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FEE ARRANGEMENTS

Preparing a Requiem For the Billable Hour

By Theodore Voss

Abraham Lincoln may have done the legal profession a disservice with his observation that a lawyer's stock in trade is his time and advice. It contributed to the legal profession's tradition of charging by the hour for services rendered. Suspicion and conflict of interest between client and lawyer have always been a byproduct of this practice; still, it became entrenched and fear of change and inertia have kept it as the pervasive means of compensating lawyers. But need can always dictate action and events now demand a serious re-evaluation of this profession-damaging practice.

Harbingers of a sea change in the business of law are too evident to be ignored. Increasingly, legal work is wooed with legions of lawyers, omnipresent locations, corporate contacts and multimillion-dollar budgets.

Not surprisingly, Big 5 accounting firms are leveraging their size and pervasive corporate relationships to obtain more of this work and are looking to do it all; part of the start of an era of multidisciplinary practices. Much of this is fallout from a worldwide corporation consolidation. By using technology to maintain communications and productivity standards, business is lowering costs by setting up plants and offices wherever local economic conditions provide for maximum profits. To provide the service coverage these world-straddling behemoths demand, law firms are merging at a frenzied pace.

Each newly formed legal giant is then positioned to be in competition

continued on page 4

INSURANCE

Business Interruption Coverage: Issues to Consider When Disaster Strikes

By Andrew M. Reidy, Robert Carter and Jodi T. Tuer

Many law firms suffered severe business disruptions as a result of the Sept. 11 attacks on the World Trade Center. It is hoped that those firms had insurance to deal with such a disruption. In light of these events, now may be a good time to evaluate whether your firm can afford such a policy—or whether it can afford to be without it.

Business interruption insurance protects a policyholder who suffers a loss of business income as a result of unanticipated events affecting business operations. It is designed to put the policyholder in the same position as if the loss had never occurred. In other words, business interruption insurance enables a company to keep net profits at the same level even though the policyholder had to suspend its business operations.

When Does Coverage Start? How Long Does It Last?

The period of time for which a policyholder may recover under a business interruption policy depends on the terms and conditions of the policy. (Many states have regulations and statutes that may affect business interruption coverage under insurance policies. These regulatory and statutory provisions should always be reviewed before filing a business interruption claim.)

Some coverage provides that recovery can be had for actual losses sustained during the "period of restoration." Other coverage, such as coverage under an "interruption by civil authority" provision, specify a fixed and definite time period during which losses sustained are measured. This article addresses each one in turn.

Some business interruption policies, but not all, require that the interruption or suspension be caused by direct physical loss of, or damage to, property at the premises described in the policy. When physical loss or damage occurs to covered property, some business interruption insurance policies provide coverage for business income loss due to the suspension of business operations during the "period of restoration." The "period of restoration" is the time required, with the exercise of due diligence or dispatch, to rebuild, repair or replace the destroyed or damaged property.

When does the period of restoration start? Courts have held that it starts when the business is interrupted or suspended. This could mean the date the

continued on page 2

In This Issue

Business Interruption

continued from page 1

covered property sustains physical loss or damage. If a business sustained physical loss or damage to its premises but decided not to immediately undergo repairs to the structure, courts have held that the period of restoration begins at the date of the loss, not the date that actual repair or rebuilding begins.

The date the policyholder is forced to vacate the business premises, even though the covered property has not yet sustained physical damage, might also start the restoration period. Thus, for those businesses who leased space in buildings located in Lower Manhattan and were required to vacate their premises because authorities determined that there was an immediate danger to the buildings, such as a danger of collapse, the period of restoration may start when the businesses were forced to depart the premises and evacuate the buildings, not when physical damage to their property inside the buildings occurred.

How long does the period of restoration last? That usually is a question of fact decided on a case-by-case basis. If a business is not able to restore the damaged property or decides not to, the period of time for which recovery is allowed is the period it would or should have taken the policyholder, with the exercise of due diligence, to rebuild, repair or replace the premises. This is sometimes referred to as the theoretical time period it would have taken to reenter business.

This theoretical period of restoration is used to determine the period of business interruption loss when the policyholder commences operations at a temporary location while it waits for its property to be repaired or rebuilt. Certain delays in rebuilding, repairing or replacing destroyed or damaged property may extend the restoration period under business interruption coverage. This includes delays caused by an insurer's failure to perform its duties under the policy and contingencies that may delay construction.

Finally, if the policy expires during the period of restoration, the period is not cut short. Most policies expressly state that the period of restoration is the time required to restore and rebuild the policyholder's premises with due diligence and dispatch, regardless of the policy expiration date.

