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A COMPREHENSIVE REPORT ON CATASTROPHIC LOSS LITIGATION AND INSURANCE RISK

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Business Interruption Claims Following Hurricane Losses

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It is no secret that the Atlantic Ocean and Gulf of Mexico are experiencing a weather cycle of increased hurricane activity. Hurricane Katrina caused unprecedented devastation in 2005, destroying vast portions of the City of New Orleans, causing substantial damage to property and the cessation of business activities. Nine months after Hurricane Katrina, many businesses in New Orleans remain closed. Claims for business interruption insurance coverage are, in some instances, the lifeline that businesses are clinging to for survival.

Many of these business interruption claims still remain unresolved. Policyholders are finding that the claims are very complex and fact intensive. They are confronting issues such as whether coverage was triggered by a covered loss under the policy, and are often facing numerous questions from accountants whose job it is to verify and quantify any losses.

Business interruption coverage is typically sold as part of the package of property insurance coverage. The terms of coverage vary greatly from policy to policy, and many policyholders are not sure of the extent of their business interruption coverage until they test its outer limits.

The purpose of this article is to provide an overview and background of business interruption coverage, and to address the key issues that will likely arise in claims following Hurricane Katrina. To date, a surprisingly small number of suits for business interruption claims have been filed, but the number has increased in recent weeks. Over the next few months, the claims adjustment process and the related accounting work will be completed, and dissatisfied policyholders may be turning to their counsel for advice and possible litigation.

I. BUSINESS INTERRUPTION INSURANCE – WHAT IS IT?

Business Interruption Insurance ("BI Insurance") is first-party property insurance that covers specific losses a policyholder sustains to its own business as a result of physical damage to insured property or, in some situations, other property which affects the insured property or the insured's operations.[1] BI Insurance generally limits the insurer's liability to actual loss of income resulting from the occurrence of a specified risk when that peril, in turn, causes a business interruption. Many policies also

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provide recovery for extra expenses incurred in returning the commercial enterprise to its pre-loss level of production and mitigating losses. Claims for extra expenses can be significant, as they may include the costs of shutting down operations in preparation for the storm, costs of relocating and costs of restoration of operations.

II. THE OUTLIERS: CIVIL AUTHORITIES AND LOSS OF UTILITIES

Certain BI Insurance policies may provide coverage pursuant to Civil Authorities and Loss of Utilities clauses. These coverages are outliers because in many instances, coverage is provided even when the physical loss or damage is not to the insured premises itself, and instead is damage to adjacent or neighboring properties, or, in the case of Loss of Utilities clauses, to equipment providing the utility services.

A. Civil Authorities Clause

Most BI Insurance policies contain a "Civil Authorities Clause," which provides coverage for business interruption, and in most cases for extra expenses, resulting from a mandate by civil authorities that prohibits use of the commercial premises. While these clauses do not fit squarely within the analytical framework stated above, the same concepts generally apply. For example, one Civil Authorities Clause provides:

> We will pay for the actual loss of Business Income you sustain and reasonable and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from a Covered Cause of Loss.

Thus, for coverage to be triggered under the above Civil Authorities Clause, there must be an order from a civil authority that prohibits access to the insured property, and some physical loss or damage to property other than that of the insured that would have triggered BI Insurance coverage had it occurred on the insured's premises.

Of particular importance to the Greater New Orleans area is the mandatory evacuation as Hurricane Katrina approached. The mayor of New Orleans ordered a mandatory evacuation on Aug. 28, 2005, when windstorm damage had already taken place at some site – even if that site is deemed to be in Florida, where Katrina had struck earlier. By Aug. 29, the evacuation order remained in effect, and wind damage had taken place off the Louisiana coast. Insurers might argue that the event that led to the order of the civil authority was a flood – not a covered loss – and therefore there is no coverage under the civil authorities clause. Policyholders, on the other hand, may contend that there is coverage because the evacuation order issued by the civil authority preceded any flooding.

