

## Extra Expenses and Business Interruption Coverages

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First party insurance policies often insure against extra expenses, as they are often called both in the policy and in trade jargon. Generally speaking, an extra expense is an amount that needs to be spent in order to accomplish some other purpose. As a general rule, the purpose to be accomplished is to avoid states of affairs which would trigger or increase coverage the insurer would have to pay. The main trouble with extra expense coverage is that it is not the kind of insurance with which pretty much everybody has at least a rough and ready understanding. It also contains twists and surprises. Finally, property policies are, in some parts, not terribly well written, and if there were a race towards awkward prose, extra expense coverage would come in second, at best.

### I. Introduction

Certain types of expenses are covered in many sorts of insurance contracts. Precisely which expenses are intended to be covered depends on the type of contract and the wording of a specific contract. Such coverage is to be found in both first party policies and liability policies. The amount of coverage provided is sometimes precisely calculable with exactitude down to the last penny. Sometimes it has to be estimated. Here we restricted ourselves to one type of first party coverage—indemnity for lost business usually caused by some sort of covered first party loss. Calculations in this area of insurance are often not capable of

absolutely precise determination.

**Business Interruption Coverage.** Consider, for example, coverage for business interruption, flows of business income, and the like. "Extra expense insurance is designed for those businesses that simply cannot allow a physical damage loss to cause a shutdown of operations. . . . Continuity

of service is the key to success for those businesses . . . ."<sup>1</sup> This form of coverage, years ago, was called "use and occupancy insurance."<sup>2</sup> It is now often attached to or made part of commercial property insurance. "[E]xtra expenses are typically incurred either to reduce loss of sales or to shorten the restoration period."<sup>3</sup>

Suppose an insured sells widgets for \$5 apiece, which it manufactures for \$3 each. Suppose after a fire, it can no longer manufacture widgets, but can buy them on the open market wholesale in large quantities for \$4 apiece. Suppose that the insured can sell all the widgets it buys for \$5 apiece. If the insured had standard extra expense coverage attached to business interruption coverage, the insured would probably be able to recover \$1 apiece from its insurance company for the widgets it bought wholesale instead of making them. Extra expense coverage is for eliminating or reducing losses only.<sup>4</sup> Generally speaking, other things being equal, extra expenses coverage is only for expenses actually incurred.<sup>5</sup> Thus, it conforms to the Principle of Indemnity.<sup>6</sup> This is true even though an insured's

1. James R. Robie, Michael J. O'Neill, and Richard C. Bennett, *Business Interruption and Indirect Loss*, PROPERTY INSURANCE (Steven Cozen and James O'Connor, Eds., 1998).

2. See *Nat'l Union Fire Ins. Co. v. Anderson-Pritchard Oil Corp.*, 141 F.2d 443 (10th Cir. 1944); *Puget Sound Lumber Co. v. Mechanics' & Traders' Ins. Co.*, 10 P.2d 568 (Wash. 1932).

3. David A. Borghesi, *Business Interruption Insurance—A Business Perspective*, 17 NOVA L. REV. 1147, 1160 (1993). See Robert M. Morrison, Alan G. Miller & Stephen J. Paris, *BUSINESS INTERRUPTION INSURANCE: ITS THEORY AND PRACTICE* (1986). "Extras are often referred to as 'expediting expenses.' They fall into three categories: those that speed up the resumption of operations, those that continue operations during the period of interruption but at a higher than normal cost, and those incurred, after operations are resumed, to refill inventory." *Id.* at 59.

4. See *A. Miller & Co. v. Cincinnati Ins. Co.*, 577 N.E.2d 885 (Ill. App. 1991) (stating that extra expense coverage is only for additional expenses undertaken to keep a business going; it is not for all of the expenses, including those expenses which would normally be involved in replenishing inventory); *Northwestern States Portland Cement Co. v. Hartford Fire Ins. Co.*, 360 F.2d 531 (8th Cir. 1966) (stating that extra expense coverage is not for enriching insureds that have losses; it is to pay for the losses but only the losses); *Puget Sound Lumber Co. v. Mechanics' & Traders' Ins. Co.*, 10 P.2d 568 (Wash. 1932) (stating that extra expense coverage is not designed to cover continuing fixed charges which are ongoing after a loss).

entitlement to business interruption and related extra expense losses often must be estimated.

Significantly, under most insuring arrangements like the one hypothesized, the insured has a duty under the insurance contract to obtain substitute widgets, if economically feasible. This duty either is or is like the duty to mitigate.<sup>7</sup> Sometimes, extra expenses are called "expediting expenses."<sup>8</sup> Not all expediting expenses are covered, and none are covered when they are undocumented.<sup>9</sup> If an insurer is going to be required to pay for actual expenses, there must actually be coverage for them. Some courts have said that expenses incurred by an insured to eliminate or reduce business interruption coverage are not covered without explicit extra expense coverage. Thus, if an insurance policy covers a particular risk, for example, the loss of rent, and the insured landlord avoids any loss of rent by extraordinary diligence [so that] the building was repaired so speedily that there was no actual loss of rent[,] there is no coverage for the expenses.<sup>10</sup>

As indicated, extra expense coverage can arise in many sorts of policies and from many kinds of losses. As we saw in the characterizations of extra expenses to be found in the text of Note 7, extra expenses can be tied to physical losses as well as to business interruption losses. It is standardly associated with business interruption coverage, however.<sup>11</sup> This is where the name "extra expense coverage" usually appears. Consequently, as stated, we will restrict ourselves and focus on that. Under virtually all circumstances, extra expense coverage is only contingently related to other kinds of coverage;<sup>12</sup> insureds need to ask for and think about it separately; and insureds may cancel it without canceling other coverages.<sup>13</sup>

Extra expense provisions have a variety of features. Some of them are subject to policy limits; some of them are not. Some extra expense coverages are in addition to policy limits. Some extra expense coverages require that the insurer sign off on the insured undertaking those expenses;<sup>14</sup> some do not.

5. *Royal Indem. Co. v. Little Joe's Catfish, Inc.*, 636 S.W.2d 530, 534-35 (Tex. App.—San Antonio 1982, no writ).

6. Robert E. Keeton and Alan I. Widiss, *INSURANCE LAW*, 134-35 (1988).

7. The insured "[p]laintiff now presents the anomalous claim that the action required of it in seeking to mitigate damages by diverting merchandise actually resulted in *increasing* those damages. Expenses in mitigation of damages must be made in the reasonable expectation of reducing the recovery below the amount of the loss; expenditures which results in an increased loss cannot be justified. Such a claim strips the business interruption insurance coverage of any rational meaning." *Howard Stores Corp. v. Foremost Ins. Co.*, 441 N.Y.S.2d 674, 676-77 (App. Div. 1981).

8. *Cotton Bros. Baking Co. v. Industrial Risk Insurers*, 941 F.2d 380, 386 (5<sup>th</sup> Cir. 1991). Then again, sometimes expediting expenses are distinguished from extra expenses. In one property policy, which did not contain business interruption provision, there were separate coverages for expediting expenses and extra expenses. Here is the language for the expediting expenses: "We will pay the reasonable and necessary extra costs of emergency and temporary repair to or replacement of covered property due to direct physical loss or damage from covered causes of loss and the extra costs of expediting the permanent repair or replacement of your lost or damaged property, including overtime, express freight, or other rapid means of transportation." In contrast, extra expenses were covered as follows: "We will pay for the additional reasonable and necessary expenses you incur in an effort to continue normal operations which are interrupted due to direct physical loss or damage from covered causes of loss to covered property. Additional expenses means that amount spent to continue your operations over and above the expenses you would have incurred had there been no loss or damage. We will pay those additional expenses during the time it would require with the exercise of due diligence and dispatch to rebuild, repair, or replace the damaged or destroyed property."

