

**BUSINESS INTERRUPTION AND
EXTRA EXPENSE COVERAGES:
STRATEGIC CONSIDERATIONS IN
CATASTROPHIC LOSSES**

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I. INTRODUCTION

Hurricanes Katrina and Rita devastated the Gulf Coast region in the fall of 2005. Most significant were the loss of life and the displacement of whole communities. Addressing the tremendous human costs is, of course, the first order of business, and there remains much to be done. Nevertheless, insurance-coverage issues are already emerging as policyholders and insurance companies grapple with the broad scope of catastrophic residential and commercial losses.

Like any catastrophic loss, Katrina and Rita will undoubtedly generate many commercial insurance claims. A great number of these claims will involve business-income (or business-interruption) losses, extra-expense coverage, and losses arising under Civil Authority clauses. Because these types of losses can be quite substantial and involve “soft costs,” rather than “hard costs” of direct physical loss or damage, they can be the source of significant coverage disputes between the policyholder and its insurer. Although it is beyond the scope of this paper to treat these topics in detail, this paper does provide a brief treatment of Business Interruption coverage and its complementary coverages: extended business income, actions by civil authority, and impairment of ingress and egress.

In general, business interruption coverage, also called business income coverage, reimburses an insured business for revenues it loses during downtime caused by damage to or loss of its property. In general, extra expense coverage reimburses an insured business for expenses incurred to avoid or minimize the suspension of business. An example: The roof of the insured’s building sustains severe damage from a hailstorm. Hail is a peril covered under the policy, and therefore, the property damage is covered under the policy. In addition, the business income coverage may pay for the income that was lost while the insured could not occupy the building. The extra expense coverage may pay for the rent for temporary premises while the roof is repaired.

II. BUSINESS INTERRUPTION COVERAGE

The purpose of business interruption coverage is to protect earnings that an insured would enjoy had there been no interruption of business. *See Royal Indemnity Insurance Co. v. Mikob Properties, Inc.*, 940 F. Supp. 155, 157 (S.D. Tex. 1996). It indemnifies an insured for losses sustained from the inability to continue to use the insured premises.

Even though an insured’s property may be damaged by a covered peril, thus triggering the property damage coverage under a policy, and the insured may suffer loss of income as a result, business income coverage may not be triggered. Several specific requirements must be met in order to trigger such coverage. Further, courts generally adhere to a strict interpretation of the policy language in finding that the specific requirements need to be met to trigger coverage.

A. Three Requirements for Business Interruption

A fairly typical business income coverage provision states as follows:

“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.’ The suspension must be caused by direct physical loss of or damage to property . . . at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss. . . .”¹

¹ ISO Commercial Risk Services, Inc., 1994 Form CP 00 30 06 95, Business Income (and Extra Expense) Coverage Form. A copy of the form is attached as part of the Appendix to this paper. Note, however, that there are differences in language of policies providing business interruption coverage, and that the law interpreting these provisions must be reviewed carefully. There is relatively little Texas case law dealing with business interruption coverage, so looking to the law of other jurisdictions may be

- There must be direct physical damage to insured property caused by a covered peril. In other words, the policy must provide coverage for the physical damage sustained.
- The physical damage must cause the interruption or suspension of the insured's business and an actual monetary loss or loss of business income.
- The monetary loss must occur during "the period of restoration," as defined by the policy. The period of restoration is typically defined as the period beginning on the date of physical loss or damage and ending when physical damage to the insured property should have been repaired or replaced with reasonable speed.

Under business interruption coverage, an insured is entitled to recover only for the actual loss sustained, because the purpose of business interruption insurance is to put the insured in the same position it would have been in had no loss occurred.

The insured generally must prove it (1) suffered an actual monetary loss; (2) during its necessary suspension of operations; and (3) the loss was not due to some reason other than the interruption. *See e.g., Royal Indemnity Co. v. Little Joe's Catfish Inn, Inc.*, 636 S.W.2d 530, 535 (Tex. App. – San Antonio 1982, no writ) (holding that in order for there to be liability for a business interruption loss, the claimant must show an actual monetary loss).

1. Direct Physical Loss/Damage to Covered Property

The direct physical damage to insured property must be caused by a covered peril, and the business interruption must be caused by the direct physical damage. Business interruption

necessary. Also note that one can obtain business income coverage without extra expense coverage. See ISO Properties, Inc., 2001 (Form CP 00 32 04 02, Business Income (Without Extra Expense) Coverage Form). A copy of that form is also attached as part of the Appendix.

caused by anything other than a covered physical loss is not compensable. This determination requires the application of what some commentators have referred to as a "sole cause" standard. In other words, the business interruption must have resulted directly from covered damage; no damages can be recovered from the insurer for any interruption resulting from uncovered damage.

An instructive case is *Compagnie Des Bauxites De Guinee v. Insurance Company of North America*, 721 F.2d 109 (3d Cir. 1983). The insured in that case mined, processed and shipped bauxite ore, and it operated its own railroad to transport the ore. 721 F.2d at 111. Two of the insured's trains collided head-on, destroying both locomotives, and destroying and damaging many ore cars and railroad tracks. *Id.* The physical damage was covered by the policy. *Id.* The issue was whether the physical damage to the property as a result of the train collision caused the insured's production losses, or whether the production losses resulted from a lack of locomotive operators, which was an uncovered cause. *Id.* The trial court had instructed the jury that the business interruption must have resulted directly from damage or destruction of real or personal property, and that the insured could not recover for business interruption losses caused by a lack of locomotive operators. *Id.* at 113. The appellate court held that the instruction was entirely consistent with the language of the policy. *Id.* Accordingly, there could be no recovery for business income losses resulting from an uncovered cause.