Although there are no Louisiana cases directly on point, a Georgia court recently accepted this rationale. In *Assurance Company of America v. BBB Service Company, Inc.*, 576 S.E.2d 38 (Ga. App. 2002), an owner of a chain of Wendy's restaurants brought a claim for business interruption losses arising out of Hurricane Floyd in 1999. The county authorities had issued an evacuation order as the hurricane approached. The insurer argued that there was no coverage under the Civil Authorities Clause because the state of emergency was declared due to the *threat of injury* posed by Hurricane Floyd, and that the evacuation was ordered as a protective measure rather than due to physical losses or damages as contemplated by the BI Insurance policy. The court observed that even if the initial evacuation order was not based upon then-existing property damage, there may have been a time over the next two and one-half days (the period of the claimed business loss) when property was actually damaged by the hurricane. That damage formed the basis for the continued emergency order denying access to the restaurants. The court remanded for further fact finding. On remand, and subsequently affirmed in the next appeal, the court held that as Hurricane Floyd approached and the county authorities issued the evacuation order, the civil authority noted extensive damages already caused by the hurricane in the Bahamas. These damages were sufficient to constitute the off-site losses and trigger the business interruption coverage. *Assurance Co. of Am. v. BBB Serv. Co., Inc.,* 593 S.E. 2d 7 (Ga. App. 2003), *reconsideration denied* (Jan. 7, 2004), *cert. denied* (May 3, 2004).

Civil Authority Clauses vary in their wording. Some require the off-premises physical loss or damage to be sustained within one mile of the covered premises. Others require the off-premises loss to be at an "adjacent premises." In these cases, Louisiana insureds may not be able to rely upon damages in Florida to trigger BI Insurance coverage, and instead should undertake its analysis consistent with the policy terms.

B. Loss of Utilities Clause

Loss of Utilities Clauses generally appear as exclusions for business interruptions caused solely by the loss of utilities, and except from the exclusion (and therefore cover) certain consequences of the loss of utilities. Frequently, these clauses are referred to as "Off-Premises Services Exclusions." For example, one policy form excludes:

> Any loss caused directly or indirectly by the failure of power or other utility service supplied to the described premises, however caused, if the failure occurs outside of a building. But if the

> failure of power or other utility service results in loss or damage by a "specified causes of loss," we will pay for the loss or damage resulting from that "specified causes of loss."

The policy defines "Specified Causes of Loss" to include fire, explosion, smoke and water damage. A reasonable interpretation of this provision suggests that when the loss of utilities itself causes one of these conditions, BI Insurance coverage is triggered. In a different approach, other policies contain Loss of Utilities Clauses focused on loss or damage to particular categories and locations of utility equipment, excluding from coverage, for example, losses arising from damages to "overhead communication, transmission and distribution equipment."

Off-Premises Services Exclusions have been challenged to mixed results. The Rhode Island Supreme Court, for instance, found the same exclusion as that appearing above to be ambiguous and illusory in two cases. See *Jerry's Supermarkets, Inc. v. Rumford Prop. Liab. Ins. Co.*, 586 A.2d 539 (R.I. 1991); *Pressman v. Aetna Cas. & Sur. Co.*, 574 A.2d 757 (R.I. 1990). In *Pressman*, a sole-proprietor psychologist's office closed for six days due to power failure that occurred when a tree adjacent to the property fell onto the electrical line leading to the office. The power failure prevented the policyholder from servicing patients and damaged a computer when restored. The court found the Off-Premises Services Exclusion at issue to be ambiguous and illusory, as it would preclude coverage in almost all circumstances, unless the insured had a power generator inside his own building. *Pressman*, 574 A.2d 757. The Rhode Island Supreme Court relied upon the rule from *Pressman* in *Jerry's Supermarkets*, where a power outage caused by a hurricane resulted in food spoilage at the insured's grocery store. *Jerry's Supermarkets*, 586 A.2d 539.

This view has not been well accepted outside of Rhode Island. Other courts have held that the exclusion clearly and unambiguously precludes coverage when the sole identified direct physical loss or damage is power failure. See *Mapletown Foods, Inc. v. Motorists Mut. Ins. Co.*, 662 N.E.2d 48 (Ohio Ct. App. 1995). In *Mapletown Foods*, high storm winds caused widespread power outages and resulted in food spoilage at the policyholder's grocery stores. The court found that the exclusion precluded coverage:

> If the power failure in the instant case does not fall within the meaning of a power failure "away from the premises" then the phrase is bereft of meaning…. We must give meaning to the exclusion if we reasonably can. Its ordinary meaning is that there is no coverage when the power failure occurs away from the premises, i.e., at the utility power site or somewhere off the [policyholder's] premises. That is a reasonable construction and the one applicable to the instant case. *Id.* at 821-22.