9. *Fold-Pak Corp. v. Liberty Mut. Fire Ins. Co.*, 748 F. Supp. 49 (W.D.N.Y. 1992).

10. *Hartford Fire Ins. Co. v. Northern Trust Co.*, 906 WL 1973 (Ill. App. 1906).

11. See *Lyon Metal Prods., L.L.C. v. Protection Mut. Ins. Co.*, 747 N.E.2d 495 (Ill. App. 2001)

12. Policy provisions providing a per diem for business interruption losses did not provide extra expense coverage. *Studley Box & Lumber Co. v. National Fire Ins. Co.*, 154 A. 337 (N.H. 1931).

13. When an insurer deletes extra expense coverage, notifies the policyholder of its action, and there was evidence that the policyholder "specifically rejected extra expense coverage and is working to relieve itself of the burden of . . . premium payments[,] there was evidence to support a verdict denying an insured an extra expense claim under its business interruption policy. *Western Am., Inc. v. Aetna Cas. & Sur. Co.*, 915 F.2d 1181, 1185 (8<sup>th</sup> Cir. 1990).

14. If a contract of insurance provides coverage for extra expenses when the insurer requires that they be undertaken, for example, to obtain machinery, duplicate parts, additional stock, and so forth, the insured has no right to recover for extra expenses under the policy, if it incurs the expenses and the insurer did not require them. *Ocean Acc. & Guar. Corp. v. Penick & Ford*, 101 F.2d 493 (8<sup>th</sup> Cir. 1939). Contracts of insurance must be read carefully on this point to determine what is required and what is simply possible.

At the same time, virtually all policies require that the extra expense either be *reasonably related* to accomplishing the purpose for which it is made or *necessary* to that purpose. Probably, there is no substantial difference, as a *practical* matter, between the concepts inherent in these italicized phrases, even though they are *theoretically* quite distinct.<sup>15</sup> Notice that the language of the policy requires that the extra expense actually be either necessary or reasonably related to the purpose. Thus, if a business undertakes an expediting project, and it fails, there would technically be no coverage.<sup>16</sup> From one point of view, this approach is a good idea: it encourages businesses to think carefully about how to respond to disasters. On the other hand, the failure of a reasonable and soundly conceived expediting expense to achieve a goal would "just be one of those things."

Perhaps policyholders are best protected under these circumstances if insurers are induced to authorize or at least consent to such expenditures. It might even be better for the insured if the insurer is asked to authorize or consent, and it refuses. It seems to us that if insureds ask insurers for advice, direction, consent, information, or help, and the insurer refuses it, juries will, at a later time, be less patient with the insurer. As a litigation-trial strategy, counsel for policyholders should try to set up as a theme of the case that extra expense insurance involves a number of subtle reshiftings back to the insured of risks which one would expect to be on the insurer. If the insurer refuses to be helpful in the adjustment process, this would be another example of reshifting, albeit of a

different type. Policyholders should attend to (and save) insurer sales literature, mission statements, newsletters, statements of inspectors, and so forth.

Because extra expense coverage is standardized, because it is abstract in certain ways, and because it is sold in a great variety of industries, care must be utilized in applying the coverage. This requires a balanced approach. First, it must be acknowledged that insureds may be tempted to exaggerate extra expenses. For this reason, courts understand that "[a]n insured's claimed expenses should be carefully scrutinized."<sup>17</sup> Second, general terms providing for extra expense coverage in an insurance policy must be read in light of the insured's industry. *Example One*: An extra expense policy may have to be read in light of how the restaurant business works, if the underlying physical—say fire-loss is at a restaurant.<sup>18</sup> *Example Two*: If an insurance policy provides coverage for controlling blowouts, expenses incurred for "fishing" and "whipstocking" are within the purview of the term "control." Similarly, expenses for employing available workers to assist in the removal of debris and in preparing the wellhead for "control" operations are within the purview of activities designed to bring the well under control. The language and concepts come from the proper care and use of drilling rigs. The court refers to this as a "pragmatic approach."<sup>19</sup> The first step of such a pragmatic approach is to learn the meanings of the key terms, "fishing" and "whipstocking." The meanings of these terms is here unimportant. In fact, our point can best be made to those who do not

15. See *Insurance Co. of N. Am., Inc. v. U.S. Gypsum Co.*, 870 F.2d 148 (4<sup>th</sup> Cir. 1989). Here, fixing a damaged building would have been more expensive than replacing it at another site, "the cost of relocating and rebuilding were fully recoverable." *Id.* at 153.

16. *American Alliance Ins. Co. v. Keleket X-Ray Corp.*, 248 F.2d 920 (6<sup>th</sup> Cir. 1957). "Had the plaintiff shown that the period of operation had been shortened by the use of overtime labor at premium wages, for example, then the premium wages would be allowable up to the point by which the liabilities of the insurers under the business interruption policies had been reduced. The record is devoid of evidence to this effect. In the absence of evidence showing that the expenditures had actually reduced business income losses, the district court was in error in allowing any decontamination expenses as expense incurred to reduce the loss under the business interruption policies." *Id.* at 930-31.

17. *Atlantic Richfield Co. v. Underwriters at Lloyds London*, 398 F. Supp. 708, 718 (S.D. Tex. 1975). Kevin M. Quinley has written an extremely interesting book for adjusters (and those interested in insurance ethics) entitled *WELL ADJUSTED: 185 SUCCESSFUL TIPS FOR THE ADJUSTER'S CAREER* (2001). Tip number 127 reads as follows: "It's amazing how profitable a business carrying time-element coverage was after it has burned to the ground! This too is a running joke among loss adjusters. The most unprofitable business dangling for survival by a thread often is magically transformed into a profitable enterprise by the time the fire claim is submitted to the insurer." *Id.* at 132.

18. *Lexington Ins. Co. v. Island Recreational Dev. Corp.*, 706 S.W.2d 754 (Tex. App.—Beaumont 1986, writ refused n.r.e.). Because of the generality of the policy and the awkward fit between the language of the contract and the restaurant business, the court implied—or at least hinted—that the policy should be treated as ambiguous.

19. *Id.* at 718-19.

understand the terms. Our point is that insurers must learn the jargon of the trades they insure. Determining which extra expenses are covered requires understanding significant facts about the business insured.

Sometimes there is confusion as to whether the price of a new piece of equipment should be treated as property damage only or as property damage plus an extra expense. This will vary with the circumstances.<sup>20</sup> The use of a lease-purchase plan followed by a purchase may solve this problem under some circumstances. We have not located case law to this effect, however.

