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Expert Analysis

Hurricane Sandy: Courts Begin Issuing Insurance Rulings

In October 2012, Hurricane Sandy charged up the East Coast pummeling everything in its path and leaving behind massive damage to commercial and residential properties.

In the aftermath of Sandy, New York and New Jersey property owners had no shortage of hurricane damage war stories to share — strong winds ripped siding and roofing off residences and commercial structures, water levels rose up suddenly, forcing their way into buildings and flooding lower levels, and power was cut off by the local utilities, leaving some property owners in the dark for weeks.

Whatever the specific cause of the damage, property owners collectively understood that Sandy had caused staggering losses. After submitting claims for these losses to their insurers, however, many insureds learned that the specific cause of the property damage would be critical to determining whether insurance coverage would be available and whether any such coverage would be severely limited. As a result, in some cases, insureds argued that damage was not caused by flood waters, in order to avoid flood exclusions or to evade special flood-related deductibles or sublimits. In other cases, insureds found themselves making creative arguments to satisfy policy requirements that there be physical damage to establish a covered loss.

While some of these insurance claims were successfully and amicably resolved, many disputed claims continue to wind their way through the court system. Over the last several months, courts have begun to hand down decisions resolving these insurance disputes. As we approach the two-year anniversary of Hurricane Sandy, we review in this column the impact that policy provisions concerning flood and water damage and physical damage requirements have had on insurance disputes concerning Sandy-related claims.

By **Howard B. Epstein**

And **Theodore A. Keyes**

Flood Exclusions

Following severe storms, one of the most common disputes between insurers and insureds is whether hurricane damage was caused by wind or by flood waters, because flood damage is often excluded by the policies. Flood exclusions are often very particular, excluding damages from water generally, including, among other specified conditions, "flood, surface water, waves, tides, tidal waves, overflow of any body of water, or their spray, all whether driven by wind or not" and even from underground water sources seeping into the property.

In *Cashew Holdings v. Canopius U.S. Ins.,* for example, the insured claimed damage to the roof and foundation of an investment rental property, including shifting of cinder block walls supporting the porch, cracking of the concrete basement floor and settling of interior columns.[1] The property insurer granted coverage for the roof damage, acknowledging that it was caused by wind, but denied coverage as to the other damages on the grounds that those damages resulted from flood water and buoyant debris hitting the structure, causes that were excluded by the policy's flood exclusion.

In the coverage litigation, the decision ultimately came down to a battle of the experts, with each side presenting its engineer's opinion of the cause of the damage. The Eastern District of New York found the insurer's expert's testimony to be more credible and ruled in its favor, holding that coverage for foundation damages was excluded by the flood exclusion.

In some Sandy cases, however, the cause of damage has been more difficult to determine. Hours prior to Sandy actually arriving in the New York/New Jersey area, as the water levels were rising, Con Edison made a decision to preemptively cut power to certain downtown Manhattan power supply and distribution centers, including the Bowling Green Network, in an attempt to limit the damage from anticipated flooding. Consequently, many office buildings in downtown Manhattan had no electric service hours before and weeks after the storm.

In *Newman Meyers Kreines Gross Harris v. Great Northern Ins.*, filed in the Eastern District, the insured law firm was unable to access its offices, which had lost power when the Bowling Green Network was shut down just before the storm on Oct. 29.[2] The law firm submitted a claim for coverage under its commercial property insurance policy, which provided coverage for loss of business income and extra expense under three potentially relevant scenarios: (1) in the event of "direct physical loss or damage by a covered peril to property"; (2) when existing "ingress to or egress from" a covered location is prevented due to "direct physical loss or damage by a covered peril" at a contiguous property"; and (3) due to loss of utilities caused by "direct physical loss or damage by a covered peril" to property of a utility.

As property owners continue to rebuild, disputes remain between carriers and policyholders as to the existence of coverage for hurricane-related losses.

The insurer denied coverage, taking the position that Con Edison's decision to cut the power did not constitute physical damage and that, therefore, there was no covered event. The insured countered that the loss of use of the premises constituted physical damage.

HOWARD B. EPSTEIN *is a partner at Schulte Roth & Zabel, and* THEODORE A. KEYES *is a special counsel at the firm.* SAMI GROFF, *a senior associate at the firm, assisted in the preparation of this column.*

The court rejected the insured's argument, finding that the policy language unambiguously required actual physical damage for there to be coverage.

Although it was undisputed that there was no flooding or physical damage to the insured's office building, it was also undisputed that the Bowling Green Network did ultimately sustain flood damage that should have satisfied the physical damage requirement for the loss of utilities coverage section. It is likely that the insured intentionally avoided this argument because a finding of flood damage would have triggered the flood exclusion in the policy. In fact, the insurer had argued that flooding of Con Edison's service center was an alternate basis for its disclaimer. The Court disagreed, however, stating that because it found Con Edison's preemptive shutdown of the power supply to be the cause of the insured's loss, rather than flooding, the flood exclusion was not an alternative basis for denial of coverage.