Texas recognizes the doctrine of concurrent causes. *See Wallis v. United Services Automobile Ass'n*, 2 S.W.3d 300, 302 (Tex. App.–San Antonio 1999, pet. denied); *Curtis v. State Farm Lloyds*, No. Civ. A. H-03-1025, 2004 WL 1621700, *10 (S.D. Tex. Apr. 29, 2004). This doctrine provides that when covered and noncovered perils combine to create a loss, the insured is entitled to recover only that portion of the damage caused by the covered peril. *Wallis*, 2 S.W.3d at 302; *Curtis*, 2004 WL 1621700, *10. Because an insured can recover only for covered events, the burden of

segregating the damage attributable solely to the covered event is a coverage issue for which the insured carries the burden of proof. *Wallis*, 2 S.W.3d at 303; *Curtis*, 2004 WL 1621700 at *10. If the insured is unable to make such an apportionment of damages, he may be entitled to no recovery at all. *Id.*

The sole causation principle has been applied to business interruption losses in Texas. See *Coastal Refining & Marketing, Inc. v. Coastal Offshore Ins., Ltd.*, 1996 WL 87205 (Tex. App.—Houston [14th Dist.] 1996, no writ) (not designated for publication). In that case, the insured made a claim for business interruption when a piece of equipment at the insured’s refinery had to be shut down to repair nozzles. *Id.* at *1. The insured presented evidence of the down time to replace all ten nozzles even though there was no evidence that three of the nozzles were damaged. *Id.* at *4. The court held that because the insured failed to segregate the business interruption attributable to the repair of the undamaged nozzles from the business interruption attributable to the repair of the damaged nozzles, the insured did not meet its burden of proof to establish a claim under the policy. *Id.*

In sum, business interruption caused by anything other than a covered physical loss is not recoverable. In addition, the insured has the burden to segregate business interruption losses attributable to covered claims from those losses attributable to uncovered claims.

2. Total v. Partial Suspension

Most policies today refer to necessary suspension of the insured’s operations.

Until fairly recently, suspension generally was not defined in business interruption policies. *Black’s Law Dictionary* defines suspension as “a temporary stop, a temporary delay, interruption, or cessation.” The literal reading of “suspension” is that the insured’s business operations cease completely.

The majority of jurisdictions that have examined the question of what constitutes a “necessary

suspension” of operations for the purposes of business interruption insurance where suspension is an undefined term, hold that a complete cessation of business is required. See, e.g., *Home Indemnity Co. v. Hyplains Beef, L.C.*, 893 F. Supp. 987, 991-92 (D. Kan. 1995).

Texas is in the majority. For instance, in *Royal Indemnity Insurance Co. v. Mikob Properties, Inc.*, 940 F. Supp. 155, 155 (S.D. Tex. 1996), one building in an apartment complex was destroyed by fire; the other two buildings had only minor damage. After the fire, Royal paid the insured the rental income that was lost from the closing of the building that was destroyed. *Id.* at 156. The insured demanded that Royal also pay the decrease in rental income from the other two buildings. *Id.* The insured argued that the fire damaged the quality of life at the complex as a whole and that tenants vacated the other two buildings as a result. *Id.*

The court held that although some tenants voluntarily moved out of the other two buildings, that did not amount to a “necessary suspension of operations or tenancy” under the policy because the apartments in those two buildings remained available for rent after the fire. *Id.* at 157. Accordingly, the insured was not entitled to a recovery for the lost rental income from the other two buildings.

Similarly, in *Quality Oilfield Products, Inc. v. Michigan Mutual Insurance Co.*, 971 S.W.2d 635, 636 (Tex. App.—Houston [14th Dist.] 1998, no pet.), the court held that a “work slowdown” did not trigger business interruption coverage. In that case, the insured’s place of business was burglarized and engineering drawings, computer media disks, and design information were stolen. *Id.* The insured filed a claim for business interruption losses asserting that the items stolen were the “nerve center of its operations and caused an interruption in its normal business activity.” *Id.* The business, however, remained open and continued to operate. *Id.* at 638.

The court held that although the term “interruption of business” was not defined in the policy, it was an unambiguous term meaning an actual “cessation or suspension” of operations

and did not include a “work slowdown.” *Id.* at 637-38. Thus, the business interruption coverage was not triggered.

The following are examples of a few cases from other jurisdictions holding similarly. In *American States Ins. Co. v. Creative Walking, Inc.*, 16 F.Supp. 2d 1062, 1064 (E.D. Mo. 1998), the insured’s business headquarters were flooded when a water main broke. After the flood, which was a covered cause of loss, the business premises were untenable, and the insured moved its operations to a temporary facility. *Id.* The insured made a claim for business income loss, asserting that it suffered a slowdown of its business operations for a period of 18 weeks following the flood. *Id.* The policy required a “necessary suspension” of operations. *Id.* The carrier argued that the insured was only entitled to reimbursement for the loss of business income sustained during the 13-day period between the flood and the relocation of the business headquarters. *Id.* at 1065. The court agreed, holding that “necessary suspension” referred only to a “total cessation of business activity.” *Id.* The court found that because the insured was able to continue its business operations at a temporary facility, it did not suffer a “necessary suspension” of its operations. *Id.* The fact that the insured did not resume operations at the original premises was of no consequence, because the policy coverage was not so limited. *Id.* What was critical, however, was that the insured was able to continue its business operations. Accordingly, the court held the insured was only entitled to reimbursement for its loss of business income sustained during the 13-day period in which its operations were necessarily suspended. *Id.*

Likewise, in *Home Indemnity Co. v. Hyplains Beef, L.C.*, the court held that slowdown of business and loss of efficiency were not a necessary suspension of operations, and thus the business income coverage was not triggered. 893 F.Supp. 987, 991 (D. Kan. 1995); *see also Keetch v. Mutual of Enumclaw Insurance Co.*, 66 Wash. App. 208, 212, 831 P.2d 784, 787 (Wash. App. Div. 3, 1992) (finding that damage from a volcanic eruption causing a reduction in

business at a motel was not a suspension of business activity).

