days after the date determined in 1) above.

Some forms provide functionally the same extension as that quoted previously, except that the "30 consecutive days" limitation is "two years" or "24 consecutive months." Most forms provide something between 30 days and two years.

Millions of $ Difference

The difference between having an "extended period of indemnity" provision and being limited to business-interruption coverage for the "period of restoration" can be millions of dollars.

Think about it. In the latter scenario, your client might be limited to claiming coverage for losses sustained for only a few weeks after the loss; whereas in the former scenario, your client might be entitled to claim coverage for losses incurred for a year or more after the loss. All of those additional months of lost income or extra expenses sustained can add up to a lot of money.

Whenever you obtain business-interruption coverage for your client, you should always review the policy form and endorsements to determine whether the policy provides for an "extended period of indemnity," not only as to lost income but also as to extra expense. (Some carriers insure these two different risks with the same endorsement or coverage form; others use different endorsements or coverage forms).

If the policy limits business-interruption coverage to the "period of restoration" (i.e., the period of time in which the lost or damaged property at issue is repaired or replaced), try to obtain at least a 12-month "extended period of indemnity." Also, delete or properly amend any indemnity-period limitations to subcategories of property, especially with respect to computers, computer data, intranets, Internet home pages, etc.

And be careful not to simply obtain the "maximum period of indemnity" coverage afforded by some forms. Depending on the type of loss sustained by the insured, such coverage might actually limit the indemnity period that otherwise might be afforded by the policy.

Loss of Computer Data

Another key issue is whether losses caused by computer viruses and other types of computer-data loss not associated with loss or damage to the CPU or other computer property are sufficient to trigger business-interruption coverage. Some coverage lawyers, especially insurance-company lawyers, say no because computer data is *not* tangible property and, therefore, such data cannot sustain "direct physical loss or damage."

Other coverage lawyers argue that computer data is, indeed, tangible property; as such, the loss thereof or loss of use thereof triggers business-interruption coverage.

Some of the courts that have dealt with this issue have agreed with insurance-company lawyers. As such, I believe it behooves all brokers and agents to address computer-data-loss issues in the policy-placement process.

It is not as if insurers do not address such issues in their policy forms. For example, some carriers have provided in their policy forms that losses caused by computer viruses are sufficient to trigger business-interruption coverage.

Similarly, many insurers use a form with the following limitation for computer-related business-interruption losses that appears to demonstrate an intent to deem losses involving only the data on computers as sufficient to trigger business-interruption coverage:

> Limitation — Electronic Media and Records
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> We will not pay for any loss of Business Income caused by direct physical loss of or damage to Electronic Media and Records after the longer of:
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> a. 60 consecutive days from the date of direct physical loss or damage; or
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> b. The period, beginning with the date of direct physical loss or damage, necessary to repair, rebuild or replace, with reasonable speed and similar quality, other property at the described premises due to loss or damage caused by the same occurrence.
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> Electronic Media and Records are:
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> 1) Electronic data processing, recording or storage media such as films, tapes, discs, drums or cells.
>
> 2) Data stored on such media; or
>
> 3) Programming records used for electronic data processing or electronically controlled equipment.
>
> This limitation does not apply to Extra Expense.

You might be asking, "Does this language really relate to computer losses?" I wondered the same thing, until I read the following language that is also part of the limitation:

> Example No.1:
>
> A Covered Cause of Loss damages a computer on June 1. It takes until Sept. 1 to replace the computer, and until Oct. 1 to restore the data that was lost when the damage occurred. We will only pay for the Business Income loss sustained during the period June 1-Sept. 1. Loss during the period Sept. 2-0ct. 1 is not covered.

I think the language quoted previously pretty much speaks for itself.

Enhancing Limitations

Please note that you *must* look for the limitation quoted previously or similar limiting language in policies and, if discovered, try to enhance it because the language quoted previously could limit your client's coverage to a mere 60-day period after a computer-related loss occurs. Accordingly, you should try to amend that 60-day period to at least 12 months, if not longer.

Also, if your client's policy contains this limitation and your client suffers a loss, please note that, by its own terms ***the limitation does not apply to extra expense***. So an insurer cannot rely on the language to limit coverage for the extra-expense portion of your client's claim.

Let's go back to the "loss to computer data" issue. After reading the policy language quoted previously, you might ask, "Given that the policy language clearly contemplates that loss to computer data triggers business-interruption coverage, how in the world can insurers, with a straight face, argue to the contrary?"

Remember my article in *InsuranceWeek* addressing how some insurers argue that unless a loss causes a complete shutdown of the insured's operations, the policyholder is not entitled to business-interruption coverage because the loss does not satisfy the "necessary interruption" or "necessary suspension" prerequisite to coverage? You wouldn't believe how many people have talked to me since that article came out and told me, "Mike, you can't be serious!"

They didn't say the same thing after I

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sent them the court decisions showing which carriers took that position and, worse yet, which courts agreed with them!

Well, add another unreasonable position to the list of unreasonable positions that *some* (but not all) insurers take under commercial-property and business-interruption policy forms.

Unfortunately, I think the "loss to computer data" issue needs to be addressed much like the issue regarding whether a complete cessation of the insured's operations is needed to trigger a covered business-interruption loss. This proves that an ounce of preventive medicine during policy placement can save everyone from a pound of problems at claims time.

Confirmation from Underwriter

First, discuss this issue with the underwriter. Explain the problem created by certain insurers in the market who argue that loss to data on computers, without other types of loss or damage to the CPU or other property, is not sufficient to trigger business-interruption coverage. This is because, according to such insurers, data is not "tangible property" and cannot, therefore, sustain "direct physical loss or damage."

Have the underwriter confirm in writing, or you confirm to the underwriter in writing, that the underwriter does not agree with that position. In other words, confirm that loss to merely computer data (whether residing on a computer, intranet, Internet home page, etc.) can trigger business-interruption coverage under the policy.

Second, if the underwriter is not willing to confirm such an interpretation in writing and you cannot place the coverage with any other insurer, you can try to "paper the tile" with your client's understanding of the language. In the event of a coverage dispute, a court might look at such a record as evidence of how the insurer understood the insured to interpret the language and apply that understanding.

This is not, however, a full-proof solution because not all courts use this rule of insurance-contract construction.

Accordingly, you should discuss this issue with your client and advise that this likely is the best that can be done for now, but that you will continue to look for alternatives during the policy period and try to address the issue again at renewal. When you market the program for renewal, if you find another insurer that is willing to address this issue, you should try to force the incumbent insurer to address the issue as well, or consider moving the program.

Business interruption is a very important coverage for policyholders to have. For smaller policyholders, it can be a life-saving coverage. But it is not enough to simply have business-interruption insurance. The coverage must be worded correctly so that it provides meaningful protection. The policy must provide for an "extended period of indemnity" that entitles the insured to coverage for all of the lost income and extra expenses sustained for as long as it takes revenue-generating activities and expenses to reach levels that would have been reached if the loss had never happened.

The policy also must provide coverage for losses caused by loss to computer data only, whether residing on a computer, intranet, Internet home page, etc., and whether caused by a computer virus or other peril.

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