

- SPECIAL ENDORSEMENT - SUPERSTORM SANDY

On October 29, 2012, Superstorm Sandy struck the eastern seaboard, the country's most densely populated region, causing widespread flooding, fire and extensive property damage along hundreds of miles of the United States coastline. Seventeen states and the District of Columbia were affected. Media reports indicated that almost 8.5 million people were left without power. Preliminary estimates are that Superstorm Sandy caused in excess of \$10-50 billion in damage. Businesses sustaining loss or damage may seek coverage under commercial property insurance policies. Some of the issues that may arise in these claims are discussed here.

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HURRICANE CLAIMS: WIND V. WATER

As the East Coast recovers from Superstorm Sandy, insurers will likely confront the question of whether the “anti-concurrent causation” clause in the policy precludes coverage for hurricane losses due to both wind (a covered loss) and water (an excluded loss). The answer is clear: it depends.

For example, in *Tuepker v. State Farm Fire & Cas. Co.*, the court found unambiguous the following anti-concurrent causation clause that preceded the flood exclusion:

We do not insure for [the following losses] regardless of: (a) the cause of the excluded event; or (b) other causes of the loss; or (c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss ...

507 F.3d 346, 351 (5th Cir. 2007) (Mississippi law). The court found that because wind and water losses in a hurricane are indivisible, the damage is excluded by the flood exclusion and the anti-concurrent cause clause excluded the claimed damage.

But, just two years later, the same jurisdiction reached a different outcome based on a different anti-concurrent causation clause. In *Corban v. U.S. Auto. Ins. Assoc.*, the Mississippi Supreme Court held that a homeowner’s insurer may be liable for a portion of the plaintiffs’ damages to their home from Hurricane Katrina where the anti-concurrent language read as follows:

We do not insure for loss caused directly or indirectly by any of the following ... regardless of any other cause or event contributing concurrently or in any sequence to the loss.

20 So.3d 601 (Miss. 2009). The court focused on the clause’s use of the terms “loss,” “concurrently,” and “in any sequence” in formulating their opinion. “Loss,” according to the court, “occurs at that point in time when the insured suffers ... destruction of the property insured” and “cannot be extinguished by a successive cause or event.” The court then held that the wind and flood acted in sequence, not “concurrently,” resulting in separate losses. Finally, the court found the phrase “in any sequence” to be ambiguous as applied to the water peril because of its location in the policy within an exclusion dealing solely with water damage. Based on this analysis, the court concluded that: “If the property suffered damage from wind, and separately was damaged by flood, the insured is entitled to be compensated for those losses caused by wind.”

The United States Court of Appeals for the Ninth Circuit, applying California law, rejected an argument that a flood exclusion did not apply to storm surge. Although the flood exclusion did not explicitly reference “wind driven water,” the court found that the plain meaning of “flood” included storm surge. In addition, the court relied on the terms “rising waters,” “waves,” and “tide or tidal water” in the policy’s definition of flood to support its decision. *Northrop Grumman Corp. v. Factory Mutual Ins. Co., Inc.*, 563 F.3d 777 (9th Cir. 2009). The court reached this conclusion even though the insurer had issued another policy to the same insured in which the flood definition did include the words “weather driven by wind or not”. The *Corban* case discussed above reached a similar conclusion on storm surge.

Most recently, the Mississippi Supreme Court ruled that even where a home was damaged by excluded storm surge, the insurer must determine whether the roof was damaged by covered wind prior to the storm surge. *Robichaux v. Nationwide Mut. Fire Ins. Co.*, 81 So.3d 1030 (Miss. 2011).



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FLOOD POLICY LANGUAGE UPDATE

In the wake of Superstorm Sandy, policyholders may submit claims for damages caused in whole or in part by flood. Policyholders may argue that their flood exclusion is ambiguous and therefore should be construed in favor of coverage. Policyholders may argue that other causes or contributory human conduct, such as negligent design of flood protection structures, caused the damage at issue. Issues may also arise when an insurer provides some flood coverage subject to flood-specific limits or deductibles.

The ISO form flood exclusion states:

We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

1. Flood, surface water, waves (including tidal wave and tsunami), tides, tidal water, overflow of any body of water, or spray from any of these, all whether or not driven by wind (including storm surge).

