BRUNER AND O'CONNOR ON CONSTRUCTION LAW

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BUSINESS INTERRUPTION

EXCERPTS FROM

CHAPTER 11 - INSURANCE

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F. COVERAGE FOR BUSINESS LOSSES AND OTHER "SOFT" COSTS

§ 11:253 Builder's risk soft cost coverage

The standard builders risk policy is limited to coverage for direct physical loss or damage. Coverage is usually not afforded for damages assessed against a builder in a negligence action or for payments made on a loan to purchase property destroyed by covered cause of loss.[1] Moreover, indirect costs associated with the repair of property damaged by a covered cause of loss may fall outside of the coverage. For example, in *Essex House v. St. Paul Fire & Marine Ins. Co.*,[2] a brick failure necessitated tenants having to relocate and store their furnishings elsewhere. These relocation costs, as well as lost rental income, did not fall within the scope of a builder's risk policy. Similarly, in *Offshore Production Contractors, Inc. v. Republic Underwriters Ins. Co.*,[3] a builders risk policy issued in connection with an offshore oil pipeline construction project contained an exclusion for delay and other "standby" costs. As a result, the policy did not respond to construction delays caused by a covered loss.

These associated or "soft" costs must usually be included by endorsement. Soft costs describe those expenses resulting from delayed completion unrelated to increases in the "sticks and bricks" costs. These costs are more in the nature of business interruption expenses, including loss of expected revenue. They also include interest expense, loan fees, property taxes, design fees, insurance premiums, legal and accounting costs, and additional commissions arising from the renegotiation of leases.

This coverage often takes the form of an endorsement ("soft cost" endorsement) to the project's builder's risk policy. Some of the typical exclusions include cost to correct construction deficiencies, delays caused by adverse weather, liquidated damages, reconstruction to comply with laws or ordinances and loss caused by strikes or labor disruption.

§ 11:253.10 Coverage for debris removal

When a building burns down or collapses, inevitably there is

[Section 11:253]

[1]See Shamrock Homebuilders, Inc. v. Cherokee Ins. Co., 486 S.W.2d 548 (Tenn. Ct. App. 1972).

[2]Essex House v. St. Paul Fire & Marine Ins. Co., 404 F. Supp. 978 (S.D. Ohio 1975).

[3]Offshore Production Contractors, Inc. v. Republic Underwriters Ins. Co., 910 F.2d 224, 17 Fed. R. Serv. 3d 896 (5th Cir. 1990).

debris that needs to be removed from the site and disposed of in an appropriate manner. Depending upon the amount and nature of the debris, this can be quite expensive. Property policies often handle the cost of debris removal by making it an additional coverage subject to separate limits. This was the case in *Whitt Mach., Inc. v. Essex Ins. Co.*,[1] where fire destroyed the insured's building and, as a consequence, the insured incurred more than $200,000 to remove debris and cleanup and remove asbestos from the building. The insurer refused to cover the insured's asbestos removal costs and declined to pay more than $10,000 for debris removal.

The policy provided for debris removal as an additional coverage. The amount afforded was limited to 25% of the amount the insurer paid for the direct physical loss of damage to covered property plus the deductible applicable to that loss or damage. In the policy's "limits of insurance" provision, however, if the direct physical loss exceeds the limit of insurance or debris removal exceeds the 25% limitation under the Debris Removal Additional Coverage, the insurer will pay up to an additional $10,000 for each location in any one occurrence under the Debris Removal Additional Coverage.[2]

The court agreed with the insurer that debris removal was limited by the policy's total limits of coverage:

> The Court also agrees with defendant that the policy's limits of insurance provision applies to the debris removal additional coverage provision. Thus, while it is true the policy requires payment of 25% of the amount paid for direct physical loss, the plain language of the policy states "[p]ayments under the following Additional Coverages will not increase the applicable limit of insurance: Debris removal" As noted above, Ohio law prohibits the Court from interpreting the plain and unambiguous language of this Policy. The Debris Removal Additional Coverage provision does not increase the Policy's $600,000 limit. . . . The plain and unambiguous language of the Policy limits plaintiff's recovery to $600,000. The only exception is a provision for $10,000 in the event debris removal expenses exceed the Policy's $600,000 limit. It is uncontested that defendant paid the $600,000 policy limit and has attempted to pay $10,000 under the Debris Removal Additional Coverage provision. Plaintiff now seeks to recover over and above the obligations of the Policy.[3]

[Section 11:253.10]

[1]Whitt Mach., Inc. v. Essex Ins. Co., 631 F. Supp. 2d 927 (S.D. Ohio 2009).

[2]Whitt Mach., Inc. v. Essex Ins. Co., 631 F. Supp. 2d 927, 930-31 (S.D. Ohio 2009).

[3]Whitt Mach., Inc. v. Essex Ins. Co., 631 F. Supp. 2d 927, 934-35 (S.D.

§ 11:253.20 Testing and commissioning coverage

The testing and commissioning process can present unique risks to a property carrier, particularly where the project involves a great deal of process machinery. Some property policies specifically address the testing and commissioning process. In *Slattery Skanska, Inc. v. Am. Home Assurance Co.*,[1] the builder's risk policy covered the construction of a light rail transit system located at JFK International Airport in Queens, New York. The builder's risk policy provided testing and commissioning coverage. As part of this coverage, the policy contained the following language:

> The Insured warrants that supervisory or safety systems shall not be deliberately circumvented during such [testing and commissioning]. But the Company shall not withhold coverage where it can be reasonably show[n] that the management or supervisory staff was not aware of such situations.[2]

During the testing operations, the light rail system's design/builder disabled the speed governors on two trains. During the second round of testing, one of the trains accelerated to approximately 58 miles per hour, entered a curved portion of the guideway with a speed limit of 25 miles per hour, and derailed. The train was severely damaged as well as 150 feet of parapet wall. More tragically, although not the subject of the builder's risk dispute, the train operator died in the crash.

The coverage question boiled down to whether recovery was conditioned upon the maintenance of safety procedures and, by deactivating the speed governors, had the insured breached the safety precaution warranty. The court held for the insurer:

> [W]e find there is no question that Bombardier deliberately circumvented "safety systems" within the meaning of the policy. Not only is it undisputed that Bombardier deliberately disconnected a wire in the drive control panel in order to disengage the speed governor, but it is also undisputed Bombardier disregarded the procedure for waiving specific operating constraints. . . .
> Here, although the term "circumvent" is not specifically defined in the policy, the lack of a definition does not, in and of itself, mean that the word must be ambiguous. Bombardier argues that the

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Ohio 2009).

[Section 11:253.20]

[1]Slattery Skanska Inc. v. American Home Assur. Co., 67 A.D.3d 1, 885 N.Y.S.2d 264 (1st Dep't 2009).

[2]Slattery Skanska Inc. v. American Home Assur. Co., 67 A.D.3d 1, 885 N.Y.S.2d 264, 270 (1st Dep't 2009).

term "circumvent" means "to get the better of or prevent from happening by craft of ingenuity." That, of course, is not the only meaning of "circumvent." Indeed, AHA cites another dictionary definition of "circumvent" that is, "to bypass." Bombardier's definition of "circumvent" is not only nonsensical when viewed within the parameters of the dispute but reduces the section to a nullity, giving it no comprehensible meaning at all. In context, there can be no question that the plain meaning of circumvent intended by the policy is to bypass or avoid.

Similarly, the phrase "safety system," also undefined in the policy, is unambiguous. Construing the phrase according to common usage, a "safety system" implies a combination of parts forming a unitary whole that is designed to prevent danger, risk or injury. . . . The record clearly reflects that Bombardier's "safety system" consisted of various component parts including but not limited to: (1) the waiver of operating constraints *and* (2) a train operating in ATC mode without a driver on board *or* a train operating in manual mode with a properly trained driver on board with the speed governor engaged. In other words, these "parts" combined to form a unitary whole that was designed to prevent danger, risk or injury. Even Bombardier's driving trainer testified that a speed governor was part of the train's "overall safety system." . . .

It is clear that an insurance company issues a policy pursuant to a calculated risk. Here, AHA entered the agreement with the bargained-for expectation that Bombardier would not "deliberately circumvent" any "supervisory or safety systems" during the testing and commissioning process.[3]

§ 11:254 Extra expense loss

Extra expense coverage provides reimbursement for reasonable and necessary expense incurred during the period of restoration to either: (1) continue operations in spite of the loss or (2) minimize covered business interruption loss.[0.50] The insured must establish that the expense would not have been incurred but for the loss.

This coverage is often packaged with business interruption insurance, but stand-alone coverage forms can be obtained. Often coverage is qualified as the "necessary extra expenses incurred in order to continue the business as nearly as practicable . . . until repairs or replacement of damaged property is completed." The extra expenses must be used for the continuation of the business and, therefore, sales or production should result from the

[3]Slattery Skanska Inc. v. American Home Assur. Co., 67 A.D.3d 1, 885 N.Y.S.2d 264, 273-76 (1st Dep't 2009) (emphasis in original).

[Section 11:254]

[0.50]See William and Henlin, Understanding Extra Expense, 45 Tort Trial & Ins. Prac. L.J. 1 (2010) (providing good introduction to the subject).

expenditures. The Texas case of *Travelers Indem. Co. v. Pollard Friendly Ford Co.*[1] is instructive. Here, costs incurred by an auto dealer following a tornado, which included employee meals and extra security, were deemed covered extra expense. These expenditures were considered necessary to continue operations as nearly as practicable under the circumstances.

Related coverage is sometimes referred to as "expediting expense." As is always the case with time element coverage, seemingly small differences in policy language can have material coverage consequences. Depending upon how "expediting expense" is characterized, the coverage may apply to costs incurred to temporarily repair damaged property or expedite permanent repair of damaged property through overtime labor or other similar actions. It is not uncommon for these expense coverages to be crafted in such a way that they are reimbursable to the extent that they mitigate or reduce the insured's business interruption loss.[2]

Another common "soft cost" property loss is extra expense damages associated with maintaining the business enterprise after the property loss and costs associated with repair and replacement of the property that are not "bricks and mortar." The cost of renting other space to maintain the business is an "extra expense" item. Architectural fees and interest expense to rebuild are extra expenses.

It is not uncommon for property policies to contain a variety of sub-limits for soft cost items. A Georgia Court of Appeals decision found an ambiguity in the manner in which the property policy addressed soft and hard costs. In *RLI Ins. Co. v. Highlands on Ponce, LLC*,[3] a fire seriously damaged an apartment complex. The complex was insured through RLI for $29 million for any one occurrence. In addition to this blanket limit of liability provision, the policy also contained "additional limits of insurance" for soft costs ($100,000 per occurrence) and business income ($100,000 per occurrence). RLI took the position that the amount of coverage available for soft costs was $100,000 and a similar amount for business income loss. The insured took the position that these were "additional" limits and applied "in addition to" the blanket limit of $29 million. The court found an ambiguity which

[1]Travelers Indem. Co. v. Pollard Friendly Ford Co., 512 S.W.2d 375 (Tex. Civ. App. Amarillo 1974).

