

Hurricane Sandy's Civil Authority Issues Bear Watching by Reinsurers

By Seth V. Jackson

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As both insurers and reinsurers are well aware by now, the destructive path left by Hurricane Sandy in many Northeast states such as New York, Connecticut, and New Jersey was devastating. To date, reports have estimated property damage at \$71 billion, lost business activity at \$25 billion, homes without power at 8 million, and homes destroyed at 305,000. Such damage has led to a proliferation of Sandy-related insurance coverage issues.

Given the mandatory evacuation orders issued by the governors of New York, Delaware, New Jersey, and Connecticut, one coverage issue arising from Hurricane Sandy that may have a potentially large impact on the insurance and reinsurance industry is civil authority coverage for business interruption losses.

Sandy Evacuations

As Hurricane Sandy moved northward from the Caribbean off the coast of the southeastern United States on a predicted path to the Mid-Atlantic, states and municipalities from Maryland to Connecticut issued mandatory evacuation orders and declared states of emergency. On October 27, 2012, Delaware's governor ordered mandatory evacuations of Wilmington starting at 3 pm and of certain coastal communities beginning at 8 pm. New Jersey Governor Chris Christie ordered the suspension of gaming at the Atlantic City casinos by 3 pm on October 28, and ordered a mandatory evacuation of the New Jersey shore barrier islands beginning at 4 pm that same day.

Also, on October 28, beginning at 7 pm, New York City's Mayor Michael Bloomberg ordered a mandatory evacuation of "Zone A," which includes Staten Island, Battery Park, and Queens. Both New Jersey Transit and New York's Metropolitan Transit Authority shut down on the Sunday before the impending storm. Municipalities and towns throughout these regions also issued localized mandatory evacuation orders.

In response to mandatory evacuation orders, thousands of businesses suspended operations, and hundreds of thousands of residents emptied low-lying cities and towns and vulnerable areas throughout the Northeast. Sandy's strong winds and torrential rainfall arrived in Washington, D.C., and northward in the afternoon of Monday, October 29. Sandy's center came ashore at Atlantic City, New Jersey, that evening at 8 p.m.

Causal Connection Needed Between Property Damage and Order

Businesses that suffered losses of income due to these mandatory evacuation orders may attempt to seek coverage for such losses under civil authority provisions of their business interruption coverage. A civil authority clause, generally speaking, provides coverage for lost income when access to property is prevented, hindered, or impaired by an order or action of a civil authority as a result of loss or damage not excluded by the policy.

Civil authority clauses vary; but, generally, a causal connection between property damage by a covered peril and the civil authority order is a prerequisite. Given the number of mandatory evacuation orders that were issued well in advance of Sandy's landfall, and therefore arguably in advance of the requisite property damage, loss of income between the time of evacuation and damage is likely to be a common source of disputes between insurers and policyholders. To obtain coverage, the insured generally must show that an order or action of civil authority *resulted from* loss or damage caused by a peril not excluded by the policy.

Prior Hurricane Cases Provide Guidance

So, will civil authority provisions be triggered when an evacuation was ordered before the evacuation area sustained any damage from Sandy? The major destructive storms of the past two decades have presented courts with ample opportunities to consider civil authority coverage for business losses resulting from mandatory evacuations issued in advance of any local storm damage.

The policy language is always the starting point to determine coverage. In *Jones, Walker, Waechter, Potevent, Carrere & Denegre, LLP v. The CHUBB Corporation*, No. 09-6057, 2010 WL 4026375 (E.D. La. Oct. 12, 2010), the insured sought coverage under a civil authority clause for business losses incurred during a period of mandatory evacuation beginning one day before Hurricane Gustav ultimately made landfall. The civil authority clause provided coverage for business income loss incurred from impairment of operations caused by the prohibition of access to the premises by a civil authority that is "the direct result of direct physical loss or damage to property away from such premises or such dependent business premises by a covered peril, provided such property is **within one mile** from such premises or dependent premises."

The court in *Jones* held that the plain language of the policy required a direct nexus between damage sustained and the order of civil authority, suggesting that the policy was designed to address circumstances where damage occurs and the civil authority **subsequently** prohibits access. The evacuation order issued before Gustav's landfall did not trigger coverage because it did not prohibit access based on property damage within one mile of the premises. This result is clearly closely tied to the specific language of the policy, which in this case required damage within a one-mile radius.