Hurricane Katrina gave rise to claims where human negligence allegedly combined with the hurricane to cause the flood. Courts nevertheless ruled that the flood exclusion applied and the loss was not covered. See *Sher v. Lafayette Ins. Co.*, 988 So. 2d 186 (La. 2008); *In Re: Katrina Canal Breaches Litig.*, 495 F.3d 191 (5th Cir. 2007). Several cases have given a broad reading to flood exclusions with anti-concurrent causation language – broad enough to exclude intentional releases of flood water. See, e.g., *White v. West Am. Ins. Co.*, 2008 U.S. Dist. LEXIS 99034 (M.D. Pa. Dec. 5, 2008) (due to the “concurrent cause clause,” the damage was excluded even if the intentional release of the floodgates caused the flood); *Kane v. Royal Ins. Co. of Am.*, 768 P.2d 678, 681 (Colo. 1989) (rejecting argument that “efficient moving cause” of loss was design negligence, citing the flood exclusion’s anti-concurrent cause language).

In *White*, the Middle District of Pennsylvania issued summary judgment for an insurer and held that the terms “surface water” and “flood” are unambiguous even when undefined in a policy. The court held that rain becomes “surface water” once it hits the ground, and therefore water damage after a heavy rainstorm was excluded under the policy’s flood and surface water exclusions.

Policyholders in some Katrina cases argued that because “storm surge” (wind-driven waves) was not specifically mentioned in the flood exclusion, the flood exclusion was ambiguous, creating coverage for the flooding in New Orleans.¹ See, e.g., *Northrop Grumman Corp. v. Factory Mut. Ins. Co.*, 538 F.3d 1090 (9th Cir. 2008) (California law); *Tuepker v. State Farm Fire & Cas. Co.*, 507 F.3d 346, 353 (5th Cir. 2007) (Mississippi law) (storm surge excluded as “little more than a synonym for a tidal wave or wind-driven flood”). The courts rejected this argument, finding that a flood caused by wind is still a flood. In rejecting the storm surge argument in *Northrop Grumman*, the Ninth Circuit observed: “Both lay and legal dictionaries characterize flood as an overflowing or inundation of water over usually dry land.” Additional issues were addressed on remand. See *Northrop Grumman*, 805 F. Supp. 2d 945 (2011).

Where an insured argues that policy descriptions of flood are ambiguous or damage is caused by something other than flood, insurers will have to look closely at the policy language and facts of each loss. The cases discussed in this article suggest that policies with standard flood exclusions and anti-concurrent causation language will not cover flood damages despite efforts by policyholders to argue other causes or to re-characterize the cause of the loss. These decisions may also apply to sublimit or deductible disputes regarding flood or water damage.

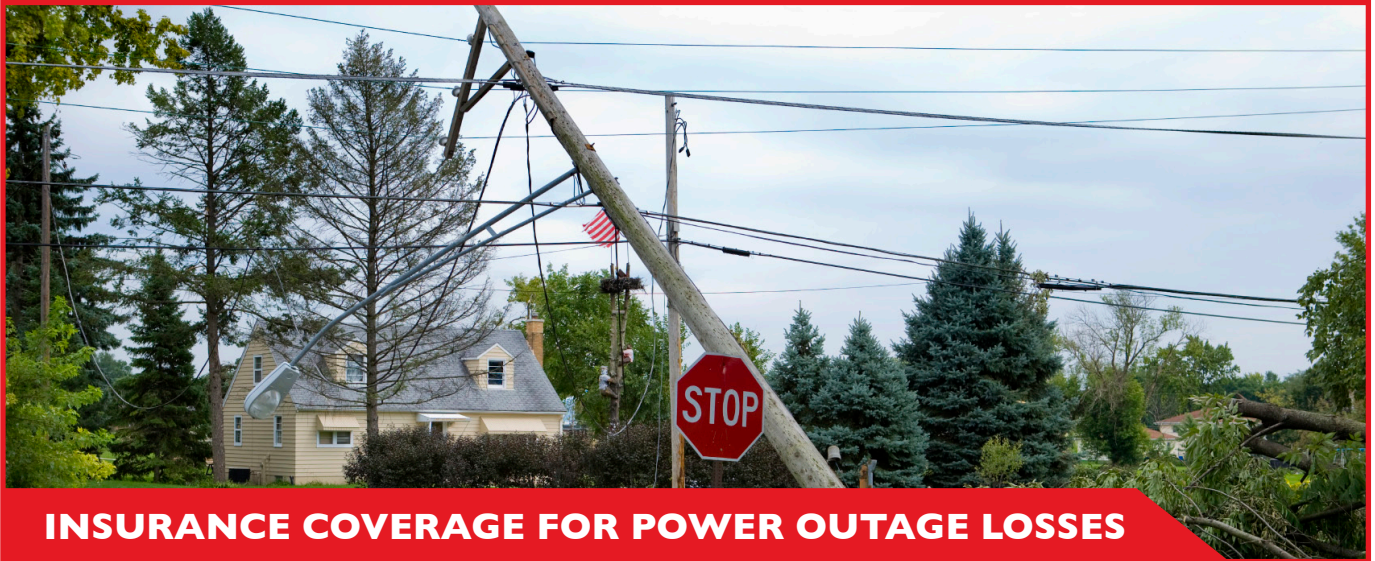


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¹ Current ISO language specifically addresses storm surge.



