A Preliminary Overview and Coverage/Subrogation Analysis

I. Overview

One of the largest and most powerful storms on record, Superstorm Sandy made landfall near Atlantic City, N.J., at approximately 8 p.m. on Monday, October 29, 2012. This superstorm extended almost 1,000 miles wide, at one point reaching from Detroit to Bermuda. Sandy generated tremendous winds reaching maximums of 80 to 90 miles per hour; storm surges upwards of 9 feet; and rainfall over 9.5 inches in some areas. Effects of Sandy included flooding, power outages, and wind damage, impacting the entire mid-Atlantic region (New York, New Jersey and Pennsylvania) as well as states north, south and west, including Connecticut, Maryland, Rhode Island, Ohio, Virginia, West Virginia, Washington, D.C., New Hampshire, Massachusetts, Delaware, Maine, and Vermont. Sandy has been blamed for more than 70 deaths in the United States and left millions without power. Total losses due to Superstorm Sandy have been estimated at $50 billion by Moody’s Analytics. Sandy has been assigned a CAT code of 90-12 by ISO.

We have attached a compilation of technical information that provides additional insight into the circumstances surrounding this horrific loss.

Included are:

- Reports, charts and maps from the National Weather Service from October 28 – November 1, 2012;
- Infographics from the New York Times, including power outage maps and a summary of all Superstorm Sandy news;
- Utility Company Outage Maps;
- Storm Photographs;

II. Coverage Issues Likely to Arise in the Aftermath of Superstorm Sandy

Given the wide range of perils and losses that can occur during or in the aftermath of a storm – including wind damage, entry of rainwater into the interior of buildings, flood losses and loss of power – and the range of policies under which claims may be made for such losses, Sandy can be expected to give rise to various coverage issues that claim professionals will need to consider when addressing claims for losses during and in the aftermath of the storm. Some of the issues will involve the potential application of flood exclusions contained in most personal lines policies and in many commercial policies; causation; provisions addressing loss of utilities, including electricity; civil authority coverage; contingent business interruption coverage and named windstorm or hurricane deductibles. What follows is a brief discussion of some of the issues likely to arise.

Flood or Water Exclusions

Many property policies contain exclusions exempting loss caused by various forms of water damage, including flood. In order to avoid application of flood exclusions to water damage, policyholders have argued damage resulting from floodwaters occurring during the course of a hurricane or other windstorm
should not be deemed to have been caused by flood for purposes of those exclusions; rather the proximate cause of such losses should be considered wind or windstorm. While courts have, by and large, rejected this argument, given the magnitude of water related damage sustained during Superstorm Sandy, challenges to the application of flood or water exclusions to such losses are inevitable.

Flooding or water damage can arise in various ways during the course of a hurricane, including storm surge and/or waves; the overflow of rivers or streams as a result of heavy rainfall often associated with such storms; the failure of flood control structures; or from the back up of water through sump pumps or other drainage systems. Various arguments and issues are likely to be raised concerning the application of specific flood or water exclusions to the range of circumstances in which insured property has suffered water damage.

**Windstorm**

In the context of claims arising out of hurricane losses, issues relating to water damage exclusions often arise in tandem with the covered peril of windstorm. This is not surprising given that a hurricane is defined as a “cyclone usually involving heavy rains and winds exceeding 74 mph.” *The American Heritage Dictionary* 416 (4th ed. 2001). For that reason, when dealing with hurricane losses, any discussion regarding the applicability of a water damage exclusion often necessitates both a review of causation and also the covered peril of windstorm. Whether wind-driven water is included in the windstorm peril is also of particular relevance to hurricane coverage claims. In more recent years, exclusions have been written into property policies precluding coverage for damage caused by wind-driven rain unless wind first caused an opening in the structure through which the rain entered. These exclusions have been enforced.

**Causation**

There are three distinct categories of damage potentially at issue in the wake of Superstorm Sandy: (1) damage caused exclusively by wind; (2) damage caused exclusively by water or flood; and (3) damage caused by wind “concurrently or in any sequence” with water. There will likely be no dispute that damage caused solely by wind is covered. Additionally, the water damage exclusion has been held applicable to damage caused by water, flood, storm surge and/or inundation of water as a result of a hurricane. As to the third category of damage, an evaluation of coverage will largely depend on the particular jurisdiction’s approach to concurrent or sequential causation. An additional consideration is whether the particular water damage exclusion at issue is preceded by anti-concurrent and/or anti-sequential causation language and, if so, whether that language will be upheld in a particular jurisdiction.

