

Now What Do We Do?

Time Element Claims Following a Megaloss

By Andrew B. Downs

Megalosses—whether due to natural disasters, terrorism, or garden variety human failures—have wider repercussions than typical first-party property insurance losses. They are more than mere catastrophes. They are losses where the impact is felt over an unusually wide geographic area or where the infrastructure for a significant region or metropolitan area is seriously damaged. Examples of megalosses would include the September 11, 2001, terrorist attacks, the Christmas 2004 tsunami in the Indian Ocean, and Hurricane Andrew in Southern Florida in 1992. Other catastrophic losses, while serious and often very expensive for both insurers and policyholders, do not have the characteristics of a megaloss. Examples of the latter would be the Florida and Gulf Coast hurricanes of 2004, the southern California fires of 2003, and the Oakland Hills fire of 1991. In simple terms, for the purpose of time element losses, a megaloss is one that changes the basic daily terms for doing business for some significant period of time because (1) business cannot be done, (2) customers or markets have disappeared, or (3) new customers and markets have appeared that cannot be catered to because of the damage sustained.

This article explores some of the aspects of business interruption coverage for megalosses.¹ It focuses

on period of restoration issues and issues relating to whether a complete suspension of operations is a condition precedent to coverage. (Equally important, but not discussed here, are ingress and egress issues and the actions of civil authorities.) Some of the questions this article hopes to answer are: (1) Is a complete suspension of operations required to trigger payment under a time element coverage? (2) What is the period of restoration? and (3) Should changes in business conditions created by the occurrence of a megaloss be taken into account in measuring the period of restoration, and if so, how?

Suspension of Operations

The current Insurance Services Office (ISO) Business Interruption and Extra Expense form applies to losses sustained by the insured “due to the necessary ‘suspension’ of your ‘operations’ during the ‘period of restoration.’”² “Suspension” is defined as “a. The slowdown or cessation of your business activities; or b. That a part or all of the described premises is rendered untenable, if coverage for Business Income including ‘Rental Value’ or ‘Rental Value’ applies.”³

This language is part of a fairly recent revision to the ISO form. Many other forms are also in use, including forms that require cessation, not simply slowdown, of the insured’s business. Most of the

forms used in the past required cessation or have been interpreted to require cessation. Thus, to the extent that the current ISO policy language is used in future policies, much of the total suspension/cessation jurisprudence is likely to be inapplicable. For example, the policy language in one of the more significant modern total suspension decisions, *Home Indemnity Co. v. Hyplains Beef, L.C.*,⁴ provided: “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.’”⁵ The *Hyplains* policy defined “operations” broadly: “Your business activities occurring at the described premises.”⁶

Following traditional policy language. In most circumstances, courts have interpreted policy language requiring suspension of operations to necessitate a total cessation of business operations at the insured premises, not just a slowdown or partial suspension of those operations. One of the leading cases espousing this view is *National Children’s Expositions Corp. v. Anchor Insurance Co.*⁷ In that case, the insured operated a children’s exposition in New York. Due to a severe storm, attendance at the exposition was significantly lower than anticipated. Anchor had issued a use and occupancy policy that provided that in the event of such “contingencies aris-

ing to prevent the holding of or continuance of the exposition, [the insurer] shall indemnify the assured for their actual expenses, monies advanced, obligations assumed and expected profits.”⁸

The Second Circuit Court of Appeals held there could be no recovery “in the absence of some interruption of this use and occupancy.”⁹ Because the exposition never closed, but simply operated with reduced attendance, the court concluded there was no coverage.

A California court reached the same conclusion in different factual circumstances in *Pacific Coast Engineering Co. v. St. Paul Fire & Marine Insurance Co.*¹⁰ Pacific Coast Engineering constructed a steel barge at its facility. Less than one hour before the barge was to be delivered to the buyer, it was damaged by an explosion and fire. Pacific Coast elected to have the repairs performed elsewhere, largely because it was less expensive and Pacific had enough other work. Pacific sought to recover under St. Paul’s business interruption coverage for penalties it paid to the barge owner on account of the delay in delivery, overtime expenses to expedite the postloss delivery of the barge, and the cost of the tug that had been chartered to tow the barge on the original delivery (and loss) date. The court held there was no coverage, explaining:

[I]t is our opinion that the business interruption insurance issued herein provides coverage

