

In the Wake of Hurricane Sandy

By J. Tyler Butts

Evacuations ordered in the face of the approaching “superstorm” suggest that one lesser known insurance provision, the civil authority provision, will be significantly litigated in the coming years.

The Scope of Civil Authority Provisions

The Coming Storm

In the days leading up to October 29, 2012, and in the face of the approaching, nearly 1,000-mile-wide super-storm that came to be known as Hurricane Sandy, states, cities,

municipalities, and towns throughout the Northeast ordered the evacuation of hundreds of thousands of people from their homes and businesses. When the storm came ashore, it brought with it driving wind, torrential rain, and a devastating tidal surge. While the vast physical property damage that Hurricane Sandy caused was immediately apparent, the storm also implicated a number of lesser-known and rarely litigated insurance provisions in commercial and business-owners property insurance policies. The evacuations mentioned above suggest that one such provision, the civil authority provision, will be significantly litigated in the coming years. The goal of this article is to give timely, relevant, and practical consideration of business interruption or extra expense claims arising from Hurricane Sandy evacuations.

The Civil Authority Provision

Generally speaking, a civil authority provision is designed to compensate or reimburse a business owner for lost profits caused by the government shutting down,

or otherwise prohibiting access to, an insured business. A typical example takes place when some governmental body issues an evacuation order that covers the area in which an insured business is located. The effect of such an order is not only to prohibit a business owner or his or her employees from opening and running the business, but also in effect to prohibit potential customers from physically patronizing that business even though the business itself has not suffered physical damage. All commercial activity essentially ceases. As a result, that business suffers lost income for every day that the evacuation order remains in place. The longer the order of civil authority lasts, the longer the closure of the insured business, and the greater the potential exposure for insurers.

To offset the risk of a potentially devastating loss caused by an order of civil authority, many commercial and business-owners property insurance policies contain a civil authority provision. Although the language of a civil authority provision differs markedly among policies, a typical



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provision provides that coverage is available under the policy

for the loss of Business Income and Extra Expenses which you incur due to the actual interruption of your operations during the period of indemnity when a civil authority prohibits access to your covered property due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from a Covered Cause of Loss.

The goal of civil authority coverage is plain, but demonstrating the right to payment in a particular circumstance requires certain showings by an insured business. As the above example provision demonstrates, an insured seeking recovery for lost business income or extra expenses must demonstrate (1) a civil authority took action; (2) the action prohibited access to the covered business; (3) the action directly resulted from or was because of a direct physical loss or damage; (4) the direct physical loss or damage causing the civil authority action happened at a location other than at the described premises, meaning away from the covered property; and (5) the loss or damage that happened away from the described location was caused by a covered cause of loss as defined in the applicable policy.

Furthermore, civil authority provisions can include additional components that differ materially from the sample provision above. For example, although some provisions simply require that the damage causing an evacuation or a civil authority order take place at some place other than at the described premises, some provisions require that the damage actually occur somewhere in the vicinity of the covered property. Even then, the geographic scope of an “in the vicinity” element can vary from policy to policy and can range from requiring that the damage happen to “adjacent” property, to within 100 miles, to some other range. *Syufy Enters. v. Home Ins. Co.*, 1995 U.S. Dist. Lexis 3771 (N.D. Cal. Mar. 20, 1995) (requiring damage to happen to “adjacent” property, interpreting “adjacent” as “denot[ing] a sense of physical proximity,” and finding that a business two blocks away was not adjacent to the damage). *Kushner Lagraize, LLC v. Phoenix Ins. Co.*, 2009 U.S. Dist. Lexis 81576

(E.D. La. Sept. 9, 2009) (requiring damage to happen within 100 miles).

Obviously, the further away a civil authority provision permits the damage on which an insured predicates a claim to be, the easier it becomes for an insured to recover under that provision. For example, in *Assurance Co. of Am. v. BBB Serv. Co.*, 265 Ga. App. 35 (Ga. Ct. App. 2003), the civil authority provision did not have a geographic limitation but only required that the damage happen somewhere “other than at the covered premises.” The insured owner of several Wendy’s restaurants sought coverage for two and a half days of lost income, caused when the county ordered evacuations as Hurricane Floyd approached. During the trial, the plaintiff also presented evidence that the governmental group that ordered the evacuation had examined photographs of damage that the hurricane had caused in the Bahamas and that these photographs had, in part, motivated the evacuation decision. *Id.* at 37. Therefore, the court found that the civil authority order for the evacuation was a result of direct physical damage to property other than the insured’s. Had the policy instead required that the damage be adjacent to, or within 100 miles of, the property, the insured probably would not have been able to recover.

