Catastrophic Losses: Pursuing Recoveries from Viable Defendants

by Richard B. Allyn

Richard B. Allyn is a partner at Robins, Kaplan, Miller & Ciresi L.L.P. in Minneapolis, Minnesotta, where he has been a litigator in the insurance and catastrophic loss practice group for almost 30 years. His work includes first- and third-party coverage and subrogation as well as complex business litigation. Prior to that, he was solicitor general and chief deputy in the office of the attorney general of Minnesota. Allyn can be reached at rballyn@rkmc.com.

TIP

Proactive catastrophic risk management and insurance plans should be in place and reviewed regularly if directors and officers and their companies want to avoid suits after a big loss.

Officers and directors generally owe their companies and shareholders a duty of diligence and due care. The law in most states ensures that reasonable and well-processed decisions that are made by business executives can be made with little fear of personal financial loss (~~"~~business judgment rule"). However, in recent times, large disasters have caused some plaintiffs and officials to look beyond just the corporate entity to obtain relief.

Officers, directors, and their corporate risk managers have had no shortage of manmade disasters to study in the United States in the last 25 years. While relatively few resulted from acts of terrorists—September 11, 2001, World Trade Center attacks; 1996 Olympics nightclub bombing in Atlanta; April 19, 1995, Alfred P. Murrah Federal Building bombing in Oklahoma City; and February 26, 1993, World Trade Center garage bombing—there are numerous examples of large, catastrophic losses. They include the 2010 *Deepwater Horizon* oil spill, 2007 I-35W Mississippi River bridge collapse in Minneapolis, 1992 Chicago flooded tunnels, and 1989 *Exxon Valdez* grounding. This list expands even further when international events are considered—e.g., the 1984 Bhopal, India, Union Carbide chemical leak.

Damage Recoveries after the World Trade Center Attacks

Although frequently lacking traditional defendant targets,
disasters involving private property have generated numerous lawsuits. The most dramatic examples arise from the 9/11 World Trade Center (WTC) litigation. Even though the perpetrators initiating the disaster were dead or beyond the reach of American courts, an extraordinary number of cases and theories of recovery resulted nonetheless. These suits were neither frivolous nor insignificant. They included:

- Over ten thousand bodily injury claims by persons involved in the postloss search for survivors and remains and site cleanup.
- Thousands of wrongful death claims against the federal Victim Compensation Fund administered by Special Master Kenneth Feinberg.
- Hundreds of insurance claims fighting over the measure of property loss and business interruption damages.
- Numerous insurance subrogation suits whose defendants variously included:
  - The Port Authority of New York and New Jersey;
  - Citigroup/Salomon Brothers;
  - The City of New York; and
  - American Airlines, United Airlines, US Airways, Pinkerton's, Burns International Security, Securitas, and Boeing Company.
- Several suits each seeking multiple millions of dollars for crash victims' families, insurers, and property owners against members of the Saudi royal family and Saudi banks and charities for supporting Muslim charities connected with Osama bin Laden and al-Qaeda.[1]
- Direct claims by tenants and neighbors alleging damages outside or in conjunction with their insurer's subrogation, including:
  - Cantor Fitzgerald, which lost 658 executives and employees on the top five floors of the North Tower (1 WTC).

7 World Trade Center Collapse as a Case Study

The 9/11 claims arising from one building are illustrative of legal exposures unleashed by a disaster. 7 WTC was a 47-story office tower located across the street from 1 WTC. It was leased by Silverstein Properties (Silverstein) from the Port Authority of New York and New Jersey (Port Authority). ConEd owned a power substation that was built underneath the building. Flying debris ignited fires in the building's interior in the morning. Rather than consuming the contents within a few hours, the fires continued all day. Suddenly, at 5:21 p.m., the entire building collapsed.

7 WTC was the only WTC high-rise to collapse without being struck by an airplane. It is reportedly the first known instance of a tall building collapsing primarily as the result of uncontrolled fires.

There is no doubt the building's internal fire sprinkler system lacked water pressure to fight the multifloor flames. However, the building

had some unique hazards that are alleged to have substantially contributed to the damage and caused the collapse. There were several tenants that had installed emergency generators to create an independent source of power able to operate 24/7 in the event of a public utility failure. These tenants included the City of New York's Office of Emergency Management and Citigroup's Salomon Brothers multifloor trading operations. Huge fuel tanks were on a lower level, and the diesel fuel was pumped under pressure to upper floors where a number of generators were located. Some experts concluded that the emergency fuel system fed the flames long enough to ultimately weaken the steel members sufficiently to cause the building collapse.