INSURANCE COVERAGE FOR POWER OUTAGE LOSSES

Many businesses experience power failures and consequent property damage or business interruption losses after a hurricane or weather event like Superstorm Sandy. Coverage for such losses will depend on specific terms and conditions of the insurance policy. But generally property insurance policies provide coverage for property damage and business interruption where there is physical damage to insured property from a covered cause of loss.

For example, courts have found coverage where a covered peril causes a power outage which, in turn, results in direct physical loss or damage to covered property. For instance, courts have found coverage for a commercial insured's food spoilage losses where a windstorm damaged the power company's off-premises supply lines, resulting in a power outage and food spoilage. See, e.g., *Fred Meyer, Inc. v. Cent. Mut. Ins. Co.*, 235 F. Supp. 540 (D. Or. 1964); *Lipshultz v. Gen. Ins. Co. of Am.*, 96 N.W.2d 880 (Minn. 1959). These courts reasoned that the policy covered direct loss by windstorm and the spoilage loss constituted a direct loss by windstorm.

But some property insurance policies specifically exclude coverage for loss or damage caused by the failure of power in these types of cases if the failure occurs away from the insured's premises. Courts often uphold that exclusion. See, e.g., *Gies v. City of Gering*, 695 N.W.2d 180 (Neb. Ct. App. 2005); *Mapletown Foods v. Motorists Mut. Ins. Co.*, 662 N.E.2d 48 (Ohio Ct. App. 1995). At least one court, however, has found the exclusion ambiguous. See, e.g., *Brooklyn Bridge v. South Carolina Ins. Co.*, 420 S.E.2d 511 (S.C. Ct. App. 1992). Other exclusions may also apply.

Some property policies include specific power outage coverages. For example, some policies include specific utility service interruption coverage. This coverage typically requires that the service interruption be caused by physical damage to the utility provider's property. But one court broadly interpreted "physical damage" to include loss of functionality. *Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co.*, 968 A.2d 724 (N.J. Super Ct. 2009).

In some cases, this coverage is subject to a waiting period, so the service interruption must exceed the indicated number of hours or days. Other policies include coverage for spoilage caused by a power outage. Some equipment breakdown coverage forms provide coverage for loss or damage caused by the interruption of utility service if the interruption was caused by an accident to certain equipment.

For additional information regarding coverage for power outage losses, please review the article written by Scott Johnson and Amy Churan, "The August 2003 Blackout and Insurance Coverage for Power Outage Losses" originally published in the *Tort Trial & Insurance Practice Law Journal* and available on our website at <http://www.rkmc.com/publications/articles/the-august-2003-blackout-and-insurance-coverage-for-power-outage-losses>.



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CIVIL AUTHORITY COVERAGE

When Superstorm Sandy threatened the eastern seaboard, scores of businesses closed, some in response to evacuation orders from civil authorities. Insurers can expect claims under civil authority provisions, which provide coverage for a loss of business income without the requirement that the insured sustain physical damage to covered property.

According to commentators, the original intent of civil authority provisions “was to afford coverage when the insured’s business was cordoned off by police or firefighters as a result of damage to a nearby property.” 2-16 Business Insurance Law and Practice Guide § 16.02. Early civil authority provisions did not include language requiring damage to adjacent property. But this phraseology was added to the ISO forms in 1969 to honor the intent of this coverage. *Id.* The ISO form states:

This policy is extended to include the actual loss sustained by the Insured, resulting directly from an interruption of business as covered hereunder, during the length of time, not exceeding 2 consecutive weeks, when as a direct result of damage to or destruction of property adjacent to the premises herein described by the peril(s) insured against, access to such described premises is specifically prohibited by order of civil authority.