Other courts have held that the loss of utilities itself must proximately cause separate physical damage to insured property as a prerequisite for insurance coverage under a Loss of Utilities Clause or Off-Premises Services Exclusion. *Lipshultz v. Gen. Ins. Co. of Am.*, 96 N.W.2d 880 (Minn. 1959); *Red Bird Egg Farms, Inc. v. Penn. Mfg. Indem. Co.*, 15 Fed.Appx. 149 (4th Cir. 2001).

Rather than viewing the loss of power itself as the trigger loss for BI Insurance coverage, courts more frequently hold that the mere lack of utility services is not "direct physical loss or damage" as that phrase is construed in BI Insurance policies. *Pentair, Inc. v. Am. Guar. & Liab. Ins. Co.*, 400 F.3d 613 (8th Cir. 2005).

III. PHYSICAL LOSS OR DAMAGE: THE "PHYSICAL" REQUIREMENT

BI Insurance policies generally require the impairment in operations "be caused by or result from direct *physical* loss or damage."

Overview of "Physical Loss or Damage"

"In ordinary parlance and widely accepted definition, physical damage to property means 'a distinct, demonstrable, and physical alteration of its structure.'" *Port Auth. of N.Y. and N.J. v. Affiliated FM Ins. Co.,* 311 F.3d 226, 235 (3d Cir. 2002) (citing 10 Couch on Insurance § 148:46 [3d ed. 1998]). Thus, direct physical loss or damage generally requires more than an inability to use the property for its intended purpose. *Pentair, Inc. v. Am. Guar. and Liab. Ins. Co.*, 400 F.3d 613 (8th Cir. 2005) (loss of power did not constitute physical loss or damage); but see, e.g., *Lipshultz v. General Ins. Co. of Am.*, 96 N.W.2d 880 (1959) (power outages can cause physical loss when they result in food spoilage).

Frequently, direct physical loss involves tangible or structural damage to the premises. See *Adams-Arapahoe Joint Sch. Dist. No. 28-J v. Continental Ins. Co.,* 891 F.2d 772 (10th Cir. 1989) (concluding, where corrosion caused collapse of small part of roof, that plaintiff's loss included entire corroded area because the corrosion made building unsafe). However, direct physical loss also may exist in the absence of structural damage to the insured property. See, e.g., *Western Fire Ins. Co. v. First Presbyterian Church,* 437 P.2d 52, 55 (Co. 1968) (concluding plaintiff suffered direct physical loss to insured building when gasoline infiltrated soil surrounding basement, contaminating foundation and rooms and rendering use of building dangerous). Furthermore, direct physical loss may exist when intangible damages affect use of the property. *Sentinel Mgt. Co. v. N.H. Ins. Co.*, 563 N.W.2d 296 (Minn. App. 1997) ("[T]hough asbestos contamination does not result in tangible injury to the physical structure of a building, a building's function may be seriously impaired or destroyed and the property rendered use-

less by the presence of contaminants"); but see *Ward Gen. Ins. Services, Inc. Employers Fire Ins. Co.,* 114 Cal.App.4th 548 (Ca. App. 2004) (loss of electronic data did not constitute physical loss without damage to the computer). Notably, mildew and mold contamination may constitute direct physical loss. *Columbiaknit, Inc. v. Affilliated FM Ins. Co.*, 1999 WL 619100 (D. Or. 1999).

IV. CAUSATION: "*DIRECT*" PHYSICAL LOSS OR DAMAGE LOSS

Causation questions often arise in BI Insurance cases because covered perils and excluded perils often combine to cause direct physical loss. These challenges are addressed by courts on a case-by-case basis. In evaluating the question of coverage courts often resort to the doctrine of "efficient proximate causation."[2] As one author noted, "[F]irst-party property claims in general are often complicated by the need to determine the 'proximate cause' of a loss – a concept that one legal scholar says has caused more disagreement *than any other in the entire field of law*." Randy J. Maniloff, "Unraveling Insurance Coverage for Hurricane Katrina: No *Big Easy* Task," (emphasis in original).

