Hurricane Season is Here – Is Your Insurance Program Ready for the Next Storm?

By James P. Bobotek

The challenges normally inherent in presenting business interruption and other economic claims were dramatically magnified with Sandy. A policy review before the next storm arrives will provide the opportunity to ensure that you understand the coverage you purchased before a loss occurs.

Last fall, Superstorm Sandy ripped across the East Coast, causing unprecedented damage to coastal and inland areas lying in its path. Making landfall near Atlantic City, N.J., the storm wreaked havoc from North Carolina to Connecticut, and as far inland as the Great Lakes. Sandy also caused tidal surges that inundated Lower Manhattan and flooded New York's airports, knocked out critical infrastructure including power, rail, and subway systems, and destroyed tens of thousands of homes. The storm caused at least $50 billion in physical damage, while tens of thousands of businesses that suffered little or no physical damage nonetheless experienced catastrophic business interruption losses.

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As is the case after any natural catastrophe, businesses affected by Superstorm Sandy promptly turned to their insurance carriers for help. Many insurance policyholders were taken aback by the significant obstacles insurers placed before them in responding to their property and business interruption insurance claims. Sandy was a wake-up call for policyholders in the Northeast, many of whom previously had perceived the risks associated with hurricane, flood, and storm surge damage as inconsequential. Given that the National Oceanic and Atmospheric Administration and other organizations have predicted "extreme activity in the Atlantic" this hurricane season, with "more and stronger hurricanes" expected, there is no better time to review your property insurance coverage. The discussion below provides an overview of some insurance coverage-related issues facing commercial policyholders after a catastrophic storm.

Review Sub-limits and Deductibles for "Named Storm" and "Flood" Coverage

Commercial policyholders should be aware of the distinction between coverage for "Flood" perils and "Named Storm" perils. This post-Sandy issue arises out of property insurers' attempts in recent years to limit their exposure to flood risks in Northeast coastal areas by reducing policy sub-limits and increasing deductibles. While many insurers restricted coverage for "Flood" perils in this fashion, in many cases they did not include similar limitations for "Named Storm" perils. Many policies categorize certain counties in New York, Connecticut, and New Jersey as high-risk flood zones, but low-risk areas for Named Storm perils.

The assumption was that the likelihood of a "Named Storm" walloping the tri-state area was remote (despite a close call in 2011 from Hurricane Irene) – particularly in comparison to the likelihood of a "Flood" event. Yet, as Sandy hit businesses with a double-whammy of hurricane force winds and resulting flooding, many insurers asserted applicability of the lower sub-limits and higher deductibles tied to Flood perils, instead of the more policyholder-friendly "Named Storm" sub-limits and deductibles. This has led to a significant number of disputes, and in cases in which policyholders are not aware of this distinction, loss of potentially significant coverage.

Beware of Concurrent Causation Language for Losses Involving Both Covered and Non-Covered Perils

Superstorm Sandy has compelled policyholders and insurers alike to scrutinize policy language and case law for guidance on the extent to which a loss is covered

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when caused concurrently or sequentially by perils that are covered (such as Named Storm, fire, or wind-driven rain) and also by perils that are expressly excluded or sub-limited (such as flood or pollution). Whether coverage exists for a loss in such a situation varies from jurisdiction to jurisdiction because courts have not yet developed a uniform approach in determining whether or not coverage is available in these situations. Some courts apply the broad doctrine of "concurrent causation," whereby coverage will be available if any one of the multiple causes of loss is a covered peril. Other courts apply the "efficient proximate cause" theory, whereby the fact finder looks at the circumstances of the loss to determine which cause was the dominant or efficient cause (which may or may not be the initiating event in the chain of events). The analysis of causation in each case requires a careful and searching inquiry into the circumstances of the loss, and is highly fact-specific.

The causation analysis may also depend on whether a policy includes "anti-concurrent causation" ("ACC") wording. Insurance companies have attempted to eliminate the need for courts to search for the efficient proximate cause, or even to consider multiple causes, by incorporating ACC clauses into certain exclusions in property policies. These clauses attempt to preclude any claim that involves the particular excluded peril, even if it is only one of multiple causes of the loss. Such clauses were challenged following Hurricane Katrina and other recent catastrophes. Because some courts have upheld their application, some states have recently introduced legislation to prohibit them or, at a minimum, to provide an express warning in the policy of their inclusion.

