

Summary of Decision

The facts were not in dispute. TXI owned a cement manufacturing plant with five kilns. TXI obtained property damage insurance from FM with business interruption coverage attached thereto. TXI started a pre-planned maintenance outage of Kiln-5 on January 5, 2003; it was to last until January 16. On January 7, fire damaged K-5 but had no physical effect on the other kilns. However, production was interrupted until January 30, and full production did not resume until February 3. There was a 23-day period during which K-5 did not operate at all, and there was another 4-day period during which it operated only partially. Ten of these days were part of the planned outage.

The parties agreed and stipulated that TXI's total Business interruption loss was \$3,916,905. Of course, it was from this that the deductible was to be subtracted. The sole issue before the court was how to calculate the deductible properly. FM's calculation was \$4,084,323, a number larger than the loss. TXI's calculation was \$2,571,444, a number smaller than the loss by \$1,345,461, and this number—plus costs and interest—was the amount TXI sought from FM.

The court entitled the deductible clause "15 Day's Value Time Element of the Objects Experiencing the Loss or Damage." The policy defined the term "deductible" as follows: "The amount equivalent to the number of days shown[,] times the 100% daily Time Element value of the objects experiencing the direct physical loss or damage[,] including the 100% daily Time Element value of all other objects or operations at the location where the loss or damage occurs which are dependent on the objects experiencing the loss or damage. The 100% daily Time Element value of the objects, including the other dependent daily value[,] will be the full percentage contribution which would have resulted had the loss or damage not occurred to the 100% daily Time Element value of the entire premises at the location. In determining the 100% daily Time Element value, due consideration will be given to the experience of the business before the loss and the probable experience thereafter."

The parties agreed on several important facts. First, K-5 was the only object suffering a loss. Second, no other kilns depended upon K-5. Third, K-5 would have produced 67.08% of the plant's total output

**Business Interruption/
Deductibles**

**Unclear and Confusing Definition of "Deductible"
for a Business Interruption Policy Must Be
Interpreted In Favor of the Insured**

Texas Law Applied

Texas Industries Inc. v. Factory Mutual Insurance Co., ___ F.3d ___, 2007 WL 1376337 (5th Cir., May 11, 2007).

Case at a Glance

Factory Mutual ("FM") insured a TXI cement manufacturing plant. There was fire at one of the five kilns. Production stopped. The parties agreed as to the amount of loss; however, there was a deductible which needed to be calculated. FM figured the deductible to exceed the insured's loss, while TXI's calculation of the deductible was substantially less than the stipulated amount of damage. The deductible language in the policy was difficult to understand; it prescribed a mysterious calculation; and it contained empirical directions which were vague and which could be met in several ways. The district court found that the definition of "deductible" was unambiguous but resolved the case in favor of the insured. The Fifth Circuit affirmed but because it found the definition ambiguous.

during the relevant 27 day period. The two parties differed on how to calculate the loss, however.

TXI calculated the loss as follows. It figured the daily time value of the entire plant for the interval. It multiplied the daily time element value of the entire premises by 67.08%. It said this equaled the daily time value of K-5. It multiplied this value by 15—the actual number of covered days—and arrived at the already stated deductible. It then subtracted this—the deductible number—from the stipulated total loss and arrived at a dollar value for the claim.

FM's methods were quite different. It proposed two different ways to calculate the deductible.

The first method was this. The stipulated average number of tons of clinker produced daily by K-5 during the previous 6 months should be multiplied by 15, the number of deductible days, and then that product should itself be multiplied, first, by the conversion rate of clinker to concrete and then by the value of cement per ton at the time. This final product far exceeded the total loss, and so FM owed nothing.

The second way involved devising and using a modification of the equation presented by TXI and utilized by the district court. FM argued that the total production value of the period should not be divided by 27 but by 17, since K-5 would not have been used during the first 10 days of the period because of the planned outage. When this is done, the final deductible number is nearly the same as than ending the first calculation, and—in any case—is a number exceeding the total loss.

The district court had determined that TXI's interpretation was "the only reasonable one," and it therefore adopted TXI's deductible figure. The district court was especially concerned about the proper interpretation of the second sentence of the herein quoted definition. (Alas, it is not clear from the opinion being discussed precisely what that concern might have been.)

The lower court's reasoning was wrong, said Circuit Judge Benavides, writing for the Fifth Circuit panel, which included Chief Circuit Judge Edith Jones, who often favors insurers. The language of the policy was ambiguous. Under Texas law, if a contract of insurance is susceptible to more than one reasonable interpretation, courts must "resolve the uncertainty by adopting the construction that most favors the insured." *Nat'l Union Fire Ins. Co. v. Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex. 1991)

Indeed, courts "must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent." *Id.*

The Fifth Circuit panel focused upon the last sentence of the definition of the term "deductible." The contract is unclear as to the proper calculation of the "100% daily Time Element value" of a kiln. The real issue is whether the dividing denominator in the court's calculation should be 27 or 17. This is not made clear by the policy, and the directions to be found in the last sentence of the definition make the policies silence even more puzzling. What could constitute *due* consideration of previous business? And how should this be done. If there are two rational methods, then there is ambiguity.

Hence, said the panel, the decision of the district court was twice correct, though for the wrong reasons. First, it was right to grant TXI's motion for summary judgment, and second, it was right to deny that of FM.

Comment

It has been standard practice for many years to ignore planned outages when calculating deductibles. It is standard practice in the insurance industry to use numbers reflecting actual production days only. In other words, it has long been standard practice to eliminate planned outage days from the calculation. Consequently, if nothing else, this case will almost certainly result in revisions of the language used to state calculative definition of the word "deductible," or the language used to formulate similar sections of policies. It will also provide intricate speeches, filled with power-point equations at insurance CLE conferences for lawyers.

Notice that the Fifth Circuit attended only to the second FM method of calculation when comparing and contrasting the methods of the two parties. The first method of calculation depends upon the meaning of the word "clinker." In this situation, that word probably means *the incombustible residue, fused into irregular lumps, which remains after the combustion of coal*. It is this substance which is converted into cement. According to FM, the conversion rate is .9912.

Why did the panel ignore this method of calculation? Was it because it was turned off by the number .9912? Probably not, even though it makes almost no difference. Was it because the word “clinker”—or its equivalent—does not appear anywhere in the insurance policy? Almost certainly. If so, then the panel ignored it because FM imported language into interpreting and applying the policy which was foreign to the contents of the policy and not absolutely necessary to its interpretation. Thus, in effect, the panel adopted a kind of literary theory into policy interpretation. A basic principle of this theory would be: *Don't use language not used in the policy in creating interpretations of the policy.* Or it would be this: *If there are two different reasonable interpretations of a contract of insurance, one of which uses a concept or language foreign to the policy, the other interpretation is to be adopted.* Could this be called a “poetics of insurance”? (There will be more about this in the next issue of *Insurance Litigation Reporter*.)

This leads to a final point. The Fifth Circuit panel implies that the FM interpretation may be the more reasonable, but since the interpretation of TXI is itself reasonable it must be adopted. But this form of inference applies only to exclusionary clauses. Hence this rule would apply only if the definition of “deductible” in the FM policy was an exclusionary clause. Is it? If it is, why is it? After all, most language, even many quite general terms—perhaps all but “universe” and “infinite”—do not apply to everything and therefore exclude something. Given the panel's reasoning doesn't this make even insuring agreements a type of exclusionary clause? // Quinn