Additionally, some civil authority provisions may include a temporal element, requiring that an order of civil authority be in place for a certain period of time before the policy will begin to cover losses and capping the coverage by offering it only for a certain length of time. A typical provision might require that “[t]he coverage for business income will begin 72 hours after the time of that action and will apply for a period of up to three consecutive weeks after coverage begins.” This time-element provision can easily serve to prohibit coverage in the case of a short evacuation and can also assist insurers in measuring their potential total exposure in a worst-case scenario. For example, in *BY Dev., Inc v. United Fire & Cas. Co.*, 2006 U.S. Dist. Lexis 14703 (D. S.D. Mar. 14, 2006), authorities closed a hotel in Deadwood, South Dakota, due to a nearby wildfire. The policy had a 72-hour waiting provision similar to the one described above. In interpreting that provision, the court found that “the Plain-

tiff is entitled to recover only for losses incurred... for longer than that amount of time.” Because the civil authority order had only prohibited access for 54 hours, the insured was denied civil authority coverage. *See also Kushner Lagraize, LLC v. Phoenix Ins. Co.*, 2009 U.S. Dist. Lexis 81576 (E.D. La. Sept. 9, 2009) (interpreting a similar 24-hour waiting period in an evacuation caused by Hurricane Gustav).

Insureds most frequently assert claims for civil authority coverage in the aftermath of catastrophic events, and as a result, courts have had limited opportunities to discuss the breadth of the provided coverage. Most recently, insureds made claims based on the provision after the terrorist attacks of 9/11 and the devastation caused by Hurricane Gustav in 2008, Hurricanes Rita and Katrina in 2005, and Hurricane Floyd in 1999. Briefly reviewing the lessons learned from those cases will offer some clues about the coverage that business owners might expect and that courts might find appropriate for the evacuations caused by Hurricane Sandy.

It should go without saying that before looking to case law for answers, a practitioner should carefully examine the relevant language of the specific policy, especially for the wrinkles described above that can limit coverage and simplify the analysis. Having a firm understanding of the various issues that can arise in a claim grounded in a civil authority provision can mean the difference between a successful defense and an unavoidable insurance payment.

Reactive vs. Preventive Evacuations

One of the principle lessons derived from the civil authority litigation following 9/11 and the recent hurricane disasters is that for a civil authority provision to apply, the civil authority order must be in response to damage that has already taken place, not in anticipation of the possibility of future damage. As described below, this requirement comes directly from the clause requiring that the order of civil authority be issued “due to direct physical loss of or damage to property.” In other words, there must be a nexus between past damage and the present order.

In the aftermath of the 9/11 terrorist attacks, a wide variety of businesses alleged that they had lost income, not as a result of

the destruction at the World Trade Center or the damage to the Pentagon, but because of the Federal Aviation Administration (FAA) “ground stop” that banned the takeoff of all civilian aircraft in the United States after the attacks. The resulting lawsuits and case law make clear that to recover under a civil authority provision, the civil authority action must be in response to actual damage, not in anticipation of future damage.

In *United Air Lines, Inc. v. Ins. Co. of the State of PA*, 439 F.3d 128 (2d Cir. 2006), the plaintiff airline alleged that it lost income “caused by the national disruption of flight service and the government’s temporary shutdown of [Reagan National Airport].” *Id.* at 129. The Second Circuit found that the civil authority provision of the policy was not triggered by the FAA ground stop order because “[t]here was apparently a temporary halt of flights into and out of the Airport on 9/11 before the Pentagon was struck.” *Id.* at 134 (emphasis added). In other words, the cessation of flights happened before any property damage to any adjacent structure occurred, namely, the Pentagon. Furthermore, the court found that the subsequent shutdown of Reagan National was not caused or prompted by the damage to the Pentagon but by “fears of further attacks.” *Id.* Therefore, the shutdown of the plaintiff’s business at the airport was not, as the policy required, a “‘direct result’ of damage to adjacent premises.” *Id.* at 135. But damage to the plaintiff’s business was the result of (1) preventive measures taken by the FAA before any nearby damage occurred, and (2) precautionary measures designed to prevent future harm.

