

## **NEW YORK DOCTRINE ON ECONOMIC LOSS: WILL IT LIMIT RECOVERY FOR BUSINESS INTERRUPTION CAUSED BY THE TERRORIST ATTACK ON THE WORLD TRADE CENTER?**

Francine L. Semaya, Esq.  
(212) 908-1270  
William K. Broudy, Esq.  
(212) 908-1289

Part of the widespread and yet-to-be fully calculated damage caused by the September 11, 2001 destruction of the World Trade Center in New York City is the enormous economic loss stemming from business interruption. The effect on businesses ranges from total physical destruction to forced closure of undamaged businesses by the City of New York for varying periods of time to permit rescue and cleanup efforts to proceed. The decline in jobs alone in New York City as a result of the terrorist attack has been estimated at over 100,000.<sup>1</sup>

Much attention has been focused on whether insurance claims arising from September 11 can be rejected under “terrorism” or “war” or “insurrection” exclusions under insurance policies. The industry response has generally been to avoid invoking such exclusions, and to maintain public confidence in the insurance industry. Going forward, however, in the absence of federal legislation to provide reinsurance support in the event of future terrorist attacks, approximately 47 states have adopted various forms of terrorism exclusions based on language prepared by ISO, with the approval of the National Association of Insurance Commissioners. New York and California have not yet approved any form of terrorism exclusion.

On the regulatory front, the New York Insurance Department responded with Circular Letters addressing the immediate insurance concerns arising from the terrorist attack. Circular Letter No. 26 (2001), issued September 12, 2001, reminded insurers authorized to do business in New York that New York Insurance Law Section 3425(b) empowers the Superintendent to declare a moratorium precluding termination of policies or to suspend or otherwise adjust the provisions relating to their cancellation or non-renewal, in areas of the State that have been declared by the President or the Governor to be in a state of emergency due to disaster or catastrophe. The Superintendent has not as yet exercised his powers under this statute.

In addition, the Superintendent issued Circular Letter No. 28 (2001) on September 24, 2001, which provided that the circumstances of the loss of life in the terrorist attacks required that “a more expeditious method of certification of death must be developed in order to streamline the payment of needed benefits to family members and designated beneficiaries. With respect to the death claims arising out of the disasters that occurred in New York City, the Pentagon, and Pennsylvania on September 11, 2001, all insurers must accept a fully executed affidavit in the form as attached, in lieu of a death certificate if such certificate is not available.” Circular Letter No. 28, as posted on the Department’s web site ([www.ins.state.ny.us](http://www.ins.state.ny.us)) includes a link to the affidavit form.

Furthermore, on October 5, 2001, in Circular Letter No. 30 (2001), the Department extended until December 31, 2001, the required nine-month time period for parties to reinsurance agreements to finalize and reduce their agreements to written form. This writing requirement avoids the presumption that such agreements are retroactive and to be accounted for as retroactive reinsurance agreements under Part 23 of SSAP 62 of the NAIC Accounting Practices and Procedures Manual. Circular Letter No. 30 specifically provides that: “This extension applies only to those contracts that involved insurers, agents, brokers or intermediaries whose offices were located in the World Trade Center (“WTC”) or the surrounding buildings affected by the September 11 disaster. Whenever an insurer utilizes this extension, the insurer must maintain satisfactory evidence that a party whose office was located in the WTC or one of the affected surrounding buildings negotiated the agreement.”

Finally, on October 26, 2001, the Department issued Circular Letter No. 31 (2001), calling on all insurers, agents and other licensees domiciled or residing in New York to review their records for any information concerning the property of individuals listed in conjunction with an Executive Order of President Bush, effective September 24, 2001 that blocked property and interests in property of persons and organizations on the list. The letter calls on New York licensees to notify the Department as well as the Federal Government of any information concerning the assets of the persons and entities on the list. The President’s Executive order and the list of those named under the

Executive Order are available through a link from Circular Letter No. 31 on the Department's web site.