A. Causation Under Louisiana Law

The two concepts of causation and "direct physical loss" are intertwined in Louisiana jurisprudence on the construction of the term "direct loss" in windstorm policies.[3] Though BI Insurance claims differ slightly from physical property claims (with "business interruption" as an additional element of the insured's proof), under the circumstances of Hurricane Katrina, windstorm cases are instructive on the issue of causation.

The term "windstorm" is not defined under the majority of homeowner's insurance policies. As such, Louisiana courts have been faced with the interpretation of the term. Jurisprudence has defined "windstorm" as it applies to homeowner's policies as "a wind of sufficient violence capable of damaging insured property either by impact of its own force or by projecting some object against the property." *Kemp v. Am. Universal Ins. Co.*, 390 F.2d 533 (5th Cir. 1968). In addressing the issue of windstorms, specifically with regard to hurricane damages, courts have held that wind is often not the sole contributing cause of the loss or damage. See, e.g., *A. P. Leonards v. Travelers Ins. Co.*, 506 So. 2d 509 (La. App. 1986). Specifically, in order to recover on an insurance policy for losses suffered due to a windstorm, not otherwise limited or defined, it is sufficient to show that wind was the proximate or efficient cause of loss or damage, notwithstanding other factors contributing to the loss. *Kemp*, 390 F.2d 533.

The Louisiana Supreme Court has held that "direct loss," as used in windstorm insurance policies, means the *proximate cause* of the loss:

> [A] review of the authorities on the subject reveals that courts of last resort (including this one) have consistently interpreted the term "direct loss," as used in a windstorm insurance policy, to be the loss proximately caused by the peril insured against, the term having essentially the same meaning as "proximate cause" applied in negligence cases. *Lorio v. Aetna Ins. Co.*, 232 So.2d 490 (La. 1970) (citing *Dubuque Fire and Marine Ins. Co. v. Caylor*, 249 F.2d 162 [10th Cir. 1957]; *Federal Ins. Co. v. Bock*, 382 S.W.2d 305 [Tex. Civ. App. 1964]; and discussion of rule, Vol. 11 Couch on Insurance, 2d, sec. 42:337, p. 148).

In *Lorio*, the Louisiana Supreme Court further elaborated on the relationship between "proximate cause" and "dominant and efficient cause." The court referenced 45 C.J.S. Insurance, which states in reference to the insurance policies covering loss by cyclone, hurricane, storm, tornado and windstorm that:

> In order that there may be a recovery on the policy, the cause designated in the policy must have been the proximate, and not a remote, cause of the loss, particularly where the policy requires it to be the "direct" cause of the loss. *Lorio*, 232 So.2d at 493 (quoting 45 C.J.S. Insurance, § 888, p. 962).

The court then quoted from a treatise:

> Wind must be an efficient cause of loss in order to recover on a windstorm policy. And where the term "direct" is used, referring to the cause of the loss, it means proximate or immediate. *Id.* (quoting Vol. 5 Appleman, Insurance Law and Practice, § 3142, p.287: Tornado and Windstorm Coverages).

Other Louisiana courts have construed "direct loss," as used in windstorm policies, to mean "the *dominant and efficient cause* of the loss."

> "Direct loss" has been construed to mean the dominant and efficient cause of the loss, as distinguished from a remote cause. It is sufficient to show that the particular peril was the efficient cause of the loss notwithstanding that another cause or causes contributed to the loss. *Riche v. State Farm Fire & Cas. Co.*, 356 So.2d 101, 103 (La. App. 1978) (citing Stephen M. Brent, "What Constitutes 'Direct Loss' Under Windstorm Insurance Coverage," 65 A.L.R.3d 1128, 1136).

The Fifth Circuit defined "efficient cause" in the context of windstorm insurance as predicated upon a "show[ing] that the wind was the proximate or efficient cause of loss or damage notwithstanding other factors contributed to loss." *Kemp v. Am. Universal Ins. Co.*, 391 F.2d 533 (5th Cir. 1968). *Kemp* involved a coverage dispute under a windstorm policy on property in Mississippi decided under Mississippi

law. The policy was silent as to the definition of "windstorm." *Id.* at 534. The court borrowed from the view that the Louisiana Supreme Court had previously established under similar factual circumstances, that the wind must be sufficiently violent, and the policyholder must demonstrate that the wind was the "proximate or efficient cause of loss or damage." *Id.* At 534-35 (citing *Roach-Strayhan-Holland Post No. 20, Am. Legion Club, Inc. v. Continental Ins. Co. of N.Y.*, 112 So.2d 680, 682 [La. 1959]).