## II. Road Map From Here

In the rest of this paper, we will analyze the key features of a standard business interruption-related extra expense proviso; we will analyze and critique a recent case; and we will formulate a list of steps policyholder lawyers and risk managers might take in trying to minimize dangers they might face in dealing with extra expense claims. Throughout our analysis it should be kept in mind that extra expenses will be at once standardized and diverse. Thus, extra expenses can include rents for alternative locations, extra compensation for overtime work, and so forth. On the other hand, they may be unusual. Thus, a business which depends upon telephones, may have extraordinary expenses for new phones, new phone lines, short-term phone line rentals, and so forth.<sup>21</sup> (Imagine how dangerous this could be in the high-tech, computer age.) Furthermore, although extra expenses may be more precisely quantifiable than business interruption losses, they may still be subject to some estimation in the end.<sup>22</sup> This will be especially true when anomalous expenses have to be divided between those caused by overt hazards and those caused by hazards which are not covered. (Such allocations must be performed if business interrup-

tion policies are legally required to pay.<sup>23</sup>)

Ostensible extra expenses bear scrutiny. Consider, for example, a situation in which the value of leased equipment is paid for under the property damage section of the policy. When that happens, accelerated lease payments might not be an actual expense made to return the insured to normal business operations. After all, the insurer will have already paid for the value of the leased equipment. Business interruption insurance, like virtually all forms of insurance, is not designed to create windfalls for insureds.<sup>24</sup>

Extra expenses also bear scrutiny because conceptualizing them is highly abstract, intimately related to accounting, and frequently determined by deceptively innocent looking contract language. There is also a striking difference in attitude between insureds and insurers with respect to how to think about them. Insureds tend to begin with losses, whether incurred or avoided, and work from there. (We call this the "Down Method.") Insurers begin with extra money spent after an insured loss and go from there. (We call this the "Up Method.") This difference in approach can lead to strikingly different results and to mutual suspicion. Consider the well-known *Eastern Associated Coal* case.<sup>25</sup> In this well-known case, the insured lost a coal mine to a fire for a year. It had to obtain coal from outside brokers in order to comply with supply contracts. Because of an international incident (to-wit: an oil embargo) the price of coal from brokers rose dramatically. The question in the case was whether those kinds of extra expenses were covered. The court thought not. In this case, the insured began with its losses and reasoned downward. In contrast, the insurer began with actual expenses, the language of the contract, and built up from there. The court sided with the insurer.<sup>26</sup> *Quinn-Hopper Question*: How would the *Island Recreational Development* court have decided this case?<sup>27</sup>

20. *Cotton Bros. Baking Co. v. Industrial Risk Insurers*, 941 F.2d 380, 386 (5<sup>th</sup> Cir. 1991), *aff'd as modified*, 941 F.2d 380 (5<sup>th</sup> Cir. 1991).

21. *American Metal Imaging Corp. v. St. Paul Fire & Marine Ins. Co.*, 749 F.2d 690, 693 (3<sup>rd</sup> Cir. 1991).

22. *Id.* at 694.

23. *Hart-Bartlett-Sturdevant Grain Co. v. Aetna Ins. Co.*, 293 S.W.2d 913 (Mo. 1956).

24. *Fireman's Fund Ins. Co. v. Mitchell-Peterson, Inc.*, 578 N.E.2d 851 (Ohio App. 1989).

25. *Eastern Assoc. Coal Corp. v. Aetna Cas. & Sur. Co.*, 632 F.2d 1068 (3<sup>rd</sup> Cir. 1980).

### III. A Fairly Typical Extra Expense Provision

Here are two fairly typical extra expense provisions in the business interruption (or, loss of business income) component of commercial property policy. They bear careful reading. One is quite general. One is rather more specific.

#### A. The Quite General Clause.

Sometimes, extra expenses clauses are quite general and proceed with only a few words. We have already referred to the *Eastern Associated Coal* case. Here is the extra expense provision from that policy. It occurs in the context of a business interruption proviso. The proviso provides coverage for the "actual loss sustained by the assured directly resulting from [an insured] interruption of business . . . . Due consideration shall be given to the continuation of normal charges and expenses, including payroll expense, to the extent necessary to resume operations of the Assured with the same quality of service which existed in the immediately preceding loss." Coverage includes expenses incurred to reduce such losses. These are said to be the following:

Any and all expense incurred by the Assured to reduce loss hereunder is covered by this insurance to the extent only of the loss which would have been sustained had such expense not been incurred.

Notice how general and abstract the language of this policy is. It is made more abstract by the fact that the really key language of the policy has not yet been cited. It is actually in a somewhat different section of the policy. In the other section of the policy, the contract announces that business interruption coverage is insurance against "loss of earnings." The

concept of *earnings* is then defined as the "[t]otal net sales value of production[.]"

#### B. An Elaborately Specific Provision.

Other commercial property policies containing business interruption sections have quite specific extra expense provisions. It is an iron-clad law of language that the more specific and elaborate the description or prescription is, the more words it takes to express it. In any case, here is an exemplar of a more specific extra expense provision.

Insuring Agreement. If Loss of Income Coverage is shown in the Declarations, we will pay:

1. 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 accidental direct physical loss to property at the described premises, including personal property in the open (or in a vehicle) within 100 feet, caused by an insured loss,

2. any necessary "extra expense" to avoid or minimize the suspension of business and to continue "operations":

a. at the described premises; or

b. at replacement premises or at temporary locations, including relocation expenses and costs to equip and operate the replacement or temporary locations;

to the extent it reduces the amount of the "business income" loss that otherwise would have been payable under this coverage

26. The court formulated the issue in terms of whether the contract authorized new expenses. It thought not. The court also thought that extra expenses to be paid for under the contract were expenses incurred to reduce an insured loss. The purchase of coal from brokers did not reduce the *insured* loss, because these expenses have resulted from the oil embargo and not from the fire of the mine. Thus, the contract mandated payment for extra expenses incurred in repairing the mine more rapidly, but not in complying with a supply contract when the cost of compliance resulted from international relations, and not from a physical loss. It is interesting to observe that lawyers for insurers tend to see *Eastern Associated Coal* as correctly decided, whereas lawyers for policyholders tend to view it as mistaken.

27. For an interesting example of the difference between the policyholder's Down Approach to a loss accounting, in contrast with the insurer's Up Approach to a guide for extra expense losses, see *Fold-Pak Corp. v. Liberty Mut. Fire Ins. Co.*, 748 F. Supp. 49, 55-56 (W.D.N.Y. 1992).

caused by an insured loss;

3. any necessary "extra expense" to minimize the suspension of business if you cannot continue "operations" to the extent it reduces the amount of the "business income" loss that otherwise would have been payable under this coverage caused by an insured loss; and

4. any necessary "extra expense" to"

a. repair or replace any property; or

b. research, replace or restore the lost information on damaged valuable papers and records;

to the extent it reduces the amount of the "business income" loss that otherwise would have been payable under this coverage caused by an insured loss.

We will only pay for loss of "business income" or "extra expense" that occurs within 12 consecutive months after the date of accidental direct physical loss caused by an insured loss.

Definitions. When used in this coverage:

1. "business income" means the net income (net profit or loss before income taxes) that would have been earned or incurred and continuing normal operating expenses, including payroll, incurred during the "period of restoration"; \* \* \*

3. "extra expense" means necessary expenses you incur during the "period of restoration" that you would not have incurred if there had been no accidental direct physical loss to property;

4. "operations" means the type of your business activities occurring at the premises shown in the Declarations;

5. "period of restoration" means the period of time that

a. begins with the date of accidental direct physical loss caused by an insured loss at the described premises; and

b. ends on the date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality.

"Period of restoration" does not include any increased period required due to the enforcement of any law that regulates the construction, use or repair, or requires the tearing down of any property. The expiration of this policy will not cut short the "period of restoration."

Limitations. . . .

2) [6] If you fail to use all available means to eliminate unnecessary delay and do not resume normal "operations" as promptly as possible, we will reduce the amount of your:

c. "business income" loss, other than "extra expense," to the extent you can resume your "operations," in whole or in part, by using damaged or undamaged property (including merchandise or stock) at the described premises or elsewhere;

d. "extra expense" loss to the extent you can return "operations" to normal and discontinue such "extra expense."

3) [7] 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 the accidental direct physical loss to property, other than at the described premises, caused by an insured loss. This coverage will apply for a period of up to two consecutive weeks from the date of that action. . . .

Loss Determination. . . .