[2]See Borghesi, Business Interruption Insurance—A Business Perspective, 17 Nova L. Rev. 1147, 1159 (Spring 1993).

[3]RLI Ins. v. Highlands on Ponce, LLC, 280 Ga. App. 798, 635 S.E.2d 168 (2006).

precluded granting summary judgment in favor of RLI:

> On the one hand, the contract could be interpreted to mean that soft costs and business costs are limited to $100,000 per occurrence, irrespective of the blanket limit of $29,507,000. On the other hand, however, given the clause that "additional limits" apply *in addition to* the blanket limit of liability and soft costs and business costs were identified as having additional limits of $100,000, the contract could also be interpreted to mean that once the blanket limit has been exhausted there remained $100,000 for use to pay for liabilities in soft cost and business income over and above the blanket limit.
>
> Moreover, the policy stipulates that "[t]he insurer shall not be liable for more than $29,507,000.00 for any one occurrence, *except as hereinafter provided.*" The contract then explains that additional limits apply *in addition to* the $29,507,000, and that there were additional limits of liability of $100,000 for soft costs, covered property while at temporary locations, covered property while in transit, and business income and rental income. RLI appears to propose that the aforementioned language which indicates that the coverage could exceed $29,507,000 is mere surplusage, since under RLI's interpretation of the policy, in no instance would the coverage exceed the blanket amount. . . .
>
> [T]he agreement between the parties remains ambiguous as to whether the coverage for soft costs and business income exceeded $100,000. Thus, it is for a jury to consider the circumstances surrounding the transaction to determine the scope and effect of the policy between RLI and Highlands. . . .[4]

The court determined that, after applying standard rules of construction (e.g., interpreting the contract as a whole, ambiguities construed against the drafter), the agreement remained ambiguous and for a jury to resolve. As is sometimes the case with these disputes, there was conflicting extrinsic evidence placed before the court with respect to what the insured's insurance agent knew about policy coverage.[5]

§ 11:255 Business interruption loss

Plain vanilla property coverage responds to the "bricks and mortar" costs of replacing destroyed property. If the insured,

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[4]RLI Ins. v. Highlands on Ponce, LLC, 280 Ga. App. 798, 635 S.E.2d 168, 171–172 (2006).

[5]See also Blis Day Spa, LLC v. Hartford Ins. Group, 427 F. Supp. 2d 621, 630–631 (W.D. N.C. 2006) (property policy ambiguous with respect to whether it responds to advertising costs as language stated that insurer would provide "necessary" extra expenses incurred during the period of restoration and both parties disputed what were "necessary" expenses and the policy did not define the term "necessary.")

however, uses the property in a commercial activity, it is quite likely that property loss will also cause business interruption damages. Valuing business interruption loss can be tricky. Claims of lost future profit may be attacked as speculative. Damages for lost profits cannot be based upon hypothetical or speculative forecasts of losses.[1] Disputes over business interruption loss have a tendency to devolve into duels between financial experts making forecasts based upon past performance and industry indices:

> Hartford contends that Blis's estimates of lost profits as a matter of law are unduly speculative and therefore it is entitled to summary judgment because there is no competent evidence of additional business interruption losses. Specifically, Hartford points to the fact that: (1) Heil's calculations assume that Blis would have increased its number of revenue producing hair dressers to sixty-six during the period of interruption, when in fact there were only fifty-six hair dressers; and (2) Heil assumed revenue generated by each hair dresser of $6,134 derived from the industry average, grossly overstates the actual revenue generated before, during, and after the period of interruption. In response, plaintiffs argue that Heil has provided ample support and explanation for his methodology, figures, and assumptions employed in reaching his estimates. Heil first examined Blis's financial documentation and its business plan, and interviewed Blis's management and supplier, Jim Barr. He then utilized the following factors to calculate anticipated monthly business income: Maximum available hours of service operation, the most used hourly service rate, available service providers, operational realization percentage, and Blis's historical records, including what he considered its upward trend towards profitability. Heil determined the maximum available hours of operation, and multiplied that by the "most used hourly service rate" of $71. Heil then multiplied this number by the anticipated number of service providers, based on the space available, for the six-month period of interruption. He then applied to that number a "realization number" of 40–55%, a number derived by starting from the "industry" figure of 70%, the assumed maximum efficiency rate of hair dressers, and then adjusted downward.[2]

A World Trade Center case discussed the length of time an insurer must pay for business interruption losses. In *Lava*

[Section 11:255]

[1]Iron Steamer, Ltd. v. Trinity Restaurant, Inc., 110 N.C. App. 843, 431 S.E.2d 767, 770 (1993).

[2]Blis Day Spa, LLC v. Hartford Ins. Group, 427 F. Supp. 2d 621, 630 (W.D. N.C. 2006) (concluding that plaintiff's estimates were not so unduly speculative so as to remove the issue from the jury).

Trading, Inc. v. Hartford Fire Ins. Co.,[3] the insured maintained offices, including a functioning data center, on the 83rd floor of One World Trade Center. The insured sold computer programs to assist in the electronic trading of equities in various equity markets. In addition to its office in the WTC complex, the insured maintained a small, nearly complete backup location at 75 Broad Street, which was not destroyed in the terrorist attacks. Following the September 11, 2001, attack, the insured converted its Broad Street location into a functioning data center. Eventually, the insured moved its operations to Connecticut.

The insured asserted a claim under its business interruption policy. A dispute arose over the amount of the claim and the period of disruption. The business interruption policy provided reimbursement for actual loss of business income sustained during the "period of restoration." The policy defined "period of restoration" as that period of time that begins with the date of direct physical loss and "ends on the date when the property at the described premises should be repaired, rebuilt, or replaced with reasonable speed and similar quality."[4] The insured took the position that the period of restoration would not end until the WTC complex was rebuilt. The court disagreed, finding that coverage terminated once the insured secured reasonable replacement space to conduct its operations.[5]

§ 11:256 Business interruption insurance—Generally

There are a variety of business interruption or time element coverages. The differences often break down along lines of whose property is damaged or the immediate cause of the disruption. One of the most common forms of business interruption coverage

[3]Lava Trading Inc. v. Hartford Fire Ins. Co., 365 F. Supp. 2d 434 (S.D. N.Y. 2005).

[4]Lava Trading Inc. v. Hartford Fire Ins. Co., 365 F. Supp. 2d 434, 439 (S.D. N.Y. 2005).

[5]See also Streamline Capital, L.L.C. v. Hartford Cas. Ins. Co., 2003 WL 22004888 (S.D. N.Y. 2003) ("period of restoration" should end when insured's business personal property in its World Trade Center offices should have been repaired, rebuilt, or replaced with reasonable speed and similar quality and did not require the building of the entire WTC); Duane Reade, Inc. v. St. Paul Fire and Marine Ins. Co., 411 F.3d 384 (2d Cir. 2005) (under New York law, restoration period of business interruption insurance coverage, i.e., limitation on period of indemnity for rebuilding, repairing, or replacing, referred to the length of time required for insured to resume operations in a permanent location reasonably equivalent to the site of its former store at the World Trade Center, which was destroyed in terrorist attack, rather than the rebuilding on the exact site of the former store).

responds to business loss resulting from injury to the insured's property. We will call this "traditional business interruption insurance."[1] Another form of coverage is triggered in certain instances where the damage occurs to the property of a critical supplier or customer of the insured's. This is often referred to as "contingent business interruption insurance."[2] Other coverage forms are triggered by the specific cause of the disturbance. For example, business loss due to the actions of a civil authority prohibiting access to the insured's premises is covered by civil authority insurance.[3] Some policies contain ingress/egress coverage that provides similar protection but does not require an act of civil authority to trigger coverage.[4]

A related coverage that frequently is associated with business interruption insurance is "extra expense coverage." This insurance is designed for those businesses that simply cannot allow physical damage to cause a shutdown of operations. Where continuity of service is key to success, a business must be able to incur the expense necessary to keep operations going. This might necessitate finding temporary facilities out of which to operate or secure replacement product.[5]

Another thematically related coverage is "service interruption" insurance, which is a time element coverage that insures against the loss of earnings resulting from a lack of: (1) incoming electricity, gas, fuel, steam, water, refrigeration; (2) outgoing sewage

[Section 11:256]

[1]See Quinn and Hopper, Katrina and her Cat-tystormy Colleague: Extra Expenses and Business Interruption Coverages, 28 No. 6 Ins. Lit. Rep. 165 (May 1, 2006); Fred, When Disaster Strikes: What Every GC Needs to Know About Business Interruption Insurance, 11/05 Corp. Legal Times 56 (Col. 1); Frome, Business Interruption Insurance, 2006 ABA Tax-CLE 1021050 (Oct. 21, 2006); Business interruption insurance, 37 A.L.R.5th 41; Polin, Recovery Under Business Interruption Insurance, 41 Am. Jur. POF3d 319; Berk and Niedzielski-Eichner, Claims for Business Interruption Coverage Arising Out of Catastrophes, Practising Law Institute (2007); Schirle, 37 Fall Brief 32.

[2]See Mascali, Jr., Contingent Business Interruption Coverage, 41 Tort Trial & Ins. Prac. L.J., 843 (Spring 2006).

[3]See Schirle, Time Element Coverages in Business Interruption Insurance, 37-Fall Brief 32 (2007).

[4]See Fountain Powerboat Industries, Inc. v. Reliance Ins. Co., 119 F. Supp. 2d 552, 555–556 (E.D. N.C. 2000) (where hurricane-related flood cut off access to insured's manufacturing facility, coverage afforded under ingress/egress clause).