Elaborating on the definition of "efficient cause," the court stated that it is "that cause of an injury to which legal liability attaches." *Id.* at 535. The court concluded that damage to the property was within the windstorm provision of the policy at issue.

Multiple Causation Issues

The windstorm cases express the principle that in the context of windstorm insurance coverage, "[i]t is sufficient to show that the particular peril was the efficient cause of the loss *notwithstanding that another cause or causes contributed to the loss*." *Riche*, 356 So.2d 101, 103 (La. App. 1978) (emphasis added).

The Louisiana Supreme Court explained:

> [S]ince in a great number of factual circumstances it has been shown that wind is not the sole contributing cause of the loss or damage, acceptance has been accorded the view that it is sufficient, in order to recover upon a windstorm insurance policy not otherwise limited or defined, that the wind was the proximate or efficient cause of the loss or damage, notwithstanding other factors contributing thereto. *Roach-Strayhan-Holland Post No. 20, Am. Legion Club, Inc. v. Continental Ins. Co. of N.Y.*, 112 So.2d 680, 682-83 (La. 1959).[4]

In *Roach*, the evidence for the insured showed that a roof collapsed due to the force of a windstorm. The insurer argued that the collapse resulted from faulty construction. The Louisiana Supreme Court granted the policyholder full recovery for his damages, notwithstanding credible evidence that the construction of the building was improper. The court reasoned that wind was the dominant and efficient cause, while faulty construction merely contributed to the event.

In the context of coverage under a windstorm policy, additional factors that cause losses or damages may not sever proximate causation or liability under the policy. However, Louisiana courts have also held that if the cause of the damages is not a direct result of the wind alone, but caused by a combination of wind and water, the *insured* bears the burden of proof and may not recover unless it proves that the damages can be separated and that the loss or damage was a direct result of the wind. *Constitution State Ins. Co. v. Werner Enter. Inc.*, 1987 U.S. Dist. LEXIS 6023 (E.D. La. 1987).

Certain negligence cases involve superseding or intervening causes that break the requisite chain of proximate causation and free the original negligent party from liability. The Louisiana Third Circuit Court of Appeal has explained:

> If there is more than one cause of the accident, the initial tortfeasor will not be relieved of the consequences of his negligent actions unless an intervening cause superseded the original negligence and alone produced the accident. *Domingue v. State Dep't of Public Safety*, 490 So.2d 772 (La.App. 3 Cir. 1986). Even if there is an intervening cause, the original tortfeasor will not be relieved of liability if he could or should have reasonably foreseen that the accident would have happened as a result of his negligence. *Acadian Corp. v. Olin Corp.*, 2001-1060 (La.App. 5/8/2002), 824 So.2d 396, 405.

If the reasonable foreseeability of the result is unaffected by the intervening cause, then the causal chain is not superseded and liability remains attached to the initial tortfeasor.

Louisiana courts do not use the terms "superseding" or "intervening cause" when addressing proximate causation in the identification of insurance losses. However, by analogy, if it was reasonably foreseeable that the "impairment of operations" was "caused by or resulted from direct physical loss or damage," despite the intervention of another superseding cause, then BI Insurance coverage should remain under the initial direct physical loss.

Identifying the specific cause of physical losses or damages may be of critical importance in BI Insurance litigation. In Louisiana, when determining whether a loss results directly from an event and is caused by it, courts will ask whether the loss was the "consequence of an event and … would have occurred without the existence or intrusion of other causes or conditions unrelated to the original event." *Lorio*, 220 So.2d 781 (La. App. 1969).

In *Urrate v. Argonaut Great Cent. Ins. Co.*, 04-256 (La.App. 5 Cir. 8/31/04), 881 So.2d 787, the owner of Brunings Restaurant sued its windstorm insurer for property and business interruption losses caused by a combination of windstorm and flood following Hurricane Georges in 1998. The restaurant was situated on the shore of Lake Pontchartrain, and suffered both wind and water damage. The restaurant was insured by two separate insurance policies, a flood policy issued by Omaha Property and Casualty ("Omaha") and a comprehensive commercial policy with property insurance, windstorm insurance and BI Insurance issued by Argonaut Great Central Insurance Co. ("Argonaut"). Omaha covered damages from flooding and tidal waves, whereas Argonaut excluded such damages.