2. The amount of "extra expense" loss will be determined based on:

a. all expenses that exceed the normal

operating expenses that would have been incurred by "operations" during the "period of restoration" if no accidental direct physical loss had occurred. We will deduct from the total of such expenses:

1. the salvage value that remains of any property bought for temporary use during the "period of restoration," once "operations" are resumed; and
  2. any "extra expense" that is paid for by other insurance, except for insurance that is written subject to the same plan, terms, conditions and provisions as this insurance;
- b. all necessary expenses that reduce the "business income" loss that otherwise would have been incurred.

Exclusions. We will not pay for:

1. any "extra expense" or increase of "business income" loss caused by:
  - a. delay in rebuilding, repairing or replacing the property or resuming "operations," due to interference at the location of the rebuilding, repair or replacement by strikers or other persons; or
  - b. suspension, lapse or cancellation of any license, lease or contract. But if the suspension, lapse or cancellation is directly caused by the suspension of "operations," we will cover such loss that affects your "business income" during the "period of restoration";
2. any "extra expense":
  - a. caused by suspension, lapse or cancellation of any license, lease or contract beyond the "period of restoration"; or

b. to repair or replace any property or research, replace or restore the lost information on damaged valuable papers and records that does not reduce the amount of "extra expense" otherwise payable under this coverage.

3. any other consequential loss; or

4. loss caused by seizure or destruction of property by order of governmental authority. But we will pay for acts of destruction ordered by governmental authority and taken at the time of a fire to prevent its spread.<sup>28</sup>

Most of our discussion from hereon will focus on the more elaborate of the two provisions quoted. When we refer to "our exemplar" we will be referring to that provision.

#### IV. Discussion and Analysis

*"Necessary."* In the loss of business income coverage just quoted at length in our section II.B., there is coverage for the actual loss of net income during a certain period, and there is coverage for extra expenses "necessary" to avoid or minimize the interruption of business or "necessary" to continue the operations of the business. Such extra expenses could be incurred either at the insured premises or at some replacement premises, including temporary locations. Such extra expenses would include moving costs incurred for the purpose of equipping and operating replacement facilities, including temporary ones. Under this policy, there is coverage for extra expenses only to the extent that those expenses reduce business income losses otherwise payable under the business income coverage.<sup>29</sup> We have already suggested that this strict interpretation of the policy may be unwise. A prudent and justified extra expense that doesn't work out—perhaps—should be treated as covered. Not doing so is an example of unexpected risk shifting, so say we.

*"Minimization."* Another difficulty in the literal interpretation of this unambiguous policy is to be

28. Some underlinings are our additions.

29. See *A&S Corp. v. Centennial Ins. Co.*, 242 F. Supp. 584 (N.D. Ill. 1965).

found in exemplar section 2 of the insuring agreement. According to that section, the only extra expenses that are covered are those which are *necessary* to avoiding or *necessary* to minimizing the suspension of business and to continue operations. The insurance contract cannot mean what it says, and it is routinely not interpreted in this fashion. Consider the following, for example: If the contract were construed literally, extra expenses would not be paid if business would not be suspended without them and if they will not minimize the suspension of business but only cut it way down. Thus, for example, the extra expenses would not be covered if they reduced the number of days a business would be down from X to X-10<sup>30</sup> and another approach would have reduced down-time to X-12.

*Actual Reduction.* Notice that in sections 2, 3, and 4 of the exemplar, extra expenses are covered to the extent that they actually reduce the amount of business income loss otherwise payable under the insuring agreements. Nothing more is covered. The interesting phrase here is "to the extent" the extra expenses caused something to happen. Suppose the extra expenses are \$100, and they reduce business income loss by \$120. In that case, the entire \$100 would be covered. Now suppose that the insured spends \$100 to reduce its business income loss, and it succeeds in doing so only to the extent of \$75. In that case, if the insurance policy is applied literally, the insurer pays only \$75. This would be true even if the insured was thoughtful, prudent, careful, and rational in making its extra expense expenditure.

*Reasonable Error.* Thus, covered extra expenses are tied to reducing the damages of the insured and hence reducing the exposure of the insurer. This is a troubling feature of extra expenses insurance for the same old reasons: it places the risk of error on the insured at a time the insured is likely to be under stress and distracted. To be sure, if an extra expense is at best implausibly related to reducing business interruption losses, the insurer should not be asked to fund it. However, if the connection is plausible, and a reasonable mistake is made, it is not clear that the risk should be on the insured. Courts have not focused on this distinction, however.<sup>31</sup> Since the risk of error is on the insured, it needs to be careful about decision making, documenting decision making, and claim preparation. It should also recruit the insurer into the process.

At least some courts hold that if an insurer is going to require an insured to mitigate its business losses while incurring extra expenses, it must pay for them.<sup>32</sup>

If, as [the insurer] strenuously urge[s], the insured has a contractual as well as a common law duty to mitigate damages, then the expenses of that mitigation must be covered. If the mitigation efforts take longer than the interruption period, then the business interruption clause cannot limit coverage to that period, since the activity is in the interest of the insurer. . . . Mitigation is a duty the insured performs for the insurer's benefit. Mitigation cost is recoverable so long as it is

30. It is also interesting to note that from a linguistic or semantic point of view, the quoted contract language is incoherent for another reason. In § 2 of the insuring agreement and in § 3 of the same agreement, the phrase "necessary 'extra expense'" occurs. Thus, the word "necessary" modifies the phrase "extra expense." Consider the definition of extra expense. In part, an "extra expense" is defined to mean a certain kind of "necessary expense." It is characteristic of definitions that the definiens may be substituted for the definiendum, in most contexts, without loss of meaning. This would make the previously mentioned phrases in § 2 and § 3 the following: "necessary expenses." This locution makes no sense. Hence, a literal interpretation of the contract language is not possible.

31. "One type of 'business loss' covered appears to be 'extra expenses' necessary to avoid suspension of operations by the policyholder. Learfield[, the policyholder here,] states that the \$10,000 cost of the small uplink dish was such an 'extra expense.' Hartford, however, is only liable for such extra expense 'to the extent it reduces the amount of loss that otherwise would have been payable.' Fortunately, this court finds no evidence in the record, nor does [the policyholder] point to any, of losses other than the money claimed for the small dish purchase that could be called 'business income' loss. [The policyholder] maintains that it believed the purchase of the small uplink was necessary to prevent suspension of operations. However, the small dish was never needed, was never used, and [the policyholder, did not appear to suffer any 'business income' losses, suspension of operations due to the destruction of the large dish. [Consequently,] Hartford bears no liability for any 'extra expenses[.]'" *Learfield Communications, Inc. v. Hartford Acc. & Indem. Co.*, 837 S.W.2d 299, 302 (Mo. App. 1992).

32. *Metal Masters of Minneapolis, Inc. v. Liberty Mut. Ins. Co.*, 461 N.W.2d 496 (Minn. App. 1990).

reasonable and less than the damages would have been without it."<sup>33</sup>

This seems to us to be a very sensible view. Sometimes insurers seek to defeat this view through what policyholders see as slavishly literal readings of policy language.<sup>34</sup> The trouble is that frequently the insurers are reading the literal language of the contract correctly. Contract hermeneutics is supposed to be literalistic. On the other hand, the purpose of insurance is supposed to be protection from loss. If an insurance policy is written in such a way that insurers will be able, surprisingly, to circumvent paying for losses, the social function of insurance is undermined. This may not be a good argument to present in a lawsuit which is essentially a contract dispute. It is, however, troubling from a more global perspective. (Then again, if an insurance policy is to provide more coverage, it will cost more.)