In *United Air Lines v. Insurance Co. of the State of Pennsylvania*, the court interpreted this language to preclude coverage where the damaged property was 1.25 miles away from the insured’s location. 439 F.3d 128 (2d Cir. N.Y. 2006). United suffered lost profits when the government restricted air traffic in the days following the 9/11 terrorist attacks. The court held that United was not entitled to civil authority coverage because the Pentagon was not “adjacent” to the airport.

In general, the order need not be formal or written—it is enough that a government officer or representative blocks access to insured property. See *Narricot Indus. v. Fireman’s Fund Ins. Co.*, 2002 U.S. Dist. LEXIS 19074 (E.D. Pa. Sept. 30, 2002). Courts have defined “access” to mean a “way of approaching, or reaching, or entering” property and “prohibit” is defined to mean to “formally forbid especially by authority” or “prevent.” *S. Hospitality Inc. v. Zurich Am.*, 393F.3d 1137 (10th Cir. 2004) (Oklahoma law). In *54th St. Ltd. Partners, L.P. v. Fidelity & Guaranty Insurance Co.*, the court held that this type of coverage is limited to that period of time when access to the insured’s premises is completely denied by an act of civil authority, not simply diverted or made more difficult. 306 A.D.2d 67 (N.Y.App. Div. 1st Dep’t 2003). This case could be relevant to claims for lost revenue caused by the subway or bridge closures, where access is impeded by a civil authority, but not entirely denied.

As previous hurricane cases have made clear, the order must be issued as a direct result of physical damage to property and not just the threat of physical damage. In *Jones, Walker v. Chub Corp.*, the insured claimed a loss due to two evacuation orders issued in response to Hurricane Gustav. 2010 U.S. Dist. Lexis 109055 (E.D. La. Oct. 11, 2010). The provision stated that “prohibition of access by a civil authority must be the direct result of direct physical loss or damage . . . within one mile from” the insured premises. The court determined the first order, issued due to the threat of damage, did not trigger coverage, but that the second order, issued after the damage, triggered coverage, as long as the damage occurred within one mile of the insured.

Similarly, in *South Texas Medical Clinics, PA v. CNA Financial Corp.*, the court concluded that the insured had failed to establish the necessary nexus between actual damage and issuance of the order where the official issued the evacuation order because Hurricane Rita was threatening the Texas coast, not because Rita had already caused property damage in Florida. 2008 U.S. Dist. LEXIS 11460 (S.D. Tex. Feb. 15, 2008).

Regardless of when the insured’s business commences operation, civil authority coverage ends when the order is lifted. *Magee, P.L.C. v. National Fire Insurance Co.*, 977 So. 2d 304 (La.App. 1 Cir. 2008) (once the insured can no longer show that an action of civil authority prohibits access to the described premises, he can no longer establish all the elements for coverage).



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INGRESS/EGRESS COVERAGE

Different from civil authority coverage, ingress/egress coverage insures against business interruption loss resulting from an inability to access the insured property due to a covered peril—no act of civil authority is required. To assess whether physical damage to insured property is necessary to trigger this type of coverage, the specific words of coverage are crucial.

In *Fountain Powerboat Industries, Inc. v. Reliance Insurance Co.*, for example, the court held that physical damage to the insured property was not required to trigger ingress/egress coverage. 119 F.Supp. 2d 552, 556 (E.D.N.C. 2000). The wording of the provision accounted for this result:

This policy covers 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.

Here, the insured's plant closed for 10 days after Hurricane Floyd flooded the only access road. Reliance argued that the policy required physical loss or damage to the insured property in order to trigger coverage for loss of ingress or egress. The court held that the plain language of the provision did not require any physical damage to the insured property—only loss of ingress or egress due to a covered peril. The court also held that the ingress/egress provision “relates only to reasonable access to the Fountain facility and does not therefore apply to extraordinary efforts by Fountain or its employees to get to work over closed or flooded roads.”

In *City of Chicago v. Factory Mutual Insurance Co.*, the court held that physical damage of the type insured was required to trigger ingress/egress coverage. 2004 U.S. Dist. LEXIS 4266, 6-8 (N.D. Ill. Mar. 11, 2004). In this case, the policy insured loss of business income “due to prevention of ingress to or egress from the Insured's property, whether or not the premises or property of the Insured shall have been damaged, *provided that such interruption must be a result of physical damage of the type insured against* and not excluded by this policy.” The City of Chicago made an insurance claim for business income it lost when the City's airports were closed after the attacks on 9/11. The parties acknowledged that the *direct* cause of the lack of access was the FAA's order grounding all planes and the *indirect* cause was the terrorist-inflicted damage. The court noted that the policy excluded coverage for “indirect or remote loss or damage.” As such, terrorist-inflicted damage, or indirect damage, was not “damage of the type insured.”