[5]See Quinn and Hopper, Katrina and her Cat-tystormy Colleague: Extra Expenses and Business Interruption Coverages, 28 No. 6 Ins. Lit. Rep. 165 (May 1, 2006).

service. As with other time element coverages, the cause of the damage must be linked to a "covered peril" or "cause of loss." Moreover, this insurance, like many time element coverages, is subject to sublimits, a defined waiting period and a discrete period of liability, beginning at the time of the direct physical loss or damage to the service provider's facilities and ending when the service is wholly restored.[6]

§ 11:257 Insured's duty to mitigate loss under common law and sue and labor clause and recovery of business losses

A provision worth a look when seeking to recover business losses is the "sue and labor clause." This clause provides recovery for sums incurred by an insured to protect against or prevent imminent covered loss or damage, including business interruption loss. Some courts have interpreted this clause to provide separate coverage for the underwriter's benefit, to which the policy's deductible does not apply.[1] The Minnesota Court of Appeals discussed the sue and labor clause in the context of a business loss incurred by a contractor that shut down operations at a construction site due to a natural gas explosion that occurred several blocks away. In *Witcher Const. Co. v. Saint Paul Fire and Marine Ins. Co.*,[2] the contractor was working on a construction project in St. Paul when, during the early morning hours, a natural gas explosion occurred four blocks away. Although the contractor perceived no obvious damage and continued operations

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[6]More common than service interruption coverage is an exclusion in property policies that eliminates coverage for loss caused directly or indirectly by power failure. In Lakes' Byron Store, Inc. v. Auto-Owners Ins. Co., 1999 SD 25, 589 N.W.2d 608 (S.D. 1999), the policy excluded coverage for loss due to power failure "if the failure occurs away from the described premises." In other words, if the power failure was due to a generator located on the premises, the exclusion would not apply. In the more common case, however, where power was disrupted because of a transmission problem somewhere between the utility and the premises, the exclusion applied. In this case, a storm knocked down power lines on third-party property. The plaintiff argued that the exclusion did not apply, as the failure of electrical service occurred on the insured's premises. This interpretation would essentially read the exclusion out of the policy. The South Dakota Supreme Court was not impressed, finding that the language "away from the described premises" unambiguously captured the situation.

[Section 11:257]

[1]See American Home Assur. Co. v. J. F. Shea Co., Inc., 445 F. Supp. 365, 369 (D.D.C. 1978); Southern Cal. Edison Co. v. Harbor Ins. Co., 83 Cal. App. 3d 747, 148 Cal. Rptr. 106, 111–112 (2d Dist. 1978).

[2]Witcher Const. Co. v. Saint Paul Fire and Marine Ins. Co., 550 N.W.2d 1 (Minn. Ct. App. 1996).

through that day, it decided to suspend work the following day until experts could determine whether the structure had sustained non-obvious harm. This investigation took nearly a month. The suspension caused the contractor significant economic loss because of idle equipment and workers and the subsequent extension of the project into winter. The contractor filed a claim with the property carrier insuring the construction site. The policy did not contain a business interruption endorsement. As a consequence, the contractor sought coverage under the policy's principal insuring clause. This claim was rejected.[3] While the policy excluded coverage for the contractor's loss, the court's discussion of the sue and labor clause and, perhaps more significantly, the common law duty to mitigate harm, reveals an analysis that could afford recovery for costs incurred by the insured to minimize a covered loss:

> Witcher's policy requires it to do everything possible to protect the property from further damage upon the occurrence of a covered loss and promises to reimburse Witcher for the insurer's share of such expenses. This language is similar to a sue and labor clause, which provides a form of indemnity separate from the main insuring clause and requires the insured to take steps to prevent or minimize an imminent covered loss. Because this provision primarily benefits the insurer by limiting its exposure to liability, the insurer must reimburse the insured for the costs of mitigation, even if the policy would not otherwise cover those expenses.
>
> The mitigation requirement of Witcher's policy differs from a typical sue and labor clause in one respect: It requires no action until a covered loss has already occurred. The insurer seizes on this distinction and argues Witcher had no contractual obligation to mitigate because it experienced no covered loss. But this does not alter either Witcher's common law duty to prevent harm to the insured property or the insurer's corresponding obligation to reimburse Witcher for those efforts. Thus, the trial court properly held the insurer accountable for its share of any reasonable and necessary costs of preventing an imminent covered loss to the insured property.
>
> Witcher argues the trial court erred in applying the policy's exclusion [consequential loss exclusion] to its claim for reimbursement of

[3]The Court concluded that the insuring clause did not extend to indemnification of the contractor's business interruption losses. Moreover, the policy contained an exclusion for "loss caused by delay, loss of market, loss of use, or any indirect loss." The Court recognized that, in the abstract, this type of exclusion serves little purpose in a policy for first-person property insurance. Nevertheless, the Court noted that this exclusion might well provide a second line of defense against the temptation to employ an expansive interpretation of the standard all-risk policy. Witcher Const. Co. v. Saint Paul Fire and Marine Ins. Co., 550 N.W.2d 1, 5–6 (Minn. Ct. App. 1996).

mitigation costs. We agree that the policy's exclusions do not limit the form of expenses that are reimbursable, provided the insured directs its efforts primarily at preventing an imminent covered loss. The exclusion's inapplicability does not resolve the matter, but requires us to decide if Witcher incurred its losses primarily for the benefit of the insurer by preventing an immediate covered loss to the insured property. Assuming, as the parties do, that the cost of expert testing at the site was a reimbursable mitigation expense, we examined whether Witcher's additional mitigation "expenses" were tied ***closely*** to preservation of the insured property. For example, an all-risk policy's sue and labor clause provides indemnity for the rental cost of equipment if its direct function is to prevent further loss. But, the rental value of contractor's idle equipment is not an "expense" recoverable under the sue and labor clause because this "cost" plays no direct role in safeguarding the insured subject matter from immediate harm.

We conclude the "costs" of Witcher's idle workforce and equipment, as well as the added "expense" or winter construction, do not bear a sufficiently direct relation to the preservation of insured property to justify reimbursement under the common law right to indemnity for mitigation expenses. Because we decline to convert this equitable principle into a latent business interruption policy, we affirm the grant of summary judgment [in favor of the insurer].[4]

§ 11:258 Traditional business interruption coverage

A typical business interruption insuring clause reads:

> We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration." The suspension must be caused by direct physical loss of or damage to property at the described premises. The loss or damage must be caused by or result from a Covered Cause of Loss.[1]

This coverage is secured in connection with a first-party property policy insuring against physical loss to covered premises.

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[4]Witcher Const. Co. v. Saint Paul Fire and Marine Ins. Co., 550 N.W.2d 1, 7–9 (Minn. Ct. App. 1996) (citations omitted; emphasis in original). See also §§ 11:217, 11:257.

[Section 11:258]

[1]ISO Form CP0030. There are variations on this theme. For example, another business interruption provision reads:

> This policy insures against loss resulting directly from necessary interruption of business caused by damage to or destruction of real or personal property by the peril(s) insured against, during the term of this policy, on premises occupied by the Insured and situated as herein described.

Insuring Real Property, § 3.02 (Matthew Bender & Co., 2001). This was the form of insuring clause at issue in Broad Street, LLC v. Gulf Ins. Co., 37 A.D.3d 126, 832 N.Y.S.2d 1 (1st Dep't 2006). See also Hummer, Basics of Business Interruption Insurance: The Ins and Outs of Tricky Coverage, 69 Def. Couns. J. 307 (July 2002).

The coverage is usually an endorsement subject to the policy's description of "causes of loss" and exclusions. While policy language can differ (and the differences can be important), there are common elements to all business interruption insurance. In general, the insured needs to establish:

1. Physical damage resulting from a covered cause of loss to covered property;
2. An actual and necessary suspension or interruption of the insured's business caused by the physical damage to the covered property;
3. The existence of actual loss resulting directly from the covered interruption; and
4. Loss must be incurred within the stated indemnity period.[2]

In addition to these elements, many business interruption forms contain additional conditions that can materially affect coverage. Many policies contain co-insurance provisions which require the insured to purchase minimum limits for business interruption coverage or bear a portion of the expense uninsured. This clause can require a policyholder to bear a share of business income loss if the actual loss sustained is substantially higher than the estimated income established at the time insurance was purchased.[3]

Special endorsements may be obtained to contractually extend the length of the indemnity period for a specified number of days. These endorsements extend the period for loss of income coverage beyond the period of restoration (or however the indemnity period is calculated) but usually for a maximum limit of six months

[2]See Schirle, Time Element Coverages in Business Interruption Insurance, 37-Fall Brief 32 (Fall 2007). Moreover, policy exclusions must not apply to bar coverage, although the insurer usually bears the burden of establishing the relevance of an exclusion.

[3]To see how this clause can affect coverage, see Montgomery, Business Interruption Insurance—An Introduction (March 2004) ("Typically, the insured must maintain policy limits relative to the gross earnings of the business, usually 50%, 80% or 100%. Premium is calculated on these amounts. In the case of our example, Quality Paper Mills, the policy should have a limit of $5.0 million, assuming a co-insurance requirement of 100%. A policy limit of $2.5 million would be necessary if the co-insurance requirement was 50%, but the insured assumes the risk for the other half in exchange for the reduced premium due to a lower policy limit.") See also Fajardo Shopping Center, S.E. v. Sun Alliance Ins. Co. of Puerto Rico, Inc., 167 F.3d 1, 11–12, 42 Fed. R. Serv. 3d 1227 (1st Cir. 1999) (rejecting insurer's argument that co-insurance penalty applied where insured declared its property was worth $30,000, but in actuality the value of the property was $45,000, and, therefore, insurer should be liable only for two-thirds of the total damages, because the difference in valuation was due to tenant improvements rather than the actual value of the insured structure).

to a year.[4] Older policies did not extend the indemnity period because of additional time occasioned by ordinances or laws, such as building codes, regulating the reconstruction or repair. More recently, however, insurers have incorporated language providing for additional time required to rebuild in compliance with current building ordinances.[5]

Questions not only arise over whether the elements of coverage have been satisfied, but also as to the valuation of loss. In some respects, valuation questions are more common and difficult to resolve than whether the policy responds at all. All business interruption policies contain a "limits of liability" or "limits of insurance" provision. This provision can vary, but the following is typical:

> In the event of such damage or destruction this Company shall be liable for the ACTUAL LOSS SUSTAINED by the Insured resulting directly from such interruption of business, but not exceeding the reduction in Gross Earnings less charges and expenses which do not necessarily continue during the interruption of business, for only such length of time as would be required with the exercise of due diligence and dispatch to rebuild, repair or replace such part of the property herein described as has been damaged or destroyed, commencing with the date of such damage or destruction and not limited by the date of expiration of this policy. Due consideration shall be given to the continuation of normal charges and expenses, including payroll expense, to the extent necessary to resume operations of the Insured with the same quality of service which existed immediately preceding the loss.[6]

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[4]See Borghesi, Business Interruption Insurance—A Business Perspective, 17 Nova L. Rev. 1147, 1158 (Spring 1993) ("Mercantile businesses, such as hotels and department stores, recognize that, after restoration, a rebuilding of customer traffic was necessary. Insurance companies have accommodated their clients by offering to extend the period for valuing the business interruption through the use of [extended period of indemnity] endorsements.").

[5]See Borghesi, Business Interruption Insurance—A Business Perspective, 17 Nova L. Rev. 1147, 1158 (Spring 1993).

