Insurance Coverage for American Businesses Affected by the Recent Japanese Earthquake and Tsunami

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First and foremost, our greatest sympathies go out to the nation of Japan and to all those who have been affected by the recent earthquake and tsunami.

Introduction

Businesses throughout the United States are likely to feel the effects of the tragic earthquake and tsunami that hit Japan on March 11. Immediately following the devastating events, Japanese automakers Toyota, Honda and Nissan were forced to temporarily close a number of their facilities. Electronic giants Sony, Toshiba and Panasonic followed suit after sustaining damage to various factories and offices. And numerous other local businesses, ranging from steel makers to paper mills, reported a halt in production as well.

Although halfway across the world, suspension of these Japanese operations may affect American companies that either have facilities located in Japan or that depend upon suppliers or customers stationed there. If your business experiences a loss of income due to the recent earthquake or tsunami, the business interruption ("BI"), contingent business interruption ("CBI") or extra expense ("EE") provisions of your property policy may reimburse you for such losses.

It is also important to keep in mind that your business may be entitled to additional coverage if it is named as an “additional insured” of a company affected by the recent events.

Real and Personal Property

This Update focuses on coverage for a loss of profits stemming from an interruption of business, but it is very likely that your company’s underlying property policy covers damage to any real and/or personal property affected by the earthquake and/or tsunami. When assessing the overall damage, it is important to consider both the actual property loss as well as the interruption of business that resulted from that loss.

Business Interruption Insurance Coverage

If your business’s facility or equipment is located in Japan and was physically damaged by the earthquake and/or tsunami, any profits that were lost due to an interruption of your business may be covered under the BI provision of your property policy. BI coverage, also known as business income insurance, reimburses the insured the amount of profit it would have earned during the period of interruption had the covered event and the ensuing physical damage never occurred. This type of coverage is not sold as a separate policy but rather is added as a separate grant of coverage onto a property policy or included in a comprehensive package policy.

A standard BI provision provides:

In consideration of additional premium, this policy is extended to cover the actual loss sustained by the Insured due to the necessary interruption of production or business operations or services during the period of interruption of the following:

A. Gross Earnings, Rents, and Expense to Reduce Loss; and

B. Extra Expense;

Directly resulting from direct physical loss or damage, insured by this policy to property not excluded, utilized by the Insured, and at a covered location, but only to the extent the Insured is unable to make up production and resume or continue operations or services, partially or entirely, by utilizing damaged or undamaged property all whether or not at a covered location.

The “period of interruption” is typically defined as the “reasonable amount of time necessary for the insured to resume business.” This amount of time differs for each insured, but usually depends on the severity of damage and the nature of the business's operations. It is important to keep in mind that most policies cover only the time needed to resume production of goods and services, not necessarily the amount of time needed to achieve the level of success the business experienced prior to the covered event.
To recover a BI loss, the insured must prove that (i) it sustained damage due to a covered loss; (ii) there was an interruption of business (suspension of operations) caused by the property damage; (iii) there was an actual loss of business income during the period of time necessary to restore the business; and (iv) the loss of income was caused by the interruption of business and not some other factor(s).

Contingent Business Interruption and Extra Expense Insurance Coverage

If your business does not have property in Japan but still experienced a loss of income because of the earthquake and/or tsunami, it may be entitled to reimbursement of lost profits under the policy's CBI provision. CBI coverage compensates the insured for lost revenue resulting from an interruption of business, stemming not from damage to its own property but from damage to property that belongs to a covered customer or supplier located elsewhere. For example, if your business depends upon electronic goods produced by a Japanese factory that was forced to shut down, any loss of income that you experience during the period of interruption due to the failure of that Japanese factory to supply you with the necessary goods may be covered under your business's CBI provision.

In order for the business interruption damage to be covered, the type of peril and type of physical damage sustained to the third party's property must be the same type of peril and damage insured under the controlling policy. In other words, your business's insurance policy must provide coverage for earthquakes and/or tsunamis as well as for damage to property, such as buildings or production facilities.

EE coverage may also come into play. This type of insurance indemnifies the insured for expenses in excess of normal operating expenses that the insured incurs in order to continue business while its damaged property is being repaired or replaced. Similarly, contingent extra expense reimburses the insured for expenses that result from a contingent loss, such as a CBI loss.

Notice, Proof of Loss and Filing a Claim

Virtually all property insurance policies require the insured to perform certain duties within a specific period of time following a loss. For example, most policies require the insured to:

1. Give a notice of claim as soon as practicable;
2. Submit a proof of loss within 60-90 days of the loss; and
3. If necessary, file suit against the insurance company within 12-24 months of the loss.

Failure to comply with these technicalities and timelines may operate as a complete bar to coverage. If your business intends to submit a claim for business interruption and/or damage to real or personal property but is unable to meet the deadlines specified in the policy, it should contact the insurance carrier immediately and ask for an extension.

Additional Insured

Finally, your business may be able to seek a separate avenue of coverage if it is named as an "additional insured" of a company affected by the earthquake and/or tsunami. An additional insured is an entity that is not automatically included as an insured but is added to the policy by means of an endorsement. An additional insured may either enjoy the same benefits as the underlying policyholder or experience a restrictive form of coverage.

The endorsement section of a company's policy will either specifically name your business as an additional insured or provide a general blanket description that pertains to your company.

Conclusion

The devastating earthquake and tsunami that struck Japan earlier this month will continue to challenge the nation's residents for years to come. The consequences of these events have also reached the shores of the United States, having both an emotional and economic impact on the American people.

Companies located in the States may very well be affected by the recent happenings, leading to an interruption in business and subsequent loss of income. If your company experiences a loss in profits it may be entitled to indemnification under the BI, CBI or EE provisions of its property insurance policy. In order to secure coverage, it is important that your company submit a timely notice of claim and proof of loss and, if necessary, initiate any legal action against your insurance carrier within the specified period of time.

Your business should also explore whether it is an "additional insured" of an affected company located in Japan. If so, it may be entitled to further indemnification.

To ensure coverage, it is recommended that your business confer with an attorney who specializes in insurance coverage issues and claims.
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