Articles

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Professor Vladimir Ž. Čolović, PhD [1]

INSURANCE AGAINST FINANCIAL LOSSES DUE TO BUSINESS INTERRUPTION

REVIEW ARTICLE

Abstract

Insurance against financial losses due to business interruption (loss profit insurance) is concluded as supplementary insurance, along with insurance for basic risks related to property or assets. In business interruption insurance, the insurer is obligated to pay compensation for indirect damage caused by the inability to use property, machinery, or facilities. This means that there must be a causal connection between the realization of the basic risks and the occurrence of indirect damage. This type of insurance is primarily concluded by individuals engaged in certain activities, regardless of whether they are legal entities or entrepreneurs. However, the damage that occurs due to business interruption must be caused by external circumstances and cannot be related to the business of the insured entity itself. One of the most important issues in business interruption insurance is related to the calculation of compensation, that is, the determination of lost profits and costs. In the paper, the author also discusses risk management and forecasting in business entities, with particular attention to the most important elements of the special terms and conditions of insurance in this field.

Keywords: *losses, business interruption, loss profit insurance, supplementary insurance, basic risks, indirect damage, lost profit, business costs.*

[1] PhD in Law, Principal Research Fellow, Full Professor; Faculty of Law, Union University Belgrade, email: *vladimir.colovic@pravnifakultet.edu.rs*; https://orcid.org/0000-0002-2016-1085.
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I Introductory

Insurance against financial losses due to business interruption caused by various types of risks, hazards, or events is important for covering the costs incurred during the interruption of business activities. In addition to covering these costs, this type of insurance also provides compensation for lost profits during the period when the business entity or other party is unable to conduct its activities. This type of insurance is also known as "chômage" insurance. The word *chômage* is of French origin and denotes a stoppage or inactivity. Business interruption insurance is concluded as supplementary insurance, but only if the same insurer also provides insurance for the basic assets of the entity, as well as for non-monetary working capital. As for the obligation to compensate for damage, it will only exist if it is agreed that the insurer is obliged to pay for the specified damage following the occurrence of the insured event. Consequently, if the basic insurance contract ceases to be valid, the business interruption insurance contract, i.e. the "chômage" insurance, also ceases to be valid.[2]

To ensure the effectiveness of business interruption insurance, the damage must result from: – fire or lightning strike; – explosion; – storm; – hail; – collision of the insured building by the insured's motor vehicle or mobile work machine; – aircraft crash; – manifestations and demonstrations. The obligation to compensate under business interruption insurance exists only when there is an obligation to pay for damage under insurance against basic risks, such as the risk of fire or other harmful events. To be eligible for compensation under business interruption insurance, the insured must generate income or determine and allocate earnings. In addition, they must conclude business interruption insurance for all organizational units at the same location, regardless of whether they are exposed to a single or separate risk. If this is not done, in the event of an insured incident, the proportionate rule will be applied when determining the amount of compensation. However, the insured can be exempt from this rule if they pay an additional premium in advance.[3]

We must also bear in mind that this insurance does not cover the insolvency of an entity resulting from the inability to meet obligations to creditors; rather, it covers the inability to conduct business because the entity cannot use its assets and work space (facilities).

Nevertheless, the business interruption must represent an insurable risk, even though it compensates for indirect damage as a consequence of the realization of basic risks. The subject of business interruption insurance against all risks is the loss of the insured party and their insured interest, meaning the profit that could have been expected but was prevented from being realized due to the occurrence

[2] Boris Marović, Vladimir Njegomir, „Poslovanje osiguravajućih i reosiguravajućih društava u korelaciji sa energetikom i energetskim izvorima", *34th Meeting of Insurers and Reinsurers*, Sarajevo 2023, p. 61.

