Hurricane Florence physically damaged large areas of the South, particularly in North and South Carolina. Businesses in the region are also certainly suffering long-lasting economic damage as they remain closed—and they will rightly want to secure business interruption coverage for those losses.

Following such disasters, one common dispute is whether the measurement of business interruption should account for the post-loss economic conditions of the impacted area. Under ordinary, non-catastrophic circumstances, the performance of a business prior to the catastrophe can be an accurate measurement for how that business would have performed if the damage had not occurred.

But the same may not be true following a wide-impact catastrophe. For example, resulting population shifts—such as an influx of temporary workers or an exodus of residents—can cause long-lasting changes in supply and demand for commodities and services. Construction supplies might be in higher demand than before the catastrophe as rebuilding efforts begin. A business that is able to open might boom if none
of its competitors are similarly able to reopen. Consequently, measuring a policyholder’s business interruption loss is one of the most contentious issues to arise from wide-impact catastrophic events like Hurricane Florence.

Two lines of authority exist for measuring a policyholder’s business interruption loss following a wide-impact catastrophe: the “economy ignored” and the “economy considered” approaches.

The Economy Ignored approach looks backward and measures the policyholder’s loss only against pre-catastrophe business levels; it does not consider the impact of actual post-catastrophe conditions on the economy, market, or demand. Consider, for example, a full-service hotel attached to a convention center that had an 85 percent occupancy rate before a hurricane. The convention center suffered massive damage that required it to close for at least one year. As a result, after the hurricane, the hotel’s occupancy sank to 15 percent. The hotel asserts that the post-hurricane economy should be ignored, and that its business interruption claim should be based on its pre-hurricane occupancy levels, while the insurer posits that the post-hurricane levels should control.

The Economy Considered approach, on the other hand, seeks to place the policyholder in the position that it would have occupied in the actual post-catastrophe environment had it been able to continue its operations. Consider the same convention center and hotel. If the carrier Construes its policy as allowing the Economy Considered measurement, the probable loss of business due to the convention center’s closure could be argued to limit the hotel’s recovery to what it would earn at a 15 percent occupancy. But the reverse could also be true. If the hotel had been operating at an 85 percent occupancy rate for the three years prior to a hurricane, but the influx of temporary workers would have caused it to operate at a 100 percent occupancy rate if it had been open, the hotel could claim full occupancy rates under the Economy Considered approach. Of course, the insurer would argue that doing so would result in a windfall to the policyholder, as opposed to putting the policyholder in the position that it would have been in had the hurricane not occurred, that is, an 85 percent occupancy rate.

Neither test consistently benefits a policyholder or an insurer in every situation. The outcome instead relies on the unique facts in each circumstance, and which method to use might be based on the particular policy language.

Although policy provisions vary, common business interruption provisions generally include something like:

*In determining the amount of the Time Element loss as insured against by this policy, due consideration shall be given to experience of the business before the loss and the probable experience thereafter had no loss occurred.*

Following Hurricane Katrina, some insurers inserted language in their policies that they argue reduces a
policyholder’s ability to recover in certain situations. These insurers attempt to limit their exposure by including measurement provisions like:

“Business Income” is to be determined by:

1. The Net Income of the business before the direct physical loss or direct physical damage occurred;
2. The likely Net Income of the business if no physical loss or no physical damage had occurred, **but not including any net income that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses.**

(emphasis added). Obviously, this provision is designed to be one-sided in the insurer’s favor. Policyholders and brokers alike should watch out for provisions like this and seek to negotiate, at a minimum, a more balanced approach.

Knowing the case law that applies in your jurisdiction is also important. Limited recent case law in this area exists, but policyholders affected by Hurricane Florence should at least be aware of a Fourth Circuit case that used the “economy ignored” approach.

In Prudential LMI Commercial Insurance Co. v. Colleton Enterprises Inc., 976 F.2d 727 (4th Cir. 1992), the Fourth Circuit, applying South Carolina law, rejected a hotel’s claim for lost profits it would have earned following Hurricane Hugo due to an influx of repair and construction workers in the area. The policy provided: “In determining loss hereunder, due consideration shall be given to: a. the earnings of the business before the date of damage or destruction and to the probable earnings thereafter, had no loss occurred . . . .” The policyholder had recorded losses during the two-year period prior to the storm. Focusing on the “had no loss occurred language,” the court reasoned that to consider post-storm economic conditions “would be to confer a windfall upon the insured rather than merely to put it in the earnings position it would have been in had the insured peril not occurred.” The court added: “It is that an insured under a business interruption provision such as that here in issue may not claim as a probable source of expected earnings (or operational expenses) a source that would not itself have come into being but for the interrupting peril’s occurrence.” Nevertheless, the Court left open the possibility of additional considerations when it stated that the policyholder “might prove that a general economic up-turn for the business had been imminent . . . or that a specific event had created a profit opportunity which the peril’s occurrence had thwarted.”

Courts across the country have found similarly and differently.

- In Catlin Syndicate Ltd. v. Imperial Palace of Mississippi Inc., 600 F.3d 511 (5th Cir. 2010), the Fifth Circuit, applying Mississippi law rejected a casino’s claim for the increased profits it would have earned had it remained open following Hurricane Katrina while other area casinos had not. Addressing the
Policyholders should therefore carefully consider their policy language and the impact of both tests before submitting their claim (and when renewing coverage next time around). Moreover, to maximize coverage, policyholders should adopt appropriate pre- and post-loss planning and claims-handling approaches. These might include, for example, determining which test courts apply in the jurisdictions in which they operate and researching what position their insurers have previously taken, so they can better anticipate possible arguments against their claim. Additionally, policyholders should consider negotiating for better and more appropriate coverage.

Post-Florence economic conditions may result in some businesses thriving and others struggling. Whether those post-storm conditions will be considered in connection with valuing a business interruption claim depends on the relevant policy language and applicable law. But one thing is certain: post-hurricane economic conditions can have a substantial impact on the value of a business interruption claim.

- In *American Automobile Ins. Co. v. Fisherman’s Paradise Boats Inc.*, 1994 WL 1720238, at *3 (S.D. Fla. Oct. 3, 1994), the policy stated that business interruption loss would be determined based on likely net income “if no loss or damage occurred.” The court rejected the policyholder’s claim for profits it would have earned due to increased post-hurricane demand for its products, holding that the policy allowed “net income projections that are not itself created by the peril” and the policyholder was not entitled to “the windfall profits.”

- On the other hand, in *Levitz Furniture Corp. v. Houston Casualty Co.*, 1997 U.S. Dist. LEXIS 5883 (E.D. La. Apr. 28, 1997), which involved a flood, the court held that the policy at issue “clearly and unambiguously provides coverage for earnings ‘had no interruption’ occurred, and does not exclude profit opportunities due to increased consumer demand created by the flood.”