In contrast, cases involving policy language providing coverage for “necessary or potential suspension” have found coverage for partial suspensions of business operations. For example, in *American Medical Imaging Corp. v. St. Paul Fire & Marine Insurance Co.*, 949 F.2d 690, 693 (3d Cir. 1991), the court held that a partial suspension of operations triggered the business interruption coverage where the business continued, but at a less than normal level. The policy in that case provided coverage for the “necessary or potential suspension” of operations. *Id.* at 692. The insured’s business headquarters suffered damages that made the use of the facilities impossible. *Id.* at 691. The insured rented a new location the next day. It returned to its original premises about six weeks later. *Id.* During the period of relocation, the insured conducted business, but at a less than normal level. *Id.* at 693.

At issue was whether the insured suffered a suspension within the meaning of the policy. *Id.* at 692. The appellate court held that the insured’s loss was covered because it “experienced a ‘necessary suspension’ of its business operations briefly on the morning following the fire. Moreover, on that morning, it faced a ‘potential suspension’ of a much longer duration.” *Id.* The court noted that the insured acted promptly to mitigate its loss by relocating and conducting its business on a scaled down basis. *Id.* Accordingly, the court held that as a result of the necessary suspension and the potential suspension, the carrier was required to indemnify the insured for lost earnings. *Id.*

In marked contrast to older business interruption forms that are still utilized, the recent ISO Business Income (and Extra Expense) Coverage Form defines the term “suspension.”² The

² Insurance Services Office, Inc., 1999 Form CP 00 30 10 00, Business Income (and Extra Expense) Coverage Form. A copy of the form is attached as part of the Appendix. This form was approved in 2001 for use by the Texas Department of Insurance.

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.”

The recent ISO form, then, provides coverage for partial and total suspensions. Accordingly, the actual policy language is absolutely critical in determining the extent of coverage. And as the cases above which deal with traditional forms demonstrate, courts generally strictly construe the language.

a. Mitigation of Damages Clauses

In interpreting whether a policy requires a total cessation of business operations to trigger the business interruption coverage, it is also instructive to look at the policy’s mitigation clause. For instance, in *Quality Oilfield Products, Inc.*, the insured argued that a finding that business interruption coverage was triggered only when an insured totally ceased operations would encourage insureds to unnecessarily shut down business and not mitigate damages. 971 S.W.2d at 638. The insurer in that case contended that a review of the entire policy supported the interpretation that the “interruption of business” had to be a total cessation. *Id.* The mitigation clause in the policy required the insured to mitigate damages by a “complete or partial resumption of operation of the property.” *Id.* The insurer contended that if the business interruption coverage required something less than a total suspension of business, the mitigation clause would be rendered meaningless. *Id.* In other words, there could no resumption if the insured never stopped doing business. *Id.*

The court agreed, finding that by requiring the insured to mitigate the loss and resume operations, even if only partially, the clause implied that the cessation must be total to qualify for coverage. *Id.*

Likewise, in *Home Indemnity Co. v. Hyplains Beef, L.C.*, the court held that a mitigation clause requiring the resumption of operations implied that “there must have necessarily been a

stoppage of operations from which it was necessary to begin anew.” 893 F.Supp. at 993. The court also noted that such a mitigation provision merely means that an insured must endeavor to resume its operations as quickly as possible following the event creating the cessation, and if it does not do so, the insurer is relieved from paying for the excessive loss. *Id.* “An insured is not ‘punished’ by continuing business at a lower level following an event causing a physical loss or damage because, if in fact the insured is able to continue business following the event, coverage never applied in the first place.” *Id.*

b. Actual Monetary Loss/Measure of Damages

The insured must have suffered an actual loss of income, as defined by the policy, in order to recover. For example, in *Royal Indemnity Co. v. Little Joe’s Catfish Inn, Inc.*, 636 S.W.2d 530, 535 (Tex. App.–San Antonio 1982, no writ), the insurer asserted that the insured had sustained no actual loss of earnings under the terms of the policy. The court agreed, holding that “there is no evidence of any loss of earnings sustained in this regard as that term is defined in the policy.”

Also note that the insured must show an actual monetary loss as the direct result of a suspension of operations, and not because of another reason, in order to recover. It must be the suspension of operations that causes the loss, and not, for example, the fact that the insured’s product was outdated.

It is not necessary, however, that the business be operating at a profit prior to the loss.

Generally, loss must be incurred during a specified time interval, typically called the “period of restoration,” and the insured is entitled only to recover for the actual loss sustained; the insured may not receive a windfall or recover for a purely speculative claim.

Business income is typically defined in a policy as “net income” (net profit or loss before income taxes) that would have been earned or incurred,

plus continuing normal operating expenses incurred, including payroll.

Although it is often difficult to determine the exact amount of an insured's loss due to an interruption of business, such an estimate cannot be speculative.

The calculation of the actual loss is largely a question of fact. The parties generally use accounting experts who rely upon theoretical projections based upon historical and projected business performance. See e.g., *Lexington Insurance Co. v. Island Recreational Development Corp.*, 706 S.W.2d 754, 756 (Tex. App.–Beaumont 1986, writ ref'd n.r.e.). Business interruption losses are determined in a practical way by reliance on the experience of the business before the loss and its probable experience thereafter.

