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Oil Slick: Protecting Your Coverage Rights

Law360, New York (May 20, 2010) -- On April 20, 2010, an explosion destroyed the BP-licensed Transocean Ltd. drilling rig Deepwater Horizon, located just 42 miles southeast of the Louisiana coastline. The explosion ruptured the underlying well, causing an estimated 25,000 to 100,000 barrels of crude oil per day to escape to the surface of the Mexican Gulf. As of the publication of this article, the resulting oil slick is the size of Delaware and spreading dangerously close to the fragile coastal wetlands of Louisiana. To date, efforts to stop the oil leak below and to contain the oil slick on the water's surface have been for the large part ineffectual.

The damage that the oil spill has already caused is enormous, and will only continue to grow in the coming weeks and months. At the forefront of those harmed by the spill is the Louisiana fishing industry, which federal authorities have already banned from operating within the affected areas of the Gulf to the east of the Mississippi River basin. As a consequence, large portions of Louisiana's enormous seafood processing industry, which produces a third of the nation's seafood, have discontinued operations, as they have no oysters, shrimp, shellfish, or finfish to process.

The hotel industry has also begun to feel reverberations from the spill. Guests at about a third of hotels along the Gulf Coast have cancelled their reservations, due to the fishing ban and the closure of much of the national wetland parks where the oil has come ashore. Should the oil slick get much closer, or enter, the Gulf seaports, the shipping industry may also be heavily impacted. Should the oil come too close to the ports, all entering ships will be required to undergo a 10-12 hour decontamination process, which will slow port traffic dramatically. If oil were to accumulate too heavily within the ports, they could be shut down entirely.

It remains unclear how much those harmed by the oil spill will be able to recoup. At Senate hearings, BP officials repeatedly stated that they would pay all "legitimate claims" for damages as a result of the spill, though they would not expand on what those claims might cover. Inevitably, businesses will seek coverage under first-party property insurance policies. To assist those facing losses, we offer the following discussion of some common issues likely to confront policyholders in making these claims.

Gulf Coast Oil Spill Losses Are Potentially Covered by Property Insurance Policies

The primary purpose of property insurance is to cover physical loss or damage to the policyholder's property that is caused by a covered cause of loss. A clear example is the devastation to numerous buildings caused by Hurricanes Katrina and Rita. However, the determination of what constitutes "physical loss or damage" can be complex, especially since this term is usually left undefined by the policy.

Several courts have held that "physical loss or damage" includes not only actual damage of the covered property, but also loss of property use, value or function. In the context of the Gulf Coast oil spill, this damage could consequently cover the loss of use of fishing boats that are no longer allowed to be taken out into the Gulf.

Ultimately, the amount that policyholders will be able to collect will depend on the specific provisions of their insurance policies. As an initial matter, policyholders should determine whether their policy is a "listed perils" policy, which covers only damage caused by listed hazards such as fire, wind or vandalism, or the potentially broader "all risks" policy, which covers any and all hazards to property except those that the policy specifically excludes.

Various Types of Business Interruption Losses May Be Covered

Coverage may also be available for business interruption losses. Commercial property policies typically provide coverage for income lost due to the interruption of the policyholder's business by a covered cause of loss. Insurance companies often argue that the business interruption provision only covers "direct physical loss of or damage to" the insured property.

Policyholders should keep in mind, however, that courts have found that "direct physical loss of or damage to" property could encompass loss of use, value, or function of the covered property. While many policies require the total suspension of business operations, some also cover only a partial shut down. This may be an important distinction for businesses such as seafood processing plants, which have or will shut down either all or part of their operations due to a drop in supplies.

Furthermore, certain property policies contain specific policy extensions that explicitly cover business interruption losses even if the policyholder's property itself has not been physically harmed. For example, "ingress/egress" provisions cover damages caused when a covered cause of loss blocks access to the insured property. Similarly, coverage may be available for business operation losses caused when an order or action of a civil or military authority, such as evacuations or property closures, prevents access to the policyholder's property.

With regard to the Gulf Coast oil spill, such provisions could come into play where government orders have closed large tracts of coastal land affected by oil landfall, potentially blocking access to covered property. Likewise, losses resulting from the suspension of seafood harvesting operations due to the federal fishing moratorium off the Louisiana coast may also be covered.

Another type of coverage that may be available is "contingent business interruption," which covers losses suffered when a covered cause of loss prevents the policyholder's suppliers or customers from conducting business as usual. Here, this type of coverage may apply to seafood processors who can no longer obtain fish, shrimp or oysters from their suppliers due to the fishing ban. It could also apply to businesses whose deliveries are delayed by oil-spill induced shipping delays at the Gulf ports.