Similarly, in *Paradies Shops, Inc. v. Hartford Fire Ins. Co.*, 2004 U.S. Dist. Lexis 30124 (N.D. Ga. Dec. 15, 2004), the plaintiff, an operator of airport gift shops, newsstands, and retail stores, sought to recover lost business income allegedly suffered as a result of the FAA ground stop. As a result of the ground stop, national air traffic came to a halt, and the constant flow of the traveling public that the plaintiff relied on similarly ceased. The U.S. District Court for the Northern District of Georgia found that to be entitled to coverage under the civil authority provision, the plaintiff was required to establish that some order of

civil authority was issued “as the direct result of the physical damage sustained by the World Trade Center, the Pentagon, or the field in Stony Creek Township, Pennsylvania.” *Id.* at *18. The court concluded that the plaintiff could not meet this burden because “the ground stop order was issued as a result of the threat of additional terrorist acts involving the nation’s airlines and not because of the existing disasters.” *Id.* at *20.

As with the 9/11 decisions, cases involving evacuations in the face of impending hurricanes make clear that to recover under a typical civil authority provision, the civil authority action must be a direct result of damage that has already happened.

In *S. Texas Med. Clinics v. CNA Fin. Corp.*, 2008 U.S. Dist. Lexis 11460 (S.D. Tex. Feb. 15, 2008), the plaintiff medical clinics sought coverage for losses caused by evacuation orders issued two days before the landfall of Hurricane Rita near the Texas-Louisiana border. In granting the insurer’s motion for a summary judgment, the court cited the Second Circuit decision in *United Air Lines* with approval. The court held that, in light of testimony that the evacuation order was issued “due to... fear that Hurricane Rita would strike nearby” and not “due to the actual physical damage that occurred in Florida and on oil rigs in the Gulf,” the civil authority provision did not cover the clinics’ losses. *Id.* at *32–33. (“The record shows that [the] decision to evacuate was based on the anticipated threat of damage to Wharton County. The only significance of the prior damage to property outside Wharton County was as an indication of the harm that could result if Hurricane Rita made landfall near Wharton County.”)

As discussed briefly above, the case of *Assurance Co. of Am. v. BBB Service Co., Inc.*, 265 Ga. App. 35 (Ga. Ct. App. 2003), involved an insured seeking coverage for two and a half days of lost income caused when the county ordered evacuations as Hurricane Floyd approached. The evacuation order specifically stated that the evacuations were necessary “because of the serious threat to the lives and property of residents of Brevard County from Hurricane Floyd [and] [b]ecause of the uncertainty of the path of devastating winds and storm surge.” *Id.* at 35. On its face,

and given the cases discussed above, it would appear that the insured in this case would be out of luck and could not recover. Instead of relying on the text of the order, however, the insured presented evidence during the trial that the evacuation order was, in part, a response to damage that Hurricane Floyd had already caused in the Bahamas. The court accepted that testi-

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mony and determined that coverage did exist. *BBB Service* demonstrates that the necessary analysis concerning evacuation orders and civil authority provisions is heavily fact-intensive and case-specific. Therefore, it may be quite difficult for an insurer to defend a coverage decision successfully with a motion for a summary judgment, at least as long as an insured can raise a factual dispute about whether an evacuation order was in response to damage and not in anticipation of it.

Finally, the case of *Dickie Brennan & Co. v. Lexington Ins. Co.*, 636 F.3d 683 (5th Cir. 2011), illustrates what can happen if a plaintiff fails to present adequate evidence to support coverage at the summary judgment stage. As with *BBB Service*, the civil authority provision in this case did not contain a geographic limitation. In other words, if the plaintiff could plausibly allege that the evacuation order that preceded Hurricane Gustav was directly related to property damage previously caused by the storm, a claim for lost business income

might succeed. Again, as in *BBB Service*, the evacuation order itself only referred to the possibility of future storm damage. *Id.* at 684. (ordering an evacuation “because of anticipated high lake and marsh tides due to the tidal surge, combined with the possibility of intense thunderstorms, hurricane force winds, and widespread severe flooding”). The plaintiff insured argued

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that because Hurricane Gustav had already caused damage in Cuba and Jamaica, the civil authority provision applied. *Id.* Crucially, however, the plaintiff failed to introduce evidence to support that argument, and the court upheld the decision of the district court, finding that the plaintiff had “failed to demonstrate a nexus between any prior property damage and the evacuation order.” *Id.* at 686.

Sandy Evacuation Orders

These cases make clear that to recover under a civil authority provision, the order, or, in the case of Sandy, the evacuation, must be in response to some damage that has already taken place. Because Sandy affected such a large area, it is virtually impossible to examine the particulars of each evacuation order. However, examining a sample of orders from around the region reveals the difficulties that insureds may have asserting claims for coverage.