Fixed Period of Recovery

Some policies provide coverage for business interruption losses incurred during a fixed period of time, even if unaccompanied by physical damage to insured property. Many businesses in the financial district in Lower Manhattan and in closed airports were not physically damaged by the terrorist attacks, but nonetheless suffered a business interruption.

Businesses affected by the terrorist attacks that were not able to resume operations as a result of the authorities denying access to their premises may be able to recover for income losses under civil interruption coverage. This coverage may be helpful to businesses in National Airport, which was closed several weeks after the terrorist attacks, and to businesses in Lower Manhattan not directly damaged but made inaccessible by orders regarding recovery efforts at or near

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"Ground Zero" in New York.

Other businesses also might be able to get coverage for loss caused by prevention or impairment of ingress, access to or egress to property. This type of coverage does not require an order of civil authority preventing access to the insured premises or physical damage to insured property. A typical ingress/egress coverage provides business interruption coverage during a fixed period of time where ingress to, egress from or access to any real or personal property used is prevented or impaired.

Under this type of coverage, recovery can be had even if events occur away from the insured premises if they cause a covered business interruption by preventing or impairing ingress, access to or egress to covered property.

What Does Business Interruption Coverage Pay For?

Business interruption policies typically provide coverage for loss of business income, which requires an analysis of "net income" and "continuing expenses." "Extra expense" also may be covered, and the cost to repair or replace "valuable papers and records." Each of these items is discussed here.

Net Income

"Business income" sometimes is defined as:

a. Net income (net profit or loss before income taxes) that would have been earned or incurred; and

b. Continuing normal operating expenses incurred, including payroll.

Business interruption coverage for "business income" is not necessarily limited to the income of the specific locations that are physically damaged. A loss of earnings at an undamaged location that results from physical loss or damage at another location may fall within the scope of the policy.

Business interruption insurance also may provide coverage for losses from business activities that commenced after the issuance of the policy.

Necessarily Continuing Expenses

Business interruption insurance also typically provides coverage for fixed charges and expenses that necessarily continue during the interruption. These include expenses incurred during the period of total or partial business interruption that would have been "earned" had the business interruption not occurred. "Earned" expenses are those the policyholder would have been able to pay for had it continued its operations. Expenses that may fall into this category include:

- taxes;
- continuing payroll expenses;
- insurance;
- licenses;
- telephone;
- heat;
- power;
- interest on business loans that the policyholder remains obligated to pay; and
- rent.

Noncontinuing expenses, which generally would not be covered under standard form policies, include such items as entertainment expenses, and perhaps depreciation expenses on damaged or destroyed property.

Extra Expense

In addition to net income and necessarily continuing expenses, business interruption insurance may provide coverage for "extra expense" costs that the policyholder incurs to reduce loss and resume business operations. Items falling under "extra expense" often include those expenses the policyholder incurs in mitigating its losses.

Some policies require that the policyholder obtain the insurer's prior written consent before such "extra expense" expenditures will be reimbursed. The insurers may argue that the failure of the policyholder to obtain such consent may preclude a policyholder from recovering any "extra expense" under the policy.

Examples of items that may be potentially recoverable under "extra expense" include:

- excess rent and telephone charges incurred in setting up at a temporary location;
- costs to equip, and operate at, the replacement or temporary location, such as utility and overhead expenses;
- extraordinary labor costs incurred to resume operations;
- premiums paid for an accelerated schedule of repairs to the damaged business property to enable the insured to resume operations earlier than anticipated;
- expenses for protection by guards to avoid theft of property; and
- cleanup costs incurred for the purpose of resuming operations.

Not all expenses incurred due to an interruption are necessarily recoverable. For example, business interruption insurance typically contains a blanket exclusion for consequential or remote loss.

Valuable Papers and Records

Some business interruption policies define "extra expense" to include coverage for replacing information on "valuable papers and records" that are damaged. If not included as an "extra expense," this type of coverage can often be purchased as a separate endorsement to the policy. Coverage for the replacement of valuable papers and records typically includes the costs associated with the recovery of data on valuable papers and records kept in the ordinary course of business, which includes documents and electronic media.

Business interruption coverage may be a valuable source of funds for law firms that suffered losses as a result of the Sept. 11 attacks. The coverage generally is designed to place businesses in the same economic position they would have been in had no interruption occurred. What is covered, and the period of time during which coverage applies, depend on individual policy language. Now is the time for law firms to examine their coverage and make sure it meets their firm's needs

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