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Memorandum

Business Interruption Coverage in Hurricane Harvey's Aftermath

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As Texas and the Gulf Coast grapple with the devastation caused by Hurricane Harvey, affected companies will likely focus on business interruption coverage to alleviate their losses. Doors of many businesses remain closed, curfews and orders of civil authority have restricted access, and forces of nature have prevented ingress and egress in certain areas. There has been massive destruction in the commercial context, with untold lost business income and commercial property losses. Insurers will soon be forced to confront the difficult task of determining the scope of business interruption coverage available to their policyholders.

The issues insurers will be called upon to consider include:

- Whether the insured sustained a total cessation of operations, because business interruption coverage generally requires a complete suspension of operations;
- Whether a supplier or receiver of the insured's goods or services suffered property damage of the type insured against, because such property damage is usually a prerequisite to contingent business interruption coverage—an interruption of the supplier or receiver's business alone is generally not sufficient;
- When the insured's (or supplier's) property should be repaired, rebuilt or replaced with reasonable speed and similar quality, given that the period of time for which the insured would be entitled to business interruption losses is usually a "theoretical" period of restoration;
- Whether an order of civil authority denied access to the insured's property as a direct result of damage of the type insured against, because civil authority provisions often require such property damage for coverage to apply, and civil authority orders issued purely to prevent damage—and not as a *result* of damage—are generally not covered;
- The rationale for curfews, because many policies only cover business interruption losses resulting from curfews imposed as a result of property damage on or near the insured's property; and

- The extent to which and reasons why ingress or egress to the insured's property was limited, because ingress/egress provisions usually require that the prevention of ingress or egress be to the insured's property itself, and it often must be a result of property damage.

Although courts considered many of these issues following the September 11 terrorist attacks and previous hurricanes, the body of law in this area is limited. Set forth below is a summary of case law dealing with these issues from courts throughout the country and, when possible, Texas state and federal court decisions.

I. Business Interruption and Contingent Business Interruption Insurance

Where an insured has suffered covered property damage, business interruption clauses typically provide coverage for business interruption losses an insured sustains "due to the necessary suspension of your 'operations' during the 'period of restoration.'"[1] Thus, it is important to ascertain the precise reason for any hurricane-related closure when determining a policyholder's entitlement to business interruption coverage. While many businesses may be closed due to property damage, others may close for other reasons (such as orders of civil authority), for which a policyholder may not have secured coverage. Additionally, because courts have interpreted "suspension" of operations to mean complete cessation of activity, an insured that seeks coverage for reduced hours of operation, for example, may not be entitled to coverage. [2]

Contingent business interruption coverage indemnifies losses incurred by policyholders resulting from damage to the property of a third-party supplier of goods or services. Cessation of business in storm-damaged areas will suspend the shipment of goods (especially oil and gas) to other areas of the country. If companies, relying on these goods cannot operate due to this suspension, the resulting losses may be covered by contingent business interruption provisions. In this way, the effects of Hurricane Harvey could spread well beyond the places actually hit by the storm.

But this contingent interruption coverage has limits. Importantly, a disruption in a supplier's ability to operate that is not caused by damage to the supplier's property will likely fall outside the scope of contingent business interruption coverage. For example, in *Pentair, Inc. v. American Guarantee & Liability Insurance Co.*,[3] an earthquake struck Taiwan, disabling an electric power substation. That substation provided power to two factories that manufactured products for a subsidiary of Pentair, Inc.[4] However, because the contingent business interruption provision extended coverage to losses incurred by Pentair as a result of "damage" to "property of a supplier of goods and/or services to the Insured," and the only damage that

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[1] *Home Indem. Co. v. Hyplains Beef, L.C.*, 893 F. Supp. 987, 990 (D. Kan. 1995).

[2] *See, e.g., Quality Oilfield Prods., Inc. v. Michigan Mut. Ins. Co.*, 971 S.W.2d 635, 638 (Tex. App. 1998).

[3] 400 F.3d 613, 614 (8th Cir. 2005).