Andrew B. Downs is a shareholder in Bullivant Houser Bailey PC in San Francisco and Las Vegas. He is a former chair of the American Bar Association Tort Trial and Insurance Practice Section’s Property Insurance Law Committee. Andrew can be reached at andy.downs@bullivant.com.

only for losses resulting directly from interruption of the business, i.e., operation of the Plant, and not merely from interruption of the work being done on the construction of a particular product at the time of the occurrence of a peril insured against.¹¹

In the context of a volcanic eruption that caused significant local disruption, but that was not a megaloss in a national sense, the Washington Court of Appeal held that a motel near Mount St. Helens that did not close following the 1980 eruption there did not have a compensable business interruption loss for the reduction in its business following the eruption.¹²

A trio of more recent decisions have all concluded that disruption of business without a complete suspension is not covered under traditional business interruption policy provisions. The first of these cases is *Hyplains Beef*.¹³ Hyplains operated a slaughterhouse in Dodge City, Kansas. As part of a renovation of its slaughterhouse, Hyplains installed a “fabrication floor” to further process carcasses into various cuts of beef. In connection with that installation, Hyplains bought a computer system that was intended to collect data relating to inventory. Hyplains’s computer vendor was to complete the computer system by August 17, 1993. The system did not work on that date, nor was it operational until sometime after October 29, 1993. Despite the inoperable computer system, Hyplains began to use the new fabrication floor on August 17, as scheduled. According to the court, “[Hyplains] continued to operate to the best of its ability, and continued fabrication operations, despite the failure of the computer system to retain its electronic data.”¹⁴

The court concluded Hyplains’s loss of efficiency was not compensable as a business interruption loss. After quoting the policy language requiring a “necessary suspension” of operations, the court looked to the dictionary definition of suspension:

Webster’s Third New International Dictionary defines “suspension” as “the act of suspending or the state or period of being suspended, interrupted or abrogated.” “Suspended” is defined as “temporarily debarred, inactive, inoperative.” These definitions comport with what appears to be the common understanding of the term “suspension,” that is, that it connotes a temporary, but complete, cessation of activity. Thus, if one were to apply the plain, ordinary meaning to the use of the phrase “necessary suspension” within the policy, in order for a claim to fall within the coverage provision it would require that any direct physical loss of or damage to property result in the cessation of Hyplains’ operations. Further, in looking at the policy as a whole, the court does not find any other provisions that would indicate that the use of the phrase “necessary suspension” in the coverage provision should be given anything other than its common, ordinary meaning.¹⁵

The second more recent case is *Quality Oilfield Products, Inc. v. Michigan Mutual Insurance Co.*¹⁶ Quality’s offices were burglarized. The thieves took engineering drawings, computer data media, and design information that Quality used to process orders. Quality never ceased operations, but its activities were hindered significantly by the loss of the drawings, data, and design information. The policy Michigan Mutual issued to Quality provided business interruption coverage for “loss resulting directly from the neces-

sary interruption of business caused by damage to or destruction of real or personal property.”¹⁷ The Court of Appeals of Texas held that “interruption of business” was unambiguous and required cessation or suspension of business operations. Accordingly, it concluded that Quality could not recover under the business interruption portion of the policy.¹⁸

The third case is *Buxbaum v. Aetna Life & Casualty Co.*¹⁹ Aetna insured a law firm, and a covered water damage loss occurred in one of the firm’s offices. The attorneys employed in that office continued to bill time for the day the damage was discovered, as well as on subsequent days, albeit not at the more industrious and productive level they claimed they would have achieved had their offices not been damaged. The policy provided that Aetna would pay for the actual loss of business income sustained by the insured “due to the necessary suspension of [its] ‘operations’ during the ‘period of restoration.’”²⁰ The court, citing *Hylplains, Quality Oilfield, Keetch v. Mutual of Enumclaw Insurance Co., Howard Stores Corp. v. Foremost Insurance Co., National Children’s Exposition, and Pacific Coast Engineering*, among other cases, held that there was no covered business interruption loss because the insured had never ceased operations at the loss location.

The suspension can be short.

