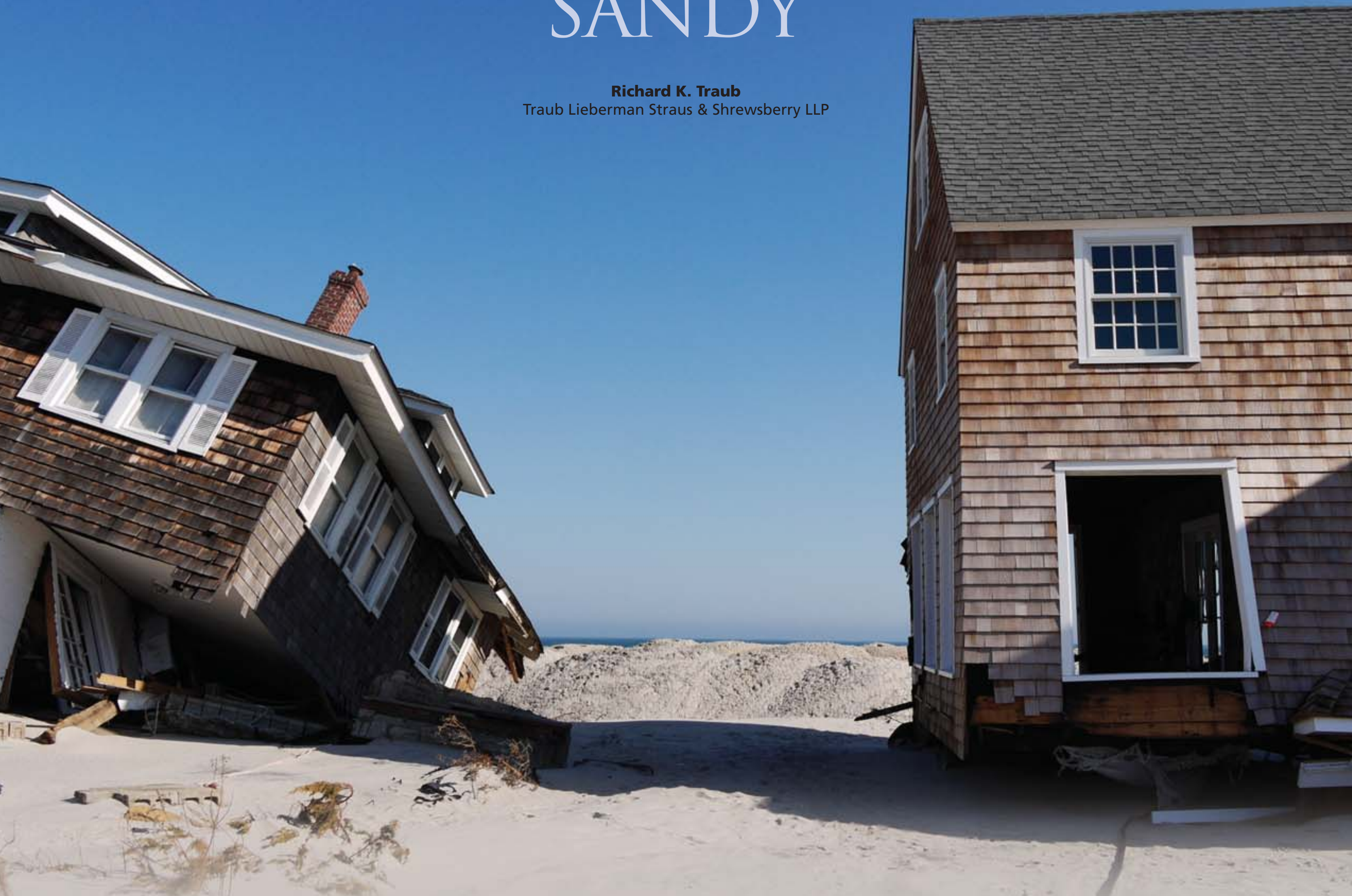
BUSINESS INTERRUPTION CLAIMS SURGE AHEAD

UNPRECEDENTED LOSSES ANTICIPATED FOR SUPERSTORM SANDY

Richard K. Traub
Traub Lieberman Straus & Shrewsberry LLP



What was heralded by the media as the "Frankenstorm" lived up to its monstrous name when it pummeled the East Coast from North Carolina to Maine in late October of 2012. Hurricane Sandy, which was downgraded to Post-Tropical Cyclone Sandy and is now referred to as "Superstorm Sandy," was one of the most economically damaging storms in U.S. history. The storm first made landfall on October 29, 2012, and months later the scale of the damage is still being assessed. Whereas the physical destruction of property was immediate, businesses in the storm's path sustained a second wave of economic losses which are likely to reach historic levels. The states affected by Superstorm Sandy account for about 23 percent of the U.S. gross domestic product. As a result, the impact of the disaster is certain to stretch beyond the East Coast. In that vein, insurers can expect not only business interruption (BI) claims from businesses on the East coast, but also contingent business interruption (CBI) claims from suppliers and customers worldwide. The ripples of Superstorm Sandy's economic impact are mounting by the day and insurers are bracing for unprecedented losses. Facing economic devastation that may threaten their own viability, business will look to their insurers to cover those losses under business interruption or time element coverage.