[6]Insuring Real Property, § 3.02 (Matthew Bender & Co., 2001); see also Hummer, Basics of Business Interruption Insurance: The Ins and Outs of Tricky Coverage, 69 Def. Couns. J. 307 (July 2002). This is a typical "actual loss" limitation. This is sometimes referred to as the "open" variety of business interruption coverage, and is contrasted with a "valued" policy in which the value of the loss is agreed upon in advance and fixed by the policy. See Business interruption insurance, 37 A.L.R.5th 41. The "open" variety is the much more common form and places the burden on the insured to prove the amount of loss sustained. Business interruption insurance, 37 A.L.R.5th 41. See also Metalmasters of Minneapolis, Inc. v. Liberty Mut. Ins. Co., 461 N.W.2d 496 (Minn. Ct. App. 1990) (no recovery on claim for loss of gross earnings where evidence supported finding that insured incurred no actual loss from business interrup-

§ 11:259 Business interruption insurance—Establishing physical damage to covered property

Business interruption coverage is, after all, a form of first-party property insurance. As such, the insured needs to establish that covered property sustained physical damage. There is no recovery where covered property did not sustain physical damage.[1] Thus, where a clothing store diverted inventory from two stories that were not damaged to replace inventory at one of its stores that suffered water damage, there was no business interruption coverage for the reduced sales at the two undamaged stores.[2]

Certain failures are more likely to meet this requirement than others. It is unlikely that the collapse of a bridge would result in physical damage to property other than that immediately adjacent or beneath the structure. On the other hand, the failure of a dam or levee could result in physical damage to properties miles away. The physical damage does not have to be of the "brick-and-mortar" type. For example, in *Southeast Mental Health Center, Inc. v. Pacific Ins. Co., Ltd.*,[3] the corruption of a pharmacy computer as a result of a storm and power outage constituted direct physical loss or damage to property under a business interruption endorsement.

Of course, physical damage to just any property is insufficient. Because business interruption insurance is written as an endorsement to an underlying property policy, the policy's schedule setting forth covered properties applies to traditional business interruption coverage. As a consequence, a bridge collapse that damages a public roadway used by customers to access an insured's business will not trigger traditional business interrup-

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tion as a result of rupture of overhead water pipes, as insured presented no evidence of lost sales and proved no reductions in gross earnings in order to maintain sales).

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[1]Pacific Coast Engineering Co. v. St. Paul Fire & Marine Ins. Co., 9 Cal. App. 3d 270, 88 Cal. Rptr. 122 (1st Dist. 1970). See also Source Food Technology, Inc. v. U.S. Fidelity and Guar. Co., 465 F.3d 834 (8th Cir. 2006) (no coverage where insured's beef products were denied entry into the United States due to a USDA embargo imposed on Canada after a "mad cow" outbreak as there was no direct physical loss to its beef products).

[2]Howard Stores Corp. v. Foremost Ins. Co., 82 A.D.2d 398, 441 N.Y.S.2d 674 (1st Dep't 1981), order aff'd, 56 N.Y.2d 991, 453 N.Y.S.2d 682, 439 N.E.2d 397 (1982).

[3]Southeast Mental Health Center, Inc. v. Pacific Ins. Co., Ltd., 439 F. Supp. 2d 831, 65 Fed. R. Serv. 3d 1070 (W.D. Tenn. 2006).

tion coverage because the property physically damaged is not owned by the insured and scheduled on its property policy.[4]

§ 11:260 Business interruption insurance—A covered "cause of loss" must cause physical damage

The insured's property must be damaged by a "covered cause of loss." Business interruption insurance, written as an endorsement to an underlying property policy, will incorporate the policy's "causes of loss" provision(s) (sometimes referred to as "insured perils" or "named perils"). This is not a difficult element to meet in the typical case where fire or wind storm damages an insured's premises. However, different failures implicate different causative agents. In the case of a dam or levee, the resulting damage will arise because of flowing surface water—in other words, a "flood." Property policies may exclude flood-related damage. Other policies place additional restrictions on recovery for flood losses, such as restricting the amount of coverage available through the use of a separate flood sublimit.

A Pennsylvania decision is instructive. In *Peerless Dyeing Co. v. Industrial Risk Insurers*,[1] an insured sought business interruption coverage for property damage which occurred when a city water main broke and flooded its factory. Reversing the jury's verdict awarding the insured damages, the court determined that, although the policy provided coverage for water damage due to fire protective equipment, it excluded from the definition of "fire protective equipment," underground water mains and, as a result, the policy provided no coverage for loss occasioned by the rupture of the city water main. As there was no coverage under the property policy, there could be no recovery under the business interruption endorsement because such coverage was available only if there was recovery for property damage.

Where flood losses are subject to a sublimit, an issue can arise as to whether business interruption losses caused by flood are also captured by the sublimit. This question can only be answered by careful examination of the policy language. In many cases, the business interruption coverage will have a separate "limit of liability," and therefore a "cause of loss" sublimit may not apply.

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[4]See Monumental Paving & Excavating, Inc. v. Pennsylvania Manufacturers' Ass'n Ins. Co., 176 F.3d 794 (4th Cir. 1999) (no business interruption coverage where policy declaration failed to list the building damaged by fire).

[Section 11:260]

[1]Peerless Dyeing Co. v. Industrial Risk Insurers, 392 Pa. Super. 434, 573 A.2d 541 (1990).

But policy language can be written in any number of ways. For example, in *Altru Health System v. American Protection Ins. Co.*,[2] an insured was required to evacuate its hospital because of flooding. It submitted a claim in excess of $5 million for property damage and business interruption losses. The insurer argued that its total liability was limited by the policy's $1.5 sublimit for flood losses. The hospital filed its business interruption claim under the "interruption by civil authority" clause because the business losses were due to the health department's mandatory evaluation order. The court concluded that the flood sublimit applied to the business interruption claims. The preamble of the policy provided, "all liability for loss or expense under this policy for any one occurrence shall not exceed the smallest of . . . any applicable sublimits of liability entered elsewhere in the policy." The flood endorsement provided that "all claims for loss, damage or expense arising out of any one flood occurrence shall be adjusted as just one claim." The court interpreted this policy language to capture the business interruption claim within the flood sublimit.

Other failures, such as bridge collapses or pipeline explosions, raise other issues, particularly if a court is inclined to peer behind the collapse to look for a cause. Many property policies exclude coverage for property loss caused by poor workmanship or defective design. In *National Union Fire Ins. Co. of Pittsburgh, Pa. v. Texpak Group N.V.*,[3] an insured eventually shut down its plant after months of attempting to correct serious design and installation defects in an upgrade renovation. While it did not seek to recover the costs of repairing the plant, it did make a claim for business interruption and extra expense due to the plant's shutdown. It argued that, while the policy excluded coverage for the cost of repairing defective work, it did cover loss flowing from the defective design. The court was not persuaded: "Since defective design or specifications are not perils covered by this policy, economic damage resulting from these causes are excluded from coverage as well."[4]

Bridge collapses or other similar infrastructure failures can

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[2]Altru Health System v. American Protection Ins. Co., 238 F.3d 961 (8th Cir. 2001).

[3]National Union Fire Ins. Co. of Pittsburgh, Pa. v. Texpak Group N.V., 906 So. 2d 300 (Fla. Dist. Ct. App. 3d Dist. 2005).

[4]National Union Fire Ins. Co. of Pittsburgh, Pa. v. Texpak Group N.V., 906 So. 2d 300, 302 (Fla. Dist. Ct. App. 3d Dist. 2005). If the defective design caused a fire or some other covered "cause of loss," the coverage analysis could very well have had a different conclusion, given the presence of "ensuing loss" language in many property policies. See also Red Bird Egg Farms, Inc. v.

raise interesting issues as many property policies treat "collapse" as a special kind of peril. For example, in *Meritcare Inc. v. St. Paul Mercury Ins. Co.*,[5] a nursing home operator closed its facility for more than two months because its roof was structurally unsound. Its insurance policy provided property damage and business interruption coverage for "the risk of direct physical loss or damage involving collapse of any building or any part of a building . . . ."[6] Coverage was denied, as the court gave the term "collapse" its plain and ordinary meaning which, in Pennsylvania, means "to fall together or fall in." As the roof did not actually "fall in," the insured was not entitled to recover its business loss.

Other courts find the word "collapse" ambiguous and construe it to mean "substantial impairment" or some lesser physical state than actually "falling in" or "falling to the ground." For example, a middle ground is to construe "collapse" to mean "imminent collapse" or collapse that is likely to happen without delay.[7]

Multiple causes of loss can also raise issues. If a covered cause of loss combines with an excluded peril, the court is faced with an interpretation challenge.[8] The analysis in an business interruption context is no different than examining the causes of physical damage to the insured premises. Courts usually engage in some form of inquiry seeking to identify the primary or "efficient

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Pennsylvania Mfrs. Indem. Co., 15 Fed. Appx. 149 (4th Cir. 2001) (business interruption claim due to loss of more than 5,000 chickens when lightning strike caused power failure was not covered, as policy excluded utility service interruptions and the failure of electrical service did not result in a covered loss such a fire); Protection Mut. Ins. Co. v. Mitsubishi Silicon America Corp., 164 Or. App. 385, 992 P.2d 479 (1999) (business interruption claim arising when insured had to shut its plant because of a shutdown of city's water treatment facility due to a flood was denied as policy's flood endorsement provided coverage only for property damage loss caused by flood, not business interruption, and, if insured wanted coverage for this loss, a further endorsement known as a service interruption time element limit of liability for flood was required).

[5]Meritcare Inc. v. St. Paul Mercury Ins. Co., 166 F.3d 214 (3d Cir. 1999) (abrogated on other grounds by, Exxon Mobil Corp. v. Allapattah Services, Inc., 545 U.S. 546, 125 S. Ct. 2611, 162 L. Ed. 2d 502 (2005)).

[6]Meritcare Inc. v. St. Paul Mercury Ins. Co., 166 F.3d 214, 224 (3d Cir. 1999) (abrogated on other grounds by, Exxon Mobil Corp. v. Allapattah Services, Inc., 545 U.S. 546, 125 S. Ct. 2611, 162 L. Ed. 2d 502 (2005)).

[7]See §§ 11:229, 11:230.

[8]Some insurers have sought to avoid an interpretation issue by inserting language that any combination of causes which include an excluded cause will result in a denial of coverage. For more discussion on "sequential loss provisions," see § 11:226.

proximate cause" of the loss.[9] For example, in *Fajardo Shopping Center, S.E. v. Sun Alliance Ins. Co. of Puerto Rico, Inc.*,[10] the insured owned a shopping center that suffered a partial roof collapse during a hurricane. The insurer denied the business interruption claim because its inspector concluded that the roof collapsed due to faulty design and construction—an excluded peril. The First Circuit rejected this theory as all the experts concluded that the roof would not have collapsed but for the hurricane:

> We conclude that SAIC [insurer] has failed to present any "genuine" evidence that water ponding due to inherent structural or construction defects proximately caused the damage to FSC [insured] property. We point out that there is evidence in the record that DT beams in the FSC roof had deflected prior to [Hurricane Hugo], FSC need not prove that wind was the sole cause of the damage to its property in order to prevail on summary judgment. In order to recover [under windstorm insurance coverage] it is not necessary that windstorm be the sole cause of the damage . . .. If the damage would not have occurred in the absence of a windstorm, the loss is covered by the policy. Because FSC has presented unrefuted evidence that the damage to its property would not have occurred by for Hurricane Hugo, we affirm the District Court's entry of summary judgment on the issue of liability in its favor.[11]

In *Yount v. Lafayette Ins. Co.*,[12] a medical office in New Orleans was damaged by Hurricane Katrina. The insurer cited the lack of "direct physical loss" from a "covered peril" in denying the business interruption claim. Flood was an excluded peril, and the insurer took the position that all the insured's losses, including business losses, were related to the flood waters.