The one case most commonly cited by policyholders for the proposition that cessation of operations is not required actually involved a brief suspension of operations followed by a more lengthy partial suspension—or at least inefficient continuation—of those operations. In *American Medical Imaging Group v. St. Paul Fire*

& Marine Insurance Co.,²² the insured’s headquarters where it conducted its back office activities suffered smoke and water damage. The loss happened early in the morning. By 1:00 p.m. the same day, the insured had secured an alternate site and had relocated there. The major issue before the court involved whether the insured could recover for its postrelocation losses. The Third Circuit Court of Appeals held the insured could recover. It concluded that if the policy did not permit recovery for the postresumption period of inefficiency or partial suspension, the insured would have no motivation to mitigate its losses by resuming operations.²³

American Medical Imaging can be distinguished because the policy did not use the traditional suspension language. Instead, it provided that “[w]e’ll pay your actual loss of earnings as well as extra expenses that result from the necessary or potential suspension of your operation during the period of restoration caused by direct physical loss or damage to property at a covered location.”²⁴

American Medical Imaging can also be explained on procedural grounds. The Third Circuit was reviewing a summary judgment entered in St. Paul’s favor on grounds *not asserted* by St. Paul.²⁵ It thus appears the court *may* have been deciding an issue not in dispute between the parties that arose only because of the district court’s decision to grant summary judgment on grounds not asserted by the moving party.

The suspension requirement also is relevant to decisions involving acts of civil authorities, a subject beyond the scope of this article. Illustrative of the suspension requirement are two cases involving hotels that claimed civil authority

losses following the September 11 attacks. In both instances, the courts found no barring of access.²⁶ In both instances there was a slowdown but no suspension of operations.²⁷

The implications for megalosses. Any future megaloss is likely to lead to many partial suspension claims created by the difficulty of conducting daily operations after the loss. To the extent that the policies in force use language similar or identical to the new ISO language, there are likely to be significant issues as policyholders, insurers, and the courts struggle with distinguishing partial suspension caused by a megaloss from the consequences of poor business conditions unrelated to the megaloss. Unfortunately, the cases to date offer little assistance and factual issues may predominate.

Unlike a complete suspension, which is generally easy to identify—either the business is in operation at a location or it is not—identifying a partial suspension is more difficult.²⁸ The 2002 ISO form defines suspension as “the slowdown or cessation of your business activities.” Because the partial suspension must still result from covered damage to the insured property, causation issues will be paramount, particularly with businesses that were not thriving before the casualty.

The Period of Restoration

The 2002 ISO Business Income form provides:

- “Period of Restoration” means the period of time that:
- a. Begins:
 - (1) 72 hours after the time of direct physical loss or damage for Business Income coverage; or
 - (2) Immediately after the time of direct physical loss or damage for Extra Expense coverage;
- caused by or resulting from

- any Covered Cause of Loss at the described premises; and
- b. Ends on the earlier of:
- (1) The date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality; or
 - (2) The date when business is resumed at a new permanent location.

“Period of restoration” does not include any increased period required due to the enforcement of any ordinance or law that:

- (1) Regulates the construction, use or repair, or requires the tearing down of any property; or
- (2) Requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of “pollutants.”

The expiration date of this policy will not cut short the “period of restoration.”

The period of restoration is a theoretical period, measuring the time it would have taken, with reasonable effort, for the insured to resume operations.²⁹ Issues likely to arise following a megaloss include: business income losses that continue beyond the end of the period of restoration; defining the end of the period of restoration when literal restoration is impossible; and the effect of external factors, such as the insurer’s claims handling and the actions of landlords and tenants.

Measuring the period of restoration in unusual circumstances. One of the characteristics of a megaloss is that restoration of a business exactly as it was before the event may be impossible. A limited number of cases, including some arising out of September 11, have addressed these issues. The cases have involved a plethora of topics, including loss of customers, multitenant leased proper-

ties, insurer-caused financial problems, landlord-tenant issues, and maintenance issues. Each is discussed below.

*Zurich American Insurance Co. v. ABM Industries, Inc.*³⁰ involved the long-term loss of a customer base. ABM, a major janitorial contractor, occupied office space in the World Trade Center and also performed janitorial services for most of the complex. The September 11 attacks not only destroyed ABM’s offices but also eliminated its World Trade Center customer base for the foreseeable future. ABM sought to recover both for the losses associated with the office space it occupied and for the losses it sustained because the premises of its former customers were no longer available to be served.