In addition to the regulatory action taken to date in New York, litigation has been commenced in the United States District Court for the Southern District of New York between SR International Business Insurance Co. Ltd. ("Swiss Re") and World Trade Center Properties LLC, Silverstein Properties, Inc., et al.<sup>2</sup> The various Silverstein Properties hold a 99-year lease on the World Trade Center property, entered into on July 16, 2001.<sup>3</sup> At the time of the attack, the wording to the Swiss Re policy was still under negotiation.<sup>4</sup> The objective of the action is to determine whether insurance coverage was in place at the time of the attack and to examine the validity of the insured's contention that the use of two hijacked airliners in the attack was two occurrences rather than one, thereby doubling the potential loss payment from insurers from \$3.5 billion to \$7 billion.

In January, 2002, Allianz Insurance Co. ("Allianz"), an insurer of World Trade Center Properties LLC under excess policies, also commenced a declaratory judgment action in the United States District Court for the Southern District of New York, seeking a declaration that the loss of the World Trade Center Buildings was a single occurrence.<sup>5</sup> The policy in the Allianz litigation defines the term "occurrence" as "any one loss, disaster or casualty, or series of losses, disasters or casualties arising out of one event." The definition permits an event to be construed as all losses arising during a 72-hour period. The insured is permitted to elect the point of commencement of the 72-hour period, "which shall not be earlier than when the first loss to the covered property or interests occurs."<sup>6</sup>

In addition to the resolution of the issue concerning the number of occurrences, a key question is whether policies in force at the time of the attack on the World Trade Center provide coverage for the economic loss caused by business interruption. Business interruption coverage can take several forms. In some policies, physical damage to the business is required as a prerequisite to any business interruption claim. For example, ISO Form CP 00 30 10 91, entitled Business Income Coverage Form (And Extra Expense) provides that:

We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration." The suspension must be caused by direct physical loss of or damage to property at the premises described in the Declarations, including personal property in the open (or in a vehicle) within 100 feet, caused by or resulting from any Covered Cause of Loss.<sup>7</sup>

Some policies provide economic loss coverage if a business is shut down by order of civil authorities. ISO Form CP 00 30 10 91 includes wording for additional coverage under the Extra Expense category as follows:

Civil Authority. We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss. This coverage will apply for a period of up to two consecutive weeks from the date of that action.<sup>8</sup>

New York Insurance Law Section 5401, the Definitions section of the New York Property Insurance Underwriting Association Article, defines business interruption insurance under "additional perils coverage" as follows:

"Business interruption insurance," means coverage against actual loss resulting from necessary interruption of business due to damage or destruction by a peril insured against.<sup>9</sup>

In the vicinity of the World Trade Center, many businesses were shut down because the physical damage to nearby properties made travel on streets and sidewalks unsafe. Businesses were also closed by extended power and telephone outages. Many places of business had extensive dust contamination that did not cause damage to the premises or the inventory, but required long periods of office closure to allow cleanup efforts to be completed.

Zurich American Insurance Co. ("Zurich") has commenced a declaratory judgment action in the United States District Court for the Southern District of New York, against its insured, ABM Industries, Inc. ("ABM") seeking to limit its payment to ABM for loss of earnings under the contingent business interruption coverage to \$10 million.<sup>10</sup> The business interruption provision of the Zurich policy "insures against loss resulting directly from the necessary interruption of business caused by direct physical loss or damage, not otherwise excluded, to insured property at an insured location."<sup>11</sup> According to the Complaint, the Zurich policy also provides Contingent Business Interruption

coverage as follows:

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(2) This policy is extended to cover the actual loss sustained by the Insured due to the necessary interruption of business as the result of direct physical loss or damage of the type insured against to properties not operated by the Insured which wholly or partially prevents any direct supplier of goods and/or services to the Insured from rendering their goods and/or services, or property that wholly or partially prevents any direct receiver of goods and/or services from the Insured from accepting the Insured's goods and/or services.<sup>12</sup>

The primary disputed issue to be resolved in the Zurich litigation is whether the \$10 million per occurrence limit of liability applies to the loss of earnings component of ABM's claim. Zurich asserts that the limit applies, while ABM has concluded that it does not.<sup>13</sup>

On June 7, 2001, in a group of cases arising from the partial collapse of a wall of an office tower and the collapse of a 48-story construction elevator tower, both in midtown Manhattan, the New York Court of Appeals, New York's highest court, examined the issue of liability for economic loss in New York.<sup>14</sup> The plaintiff businesses, including a deli, a candy store, a law firm, a public relations firm and a clothing manufacturer, sought recovery for economic loss from the owners of the properties where the mishaps occurred on behalf of themselves and purported classes of similarly situated businesses. None of the plaintiff businesses had suffered physical damage. Their claims were based on economic loss alone.<sup>15</sup> In dismissing all their causes of action, the Court reasoned that:

Policy-driven line-drawing is to an extent arbitrary because, wherever the line is drawn, invariably it cuts off liability to persons who foreseeably might be plaintiffs. The *Goldberg Weprin* class, for example, would include all persons in the vicinity of Times Square whose businesses had to be closed and a subclass of area residents evacuated from their homes; the *5<sup>th</sup> Avenue Chocolatiere* class would include all business entities between 42<sup>nd</sup> Street and 57<sup>th</sup> Streets and Fifth and Park Avenues. While the Appellate Division attempted to draw a careful boundary at storefront merchant neighbors who suffered lost income, that line excludes others similarly affected by the closures -- such as the law firm, public relations firm, clothing manufacturer and other displaced plaintiffs in *Goldberg Weprin*, the thousands of professional, commercial and residential tenants situated in the towers surrounding the named plaintiffs, and suppliers and service providers unable to reach the densely populated New York City blocks at issue in each case.

As is readily apparent, an intermediate group in the affected areas thus may have provable financial losses directly traceable to the two construction-related collapses, with no satisfactory way geographically to distinguish among those who have suffered purely economic losses (*see also, Kinsman Transit Co. v. City of Buffalo*, 388 F2d 821, 825 n 8). *In such circumstances, limiting the scope of defendants' duty to those who have, as a result of these events, suffered personal injury or property damage -- as historically courts have done -- affords a principled basis for reasonably apportioning liability.*

*We therefore conclude that plaintiffs' negligence claims based on economic loss alone fall beyond the scope of the duty owed them by defendants and should be dismissed.*<sup>16</sup>

It is ironic that a mere three months before massive economic losses were incurred in New York, its highest court, ruling in cases arising from routine construction mishaps, strongly reaffirmed the case law principles that govern responsibility for economic loss. Will these principles have to be re-examined in light of the incomprehensible nature of the events that caused the extensive economic loss to the World Trade Center and surrounding businesses? If actions are brought by businesses against the City and State authorities and against private parties for liability for September 11, 2001-related economic loss, will the courts be willing to adhere to and reaffirm the requirement for personal injury and property damage as a condition precedent for recovery? The answers to these and other questions arising within the context of these unprecedented events, might well signal not only the development of new theories of liability in the area of economic loss but also insurance regulatory consideration for enforcement of current business interruption provisions in insurance policies or revisions to current policy wordings to cover purely economic loss.

### *Endnotes*

1. Report of the Fiscal Policy Institute, prepared for the New York City Central Labor Council and the Consortium for Worker Education, September 28, 2001.
2. *SR International Business Insurance Co., Ltd. v. World Trade Center Properties LLC*, No. 01-CV-0233, S.D.N.Y.
3. Complaint in *SR International Business Insurance Co., Ltd.*, paragraph 26.
4. *Id.* paragraph 34.
5. *Allianz Insurance Co. v. World Trade Center Properties LLC*, No. 02-CV-0017, S.D.N.Y.
6. Excerpts from Allianz policy quoted in *Mealey's Litigation Report: Reinsurance*, vol. 12, #18, January 24, 2002, p.14
7. *Miller's Standard Insurance Policies Annotated*, Vol. I, p. 482.103.
8. *Id.*, Vol. I, p. 482.104.
9. N.Y. Ins. L. § 5401 (c) (4).
10. *Zurich American Insurance Co. v. ABM Industries Inc.*, No. 01-1246, S.D.N.Y.
11. Complaint in *Zurich American Insurance Co. v. ABM Industries Inc.*, paragraph 15.
12. *Id.*, paragraph 17.
13. *Id.*, paragraphs 23, 24.
14. *532 Madison Avenue Gourmet Foods, Inc. v. Finlandia Center, Inc.*, 96 N.Y. 2d 280, 750 N.E. 2d 1097, 727 N.Y.S. 2d 49 (2001).
15. *Id.* at 727 N.Y.S. 2d 53.
16. *Id.* at 727 N.Y.S. 2d 55, emphasis added.