**Loss of Power**

One of the most significant impacts of Superstorm Sandy was the widespread and, in many instances, prolonged loss of electric power. Power outages and loss of other utilities can negatively impact businesses and homeowners in various ways. However, without resulting property damage, the loss of electricity alone will not typically result in a covered claim under a standard homeowners or commercial property insurance policy. Most often, insured property that has lost its power supply does not sustain structural or other direct damage, which is often a prerequisite to coverage under first-party property policies. Courts generally hold that when a policy requires direct physical loss or damage, the mere loss of power and utilities, without more, will not trigger coverage including basic business interruption coverage. However, in situations where an insured has been forced to suspend its business operations due to loss of power, claims for coverage may be expected.
Loss of power or other utilities can, of course, result in losses to insured property at the insured premises. Personal and commercial lines property policies often contain exclusions precluding coverage for such loss or damage. Such exclusions are enforced by a majority of jurisdictions. A typical exclusion provides the insurer “will not pay for loss or damage caused directly or indirectly by utility services and the failure of power or other utility service supplied to the described premises, however caused, if the failure occurs away from the described premises.” Factual issues can arise regarding the cause of the failure and its location.

Some insurers now offer utility service interruption coverage either as a part of standard coverage or as an optional coverage that can be separately purchased by the insured. For example, the ISO utility service direct damage endorsement adds coverage for damage to the insured’s property resulting from interruption of utility services, including water, communication, and power. Similarly, many commercial forms provide extensions of coverage for business income losses sustained as a result of loss of utilities, even in the absence of physical damage to insured property. However, even with an extension, it is not just any loss of services that will trigger business interruption coverage. The typical extension of coverage requires physical loss or damage to the property of the service provider caused by a peril insured against under the policy to which the extension is attached. Issues will arise as to cause of the service interruption and whether it falls within the scope of the coverage extension.

**Civil Authority Coverage**

Many policies providing business interruption coverage contain extensions of coverage for loss caused by “Order of Civil Authority.” This coverage is intended to provide protection where the insured's property does not sustain physical loss or damage, but the insured's business operations are disrupted when a governmental authority issues an order that prohibits access to the insured's place of business. There is a similar extension of coverage available in some commercial policies for business interruption losses sustained when ingress to or egress from the insured premises is prevented or impaired due to a covered peril. Hurricanes frequently give rise to civil authority and ingress/egress claims and these types of claims can be anticipated in the aftermath of Sandy.

One of the required elements of covered civil authority loss is that access to the insured premises be prohibited by order or action of civil authority. The courts strictly apply the requirement that access to the insured premises be *prohibited*. Such coverage is unavailable when access is still possible though it may be limited or hindered by physical damage or orders of civil authority. The existence of an order or action of civil authority that prohibits access to an insured property may at time be obvious, but under other circumstances there will likely be disputes as to whether this requirement has been met.

In addition to showing access was prohibited, an insured seeking civil authority coverage also must demonstrate the prohibition of access to the insured premises was caused by the property damage giving rise to the order of civil authority. This requisite causal link is not established when the order of civil authority is predicated on the threat of a potential future event, as opposed to the past happening of a covered peril that has already impacted property in the vicinity of the insured location. That could raise an issue as to whether losses that arose as a result of evacuation orders that came into effect before Sandy made landfall, and thus before any damage arose in the vicinity of property along the mid-Atlantic and Northeast coast, would give rise to covered civil authority losses.

Another issue that will likely be presented involves the requirement that *covered* physical loss or damage in the vicinity of the insured premises resulted in issuance of the civil authority order. It would appear that most of the orders along the mid-Atlantic and Northeast coastlines were issued due to concerns about storm surge and its aftermath. Damage caused by storm surge should be considered loss by flood. Therefore, with respect to those policies that do not afford flood coverage, it is arguable the evacuation...
orders and orders prohibiting return to those areas along the coast impacted by storm surge were not
issued as a result of a covered cause of loss. This same consideration may act to bar coverage under
those policies that contain ingress/egress extensions of coverage.

**Contingent Business Interruption Coverage**

It is a prerequisite to standard business interruption coverage that the insured's business interruption loss
result from covered damage to covered property. However, many commercial insureds may suffer losses
due to their inability to obtain services or materials from suppliers upon which they depend, or because
some of their key customers cannot receive the services or products that are provided by the insured. In
such cases, insureds may seek coverage for their losses under Contingent Business Interruption (CBI)
provisions, if such coverage is afforded under the applicable policy.