The court denied ABM any recovery for business interruption losses associated with any property other than that occupied by ABM and the personal property it lost in the attacks. The court held that ABM’s insured property, on which it could base a claim, was limited to the property it occupied and/or owned and did not include its customers’ premises.³¹

*Duane Reade, Inc. v. St. Paul Fire & Marine Insurance Co.*³² involved another insured tenant of the World Trade Center whose revenue stream was dependent upon other occupants there. The insured operated a drugstore in the retail concourse. It claimed that the period of restoration was the same as the time necessary to rebuild the complex that will replace the World Trade Center. The court disagreed, holding that the period of restoration was measured by the time it would hypothetically take to rebuild or replace the specific store, not the entire complex that once surrounded it. The court also held

that the insured property was the specific premises at the World Trade Center, not Duane Reade’s business in general. Thus it rejected the insurer’s attempt to measure the period of restoration by when the insured’s overall business returned to pre-September 11 levels.³³ The court then permitted calculation of the actual period of restoration to be decided by appraisal.³⁴

In contrast is the 2004 decision of the U.S. District Court for the District of Massachusetts in *RLI Insurance Co. v. Wood Recycling, Inc.*³⁵ In this case, the insured operated a waste management and recycling operation. A fire in a debris pile led to a nine-day shutdown of the facility. The facility was scheduled as an insured property, but no damage occurred to any insured property because the debris pile itself was not insured. The court concluded that because the value of the insured’s business lay in the activity of collecting and recycling waste, not the waste itself, there was insurance coverage when the business activity itself was interrupted.³⁶ The court’s decision ignores the fundamental nature of business interruption coverage, which is that it is an adjunct to *property* insurance and normally provides coverage only for interruptions caused by damage to insured property.

Like most office buildings, the World Trade Center had multiple tenants, each of which occupied only a small portion of the overall complex. Streamline Capital was one of those companies. Streamline attempted to recover for the maximum possible period of restoration under a policy issued by Hartford Casualty Insurance Co., arguing that the period of restoration must be measured by the time it would take

to rebuild the World Trade Center towers. In *Streamline Capital LLC v. Hartford Casualty Insurance Co.*,³⁷ the court disagreed. It held that because the insured property was only the insured's personal property, the period of restoration was measured by the time necessary to restore the insured's operations, namely, its personal property, "not a specific office at a specific location."³⁸

Policyholders frequently complain that the insurer's claims handling conduct has put them in postloss financial difficulty that should result in an extension of the contractual period of restoration. This claim has met with mixed success in the courts, related in part to the particular jurisdiction's law regarding bad faith. In *Streamline Capital*, the court denied the policyholder's motion for summary judgment on this issue, holding that factual issues were present that precluded summary judgment.³⁹

One of the earlier cases to take claims handling into account was *Omaha Paper Stock Co. v. Harbor Insurance Co.*⁴⁰ In this case, in calculating the period of restoration, the district court took into account delays caused by the manner in which Harbor and its independent adjuster handled the claim. The court, in a very factually focused opinion, explained:

The requirement of due diligence on the part of the insured must be juxtaposed with the actions of the insurer. Harbor, through its adjusters at GAB essentially took over the decision of whether to repair or replace the belts. However, the assumption of responsibility by the insurer to make the actual decision did not eliminate the duty of the insured to perform functions that are peculiarly within its province. The insured cannot consciously ignore an apparent mistake

made by the insurer in this type of claim adjustment. Nor can an insured fail to inquire when an inquiry is dictated by good business practice.⁴¹

In *Hampton Foods, Inc. v. Aetna Casualty & Surety Co.*,⁴² the Eighth Circuit Court of Appeals agreed with the district court in *Omaha Paper* and held that while a theoretical period of restoration should be used, there also should be a "reasonable extension of that period where restoration delay was due to actions of the insurance company."⁴³

Even the cases that refuse to extend the period of restoration based on the conduct of the insurers tend to be very factually driven. For example, in *Jonari Management Corp. v. St. Paul Fire & Marine Insurance Co.*,⁴⁴ the court rejected the insured's attempt to extend the period of restoration, stating that the facts and jury verdict demonstrated that the insurer was reasonable in resisting the insured's demands under the policy.

*Bard's Apparel Manufacturing, Inc. v. Bituminous Fire & Marine Insurance Co.*⁴⁵ involved an insured that was operating in bankruptcy at the time of the loss. The insured's poor financial condition extended the time required to resume operations. The Sixth Circuit Court of Appeals held that the jury should not have been allowed to take into consideration any delays resulting from the insured's financial condition.⁴⁶

Businesses that operate in leased space and that wish to remain there after a loss often have little control over the pace of repairs to the real property. The Court of Appeals of Arizona, in *Eureka-Security Fire & Marine Insurance Co. v. Simon*,⁴⁷ concluded that landlord-induced delays should be taken into account in cal-

culating the period of restoration.