A number of policies contain language indicating the business's historical sales figures will be taken into account in calculating business-interruption losses. A recent Fifth Circuit case, *Finger Furniture Company, Inc. v. Commonwealth Ins. Co.*,³ involving losses from Tropical Storm Allison is illustrative of this issue. In *Finger Furniture*, the insurer claimed that because the insured held a post-loss sale, the insurer was entitled to an offset against the losses the insured incurred during Tropical Storm Allison. The business-interruption provision provided in relevant part:

In determining the amount of gross earnings covered hereunder for the purposes of ascertaining the amount of loss sustained, due consideration shall be given to the experience of the business before the date of the damage or destruction and to the probable experience thereafter had no loss occurred.

Rejecting the insurer's "offset" position, the court stated, "The contract language does not suggest that the insurer can look prospectively to

what occurred after the loss to determine whether its insured incurred a business-interruption loss." *Id.* Note that whether the insured mitigated its damages was not an issue on appeal and could have affected the court's analysis if it were.

In practice, situations where the suspension of operations will be lengthy, the business interruption claim is commonly settled long before the period of restoration is concluded, and is actually based on a probable loss-sustained basis.

This is particularly true in Texas with Texas Insurance Code Section 542 and its dictates (previously article 21.55).

3. Duration of the Business Interruption/ Period of Restoration

The purpose of "the period of restoration" is to restrict coverage to earnings lost during the period of time necessary to restore the business to its pre-accident condition.

As with the other terms, in interpreting the extent of the period of restoration, the policy language itself is critical. For instance, in *Lexington Insurance Co. v. Island Recreational Development Corp.*, 706 S.W.2d 754, 755 (Tex. App.–Beaumont 1986, writ ref'd n.r.e.), the insured operated a restaurant that was damaged by a severe storm, which caused the restaurant to be closed from September 11, 1982 through December 3, 1982. The insured sought business interruption losses from September 11, 1982 through June 1983, when the restaurant finally regained its previous level of operation. *Id.* The insurer argued that the insured was only entitled to business income losses through December 3, 1982 because that is when the restaurant reopened. *Id.* at 756. The court held that the insured was entitled to recover through June 1983, when the previous level of operation was returned. *Id.* The court found that because there were undefined terms in the policy, uncertain language was to be interpreted to avoid forfeiture. *Id.* The court affirmed the trial court's holding that the terms of the policy

³ 404 F.3d 312, 314 (5th Cir. 2005).

“were such as to allow recovery for the period the restaurant was rebuilding its business.” *Id.*

In *Duane Reade, Inc. v. St. Paul Fire & Marine Insurance Co.*, 279 F. Supp. 2d 235 (S.D.N.Y. 2003), the insured owned a drugstore that was destroyed in the September 11, 2001 terrorist attack on the World Trade Center. The principal dispute in the case concerned the length of the period of restoration under the business interruption coverage. *Id.* at 238. The policy contained a period of restoration clause that provided that the “measure of recovery or period of indemnity shall not exceed such length of time as would be required with the exercise of due diligence and dispatch to rebuild, repair, or replace such property that has been destroyed or damaged, and shall commence with the date of such destruction or damage and shall not be limited by the date of expiration of this policy.” *Id.*

The insured argued that the period of restoration consisted of the actual time period that would be required to restore its operations, and that the period was coterminous with the time necessary to rebuild the complex which would replace the World Trade Center. *Id.* The insurer, in contrast, argued that the period of restoration terminated when, at a time that was already passed, the insured could have restored operations at locations other than the World Trade Center. *Id.*

The court concluded that neither side’s interpretation accorded with the plain language of the policy. *Id.* It found that the insurer’s interpretation was unreasonable because the term “property” referred to the specific premises at which the insured operated its World Trade Center store. *Id.* Thus, the insurer’s argument that “property” referred not to a store in any particular location, but to the business of the entire chain owned by the insured was manifestly unreasonable. *Id.* The court also found the insured’s interpretation unreasonable.

The court held that the period of restoration clause, on its face, “envision[ed] a hypothetical or constructive (as opposed to actual) time frame for rebuilding, as evidenced, for example, by the

use of the subjunctive “would.” *Id.* at 239. The court further noted that “what is to be hypothesized is the time it would take to rebuild, repair or replace the World Trade Center store itself, not the entire complex that once surrounded it. Once [the insured] could resume functionally equivalent operations in the location where its WTC store once stood, the Restoration Period would be at an end.” *Id.*

Other courts also hold that policies which define “period of restoration” as the length of time which “would” be required to repair, et al., contemplate a theoretical time period it would have taken the insured to reenter business. *See e.g., Hampton Foods, Inc. v. Aetna Casualty & Surety Co.*, 787 F.2d 349, 355 (8th Cir. 1986).

It should also be noted that courts may allow a reasonable extension of the period of restoration where the restoration delay was due to the actions of the insurance company. *See id.*

III. EXTENDED BUSINESS INCOME

Extended Business Income, if applicable, compensates for business losses that continue during the short window of time immediately after the business is rebuilt but before the level of business activity has fully resumed. It is in addition to the core business interruption coverage that functions during the period of restoration.