[3] B. Marović, V. Njegomir, p. 62.

of the insured event. Compensation under business interruption insurance can be agreed upon as compensation for gross profit or fixed costs and net profit, which represents the amount that was not earned due to a reduction in business income and an increase in employment costs. The sum insured that can be agreed upon for business interruption cannot be less than the annual gross profit if gross profit insurance is contracted, or less than the net profit and the aforementioned fixed costs.[4]

II The History of Business Interruption Insurance

Business interruption insurance has existed for a very long time, nearly three and a half centuries. We will briefly review the development of this type of insurance protection. The first coverage for indirect damages as supplementary insurance is attributed to the English insurer Minerva Universal in 1707. Subsequently, in Hamburg, a similar insurance policy was issued in 1817 by the company *Cassa Generale Incendio*. In France, coverage under the name *chômage* emerged in 1857. All these policies provided lump-sum compensation for indirect costs as a percentage of the damage from the basic risk. Later, *Lloyd* adopted this insurance as a *percentage of fire loss*. These were, therefore, lump-sum insurance amounts, as accounting practices within companies at that time were not reliable sources of data on the profits and losses of the insured, hence, it was impossible to determine the exact amount of indirect damages. Naturally, this became possible later with the development of accounting standards, leading to the introduction of a policy in 1899 covering indirect costs under the name *Loss of Profit*, which was tied to the basic risk for a specific period. The Scottish broker Mac Lellan Man played a significant role in the emergence of this type of coverage. However, this type of coverage faced criticism from some insurers, who believed it involved unethical business practices that enabled the insured to gain unjust enrichment. Nevertheless, the demand for this type of insurance led to policies being issued in this area in Germany in 1911, and by 1955, business interruption insurance had evolved into an autonomous type of insurance with its own premium rates. In France, insurers adopted it under the name *pertes d'exploitation* – operational losses.[5]

III Insurance Against Losses

A contract for insurance against losses due to business interruption is a contract of indemnity. This coverage ensures the reinstatement of the economic

[4] Milovan Jovanović, „Osiguranje od svih rizika na tržištu osiguranja u Srbiji", *European Insurance Law Review*, No. 4/2012, Belgrade 2012, p. 72.

[5] Marijan Ćurković, „Osiguranje financijskih gubitaka nastalih zbog prekida djelatnosti uslijed nastanka osiguranog slučaja (šomažna osiguranja)" 13. 5. 2024.; *https://www.osiguranje.hr/ClanakDetalji.aspx?22746*, accessed on: 10.7.2024.

position that allows for the continuation of business activities, i.e. the position that existed prior to the occurrence of the insured event. Business interruption insurance compensates for lost cash flow and additional costs incurred due to the inability to operate or the destruction of insured assets.[6] Insurance for losses due to business interruption results from the use of property, and for a claim to be paid, five interrelated criteria must be met. First, there must be physical damage to the property. Then, the damaged property must be insured, and the risks must be incurred risks covered by that insurance. Additionally, the damage must result in a measurable loss due to the business interruption, and this must be for a specific period needed to procure other means of production and take other actions to continue business activities. These five conditions are interconnected, and a break in any part of this chain would prevent compensation for the damage.[7] Insurance against losses due to business interruption encompasses not only the physical assets but also the insured's interest, particularly the potential profit that was not earned. This must be considered when the business operates across multiple interconnected locations, meaning that the insured's interest must extend to all places where the insured conducts business, i.e. their property should be considered as an integrated whole.[8]

1. Risk Management by Entities Engaged in Certain Activities

We will also address risk management by entities engaged in economic or other activities. There are several methods for managing risk within such an entity. The choice of method depends on the nature of the business, the size of the entity, the number of employees, available resources, and many other factors that define the business entity. We will highlight four methods of risk management, noting that other methods can also be defined and that multiple methods can be combined in risk management. These methods are as follows: 1) Predictability and damage control; 2) Financing of damages; 3) Reducing the likelihood of damages;[9] and 4) Supervision of business activities within the business entity.[10] The most common risk control method within a business entity is the risk transfer to an insurance company. The business entity must assess whether it is advisable to allocate funds for paying insurance premiums. The fact is that risk transfer is most beneficial not only when transferring risk to an insurance company but also in the context of selling part of

[6] David A. Borghesi, „Business Interruption Insurance--A Business Perspective", *Nova Law Review* vol. 17-1993, pp. 1147–1148.

[7] D. A. Borghesi, p. 1151.

[8] Alan G. Miller, „Business Interruption Insurance, A Legal Primer", *Drake Law Review*, vol.24 – December 1975, p. 801.

[9] Svetlana Ivanović, „Upravljanje rizikom i osiguranje", *Industrija,* No.1-2/2003, p. 72.