After the storm, Argonaut claimed that the major damage was due to the flood-

ing, but was willing to grant recovery for three days of lost business income. Omaha agreed that most of the damages were due to flooding. The policyholder sued for losses he claimed that Argonaut owed under the commercial policy. The trial judge granted the restaurant damages for broken windows and concluded that the policyholder had suffered serious business losses for which Argonaut was liable. On appeal, the appellate court affirmed, granting coverage under the Argonaut policy even though the floodwaters caused the majority of the damage. The court then allocated the property damages among Omaha, for flood damages, and Argonaut, for damages caused by wind. The appellate court affirmed the trial court determination that Argonaut was liable for 25% of the losses. Argonaut was therefore liable for 25% of the business interruption losses in the first year.

Concluding that the flood damage was more substantial and would take longer to repair than the windstorm damages, the court held the property carrier, Argonaut, liable for only 15% of the business interruption losses in the second year following the storm. Arguably, this case may support allocating BI Insurance losses among multiple causes by a percentage of causation approach.

B. Other Jurisdictions on Causation: Wind v. Water

Full Recovery Despite Multiple Contributing Causes

Some jurisdictions allow the policyholder to recover completely, even when excluded concurrent causes contribute to the asserted damages. *In Providence Washington Ins. Co. v. Cooper,* 223 S.W.2d 329 (Tex. App. 1949), a frame building was struck by a severe windstorm accompanied by snow. The snow remained for several days causing the roof to sag and eventually cave in. The insurer argued the cause of the damage was snow, which was excluded. The court agreed with the jury that found the dominant and efficient cause was windstorm as witnesses heard cracking of supporting timbers during the windstorm. See also *Trexler Lumber co. v. Allemannia F. Ins. Co.,* 136 A. 856 (Pa. 1927) (granting full recovery when windstorm proximately caused shed destruction and snow was merely a contributing cause).

Reduced or Precluded Recovery: Doctrine of Concurrent Causation

However, some courts apply the doctrine of concurrent causes. This doctrine provides that when covered and non-covered perils combine to create a loss, the insured is entitled to recover only that portion of the damage caused solely by the covered peril(s). *Wallis v. United Services Auto. Ass'n.,* 2 S.W.3d 300 (Tex. App 1999).

In *Niagara Fire Ins. Co. v. Muhle,* 208 F.2d 191 (8th Cir. 1953), the Missouri River flooded the policyholder's farm and buildings, but, other than the presence of water, did no further structural damage to the buildings. A tornado then struck the area, collapsing walls, shifting the foundation and damaging the roof. The policy sued upon provided coverage for damage from windstorm, but excluded losses from high water, whether driven by wind or not.

The insurer presented expert testimony to the effect that high water was an active instrumentality in causing the damage. The tornado caused the air inside the buildings to expand with explosive force, pressuring standing water in the buildings to force outwardly against the walls, which caused or directly contributed to the damages. The court stated that the lower court correctly instructed the jury that if the damage was "the result of the combined force of the water and wind, or the water driven by the wind, then it would be your duty to find for the defendant because that would not be direct loss or destruction as a result of the windstorm." The court further held that it was not unreasonable to infer that the explosion of the air could have pushed out the walls even absent standing water. Such being the case, the policyholder could not be denied recovery because of the standing water.

Despite these determinations, the Eighth Circuit reversed the trial grant of full recovery to the policyholder and remanded the case for a new trial on the ground that the plaintiff's evidence had failed to fix the amount of damage directly caused by the wind, and to separate it from the damage previously caused by the standing water.

Concurrent causes can even present a complete bar to recovery. In *Palatine Ins. Co. v. Petrovich*, 235 S.W. 929 (Tex. App. 1917), the court held that sea water sufficiently contributed to hurricane and flooding losses to preclude recovery. A policyholder's house was engulfed by wind-driven waters and completely destroyed. The policy insured against direct loss by windstorm, but excepted loss occasioned directly or indirectly by tidal wave, high water or overflow. The court held that the water was at least a contributing factor in the damage and as a concurrent cause brought the loss within the exception and prevented recovery.