A typical Extended Business Income clause provides as follows: (1) “. . . we will pay for the actual loss of Business Income you incur during the period that: (a) Begins on the date property (except “finished stock”) is actually repaired, rebuilt or replaced and ‘operations’ are resumed; and (b) Ends on the earlier of (i) the date you could restore your ‘operations,’ with reasonable speed, to the level which would generate the business income amount that would have existed if no direct physical loss or damage occurred; or (ii) 30 consecutive days after the date determined in (1)(a) above. However, Extended Business Income does not apply to loss of Business Income incurred as a result of unfavorable business conditions caused by the impact of the Covered Cause of Loss in the area

where the described premises are located. Loss of Business Income must be caused by direct physical loss or damage at the described premises caused by or resulting from any Covered Cause of Loss....”⁴

IV. ACTIONS BY CIVIL AUTHORITY

The actions of civil authorities, such as fire departments and police departments, may require a business to shut down, usually in times of emergency. Business interruption coverage may allow for reimbursement of lost income under such circumstances.

The following is a fairly typical provision:

“We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss. . . .”⁵

A civil-authority provision also typically contains a period of time for which it applies, such as the number of weeks from the date of the action.

The purpose of these types of provisions is to broaden business interruption coverage to include situations where the insured’s own property has not itself been damaged, but the business has been forced to shut down by order of a civil authority.

Coverage for business interruption due to civil authority requires five basic triggering events:

- An order of civil authority that prevents access to the policyholder’s place of business.
- The order is the result of direct physical loss or damage to property other than at the insured

⁴ See footnote 1, *supra*, ISO Form CP 00 30 10 00.

⁵ See footnote 2, *supra*.

premises. The further the physical damage is from the insured premises, the more difficult it can be for the insured to establish the causal link between that damage and the order.

- The physical loss or damage must be from a covered peril.
- The order must cause an interruption of the business. The coverage would not apply where, for example, the area is cordoned off, but the insured’s business was not open during that time period.
- The interruption resulting from the order must cause a loss of income. The loss of business income must be caused by the order itself, as opposed to problems resulting from the peril that caused business to fall off.

Also note the insurer becomes liable for only the actual loss of business income the insured sustains as a result of the order, not simply as a result of the peril.

A. What Is an Action of “Civil Authority”?

Civil authority generally is an undefined term in most policies. An official order of governmental authority, such as from the police or fire departments, falls within this term. Is something less “official” sufficient? For instance, a general warning from the news media “not to travel on roadways unless absolutely necessary” probably will not suffice.

B. What Is a Sufficient Causal Connection Between the Property Damage and the Denial of Access to the Property?

A few recent cases are instructive. In *730 Bienville Partners, Ltd. v. Assurance Co. of America*, 2002 WL 31996014 (E.D. La. Sept. 30, 2002) *aff’d* by 2003 WL 21145725 (5th Cir. 2003), the court found that civil authority coverage did not extend to business income losses suffered by hotels in New Orleans after the FAA closed airports around the country on September 11, 2001 in response to the terrorist

attacks in New York, Washington, D.C. and Pennsylvania. The court found that the hotels suffered losses due to cancellations and passengers' inability to fly, but not because the hotels had been closed. The court held that no suspension of business took place because the FAA's action did not prohibit access to the insured premises within the meaning of the policy.

In *Assurance Co. of America v. BBB Service Co.*, 259 Ga. App. 54, 576 S.E.2d 38 (Ga. App. 2002) the court held that an order of a civil authority based on the threat of damage, without any actual damage occurring, would not trigger coverage. The insured owned several Wendy's hamburger restaurants in Florida and Georgia. In September 1999, Brevard County, Florida issued an evacuation order for the county. Evacuation was ordered because of "the serious threat to the lives and property of residents of Brevard County from Hurricane Floyd . . ." *Id.* at 55. The insured closed its Brevard County locations for two and one-half days based on the evacuation order, and made a claim for business income losses. The insurer denied the claim stating that coverage did not exist because the order that triggered the evacuation was not the result of damage to property other than the insured premises, but rather only the threat of injury. *Id.* at 56. The court of appeals remanded the case to answer the factual question of whether the evacuation order was issued, at least in part, because of property damage somewhere, or whether after the evacuation order was issued, property was actually damaged by the hurricane and that damaged property became a basis for the county to prohibit the insured's access to its restaurants. *Id.* at 57. The court instructed that there would only be coverage if there was actual damage. Therefore, unless there was actual hurricane damage, as opposed to the mere threat of damage, the denial of coverage was correct. *Id.*

After a bench trial in which the parties stipulated that "[p]roperty damage was occurring throughout the effective term of the evacuation order" and agreed that the only issue to be tried was whether the evacuation order was issued pursuant to damage to property other than the

insured's premises, the trial court ruled in favor of the insured—implying a finding that the basis for the evacuation was, in fact, actual damage to property other than the insured's. The trial court's holding was upheld on appeal. *Assurance Co. of America v. BBB Service Co.*, 265 Ga. App. 35, 593 S.E.2d 7, 8-9 (Ga. App. 2003).

These cases demonstrate that there must be actual physical damage to trigger coverage. In addition, there must be a causal connection between the actual physical damage and the action of the civil authority. Further, the action of the civil authority must cause a suspension of operations.

In *U.S. Airways, Inc. v. Commonwealth Ins. Co.*, 64 Va. Cir. 408 (Va. Cir. Ct. May 14, 2004), the court found that civil authority coverage extended to business income losses suffered by U.S. Airways after the FAA closed airports around the country in response to the terrorist attacks of September 11, 2001.

In that case, U.S. Airways sought business interruption coverage under its policy with PMA Capital Insurance Corp. caused by the FAA's ground halt order of September 11, 2001. The policy was an "All Risk Manuscript Property Policy" that contained a provision entitled "Interruption by Civil or Military Authority." This provided coverage where "as a direct result of a peril insured against, access to real or personal property is prohibited by an order of civil or military authority." *Id.* at *3.