When an order to evacuate is issued in advance of landfall or damage in the area covered by the evacuation order, the damage trigger may not be satisfied, even absent policy

language containing a “one-mile” requirement. In *Dickie Brennan & Co., Inc. v. Lexington Ins. Co.*, for example, the court denied civil authority coverage for a period of evacuation preceding Hurricane Gustav’s arrival in Louisiana because no property damage had occurred in Louisiana at the time the evacuation order was issued for Hurricane Gustav. 636 F.3d 683, 686-87 (5th Cir. 2011). The civil authority clause provided coverage for loss of business income caused by an action of civil authority prohibiting access to the premises “due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any [c]overed [c]ause of [l]oss.”

The court in *Dickie Brennan* rejected the insured’s argument that prior property damage Gustav caused in the Caribbean combined with Gustav’s projected path toward New Orleans satisfied the requisite nexus between prior property damage and the evacuation order. The evacuation order, however, did not mention the earlier property damage in the Caribbean; rather, it listed possible future storm surge, high winds, and flooding based on Gustav’s predicted path as reasons for evacuation. It was undisputed that no damage to property had been sustained in Louisiana when the order was issued. Because nothing in the record demonstrated that the order was issued “due to” physical damage to property—either in the Caribbean or Louisiana—the court concluded that civil authority coverage for the period of evacuation before Gustav caused damage in Louisiana was not triggered. This is consistent with a Texas decision interpreting nearly identical property language. *See S. Tex. Med. Clinics, PA v. CAN Fin. Corp.*, No. H-06-4041, 2008 WL 450012, at *10 (S.D. Tex. Feb. 15, 2008) (holding that civil authority clause did not cover business losses when the record demonstrated that an evacuation order was issued because Hurricane Rita threatened the Texas coast, not because Rita had already caused property damage in Florida).

The cases of *Dickie Brennan* and *South Texas Medical* illustrate that an evacuation order provoked by the mere threat of future damage—even if the awareness of the threat is informed by past damage caused by the same storm system—is less likely to trigger civil authority coverage, because the causal link between the prior damage and civil authority order is too attenuated. However, when the causal connection between prior damage and the order of civil authority is clearly established, an evacuation order issued in anticipation of an impending storm based on damage that storm caused in its path could satisfy the damage trigger. In *Assurance Company of America v. BBB Service Co., Inc.*, 265 Ga. App. 35 (2003), a Georgia appellate court considering a nearly identical civil authority clause to those considered in *Dickie Brennan* and *South Texas Medical Clinics* held that property damage Hurricane Floyd caused in the Bahamas before it struck Georgia triggered civil authority coverage for the evacuation period beginning before Floyd landed in Georgia. The insured presented evidence that the county’s decision to order the evacuation in advance of the storm was based on the significant damage the storm caused in islands in the Bahamas in its path, the forecast that the storm was heading for the county, and the anticipated impact of the storm if it reached the county. Because of this evidence that actual damage to property other than the insured premises was a basis for the evacuation order, the court concluded that the civil authority coverage was triggered.

When Sandy approached the Mid-Atlantic region, she had already destroyed homes and businesses throughout the Caribbean, washed out portions of highway in the Outer Banks, and caused nearly 60 deaths. Although the destruction and damage inflicted in the Caribbean may have provided a basis for anticipating the harm that could result if Sandy made landfall in the northeastern United States, coverage under standard civil authority clauses will partly depend on whether evidence demonstrates that it was the threat of harm itself—not the damage already caused elsewhere—that led officials to issue mandatory evacuations in the northeastern United States.

Reinsurance Implications

With respect to these civil authority issues, reinsurers should understand the coverage positions being taken by their cedents in light of the complexity and potential lack of clarity in the law. The follow-the-fortunes doctrine may become a key issue in the payment of Hurricane Sandy claims. To determine whether this doctrine applies to a Hurricane Sandy claim, a court will need to look at the investigation relating to the claim and the ultimate coverage determination. For example, in a Sandy civil authority claim, a court would most likely analyze if there was a causal connection between the evacuation order and the loss or damage caused by Sandy.

A reinsurer may not be obligated to provide reinsurance for a payment by the cedent where the loss falls squarely outside of the scope of civil authority coverage afforded by the reinsured policy. *See, e.g., North River Ins. Co. v. CIGNA Reins. Co.*, 52 F.3d 1194, 1199 (3d Cir. 1995). Thus, given the complexity of the underlying law and the very real potential for courts to find coverage, the follow the fortunes doctrine suggests the need for flexibility in reviewing ceding companies' settlement decisions of Hurricane Sandy civil authority claims.