[iv] Actual Post-Loss Market Conditions During the Period of Recovery

[A] Consideration of Post-Loss Market Conditions Is a Contentious Matter

There are sharp differences among courts regarding whether it is appropriate to consider actual post-loss market conditions during or after the period of recovery in measuring the insured's actual loss sustained. These disputes may arise when an insured peril creates a significantly different market environment after the loss than the environment immediately preceding the loss. For example, a hurricane that shuts down multiple refineries and hotels in the same region might result in higher refining profit margins and hotel demand after the loss than existed before, for those businesses able to escape damage or to re-open for business before their competitors. Of course, an insured peril may just as easily create a post-loss environment in which earning opportunities diminish, for any number of reasons, such as reduced hotel occupancy in a devastated, post-loss resort area. Further, disputes also arise when the post-loss market is significantly different for reasons unrelated to an insured peril, for example, a regional economic boom or downturn.

Disputes regarding the propriety of considering post-loss market conditions typically focus on the proper interpretation of the phrase "had no loss occurred." One interpretation is that the word "loss" in the phase "had no loss occurred" means the financial result to the policyholder of the peril insured against, and does not mean either the peril itself or the effect of the peril on customers or other business. Under this reading, therefore, gross earnings provisions direct the parties to give due consideration to the policyholder's probable experience at the insured location had that location not been damaged, but instead had been able to operate in the environment that existed in the immediate aftermath of the peril. Although neither courts nor litigants are rigidly consistent in their interpretations, this reading tends to permit consideration of actual post-loss market conditions. As will be seen, this approach is neither inherently coverage-maximizing nor coverage-minimizing.

A contrary interpretation is that the words "had no loss occurred" mean "had no peril occurred," or, stated otherwise, had no hurricane (or flood, or earthquake, or explosion) occurred. Generally (though not uniformly), this reading tends to forbid consideration of actual post-loss conditions, at least when those conditions are related to the insured peril, because it posits that the peril did not occur.

[B] The Divided Panel in *Colleton Enterprises* Aptly Frames the Issue

In an unreported decision of a divided panel of the Fourth Circuit in *Prudential LMI v. Colleton Enterprises, Inc.*,[1] the majority interpreted the "had no loss occurred" language to preclude a motel owner's claim that, had a hurricane not damaged the motel, the insured would have been able to profit from increased demand for hotel rooms caused by the hurricane. The

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[1] **US/SC**--976 F.2d 727 (Table), No. 91-1757, 1992 U.S. App. LEXIS 25719 (4th Cir. Oct. 5, 1992).

majority's decision rested not on its interpretation of the insurance policy language, but on its conclusions regarding the parties' reasonable expectations and the proper purposes of business interruption insurance.

The *Colleton* majority ignored the difference between "loss" and "hurricane" (or other peril) and held that the phrase must be read to mean that gross earnings should be determined by giving due consideration to likely earnings "had no hurricane occurred."

The *Colleton* majority criticized the policyholder's interpretation of the policy as conferring a windfall, but the majority failed to consider that the same policy interpretation would *diminish* recoveries in the event that a regional catastrophe destroyed or eliminated the insured's market, rather than created an increased profit opportunity. The *Colleton* majority held that this result is not what "contracting parties rightly could have expected," which arguably was a substitution of the majority's judgment for the language of the contract.

The dissent in *Colleton* applied a stricter standard to the construction of the policy. The dissent reasoned:

> The majority persists in framing the issue as what the motel's situation would have been had the hurricane not occurred at all. However, the contract states that "due consideration" be given to pre-damage earnings and "the probable earnings thereafter, *had no loss occurred*" (emphasis added). "Had no loss occurred" does not refer to the overall loss in the surrounding area; rather, it clearly refers only to the loss incurred by the insured.[2]

The majority acknowledged that the language of the policy would permit recovery if the policyholder could prove that it would have earned a profit during the period of interruption, even though it had been losing money for many months before the hurricane. Therefore, the dissent reasoned that, although the hurricane "caused both the property loss and created the profit opportunity, it does not strike me as an 'intuitively-sensed logical flaw' to permit recovery under these circumstances."[3] (Another unreported decision, *American Automobile Insurance Co. v. Fisherman's Paradise Boats, Inc.*,[4] followed the reasoning of the *Colleton* majority without independent reasoning).