[10] Vladimir Čolović, „Upravljanje rizikom u privrednim društvima", *EMC Review* – Journal of Economics and Market Communications, 10(2)/2015, p. 242.

the business, selling shares, merging, or acquiring other entities.[11] Large companies must also be aware of risk multiplication and interconnected risks, which can result in losses across multiple insurance lines or losses in unexpected areas, including various geographical markets, due to interlinked business relationships (for example, floods in Thailand led to business interruption losses in the U.S. market).[12]

IV Characteristics of Business Interruption Insurance

Business interruption insurance is primarily supplementary insurance. Supplementary insurances are those that are contracted alongside basic risks and cannot be agreed upon separately. This means that in order to conclude business interruption insurance, there must be insurance coverage for basic risks whose occurrence can also lead to consequential, indirect damage. The conditions of the insurance, as well as the policy itself, must define which risks are covered by the supplementary insurance. Furthermore, supplementary insurance is classified as voluntary insurance, meaning that policyholders themselves decide not only whether they will purchase this type of insurance, but also which risks will be covered. On the other hand, supplementary insurance refers to coverage for risks that are not related to the insurance of basic risks. Business interruption insurance primarily pertains to companies and industries. However, other insured parties may also conclude this type of insurance, for example, to cover losses related to leased property due to the inability to collect rent, the inability to use a specific property, rental costs for another property, etc. This type of insurance applies specific terms and conditions, which include provisions that limit insurer's obligations, such as coverage duration, types of costs covered, requirements for proper accounting, determining the legitimacy of expenses through expert evaluation, etc.[13]

Some authors argue that business interruption insurance is a distinct type of insurance, typically purchased alongside fire insurance policy.[14] However, we cannot classify business interruption insurance as entirely distinct because, if it were, it would not be linked to basic risk insurance and could be contracted independently. Given that this type of insurance is clearly defined and linked to the damage or destruction of an asset or property, which prevents a business or another entity from carrying out its activities, it is only available in conjunction with basic risk insurance.

An insured party whose property has been damaged will not be entitled to coverage for losses if those risks are not included in the insurance policy. This type

[11] V. Čolović (2015), p. 239.

[12] Marija Kerkez, Ivan Ivanović, „Katastrofalni rizici i osiguranje", *Megatrend revija*, Vol.13, No.2, 2016, p. 25-26.

[13] M. Ćurković, „Osiguranje financijskih gubitaka nastalih zbog prekida djelatnosti uslijed nastanka osiguranog slučaja (šomažna osiguranja)", 13. 5. 2024.

[14] Andrej Pak, *Zaključenje i prestanak ugovora o osiguranju*, doctoral dissertation, Educons University, Faculty of European Legal and Political Studies, Novi Sad, 2016, p. 79.

of insurance cannot mitigate the consequences of poor business performance, large debts to creditors, poor market placement of goods, production losses due to poorly executed business plans, and so on.

Additionally, business interruption insurance is often categorized alongside property insurance, such as fire insurance, burglary and robbery insurance, machinery breakdown insurance, comprehensive car insurance, and crop and yield insurance.[15] However, we cannot fully agree with this classification. While it is true that business interruption insurance is categorized as property insurance because it is linked to the insurance of assets, it would be more appropriate to consider it separately. This is because the realization of business interruption insurance may or may not occur, even if the basic risk has occurred. Whether the insurer is obligated to pay out under a business interruption insurance policy depends on whether the consequences, which may or may not occur, actually do arise. If consequences do arise, it means that losses have been sustained, and the insurer is obligated to provide compensation. If they do not, the insurer will not have any obligation to pay.

1. Business Interruption Insurance in Domestic Legislation

The Insurance Law of the Republic of Serbia (hereinafter: IL)[16] regulates the financial loss insurance. However, it should be noted that the IL defines this type of insurance somewhat imprecisely, as its provisions do not clearly indicate whether financial losses are covered independently or if they are related to a harmful event, i.e. as a consequence of such an event. Specifically, the IL stipulates that this insurance covers losses due to unemployment, insufficient income, adverse weather conditions, lost profits, unexpected general expenses, unplanned operating costs, loss of market value, loss of rent or income, indirect business losses, as well as other non-business and financial losses.