There are a wide range of CBI provisions available in the market, and ultimately the scope of CBI
coverage will depend on the language of the applicable CBI provision. Depending on the language used,
some of the potential limitations on CBI coverage include: (1) dependent business must be scheduled; (2)
suppliers or customers must be “direct”; (3) dependent business must fall within the policy definition of
either contributing properties, recipient properties, manufacturing properties, or leader properties; (4) sub-
limits; (5) the insured’s losses must result from damage to property of a dependent business at a
dependent business; (6) as a result of a peril covered under the policy. Whether one or more of the
limitations to the coverage afforded by the policy’s CBI provision will apply, gives rise to frequent issues.

In many instances, an insured may suffer business income losses due to unfavorable business conditions
in the area in which the insured’s premises are located caused by the catastrophe. The insured may not
be entitled to coverage for such losses either under the basic business income coverage or under the CBI
extension of coverage. However, some insureds may assert claims for such losses, particularly where
their own business operations have been interrupted, raising issues concerning the proper measure of
covered losses.

**Hurricane and Named Windstorm Deductible Provisions**

Many personal lines and commercial property insurance policies contain hurricane or named windstorm
deductible provisions or endorsements. The endorsements vary from state-to-state, but generally set the
deductible as a percentage of the value of risk, the measure of which is usually based upon the Schedule
of Values previously supplied by the insured to the insurer during the underwriting process. Many of the
endorsements are approved by the Insurance Departments in the respective states and may be
mandated by state regulation. The endorsements are generally triggered in the event a tropical storm or
other windstorm is “named” by the National Hurricane Center of the National Weather Service, or other
recognized meteorological authority. Whether the deductible endorsements are actually triggered
depends on the endorsement’s specific language.

Some hurricane/named windstorm deductible provisions are triggered when a hurricane advisory, watch
and/or warning is declared by the National Hurricane Center for anywhere in the state. Some are
triggered when sustained winds reach hurricane force of 74 miles per hour or greater in the state, as
measured by the National Weather Service. Other deductible provisions are triggered when a “named
windstorm” makes landfall anywhere in the state as a Category 2, 3, 4 or 5 hurricane as declared by the
National Weather Service.
Given the extraordinary nature of Sandy, and the lack of definitive data on its characteristics and sustained wind speed at particular locations, various issues regarding the application of such deductibles have already arisen. This is further complicated by the fact that certain state insurance commissioners have issued bulletins indicating their view that the hurricane deductibles should not apply to claims arising in their states, at least under personal lines policies.

Other issues can arise with respect to the potential application of a hurricane or named windstorm deductible provision. Many policies containing named storm deductibles may also include other deductible provisions applicable to other widespread catastrophic events such as flooding. When a named storm leads to flood losses, careful consideration must be given both to deductible provisions and how they may relate to one another in order to determine which deductible applies.

### III. Summary of Subrogation and Recovery Opportunities Arising From Sandy

Even for mega-losses caused by severe acts of nature, there may be significant recovery opportunities. At first blush, Sandy does not present any overarching theory of recovery that would point in the direction of third-party responsibility. Consequently, it is incumbent upon property and subrogation claim handlers to be alert to one-off subrogation opportunities that may be presented in a variety of scenarios, ranging from separation of roofs to penetration of rainfall into building envelopes to snow induced collapses (in West Virginia).

“The Natural Catastrophes Handbook: An Overview and Jurisdictional Survey of Subrogation Issues in the Disaster Context,” prepared by John W. Reis of our Charlotte office and Sean O’Donnell of our Philadelphia office, contains a 50-state survey of theories of liability and affirmative defenses likely to be applicable when pursuing recovery claims arising from acts of nature. Register here to receive access to the handbook, 50-state survey and related materials in the Cozen O’Connor Electronic Library.

In the following section we provide a succinct summary of best practices that may assist you in identifying recovery opportunities that may benefit your company and your insureds in obtaining compensation for the substantial losses resulting from this horrendous, unprecedented storm event.

#### Wind Losses

If feasible, attempt to compile a list of recorded wind speeds, as measured by approved climatological facilities, in key geographical locations where losses are being adjusted. These wind speeds then should be compared with requirements under applicable building codes – both local and national – which determine the wind speed ratings that buildings must be constructed. Frequently, the wind speed requirements will vary based upon whether construction was ongoing or completed; the occupancy of the facility; and construction materials and methods.