*Definition.* A definition of the phrase "extra expense" is quite general. It means (1) any expense, (2) incurred by the insured (3) during the temporal interval required to repair, rebuild, or replace the damaged property, with property of similar quality, (4) assuming that restoration proceeds with reasonable speed, (5) which would not have been incurred by the insured (6) had there been no physical loss accidentally and directly inflicted upon (tangible) property. The generality of the definition is limited by the conjunctive components of the insuring agreement, limitations, and the exclusions. Two limitations are quite significant. One of them requires that the insured restore normal operations "as promptly as possible." That limitation, contained in section 6 of the Limitations section, indicates that the insurer will reduce payments for "business income" losses, except for "extra expenses," if the insured does not figure out possible ways to restore operations using other equipment, other stock, and other merchandise, including jerry-rigged equipment. Section 6 also states that extra expenses will be reduced if and to the extent that the insured could

have returned to whatever it is that it does and stops extra spending.

*Actions of Civil Authorities.* A second significant limitation is to be found in section 7 of the Limitations section. The insurer promises to pay both "business income" and "necessary 'extra expenses'" if a civil authority takes some action which prohibits access to the insured's premises because of some accidental direct physical loss to some property other than the described premises, if that direct physical loss is caused by an insured loss. Thus, if an insured's building explodes accidentally, causes a building nearby to catch fire, and that building explodes, with the consequence that debris partially blocks some legitimate entrances to the insured's building, and the police keep entrants off the insured's property, there is coverage. So far, section 7 looks like a coverage extension or an articulation of coverage which might otherwise seem obscure. The limitation component of section 7 is that this coverage lasts for only two weeks, beginning with the date of the action by the civil authority prohibiting access.<sup>35</sup>

*Calculation.* The policy contains a section prescribing how to determine extra expense losses. Generally speaking, loss determination proceeds on a dual basis. One basis is particular, while the other is a net basis. Under section 2.b of the Loss Determination proviso, the amount of extra expenses are determined by adding up all the necessary expenses which in fact do reduce the amount of the insured's "business income" loss, if that loss would have occurred but for the relevant expenditures. This is the particularized component of loss termination. The more general part involves adding all these expenses together, and all such expenses recovered, subject to two deductions. The first deduction is the salvage value of equipment and other property purchased for temporary use. The second deduction is any "extra expense" paid for by other insurance. (In other words, section 2.a.(2) is an "Other Insurance Clause," as they are often called.) Excepted from the other insurance clause is insurance "subject to the

33. *Id.* at 501.

34. For an interesting example of this kind of controversy, see *Travelers Indem. Co. v. Pollard Friendly Ford Co.*, 512 S.W.2d 375, 380 (Tex. Civ. App.—Amarillo 1974, no writ).

35. See *Davidson Hotel Co. v. St. Paul Fire & Marine Ins. Co.*, 136 F. Supp. 2d 901 (W.D. Tenn. 2001); *Travelers Indem. Co. v. Pollard Friendly Ford Co.*, 512 S.W.2d 375 (Tex. Civ. App.—Amarillo 1974, no writ).

same, terms, conditions and provisions as this insurance[.]”

*Exclusions.* The series of exclusions to be found in our example policy are fairly typical. First, under Exclusion 1.a., delays in restoration of property are not covered if they are caused by interference from strikers or other persons at the location of the physical restoration activities. Notice that relevant income losses are excluded as well as extra expenses. (Of course, we don't care about that aspect of the policy just now.) Also notice that the dangerous risk arising from trying to do something about physical catastrophe is left with (or shifted back to) the insured. If the insured goes out and hires, say, a construction company (or any other type of contractor) to do work which would obviate its business income loss, and something goes wrong with personnel relations inside the contractor's business, and the contractor cannot proceed, the risk of that loss—if any—is on the insured. Usually, of course, construction contracts have clauses in them having to do with strikes. However, if a contractor was not able to continue and it was necessary to go find another one, that would cause additional days of business income loss. From the looks of things, those extra days would be excluded by Exclusion 1.a.

From a strictly functional point of view, it makes no difference where in an insurance contract exclusionary language is to be found. The same is true for where, in an insurance contract, a risk is allocated. From a rhetorical point of view, however, whether a risk is allocated in an insuring agreement or in an exclusion may make some difference. From a rhetorical point of view, as opposed to the point of view of literal meaning, how many words are involved in the applicable proviso may make some difference to the extent to which it is studied and understood. Of course, courts do not—at least on the surface of things—look at matters of rhetoric. They look at matters of literal meaning.

Exclusion 1.a. does not shift the risk of all sorts of person-generated delays and repair. Clearly, this exclusion does not apply to the activities of police, if they are acting consistently with Limitation 7. So much for Exclusion 1.a.

Exclusion 1.b is somewhat similar. This exclusion says that there is no coverage for extra expenses resulting from contracts (or leases) which are affected adversely by a loss triggering the extra expense

coverage. In particular, what are excluded are suspensions, lapses, or cancellations of contracts or leases. Thus, if a supply-contract is cancelled if the insured cannot perform for thirty days (or cannot provide X-number of widgets) and if the contract is to run for five more years, but is cancelled, the insurer will not be responsible for any losses attributable to the cancellation of the contract. The same is true for leases. This idea applies not only to cancellations of contracts but the related ideas, such as lapses, and it applies to temporary suspensions, as well as permanent determinations.

This exclusion is subject to an exception. Thus, what was said in the previous paragraph is too broad. We have formulated the need of the exclusion in this phrased—and potentially misleading—way for reasons which will become apparent presently. The exception to the exclusion provides that the exclusion does not apply to a certain range of terminations and suspensions. It does not apply if the termination or suspension is directly caused by the suspension of the operations of the insured. If it is *indirectly* caused by such a suspension of operations, the exception will not apply. This exception to the exclusion contains a second component. That part of the exception says that the exception applies only to losses that affect the insured's business income during the period of restoration.

The question now arises whether extra expenses incurred as a result of the (permanent or temporary) termination of a contract (or a lease) were incurred during the period of restoration. On one hand, the explicit verbiage in the exception says that it will cover “loss that affects your ‘business income’ during the ‘period of restoration[.]’” Extra expenses constitute a loss. They would affect business income, because business income is a concept defined in terms of the *net* income the business would have earned. Obviously, extra expenses affect that amount. Hence, they should be regarded as covered. On the other hand, business income and extra expenses are treated as separate categories in the policy, so that it is reasonable to suppose that the exclusion pertains to changes in business income without respect to extra expenses. Moreover, the definition of “business income” does not include extra expenses but only normal operating expenses. “Extras” are sometimes defined as abnormal expenses.<sup>36</sup> It seems to us that both of these interpretations are reasonable. If so,

then the contra-insurer ambiguity rule requires that the exception be read in favor of the insured.<sup>37</sup>

The exclusion and the exception were set forth in a phased manner for two reasons. First, we wanted to be able to explore the potential ambiguity to be found in the exception. Second, it useful to discuss exclusions and exceptions separately, since the burden of proof on exclusions is generally born by the insurer, whereas the burden of proof on exceptions to exclusions is generally born by the insured.

It is worth remembering that Exclusion 1.b. applies not only to contracts and leases but also to licenses. We have located no cases on this issue suggesting any interesting differences. The payment of extra expenses to get things done in a hurry in order to prevent the cancellation of a license necessary for business fits with the general idea of extra expense insurance. As pollution insurance litigation has matured, business interruption coverage linked to license cancellation is appearing.<sup>38</sup> Nothing much has yet reached the official reporters about this, however.

Exclusion 2.a. excludes coverage for extra expenses caused by the permanent or temporary termination of a contract, lease, or license if that termination occurs outside the defined period of restoration. It looks to us as though Exclusion 2.a. is intimately-related to Exclusion 1.b. That exclusion is based upon terminations resulting from suspensions of operations. Exclusion 2.a. pertains to when the termination takes place and/or how long it lasts. Thus, under Exclusion 2.a., if a contract is terminated after the period of restoration, there is no extra expense coverage. Similarly, if the contract is terminated during the period of restoration and the termination lasts beyond the period of restoration, there is no coverage for the days and weeks beyond the end of the period of restoration.