1.1. Business Interruption Insurance in Specific Insurance Conditions

The regulation of business interruption insurance within specific insurance conditions stems from the specific characteristics of this type of insurance coverage. We will focus on certain provisions found in the Special Conditions for insurance against business interruption due to fire and other perils, issued by one insurance company[17],

[15] Nataša Petrović Tomić, „Aktuelnost razlikovanja prava na naknadu štete i prava na osiguranu sumu u delu Mihaila Konstantinovića: klasični instituti i moderno pravo osiguranja", *Annals of the Faculty of Law in Belgrade*, Special Issue in Honor of Professor Mihailo Konstantinović, Belgrade 2022, p. 567, fn. 6.

[16] Insurance Law, IL, *Official Gazette of the Republic of Serbia*, No. 139/2014 and 44/2021.

[17] Special Conditions for Insurance Against Business Interruption Due to Fire and Certain Other Hazards, Sava Insurance; *https://www.sava-osiguranje.rs/sr-rs/uslovi-osiguranja/*, accessed: July 11, 2024.

particularly regarding cases of exclusions from coverage. These situations includes: 1) when the damage results from extraordinary events related to macroeconomic changes, uninsured risks, etc.; 2) if the damage is a consequence of restrictions imposed by government authorities on the repair of damaged property; 3) when there is a lack of financial resources for the repair or replacement of damaged or destroyed property; 4) if the causes of damage originate from other entities with whom the insured has business relations; 5) if the damage is due to the destruction of money, securities, plans, business records, and similar items; 6) if the damage occurs due to job loss, lease termination, or license revocation in specifically defined situations.[18]

The same conditions also define the types of losses that the insurance will cover. Primarily, this includes gross profit losses due to a reduction in revenue, calculated as the difference between standard revenue and actual revenue at the time of the business interruption, which is then multiplied by the gross profit margin. Additionally, the insurance will cover increased operating expenses, as these are the additional costs necessary to mitigate or reduce the loss of revenue during the interruption period.[19]

We have highlighted the provisions regarding exclusions from insurance coverage, as well as the calculation of losses, to illustrate the specificities of business interruption insurance. These provisions emphasize the connection of this insurance to the basic risk and the requirement that a loss must occur, specifically in relation to profit loss and increased expenses during the period of business interruption.

2. Insured Event in Business Interruption Insurance

Upon the occurrence of an immediate peril or when it begins to manifest, the insured is obligated to promptly notify the insurer, without delay, on the same day orally, and then in writing by the following day. If the insured fails to notify the insurer in the specified manner, the insurer may determine the financial impact of the failure to report the occurrence of the peril and proportionately reduce the compensation amount. Naturally, in the event of a business interruption, the insured is also required to take the necessary measures to eliminate or reduce the damage, that is, to take actions that will shorten the duration of the interruption, and to follow the insurer’s instructions.[20] If the insured experiences a business interruption that lasts shorter than the agreed period and wishes to renew coverage for the entire guarantee period, a supplementary agreement for business interruption insurance must be concluded. In such a case, the premium is reduced proportionally to the unused guarantee period from the previous contract.

[18] Article 3, Paragraph 6 of the Special Conditions.

[19] Article 4 of the Special Conditions.

[20] B. Marović, V. Njegomir, p. 63.

In the context of business interruption insurance, since it does not cover property damage, a question arises as to when the insured event occurs. This is particularly pertinent given that losses covered by the insurance occur after the damaging event, and already incurred financial losses often lead to further such damages. If we were to accept that the insured event related to losses due to business interruption occurs simultaneously with the realization of the basic risk event, then the risk of the inability to conduct business would be difficult to assess. It can be questioned whether the insured event related to business interruption can be accepted as occurring when the first covered damage in a series of causally related damages arises.[21] We can provide a positive response to this. In any case, the business interruption must result from the realization of the basic risk. Whether or not a business interruption will actually occur, despite the basic risk being realized, is another matter. However, if it does occur, the moment of the insured event is determined by the moment of the damaging event associated with the basic risk. In any case, upon the occurrence of an insured event related to risks such as fire, flood, machinery breakdown, or destruction, the insurer's obligation to provide compensation for the damage arises.[22]

Then, it may happen that a business interruption loss arises due to multiple causes. Specifically, this refers to damage or destruction of property or an object resulting from several different causes. Some of these causes, or realized risks, may be covered by insurance, while others may not. We will mention an example from U.S. practice, which involved a shopping mall whose roof was destroyed by a hurricane. After the damage occurred, the question arose as to whether the roof was constructed according to standards, whether appropriate materials were used, and whether it met design specifications, etc. Naturally, these causes were not covered by insurance. The insurer's representative argued that the roof collapse was also due to poor design and inadequate construction. In such cases, it is crucial to establish the cause of the damage. In this regard, it must be determined whether the secondary cause contributed to the effectiveness of the basic cause. For instance, it was found that before the hurricane, there was no danger of the roof collapsing, so the decision was made in favor of the insured.[23] In such cases, the question may also arise as to which cause led to greater damage, or whether it is possible to determine, either percentage-wise or otherwise, how much each risk contributed to the damage. On the other hand, there may be issues related to negligent or inadequate construction or the use of substandard materials that contributed to the risk to the property.