The total loss of 7 WTC resulted in damages exceeding three-quarters of a billion dollars to the structure alone. Tenants such as Salomon Brothers, the Secret Service, and the Securities and Exchange Commission (SEC) lost irreplaceable files. Although the initiators of the disaster were dead and beyond the law, plaintiffs initiated the following claims:

- Silverstein's damages and coverage dispute with its property insurer lasting for several years.
- Silverstein's property insurer subrogation suit against the Port Authority and Citigroup/Salomon for permitting and operating the diesel generator system; and against the airlines whose planes were hijacked, security companies, Boeing, and other aviation-related defendants for allowing terrorists to board and commandeer the planes.
- ConEd's property insurer subrogation suit against the City of New York; the Port Authority (as the code enforcer and owner permitting the generator system); Silverstein (for allowing the system); Citigroup/Salomon (for operating the system); and several architects, engineers, and contractors who assisted in designing and building the system.
- Citigroup/Salomon's insurer's subrogation suit against the Port Authority.

Note that all of these claims were against parties that had no hand in starting the cataclysmic destruction.[2] To sustain claims within traditional tort actions, the plaintiffs argued that all of the defendants were negligent in either preventing the hijacking at the front end or permitting conditions that aggravated the damages after the events were started.

The WTC suits included some novel damage theories. A good example is Cantor Fitzgerald's suit against American Airlines, whose plane struck the North Tower. Its principal office was destroyed, and 658 of approximately 1,000 officers and employees perished. This suit claimed several categories of damages:

- harm to its brand identity as a financial services firm;
- destruction of its office;
- destruction of its corporate property, such as art and furniture;
- destruction of its technological infrastructure;
- destruction of its business records and transactions;
- business interruption losses; and
- extra expenses for temporary relocation.

Within these claims, Cantor Fitzgerald included a substantial amount for the loss of its employees and their profitable interpersonal client relationships. This attempted extension of traditional measures of commercial damage was rejected by the courts because it would circumvent wrongful death laws, which reserved such damages for the various decedents' estates.

Insurance Coverage for Terrorist-Caused Damage

Most plaintiffs after a catastrophic property loss are the subrogating insurers who have paid some of or the entire property claim. Frequently, the insured company suffering the loss will also participate to recover its uninsured loss. By the same token, virtually all plaintiff WTC targets were defendants backed by insurance or state-funded equivalents. Without insurance coverage, the sole means to recoup losses would have been the fruitless exercise of suing the terrorists and their supporters. However, at the outset, insurance as a backstop was in question.

Monetary losses from the 9/11 attacks were estimated to total between $35 billion and $75 billion. There was concern that insurers were going to deny coverage under existing policies by invoking the "war risk exclusion."[3] However, Congress and state insurance commissioners applied great pressure upon the industry to not interpret the exclusion to apply. In the face of such pressure, insurance industry leaders announced that their companies would not deny coverage based on the war risk exclusion. However, looking to a future with an expected increase of terrorist attacks, the insurance industry developed a "terrorism exclusion." Unlike the war risk exclusion, there would be no room for ambiguity. Claims like those generated by 9/11 would be excluded. The economic burden of a terrorist attack shifted to policyholders.

In November 2002, Congress passed the Terrorism Risk Insurance Act (TRIA). The Act nullified all existing terrorism exclusions and required all property and liability insurers to offer terrorism insurance. In recognition of the underwriting and premium quantification challenges to both insurers and insured purchasers, Congress agreed that the federal government would cover 90 percent of the loss and the insurer would pay the remaining 10 percent. To apply: (1) the loss must be certified as a foreign act of terrorism; (2) the loss must exceed $5 million; and (3) the insurer must first pay a deductible. Although initially approved to be a two- to three-year program, Congress has reauthorized the funding to the present time. TRIA makes a federal cause of action the exclusive remedy for claims arising from a single act of terrorism.[4] Policyholders can decline the coverage, and many do to save premium dollars. The corporate management wisdom for such a decision will be tested in the event of another catastrophe.

Claims and Subrogation under the Antiterrorism Act

Following 9/11, Congress passed the Antiterrorism Act of 2001. It provides, "Any national of the United States injured in his or her person, property, or business by reason of an act of international terrorism . . . may sue therefore in any appropriate district court of the United States and shall recover threefold the damages he or she sustains . . . ."[5] The Act defines "international terrorism" as activities that

(A) involve violent acts or acts dangerous to human life that are a violation of the criminal laws of the United States . . . ;
(B) appear to be intended—
    (i) to intimidate or coerce a civilian population; [or]
    (ii) to influence the policy of a government by intimidation or coercion; . . . and
(C) . . . transcend national boundaries in terms of the means by which they are accomplished, the persons they appear intended to intimidate or coerce, or the locale in which their perpetrators operate or seek asylum.[6]

By its plain language, this statute establishes a civil cause of action against terrorists. But perhaps more fruitful, this Act also may be enlisted to sue entities that provide material support to terrorist groups.