*Implied Exclusion: "Period of Restoration."* In thinking about extra expense insurance, it is well to remember that not all of the genuine exclusions are explicit exclusions, named as such. There are also implicit or hidden exclusions. This is particularly true

with the concept of *period of restoration*. The phrase "period of restoration" refers to a period of time. Like all periods of time it has a beginning and an end. The period of restoration in our exemplar policy begins on a certain date. But it is not just the date of a loss. It is the date of an accidental physical loss directly caused by an insured event. Thus, there are a great many substantive considerations built into the definition of the phrase "period of restoration" which are not related to temporal matters. (It is also important to notice that Definition 5.a. is incoherent, as it stands.) Thus, our explication is a gloss. Here is the literal language:

[The phrase] "Period of Loss" means the period of time that . . . begins with the date of accidental direct physical loss caused by an insured loss at the described premises[.]

This definition requires that there be two losses, and that the physical loss which starts the period of restoration be caused by a different loss which is also insured. This literal reading cannot possibly be correct. As a consequence, the insurers and insureds must do the best they can and use their common sense. (Of course, if an ambiguity actually turns on this incoherence, it would be resolved in favor of the insured.)

The second portion of Definition 5.b. has to do with the last day of the "period of restoration." The definition states that the "period of restoration" ends on a day which must be estimated, inferred, and possibly even guessed at. The end of the period of restoration is the date upon which the premises [i] *should have been* repaired, rebuilt, or replaced, [ii] with personalty or realty of *similar* quality, assuming [iii] that the repair, rebuild, or replacement proceeded at a *reasonable* pace, under the circumstances. Notice how many hypothetical concepts involving contrary-to-fact conditionals are built into Definition 5.b.

It should also be noticed that there is fairly obvious exclusionary language in the definition of the

36. Id.

37. Hazel Glen Beh, *Reassessing the Sophisticated Insured Exception*, 39 TORT TRIAL & INS. PRACTICE L. J. 85 (2003).

38. *Browning-Ferris Indus. v. Certain Underwriters at Lloyds*, No. 98-56362 (215<sup>th</sup> Dist. Ct., Houston, Texas, Nov. 24, 2003). The Tenth Amended Original Petition sues U.S. Fire on a BI policy linked to license cancellation some years ago.

phrase "period of restoration." If there is a public law which regulates construction, use, or repair and that loss slows down the construction or repair process, the additional length of time is not part of the period of restoration; hence not covered. Similarly, if a public law regulating construction from a use or repair requires that something be torn down—whether damaged property or defectively built replacement property—the additional time added onto restoration is not part of the "period of restoration." This could reduce coverage significantly if things go wrong during the process of repair. Here is another example of subtle risk shifting (back) to an insured. The length of the period of restoration can be extremely important from the point of view of determining covered extra expenses, because at least some extra expenses incurred outside (and hence not part of) the period of restoration are not covered.

One might wonder whether any of the definition of the phrase "period of restoration" constitutes an exclusion with respect to which the insurer would bear the burden of proof. We suggest that the components of the exclusion pertaining to the results of law enforcement should be treated as an exclusion. We doubt this is particularly controversial. There is a more interesting question. What about the difference between the time it has taken to get premises repaired and the time it should have taken to get them repaired? Obviously, the insured should bear the burden of proof of showing how long it took to get the building repaired and should probably bear some burden of proof with respect to showing that the time is reasonable. One wonders if, once that is shown, the insurer should not bear some burden of proof if it wishes to reduce an already reasonable time to an even more reasonable time. These comments are entirely speculative, since we know of no reported cases which have tried to deal with the problems.

*Lost Information Exclusion.* Exclusion 2.b. excludes extra expense incurred in dealing with lost information which is to be found on or in the papers, documents, or other types of records (presumably including computer records) which has to be somehow recovered or resurrected.<sup>39</sup> We suspect

that this kind of extra expense fits well with the general idea that extra expense coverage is for abnormal expenses necessary to get a business up and running again fairly quickly. We suspect that the reason this is excluded is because it's difficult to underwrite. The world doesn't have very much experience with what it costs to restore computerized information, and so we suspect insurers have concluded it's a good idea to stay away from all this kind of stuff.

The foregoing description is actually a gloss made necessary by the virtual incoherence of the actual language of the exclusion. The actual language of the exclusion is this:

We will not pay for any "extra expenses" to repair or replace any property or research, replace or restore the lost information on damage to valuable papers and records [.]

If read literally, this exclusion says (in part) that the insurer will not repair or replace any property at all and will not research, replace, or restore lost information to be found in certain places. One wonders about meaning here. If the exclusion is separated at the disjunct, then the former part of it says this:

We will not pay for any "extra expense" to repair or replace any property.

Such a reading, of course, is simply silly. On the other hand, if you try to read it as follows, it makes no sense:

We will not pay for any "extra expense" to repair or replace any property on damaged valuable papers and records.

The idea that property is somehow on papers (whether damaged or not) is, of course, nonsense. Intellectual property may actually be property, but if it is intellectual property, it is not *on a piece of paper*.<sup>40</sup> This point is true even if the paper contains

39. The writers of our exemplar contract are fond of *r*-based alliteration. Thus, there is a good deal of discussion having to do with the rebuild, repair, or replacement of property. Similarly, in discussing lost information, the contract is looking to exclude repairs, replacements, research, and restorations. *Question:* Why is it that lawyers and insurance scrivener are tempted by simple-minded and cheap rhetorical theatrics? Perhaps its because policy pro se is boring. Poets we are not.

a diagram or a description of the thing physical instantiations of which constitute property or the paper has ink affixed to it which constitute words which express ideas where those ideas are intellectual property. We doubt that even radical nominalists like William of Ockam (c.1285-c.1349) or Nelson Goodman (1906-1998)<sup>41</sup> would subscribe to this kind of physicalistic reductionism.<sup>42</sup>

Exclusion 2.b. is subject to an exception. If the kind of intellectual property-related extra expenses described in Exclusion 2.b. reduce other extra expenses which would be mandated under the policy, then those intellectual property-related extra expenses are covered.

Exclusion 3 is a kind of closure clause. It states that the insurer will not pay for any consequential losses other than those referenced in the exclusion section. Exclusion 3 does not support the inference that all extra expenses are consequential losses. But some of them might be.

There is a final exclusion, Exclusion 4. It relieves the insurance company of paying for losses caused by governmental seizures or destruction of property. Thus, if a building burns, one wall is left standing, and the government orders it torn down, the price of tearing down the wall is probably covered under the property policy. If the tearing down of the wall causes an additional loss in the nature of an extra expense, it would not be covered. Here is another example of subtle, unexpected, somewhat-hidden risk re-shifting.

The foregoing discussion has introduced the topic of extra expenses, placed it in the context of evolving insurance jurisprudence, provided an illustration of extra expense coverage, and explicated that coverage at some length. We have used a concrete exemplar policy. Other policies are different. Many of the main ideas of the coverage in general are in our exemplar, however. It is characteristic of these kinds of policies that they are

neither elegantly written nor terribly clear. It might be valuable now to examine a recent case of some interest.

### V. World Trade Center Case

As everyone is aware, the attack on the World Trade Center has given rise to substantial insurance litigation.<sup>43</sup> Billions are at stake. There is a lesser known case, however, which pertains to extra expenses. This case is *Zurich American Insurance Company v. ABM Industries, Inc.*<sup>44</sup> This district court decision is an appeal to the Second Circuit.