[21] Jasna Pak, Insurance Law, Singidunum University, Belgrade 2011, p. 198.

[22] M. Ćurković, „Osiguranje financijskih gubitaka nastalih zbog prekida djelatnosti uslijed nastanka osiguranog slučaja (šomažna osiguranja)", May 13, 2024.

[23] Paul M. Hummer, „Basics of Business Interruption Insurance: The Ins and Outs of Tricky Coverage", *Defense Counsel Journal*, July 2022., p. 310.

Likewise, external causes are typically covered by insurance, while internal causes related to the insured's responsibility are not.

3. Compensation under Business Interruption Insurance

When a risk materializes on the insured property, consequential, direct damage occurs. However, the insured may also suffer uncovered damage that is causally related to the insured property. Such damage represents the financial consequence of the insured event that arises regardless of whether the insured has already received compensation for the damage or destruction of the property. This indirect or consequential damage can be greater than the direct damage resulting from the basic risk. Here, this pertains to the inability to conduct a particular business activity during a period necessary to address all consequences arising from the basic risk. During this period, the insured incurs certain fixed costs that must be borne even though the business activity is at a standstill or interrupted. Thus, on one hand, we are discussing indirect damage caused by the inability to conduct business, and on the other hand, we are addressing the costs incurred by the insured during the period of business interruption.[24]

In business interruption insurance, the compensation is calculated based on specific criteria depending on whether the business interruption occurred and how it impacted the resulting losses. Consequently, it is crucial to consider the potential causal relationship if there has been a business interruption, the occurrence of indirect (consequential) damage, as well as what will determine the compensation.

What does business interruption insurance cover? In calculating the amount of compensation, the starting point must be the gross profit and business revenues. When discussing damage due to business interruption, it includes the amount of income that the insured was unable to earn during the period of interruption, as well as the insured expenses incurred during that time. The insurer is obligated to compensate for the losses for the agreed period of indemnity, but not exceeding 12 months from the date of the insured event. This period may be different if specified in the policy. If the interruption lasted three days or less, the insurer is not obligated to provide compensation. Insurance coverage will cease when the insured has utilized the coverage for the entire guarantee period due to one or multiple interruptions. It is often required that the insured participates in the loss, i.e. a deductible applies. The amount of compensation is determined based on the income that the insured would have earned and the insured expenses that would have been incurred if there had been no business interruption. This is determined based on data from the current year or several previous years of business activities. Any deviations from

[24] M. Ćurković, „Osiguranje financijskih gubitaka nastalih zbog prekida djelatnosti uslijed nastanka osiguranog slučaja (šomažna osiguranja)", May 13, 2024.

the determined income or expenses must be substantiated by the insured with appropriate documentation. A fixed sum of compensation for the insurer may also be agreed upon, which applies both income and expenses. This fixed compensation is determined as previously described. Additionally, business revenues refer to the net income the insured would have earned, with fixed costs such as salaries and taxes added. The amount of loss due to business interruption should be consistent in both forms of compensation.[25]

3.1. Indirect (Consequential) Damage; Lost Profit

In this section, we will focus on the key elements of compensation under business interruption insurance, specifically indirect damage and lost profit.[26] Indirect damage is defined as the consequence of another form of damage.[27] When is it considered that a causal connection exists, which is necessary to determine indirect damage? There are two theories: the theory of equivalent causation and the theory of adequate causation. The choice of theory affects the definitions of direct and indirect damage. There are also variations of these theories. According to one, direct damage is seen as that which directly follows the harmful action, while indirect damage follows from this direct damage. According to another theory, direct damage is any harm that was necessary and unavoidable. According to a third theory, direct damage is the typical consequence of the harmful action. According to a fourth theory, direct damage results directly from the harmful action, while indirect damage is merely initiated by it Not only does each of these definitions have its supporters, but the same definition is often used to make different qualifications.[28] Thus, indirect damage refers to financial losses that occur due to the malfunction or destruction of operational means or objects. It is generally accepted that for both direct and indirect damage, the same liable party must be accountable.[29]