The court stated that the insurer's obligation under the policy was not divisible where the insurer could be held liable for *any* part of the loss shown to have been proximately caused by high water. If the policy had insured partly against wind and partly against water it would have been necessary for the court and jury to distinguish between the two elements of damage, and to find and apportion to each its proper and proportionate amount of the actual loss suffered.

Proving causation is critical when an excluded concurrent cause presents an absolute bar to recovery. In *Firemen's Ins. Co. v. Senseney*, 250 F.2d 130 (4th Cir. 1957), the policyholder sued on a windstorm policy which excluded loss from water, whether wind-driven or not. The sole question was whether the damage to

the policyholder's house was caused by another house blown against it by the wind, or whether the other house was floated against it by wind-driven tidal waters.

After the case was heard without a jury, the district judge found that there was no testimony indicating that water blown in from the sea ever reached a depth of more than 30 inches. Pointing out that there was a 32-inch fire hydrant in front of plaintiff's cottage which had not been damaged or scarred, the court reasoned that if a high wave had propelled another house against the policyholder's, it would necessarily strike and damage the fire hydrant. The judge concluded that the absence of such evidence signified that wind blew another house through the air, over the hydrant, and hence the loss was the result of windstorm and not the excluded peril. The Fourth Circuit affirmed the judgment of the lower court and stated that the question involved was purely one of fact, and that nothing in the record could justify finding the trial court had erred.

In cases of concurrent winds and floods, courts may be hesitant to undertake the burdensome effort to apportion losses between covered and excluded perils. This appears particularly true if one cause of loss is dominant. In *Home Ins. Co. v. Sherrill*, 174 F.2d 945 (5th Cir. 1949), the policy excluded damage from high water, whether driven by wind or not. A hurricane caused major structural damage to a building, which subsequently flooded. In affirming judgment for the plaintiff, the Fifth Circuit stated that whether the building was destroyed by the sole and direct action of the wind before the water rose to contribute to the injury was a question of fact. Given that the parties stipulated that the sole issue at trial was whether the insurer was liable for the full amount of the policy or not at all, the court refused to "split hairs" as to whether water, rather than the wind, did minor damage after the hurricane flattened the building. In such disputes, the question of fact is determined by the trier of fact, and deserves deference.

V. DAMAGES

Although an extensive survey of damages in business interruption claims is beyond the scope of this paper, one case on damages is worth noting because it highlights the kinds of problems that courts might encounter in attempting to quantify damages, and a way that some of the issues may be addressed.

In *Nerco Oil & Gas, Inc. v. Otto Candies, Inc.*, 74 F.3d 667 (5th Cir. 1996), a vessel collided with an oil and gas drilling platform that caused a shutdown of production on the drilling platform for 130 days. The operator sought damages for loss of production, and the defendant asserted that production was only delayed, not lost. Siding with the plaintiff, the court observed that a delay in production is, in essence, a loss of production, considering among other things, the time value of money, the loss of cash flow during the shut-in period, and the additional time necessary to recover all oil and gas from the reservoir. This case may be instructive as courts grapple with claims for lost income that are difficult to measure.

VI. EXTENDED BUSINESS INCOME

Although policy language varies greatly, many policies contain language providing for "extended business income" after the "period of restoration" has been concluded. The idea is simple: after the physical repairs have been made, the policy covers additional business income losses incurred while the business is getting back up to speed to the point where it was prior to the loss.

Implementation of this simple idea can be a challenge. As policyholders pursue these claims, they will likely confront and be perplexed by exclusions or limitations for "unfavorable business conditions." One such exclusion reads:

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In the aftermath of Hurricane Katrina, Mr. Geary is handling a number of property and business interruption insurance coverage disputes. In April, he was named by *New Orleans CityBusiness* magazine as one of the community's Leaders in Law for his success in practice and his contributions to the community following the Katrina disaster.

Mr. Geary is a member of the American Bar Association, Defense Research Institute, Louisiana State Bar Association and Federal Bar Association.

He received his J.D. from Louisiana State University in 1984, and a B.S. from Washington and Lee University in 1980. Mr. Geary is licensed to practice in all Louisiana federal courts, Northern and Southern Districts of Texas, District of Colorado, and the U.S. 5th Circuit and 10th Circuit Courts of Appeal.

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> . . . Extended Business Income does not apply to loss of Business Income incurred as a result of unfavorable business conditions caused by the impact of the Covered Cause of Loss in the area where the described premises are located.