In addition, for commercial facilities and certain high-end housing, there may be building specifications, architectural drawings and engineering details that need to be consulted to determine if there were any construction requirements above and beyond the minimum levels mandated by applicable codes.
Rain Loss

Notwithstanding the severity of this event, the usual suspects must be consulted: were there breaches or penetrations that allowed external elements to enter the household or facility; was there appropriate design, installation and maintenance of the drainage system, in accordance with industry standards; did under-design or deficient maintenance of stormwater drainage system for the municipality cause or contribute to the flow of water in the direction of your insured's property?

If the wind or storm conditions brought about a structural failure involving steel members, then close analysis must be performed to ascertain if there were installation errors or material defects. Frequently, key components can be identified and preserved to allow for post-adjustment inspection and testing. Even if potentially responsible third-parties cannot be placed on notice at that time, careful recording of the scene photographically, in conjunction with preservation of critical evidentiary artifacts, can discharge obligations to allow for meaningful inspection and evaluation opportunities by prospective defendants in the future.

Basic, but important, written agreements also should be consulted: is there a lease agreement that imposes responsibility for pertinent inspection or maintenance activities, and/or for the cost of repair or restoration? Was there a service agreement in effect, which entailed pre-loss inspection activities? In this vein, were there any public sector inspections and approvals, prior to the loss, that failed to identify construction deficiencies that contributed to the cause of the loss?

Causation

It is important to remember in most jurisdictions, the uniform rule is that despite the involvement of an act of nature, if human conduct was a substantial, contributing factor in bringing about the loss, or some aspect of the damage, then, upon proof of liability, the actor is responsible for the resulting damage. To state it differently, the fact that a natural disaster also was involved does not eliminate legal liability on the part of individuals or companies whose conduct also were substantial contributing factors.

Consultants

Adjusters will be called upon to perform many important tasks on behalf of their companies and insureds during a concentrated period of time, so outside consultants, including experienced subrogation counsel, should be consulted to assist in this effort, wherever it is deemed appropriate. There are especially critical legal considerations that must be addressed early on in the process, such as potential time bars arising from application of each state’s statute of repose (running from the date work was performed, as opposed to the date of loss) that frequently will expire and bar the claim even though the otherwise applicable statute of limitations under that jurisdiction has not yet run. Certain states have enacted statutes requiring notice requirements with an opportunity to cure in claims involving construction defects. Claims against governmental subdivisions frequently are subject to very early notice requirements that must follow a form prescribed by statute. There may be time limitations in lease agreements or construction contracts, and the economic loss rule (which restricts victims to contractual remedies for claims involving primary damage to the failed product itself) may limit remedies to these contractually responsible parties. Similarly, the Uniform Commercial Code may be applicable, for which the statute of limitations is four years from tender of delivery (in other words, sale of the product), may expire long before the otherwise applicable statute of limitations for tort claims.
Summary
Subrogation should not be an afterthought when adjusting property losses resulting from acts of nature. However, in order to evaluate recovery issues in a way that will allow for a meaningful exercise of your company’s subrogation rights, there needs to be immediate coordination among all team members: the adjuster, the recovery representative, forensic consultants and legal counsel.

IV. Conclusion
Cozen O’Connor’s Sandy Taskforce is monitoring losses arising from this event, and will continue to analyze pertinent coverage and subrogation issues. For additional information regarding any losses involving your company, please feel free to contact any of the following:

Global Insurance Group
William Patrick Shelley, Co-Chair, Global Insurance Group
1900 Market Street
Philadelphia, PA 19103
215.665.4142 Direct
215.701.2442 Fax
wshelley@cozen.com

Joseph A. Ziemianski, Co-Chair, Global Insurance Group
LyondellBasell Tower
1221 McKinney Street, Suite 2900
Houston, Texas 77010
832.214.3920 Direct
832.214.3905 Fax
jziemianski@cozen.com

Richard M. Mackowsky
1900 Market Street
Philadelphia, PA 19103
215.665.2064 Direct
215.665.2013 Fax
rmackowsky@cozen.com

Kellyn J. W. Muller
457 Haddonfield Road
Suite 3003
Cherry Hill, NJ 08002
856.910.5063 Direct
215.701.2292 Fax
kmuller@cozen.com

Subrogation & Recovery Group
Elliott R. Feldman, Chair
National & International Subrogation & Recovery Department
1900 Market Street
Philadelphia, PA 19103
215.665.2071 Direct
215.701.2071 Fax
efeldman@cozen.com

Kevin J. Hughes, Vice-Chair
National & International Subrogation & Recovery Department
1900 Market Street
Philadelphia, PA 19103
215.665.2739 Direct
215.701.2439 Fax
khughes@cozen.com

John W. Reis
301 South College Street, Suite 2100
Charlotte, North Carolina 28202
704.348.3416 Direct
704.334.3351 Fax
jreis@cozen.com