When it comes to lost profit, under business interruption insurance, the insurer or the court (depending on who is calculating the damage and in what procedure) must consider that compensation for damaged or destroyed property includes compensation for lost profit if it could otherwise have been achieved by using that property.[30] Lost profit is also defined as the profit that the injured party would have earned from reselling someone else's property.[31] A person who intended to fulfill a

[25] Chris French, „The Aftermath of Catastrophes: Valuing Business Interruption Insurance Losses", *Georgia State University Law Review*, vol. 30:2/2014, pp.69–470.
[26] Obren Stanković, „Pojam i vrste štete", *Annals of the Faculty of Law in Belgrade*, Vol. 25, No. 3/1977, p. 306
[27] Jakov Radišić, *Obligatory Law*, General Part, Center for Publications of the Faculty of Law in Niš, 2023, p. 223.
[28] O. Stanković, p. 307.
[29] J. Radišić, p. 224.
[30] O. Stanković, p. 289.
[31] *Ibidem*.

need by purchasing property with anticipated profit that was lost due to the fault of the wrongdoer or another harmful event is no less affected than someone who needed to fulfill the same need by using their own property or by purchasing such property for cash (already earned profit), and who is hindered by the destruction of the property due to a harmful event.[32] Lost profit represents a form of negative damage, which manifests as unrealized property value or a prevented increase in the injured party's assets due to the harmful act.[33] Additionally, the Law of Contract and Torts (hereinafter: LCT)[34] defines lost profit as the prevention of the increase in profit.[35] When determining the amount of damage, lost profit will be considered only if it is stipulated in the contract.[36] Lost profit is assessed by considering the profit that could have been expected based on all reasonable circumstances, according to regular course of events or specific circumstances, and which was prevented by the wrongdoer's actions or omissions.[37] Lost profit can also be defined as the expected increase in assets.[38] However, what the injured party expects is not applicable; instead, it is the objective possibility of profit acquisition, meaning the profit that could reasonably have been expected based on the regular course of events or specific circumstances. Likewise, it is not necessary to determine complete realization of profit, but a certain degree of probability.[39] In any case, lost profit under business interruption insurance will be compensated if it is specifically agreed upon, meaning if the premium or a premium supplement to the base premium has been paid. Lost profit is also discussed in cases of rental loss, property fire, crop insurance losses, and similar situations.[40]

3.2. Specific Aspects and Challenges in Insurance Compensation Calculation

When determining an insured event and the necessary elements of this type of insurance, the valuation of business interruption can be a highly complex task. What should be the starting point for determining the amount to be paid to the injured party? Primarily, the actual incurred loss, the duration of business interruption, and the costs incurred to mitigate losses, which are continuous compared

[32] O. Stanković, p. 290.
[33] J. Radišić, p. 221.
[34] Law of Contract and Torts, LCT, *Official Gazette of SFRY*, No. 29/78, 39/85, 45/89, and 57/89, *Official Gazette of FRY*, No. 31/93, *Official Gazette of SCG*, No. 1/2003 – Constitutional Charter, and *Official Gazette of RS*, No. 18/2020.
[35] Article 155 LCT.
[36] Article 925, para. 5 LCT.
[37] Article 189 LCT.
[38] J. Radišić, p. 221.
[39] J. Radišić, p. 222.
[40] J. Pak, p. 234.

to variable costs. It is important to note that calculating this compensation amount is significantly more complex in the manufacturing sector than in the retail sector.[41]

A crucial issue in calculating compensation is the duration of the business interruption, during which the entity was unable to conduct its business activities. The duration of this period can depend on numerous factors. The basic factor is the consequences of the insured event, i.e. the realized risk, which may not only affect the insured entity. Whether the policyholder can restore their assets to resume operations also depends on the resources available to them.[42] Calculating the loss, or the corresponding compensation, will be complex even when the interruption period is precisely defined. There are several guidelines for determining compensation. Business operations are rarely static, so external conditions and revisions to the policyholder's operational program can influence the compensation amount. The policyholder may argue that there would have been an increase in earnings (had the interruption not occurred), if the potential efficiency of the business operation program could be demonstrated. Similarly, any declining business trends that could lead to reduced earnings must also be considered. For a manufacturing company, the loss depends on production losses rather than sales losses.[43] In the case of a policyholder engaged in manufacturing, the profit from finished products that suffered damage from the insured risk is compensated based on the amount that would have been earned after the agreed indemnity period, with this amount needing to be covered by a specific sum specified in the insurance policy.[44] We can apply similar approach to trading companies.