In 2007, the Seventh Circuit issued its ruling in *Boim v. Holy Land Foundation for Relief & Development*.[7] The court upheld earlier rulings that the Act criminalizes providing support to terrorist organizations.[8] Congress intended such activity to constitute "international terrorism" and give rise to civil liability under Section 2331. The court also held that liability can be imposed on those who knowingly and intentionally aid and abet terrorism. In *Boim*, Stanley and Joyce Boim, the parents of a man who had been killed by Hamas terrorists in Israel, brought an action against several charitable organizations and individuals under the Act. The Boims alleged that the defendants provided material support in the form of monetary funds to the Hamas.

The main obstacle to an insurer seeking to subrogate under the Antiterrorism Act is the statute's use of the word "national." The Immigration and Nationality Act defines the word "national" as "a citizen of the United States."[9] Under 28 U.S.C. § 1332, corporations and other artificial entities are "citizens" for purposes of judicial diversity of citizenship, but the United States Supreme Court has held that the term "citizen," as used in the Fourteenth Amendment of the Constitution, applies only to natural persons.[10] Therefore, a defendant could argue that by using the term "national" instead of "person," Congress intended that only natural persons can sue under the Antiterrorism Act.

Man-Made Disasters Challenge Recovery Efforts

Bhopal, India. Union Carbide Corporation and its Indian subsidiary owned a pesticide manufacturing plant surrounded by a slum in Bhopal, India. On December 2–3, 1984, the chemical plant leaked a mixture of deadly gases. It has been estimated that over 2,000 people died and over 200,000 were injured, many chronically. This loss has been called the world's worst industrial disaster. Because the plant was American-owned, hundreds of personal injury and death suits and class actions were brought in America by American lawyers. The Indian government resisted this development and passed a law making it the sole representative of its citizens. It hired an American law firm to represent it as a plaintiff. When the American courts sent the cases back to India for discovery and trial, the American firm litigated against Union Carbide to the point where it settled by paying India $470 million. This recovery was only achieved by litigating in two countries and applying the traditional legal standards for culpability for negligent wrongdoing. In the end, a defense that a disgruntled worker was to blame proved to be unsupported. Many investigations laid the blame on negligent operation and maintenance.

A senior executive of Union Carbide went to the disaster site but, according to reports, was promptly charged and arrested with culpable homicide and assault. After release on bail, he did not return to India. While the United States refused to extradite the American executive, eight former employees of the corporate subsidiary were charged and eventually convicted in 2010. In a related development, Dow Chemical Corporation proposed to buy Union Carbide in 1999. There was a shareholders' lawsuit against Dow Chemical and certain of its officers and directors for filing false and misleading statements with the SEC concerning the ongoing criminal charges and civil suits arising from the Bhopal disaster. The officers and directors were alleged to have breached their fiduciary duty.[11]

I-35W Mississippi River bridge collapse. On August 1, 2007, an eight-lane steel truss arch bridge that carried traffic across the Mississippi River in the middle of Minneapolis suddenly collapsed into the river during evening rush hour. Thirteen people were killed and 145 were injured. The bridge was owned by the State of Minnesota and had been constructed in 1967. The state created a victims' reparations fund that paid moderate claims and, in return, immunized the state from personal injury claims. The victim plaintiffs brought suits principally against the engineering firm that had been conducting inspections of the bridge for the state highway department. Experts who had worked on investigating 9/11 claims in New York supported the plaintiffs' negligence theory. Following extensive pretrial discovery into the history, engineering, and construction of the bridge, in the end, the liability insurers and the named defendants settled all of the claims for more than $50 million. The political and shareholder response to this cataclysmic event is yet unfolding.[12]

Oil spill litigation. Both the Exxon Valdez ship grounding and oil spill in Prince William Sound, Alaska, in 1989 and recent Deepwater Horizon explosion and oil spill in the Gulf in April 2010 are examples of disastrous man-made losses that create catastrophic damage extending far beyond the owner's property where the loss originates. The litigation, trial, and appeals of the Exxon Valdez case, with its enormous punitive damage award, dragged on for years, with Exxon found liable to the plaintiffs and their lawyers in the end. The fault of the loss was found to be multiple negligent acts or omissions by the operators of the vessel. It is believed that Exxon recovered a significant amount of its cleanup and legal expenses through claims against its own insurers.

A federal grand jury indicted Exxon on five criminal violations. In October 1991, the company pleaded guilty to certain counts and agreed to pay $125 million in fines and restitution. The ship's captain was charged with several crimes and was convicted by a jury of the misdemeanor of

negligently discharging oil.

After the April 20, 2010, explosion, the Deepwater Horizon fault litigation heated up. BP sued Cameron International Corporation (Cameron) over the design and maintenance of the blowout preventer that failed to contain the oil spill after the explosion and death of 11 persons. BP also sued Transocean, owner of the Deepwater Horizon, for $40 billion for negligence in the operation of the rig. The Coast Guard has reportedly placed certain of the blame for the explosion on Transocean. BP also sued Halliburton Energy Services, which counter-sued BP based on an indemnification clause.