[4] *See id.*

occurred was to the electric power substation (which did not supply power to Pentair itself), Pentair was not entitled to coverage under this provision.[5]

Pentair limits coverage to circumstances where the supplier itself has suffered property damage. So businesses with suppliers unable to operate for reasons other than property damage to the supplier itself—for example, due to evacuation orders or lack of power or running water—would not be entitled to contingent business interruption coverage.

II. Identifying the Period of Restoration

Given that business interruption coverage (and contingent business interruption coverage) is generally only available for the length of time often referred to as the "period of restoration," determining the appropriate period will be a critical factor in evaluating business interruption claims. The period of restoration generally begins on the date the physical damage occurred that caused the suspension of operations and terminates on the date by which the insured *should reasonably have* repaired, rebuilt, or replaced damaged property.

Identifying the appropriate termination date is particularly challenging because it does not involve looking at when the insured did, in fact, repair, rebuild, or replace its property, but rather when the insured *could* have done so. For example, in *SR International Business Insurance Co., Ltd. v. World Trade Center Properties LLC*, although the insured sought to recover its World Trade Center rental losses for the actual time necessary to rebuild the properties, the court held that the restoration period was "theoretical," even though the insured was actually rebuilding its property.[6]

Additionally, delays in reconstruction beyond the control of the insured—for example, a shortage of labor or materials needed to rebuild—are generally found to be reasonable so long as the insured acted with due diligence in attempting to restore the property.[7] But where a business has the ability to resume business, but

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[5] *Id.* at 614-15.

[6] No. 01 Civ. 9291 (MBM), 2005 WL 827074, at *6, *8 (S.D.N.Y. Feb. 15, 2005). *See also Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co.*, 411 F.3d 384, 393 (2d Cir. 2005) (holding that the reasonable restoration period for a business inside the World Trade Center was dependent only on the reasonable time needed to restore operations in a permanent location reasonably equivalent to the site of its former store at the World Trade Center, rather than exact site of former store); *Lexington Ins. Co. v. Island Recreational Dev. Corp.*, 706 S.W.2d 754, 756 (Tex. App. 1986) (upholding trial court's interpretation that the specific policy language at issue permitted restaurant to recover business interruption losses during period restaurant had re-opened but had not yet returned to previous level of operation).

[7] *See, e.g., Pontchartrain Gardens, Inc. v. State Farm Gen. Ins. Co.*, No. Civ.A. 07-7965, 2009 WL 86671, at *9 (E.D. La. Jan. 13, 2009) (suggesting that delay in indemnifying property damage claim may extend the time the insured reasonably needed to rebuild).

chooses not to—even if for reasons related to the damaging event—courts find that the period of restoration ends when the business could reopen.[8]

III. Civil Authority Coverage

Orders of civil authority have been issued over the past week or so, including evacuation orders and curfews. The scope of civil authority coverage, where afforded in commercial first-party insurance, can vary based upon the language of the policy. For example, some civil authority provisions require the order to have been issued as a direct result of damage to insured property, while others require the damage be to adjacent property, and still others do not contain that requirement at all but are concerned instead that the order be a direct result of a peril insured against. In the post-Harvey arena, this distinction may be particularly important where orders of civil authority prohibited access beyond areas that actually sustained damage from the hurricane for safety reasons or to prevent looting. Some policyholders may also seek civil authority coverage as a result of orders that affected (but did not actually prohibit) access to their property, for example, by prohibiting access to surrounding areas. Courts generally require a *complete* denial of access *to the covered property* in order for civil authority coverage to be implicated.[9]

Notably, courts have been reluctant to find that curfews implicate civil authority coverage, particularly where the curfews were not a direct result of property damage on or near the insured's property.[10] However, some courts have not required physical damage for civil authority coverage to apply.[11]

There will likely also be questions concerning purely preventative orders of civil authority. To the extent that areas were evacuated pre-hurricane in anticipation of property damage, policyholders may not be entitled to civil authority coverage for that period of time. Civil authority coverage is only available where orders of civil authority are made because property has been damaged, not because of the *threat* that property will be

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[8] *See, e.g., Admiral Indem. Co. v. Bouley Int'l Holding, LLC,* No. 02 Civ. 9696 (HB), 2003 WL 22682273, at *4 (S.D.N.Y. Nov. 13, 2003) (holding that the period of restoration had ended where a restaurant owner delayed reopening to serve food to the Red Cross during post-September 11 aid efforts).