Furthermore, losses by a landlord-insured occasioned by a tenant's cancellation of a lease as a result of an insured loss were held not covered in *Landes v. State Farm Fire & Casualty Co.*⁴⁸

Insured property often is subject to wear and tear and needs periodic maintenance and upkeep. The issue that faced the court in *American Guarantee & Liability Insurance Co. v. Southern Minnesota Beet Sugar Cooperative*⁴⁹ was whether the period of restoration should take into account the fact that the insured machinery needed to be cleaned at the time of the fire. The court rejected the insured's argument that the time needed for cleaning should be added to the period of restoration. It concluded that because the contract defined the period of restoration as ending when the property should be "repaired, rebuilt or replaced with due diligence and similar quality," the similar quality provision precluded the insured from adding the time for cleaning that would have been necessary in any event to the period of restoration.⁵⁰

Losses incurred after the end of the period of restoration. A series of cases have discussed whether coverage is provided for losses incurred by the insured after the period of restoration, other than losses covered by any extended period of indemnity, other "ramp up" provision, or the like. No consistent pattern emerges from the decisions.

In *Pennbar Corp. v. Insurance Co. of North America*,⁵¹ the court refused to allow the insured to recover for lost sales that occurred long after production at the two loss locations had resumed. Pennbar, formerly Remington, was

a typewriter manufacturer. All its typewriters were manufactured by two European subsidiaries, one in Italy. In November 1980 and again in January 1981, the insured property of the Italian subsidiary was damaged by earthquakes, a covered peril. Production at the Italian plant stopped for a few days after the first earthquake and for about five weeks after the second earthquake. By February 17, 1981, the Italian subsidiary was back in operation. Shortly afterwards, Remington and both European subsidiaries went bankrupt. The Italian subsidiary ceased operations as a result of its bankruptcy. Remington did not lose any sales during the time its Italian plant was closed due to the earthquakes. It claimed, however, that at some time between May 1981 and June 1982 it did lose sales equivalent to the lost production from that plant. During that later period, Remington claimed its inventory was so depleted that it could not meet its ordinary sales obligations.

The Third Circuit concluded that those losses were not covered. Relying on the resumption of operations clause, which is a condition of coverage, it held that the selling off of inventory before an interruption was not appropriate because the resumption of operations clause required that existing inventory be used to reduce the loss.⁵² The court was concerned that if the insured were permitted to deplete its inventory and then claim a loss, it would create an open-ended and speculative business interruption coverage in which the loss could be pushed to a point long after the end of the period of restoration.⁵³

A different result was reached by the Fourth Circuit Court of

Appeals in a very fact-driven opinion, *High Country Arts & Craft Guild v. Hartford Fire Insurance Co.*⁵⁴ In that case, the insured's business was the promotion and sponsorship of arts and crafts shows. A fire destroyed the insured's office, including its computer database containing fundraising and donor information. The insured reopened its office about a month after the loss, but it struggled due to the lack of the database and a reduced volume of donations.⁵⁵ According to the court's opinion, the independent adjuster hired by the insurer told the insured that it had to put on scheduled shows in order to mitigate its business interruption losses, despite the fact that the insured did not feel it was capable of promoting those shows. The shows were held after the insured had resumed operations and the insured sustained substantial losses on them. It then sought to recover for all losses sustained during the 12 months after the fire, not just during the period of suspension.

The Fourth Circuit allowed the insured to recover for the postperiod of suspension losses, up to the 12-month limitation. It held that as long as the loss is causally related to the period of suspension, it is covered, provided that it occurs within 12 months:

[Hartford] still is responsible to pay High Country in accordance with the written promises contained in the policy and those promises include a promise to pay for the actual loss of business income that occurs "within 12 consecutive months after the date of direct physical loss or damage" which is "due to necessary suspension of your 'operations' during the 'period of restoration.'" In other words, Hartford is responsible for losses

caused by the close of High Country's business during the 60-day period, whether or not those losses showed up during the 60-day period, so long as they occurred within 12 months.⁵⁶

The opposite result was reached in *Rogers v. American Insurance Co.*⁵⁷ The insured operated a bowling alley. The bowling alley was closed for several months because of a fire. That closure coincided with the time of the year when annual contracts with bowling leagues were negotiated. As a result, the insured lost an entire year of bowling league business, which it claimed under the policy. The policy provided for coverage "for only such length of time as would be required with the exercise of due diligence and dispatch to rebuild, repair or replace."⁵⁸ The court held the losses from the postrestoration lack of bowling league business were not recoverable under this provision. It also held that the exclusion for losses occasioned by the suspension, lapse, or cancellation of any contract applied.⁵⁹