A jury trial was conducted on the matter and, after the close of evidence, the trial judge granted directed verdict in favor of the insured, finding that there was sufficient evidence to establish direct physical damage caused by wind, which resulted in mold, and that there was coverage under the policy for such. While the Court of Appeals disagreed with the trial court's granting of a directed verdict, in considering the matter *de novo,* it also concluded that the insured had established entitlement to business interruption coverage:

> We conclude that the suite did sustain direct physical loss and

[9]See §§ 11:224, 11:235.

[10]Fajardo Shopping Center, S.E. v. Sun Alliance Ins. Co. of Puerto Rico, Inc., 167 F.3d 1, 42 Fed. R. Serv. 3d 1227 (1st Cir. 1999).

[11]Fajardo Shopping Center, S.E. v. Sun Alliance Ins. Co. of Puerto Rico, Inc., 167 F.3d 1, 11, 42 Fed. R. Serv. 3d 1227 (1st Cir. 1999) (citations and inner quotations omitted).

[12]Yount v. Lafayette Ins. Co., 4 So. 3d 162 (La. Ct. App. 4th Cir. 2009).

> damage as a result of the wind and rain, and not due to direct contact with flood waters. Further, we find these losses and damages, alone, would have and did cause a suspension in operation of Dr. Yount's medical practice.
>
> Dr. Yount paid the premium for the additional coverage for "business interruption" for the term of the policy. The general purpose of such insurance is to protect the earnings which the insured would have enjoyed had no interruption or suspension occurred. Generally, a business interruption is a temporary cessation or impairment of the operations of an established business. Dr. Yount sustained her burden of proving by a preponderance of the evidence direct physical damage to her property in the leased suite sufficient to impair and suspend the operation of her medical practice. For these reasons, we find an award of insurance proceeds under the business interruption coverage of the policy to be appropriate under the facts.[13]

§ 11:261 Business interruption insurance—Business interruption must be caused by the physical damage

There must be a nexus between the physical damage and the business interruption loss. This is a causation requirement. A case arising out of the eruption of Mount St. Helens illustrates this point. In *Keetch v. Mutual of Enumclaw Ins. Co.*,[1] hotel operators brought an action against their property insurer seeking business interruption coverage due to a loss of business after the volcanic eruption. The insured claimed business interruption loss because the number of motel guests decreased after the eruption. They claimed the property sustained physical damage when ash fell on plants and shrubs causing the destruction of shrubbery and a general lack of physical attractiveness. The insurer contended the interruption loss did not directly result from the damage sustained by the motel. The court agreed with the insurer:

> The damage to landscape or shrubbery did not directly result in a business interruption loss. The motel had the same number of rooms available both before and after the eruption; none of the motel rooms were unavailable because of ash damage.[2]

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[13]Yount v. Lafayette Ins. Co., 4 So. 3d 162, 171 (La. Ct. App. 4th Cir. 2009).

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[1]Keetch v. Mutual of Enumclaw Ins. Co., 66 Wash. App. 208, 831 P.2d 784 (Div. 3 1992).

[2]Keetch v. Mutual of Enumclaw Ins. Co., 66 Wash. App. 208, 831 P.2d 784, 786 (Div. 3 1992).

§ 11:262 Business interruption insurance—Causation element in light of area-wide disruption due to massive infrastructure failure—The Katrina effect

How is the causation element handled where the infrastructure failure seriously disrupts the economy of an entire region? In the wake of Katrina, a number of commentators have examined this question.[1] As one commentator argues, business interruption insurance is not intended to provide coverage for the effects on net income of a hurricane (and especially not for the effects of flooding) on the local economy.[2] From a policy interpretation standpoint, others have argued that business interruption insurance provides protection from loss of income due to physical damage to an insured's property, rather than lost earnings due to physical damage to the surrounding community:

> [T]he general economic disruption caused by Katrina would have resulted in many insureds suffering reduced earnings in the absence of physical damage. Insurers should be entitled to reduce their insureds' recoveries by the amount of earnings that would have been lost in the absence of physical damage to covered business property. Such a result is no different than when an insured does not recover for losses caused by noncovered events. Although Hurricane Katrina may have dramatically changed the physical and economic landscape, there is no need to change the basic principles of business interruption coverage.[3]

This approach, however, creates innumerable calculation challenges. How is one to determine the amount of lost earnings that would have flowed from the hurricane's effect on the insured's property as opposed to the surrounding economic environment? Are insureds devastated by catastrophic infrastructure failures essentially to do without coverage because their neighbors were likewise devastated? This is counterintuitive—the greater the harm, the less the coverage. Is a situation like Katrina really no different than when the insured's losses are

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[1]See Rice, Business Interruption Coverage in the Wake of Katrina: Measuring the Insured's Loss in a Volatile Economy, 41 Tort Trial & Ins. Prac. L.J. 857 (2006); Barker, Business Income Insurance in a Disrupted Economy: New Orleans After Hurricane Katrina, 28 No. 2 Ins. Litg. Rep. 49 (2006).

[2]Barker, Business Income Insurance in a Disrupted Economy: New Orleans After Hurricane Katrina, 28 No. 2 Ins. Litg. Rep. 49 (2006).

[3]Rice, Business Interruption Coverage in the Wake of Katrina: Measuring the Insured's Loss in a Volatile Economy, 41 Tort Trial & Ins. Prac. L.J. 857, 882–883 (2006).

caused by noncovered events? In the case of Katrina, it is a single event (presumably a covered cause of loss if business interruption coverage is implicated at all) that causes all loss. In the latter, it is the existence of another event, one that is not a covered cause of loss, that disrupts the causation chain.

Is this really a close question? Perhaps, in certain situations, such as a dispute between insurers over contribution owed. In *Manufacturers Mut. Fire Ins. Co. v. Royal Indem. Co.*,[4] Hurricane Betsy struck the New Orleans area causing physical damage to plants and facilities owned by Kaiser Aluminum. As a result of this physical damage, Kaiser suffered property damage and business interruption losses of approximately $8,400,000. The hurricane also knocked out 74% of the natural gas capacity of Kaiser's gas supplier. As a consequence, had Kaiser been able to operate immediately after the hurricane, it would have received only a fraction of its natural gas needs.

A dispute arose between two of Kaiser's carriers. Manufacturer's issued a Physical Damage and Business Interruption policy. Royal provided coverage under a Boiler and Machinery policy. Both policies provided business interruption coverage. In addition, Royal's policy extended coverage to include business interruption losses arising out of a deprivation of power caused by off-premises occurrences. Both policies contained an "idle period" clause. These clauses required the court to hypothesize a situation in which no damage had been suffered by on-premises facilities. If, in that hypothetical situation, there was a period when (for periods other than on-premises damage) goods would not have been produced or operations and services maintained, then, as to that hypothetically "idle" period, there was no liability. The majority ruled for Manufacturers, finding that most of the loss fell on Royal as its policy responded to Kaiser's loss because of the deprivation of power endorsement, which was not subject to the "idle period" exemption. The dissent viewed the matter differently:

> [I]n the next case between the insured and the insurance company, the majority's holding will compel the following bizarre result: If a plant, insured for fire, is burned to the ground, and five seconds later the charred remains fall into a pit caused by an earthquake, for which the plant was not insured, then the idle period clause operates to eliminate the insurance company's liability. The company can successfully argue, after this decision, that if there had been no fire, there would still have been an earthquake five

[4]Manufacturers Mut. Fire Ins. Co. v. Royal Indem. Co., 501 F.2d 299 (9th Cir. 1974).

seconds later, so the insured can only recover what the business would have earned in the next five seconds. This would result in allowing the carrier to avoid liability for losses that it insured—lost profits due to fire. Since the fire occurred first and was the proximate cause of the damage, the insured should be able to recover notwithstanding that an earthquake occurred later, causing no further damage. Of course, if the earthquake in some way added to the actual damage suffered by the insured, for example, by extending the time required to rebuild the plant, the idle period clause should properly eliminate the additional damage from the company's liability. But the majority's result will require that the insurance company be relieved from liability in the above example. That result is completely contrary to the existing principles of insurance law.[5]

§ 11:263 Business interruption insurance—Extent of suspension or business interruption necessary to trigger coverage

How much of an interruption does one need in order to trigger coverage? This is a common issue of contention. As a general rule, a mere reduction in business is insufficient to meet the "interruption" or "suspension" requirement. Much authority favors a "complete cessation" rule.[1] The rule has the benefit of being a "bright line" test. Certain businesses that cater to the public, such as hotels, restaurants, and other retail establishments can experience business downturns for any number of reasons.[2]

Sometimes an insured will seek to characterize the damaged

[5]Manufacturers Mut. Fire Ins. Co. v. Royal Indem. Co., 501 F.2d 299, 304 (9th Cir. 1974).

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[1]See Home Indem. Co. v. Hyplains Beef, L.C., 893 F. Supp. 987, 991–992 (D. Kan. 1995), judgment aff'd, 89 F.3d 850 (10th Cir. 1996); Madison Maidens, Inc. v. American Mfrs. Mut. Ins. Co., 2006 WL 1650689 (S.D. N.Y. 2006); American States Ins. Co. v. Creative Walking, Inc., 16 F. Supp. 2d 1062, 1065 (E.D. Mo. 1998); Apartment Movers of America, Inc. v. OneBeacon Lloyd's of Texas, 2005 WL 106477 (N.D. Tex. 2005), aff'd, 170 Fed. Appx. 901 (5th Cir. 2006) (interpreting the "necessary suspension" language); Broad Street, LLC v. Gulf Ins. Co., 37 A.D.3d 126, 832 N.Y.S.2d 1 (1st Dep't 2006) (coverage ceased after tenants were allowed to return to rental property three blocks away from World Trade Center after terrorist attack, notwithstanding the fact that many tenants stayed away due to continuing disruptions in the area).