The insurer argued there was no coverage for business interruption because U.S. Airways could not demonstrate that the order grounding flights was due to a covered peril. *Id.* The insurer argued that the grounding was a precautionary measure taken to prevent property damage and injury that had not yet occurred and as such, mere precautionary measures were not covered perils. *Id.* U.S. Airways countered that the plain language of the policy provided for coverage because as a result of civil authority intervention, a business interruption loss was sustained. *Id.* U.S. Airways further argued the policy did not specify that the insured's property

had to be damaged to serve as the predicate to intervention by a civil authority. *Id.* It argued that it suffered a direct physical loss of all of its airport facilities and its abilities to service customers by being denied access by civil authorities to those facilities, and that damage alone was sufficient under the terms of the policy. *Id.*

In contrast, the insurer maintained that actual damage to U.S. Airways property was required. *Id.* at *4. The court found that the policy did not require property damage to the insured's property because the policy language was not specific on that issue. *Id.* at *4. The court held that the policy only used the terms "direct" and "property" without any definitions or references to what property must be damaged or where the loss must have occurred prior to civil authority intervention. *Id.* The court held that damage to the physical property of U.S. Airways was not a condition for recovery, and thus, the civil or military intervention coverage applied. *Id.* at *5.

V. IMPAIRMENT OF INGRESS AND EGRESS

Many policies also provide coverage for loss sustained during a stated period of time when, as a result of an insured peril, ingress or egress from property used by the insured is prevented or impaired. These provisions usually do not require that there be any property damage.⁶ Further, no order of civil authority preventing access is required.

A typical ingress/egress provision is as follows:

"This policy is extended to cover the loss sustained during the period of time, not exceeding 90 consecutive days when, as a result of an insured peril, ingress to, egress from, or access to any real or personal property used by the insured is prevented or impaired."

⁶ However, some policies do require property damage. *See, e.g., City of Chicago v. Factory Mut. Ins. Co.*, 02 C 7023, 2004 Lexis 4266, (N.D. Ill. Mar. 11, 2004).

Coverage for ingress/egress requires five basic triggering events:

- Ingress or egress from the insured premises must be impaired. It is not sufficient that the peril made it more difficult for people to move around. Rather, the premises must have been open and accessible, but the peril impaired or prevented ingress or egress.
- The event preventing ingress or egress must be an insured peril. Most ingress/egress coverage clauses lack a geographic limitation. Therefore, there may be coverage even if the events causing barred access occurred far from the insured premises. However, the greater the distance from the insured premises, the more difficult it becomes for the insured to show the causal link between the peril and the impaired access.
- The impairment or prevention of ingress must cause an interruption of the business. For instance, the coverage does not apply if the business would not have been open anyway. Nor will it apply to a decrease in customers.
- The interruption of business caused by the prevention of ingress or egress must cause an actual loss of business income.
- Whether physical damage is required will turn on the language of the specific policy.

VI. EXTRA EXPENSE

Extra expense coverage is designed to compensate an insured for those necessary extra costs incurred while physical damage repairs are being made to the property to enable the insured to continue operations or to minimize the suspension of its operations. For example, the cost of renting temporary office space and substitute equipment following a loss are typical extra expenses. Extra expense coverage provides the necessary funds to enable the insured's business to continue, thus allowing it to generate income. In contrast, business interruption coverage replaces income lost due to a suspension of business following a loss.

A typical extra expense coverage provision states as follows:

“Extra Expense means necessary expenses you incur during the “period of restoration” that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss.

(1) We will pay any Extra Expense to avoid or minimize the suspension of business and to continue operations:

- (a) At the described premises; or**
- (b) At replacement premises or at temporary locations, including:**
 - (i) Relocation expenses; and**
 - (ii) Costs to equip and operate the replacement or temporary locations.**

(2) We will pay any Extra Expense to minimize the suspension of business if you cannot continue operations.

(3) We will pay any Extra Expense to:

- (a) Repair or replace any property; or**
- (b) Research, replace or restore the lost information on damaged valuable papers and records;**

to the extent it reduces the amount of loss that otherwise would have been payable under this Coverage Form.”⁷

Extra expense coverage provides for the payment of extra expenses incurred by an insured in order to continue the normal conduct

⁷ See ISO Commercial Risk Services, Inc., 1994 Form CP 00 30 06 95, Business Income (and Extra Expense) Coverage Form; and Insurance Services Office, Inc. 1999 Form CP 00 30 10 00, Business Income (and Extra Expense) Coverage Form. As explained above, the policy language is absolutely critical in determining the extent of coverage.

of its business during the period of restoration, providing that the damage to the insured’s property was caused by a risk insured against. *See, e.g., Valley Forge Ins. Co. v. Hicks Thomas & Lilienstern, L.L.P.*, No. 01-03-00708-CV, 2004 WL 2903521, *3 (Tex. App.–Houston [1st Dist.] Dec. 16, 2004, no pet. h.) (holding that insured law firm was not entitled to coverage for loss of business income or extra expense when firm had to temporarily relocate due to heavy rains from Tropical Storm Allison which flooded downtown Houston causing water to pour into basement, damaging electrical equipment that supplied power to office building, because policy contained specific exclusion for losses due to flood or surface water).