Two unpublished decisions reach differing results. In one, a federal court applying Kansas law found that policy language promising to pay for "'Actual Loss' and 'Extra Expense' during the 'period of restoration'" was ambiguous because it was unclear whether "during the 'period of restoration'" applied to both "actual loss" and "extra expense" or only to "extra expense."⁶⁰

In the second, the court concluded that the period of restoration ended not when the damaged components were repaired or replaced, but when the operations at the loss location were restored to normal.⁶¹ In doing so, it rejected

the insured meat packer's argument that the period of restoration continued until the entire lost production had been made up.

Resuming operations elsewhere. *Streamline Capital*, although arising in the unique context of September 11, 2001, is but one of a number of cases addressing the impact of the insured's postloss relocation. For example, in *American States Insurance Co. v. Creative Walking, Inc.*⁶² the insured relocated to a temporary facility, then decided to stay at the temporary facility because the loss location was no longer desirable. The court held that the period of restoration ended when operations resumed at the new temporary, not yet permanent, facility. It explained: "If the insured is able to continue its business operations at a temporary facility, it has not suffered a 'necessary suspension' of its operations."⁶³

The Sixth Circuit reached the opposite result in *Beautytuft, Inc. v. Factory Insurance Associates*.⁶⁴ In that case, the insured relocated its operations to a new location after the loss. The insurer contended that the period of restoration ended when the insured reached full production at its new location whereas the insured contended that it continued to suffer losses. The Sixth Circuit held that the theoretical period of restoration applied regardless of the earlier resumption of operations by the insured at a different location:

We agree with [the district judge] that this contract provides a theoretical as opposed to an actual replacement time as the basic time standard for computation of business interruption loss. . . . Although a substitute plan of potentially equivalent capacity was promptly obtained, appellees' actual losses as shown by the proofs continued beyond that date; and appellees were

entitled to reimbursement for such losses for the term of the theoretical replacement period as provided by the contract.⁶⁵

The policy in *Beautytuft* did contain provisions obligating the insured to resume operations. The jury had been instructed on those provisions, and the Sixth Circuit assumed that the jury, in calculating its award, had taken into account any reduction of the loss resulting from the resumption of operations at the new location. It did not, however, bar the insured from recovering for losses sustained simply because they occurred after operations resumed.

Postloss sale of the insured business. Several recent cases have addressed the impact of a postsale loss of the insured business. *B A Properties, Inc. v. Aetna Casualty & Surety Co.*⁶⁶ arose out of hurricane damage to a hotel in the Virgin Islands. After the hurricane, the insured sold the hotel but sought to recover losses beyond the date of sale. The insurers contended that the sale cut off B A's business interruption losses. The court disagreed, stating:

The term "actual loss sustained" does not mean that an actual loss must be experienced. . . . The policy clearly states that the actual loss can be determined with "due consideration given to the experience of the business before the date of damage or destruction and to the probable experience thereafter had no loss occurred." Thus, the "actual loss sustained" limitation means only that an actual loss must be predictable from past business experience. The further restriction that only those expenses that continue during the business interruption are covered means that the Policy covers only expenses that the insured would have been able to pay had it continued in operation. To construe this restriction

as requiring that B A Properties continue to own the Hotel to be able to recover its continuing expenses would be to stretch it beyond its common meaning.⁶⁷

With all due respect to the Virgin Islands' court, the court's reasoning defies logic, particularly as it relates to continuing expenses.⁶⁸

In slightly different circumstances, the court in *Bronx Entertainment LLC v. St. Paul's [sic] Mercury Insurance Co.*⁶⁹ reached a very different conclusion. In that case, the insured property included a driving range, miniature golf course, and batting cages. At the time of the loss, the insured was bankrupt. Shortly after the loss, the insured sold the property and executed an assignment of its claims, including the business interruption claim. The court held, relying in part on the original, later vacated, *B A Properties* opinion, that after the sale the insured no longer suffered any business interruption losses.⁷⁰ It also held that the assignee could not assert its own postsale business losses.⁷¹