[2]This rule seems particularly well-suited for the hotel business. See Ramada Inn Ramogreen, Inc. v. Travelers Indem. Co. of America, 835 F.2d 812 (11th Cir. 1988); Wyndham Intern., Inc. v. Ace American Ins. Co., 186 S.W.3d 682 (Tex. App. Dallas 2006); Keetch v. Mutual of Enumclaw Ins. Co., 66 Wash. App. 208, 831 P.2d 784 (Div. 3 1992). However, hotels are not the only insureds to have coverage declined because of this requirement. A law firm's reduced capacity resulting in fewer billable hours after a flood was not a "suspension of

business operations as separate and distinct from operations of which they form a party so as to meet the "complete suspension" requirement. This approach was unsuccessful for a resort owner that sought recovery for storm damage to four of 20 cabins.[3] Similarly, no coverage is afforded where a hotel's restaurant was shut due to a fire, where the hotel continued to operate.[4] Yet, there is a point where this analysis wins out. General Electric does not cease operations merely because a turbine plant is shut down due to a flood and, hence, if coverage is to have any meaning to large insureds with multiple facilities, it must respond when something less than complete operations are suspended. Moreover, where an insured's business involves multiple locations that depend upon one another's production, the shutdown of one plant may well affect others. This gives rise to the concept of "mutual dependency." May an insured seek recovery for the loss of production in "dependent" facilities, where it can establish that at least one business unit or facility has suffered a complete suspension? Authority splits on the issue.[5]

It is important, however, to carefully review policy language. The industry has developed endorsement forms that permit partial suspensions to meet the interruption requirement.[6] To some extent, this is a return to earlier policy forms written when the coverage was known as "use and occupancy" insurance.[7]

§ 11:264 Business interruption insurance—Establishing an actual loss sustained

Most business interruption policies are of the "open" variety, which require demonstration of an actual loss sustained.[1] By contrast, a "valued" policy form contains an amount or "value"

operations" within the meaning of business interruption coverage. See Buxbaum v. Aetna Life & Casualty Co., 103 Cal. App. 4th 434, 126 Cal. Rptr. 2d 682 (2d Dist. 2002).

[3]Forestview The Beautiful, Inc. v. All Nation Ins. Co., 704 N.W.2d 773 (Minn. Ct. App. 2005).

[4]Ramada Inn Ramogreen, Inc. v. Travelers Indem. Co. of America, 835 F.2d 812 (11th Cir. 1988).

[5]See Studley Box & Lumber Co. v. National Fire Ins. Co., 85 N.H. 96, 154 A. 337, 75 A.L.R. 248 (1931) (following the "mutual dependency" theory); Royal Indem. Ins. Co. v. Mikob Properties, Inc., 940 F. Supp. 155 (S.D. Tex. 1996) (declining to follow theory).

[6]See ISO CP 00 30 04 02.

[7]See Firemen's Ins. Co. v. Lasker, 18 F.2d 375 (C.C.A. 8th Cir. 1927).

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[1]Business interruption insurance, 37 A.L.R.5th 41.

(arrived through some computation) which is agreed upon in advance. As a general rule, the amount specified in the valued policy controls recovery.[2]

It is important to carefully review policy language as it can vary with respect to how loss (whether characterized as "actual loss sustained" or otherwise) is determined. As one commentator put it:

> The one item of loss that is indisputably covered by business interruption insurance is "lost earnings." One admirably clear definition of the measure of loss is "the reduction in gross earnings less charges and expenses which do not necessarily continue during the interruption of business."
>
> There is a significant difference between a policy that insures "gross earnings" and one that insures "profits." That is, a business may suffer a compensable loss of gross earnings even in the absence of profit, or even where it was losing money.[3]

Where the term "actual loss sustained" was not defined in the policy the court determined that it meant actual loss of earnings, as this interpretation was consistent with the basic purpose for which business was conducted—to realize earnings from

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[2]The "use and occupancy" policy, a precursor to the modern business interruption policy, was often written on a "valued" basis. As a result, much of the case law interpreting this policy form is fairly old. See Michael v. Prussian Nat. Ins. Co., 171 N.Y. 25, 63 N.E. 810 (1902); New England Gas & Elec. Ass'n v. Ocean Acc. & Guarantee Corp., 330 Mass. 640, 116 N.E.2d 671 (1953).

[3]David Polin, 41 Am. Jur. POF3d 319, § 9 (quoting Gregory v. Continental Ins. Co., 575 So. 2d 534 (Miss. 1990). The author discusses a Washington decision involving a restaurant that experienced a fire loss. Its business interruption policy provided coverage for "actual loss sustained to gross earnings," up to a monthly maximum of $3,000, but contained no definition of gross earnings. The restaurant was not successful. It averaged monthly gross earnings of $7,445 but had average monthly expenses of $10,886, for an operating loss of $3,441. Notwithstanding an unprofitable business, the court held there was coverage. It defined gross earnings as total sales less the cost of goods sold. Under that definition, it was not necessary for the store to have any expectation of profit in order to recovery lost gross earnings. The policy also provided that "due consideration shall be given" to "savings of or the continuation of normal charges and expenses." The court found this language to be ambiguous. As a result, it held that the insured was entitled to $3,000 in gross earnings in each month, regardless of a lack of any net profit. See Washington Restaurant Corp. v. General Ins. Co. of America, 64 Wash. 2d 150, 390 P.2d 970 (1964). See also Hampton Foods, Inc. v. Aetna Cas. and Sur. Co., 787 F.2d 349 (8th Cir. 1986) ("Earnings" defined as "net profit plus payroll expense, taxes, interest, rents and all other operating expenses earned by the business" and, as such, the insurer was potentially liable for certain business interest expenses incurred, although the insured could not prove that it had suffered lost profits).

operations.[4]

An issue that comes up with some regularity is whether there is an actual loss sustained where sales are made up at a later date. In *Finger Furniture Co. v. Commonwealth Ins. Co.*,[5] the insured operated a furniture store damaged by flooding during a tropical storm. The store was closed on June 9 and part of June 10. The following weekend, the insured discounted its prices and sales soared. The insurer argued that the insured suffered no actual loss, as sales it lost on June 9–10 were made up the following weekend. This argument was rejected, as the court looked to policy language which calculated business interruption on historical sales figures and therefore the strongest, most reliable evidence of what the business would have done had the event not occurred was the period just before the interruption. There was nothing in the policy language that allowed the insurer to take into account post-damage sales when determining actual loss.[6]

§ 11:265 Business interruption insurance—Period of indemnity

An insured is not entitled to business interruption payments for an indefinite period of time. Most policies cease payments after such time as the insured, with the exercise of due diligence and dispatch, would have been able to rebuild, repair, or replace the property damaged, but in no event beyond the date of expira-

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[4]Northwestern States Portland Cement Co. v. Hartford Fire Ins. Co., 360 F.2d 531 (8th Cir. 1966). See also Metalmasters of Minneapolis, Inc. v. Liberty Mut. Ins. Co., 461 N.W.2d 496 (Minn. Ct. App. 1990) (actual loss of earnings was required under business interruption policy, which was the difference between the net profit the insured would have earned during the period of interruption and the net profit the insured did earn during the period); Lyon Metal Products, L.L.C. v. Protection Mut. Ins. Co., 321 Ill. App. 3d 330, 254 Ill. Dec. 455, 747 N.E.2d 495 (2d Dist. 2001) (where there is loss of production capacity without a loss of earnings, there is no recoverable business interruption except the extra expense necessary to prevent loss of earnings).

[5]Finger Furniture Co. Inc. v. Commonwealth Ins. Co., 404 F.3d 312 (5th Cir. 2005).

[6]But see Fireman's Fund Ins. Co. v. Holland America Line-Westours, Inc., 25 Fed. Appx. 602 (9th Cir. 2002) (makeup reservations were to be taken into account in calculating loss); Admiral Indem. Co. v. Bouley Intern. Holding, LLC, 2003 WL 22682273 (S.D. N.Y. 2003) (post-damage sales to Red Cross workers after 911 terrorist attack to be taken into account in calculating actual loss); Baxter Intern., Inc. v. American Guarantee and Liability Ins. Co., 369 Ill. App. 3d 700, 308 Ill. Dec. 198, 861 N.E.2d 263 (1st Dist. 2006), appeal denied, 224 Ill. 2d 571, 312 Ill. Dec. 654, 871 N.E.2d 54 (2007) (sale of damaged inventory to insurer as part of settlement was properly considered a sale for purpose of determining actual loss).

tion of the policy. This time frame is sometimes referred to as the "period of restoration," "period of indemnity," or "due diligence and dispatch period."

Because the common policy approach is to measure the "period of indemnity" by the time reasonably necessary to restore the insured's property to pre-loss conditions, the greater the property damage the longer the period of indemnity. If the insured commences business at a new permanent location, that date is the end of the indemnity period. It is possible to obtain coverage for an "extended period of indemnity," usually one year in duration. This "extended" coverage is offered on the recognition that some insureds require a period of time beyond the restoration of their physical premises to build back a level of normal business. Retail establishments often require a period of time beyond the restoration of the premises to build back customer traffic.

The 9/11 terrorist attack on the World Trade Center has given rise to a number of decisions discussing the duration of business interruption coverage. Perhaps the leading decision is the Second Circuit's opinion in *Duane Reade, Inc. v. St. Paul Fire and Marine Ins. Co.*[1] At the time of the attack, Duane Reade operated a store in the World Trade Center. After the attack, it sought coverage for business interruption claiming it was entitled to recover for the period of time it would take to rebuild the entire World Trade Center complex. Not surprisingly, the insurer disagreed with this position. The contract defined "period of restoration" as the "[t]ime it would take with the exercise of due diligence and dispatch to rebuild, repair or replace such property as has been destroyed." The dispute boiled down to just what needs to be replaced—a drugstore, or a major building complex. The Second Circuit agreed with the insurer:

> [T]he physical premises of the WTC building in which Duane Reade's store was located was not the subject of the St. Paul policy. Nor was the WTC even mentioned by name, as might be expected had the parties intended to single out the WTC store in a policy that covered all of Duane Reade's 200 stores. Instead, the declarations page lists only Duane Reade's corporate address and no specific property is referred to in the BI [business interruption], which omits even generic terms for location, such as "premises," "site," or "building." Thus nothing in the BI clause supports Duane Reade's claim that it provides site-specific coverage for its WTC store . . . .

[Section 11:265]

[1]Duane Reade, Inc. v. St. Paul Fire and Marine Ins. Co., 411 F.3d 384 (2d Cir. 2005).