In *Travelers Indem. Co. v. Pollard Friendly Ford Co.*, 512 S.W.2d 375 (Tex. Civ. App. 1974, no writ), the court addressed the purpose of extra expense coverage. In that case, the insured’s auto dealership was damaged by a tornado. The court stated that the purpose of extra expense coverage was “not for the cost of rebuilding or restoring the physical structure on the premises, but primarily for securing extra facilities and for ‘necessary emergency expenses’ of a concrete or practical nature to compensate for extra expenses incurred in getting the business back in normal operation at the earliest practicable time.” *Id.* at 380. The court found that costs to clean up debris, watch protection for unsecured doors and windows, extra compensation for employees, costs of meals to reduce the employees’ time spent away from the job site, and costs of property obtained for temporary use were all covered as extra expenses under the language of the policy at issue. *Id.* at 380-81. The court, however, excluded coverage for expenses that were no greater than “normal” or which were not necessitated by the loss. *Id.* at 381. (Note that the extra expense coverage language at issue in *Pollard* was not exactly like the policy language quoted above. The court found the language ambiguous, and construed it against the insurer. *Id.* at 379.)

A. Three Requirements for Extra Expense

In general, there are three major requirements for extra expense coverage:

- The extra expense must be necessary.
- The extra expense must be incurred during the period of restoration.
- The expense incurred must be a type that would not have been incurred had there been no loss to the covered property.

Under the ISO form, extra expense includes two categories of expenses:

- Expenses to avoid or minimize the suspension of business; these are known as “true extra expenses.”
- Expenses to repair or replace property, but only to the extent that such expenses reduce the amount of loss that otherwise would have been payable, i.e., reduce the business interruption claim. These expenses are sometimes referred to as “expediting expenses.”

The following cases are instructive.

In *Snelling and Snelling, Inc. v. Fed. Ins. Co.*, 2005 WL 2767610 (Oct. 25, 2005 N.D. Tex), the court rejected the insured’s position that attorney expenses it incurred in evicting tenants from the insured premises and Worker’s Compensation costs were covered under its first-party property policy’s extra-expense coverage. *Id.* at *3-4.

The insured, which was in the business of providing personnel services around the United States, claimed losses from the terrorist attacks of September, 11, 2001. In an effort to mitigate its losses, the insured rented out some of its insured office space near the World Trade Center. The insured claimed its eviction costs, which included attorney fees, were over and above the expenses the business would normally incur. The policy at issue defined extra expense as an expense incurred “in an attempt to continue operations, over and above the

expenses you would normally have incurred.” *Id.* at *3. Applying this definition to the claimed attorney fees, the court reasoned that “Snelling’s attorney’s fees were not incurred in an attempt to continue a business activity occurring prior to the loss,” but were, instead, incurred in an attempt to terminate a business that incepted post-loss — the subletting of its office space. *Id.* at *4

As to the insured’s extra-expense claim for its Worker’s Compensation costs, which the insured stated were incurred because of the terrorist attacks, the court, citing policy language, held they were not covered because the claims did not “result from direct physical loss or damages by a covered peril to [covered] property.” *Id.* at *3. The fact that the Worker’s Compensation claims would not have arisen but for the terrorist attacks was not sufficient, absent direct physical loss to covered property, to bring them within the policy’s scope of coverage.

In *Zurich American Ins. Co. v. ABM Indus. Inc.*, 265 F. Supp. 2d 302 (S.D.N.Y. 2003), the insured, ABM, was responsible for providing janitorial and related services for most of the World Trade Center complex. *Id.* at 304. After the terrorist attack of September 11, 2001, ABM made a claim on Zurich for business interruption loss and extra expense, which it claimed resulted from the destruction of the World Trade Center premises it served. ABM provided janitorial, lighting and engineering services to the public common areas of the World Trade Center and also provided janitorial services to almost all of the tenants in the World Trade Center. *Id.* ABM itself occupied office and storage space in the World Trade Center, had access to janitorial closets and sinks located on every floor, and had exclusive after-hours use of the World Trade Center’s freight elevators. *Id.*

ABM sought coverage for its business interruption losses relating to all of the World Trade Center premises it served but did not otherwise occupy (i.e., the tenants’ premises and the public common areas), as well as the destruction of the World Trade Center space that ABM itself occupied, and the destruction of its own supplies and equipment located in the

World Trade Center. The court held that because the policy insured against loss resulting directly from the necessary interruption of business caused by direct physical loss or damage to property owned, controlled, used or leased by ABM, ABM was not entitled to recover business interruption loss as a result of the destruction of premises it served but did not otherwise own, control, etc. *Id.* at 305. Accordingly, it only had coverage for business interruption loss caused by the destruction of the spaces it occupied itself, or caused by the destruction of its own supplies and equipment located in the World Trade Center.

ABM also sought to recover extra expenses for millions of dollars in increased employee costs incurred pursuant to a union contract regarding employees displaced after September 11, 2001, increased state unemployment obligations incurred as a result of the termination of employees caused by the events of September 11th, and termination costs incurred in severance packages for employees resulting from the events of September 11th. *Id.* at 306. The policy in that case defined “extra expense” to mean the excess of the total costs chargeable to the operation of the insured’s business over and above the total costs that would normally have been incurred to conduct the business had no loss or damage occurred. *Id.* at 307. Under the policy, coverage only extended to those extra expenses resulting from covered loss or damage to real or personal property of ABM. *Id.* Accordingly, the court held that ABM’s extra expense claim, like its business interruption claim, failed to the extent the extra expenses incurred by ABM resulted from the destruction of property that was not owned, controlled, used, leased, or intended for use by ABM. *Id.* at 306-07. The extra expenses claimed by ABM for increased employee costs, employee termination costs, employee wages and expenses, and increased unemployment costs resulted from the destruction of the tenanted premises and common areas ABM serviced in the World Trade Center, and the loss of business caused thereby, and not from the destruction of ABM’s own equipment, supplies, or office or storage space in the World Trade Center. *Id.* at 307. As the court had determined that such premises

were not owned, controlled, used, leased, or intended for use by ABM, the extra expenses claimed by ABM were not recoverable. *Id.*