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COVERAGE FOR “SUE AND LABOR” EXPENSES

Businesses along the East Coast were aware that Superstorm Sandy was approaching for several days. Some took measures to protect their property before the storm hit—for some the costs of these efforts were substantial. Policyholders may look to their property insurers to pay for these costs as a “sue and labor” expense.

The sue and labor (now often designated as “Preservation of Property”) clause of a commercial property insurance policy imposes a duty on the insured to take reasonable steps to protect insured property in the event of imminent covered damage and to minimize further damage once it occurs. In turn, the insurer will reimburse the insured for these expenses under appropriate circumstances. For example, an insured may be able to recover the costs of moving covered property out of harm’s way.

The concept of sue and labor, which has existed in ocean marine insurance since the seventeenth century, is designed to benefit the insurer by reducing the amount of loss it would have to pay. But sue and labor coverage is available only in limited circumstances. To be recoverable, several criteria must be met.

First, the expenses must have been incurred to avert or minimize a loss for which the insurer would have been liable under the policy. Thus, if the loss sought to be avoided would not be covered under the policy, there is no sue and labor coverage. See, e.g., *GTE Corp. v. Allendale Mut. Ins. Co.*, 372 F.3d 598 (3d Cir. 2004) (applying New Jersey law and finding no sue and labor coverage for costs and expenses incurred in remediating computer systems to avoid Y2K-related date recognition problems where such costs were excluded by the policies’ defective design and inherent vice exclusions).

Second, the loss being averted or minimized must be actual or “imminent.” Webster’s Third New International Dictionary defines “imminent” as “ready to take place; near at hand; impending.” Courts have defined the term in a similar manner. See, e.g., *Buczek v. Cont’l Cas. Ins. Co.*, 378 F.3d 284 (3d Cir. 2004) (applying New Jersey law).

Third, the expenses must be incurred primarily for the benefit of the insurer. For example, the court in *Einard LeBeck, Inc. v. Underwriters at Lloyd’s of London* found that the rental value of moving equipment, which was left in place under a synagogue that the insured was transporting, and the cost of demolition of the synagogue after it was determined that the building could not be moved, were not primarily for the benefit of the insurer. 224 F.Supp. 597 (D. Or. 1963).

Fourth, to be recoverable under a sue and labor clause, expenses must be preventative rather than corrective or remedial. For example, in *American Home Assurance Co. v. J. F. Shea Co.*, the insured sought sue and labor coverage for expenses it incurred to repair a recently excavated subway tunnel to prevent a collapse. 445 F. Supp. 365, 370 (D.D.C. 1978). The court found that the sue and labor provision applied but specifically recognized that expenses for “corrective” rather than “preventive” activities were not proper sue and labor costs.

A sue and labor clause provides a mechanism for an insured to recover expenses incurred to minimize or prevent loss or damage to covered property due to an imminent covered cause of loss. But expenses incurred to minimize or prevent losses for which there is no coverage, as well as expenses that are corrective or remedial in nature, are not recoverable. Depending on the factual circumstances, an insured may be able to satisfy all or only some of these criteria required for sue and labor coverage.



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Even insureds who do not sustain any physical loss or damage from Superstorm Sandy may suffer business income losses if their suppliers' or customers' premises were damaged. These insureds may be able to recover for their business income losses if they have contingent business interruption ("CBI") coverage.

In contrast to regular business interruption coverage—which applies only where there is physical damage to the insured's property—CBI coverage is available where an insured's customer or supplier sustains physical damage to property. But without physical damage to a supplier or customer location, there can be no CBI coverage. In *Southern Hospitality, Inc. v. Zurich American Insurance Co.*, the insured, which managed a number of hotels that were highly dependent on air travel, sought CBI coverage after the 9/11 terrorist attacks. 393 F.3d 1137 (10th Cir. 2004) (Oklahoma law). The court found no coverage under the CBI provision because there was no damage at any customer or supplier location.

Additionally, to recover under a CBI provision, the insured must prove that its business income loss was the direct result of damage to a particular supplier or customer. A generalized revenue shortfall after a catastrophic event alone is not sufficient to trigger CBI coverage. See, e.g., *Arthur Andersen LLP v. Federal Insurance Co.*, 3 A.3d 1279 (N.J. Super. Ct. App. Div. 2010) (accounting firm that could not identify any specific supplier or customer whose property was damaged during 9/11 terrorist attacks could not meet its burden of proving coverage "by merely showing a decline in income coupled with property damage").