Sean P. O’Donnell
1900 Market Street
Philadelphia, PA 19103
215.665.2089 Direct
215.701.2089 Fax
sodonnell@cozen.com
ATLANTA
SunTrust Plaza
303 Peachtree Street, NE
Suite 2200
Atlanta, GA 30308-3264
P: 404.572.2000 or 800.890.1393
F: 404.572.2199
Contact: Kenan G. Loomis

CHARLOTTE
301 South College Street
One Wells Fargo Center, Suite 2100
Charlotte, NC 28202-6037
P: 704.376.3400 or 800.762.3575
F: 704.334.3351
Contact: T. David Higgins, Jr.

CHERRY HILL
LibertyView
457 Haddonfield Road, Suite 300
P.O. Box 5459
Cherry Hill, NJ 08002-2220
P: 856.910.5000 or 800.989.0499
F: 856.910.5075
Contact: Thomas McKay, III

CHICAGO
333 West Wacker Drive, Suite 1900
Chicago, IL 60606-1293
P: 312.382.3100 or 877.992.6036
F: 312.382.8910
Contact: Tia C. Ghattas

DALLAS
Comerica Bank Tower
1717 Main Street
Dallas, TX 75201-7335
P: 214.462.3000 or 800.448.1207
F: 214.462.3299
Contact: Anne L. Cook

DENVER
707 17th Street, Suite 3100
Denver, CO 80202-3400
P: 720.479.3900 or 877.467.0305
F: 720.479.3890
Contact: Brad W. Breslau

HARRISBURG
305 North Front Street, Suite 400
Harrisburg, PA 17101-1236
P: 717.703.5900 or 877.868.0840
F: 717.703.5901
Contact: Vincent R. McGuinness, Jr.

HOUSTON
LyondellBasell Tower
1221 McKinney Street, Suite 2900
Houston, TX 77010
P: 832.214.3900 or 800.448.8502
F: 832.214.3905
Contact: Joseph A. Ziemianski

LONDON
9th Floor, Fountain House
130 Fenchurch Street
London, UK
EC3M 5DQ
P: 011.44.20.7864.2000
F: 011.44.20.7864.2013
Contact: Simon D. Jones

MIAMI
Wachovia Financial Center
200 South Biscayne Boulevard
Suite 4410
Miami, FL 33131
P: 305.704.5940 or 800.437.7040
F: 305.704.5955
Contact: Richard M. Dunn

NEW YORK DOWNTOWN
45 Broadway Atrium, Suite 1600
New York, NY 10006-3792
P: 212.509.9400 or 800.437.7040
F: 212.509.9492
Contact: Geoffrey D. Ferrer

NEW YORK MIDTOWN
277 Park Avenue
New York, NY 10172
P: 212.883.4900 or 888.864.3013
F: 212.986.0604
Contact: Abby M. Wenzel

PHILADELPHIA
1900 Market Street
Philadelphia, PA 19103-3508
P: 215.665.2000 or 800.523.2900
Contact: Vincent R. McGuinness, Jr.

SAN DIEGO
501 West Broadway, Suite 1610
San Diego, CA 92101-3536
P: 619.685.1716 or 800.782.3366
F: 619.234.7831
Contact: Kevin Bush

SEATTLE
1201 Third Avenue, Suite 5200
Seattle, WA 98101-3071
P: 206.340.1000 or 800.423.1950
F: 206.621.8783
Contact: Jodi McDougall

TORONTO
One Queen Street East, Suite 1920
Toronto, Ontario M5C 2W5
P: 416.361.3200 or 888.727.9948
F: 416.361.1405
Contact: Douglas B. Fox

WASHINGTON, DC
The Army and Navy Building
1627 I Street, NW, Suite 1100
Washington, DC 20006-4007
P: 202.912.4800 or 800.540.1355
F: 202.912.4830
Contact: Barry Boss

WEST CONSHOHOCKEN
200 Four Falls Corporate Center
Suite 400, P.O. Box 800
West Conshohocken, PA 19428-0800
P: 610.941.5400 or 800.379.0695
F: 610.941.0711
Contact: Ross Weiss

WILKES-BARRE
120 South Franklin Street
Wilkes-Barre, PA 18701
P: 570.826.1408
Contact: John P. Moses

WILMINGTON
1201 North Market Street
Wilmington, DE 19801-1147
P: 302.295.2000 or 888.207.2440
F: 302.295.2013
Contact: Mark E. Felger

© 2012 Cozen O'Connor. All Rights Reserved.