Similarly, "dependent property" extensions provide coverage when a business is harmed due to damage to a separate property caused by a covered cause of loss. This occurs where the separate property was essential to the policyholder's business operations, such as delivering materials to the policyholder, accepting the policyholder's products or services, manufacturing goods for the policyholder, or attracting customers to the policyholder's business. The latter, for example, would apply to the loss of business to Gulf Coast hotels, where guests have cancelled reservations because the oil spill has blocked recreational fishing and access to the public wetland parks.

Policyholders should expect insurance companies to take the position that business income coverage does not cover losses resulting from "unfavorable business conditions" in areas generally impacted by the covered cause of loss. This could be argued in response to claims linked to decreased tourism levels in the area affected by the oil spill. This position need not be accepted, however, and can be countered by enforcing the supplemental business interruption coverage provisions, such as "dependent property."

Measure of Damages for Property Insurance Losses

In addition to the cost of repairing or replacing the damaged property itself, property business interruption insurance generally covers lost business income during the "period of restoration."

Business income is typically defined as the sum of the net profit or loss before income taxes that would have been earned but for the business interruption and the continuing normal operating expenses incurred during the interruption. The "period of restoration" usually runs from the date of loss to the date that the damaged property should have been rebuilt, repaired, or replaced with reasonable speed and similar quality.

Property policies also generally cover "extra expenses," or costs incurred during the period of restoration that would not have been incurred if the physical loss or damage to property had not occurred. Further, after the damaged property is repaired, replaced, and/or rebuilt, policyholders may also be able to claim "extended business income" coverage.

This coverage compensates the policyholder for a continuing reduction in income resulting from the business interruption. Extended business income coverage begins on the date that the property is actually rebuilt, repaired, or replaced. The policy will provide how long the extended period of coverage lasts, ranging generally from 30 days for smaller businesses to 365 days for larger companies.

What Policyholders Should Do Now

The following provides a summary of actions that policyholders affected by the Gulf Coast oil spill should take immediately to protect their rights to valuable first-party property insurance coverage:

1) Review All Insurance Policies

Policyholders should review all parts of their first-party property insurance policies, including endorsements and policy extensions. The policyholder should be careful to review the policies with an eye toward the business interruption coverages discussed above. As the extent of the coverage may be unclear, it is advisable to have the provisions reviewed by individuals who are familiar with such policies and their legal interpretations as soon as possible.

2) Notify All Insurance Companies Of Potential Claims Immediately

Policyholders should notify insurance companies immediately in writing of any and all claims they may have, even if they are not sure if a particular loss is covered. Insurance policies may set deadlines by which time the policyholder must notify the insurance company of any potential claims. If a policyholder misses this deadline, it risks an argument from its insurance companies that it has forfeited its coverage claims.

3) Be Aware of Deadlines to Submit Proof of Loss

The policy's proof of loss provisions may require policyholders to submit a statement under oath describing the claimed loss and amount being claimed. Policies also may require that the proof of loss be submitted within 60 or 90 days of the date of the loss. Insurance companies may, upon request, extend the filing deadline, but the policyholder should be sure to obtain any extension in writing before the deadline passes. It is imperative to submit the proof of loss by the stipulated deadline.

4) Be Aware of Deadlines to File Suit Against Insurance Companies

Policyholders should consult the policy and relevant state law to identify both the contractual suit limitations and relevant statute of limitations, if any, to determine the date by which they must sue their insurance companies.

State lawmakers may extend the statute of limitations deadline, as they did in Louisiana for Hurricanes Katrina and Rita claims.

Insurance companies may also be willing to enter written tolling agreements to extend the time period in which such lawsuits must be brought. Nonetheless, it is important to take note of the deadline so as to avoid losing the ability to bring legal action against insurance companies should they refuse or limit coverage.

5) Maintain Records

Complete records are a vital element of first-party property insurance claims. Policyholders should be sure to document all costs and expenses caused by the Gulf Coast oil spill, including any resulting business interruption losses.

6) Cooperate with the Insurance Company

Policyholders are contractually obligated to cooperate in insurance company investigations. For example, insurance companies may ask policyholders to respond to questions, provide documents, and/or submit to an "examination under oath," which is similar to, but also different from, a deposition.

7) Retain Experts

Consider hiring experts to assist in calculating alleged losses and damages. Also, in-house or outside counsel should be involved at an early date.

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