[T]he St. Paul policy says nothing about the specific location of the interrupted business. It simply provides coverage until Duane Reade can "repair, rebuild or replace" the property that was damaged and resume operations . . .. That was, if awaiting the rebuilding of the WTC and moving Duane Reade's WTC store to a new location were roughly equivalent tasks, the BI coverage would extend to whatever task Duane Reade, in its discretion, chose to do. The rebuilding of the WTC, however, will be a Herculean undertaking far exceeding the rebuilding of a Duane Reade store in an existing building, or even in an as-yet-to-be-built Manhattan office building, and involving numerous and complex contingencies over which neither Duane Reade nor St. Paul has any control. Under these circumstances, it would be entirely unreasonable to interpret the Restoration Period to include the time it would take for Duane Reade to resume operations in a store located at its former site where that site was neither the subject of the insurance policy nor expressly provided for in the calculus set forth in the Restoration Period.[2]

§ 11:266 Business interruption insurance—Contingent business interruption coverage

Contingent business interruption insurance provides reimbursement for losses caused by physical damage to the property of others, as opposed to the insured's own property. Under most forms, the specific third-party property covered are suppliers or customers of the insured. Another form of this coverage applies where physical damage is sustained by a neighboring business (sometimes referred to as a "leader property") that attracts customers to the insured's premises. The specific wording for this coverage can differ and, as is the case with most time element coverage, specific policy language can make a difference. This coverage is often subject to sublimits. Moreover, it is not uncommon for contingent business interruption insurance to be subject to a number of the same conditions as govern traditional business interruption insurance. Damage to property of utility provid-

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[2]Duane Reade, Inc. v. St. Paul Fire and Marine Ins. Co., 411 F.3d 384, 395–396 (2d Cir. 2005). The Second Circuit held that the period of restoration encompassed only the theoretical time to rebuild, replace, or repair functionally equivalent operations. See also Streamline Capital, L.L.C. v. Hartford Cas. Ins. Co., 2003 WL 22004888 (S.D. N.Y. 2003) (same analysis and result). But see International Office Centers Corp. v. Providence Washington Ins. Co., 2005 WL 2258531 (D. Conn. 2005) (insured that operated suite of temporary offices in WTC entitled to "period of restoration" to rebuild the entire complex as policy specifically referenced WTC property and insured's business was located only at the complex and its business model depended upon this geographic location); Zurich American Ins. Co. v. ABM Industries, Inc., 2006 WL 1293360 (S.D. N.Y. 2006) (where insured provided engineering and janitorial services to WTC, it was entitled to restoration period measured by the rebuilding of the complex, as this was necessary for insured to resume its operations).

ers is usually excluded.

Contingent business interruption insurance, by its very nature, is nongeographic centric. A hurricane, such as Katrina, that damages businesses in one part of the country can trigger coverage under policies issued to insureds thousands of miles away. Moreover, depending upon how courts interpret policy language (which, until 9/11 and Katrina, was seldom reviewed), the scope of this coverage can be quite broad:

> It is not hard to imagine the enormous scope of CBI claims that Hurricane Katrina potentially spawned. If, for example, the term "recipient property" [common CBI language] is substituted for "customer" in the CBI provision, even broader intent can be read into the policy, demonstrating the parties' contemplated coverage would apply whenever any "receiver" of the policyholder's goods or services sustains property damage. For example, a damaged household property that "received" broadcast transmissions can be viewed as a "recipient property" of a broadcaster's "services," thus triggering the broadcaster's contingent business interruption policy. Other examples abound: An importer/exporter may have significant contingent business interruption losses if it depended on the "operation" of the Port of New Orleans to move its products; hotels have tremendous CBI exposures based on, *inter alia*, the damage to the New Orleans Convention Center, a "leader" property; food vending companies have similarly large CBI claims for the damage to the New Orleans Super Dome, a "dependent" property. Extrapolating these examples to every industry, it is easy to see why experts conclude that Hurricane Katrina will clearly be the most expensive insured event to date.[1]

As one would expect, disputes can arise over just who is a "supplier" or "customer." A rather broad approach to the concept of "supplier" was adopted in *Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of New York*,[2] where the insured claimed business loss as a result of extensive flooding throughout the Midwest during the summer of 1993. The insured's business included processing farm products for international and domestic consumption. The court determined that a large variety of entities were suppliers of goods and services to the insured, including the Army Corps of Engineers, the U.S. Coast Guard, and farmers who grew crops that the insured processed. A somewhat different approach was taken in *Pentair, Inc. v. American Guarantee and Liability Ins.*

[Section 11:266]

[1]Mascali, Jr., Contingent Business Interruption Coverage, 41 Tort Trial & Ins. Prac. L.J. 843, 856 (2006).

[2]Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of New York, 936 F. Supp. 534 (S.D. Ill. 1996).

Co.,[3] where an earthquake struck Taiwan, disabling a substation that provided power to two Taiwanese factories. These factories supplied product to a subsidiary of Pentair. The court determined that contingent business interruption coverage was not triggered, as the property damaged was not that of the suppliers but a utility that provided power to the suppliers.

A Louisiana decision, unrelated to Katrina, illustrates how this coverage operates. In *CII Carbon, L.L.C. v. National Union Fire Ins. Co. of Louisiana, Inc.*,[4] the insured processed petroleum coke in kilns to sell to customers. The insured also sold excess steam from its facilities to a nearby facility owned by Kaiser. In July of 1999, a massive explosion occurred at Kaiser's plant. The plant suffered extensive damage and, moreover, damaged powerhouse equipment that was subleased to the insured. Once the damaged powerhouse equipment was repaired, the insured was able to make steam again. Kaiser, however, was not able to purchase it. The insured was not entitled to any recovery under its traditional business interruption coverage once repairs were made to the powerhouse equipment. Coverage after that time was governed by the policy's contingent business interruption coverage:

> The trial court determined that the Kaiser Bayer plant was a "recipient property" within the meaning of the contingent business interruption endorsement to the National insurance policy. That endorsement provides that there is coverage for the length of time required to rebuild, repair, or replace the recipient property "which is not operated by the insured." The loss suffered by CII Carbon after the subleased powerhouse equipment was repaired was exactly the type of loss that contingent business interruption insurance is designed to cover. Damage to the subleased powerhouse equipment was not responsible for CII Carbon's losses after the equipment was repaired as of November 15, 1999. Instead, the damage to the Kaiser plant, which was neither owned nor operated by CII Carbon, was responsible for the losses suffered by CII Carbon thereafter.[5]

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[3]Pentair, Inc. v. American Guarantee and Liability Ins. Co., 400 F.3d 613 (8th Cir. 2005).

[4]CII Carbon, L.L.C. v. National Union Fire Ins. Co. of Louisiana, Inc., 918 So. 2d 1060 (La. Ct. App. 4th Cir. 2005), writ denied, 925 So. 2d 1235 (La. 2006).

[5]CII Carbon, L.L.C. v. National Union Fire Ins. Co. of Louisiana, Inc., 918 So. 2d 1060, 1067–1068 (La. Ct. App. 4th Cir. 2005), writ denied, 925 So. 2d 1235 (La. 2006). The reason the insured appealed the trial court's decision that coverage existed under the contingent business interruption endorsement, rather than under the policy's business interruption coverage, was the fact that the former was subject to a $500,000 sublimit.

§ 11:267 Business interruption insurance—Civil authority coverage

Civil Authority insurance insures against business loss resulting from an order of a civil authority restricting access to the insured's premises. There is often a defined "waiting period," usually between 24 and 48 hours. The duration of coverage is also limited to a specified number of days or weeks, rather than a theoretical time limit such as a "period of restoration." In addition, the coverage is often subject to separate sublimits. Policy language differs with respect to limitations placed on the cause of the authority's action to restrict access. Some policies require there to be damage to the insured's property by a covered peril. An example might be where the insured's premises are condemned due to a covered windstorm. Other policy forms permit coverage where the order arises out of nonexcluded damage to third-party property. Still other policies allow coverage without limitation as to cause.

One causation requirement that varies little from policy to policy is the requirement that there be a direct link between the civil authority's order and the insured's loss. A number of cases arising out of the 9/11 terrorist attacks emphasize this requirement.[1] Even though the courts have consistently rejected civil authority coverage for business loss claimed to be the result of the FAA's restrictions on air traffic, this coverage can be implicated in instances of infrastructure failures. If a railroad bed fails and a car tips over spilling toxic gas causing an author-

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[1]See Southern Hospitality, Inc. v. Zurich American Ins. Co., 393 F.3d 1137 (10th Cir. 2004) (no coverage because FAA ground halt order did not "prohibit access" to insured's hotels, as required by the policy; furthermore, there is no coverage under "dependent property" clause because no proof of physical loss or damage to property operated by others upon which insured relied for services); Abner, Herrman & Brock, Inc. v. Great Northern Ins. Co., 308 F. Supp. 2d 331 (S.D. N.Y. 2004) (no coverage once access was restored despite continued diversion of traffic in area and confusion regarding access to building); 730 Bienville Partners, Ltd. v. Assurance Co. of America, 67 Fed. Appx. 248 (5th Cir. 2003) (no coverage because FAA's closure of nation's airports after 9/11 did not "prohibit access" to insured's hotel); United Air Lines, Inc. v. Insurance Co. of State of PA, 439 F.3d 128 (2d Cir. 2006) (United Airlines' claim for lost earnings due to shutdown of Reagan International Airport as a result of the attack on the Pentagon was rejected as the airport and the Pentagon were not "adjacent" within the meaning of the policy, as the Pentagon was at least 3.4 miles away by car from the airport and the two facilities were separated by several intervening structures and properties). But see US Airways, Inc. v. Commonwealth Ins. Co., 65 Va. Cir. 238, 2004 WL 1637139 (2004) (coverage afforded insured airline due to shutdown of Reagan Int'l Airport due to terrorist attack on Pentagon).

ity to evacuate the surrounding premises, the coverage might well apply. Similarly, a bridge collapse, which results in the public authority closing certain streets denying access to an insured's premises, could trigger this coverage. However, the denial of access must be complete or, at least, nearly complete. The closure of the road may not result in coverage where other means of access exist, even though they are less convenient.[2] Nevertheless, policy language can be important. If the policy provides coverage where access is restricted or hindered or impaired, the coverage grant is broader than where coverage only arises where the civil authority "prohibits" or "denies" access.[3] A case arising out of the 9/11 terrorist attack is instructive. In *Abner, Herrman & Brock, Inc. v. Great Northern Ins. Co.*, the insured ran an investment