Babylon, New York, is a town of just over 200,000 people, located 40 miles to the east of New York City on Long Island. On October 28, 2012, as Hurricane Sandy approached, the town supervisor issued Executive Order 1 of 2012, declaring a state

of emergency and ordering the evacuation of certain beach communities and other areas. The Executive Order stated, in part:

[O]n October 28, 2012, and continuing thereafter, Hurricane Sandy is forecast to impact the State of New York, which will result in evacuations of the threatened populations and poses an imminent danger to public health, and public safety systems within the Town of Babylon.

[T]his event may cause power outages and extensive flooding; damage to homes, businesses and transportation infrastructure; the disruption of local water supplies, and may result in personal hardships, displacing thousands of families, as well as hamper the movement of emergency personnel, and will continue to pose a threat to the public health and safety.

The executive order does not reference damage already caused by Hurricane Sandy, but it frames the evacuation as a necessary precautionary measure.

Similarly, the town of Branford, Connecticut, located on Long Island Sound, ordered mandatory evacuations in a press release on the night of October 28, 2012. The press release declared, in part: “Sandy’s storm force winds are expected to affect Branford around midnight tonight and are expected to become increasingly worse in the succeeding 36 hours. Storm surges are predicted to be worse than what we experienced in Hurricane Irene and have been compared to the 1938 Hurricane.” Once again, the decision by Branford officials to evacuate appeared to be driven by the fact that Sandy *could* or *might* bring significant storm damage, not that storm damage had already taken place.

In some cases, the evacuation orders do not specify a reason for an evacuation. For example, Manasquan, New Jersey, a borough of less than 6,000 people on the New Jersey shore, ordered mandatory evacuations on October 27, 2012. No particular reason was given for the order on the borough’s website. Insurers facing civil authority claims in similarly small towns may encounter difficulties determining the precise when and why of evacuations related to Sandy.

The evacuation orders from Babylon, Branford, and many other locales that

were affected by Sandy demonstrate that the primary concern in the minds of the authorities ordering the evacuations was the impact that Sandy *could* have if it came ashore. Because of that, insureds may have a difficult time proving entitlement to civil authority coverage. However, a difficult time does not mean an impossible time, and insureds facing this situation may turn to *Assurance Co. of Am. v. BBB Service Co., Inc.*, 265 Ga. App. 35 (Ga. Ct. App. 2003), for guidance. They are likely to argue that even though the evacuation orders do not discuss prior damage, Hurricane Sandy did, in fact, cause significant property damage and death in Jamaica, the Bahamas, the Dominican Republic, Cuba, and Haiti before any orders were issued in the United States. Similar to the insured in *BBB Service*, 265 Ga. App. 35 (Ga. Ct. App. 2003), the insured here will need to produce testimony that those making the evacuation decisions were aware of the damage in the Caribbean and that their actions were motivated, in part, by that damage.

Finally, it is important to keep in mind that the damage that caused a Sandy-related evacuation must have been caused by a covered cause of loss as defined in the relevant policy. This requirement could be problematic for policyholders when they do not have coverage for flood-caused losses. A large portion of the damage that Sandy caused resulted from flooding, storm surge, or both. Standard commercial or business-owners property insurance policies typically do not cover these causes of loss. Faced with that, an insured might argue that an evacuation order was not solely a result of flood damage but also due to other causes of loss, potentially including covered causes of loss such as wind or fire. When a civil authority provision does not have an anti-concurrent causation clause, how a court would handle such a claim is unclear. Surely a court would initially require an insured to demonstrate what caused a civil authority to issue an evacuation order.

Additional Issues in Zone A

More so than any other location affected by Hurricane Sandy, “Zone A,” in New York City, presents some additional civil authority provisions issues that have not yet been litigated. Zone A is a dense and populous

area of some 375,000 residents and consists of portions of Manhattan, including the lower East Side and East Village, as well as parts of Staten Island, Coney Island, Queens, Brooklyn, and the Rockaways.

Similar to many other areas, Zone A was evacuated before Sandy hit. Mayor Michael Bloomberg issued Executive Order 163 on October 28, 2012. As with many of the areas discussed above, the evacuation order seems preventive, as opposed to reactive. Executive Order 163 states, in part:

the National Weather Service is predicting that a hurricane or tropical storm may hit the City within hours.... This State of Emergency has been declared because anticipated weather conditions are likely to cause heavy flooding, power outages, and disruption of public transportation and other vital services, and these conditions imperil the public safety.