In *Johnson Gallagher Magliery v. Charter Oak Fire Ins. Co.*,[3] on the other hand, the Southern District held that the flooding of the Bowling Green Network triggered the flood exclusion in the insured's business property policy. In that case, the insured sought coverage for lost business income for a two-week period — the first week, while the Bowling Green Network was shut down and the insured's office was without power; and the second week, during which Con Edison had yet to restore power to the office building even though the Network had been restored.

As in *Newman Meyers*, the business casualty policy at issue provided coverage for lost business income only where the loss was caused by "direct physical loss" to the insured premises or to utility property. Also, as in *Newman Meyers*, the insured's office building was cut off from electricity when Con Edison chose to preemptively shut down the Bowling Green Network.

Again, the insurer argued that there was no coverage because Con Edison's decision to preemptively shut down power did not constitute physical damage. The insurer also argued that, in the alternative, if there was physical damage, it was caused by flooding of the Bowling Green Network, which was excluded by the flood exclusion.

Unlike the Eastern District in *Newman Meyers*, the Southern District in *Johnson Gallagher* focused on the undisputed evidence, including Con Edison reports and testimony by Con Edison employees, that the Bowling Green Network suffered severe physical damage and that the damage was caused by flood waters. The court first ruled that there was no physical damage during the first few hours — the time period between Con Edison's decision to shut down the power and the time that flooding actually damaged the power station.

The court then held that even though there was physical damage after the storm commenced, that damage was caused by flooding and barred by the flood exclusion. Therefore, there was no coverage for loss incurred by the insured during the first week of loss, during which the Bowling Green Network was shut down. Interestingly, the Court refused to grant the insurer's motion for summary judgment as to the second week of lost power, after power had been restored to the Bowling Green Network but not yet to the building, finding that the insurer did not demonstrate that Con Edison's failure to restore power to the building during this time was caused by the water damage sustained by the Bowling Green Network.

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Special Deductibles

The specific cause of damage can also have a crucial impact on the applicable limits of liability and deductibles. In *New Sea Crest*, for example, the storm damaged the insureds' nursing homes in Brooklyn.[4] Although their policy was an "all risk" policy, it imposed sublimits on coverage for various types of damage, including a $1 million sublimit for flood damage and a $36 million sublimit for damage from a "named storm."

To avoid the flood damage sublimit, the insureds argued that the damage to the nursing homes was caused by storm surge rather than by flood waters. After discussing that "storm surge" v. "flood water" determinations were the subject of many insurance disputes brought in the aftermath of Hurricane Katrina,[5] the Eastern District looked to the language of the policy, which expressly provided that storm surge was included in the definition of flood. The court found that the damage to the insureds' properties was caused by flood, as defined by the policy, and held that the policy imposed a $1 million sublimit on flood damages, even if the damages were also caused by a named storm. Accordingly, the court ruled that the insureds could not recover above the $1 million flood sublimit.

Similarly, in *El-Ad*, the insured contractor submitted a claim for delay damages incurred due to Hurricane Sandy in connection with a construction project. Although the Builders' Risk Policy provided total limits of $115 million, the insurer took the position that the claim was limited by the policy's $5 million sublimit for flood damage and subject to its higher flood deductible. The insured countered that the special flood provisions only applied to claims for physical damage, not to claims for downstream financial losses such as delay in completion.

The Supreme Court, New York County, rejected this argument, holding that the plain language of the policy dictated that the flood limit and special deductible for "all losses or damages arising during a [flood]" were applicable to the delay claim. Accordingly, the insured was only entitled to a maximum of $5 million under the flood sublimit and the claim was subject to the higher flood deductible.[6]

Looking Forward

As property owners continue to rebuild from Hurricane Sandy damage, two years after the storm, disputes remain between carriers and policyholders as to the existence of coverage for hurricane-related losses. The cases discussed in this column represent only some of the initial rulings, and we expect to see many more decisions handed down over the next few years. As these initial cases demonstrate, where the plain language of the policy unambiguously excludes or limits coverage for damage from flood waters, it will be difficult for policy holders to prevail in obtaining insurance coverage for Hurricane Sandy losses.

1. *Cashew Holdings v. Canopius U.S. Ins.*, 2013 WL 4735645 (E.D.N.Y. Sept. 3, 2013).
2. *Newman Meyers Kreines Gross Harris v. Great Northern Ins. Co.*, 2014 WL 1642906 (S.D.N.Y. April 24, 2014).
3. *Johnson Gallagher Magliery. v. Charter Oak Fire Ins. Co.*, 2014 WL 1041831 (S.D.N.Y. March 18, 2014).
4. *New Sea Crest Healthcare Center v. Lexington Ins. Co.*, 2014 WL 2879839 (E.D.N.Y. June 24, 2014).
5. Howard Epstein and Theodore A. Keyes, "Wind vs. Water: Insurance Coverage for Storm Damage," New York Law Journal, Vol. 234 – No. 103, Nov. 29, 2005.
6. *El-Ad 250 West LLC, v. Zurich American Ins. Co.*, 988 N.Y.S.2d 462 (June 2014).

Schulte Roth&Zabel
Schulte Roth & Zabel LLP
919 Third Avenue, New York, NY 10022
212.756.2000 tel | 212.593.5955 fax | www.srz.com
New York | Washington DC | London