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Perspectives

Don't get shortchanged on Katrina cover

In the aftermath of Hurricane Katrina, many businesses are grappling with obtaining coverage under their property insurance policies for both physical property losses and time-element losses. Because of the length and complexity of provisions in property policies, policyholders may overlook coverage that is worth potentially millions of dollars or lose coverage because of various time traps.

One common question that policyholders now face is that of what caused their loss—the winds and rain of Katrina, tides or “flood,” or something else. Many policies have differing deductibles and limits for hurricane-caused damage and flood-caused damage, and many policies exclude flood damage.

Policyholders generally are aware of the rule of “efficient proximate causation,” which applies in many jurisdictions. Under this rule, coverage typically depends on what is the “efficient proximate cause”—that is, the primary cause, or the cause that set the others in motion. If that cause is covered by a policy, then coverage is afforded. If that cause is excluded, then even if other causes contribute to the loss, coverage typically is not afforded. However, policyholders often overlook that the efficient proximate cause doctrine may not apply when two covered causes contribute to a loss. In its Aug. 26 decision in *Hit Factory Inc. vs. Royal Insurance Co. of America*, the U.S. District Court for the Southern District of New York held that the doctrine of efficient proximate cause does not apply when two coverages potentially apply to a given loss. As the court explained, there is no reason to apply the doctrine to a loss caused by two covered perils when the insurer “knew of the possibility that two coverages might apply to one damage, and yet did not outline any limita-

tions, aside from limiting damages to the actual loss or damages sustained by the insured.” Thus, when two perils contribute to a single loss, the policyholder should seek the full limits available for each of the coverages, not a single limit based on the efficient proximate cause doctrine.

Regardless of the number of causes, policyholders should look at the full scope of time-element coverages available. Policyholders should consider all potential extensions of coverage and the specific wording of each extension. For example, many property insurance policies provide coverage for “service interruption.” Most of those policies address “service interruption” in the form of an interruption of services such as energy or water.

But some service interruption provisions are not restricted to energy or water. Instead, they may apply to other sources of interruption. For example, some policies may provide coverage for interruption arising from damage or loss to any “direct service provider’s property” that is situated outside of the insured’s premises. This provision can be construed to include services provided by employees and thus may afford coverage if employees cannot work because their homes have been destroyed or damaged by the hurricane.

When a policyholder is attempting to measure the amount of its business interruption loss, it should not short-change itself. Policyholders frequently measure their loss by comparing the income they would have generated without the hurricane to the income they actually generated. This may result, though, in a lower insurance recovery than the law permits. A policyholder should consider measuring its loss not based on what it would have made if there had been no hurricane but based on what it would have made

had its facilities and operations not been affected by the hurricane while others were negatively impacted by the hurricane. As the U.S. District Court for the Eastern District of Louisiana explained in its 1997 decision in *Levitz Furniture Corp. vs. Houston Casualty Co.*, the policy “does not exclude profit opportunities due to increased consumer demand created by” an insured peril. As it further explained, “Business interruption loss earnings may include sales (the insured) would have made in the aftermath of the flood had it been open for business during that period.”

Finally, property policies typically have time requirements for things like providing notice, filing a proof of loss and filing suit. While many states show some leniency if an insured fails to comply with a deadline—typically when the insurer has not been prejudiced by any delay—other states do not. Many policies provide a short period within which the insured must give notice or file a proof of loss—some as short as 30 or 60 days—rather than simply requiring the insured to file a proof of loss upon the insurer’s request or as soon as practicable. Therefore, a policyholder should carefully review all such provisions of the policy to avoid any potential forfeiture of coverage.

Property policies may provide a wide range of coverage for losses following Katrina. A policyholder must carefully navigate the policy provisions and claim process, though, to ensure that it is obtaining all of the coverage for which it has paid and that it is complying with deadlines and procedural requirements.

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