Although most policies limit coverage for property damage to losses to the insured's property resulting from a covered peril, many claims are not confined to damages resulting from a single, indivisible cause of loss. Instead insurers are often presented with a claim which stems from both a covered cause of loss and a non-covered cause of loss. The quintessential example of this scenario is a claim arising out of both wind and flood damage, where the subject policy covers damage caused by wind but precludes coverage for damage resulting from flood. In that context, the preliminary issues to address are each state's posture regarding concurrent causation and the enforceability of anti-concurrent causation (ACC) clauses. A majority of states employ the "efficient proximate cause" doctrine in determining causation for insurance coverage purposes. Under this theory, as long as a covered peril is the predominant cause of damage or sets into motion a chain of events leading to the loss, coverage is extended to the insured. In an effort to avoid liability in states that find in favor of coverage where multiple causes exist, insurers introduced ACC clauses into property policy forms. Generally these clauses include language that excludes coverage when any portion of a loss was caused by an uncovered peril. The vast majority of states that have ruled on ACC clauses have upheld their validity.[1]

Superstorm Sandy claims will undoubtedly move beyond the already complex case law regarding ACC clauses and into the arena of business interruption (BI) claims. In past catastrophes, BI losses have accounted for as much as half of the total insured losses. Given the economic vibrancy of the impacted area, BI losses are certain to be a significant portion of the total insured losses from Superstorm Sandy. The most interesting and complex BI claims are those flowing from physical damage caused by covered and uncovered claims, often in the context of property damaged by both wind and flood. In that scenario, insurers may invoke ACC clauses to deny coverage for BI losses resulting from the indivisible combination of wind and flood damage, while insureds may contend that the covered wind loss alone was enough to result in a suspension of operations. Unsurprisingly, policyholders and insurers often disagree as to whether loss arises from concurrent or divisible perils, leaving courts to make these determinations in light of ACC clauses and battling expert opinions.

The most straightforward application of BI coverage occurs when the damage that actually causes the business to suspend operations is attributable only to one source, either covered or excluded. In disaster scenarios such as Superstorm Sandy, damage is often difficult to separate into covered and non-covered categories. When the distinction can be made, though, and a trier of fact finds that all of the damage to an insured property was caused by a covered peril, then BI coverage will likely be available.

A more problematic scenario occurs where some excluded and covered damage is intermingled. In these instances, expert opinions are crucial in determining coverage. In *Buffman Inc. v. Lafayette Ins. Co.* 36 So. 3d 1004, 1019 (La.App. 4 Cir. 2010), a Hurricane Katrina case, the insured suffered both covered wind damage to its roof and excluded concurrent flood-wind damage to the rest of the building. An ACC clause applied and coverage was denied for the concurrent wind and flood damage to the majority of the building. Damage to the roof, however, was found to be exclusively caused by wind and the court held that BI coverage applied in relation to the roof damage. A battle of the experts ensued but both experts had to limit their opinions exclusively to damage and repair costs related to the roof.

Where circumstances like those in *Buffman* exist, the difficult task of calculating the period of restoration is apparent. Insurers and ultimately courts must determine the period of restoration for only the covered damage. Experts will be called upon to isolate the covered damage despite the existence of potentially extensive excluded damage to the rest of the property. If damage can be apportioned to two different causes, one covered and one excluded, then courts may turn to expert testimony to calculate the period of restoration based on repair of the covered peril alone. Moreover, the definition of "period of restoration" may be scrutinized to determine what scope of coverage is warranted under the policy's language. The calculation of the period of restoration will rely on highly scrutinized and hotly contested expert testimony as to what "reasonable speed" and "similar quality" mean in each case.

The courts' willingness to parse out covered and excluded damage is apparent in cases where an ACC clause does not apply, as was the case in another Hurricane Katrina case, *Yount v. Lafayette Ins. Co.* In *Yount* the court held that a doctor's office "did sustain direct physical loss and damage as a result of the wind and rain, and not due to direct contact with the floodwaters. Further, we find these losses and damages, alone, would have and did cause a suspension in the operation of Dr. Yount's medical practice." 4 So. 3d 162, 171 (La.App. 4 Cir. 2009). Correspondingly, given that a covered loss would have caused an interruption to the insured's business regardless of the excluded damage, BI coverage was triggered. Although an ACC clause would likely have prevented coverage, the court's determination that BI coverage is applied exclusively in relation to the covered loss lends support to the notion that the period of restoration calculation should disregard uncovered damage. This issue will undoubtedly arise in post-Sandy claims as the actual cause of damage is assessed for each claim.

In scenarios where there is concurrent causation for a single loss and an ACC clause applies, some courts have found BI coverage to be unavailable. Given that a general requirement of a BI claim is that it involves a covered peril, it is intuitive that where ACC clauses apply to preclude coverage to the underlying property, BI coverage for damage will likewise be barred. Indeed, the jurisdictions that enforce ACC clauses have found that loss must be solely caused by a covered peril in order to trigger property coverage and, therefore, BI coverage.

Many issues regarding business interruption coverage and ACC clauses remain unanswered. As insurers assess their liability in relation to BI claims it will be important to analyze the specific language in their policies as court rulings often hinge upon the specific terms of a policy. Insurers must be vigilant in their investigations and consistent in their policy interpretation to avoid bad faith claims from policyholders. Differentiating between BI losses that arise out of covered perils, excluded perils, or a combination of covered and uncovered events will be crucial. This task is likely to be further complicated in the wake of the relaxed proof of loss standards and heightened deadlines for investigation issued by government officials.[2] Superstorm Sandy may have dissipated, but her effects will surely linger for some time to come.

Richard Traub is a founding partner of Traub Lieberman Straus & Shrewsberry LLP and practices in the firm's insurance coverage, construction litigation, environmental, products liability (including pharmaceuticals), litigation management and technology areas. He has represented numerous manufacturers; design professionals and contractors in all phases of construction projects; insurers and reinsurers in connection with coverage litigation; and has been extensively involved with technology, privacy issues and disaster management.

1 Only California, Mississippi, West Virginia, and Washington have rejected or limited the application of ACC clauses.

2 Delaware, Maryland, New Jersey, and New York have specifically altered insurance regulations in regards to Sandy claims.