Were that the only executive order for Zone A, the applicable analysis would be the same as the analysis discussed above. After Sandy hit, however, the mayor issued a number of additional executive orders that might affect interpreting a civil authority claim.

On October 31, 2012, Mayor Bloomberg issued Executive Order 165, which, in the second paragraph, stated: "WHEREAS, as forecasted, a severe storm hit New York City in recent days, causing heavy flooding, power outages, and disruption of public transportation and other vital services." Executive Order 165 indicated that Executive Order 163 "remain[ed] in effect," except that owners, residents, and employees of businesses were permitted to reoccupy buildings in Zone A upon a determination by the Department of Buildings that reoccupation was permitted.

Executive Order 165 presents interesting questions in connection with a civil authority insurance claim. First, is Executive Order 165 a separate act of civil authority that could, separate and independent from Executive Order 163, trigger coverage? Faced with the distinction between a reactive and preventive civil authority order, an insured in Zone A might advance that exact argument. Such an argument would allow the insured to point to the "whereas" clause of Executive Order 165 as proof that the evacuation was ordered

as a result of damage that took place when Sandy came ashore. Obviously, an insurer would likely argue that Executive Order 165 simply modified Executive Order 163 and that only Executive Order 163 should matter for the purposes of a civil authority provision analysis.

Although an insured may succeed in arguing that Executive Order 165 is a separate evacuation order, issued in response to Sandy damage, the insured would still face a steep climb recovering any money because of the civil authority insurance provision requirement that an evacuation order "prohibit[] access" to the covered property. Courts have interpreted this requirement as meaning that no one could have access to the property. In *Abner, Herman & Brock, Inc. v. Great Northern Ins. Co.*, 308 F. Supp. 2d 331 (S.D.N.Y. 2004), the plaintiff insured claimed that post-9/11 traffic restrictions made it difficult for employees to come to the office, despite the fact that pedestrian traffic and public transportation was functioning. The court found that the insured was only entitled to coverage for the period of time during which people were completely prohibited from accessing the premises, not for the longer period of time during which access was merely made more cumbersome due to the rerouting of traffic.

Similarly, in *TMC Stores, Inc. v. Federated Mut. Is. Co.*, 2005 Minn. App. Lexis 585 (Minn. App. Ct. 2005), the insured store sought coverage as a result of damage to its parking lot caused by a nearby construction project. The court found that it was undisputed that the store had remained open although ease of access for customers was diminished. The court noted that access was not prohibited "[e]ven if more difficult or less convenient access discouraged customers from patronizing" the insured's store. The court did note that if the store had demonstrated "a virtual economic shutdown," it would have been "a more difficult case."

The terms of Executive Order 165 allowed certain people, including employees, to return to the covered premises. An insured arguing that Executive Order 165 was a new evacuation order would have a difficult time making an internally consistent argument for coverage because the insured would have to admit that it and/or its

employees were allowed back into its business while continuing to maintain that the evacuation order prohibited access to the business.

Whether a civil authority provision applies in that case could conceivably turn on the nature of the business. If the business was one that does not require much direct or everyday contact with customers or clients, such as a large law firm, the firm would have difficulty arguing that the firm's operations were shut down if all employees were allowed to go to work. Conversely, a business that heavily depends on customer traffic, such as a corner bodega, would have a stronger argument for coverage because even under Executive Order 165, the general public was still prohibited from accessing Zone A. Even in the situation of the bodega, however, an insurer could argue that the bodega's main client base, people who lived and worked in the area, were in fact allowed into Zone A by Executive Order 165. In that case, the order would not directly prohibit accessing the business. The insured would then have to demonstrate that customers were not able to access the business, or that the business suffered an economic shutdown.

Conclusion

Hurricane Sandy has the potential to generate a significant amount of litigation surrounding civil authority provisions in insurance policies. Businesses that lost significant revenue as a result of the evacuation orders will be eager to recover their losses. Many businesses may find it difficult to establish the elements necessary to succeed based on a civil authority provision claim. Although a typical provision requires that a civil authority action have been in response to damage, it appears that many of the evacuation orders were issued in preparation for Sandy's arrival and not as a result of prior Sandy damage. Additionally, if an insured is able to prove that an evacuation was ordered as a result of Sandy damage, they will still have to show that the prior damage was due to a covered cause of loss and that access to the business was prohibited. Given that, it may be difficult for many insureds to recover for loss of income caused by Sandy-related evacuations.