The most recent case, *Globecon Group LLC v. Hartford Fire Insurance Co.*,⁷² arose out of the September 11 terrorist attack. The Globecon Group, Inc., was headquartered approximately 250 feet from the World Trade Center. It had been in financial difficulty and had considered filing for bankruptcy before the September 11 attack. After September 11, Globecon filed bankruptcy. While in bankruptcy, it sold substantially all its assets, including its insurance policies and claims, to a new entity that then renamed itself Globecon Group LLC. New Globecon then attempted to present old Globecon's claims for business

interruption as a consequence of the September 11 attack. The court concluded that the policy's antiassignment clause, which in most jurisdictions does not apply to post-loss assignments, did bar Globecon's claim because permitting a claim by the transferee of the insured's assets would "require Hartford to seek verification of the claim from New Globecon, a third-party to the policy with, at best, second-hand information about Old Globecon's property damage and income loss when Hartford contracted to acquire that information from the damaged party itself."⁷³ The court reasoned that because performance of the insured's duties by the purchaser, New Globecon, would necessarily vary materially from that contracted for, the antiassignment clause should be applied.

Applying these factors to megalosses. The major lesson that can be drawn from these cases is that policy drafting matters. The current ISO language, which terminates the period of restoration when the insured occupies a new permanent location, should provide a degree of certainty to both insurers and policyholders. In many jurisdictions, especially those that allow a tort cause of action for bad faith, adjustment delays by the insurer are likely to result in an extension of the period of restoration.

The other significant lesson drawn from these cases, particularly the September 11 cases that have been decided thus far, is that structural changes in the insured's business environment do not provide a loophole through which an insured can claim an artificially long period of restoration. If the insured's market is destroyed as well as its premises, the insured is compensated for

its losses until it resumes operations, but not for losses stemming from events that eliminate or displace some or all of its customer base. The policy insures property, not a customer base.

Conclusion

Under traditional policy language, a complete suspension of operations at the insured location is a condition precedent to recovery under a business interruption policy. The most recent ISO business income form permits recovery for partial suspensions, as do some manuscript policies.

Absent policy language to the contrary, the period of restoration, whether for a megaloss or otherwise, continues to be a hypothetical period based on how long it should take for the insured to resume operations, either at the insured location or elsewhere. Although hypothetical, in most jurisdictions the period of restoration is affected by postloss events and the insured is obligated to take action to mitigate its losses.

Finally, as the losses and resulting insurance claims arising out of the events of September 11, 2001, illustrate, the extent and specific traits of a megaloss are difficult to anticipate, which makes it difficult for both insurers and policyholders to craft policy language that addresses every eventuality. In those circumstances, the parties and the courts will be left to apply general principles of law and general policy provisions to novel circumstances, much as litigants and the courts have done for generations outside the insurance field. ■

Notes

1. The terrorist attacks of September 11, 2001, spawned consider-

able litigation regarding business interruption coverage issues. As of the end of 2004, many of those cases were still pending. While some decisions have been rendered and are discussed in this article, readers should review new decisions as they become available.

2. Insurance Services Office Form CP 00 30 04 02. Copyright © ISO Properties, Inc., 2001.

3. *Id.*

4. 893 F. Supp. 987 (D. Kan. 1995).

5. *Id.* at 990.

6. *Id.*

7. 279 F.2d 428 (2d Cir. 1960).

8. *Id.* at 429.

9. *Id.* at 431.

10. 9 Cal. App. 3d 270 (1970).

11. *Id.* at 275.

12. *Keetch v. Mut. of Enumclaw Ins. Co.*, 831 P.2d 784 (Wash. Ct. App. 1992).

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

14. *Id.* at 989.

15. *Id.* at 991.

16. 971 S.W.2d 635 (Tex. Ct. App. 1998).

17. *Id.* at 637.

18. *Id.* at 639.

19. 126 Cal. Rptr. 2d 682 (Cal. App. 2002).

20. *Id.* at 687.

21. 441 N.Y.S.2d 674 (1981). It appears the most important consideration for the court was not the absence of a suspension but the policyholder's failure to prove it suffered a loss. *Id.* at 677.

22. 949 F.2d 690 (3d Cir. 1991).

23. *Id.* at 692-93.

24. *Id.* at 692.

25. *Id.* at 691.

26. *Southern Hospitality, Inc. v. Zurich Am. Ins. Co.*, 2004 WL 3017260 at *1 (10th Cir. Dec. 30, 2004); *730 Bienville Partners, Ltd. v. Assurance Co. of Am.*, 2002 WL 31990614 at *1 (E.D. La. 2002).