On May 7, 2010, a BP shareholder filed a shareholder's derivative class action lawsuit against BP and 15 individual directors and officers, including Tony Hayward, BP's CEO. The defendants also include other entities such as Transocean and Cameron and seek to name the defendants' insurers as third-party defendants.[13] The complaint seeks recovery against the directors and officers for breach of fiduciary duty and corporate waste. The plaintiffs have added the defendants' insurers to take advantage of the fact that Louisiana is one of the few jurisdictions permitting tort claimants to bring direct actions against the alleged tortfeasors' liability insurers.

Derivative shareholder actions were filed in other states.[14] Shareholders have also filed securities fraud actions against BP, and lawsuits have been filed by employees claiming losses from mismanagement of their company pension funds. Such suits will be litigated while personal injury and wrongful death plaintiffs pursue BP and the other target defendants.

Summation

Corporate risk managers who answer to management and report to boards of directors have an abundance of examples from which to gain insight as they prepare and execute both disaster avoidance and recovery plans. Every major catastrophe has been studied in both the public and private sector.[15] These disaster cases offer vivid examples of plaintiffs ferreting out negligent conditions, both in a structural sense and operationally.

Planning ahead for the event of a large loss or disaster means combining a corporation's own particular operational alternatives with a comprehensive insurance program. Adequate property insurance surely is a cornerstone. Given the dependence on suppliers of goods and services, particularly public utilities, contingent business interruption insurance is strongly recommended. Certainly, the advice of an experienced insurance broker can assist in preparing a comprehensive package of both property and liability protection.

Recall that after a disastrous loss, a corporation can frequently end up as *both* a defendant and a plaintiff. An individualized corporate disaster plan that includes strong and adequate insurance protection demonstrates a prudent consideration by corporate leadership of both sides of this equation. It will provide directors and officers with a response to claims and derivative suits alleging that the defendant directors and officers negligently caused, permitted, or failed to mitigate the corporation's massive loss. ■

Endnotes

1. *See, e.g.*, *In re* Terrorist Attacks on Sept. 11, 2001, 689 F. Supp. 2d 552 (S.D.N.Y. 2010).
2. For an in-depth understanding of the 7 WTC claims and theories of recovery, see, for example, *Industrial Risk Insurers v. Port Authority of New York & New Jersey*, 387 F. Supp. 2d 299 (S.D.N.Y. 2005).
3. *See* Pan Am. World Airways, Inc. v. Aetna Cas. & Sur. Co., 505 F.2d 989 (2d Cir. 1974).
4. A discussion of the history and enactment of TRIA can be found in Richard Allyn & Heather McNeff, *The Fall and Rise of Terrorism Insurance Coverage since September 11, 2001*, 29 WM. MITCHELL L. REV. 821 (2003).
5. 18 U.S.C. § 2333 (2006).
6. *Id.* § 2331(1).
7. 511 F.3d 707 (7th Cir. 2007), *vacated*, 549 F.3d 685 (7th Cir. 2008).
8. *See* 18 U.S.C. §§ 2339A, 2339B.
9. 8 U.S.C. § 1101(a)(22).
10. *See* Pembina Consol. Silver Mining & Milling Co. v. Pennsylvania, 125 U.S. 181, 187 (1888).
11. *See* Bano v. Union Carbide Corp., 273 F.3d 120 (2d Cir. 2001); *In re* Dow Chem. Sec. Bhopal Litig., No. 00 CIV. 3364, 2000 U.S. Dist. LEXIS 18698 (S.D.N.Y. Dec. 28, 2000); Union Carbide Corp. v. Union of India (*Union of India I*), A.I.R. 1990 S.C. 273, 274–76 (India).
12. *See, e.g.*, *In re* Individual 35W Bridge Litig., 806 N.W.2d 820 (Minn. 2011).
13. Firpo v. Hayward, No. 2:10-cv-01430 (E.D. La. May 7, 2010).
14. *See, e.g.*, *In re* BP S'holder Derivative Litig., No. 4:10-cv-03447 (E.D. Tex. Sept. 23, 2010) (naming officers and directors as defendants).
15. See, for example, the WTC studies carried out by the Federal Emergency Management Agency (FEMA) and the National Institute of Standards and Technology (NIST). *E.g.*, NAT'L INST. OF STANDARDS & TECH., FINAL REPORT ON THE COLLAPSE OF THE WORLD TRADE CENTER TOWERS (NIST NCSTAR 1) (2005); NAT'L INST. OF STANDARDS & TECH., FINAL REPORT ON THE COLLAPSE OF WORLD TRADE CENTER BUILDING 7 (NIST NCSTAR 1A) (2008).