In *Nassau Gallery, Inc. v. Nationwide Mut. Fire Ins. Co.*, No. Civ. A. 00C-05-034, 2003 WL 21223843 (Del. Super. Apr. 17, 2003), the insured’s property was damaged by fire. In that case, the dispute revolved around whether costs related to the insured’s physical restoration were extra expenses under the policy. The extra expense provision at issue in that case is the ISO provision quoted above. The court held that the reconstruction-related expenditures were not valid extra expenses because such expenditures were related to the policy’s primary coverage, not the extra expense provisions. *Id.* at *3. In other words, the court found that the insured could not use extra expense coverage to rebuild its premises. *Id.* The court also noted that under subsection 3 of the provision, an insured may be compensated for the cost of repairing and replacing damaged property during the period of restoration. *Id.* However, the coverage is not for the cost of rebuilding and restoring the physical structure on the premises, but primarily for securing extra facilities and for necessary emergency expenses of a concrete or practical nature. *Id.* citing *Pollard Friendly Ford Co.*, 512 S.W.2d at 380. Because the insured’s construction-related expenses did not relate to either relocation or exigent circumstances, they were held not to be covered. *Id.*

The court also noted that extra expense coverage requires that the insured show that the expenses incurred exceed what it would have normally cost the insured to conduct its business had no loss occurred. *Id.* In addition, subsection 3 quoted above provides the expense must reduce the amount of loss that otherwise would have been payable. In sum, the court held that the disputed reconstruction expenses were losses to covered property, not valid extra expenses. *Id.* at *4. The court held, however, that advertising expenses incurred to inform the public of the insured’s post-fire status were valid extra expenses under subsection 1 of the extra expense coverage. The insured used the advertisements to inform the public that it remained open for business. This publicity was related to the

normal conduct of business and allowed the insured to operate during its restoration. *Id.* These would be covered because extra expense coverage deals with the increased costs of doing business after a covered loss. However, the court noted that the advertising expenses would have to be offset against the insured's normal advertising expenditures. *Id.*

Thompson v. Threshermen's Mut. Ins. Co., 493 N.W.2d 734 (Wis. App. 1992, pet. denied) is another instructive case. The insureds owned and operated a supermarket, which was insured under a Business Owners policy containing business interruption and extra expense coverages. *Id.* The insureds rented the building that housed the supermarket. *Id.* The building and most of the insureds' equipment, fixtures, and wares were destroyed by fire. *Id.* The landlord opted not to rebuild and the insureds were unable to locate suitable rental space, so they built their own supermarket. *Id.* They then submitted a claim under the extra expense portion of the policy for certain expenses involved in building a new structure, such as the loan guarantee fee, builder's permit, and certain equipment. *Id.* at 736. The insured contended that these expenses were incurred to minimize the suspension of business and to continue operation at replacement premises. *Id.*

The court found that certain terms in the policy at issue, *i.e.* "relocation expenses" and "costs to equip and operate the replacement locations" were ambiguous. *Id.* The court found, however, that neither the insureds nor the insurer contemplated coverage for these types of items under the extra expense portion of the policy. *Id.* at 737. The court held that costs to repair or replace property owned by the insureds and destroyed by the fire would be covered under the policy's property damage coverage and payable to the insureds as such. On the other hand, damage to the property owned by the landlord for which the insureds were paying rent and would have continued to pay rent, was not covered as an extra expense. The court noted that if it were to construe coverage for these items under the extra expense coverage, the insureds would have received ownership of a new building as a payoff under the policy. *Id.*

In sum, in order for extra expense claims to be covered, the expense must be loss related, it must be necessary and it must have been incurred during the period of restoration. Additionally, the expense must be over and above the insured's normal operating expenses. In other words, the insured must have incurred the expense because there was direct physical loss or damage to covered property at the described location caused by a covered cause of loss. Whether there will be coverage for extra expenses may often come down to how well the insured has documented and presented its expenditures. As noted above with business interruption coverage, forensic accountants are also generally required to help sort through extra expenses.

VII. CONCLUSION

Although commercial property policies typically include business interruption and extra expense coverages, it does not necessarily follow that a catastrophic property loss that severely undermines the income-generating capacity of the property qualifies for business interruption or extra expense coverage. The wording of most business interruption and extra expense policy provisions, including traditional ISO forms, yields itself to a fairly rigorous interpretation by Texas and other courts.

Typical coverage provisions usually require three basic elements to be met before an established business interruption loss qualifies for coverage: 1) the policy must provide coverage for the physical property damage sustained; 2) the physical damage itself must in turn result in an interruption of the business at that location causing an actual monetary loss; and 3) the monetary loss must occur during a specified "period of restoration." The interruption of the business must be complete and absolute. Under older policies, a business slowdown, even a business slowdown directly linked to the damaged property, usually will not qualify for coverage if the insured's business operations nonetheless continue at a reduced level.

Perhaps as a result of these traditional criteria for business interruption coverage, some policy forms provide coverage for business interruption caused by related events which would not qualify for coverage under a traditional form: actions by civil authority that result in business interruption and coverage for impairment of ingress and egress. Nonetheless, even these types of coverages likewise require relatively strict compliance with the literal policy terms. The coverage requirements for the business interruption in question may therefore dictate the scope, and the presentation, of a business interruption claim.

ISO Commercial Risk Services, Inc., 1994, Form CP 00 30 06 95, Business Income (and Extra Expense) Coverage Form.

Insurance Services Office, Inc., 1999, Form CP 00 30 10 00, Business Income (and Extra Expense) Coverage Form.

ISO Properties, Inc., 2001, Form CP 00 32 04 02, Business Income (Without Extra Expense) Coverage Form.

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APPENDIX