And for CBI coverage to exist, the entity sustaining physical loss or damage from Superstorm Sandy must actually supply to or purchase goods or services from the insured. In *Pentair, Inc. v. American Guarantee & Liability Insurance Co.*, the court found that such an actual customer-supplier relationship was lacking. 400 F.3d 613 (8th Cir. 2005) (Minnesota law). There, an earthquake struck Taiwan, disabling a utility company substation that provided electrical power to two Taiwanese factories that supplied parts to Pentair. Lacking electrical power, these two factories could not supply parts to Pentair. The court rejected Pentair's argument that the Taiwanese utility company was one of Pentair's "suppliers," reasoning that it did not supply a product or service ultimately used by Pentair.

Some CBI provisions require that loss or damage be to a "direct" supplier or customer. Recently, there has been some debate about the meaning of "direct." In *Park Electromechanical Corp. v. Continental Insurance Co.*, the court considered whether a subsidiary of the insured could be considered a direct supplier. 2011 U.S. Dist. LEXIS 16344 (E.D.N.Y. Feb. 18, 2011). The court found the term "direct suppliers" to be ambiguous and that its meaning would be determined by the jury after consideration of extrinsic evidence of the parties' mutual intent. In *Millennium Inorganic Chemicals Ltd. v. Nationals Union Fire Insurance Co.*, the court considered whether a supplier or customer must be in contractual privity with the insured to be considered a "direct" supplier or customer. 2012 U.S. Dist. LEXIS 140257 (D. Md. Sept. 28, 2012). The court, applying New York and New Jersey law, found the term "direct suppliers" ambiguous. And given the absence of any relevant extrinsic evidence as to the meaning of the term, the court resolved the ambiguity in favor of the insured.



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DEDUCTIBLES AND STATE INSURANCE DEPARTMENT DIRECTIVES

As of this writing, insurance commissioners in Connecticut, Maryland, New Jersey, New York, Pennsylvania, and the District of Columbia have issued directives or warnings that may affect deductibles for claims stemming from Superstorm Sandy. Generally, insurance regulators warn carriers not to charge hurricane deductibles for claims arising from Superstorm Sandy, saying hurricane deductibles, which are higher than those for standard claims, should not apply because the storm was no longer a hurricane when it made landfall. Insurers will need to evaluate the specific wording of the directives, their policy language, and the factual circumstances surrounding the claim in order to properly determine the import of these directives. For example, some directives may be limited to homeowner's policies. The legal impact of these directives may also need to be evaluated if they appear to change private contracts after they are already in effect.

On a related note, where damage is due to both wind and water from a storm, it can be problematic to determine which deductible applies. Courts have analyzed this issue in light of specific policy language and the facts of the

damage. See, e.g., *SEACOR Holdings, Inc. v. Commonwealth Ins. Co.*, 635 F.3d 675 (5th Cir. 2011) (applying Louisiana law); *Turner Constr. Co. v. Ace Prop. & Cas. Ins. Co.*, 429 F.3d 52 (2nd Cir. 2005) (applying Texas law).

In *SEACOR*, the 5th Circuit Court of Appeals affirmed the Eastern District of Louisiana in a dispute over Hurricane Katrina and Hurricane Rita claims to commercial property. The court evaluated whether the Named Windstorm deductible or both the Named Windstorm and Flood deductibles applied to the damage at issue. The court evaluated the policy language describing Named Windstorm: “any Windstorm, as defined [by the policy], or any atmospheric disturbance...declared to be a tropical storm and/or hurricane by the National Weather Service or the National Hurricane Center.” The court also looked to Louisiana Supreme Court precedent to determine “what events or conditions qualify as a windstorm,” and held that in this context Named Windstorm encompassed both wind and water damage. Therefore the Named Windstorm deductible applied rather than separate deductibles for Named Windstorm and Flood.

In *Turner Construction*, the Second Circuit Court of Appeals applied Texas law and reversed the Southern District of New York in a dispute over builder’s risk coverage for a hotel construction project in Houston. In that instance, rain entered the structure through a wind-caused opening. The court held that the general deductible rather than the wind deductible should apply because the damage was caused directly by rain and only indirectly by wind. The court stated that “[n]othing in the policy suggests that the wind deductible applies to damages only indirectly caused by wind... Texas law requires us to construe ambiguities in an insurance policy against the insurer.” Because the damage at issue was calculated at below the wind deductible, the court construed the policy in favor of the insured and held that the general deductible applied.



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