Clauses such as this were the subject of dispute following the Sept. 11, 2001, terrorist attacks, as a number of insureds made the argument that their "period of restoration" should extend until the time that the World Trade Center ("WTC") could be reconstructed. Although that argument failed, courts then construed the extended business interruption clauses.

In *Duane Reed, Inc. v. St. Paul Fire and Marine Insur. Co.*, 411 F.3d 384 (2nd Cir. 2005), the insured owned retail stores in the WTC. When the district court judge ruled that the retailer was entitled to recover for BI losses until it could resume "functionally equivalent operations in the location where its WTC store once stood,"[5] the insurer appealed, arguing that such an interpretation essentially rewrote the policy. *Id.* at 392 (quoting the lower court). The Second Circuit agreed, holding that the "period of restoration" only should extend until the retailer could "build a reasonably equivalent store in a reasonably equivalent location." *Id.* The court noted that allowing the period to include all time until the WTC store reopened would conflict with the insured's "Extended Recovery Period."[6] It noted that the parties contracted for extended indemnity, and the lower court's ruling "leaves no room for the Extended Recovery Period to operate." *Id.*

In *Hold Bros., Inc. v. Hartford Cas. Insur. Co.*, 357 F.Supp.2d 651 (S.D. N.Y 2005), the insured sought consequential damages, including lost business and increased costs, stemming from the insurer's alleged breach of its business interruption policies after Sept. 11. The insurer argued that an exclusion precluded liability for failure to properly indemnify. The exclusion provided that the insurer "will not pay for loss or damage caused by or resulting from… Consequential losses: Delay, loss of use or loss of market." *Id* at 658. The court disagreed, and held that the provision "appears in the context of exclusions from coverage of certain kinds of losses," and did not function to eliminate the availability of consequential damages. *Id.*

In the end, claims for extended business income are in largely uncharted waters, given the lack of jurisprudence addressing "loss of market" limitations. Courts might look to jurisprudence defining the "period of restoration" and hold that the business interruption insurance is triggered only by property losses, which do not include loss of customers. Insureds may have an argument, however, that the entire extension of coverage with an exclusion that eliminates the coverage is meaningless, and that the exclusion is invalid as an illusory promise.[7]

ENDNOTES

[1] For additional discussion of issues arising under business interruption policies, see William H. Danne, *Business Interruption Insurance*, 37 A.L.R.5th 41 (2005).

[2] The doctrine, commonly referred to as proximate causation or efficient causation, is "the all but universal method used in the United States for resolving coverage issues involving the concurrence of covered and excluded perils." *See* Mark K. Wuerfel, "Efficient Proximate Causation" in the context of Property Insurance Claims, 65 Def. Couns. J. 400 (1998).

[3] The absence of the word "physical" in the windstorm insurance cases that address "direct loss" (not "direct physical loss") is likely of no concern. Courts have held that losses and damages necessarily mean "physical" losses and damages. See *United Airlines, Inc. v. Ins. Co. of the State of Pa.*, 2005 WL 756883 (S.D. N.Y.) ("The policy does not define 'physical loss or damage.'" Nevertheless, courts have largely held that "[t]he plain and ordinary meaning of the word 'damage' conveys physical damage and … the word physical need not precede the word damage to convey that meaning." (internal quotation omitted).

[4] Note that this language was quoted by the Fifth Circuit in *Kemp*, 391 F.2d at 534-35, even though that case was decided under Mississippi substantive law.

[5] At the lower court level, the judge ruled that the specific property at the WTC had been insured, not the WTC complex itself, so the time period extended only until the store itself, within the WTC, could be rebuilt. The court also held that the insured property was the store itself, not the retailer's business in general. Even the lower court rejected the insured's argument that the "period of restoration" should extend until its overall business returned to pre-Sept. 11 levels.

[6] The policy provision was essentially identical to Liedehiemer's, except that it granted recovery for a year and didn't include the purported exclusion of losses from unfavorable business conditions caused by the Covered Cause of Loss.

[7] The author thanks his many colleagues who assisted in the preparation of this paper including Amy Glovinsky, Jay Rosenquest, Joshua Lewis and Thomas Morante. The views expressed in this paper are those of the author and not those of the firm. Each case may turn on its facts and policy language.