ABM provided janitorial, lighting, building-engineering, and related services to most of the World Trade Center. Zurich was ABM's insurer. ABM had offices in the complex; it had access to all spaces and fixed equipment used in the janitorial process; and had the exclusive use of the freight elevators after hours. The Zurich-ABM policy contained a business interruption component and covered "loss resulting directly from the necessary interruption of [ABM's] business caused by direct physical loss or damage . . . to insured property at an insured location[.]" This section of the policy defined the phrase "insured property" to include the "interest of [ABM] in all real and person property including but not limited to property owned, controlled, used, leased or intended for use by [ABM.]" The policy also provided coverage for extra expenses incurred by ABM as the result of "loss, damage, or destruction . . . to [ABM's] real personal property." Apparently the coverage encompassed losses related in various ways to off-premises utility facilities and power stations, certain properties not operated by ABM, impounded water under certain circumstances, so-called "leader property," i.e., property and businesses not owned by the insured which generate revenue for the insured business interruption caused by several military authorities, and coverage for "Ingress/Egress."

**Business Interruption Coverage.** It is

40. William M. Landes & William A. Posner, *THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW* (2003).

41. Nelson Goodman, *THE STRUCTURE OF APPEARANCE* (1951).

42. The reader will recall the historical distinction between Realism or Platonish, according to which some terms name abstract (im-material) entities, like universals, e.g., redness, or platonic forms, e.g., being-a-bed, or numbers, while according to Nominalism, the opposite is true, and all meaningful terms refer to individuals, usually physical and not abstract entities.

43. *World Trade Ctr. Properties, LLC v. Hartford Fire Ins. Co.*, 345 F.3d 154 (2<sup>nd</sup> Cir. 2003).

44. 265 F. Supp. 2d 302 (S.D.N.Y. 2003).

necessary to discuss business interruption coverage in this case, in order to understand the court's treatment of extra expenses.

The district court found that there was no business interruption coverage resulting from the destruction of any part of the World Trade Center other than the spaces occupied by ABM itself. The court said that none of the other property was insured property with respect to ABM. ABM had argued that the phrase "insured property" in the policy extended to any interest ABM had in any real or personal property on the premises. Its interests were not alleged to be property interests, apparently, as that idea is usually understood. Instead, it included all property used or intended for use by the insured. ABM argued that since it cleaned all of the public areas in the building and 97% of the private areas, it used that property when it cleaned it.

The district court rejected this argument. It observed that a person uses property only if he uses it as a means to something else. Thus, if one is cleaning a floor, one is using the mop but not the floor. The court also provided a second argument. Even if ABM's view about the meaning of *use* were correct, this sense of use would not provide ABM with "any legally cognizable 'interest' in the property[,] i.e., no insurable property interests.

Not only did the district court reject ABM's argument based upon *use* as far-fetched, it rejected another argument as even more so. The functional definition of the word "interest" in the policy includes *control*. Thus, an insured has an interest in property if it controls the property. ABM argued that it did indeed control the property, but Judge Rakoff—the district judge—disagreed. Here is what he said:

To "control" is "to exercise restraining or directing influence over" or "to have power over." While no one questions the importance of janitorial services in modern urban society, the notion that by providing such services to a building's owner or tenants the janitor thereby "controls" the building is the functional equivalent of saying that the

ground crew "controls" Yankee Stadium. This umpire is not persuaded.<sup>45</sup>

As with all of the arguments Judge Rakoff rejects—the Argument from Use, the Argument from Control, and the Argument from Operating (to be considered presently)—Judge Rakoff relies upon the dictionary.

Third, there was language in the policy which suggests that ABM had coverage for property it *operated*. The issue then was whether ABM operated the property it cleaned. Based on a consultation with the dictionary, the closest meaning of the word "operate" appears to have to do with management, and that is something—said the court—ABM did not do for the spaces it cleaned.

**Extra Expense Coverage.** Similarly, the court found that ABM could not recover something in excess of \$25 million in extra expenses. These pertain to increased employee costs as a result of union agreements, increased in-state unemployment obligations incurred by the termination of employees caused by 9/11, termination costs resulting from union contracts, various wage expenses, and claim reparation fees.

One of the reasons ABM could not recover extra expenses was because the policy provided for extra expenses resulting from the destruction of property owned, controlled, used, leased, or intended for use by ABM. Roughly speaking, the district court appeared to embrace the same arguments it gave in connection with rejecting business interruption coverage. (Remember we suggested that in order to understand the court's treatment of extra expenses, it would be necessary to discuss its discussion of business interruption.)

Fairly clearly, ABM had some potential coverage based upon physical damage to "Leader Property." This type of property is defined as property ABM does not own, or have an interest in, which generates business for it. Thus, if an insured had a souvenir stand next to a very popular restaurant, the destruction of the restaurant might negatively affect the business of the souvenir shop. ABM, apparently,

45. Judge Rakoff also observes that ABM's sense of "control" would not be sufficient to create a legally cognizable property interest in the property and hence would not be sufficient to create an insurable interest. Judge Rakoff conjoins to the Argument from Operation, the Argument from No Insurable Interest, which he suggests, although it does not spell out, for support, in each of his three discussions.

suggested that the World Trade Center constituted leader property with respect to its covered losses.

The district judge rejected this argument, and characterized it as an attempt to "shoe-horn" coverage into an unnatural category. According to the court:

It is plain that neither the World Trade Center nor its constituent parts is 'leader property' in the 'vicinity' of ABM which 'attracts business' to ABM, but rather is itself the site and source of the ABM business here at issue. This is not a case, for example, where a related business located near a ball park might suffer a loss if the ball park were destroyed.

Obviously, the World Trade Center was leader property with respect to some nearby shops, say, souvenir shops. One wonders if it was leader property with respect to businesses housed within the complex. Similarly, ABM sought coverage on the basis of destruction to off-premises utility lines. This argument failed because of a requirement of causation. The insured losses must be caused by the failure of utility lines. Here, that can't possibly be true. The utility lines failed, but that to which power was supplied was also gone.

**Critique.** Insofar as extra expense coverage is concerned, the only really interesting component of the court's reasoning has to do with the ideas of use and control. To be sure, the insured's arguments were unusual and somewhat awkward. Then again, the destruction of the World Trade Center was a very unusual situation.

It seems to us that there is a sense in which ABM used the property it cleaned. ABM was a profit-making entity. Its economic mission was to make money for its owners.<sup>46</sup> It used the property it cleaned in the service of its business goal, profit maximization. While this is not the way non-business people normally talk, it makes perfect sense, and it is not only coherent but economically and financially sophisticated. Indeed, business people, financial

intellectuals, business journalists and corporate lawyers say this sort of thing all the time.

Furthermore, it seems to us that at various times the ABM crews probably did control the property they were cleaning. Judge Rakoff seems to us to be dead wrong when he ridicules ABM's arguments by comparing it to the ground crew controlling a baseball park and then scorning the idea that a ground crew ever controls a ballpark. In fact, the ground crew does control the baseball park, at some times. Anyone who has ever been to a baseball park when it rains knows that the ground crew is in control when it rolls out the covering. No doubt it is also in control when it cuts the grass, draws the baselines, turns off the lights, and so forth.

This kind of abstract, economics oriented, argument makes sense to us for two reasons. First, there is nothing absurd about it; further, the terms "use" and "control" are extraordinarily vague and hence ambiguous; consequently, the terms should be resolved in favor of the existence of coverage. Second, all of the entities involved are sophisticated businesses; they are familiar with the role of abstract economic and financial ideas in business. Thus, it will come as a shock to no one relevant that physical objects can be used for profit maximization.