Identify Challenges of Proving Contingent Business Interruption Loss

Although many companies have experienced loss due to "Contingent Business Interruption" ("CBI") – that is, the adverse economic impact on the insured resulting from damage to the property of its customers and suppliers – proving CBI loss can present significant challenges. Policies usually offer little guidance on the proof required to establish that a loss of business is attributable to the impact of a covered peril on a policyholder's customers or suppliers. For example, with Sandy, retailers in Lower Manhattan suffered major losses because their customers were affected; however, as a condition to payment under CBI provisions, many insurers required these policyholders to prove exactly which customers were affected by the storm – a burden that is challenging to meet, and, in the opinion of most experts, highly unreasonable. Requiring policyholders to overcome such evidentiary burdens as a condition to coverage is almost certainly contrary to the reasonable expectations of the commercial insured.

In the best of circumstances, proving losses due to damage to a supplier is difficult for policyholders. The insured typically does not have access to the suppliers' records, suppliers may fail to document their damages or repairs, and suppliers often have commercial reasons for not disclosing the cause or magnitude of their losses. The same is true of customers. In the case of gasoline station operators, for example, who were unable to secure adequate supplies due to flooding and closure of tank farms and distribution facilities, insurers are requiring proof of damage to facilities of suppliers, who are generally reluctant to disclose information about their operations.

Review Civil Authority, Ingress/Egress, and Service Interruption Coverage Language

After a catastrophic storm, commercial policyholders may benefit from having Civil Authority, Ingress/Egress and Service Interruption insurance coverage. However, it is important to review these coverages and understand their potential limitations and restrictions.

Civil Authority provisions provide coverage for an insured's business interruption losses resulting from orders of civil authority, such as evacuation orders, curfews, highway closures, and the like, which prevent or impair access to the insured's property. However, many Civil Authority coverage provisions contain limitations and restrictions that can make it challenging to establish when Civil Authority coverage begins. For instance, most policies require that the governmental order be the result of physical damage "of the type insured," and not just a preventive or general public safety measure. Some policies require that the physical damage be within a limited distance of the insured's location. Also, in the case of Sandy, insurers have resisted this coverage by arguing that while there were numerous orders affecting business, the orders were not the direct result of physical damage, but rather to prevent harm to public health and safety. In some cases, insurers have claimed that the insured has not demonstrated the orders were the result of physical damage to property of the type insured, within a certain distance of the insured's premises. Likewise, insurers have argued that the orders did not totally prevent or prohibit access.

In addition to orders of Civil Authority that restrict access to an insured property, storm-related physical damage may limit an insured's ability, or the ability of its customers or employees, to enter or exit its property. Ingress/Egress coverage typically insures business

interruption losses incurred when access to or from an insured's premises is "physically prevented" by the loss or damage. Even if a governmental authority does not issue an evacuation order, storm or flood damage may limit access to a business or property and result in business loss. Ingress/Egress clauses, which can extend business interruption coverage where property damage "in the vicinity" (such as flooding, downed power lines, road closures, snow, or fire) restricts access to insured premises.

When utility services to insured premises are interrupted, Service Interruption coverage may be available to cover damage to property (e.g., spoiling of refrigerated food or medicine) and loss of income or extra expense. The coverage for such interruption can be substantial, including payroll incurred when the company is closed, loss from event cancellation, extra expense, contractual penalties and lost profits. Post-Sandy disputes have arisen under this coverage, particularly with regard to whether the coverage applies to loss of power caused by damage to electrical equipment away from an insured's premises. Service Interruption coverage generally requires damage to the property of a utility supplier used by the insured, and sometimes includes requirements that the damage occur within a specified distance to the insured property, or even on the insured property. Service Interruption coverage would typically apply to power outages where overhead power lines downed by a storm or physical disruption to a transformer or generating station prevent a manufacturing plant or hotel from operating normally.

Conclusion

After striking heavily populated areas and wreaking unprecedented destruction, Superstorm Sandy left a legacy that will have lasting repercussions for the field of insurance coverage. Major disputes with insurers, including some already in the courts, will challenge conventional wisdom regarding Flood and Named Storm coverage. In one sense, we have all been here before– numerous issues raised and litigated with respect to Hurricane Katrina and other catastrophes are emerging again. As in every catastrophe, however, the unique aspects of Sandy have presented new challenges and opportunities to maximize coverage. One point on which all those knowledgeable about these nuances agree is that the challenges normally inherent in presenting business interruption and other economic claims were dramatically magnified with Sandy. A review of your policy before the next storm arrives will provide the opportunity to ensure that you understand the coverage you purchased before a loss occurs.