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Shutdowns by Civil Authority

MAY NOT TRIGGER
TRADITIONAL
BUSINESS INCOME
COVERAGE

WHITE PAPER

Shutdowns by Civil Authority May Not Trigger Traditional Business Income Coverage

Civil authority insurance coverage on the traditional business income form requires damage to property on the described premises. Civil authority coverage usually applies only to restricted access to the premises, and even when an order of civil authority is the reason for the loss of business income, coverage usually extends for only a few weeks.

Bill Wilson, author of *When Words Collide: Resolving Insurance Coverage and Claims Disputes*, writes, “According to my private research, 95 percent of business income losses countrywide do not adequately compensate the insured. A full 85 percent are underinsured by 40 to 50 percent. Clearly, considering all avenues contributing to business income loss exposures is a critical aspect of sound risk management.”

“There is no standard ISO form or traditional non-ISO forms in the marketplace to cover this unusual business risk. You need to look into the excess and surplus or nontraditional marketplaces for coverage,” Wilson said.

Consider this scenario: A state agency shuts down the insured’s oil production facility due to a nearby earthquake and safety concerns. The earthquake did not damage the insured’s property or well; however, civil authority shuts down the well indefinitely, resulting in loss of revenue, a loss of use and restricted access to the property.

How does the insured protect the income stream from this type of loss? Denial of access by order of civil or military authority is available as an endorsement and additional coverage provision in the excess market.

Triggers for Civil Authority Coverage

In one often-cited case in the Federal Fifth Circuit court, *Dickie Brennan & Company, Inc. v. Lexington Ins. Co*, the insured sued Lexington Insurance Company when the carrier denied coverage for business losses after Dickie Brennan & Company were unable to run their business because the government had ordered the evacuation of New Orleans as Hurricane Gustav approached. The insured's property suffered no damage and the appellate court affirmed a motion for summary judgment, which dismissed the company's suit.¹ Another Louisiana court ruled similarly.

To trigger business interruption coverage, there must be damage to property followed by a civil authority action.

According to one attorney, "Civil authority is like playing the lottery. If your numbers don't match, you lose."²

Here is the wording from CP0030:

When a Covered Cause of Loss causes damage to property other than at the described premises, we will pay for the actual loss of Business Income you sustain and the necessary Extra Expense caused by action of civil authority that prohibits access to the described premises, provided that both apply:

- 1) Access to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the described premises are within that area but are not more than one mile from the damaged property; and
- 2) The civil authority takes action in response to dangerous physical conditions resulting from the damage, or continuation of the Covered Cause of Loss that caused the damage, or the civil authority takes action

to enable a civil authority to have unimpeded access to the damaged property.

Coverage is subject to a 72-hour waiting period after the “first action of civil authority” and applies for only four consecutive weeks.... Or when your Civil Authority Coverage for Business Income ends; whichever is later.

These conditions must occur for Civil Authority coverage to apply.


- ✓ Government authority must prohibit access to the insured property or dependent business.
- ✓ That prohibition must result from an occurrence of physical loss or damage to the property within a one-mile radius.
- ✓ The event meets the waiting period.³

An *Insurance Journal* article discussing civil authority provisions states, “...civil authority provisions are intended to provide insurance coverage where damage to property first occurs and then, following the damage, a civil authority prohibits access to the area of the damaged property as opposed to an action by a civil authority taken in anticipation of, and to prevent, possible damage in the future.”⁴ Another area that responds similarly is the ingress/egress provision of the policy. Physical damage of a covered loss triggers this provision.

Given these provisions, a significant coverage gap may occur in many instances.

Remote Events May Not Trigger Coverage

Civil authority insurance coverage is at the forefront after every natural disaster. Civil authority coverage grants contain different geographical distances from the physical damage-triggering event: from damage in the immediate area to 10 miles to 100 miles and in some cases no geographical limitation.



Earthquakes in states like Oklahoma and Alaska occur with increasing frequency. The largest recorded quake struck Prince William Sound in Alaska in 1964, a record 9.2 magnitude. Prince William Sound, an area loaded with oil and gas pipeline, is the location of the infamous Exxon Valdez oil spill.

Oklahoma is the site of a number of well operations, and increasingly, experts link thousands of quakes to wastewater injection in oil and natural gas production. Fracking or hydraulic fracturing uses high pressure to inject water and chemicals like acids (fracking fluid) into shale formations to cause rock fracture. This fracturing releases oil, natural gas and other natural gas liquids trapped in the shale.⁵ Average fracking well depth can be about 1.5 miles.⁶

In one case after an earthquake, a well operation ran by Roan Resources permanently closed its operation after a 3.4-magnitude earthquake.⁷ The Oklahoma Corporation Commission (OCC) developed set protocols for closure and first ordered the immediate shutdown of the Roan site after the quake that was “within a mile of the frac site.” OCC regulations require a shutdown whenever a 3.0 quake strikes within five miles of a well.⁸

In September 2016, Oklahoma regulators ordered 37 wastewater wells shuttered after a 5.6 earthquake hit the region.⁹ These types of incidents also occur in Kansas, Texas and other states, according to an Insurance Journal article. Most policies exclude civil authority coverage for earthquakes, even though many earthquakes still trigger shutdowns even when they cause no damage.

