

expert ease

Earthquake and Business Interruption

The Canterbury earthquake and business interruption

On September 4 this year, a major earthquake caused severe damage to commercial and residential buildings in Christchurch and the wider Canterbury area. The Christchurch CBD and other retail and industrial premises were off-limits to the public for several days while the safety of buildings was assessed and the aftershocks continued.

It is highly likely that the earthquake will have an ongoing impact on many businesses, long after the damage to their premises has been repaired. The disaster raised a number of technical questions for brokers, particularly in relation to Prevention of Access and Depopulation.

In response to the high demand for information, Lumley hosted a Business Interruption Information Session for Canterbury brokers earlier this month.

This involved a panel of expert speakers including: Peter Faire, Claims Preparer and Director of Fawcett Faire Ltd; National Chief Adjustor Darryl Cowan of Cunningham Lindsey NZ Ltd; Insurance Lawyer Tony Paterson of Markit Law; Material Damage Loss Adjuster Ross Sneddon of Sneddon & Associates Ltd; and Technical Claims Manager Roger Scholes of Lumley.

What do Business Interruption policies actually cover?

The main message from Peter Faire and Darryl Cowan was that Business Interruption (BI) policies cover losses that arise from



damage to property owned or used by your clients. Also that sometimes cover is extended for 'deemed damage' to suppliers, customers, utilities, certain infrastructure, prevention of access and the actions of civil authorities from that damage.

However, BI policies do not cover losses that arise from the general 'depopulation' or economic downturn that often follows an event that causes widespread damage.

In other words, the BI loss from the earthquake will be measured against the turnover that you would have achieved

'but for the damage', not *'but for the peril'* of the earthquake. For example, tourist numbers are down and the local population is behaving differently. The negative impacts of these situations are not covered because they fall under *'but for the peril'*.

This means we have to establish the standard against which the loss will be measured. This involves considering what the turnover would have been if the surrounding businesses, private property and infrastructure had been damaged (as they were), but your client's own business

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had not. For many businesses, there would still have been a downturn in business activity even if there was no damage and the business had not been affected in any way.

Conversely, if your client's business had suffered damage but nothing much else had been damaged in Canterbury, any loss you suffered would then have been easy to attribute to that damage. Authority for such adjustments to the standard is contained in what is commonly known as the 'Adjustments Clause' in the typical BI policy.

Peter Faire explained that this factor is commonly referred to as the "depopulation effect" but that depopulation as a term did not exist under a BI policy.

He called it a "short and dirty word" for the application of the adjustments clause in a BI policy. The turnover to be measured against is what a business would have achieved during the indemnity period, *'but for the damage'*.

Peter used the following example:

A client owns a café. As a consequence of the earthquake, chairs and tables fell over and there was a bit of a mess. However, a couple of days later it has been cleaned up and they are back operating again. Normally they have a turnover of \$1,000 a day but this has been reduced to \$100. As they can see that there are no customers around, they feel that they need to make a claim. The tourists aren't here because they don't want to be in a city where there's been an earthquake.

"That sort of general economic effect is the depopulation effect. Under *'but for the damage'*, that would have happened anyway. So if there had been no damage to that cafe and they had simply opened the door, the streets would be the same. There would still be no one there and they still would not be able to make a claim. That is the depopulation effect." Peter said.

What can be claimed is Business Interruption due to damage and deemed damage to the following:

- Insured's property
- Other property that the insured uses or is responsible for
- Utilities
- Customers
- Suppliers
- Specified infrastructure
- Property 'in the vicinity' that hinders or prevents access
- Closure or restriction by a constituted authority

Prevention of Access

During the seminar, questions were raised about the various definitions of 'Prevention of Access' including 'hindrance' and 'in the vicinity'.

It was hotly debated whether depopulation losses were in fact actually losses arising from prevention of access and/or hindrance of access due to road closures etc within the CBD area.

The difficulty for claims preparers and loss adjusters is in assessing the levels of turnover a business would have achieved *'but for the damage'*, taking into account both the prevention of access – which is covered – and depopulation – which is not.

Peter went on to say it was likely that levels of business would not be as high as they had been before the earthquake. Soon, statistical information would become available to provide a benchmark for the reduction in the number of tourists, at which point adjustments could be made.

"The claim will be in two parts. There will be a claim for the prevention of access which will allow for the genuine customers that would have gone there but couldn't. What it won't do is compensate for the tourists who have gone to say, the Marlborough Sounds

instead because they didn't want to be in a city that's had an earthquake," he said.

"I'm going to be pushing it like hell for the insured, but obviously some of that loss is not insured."

He said that insurers should take a pragmatic view. "If it's an area where there are no tourists and conditions are such that they can't get there, then chances are it is hindrance, because hindrance is deemed damage. You've got to err on the side of giving the insured the benefit of the doubt in those sorts of cases."

The damage could be very slight, and did not have to exceed the excess. It could be a major supplier that had been badly damaged and could no longer supply you, or a major customer who couldn't trade and can no longer buy half of your turnover. It was not the size of the material damage claim that mattered, but the *impact* of it.

However, according to Tony Paterson, "brokers should be looking for interruption or interference that has been caused by the damage".

For example, if your client was a dairy owner and the road was blocked, one reason people aren't coming to their dairy is because they can't. But people still need their bread and butter, so if the dairy around the corner is not blocked, and they're doing a booming trade, then your client has a good case for hindrance.

Conversely, if the revenue of the dairy around the corner is 30% down, then it's probably due to depopulation. And that dairy won't be covered, and neither is your client's – regardless of their damage.

Roger Scholes pointed out that for certain types of businesses, losses were usually recoverable. This applied to the likes of dentists and hairdressers in that they might have a reduction in turnover one week, but most people will go back the next week to have their teeth done by

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their regular dentist and their hair done by their favourite hairdresser.

“With a BI claim you’ve got to look at the loss over the indemnity period,” Peter said. “Whilst most indemnity periods – to be blunt – are too short, you are going to look at that indemnity period over a reasonable length of time to see if there is a subsequent recovery that has to be taken into account.

“With some businesses if you’ve lost it today, you’ve lost it forever.”

Depopulation

Peter said the word “depopulation” had caused a lot of confusion. “It’s emotive and misleading and it’s a shame that it ever became entrenched.”

The principle of depopulation has been debated in New Zealand and the Pacific Islands since the early 1980s, and has been applied to claims. In May, for the first time there was a High Court case in London, which questioned depopulation. The Court found in favour of the insurer, the first time that the principle was legally affirmed.

Both Roger and Tony emphasised that when in doubt, come back to the wording of the contract, as not all policies are created equal.

Peter finished by saying: “There’s still going to be a lot of debate and there’s no easy answer to this. In the end all the available information is going to be tossed about and some sort of compromise is going to be reached”.

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