[2]See St. Paul Mercury Ins. Co. v. Magnolia Lady, Inc., 1999 WL 33537191 (N.D. Miss. 1999) (closure of bridge, which resulted in 80% decrease in casino's business, did not result in coverage as there were still other routes to the premises); Royal Indem. Co. v. Retail Brand Alliance, Inc., 33 A.D.3d 392, 822 N.Y.S.2d 268 (1st Dep't 2006) leave to appeal denied, 8 N.Y.3d 813, 836 N.Y.S.2d 553, 868 N.E.2d 236 (2007) and leave to appeal denied, 11 N.Y.3d 705, 866 N.Y.S.2d 609, 896 N.E.2d 95 (2008) (no coverage where restrictions arising after World Trade Center destruction did not completely deny access to insured's clothing store, even though one entrance remained closed and there was scaffolding around the structure, where there was no proof that the entrance that was open was insufficient to accommodate all customer needs); 54th Street Ltd. Partners, L.P. v. Fidelity and Guar. Ins. Co., 306 A.D.2d 67, 763 N.Y.S.2d 243 (1st Dep't 2003) (no coverage for restaurant's lost business once access was restored, even though traffic in area was diverted as restaurant was accessible to the public); Syufy Enterprises v. Home Ins. Co. of Indiana, 1995 WL 129229 (N.D. Cal. 1995) (dawn-to-dusk curfew did not trigger coverage, as it did not specifically prohibit any individual from entering insured's theatre); Dixson Produce, LLC v. National Fire Ins. Co. of Hartford, 2004 OK CIV APP 79, 99 P.3d 725 (Div. 2 2004) (no coverage where some streets were closed after tornado and travel to insured's business was not convenient as civil authority did not prohibit access to insured's business); TMC Stores, Inc. v. Federated Mut. Ins. Co., 2005 WL 1331700 (Minn. Ct. App. 2005) (no coverage where construction adjacent to insured's store did not prohibit access as store remained open although access was diminished); Kean, Miller, Hawthorne, D'Armond McCowan & Jarman, LLP v. National Fire Ins. Co. of Hartford, 2007 WL 2489711 (M.D. La. 2007) (no coverage where insured closed Baton Rouge office for one day in response to civil authority advisories to stay off streets in light of Hurricane Katrina, as there was no evidence that authorities formally forbade or prevented access to premises); Penton Media, Inc. v. Affiliated FM Ins. Co., 2006 WL 2504907 (N.D. Ohio 2006), aff'd, 245 Fed. Appx. 495 (6th Cir. 2007) (no coverage where insured postponed trade show set for October 2001 in Javitz Center due to events of 9/11 as the Center itself was not damaged and no order of civil authority prohibited access to the Javitz Center; instead Center was unavailable due to lease agreement with FEMA for emergency use of the facility).

[3]Abner, Herrman & Brock, Inc. v. Great Northern Ins. Co., 308 F. Supp. 2d 331 (S.D. N.Y. 2004).

advisory firm located in Lower Manhattan where, from September 11, 2001, through September 14, 2001, all access was denied and thereafter, for some period of time, vehicular traffic was restricted but pedestrian and public transit was available. The insurer paid under the civil authority provision for the period of time when complete access was denied, but declined coverage for the period of time when only vehicular traffic was restricted. The insured's policy provided coverage "when a civil authority prohibits access to your premises or a dependent business's premises."[4] The court found this language to unambiguously restrict coverage to situations where complete access is denied by a civil authority:

> In this case, the language of the insurance policy is unambiguous. The relevant part of the Civil Authority insurance provision states that Great Northern will pay for loss "when a civil authority prohibits access to your premises." Because access was prohibited by civil authority from September 11, 2001, through September 14, 2001, the coverage applies only to these four days. The coverage does not extend through September 17, 2001, despite any confusion that AHB employees have had about access to the premises and despite any difficulties AHB's Chairman or his driver may have had in getting around the city. The record is clear that as of September 17, 2001, no civil authority prohibited access to AHB's premises.[5]

§ 11:268 Business interruption insurance—Ingress/egress coverage

Ingress/egress coverage is similar to civil authority insurance, except that it is not limited to prohibitions imposed by a civil authority. Like civil authority coverage, depending upon the jurisdiction and policy terms, this insurance is triggered either by complete lack of access or a lack of reasonable access. The coverage also is often subject to sublimits, some form of waiting period, and a maximum duration of liability (usually between 30 and 90 days). Some policy forms require damage to the insured's property or third-party property within some finite distance of

[4]Abner, Herrman & Brock, Inc. v. Great Northern Ins. Co., 308 F. Supp. 2d 331, 334 (S.D. N.Y. 2004).

[5]Abner, Herrman & Brock, Inc. v. Great Northern Ins. Co., 308 F. Supp.2d 331, 336 (S.D. N.Y. 2004). Great Northern's policy did not require an "order" of the civil authority. Some policy forms require an "order," while others require only some form of action. Those policies requiring an order usually do not specify the level of formality required. In the event the policy does not specifically state a formal written order is required, standard contract interpretation analysis should favor the insured. See Narricot Industries, Inc. v. Fireman's Fund Ins. Co., 2002 WL 31247972 (E.D. Pa. 2002).

the insured's premises.[1] Moreover, unless policy language provides otherwise, the event directly causing lack of access must not be an excluded cause of loss.

A case arising out of flood damage caused by Hurricane Floyd in 1999 illustrates this coverage. In *Fountain Powerboat Industries, Inc. v. Reliance Ins. Co.*,[2] the insured's boat manufacturing facility was located in an area solely accessible by U.S. Highway 17. Hurricane Floyd flooded Highway 17 for several days. As a result of the restricted access, the insured's production fell to a third of full capacity.

The insurance policy's ingress/egress provision read:

> This policy covers loss sustained during the period of time when, as a direct result of a peril not excluded, ingress to or egress from real and personal property not excluded hereunder is thereby prevented.[3]

While both parties agreed that the terms ingress and egress were unambiguous and meant "access" to the premises, the insurer claimed there was no coverage without property damage. The court rejected this analysis, finding that the ingress/egress provision contained no limitation in the way of a requirement of physical loss, but rather covered loss sustained due to lack of access to the property. Moreover, the court found coverage for the period of time the insured was able to deliver employees to the premises by picking them up:

> The efforts of Fountain to pick up employees and drive them to work are extraordinary. The court finds that the ingress/egress provision relates only to reasonable access to the Fountain facility and does not therefore apply to extraordinary efforts by Fountain or its employees to get to work over closed and flooded roads.[4]

§ 11:268.10 Service interruption coverage

Another additional coverage sometimes added to a property

[Section 11:268]

[1]See City of Chicago v. Factory Mut. Ins. Co., 2004 WL 549447 (N.D. Ill. 2004) (damage in New York and Washington due to 9/11 terrorist attack did not directly prevent access to airport in Chicago).

[2]Fountain Powerboat Industries, Inc. v. Reliance Ins. Co., 119 F. Supp. 2d 552 (E.D. N.C. 2000).

[3]Fountain Powerboat Indus., Inc. v. Reliance Ins. Co., 119 F. Supp.2d 552, 556 (E.D. N.C. 2000).

[4]Fountain Powerboat Indus., Inc. v. Reliance Ins. Co., 119 F. Supp.2d 552, 557, n. 4 (E.D. N.C. 2000). But see Harry's Cadillac-Pontiac-GMC Truck Co. v. Motors Ins. Corp., 126 N.C. App. 698, 486 S.E.2d 249 (1997) (no coverage under policy language requiring premises to suffer direct physical loss where insured could not access premises due to snowstorm).

policy is service interruption coverage. This coverage is intended to protect against business losses due to disruptions in utility service. In order for coverage to attach, however, a number of conditions must be satisfied, such as the requirement that the interruption be caused by physical damage to specified electrical equipment and property located away from the insured's property. At least that was the condition for coverage in *Wakefern Food Corp. v. Liberty Mutual Fire Ins. Co.*,[1] where a grocer sustained damage in the nature of spoiled food and business interruption a four-day electrical blackout. On August 14, 2003, problems with the interconnected North American power system (the "electrical grid") resulted in a four-day electrical blackout over much of the Northeastern United States and Eastern Canada. The insurer denied coverage on the ground that the utility interruption had not been caused by physical damage to off-premises electrical plant and equipment. It contended that, although the power grid was physically incapable of supplying power for four day, it suffered no "physical damage" and therefore there was no coverage. According to the insurer's expert, a cascading outage or blackout occurs when an interconnection becomes unstable because of inadequate generation capacity, transition-line failure, or other abnormalities. Because of the instability and imbalance that results from such abnormal events in one part of the interconnection, "protection systems" operate to prevent physical damage to very expensive generators and transmission lines throughout the rest of interconnection. The insured's expert disagreed, concluding that physical damage to generating and transmission equipment did occur. The court, for its part, determined that the undefined term "physical damage" was ambiguous, and that the trial court construed it too narrowly in favor of the insurer and inconsistent with the reasonable expectations of the insured. In the court's view:

> [T]he electrical grid was "physically damaged" because, due to a physical incident or series of incidents, the grid and its component generators and transmission lines were physically incapable of performing their essential function of providing electricity. There is also undisputed evidence that the grid is an interconnected system and that, at least in some areas, the power could not be turned back on until assorted individual pieces of damaged equipment were replaced. However, we do not rest our decision on that

[Section 11:268.10]

[1]Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co., 406 N.J. Super. 524, 968 A.2d 724 (App. Div. 2009), certification denied, 200 N.J. 209, 976 A.2d 385 (2009).

evidence. Rather, we look to the larger picture concerning the loss of function of the system as a whole.

We recognize that, to some extent, the blackout was caused by a combination of fortuitous events, together with the operation of safety features built into the system to insure that the essential elements of the grid could not be severely damaged. However, in concluding that the term "physical damage" is ambiguous, we consider the context, including the identity of the parties. These are not two electric utilities contracting about the technical aspects of the grid. Rather, the parties are an insurance company, in the business of covering risks, and a group of supermarkets that paid for what they believed was protection against a very serious risk—the loss of electric power to refrigerate their food. The average policy holder in plaintiffs' position would not be expected to understand the arcane functioning of the power grid, or the narrowly-parsed definition of "physical damage" which the insurer urges us to adopt. In this context, we conclude that if Liberty intended that its policy would provide no coverage for an electrical blackout, it was obligated to define its policy exclusion more clearly.[2]

G. VALUATION ISSUES

~~§ 11:269 Generally~~

Disputes can arise over how to calculate or valuate an insured's property loss. In *F.P. Woll & Co. v. Valiant Ins. Co.*,[1] an insured's manufacturing facility was severely damaged by fire. The insured recovered more than $1 million from its property carrier for loss of business income and extra expense, as well as another $1 million for loss of its manufacturing facility. Nevertheless, the insured sought additional recovery, including architectural and construction expenses incurred to expand leased office space it took over in order to continue its operations. The insurer contended that the $1 million paid for the loss of the existing facility took into account any construction and architectural expenses that would be incurred in building a new or expanding an existing facility. The court agreed with the insurer. The court reviewed the party's negotiations and determined that the $1 million plus figure for the loss of the building involved calculating the cost of rebuilding the facility and subtracting any applicable "holdback" end value. Therefore, the insured's architectural and construction expenses were taken into account when

[2]Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co., 406 N.J. Super. 524, 968 A.2d 724, 734-35 (App. Div. 2009), certification denied, 200 N.J. 209, 976 A.2d 385 (2009).

[Section 11:269]

[1]F.P. Woll & Co. v. Valiant Ins. Co., 226 F. Supp. 2d 688 (E.D. Pa. 2002).