## VI. Some Suggestions for the Policyholder Lawyer

Perhaps these are really suggestions only for the novice. Most of them are obvious enough. There are analogous suggestions for insurance lawyers.

1. Insureds need to understand the variety of risks they still bear even if they buy extra expense coverage. They need to understand this before they buy it. Professional risk managers and large insureds frequently already know all this. Smaller insureds may not. Lawyers can be helpful on this point.

2. As part of the sales and underwriting process, consider soliciting from the insurer whatever mission statements there are for its adjustment department, copies of the claims manual insofar as it's relevant, if there is one, and copies of any circulars the insurer has on the conduct of adjustments. There is almost

46. Henry T. C. Hu, *New Financial Products, The Modern Process of Financial Innovation, and the Puzzle of Shareholder Wealth*, 69 TEX. L. REV. 1273 (1991). ("The most basic principle of corporate law is that a corporation is to be primarily run for the pecuniary benefit of its shareholders." *Id.* At 1228.) John C. Coffee, *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269 (2004).

always some sort of a general philosophical statement about how adjustments should be conducted. These general philosophical statements are almost always idealistic in formulation. Try to get it up front. Don't lose it.

3. Policyholder lawyers should ask that alternative language for extra expense coverage be explored. Quite often one insurance company will offer several alternative policy forms. Certainly, different insurers offer different policy forms. There is no nationwide established coverage form. To our knowledge, no state mandates any particular coverage form.

4. If an insured is expanding, or already quite large, it might be a good idea to set up a meeting between the insurance people at the insured and adjustment people at the insurer to explore the best ways to make a business interruption and extra expense claim. This meeting should be somehow memorialized in a shared document. That document should not be lost. (Be sure to attach copies of the mission statement for the insurer's adjustment department and/or the general philosophical principles of adjustment to the memorialization of this meeting.)

5. At that meeting, the idea that an insured and an insurer should deal with substantial losses in concert should be explored. If an insurer insists upon the proposition that the insured is on his own—that the insured takes his chances in the adjustment process until the end—get rid of the insurance company and buy policies from another one which takes seriously the idea that insurance is a helping industry—that adjusting is a helping profession.

6. Remember that the insurer will have tendency to treat the contract language quite literally. Try to formulate the claim in categories the insurer will find natural and plausible given the language of the contract.

7. At the same time, keep in mind that when insurance adjusters read the contract and study it, they will interpret it literally. They don't always read the contract itself. Sometimes they rely on institutional and individual memory as to what the contract must say (or, probably says). Sometimes they get the contract quite wrong. Other times, they have the contract language in mind, but the institutional memory is distorted. It takes patience, repetition, and good humor to get experienced adjusters to revise their view of what a contract means, if they have

worked with that contract over and over and over again. (Imagine how plausible for an adjuster to say the following to himself. "The contract now means what it has always meant. I have experience in dealing with this document. You do not." There is even vague legal support for this kind of approach. The forces of dealing and market tendencies are always important in common law interpretation.)

8. If a loss occurs, get out the written description of the meeting, provide it to the insurer again (since many of the personnel will have changed) and proceed accordingly. At the same time, proceed flexibly. Use not only the idea of notice liberally. Use also the idea of consultation.

9. If an insurer resists consultation during the adjustment process, memorialize that fact every time it happens. (At the same time, if the insured's losses are the result of a natural disaster affecting a large geographical area, an insured will have to understand that the insurer is nearly overwhelmed.)

10. It is extremely difficult for an insurer, after the fact, to resist paying expenses which it has approved, consented to, or something of the sort. An insured should get as much of this kind of affirmation from the insurer as possible. If the insurer resists, document the fact. If the insurer concurs, document that fact. Do it truthfully and fairly. Many lawyers experience some temptations toward hostile exaggeration in this area.

11. Ask the insurer, early in the adjustment process, how it would like extra expenses documented. Ask how it would be most helpful to present the claim. If the insured doesn't have an accounting staff able to perform this function, hire insurance accountants. Most large accounting firms have them. There are now many consulting accounting firms of this type. Ask the insurer for a list of the ones they like the best, and have the most confidence in. Consider using these people to train in-house accounting people.

12. Remember, insurers tend to begin with actual expenditures, construed in the literal language of the contract, and build *up* aggregate expenses from there. The tendency of the insured will be to begin with losses, whether incurred or potential, and work *down* from there. Each side may be trying to justify an extra expense in order that it be paid. The strategy will be quite different if one is working "down" and one is working "up." If possible, an insured is well-advised

to try to use the insurer's methodology. Sophisticated courts tend to accept the "Up Approach."

Consider using a public adjuster.<sup>47</sup> Insurance companies do not like public adjusters, at least as a general rule. At the same time, if a good one who is knowledgeable can be found and counted on to devote time to the preparation of a claim, it will frequently enhance recovery. It may take time to interview and find the right one. An insured should not rush into the selection.

13. The documenting of the adjustment process should be designed carefully to show the relationship between extra expenses incurred and business interruption losses obviated or eliminated.

14. These measures should be undertaken with the right attitude. They should not be viewed as attempts to set the insurance company up. They should not be undertaken in a hostile spirit, with lots of nasty letters, and so forth. They should be undertaken in the spirit of getting the claim articulated, documented, presented, and paid at the highest level authorized by and consistent with the contract. Thus, the rhetoric should be soft and solicitous. The demeanor of the insured and its representatives should be cooperative and help-seeking.

15. Ask for and/or demand partial payments. If they are not forthcoming, ask why not. Document all of this.

16. The goal here should not be to set the insurance company up for bad faith but to get the claim resolved. At the same time, because of litigation trends over the last quarter century, or so, insurers have become wary, and an insurer who is treated in the manner just outlined will suspect that that is the insured's goal. This assumption or inference is not entirely irrational. After all, even if the insured does not have the goal of setting up the insurance company by following the philosophy just outlined, that will be a consequence if the insurer does not respond helpfully.

17. The word "partnership" is a currently

fashionable buzzword in business circles. There is even now a verb "to partner." It does not mean *form a partnership*. Rather, it means *work together cooperatively, openly, and flexibly*. Judges do not take seriously the idea that entities that are using the concept of *partnering* and its relatives to characterize their relationship with customers or vendors are really in a legally binding partnership. If an insurer uses this concept, however, to characterize its attitude towards its insured—for example, by saying things like "we are partners in loss"—(and many do), the use of that phrase can provide enormous rhetorical leverage in adjustment negotiations and it can be enormously useful in trying the factual part of a case to jury.

Clearly presented, well-documented, and logically argued claims achieve better results. So do patience and persistence. Cordiality and affability, when combined with truth and reason, get better results, at least usually, although there is a different school of thought. We do not believe that aggressive claims presentation by policyholders requires aggression or hostility. Then again, there is a different school of thought.<sup>48</sup>

18. The policyholder lawyer should keep careful track of her time and should do so in verbiage that will fit with proving claims under the contract of insurance.

### Conclusion

It is not necessary in a paper like this one to include a section of suggestions for insurers. They are experienced in dealing with these claims and don't need any suggestions. Similarly, lawyers who represent property insurers and business interruption and extra expense claims are generally experienced and don't need introductory-level suggestions. Some insurers already know that the best adjustment strategy is helpfulness, devotion to helping those in loss, and patience.

47. A public adjuster is someone experienced in insurance claims who represents the insured. Often they work on a contingency fee, at least in the smaller cases which can be resolved fairly quickly. Often, they are licensed by state statute.

48. Our view suggests that a policyholder engage with insurers and genuinely debate the issues. This might be called the "Socratic Approach." Its opposite is the "Kruschev Approach"—no engagement, lots of repetition, some shoe banging.