27. *See also Paradies Shops, Inc. v. Hartford Fire Ins. Co.*, U.S.D.C., N.D. Ga. No. 1:03-CV-3154-JEC (Order of Dec. 15, 2004) (unpublished as of Dec. 31, 2004), where the court rejected a September 11-related civil authority claim by the owner of retail businesses in various airports.

28. For example, in *Archer Daniels Midland Co. v. Aon Risk Servs., Inc.*, 356 F.3d 850 (8th Cir. 2004), a broker

errors and omissions claim, the underlying Difference in Conditions policy's Contingent Business Interruption and Extra Expense coverage applied to "necessary interruption of [the insured's] business . . ." The Eighth Circuit agreed with the district court that "[a]n interruption of business means some harm to the insured's business, including the payment of extra expense, that would not have been incurred but for damage that an insured peril has caused to the property of any supplier." *Id.* at 855.

29. *Hampton Foods, Inc. v. Aetna Cas. & Sur. Co.*, 787 F.2d 349, 355 (8th Cir. 1986).

30. 265 F. Supp. 2d 302 (S.D.N.Y. 2003). This decision was affirmed in part, reversed in part, vacated and remanded by the Second Circuit on February 9, 2005, in *Zurich American Ins. Co. v. ABM Industries, Inc.*, 2005 WL 299700 at *1 (2nd Cir. 2005) (after this article had gone into production).

31. *Id.* at 305.

32. 279 F. Supp. 2d 235 (S.D.N.Y. 2003).

33. *Id.* at 239.

34. *Id.* at 241–42.

35. 2004 WL 1895132 at *1 (D. Mass. 2004).

36. *Id.* at *2.

37. 2003 WL 22004888 at *1

(S.D.N.Y. 2003).

38. *Id.* at *8. See also *Lava Trading, Inc. v. Hartford Fire Ins. Co.*, 326 F. Supp. 2d 434 (S.D.N.Y. 2004).

39. 2003 WL 22004888 at *7.

40. 445 F. Supp. 179 (D. Neb. 1978), *aff'd*, 596 F.2d 283 (8th Cir. 1979).

41. *Id.* at 187.

42. 787 F.2d 349 (8th Cir. 1986).

43. *Id.* at 355. In a later opinion, *Hampton Foods II*, 843 F.2d 1140 (8th Cir. 1988), the Eighth Circuit affirmed the trial court's factual conclusion extending the period of restoration based on the insurer's conduct.

44. 461 N.Y.S.2d 760 (N.Y. 1983).

45. 849 F.2d 245 (6th Cir. 1988).

46. *Id.* at 251–52.

47. 401 P.2d 759 (1965).

48. 907 S.W.2d 349, 358 (Mo. Ct. App. 1995).

49. 320 F. Supp. 2d 879 (D. Minn. 2004).

50. *Id.* at 882.

51. 976 F.2d 145 (3d Cir. 1992).

52. *Id.* at 152.

53. *Id.* at 153.

54. 126 F.3d 629 (4th Cir. 1997).

55. Whether the destruction of data was an insured loss was not addressed by the court, which apparently assumed that loss of data was an appropriate factor to consider in analyzing the business interruption claim.

56. 126 F.3d at 633.

57. 338 F.2d 240 (8th Cir. 1964).

58. *Id.* at 242.

59. *Id.* at 243–44.

60. *Vinyl-Tech Corp. v. Cont'l Cas. Co.*, 2000 WL 1744939 at *1 (D. Kan. 2000).

61. *Gus Meat Co. v. Hartford Steam Boiler Inspection & Ins. Co.*, 1992 WL 107313 at *1 (N.D. Ill. 1992).

62. 16 F. Supp. 2d 1062 (E.D. Mo. 1998).

63. *Id.* at 1066.

64. 431 F.2d 1122 (6th Cir. 1970).

65. *Id.* at 1124–25.

66. 273 F. Supp. 2d 673 (D.V.I. 2003).

67. *Id.* at 683 (citations omitted).

68. The case has an unusual procedural history. This opinion replaces one issued by a different judge that reached the opposite conclusion. After the original judge recused himself, the original opinion was vacated and this opinion was issued by the new judge. The opinion arose on a motion for summary judgment that did not dispose of the entire case.

69. 265 F. Supp. 2d 359 (S.D.N.Y. 2003).

70. *Id.* at 361.

71. *Id.*

72. 2004 WL 1574692 at *1 (S.D.N.Y. 2004).

73. *Id.* at *10.