We must also address several issues that may arise during the process of determining the amount of compensation. Firstly, damage calculation due to business interruption is based on pre-tax earnings. If the company insures property located in other countries, differences in income tax rates must be considered, particularly if these differences pose a significant risk to the insurance revenue. Furthermore, not all expenses above the usual are compensable. It can be determined that certain expenses are reasonable and realistic. However, some costs may not have been incurred with the intent of mitigating losses and restoring business to normal. Costs related to preparing compensation claims, consulting fees, and travel expenses are generally not covered. Additionally, lost interest on claims is excluded from the calculation of losses due to business interruption.[45]

Finally, the value of the business interruption, or the amount representing lost profit, is determined based on accounting records or other evidence of net loss

[41] D. A. Borghesi, p.1152–1153.
[42] A. G. Miller, p. 804.
[43] A. G. Miller, p. 805.
[44] M. Jovanović, p. 72.
[45] D. A. Borghesi, p. 1164.

during the period of business interruption. However, it must be ensured that the insured does not unjustly enrich themselves in this manner. For instance, a company that was already operating at a loss before the occurrence of the insured event might not be in a position to continue its operations, despite compensation from the insurer. Moreover, compensation will not be granted if the insured cannot prove that the business interruption led to a loss in production or sales.[46]

4. Conditions for the Implementation of Business Interruption Insurance

As previously noted, business interruption insurance is specific in nature. However, based on the primary characteristics of this type of insurance, we can identify the conditions necessary for its implementation. These conditions are as follows:

1. The risk in business interruption insurance is not separate, it is directly linked to the realization of the basic risk event;
2. Business interruption insurance is supplemental, which involves paying a higher premium, meaning that appropriate coverage must be contracted;
3. Business interruption insurance is not a standalone policy, as it is not an independent;
4. Obligation under business interruption insurance arises only if there are consequences, i.e. losses due to the interruption of business operations;
5. This type of insurance does not address successful or unsuccessful business operations, and therefore, it is not connected to insolvency issues;
6. Other types of insurance can be contracted to cover risks of losses, such as liability insurance, comprehensive coverage, and traditional property insurance. However, business interruption insurance is broader in terms of coverage for various types of losses and incurred costs;
7. Losses can be calculated only if clear accounting values from the relevant prior period are available.

We have mentioned several times that business interruption insurance cannot address insolvency of the insured party, nor can it cover losses of the entity in this sense, including its debts to creditors. However, we will still discuss the issue of insolvency a particular entity in relation to the moment such a condition arises. Specifically, if the interruption of business operations persists for an extended period, a business or other entity may find itself unable to meet its obligations. This raises the question of whether we can even discuss bankruptcy proceedings in such situations, especially when insolvency occurs before the basic risk event materializes.

Therefore, there may be situations where we need to differentiate between insolvency reasons that arise from the business activities and actions of the entity

[46] P. M. Hummer, p. 311.

(before the insured event occurs) and those caused by situations for which the entity is not liable.[47] Regardless of when insolvency occurs or its causes, business interruption insurance cannot be applied in these situations due to the specific conditions and characteristics of this type of insurance.

V Business Interruption Insurance Today

In recent years, business interruption insurance has gained significant attention, particularly due to the pandemic, which led many commercial and other entities to halt their business activities. According to OECD data, a month of stringent lockdowns during the COVID-19 pandemic resulted in approximately $1.7 trillion in lost revenue for businesses across various sectors.[48] The National Association of Insurance Commissioners (NAIC) in the U.S. reports that, in 2020, nearly eight billion commercial insurance policies included coverage for business interruption.[49] Moreover, the pandemic caused dramatic declines in consumer spending and the highest unemployment levels in the U.S. since the Great Depression. This crisis prompted swift action from Congress and the Federal Reserve, including the approval of a $600 increase in unemployment benefits through the Federal Pandemic Unemployment Compensation program. Meanwhile, numerous state and local governments in the U.S., along with federal agencies, implemented moratoriums on various relief measures.[50] In neighboring Croatia, similar measures were also introduced to mitigate the impact of business interruptions on the financial stability of economic entities. Specifically, if insolvency occurred during the pandemic and was the cause of such a condition, no proceedings were initiated to dissolve the entity. Decisions made in Croatia extended their relevance based on the duration of the pandemic's effects. A similar situation was observed in other countries within the region.[51]

