TERRORIST ATTACKS

WTC Tenant Covered Until 'Permanent Operations' Resume

***Duane Reade Inc. v. St. Paul Fire & Marine Insurance Co.*, No. 03–9064, 2005 WL 1460641 (2d Cir. June 22, 2005).**

The 2d Circuit has ruled that a World Trade Center tenant was entitled to business interruption coverage from its insurer until it could resume permanent operations, though not necessarily at its former site and not necessarily at pre-Sept. 11 levels.

St. Paul Fire & Marine Insurance Co. had appealed a District Court ruling that it could be required to provide coverage past the policy renewal date.

Duane Reade Inc. operated a drugstore in the WTC. After the building was destroyed in the Sept. 11 terrorist attacks, the company sought coverage for ongoing business interruption losses under a policy issued by St. Paul.

St. Paul contended that Duane Reade's right to recover was limited to the 21 months following the attacks.

Duane Reade alleged causes of action for breach of contract and sought declaratory relief, arguing that it had a right under the policy to recover for the entire period from Sept. 11 until the WTC is rebuilt.

Duane Reade argued that the policy should be read to provide that the restoration period consisted of the actual time period that would or will be required to restore the company's operations to the kind, quality and level that existed at the WTC store prior to the terrorist attacks and that the restoration period is coterminous with the time necessary to rebuild the complex that will replace the WTC.

St. Paul argued that the restoration period terminated when, at a time already past, Duane Reade could have "restored operations" at locations other than the WTC.

In August 2003 U.S. District Judge Jed Rakoff of the Southern District of New York rejected both interpretations, ruling that the plain language of the policy, which governs as a matter of law, referred unambiguously to the specific premises at which Duane Reade operated its WTC store (see *Insurance Coverage LR*, Vol. 13, Iss. 34).

However, the judge also found untenable Duane Reade's contention that the restoration period must be the same as the time actually required to rebuild the entire complex that will replace the WTC.

"What is to be hypothesized is the time it would take to rebuild, repair or replace the WTC store itself, not the entire complex that once surrounded it," Judge Rakoff said.

The decision permitted Duane Reade to recover business interruption losses beyond Dec. 31, 2007, if the policy-provided appraisers determine that the restoration period extends beyond that time.

On appeal St. Paul argued that the District Court erred in tying the "hypothesized time" of the restoration period to the time required to rebuild Duane Reade's store at the WTC location and that the restoration period continues until Duane Reade resumes "functionally equivalent" operations.

The U.S. Court of Appeals for the 2d Circuit agreed and modified the lower court's opinion accordingly. St. Paul need only provide coverage until Duane Reade could resume permanent operations, the appeals court said.

At the same time, the panel rejected a number of other arguments made by St. Paul: the District Court lacked jurisdiction, the action was barred because Duane Reade failed to submit a proof-of-loss statement or submit to an appraisal, the District Court erred in denying St. Paul's motion to compel appraisal, Judge Rakoff's ruling inconsistently tied the duration of coverage to both the rebuilding of the store and the resumption of operations, and Duane Reade's losses were barred because they resulted from the elimination of a consumer market in the area of the WTC, a peril expressly excluded under the policy.

Duane Reade was represented by James W.B. Benkard and Jeffrey Brown of Davis Polk & Wardwell in New York.

St. Paul was represented by Charles Fried, Lon A. Berk, Edward J. Grass, Charles A. Cowan and Stephanie Manson, all of McLean, Va.

See Document Section B for the opinion.

AVIATION

6th Cir. Says 'Wear And Tear' Ambiguous

***Meridian Leasing Inc. v. Associated Aviation Underwriters Inc.*, No. 04-1184, 2005 WL 1280797 (6th Cir. May 24, 2005).**

The 6th Circuit has found the term "wear and tear" ambiguous as used in an aircraft insurance policy and affirmed a judgment awarding the insured full indemnification for a claimed loss.

Meridian Leasing Inc. owned a Piper Meridian airplane that it purchased new in March 2001. When James Robins, Meridian's owner and the plane's authorized pilot, attempted to start the engine for an August 2001 flight, flames shot out of the aircraft's exhaust stacks.

Robins immediately shut down the engine and eventually extinguished the flames, but the engine was severely damaged. The cost of repairing the plane, plus substitute transportation costs, totaled nearly $250,000.

The Piper Meridian was insured under a policy from Associated Aviation Underwriters Inc. that covered "physical damage" on an "all-risk basis." Meridian filed a claim with AAU but the insurer denied it, citing the policy's exclusion for wear and tear.

Meridian filed suit in the U.S. District Court for the Western District of Michigan, seeking a declaration that the exclusion did not apply. It then moved for partial summary judgment on the proper interpretation of the policy's wear-and-tear exclusion.

Judge Ellen S. Carmody found that the policy did not define the term "wear and tear" and therefore, the term must be given its ordinary meaning. This in turn required that the wear and tear arise from "ordinary" or "normal" operation of the aircraft.

Concluding that the engine should not have caught fire during the ordinary or normal use of the plane, Judge Carmody awarded Meridian $295,333 in damages.

The U.S. Court of Appeals for the 6th Circuit affirmed, finding that the term "wear and tear" was ambiguous and that it did not encompass any and all damage, but was limited to the damage that resulted from normal or ordinary usage.

The District Court should not have attempted to define "wear and tear," the panel added, because the policy was "all-risk" and the "law demanded that the exclusionary language be exacting."

Further, the 6th Circuit held, AAU "was on notice that its wear-and-tear exclusion was susceptible to an interpretation requiring ordinary or normal operation of the engine [because] in *Carlson Cos. v. Associated Aviation Underwriters,* No. 89-819, 1989 WL 124372 (Minn. Ct. App. Oct. 24, 1989), the Minnesota Court of Appeals found ambiguity in the term 'wear and tear' and interpreted the term in accordance with its common usage."

Meridian was represented by Jon R. Muth of Miller, Johnson, Snell & Cummiskey in Grand Rapids, Mich.; and by Jon R. Muth and Mark P. Hunting of Miller, Johnson, Snell & Cummiskey in Grand Rapids.

AAU was represented by Barry R. Smith of the McCarthy Smith Law Group in Portage, Mich.

See Document Section C for the opinion.