[9] *See, e.g., Abner, Herrman & Brock, Inc. v. Great N. Ins. Co.,* 308 F. Supp. 2d 331, 337 (S.D.N.Y. 2004) (finding that traffic restrictions which merely made it *difficult* for customers to access the covered property were insufficient to implicate business interruption indemnity); *730 Bienville Partners, Ltd. v. Assurance Co. of Am.,* No. Civ.A. 02-106, 2002 WL 31996014, at *2 (E.D. La. Sept. 30, 2002) (holding that no coverage was warranted where the FAA prohibited flights into the affected city but there was no order prohibiting access to the insured's hotel for those actually in the city).

[10] *See, e.g., Syufy Enters. v. Home Ins. Co. of Indiana,* 94-0756 FMS, 1995 WL 129229, at *2-*3 (N.D. Cal. Mar. 21, 1995) (where civil authority coverage was denied because the curfew was not inspired by damage to the covered property); *Two Caesars Corp. v. Jefferson Ins. Co.,* 280 A.2d 305, 307-08 (D.C. Ct. App. 1971) (holding similarly).

[11] *See Sloan v. Phoenix of Hartford Ins. Co.,* 207 N.W. 2d 434, 436-37 (Mich. Ct. App. 1973) (holding that though theaters were not physically damaged, civil authority coverage applied because curfews were inspired by "widespread riots").

damaged.[12] But where a policy covered actual loss "caused by action of civil authority that prohibits access to the described premises, caused by or resulting from any 'covered cause of loss,'" one court found that coverage would be warranted even if the orders of civil authority were purely preventative (though this is likely dictum, as the court also found that actual damage in the evacuated area caused the order).[13]

IV. Ingress/Egress Coverage

Although very little published case law interprets ingress/egress coverage in the commercial first-party insurance context, several cases have resulted in differing outcomes, indicating that the availability of ingress/egress coverage may be highly dependent on the specific policy language at issue. For instance, the FAA's prohibition on flights into the City of Chicago immediately following the September 11 attacks was found to not be a covered business interruption because the policy excluded coverage for "indirect and remote damage."[14]

But in *Fountain Powerboat Industries, Inc. v. Reliance Insurance Co.*, the ingress/egress provision granted coverage for "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."[15] So a damage similar in remoteness to the City of Chicago's was found to be covered, as the ingress/egress provision did not require direct property damage.[16]

V. Conclusion

In the aftermath of Hurricane Harvey, many policyholders will seek coverage for business interruption losses. Many will not have experienced property damage themselves but may have suffered losses due to civil authority orders, the prevention of ingress and egress to their property, or the inability to receive goods or services from suppliers located in regions hit by the hurricane. The validity of these claims will largely depend on the particular circumstances of the claimed interruption and the language of the insurance contracts at issue. However, it is certain that insurers will be called upon to make coverage decisions for a great many claims where the policyholder did not sustain actual property damage losses. Even where the insured did suffer physical damage, there will be thorny questions concerning the period of restoration.

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[12] *See Dickie Brennan & Co. v. Lexington Ins. Co.,* 636 F.3d 683, 686 (5th Cir. 2011) (holding that no coverage was available because there was no nexus between hurricane evacuation order and prior property damage); *S. Texas Med. Clinics, P.A. v. CNA Fin. Corp.,* No. Civ.A. H-06-4041, 2008 WL 450012, at *10 (S.D. Tex. Feb. 15, 2008) (finding no causal link to "property damage" where there was only fear of future damage).

[13] *Narricot Indus., Inc. v. Fireman's Fund Ins. Co.,* No. Civ.A.01-4679, 2002 WL 31247972 (E.D. Pa. Sept. 30, 2002).

[14] *City of Chicago v. Factory Mut. Ins. Co.,* No. 02 C 7023, 2004 WL 549447 (N.D. Ill. Mar. 18, 2004).

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

[16] *See id.* at 557.

Accordingly, insurers must be prepared to analyze substantial claims in a sophisticated fashion in a legal context where there is some, but not extensive, case law.

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