One current issue with business interruption insurance is its limitation, as it is tied to the basic insurance, and it can only be contracted with insurers who also cover the basic risk. Thus, the fact that it is a supplementary insurance, presents a limitation which reflects in its market presence. For instance, we will mention the data in the Croatian insurance market, where the premium for business interruption insurance

[47] Vladimir Čolović, „Uticaj pandemije na pokretanje i vođenje stečajnog postupka", *Zbornik Pandemija kovida 19: pravni izazovi i odgovori,* Institute for Comparative Law, Belgrade 2021, p. 140.

[48] Piotr Tereszkiewicz, „Business interruption insurance as a means of spreading pandemic – related losses", *The Geneva Papers on Risk and Insurance – Issues and Practice,* vol.48, 2023, p.714.

[49] David L. Eckles, Robert E. Hoyt, Johannes C. Marais, „The History and Development of Business Interruption Insurance", *Journal of Insurance Regulation* 2022, article 7, p. 5.

[50] Jialan Wang Jeyul Yang Benjamin Iverson Raymond Kluender, „Bankruptcy and the COVID-19 Crisis", Harvard Business School, Working Paper 21-041, September 2020, p.2.

[51] „Covid-19 coronavirus measures impacting insolvency proceedings and enforcement", Allen & Overy, 24 June 2020, p. 7;
file:///C:/Users/Vlada/Downloads/Covid-19%20Insolvency%20map%20updated%2024%20June%202020%20(10).pdf; V. Čolović (2021), p. 135.

in 2022 amounted to €26,515,000, which represented only 1.58% of the total gross premium written, or just 2.03% of the total gross premium for non-life insurance.[52]

Additionally, in Croatia, insurers have developed specialized insurance packages for small and medium-sized enterprises (SMEs). For example, an entrepreneurial insurance package allows SMEs to insure their entire property under a single policy. This policy can cover risks such as fire, earthquake, machinery breakdowns, burglary and robbery, glass breakage, business interruption due to fire, business interruption due to earthquake, general and professional liability, comprehensive vehicle insurance, and accident insurance.[53] This approach might be one of the opportunities to increase the number of business interruption insurance contracts in the future.

VI Conclusion

What we must first emphasize is that business interruption insurance depends on the realization of the basic risk. It is essential to understand the scope of coverage and what it encompasses. When discussing this type of insurance, it is important to remember that external causes, over which the insured could not have influence, will primarily be considered. Business interruption insurance cannot be purchased independently. This means that there must be a causal link between the occurrence of the basic risks and the resulting impact on the insured's business. Moreover, we have established that insolvency cannot be covered by this type of insurance due to its implications in terms of potential business closure or reorganization.

We must also address the fact that business interruption insurance should not be limited solely to coverage for interruptions caused by fire, destruction, or breakdown of equipment (machinery). A broader range of risks could result in financial losses over varying periods. Insurers need to take this into account to make business interruption insurance more attractive to businesses and other entities. On the other hand, the consequences of basic risks can be unforeseeable from the perspective of a particular business, potentially leading to significant costs and profit loss. Although the period of interruption is limited from the insurer's standpoint, it is important to recognize that, in many cases, insurers may not be able to compensate for the damage. Therefore, clear insurance programs in this area must be defined, and adaptable to both insurers and future insured parties, including businesses and other entities. These programs should not only address the projected premiums and damage amount in relation to the occurrence of loss and interruption period, but also include clear risk management models for future insured parties and risk dispersion strategies among multiple insurers and reinsurers.

[52] M. Ćurković, "Osiguranje financijskih gubitaka nastalih zbog prekida djelatnosti uslijed nastanka osiguranog slučaja (šomažna osiguranja)", 13. 5. 2024.

[53] M. Jovanović, p. 74.

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