

PAYMENTS TO CEASE

The end of the month could bring a fatal blow to some businesses, writes Christchurch lawyer EMILY WATSON (sic)

With the anniversary of the 22 February earthquake fast approaching, business interruption insurance is poised to re-enter the spotlight.

During the past year many businesses have been receiving interim insurance payments to stay afloat. For those businesses with a 12-month indemnity period, payments will soon end. This could be a fatal blow for some businesses which have been unable to re-establish themselves during the indemnity period.

Businesses whose re-establishment has been delayed by the CBD cordon, delays in building repairs, delays in relocating, or insurer delay may wonder whether an extension of their indemnity period is possible. Unsurprisingly, insurers are rejecting this possibility. If a business can show the delays were solely caused by the insurer, it may be worth an argument, although in this climate of uncertain ground conditions and ongoing aftershocks, it will be an uphill battle.

That's not all. The interim payments paid by insurers to date usually bear no resemblance to the detailed claims submitted. Insurers have been making generic payments in lieu of finalising claim entitlements. There will be a wash-up at the end of each business's indemnity period, where the complexities of the claim will need to be thrashed out. Some common issues will arise.

The basic purpose of business interruption insurance is often misunderstood. It does not cover business losses suffered because of the earthquake. Instead, it covers business losses resulting from earthquake damage to the insured property. So for a loss to be covered by business interruption insurance, for a manufacturer, for example, a machine would need to have been damaged by the earthquake, the damage to the machine would have to be covered by the business's material damage policy, and the inability to use the machine would have to result in the financial loss.

Depending on the policy wording, business losses are usually calculated by comparing business results during the interruption with the same period in the previous year. The aim is for the business to receive what it would have achieved but for the damage to its insured property. This is a bit difficult because it involves some crystal ball gazing about how well the business would have done if the damage hadn't happened.

Sometimes, the raw numbers don't tell the whole picture, so business interruption policies have in-built flexibility in the form of adjustment clauses. This flexibility can create problems. Evidence of business growth before the earthquake can justify a claim uplift. A probable drop in profits, for reasons unrelated to the earthquake damage, can justify a discount.

Some businesses hard hit by the earthquake, such as hospitality and tourism businesses, are particularly exposed to discounts for "depopulation"; the negative effect of the earthquake on the wider economy and the drop in visitor numbers on business results. This

is a prime example of business losses caused by the earthquake, but not necessarily the physical earthquake damage sustained by the business.

However, adjustments are not necessarily downwards. Hospitality businesses in Merivale have boomed. So there is a good argument for an adjustment upwards for those types of business in that area.

During the wash up, some businesses will be unpleasantly surprised to be asked to contribute to the cost of temporary structures or plant and equipment supplied by the insurer, if the business intends to keep using them. Unless the business has taken out additional costs of working cover, with a separate sum insured in the policy schedule, it may have to contribute. The additional cost of working cover automatically included in most policies only applies to costs incurred to avoid or diminish the losses during the indemnity period.

There are fears that insurers will try to claw back payments already made through retrospectively scrutinising management decisions. Businesses are obliged to mitigate and minimise losses, through rehabilitation efforts. However, clawback is unlikely if a business can show it has acted reasonably and maintains its intention to continue the business after the indemnity period.

The first stop when questions or issues arise is the policy wording. The devil in the detail is usually found in the definitions.

Practically, however, all issues will usually be resolved by negotiation. Being prepared with all supporting accounting, business and statistical information is crucial because the party wanting an adjustment (upwards or downwards) bears the burden of proving that it's more likely than not the adjustment is appropriate. This technical legalese is not often used in negotiation, but it can have a bearing on strategy. It's reasonable to ask to see the information the other side relies on.

Good advice from accountants, insurance brokers and lawyers should help businesses maximise their results. It's worth considering the Recover Canterbury grants for small and family businesses to obtain professional advice on post earthquake insurance issues.

By line: Emily Walton is a partner at Wynn Williams