Other Events May Not Trigger Coverage

Civil authorities may request site closure for reasons other than earthquake. Civil unrest may not trigger coverage. For example, the Rodney King riots in LA did not trigger coverage under the civil authority provision when curfews were enacted to prevent looting.¹⁰

Natural disasters like hurricane evacuation may not trigger coverage. Many business owners discovered this the hard way after Hurricane Irma, a 2017 category 5 hurricane. When evacuation orders arise prior to the occurrence of physical damage, coverage may not apply. According to one attorney, voluntary and advisory evacuation will not trigger coverage either.¹¹

Global Events Can Trigger Coverage Issues

Well shutdown concerns are not only a worry in the U.S. In December 2018, the British Columbia Oil and Gas Commission ordered at least a 30-day shutdown after seismic events between 3.4 and 4.5 magnitude struck about 20 kilometers from a hydraulic fracturing site.¹²

Exxon, which has numerous global operations, shut down its main gas treatment plant in Papua New Guinea in February 2018 after a 7.5-magnitude quake. This closure lasted almost two months. In this case, it is unclear if authorities shut the plant or Exxon did so voluntarily due to the belief that its gas field infrastructure may have been damaged in the quake.¹³

For agents writing oil-and-gas accounts, the threat of closure by civil authority is very real. Additionally, public opinion may be turning against fracturing, causing regulators to take a stronger stance after natural disasters. In 2015, a report by the States First Initiative clearly linked fracking and deep-water injection wastewater disposal to tremors in Oklahoma, Texas, Colorado and Ohio.¹⁴ According to one activist involved in monitoring fracking activities, “The risk of causing larger, damaging, even life-threatening earthquakes is too high a price to pay.”¹⁵



How to Find Coverage for Civil Authority Losses When No Physical Damage Occurs

Most insureds give little or no thought to remote events. Agents familiar with oil-and-gas exposures understand that remote events can cause well shutdown. Resultant business interruption costs can be high.

Even when an earthquake does not damage the insured's property or well, civil authority can order well closure indefinitely, resulting in loss of revenue, loss of use and restricted access to the property. How does the insured protect the income stream from this type of loss?

Few Solutions to This Coverage Quandary

Given the potential for catastrophic and lengthy closures after a natural event, what can business owners do to protect themselves? No ISO standard or traditional non-ISO forms exist to cover this shutdown risk. The non-traditional insurance marketplace remains the only source of coverage.

Conclusion

A skilled agent helps business owners understand the risks they face from civil authority shutdown. Pointing out this coverage issue can set you apart from your peers and help ensure your insured mitigates losses arising from civil authority. Working with an experienced wholesaler can provide access to coverages not available in the traditional market.

Notes

- 1 United States Court of Appeals, Fifth Circuit, "[Dickie Brennan Company Inc. Cousin Restaurant Inc. Seven Sixteen Iberville Brasserie v. Lexington Insurance Co.](#)," *FindLaw*. March 22, 2011.
- 2 Merlin Law Group, "[The Nuances of Civil Authority Coverage – Understanding Business Interruption Claims.](#)" June 17, 2012
- 3 Ibid.
- 4 Robert Redfearn, Jr. "[Business Losses Due to Civil Authority Action: When Is There Coverage?](#)" *Insurance Journal*. May 12, 2011.
- 5 BrainStuff - [HowStuffWorks, "What Is Fracking?"](#) *YouTube*. January 29, 2015
- 6 Ibid.
- 7 Zachary Frazier, RPL, "[Roan Resources Permanently Shuts Down Grady County Well After Earthquake,](#)" *Oklahoma Minerals*. November 7, 2018.
- 8 Ibid.
- 9 Doug Stranglin, "[Oklahoma Quake Prompts Shutdown of Gas-Linked Wells,](#)" *USA Today*. September 6, 2016.
- 10 Robert Redfearn, Jr. "[Business Losses Due to Civil Authority Action: When Is There Coverage?](#)" *Insurance Journal*. May 12, 2011.
- 11 Iris Kuhn, "[Hurricane Michael May Trigger Civil Authority Coverage For Businesses In Florida Panhandle,](#)" *Merlin Law Group*. October 31, 2018.
- 12 Audrey McKinnon and CBC's Daybreak North, "[Regulator halts fracking operations in northeastern B.C. while investigating earthquakes,](#)" *CBC News*. December 8, 2018.
- 13 Osamu Tsukimori, Sonali Paul, "[Exxon declares force majeure on exports from Papua LNG project: source,](#)" *Reuters*. March 1, 2018.
- 14 The Associated Press, "[Fracking in Utah, other states linked to earthquakes,](#)" *KUTV*. September 30, 2015.
- 15 Ibid.

About Worldwide Facilities, LLC

Established in 1970, Worldwide Facilities is a national wholesale insurance broker, managing general agent and program underwriter. Our team of insurance specialists has access to virtually every specialty domestic and international insurance market.

Take advantage of our expertise in Civil Authority today—contact Loren Henry in our San Diego office at lhenry@wwfi.com or (619) 541-4265 to schedule a conversation.

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An aerial, top-down view of North America from space, showing the continent's topography and the surrounding oceans. The colors range from deep blues of the oceans to greens and yellows of the landmass, with the Earth's curvature visible at the top.

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