The reasoning of the *Colleton* dissent accords with the common definition of "gross earnings," which focuses on the individual insured's business – how the business was doing before it suffered damage or destruction, and how it would have done had it not suffered the

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[2] **US/SC**--1992 U.S. App. LEXIS 25719, at *13.

[3] **US/SC**--1992 U.S. App. LEXIS 25719, at *14.

[4] **US/FL**--Nos. 93-2349-CIV-GRAHAM, 94-0014-CIV-GRAHAM, 1994 U.S. Dist. LEXIS 21068, at *9-10 (S.D. Fla. Oct. 3, 1994).

"loss." Dictionaries define the term "loss" to mean "injury or diminution of value,"[5] or "the amount of an insured's financial detriment by death or damages that insurer becomes liable for."[6] "Loss" is not commonly defined to mean "peril" or "catastrophe," and therefore it is arguably mistaken to treat the words as equivalent in an insurance policy.

[C] Post-*Colleton* Cases Disregarding Post-Loss Conditions

In *Finger Furniture Co., Inc. v. Commonwealth Ins. Co.*,[7] the insured owned furniture stores in Texas, and the business of the stores was interrupted by flooding caused by a tropical storm. The weekend following the stores' reopening, sales soared as Finger cut prices and customer demand increased.

The insurer argued that Finger's losses during the period of interruption should be offset with Finger's additional post-storm profits after re-opening. The Fifth Circuit rejected this argument, in a holding which maximized coverage on the facts before it, reasoning that:

> The contract language does not suggest that the insurer can look prospectively to what occurred after the loss to determine whether its insured incurred a business-interruption. Instead, the policy requires due consideration of the business's experience before the date of the loss and the business's probable experience had the loss not occurred. Finger's historical sales figures reflect that consideration.[8]

Another more recent Fifth Circuit case illustrates that this reasoning minimizes coverage on different facts. In *Catlin Syndicate Ltd. v. Imperial Palace of Mississippi, Inc.*,[9] the policyholder was a casino whose business was interrupted as a result of damages caused by Hurricane Katrina. After the casino re-opened, its revenue was significantly greater than before the hurricane because several competitors remained closed after the hurricane. The court addressed whether the amount of a covered loss should be calculated solely on the basis of the policyholder's pre-loss sales, or whether the court could consider post-loss sales, which in this case were significantly greater. The casino claimed a loss of $80 million during the period of recovery; the insurer calculated a loss of $6.5 million.

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[5] FUNK & WAGNALLS STANDARD DICTIONARY 753.

[6] WEBSTER'S NINTH NEW INTERCOLLEGIATE DICTIONARY 706.

[7] **US/TX**--404 F.3d 312 (5th Cir. 2005).

[8] **US/TX**--404 F.3d at 314 (footnote omitted).

[9] **US/MS**--600 F.3d 511 (5th Cir. 2010).

The parties urged different constructions of the policy language "had no loss incurred." The casino argued that its loss should be calculated as if the hurricane had struck and damaged all of the competitors but spared the policyholder. The insurer argued that the loss should be calculated as if the hurricane had never happened. The court agreed with the insurer and held that "only historical sales figures should be considered when determining loss, and sales figures after reopening should not be taken into account."[10]

The Fifth Circuit drove home the point in another post-Katrina case, *Consolidated Companies, Inc. v. Lexington Ins. Co.*[11] The owner of a warehouse damaged in the hurricane sought coverage for business interruption damages, and the insurer resisted, arguing that the adverse effects of Katrina on the insured's market should effectively reduce the amount of actual loss sustained. The court, applying Louisiana law, disagreed:

> This is effectively the same interpretation rejected in *Catlin*, namely, that the policy requires Conco to calculate damages as if Hurricane Katrina 'struck but did not damage [Conco's] facilities,' *not* as if 'Hurricane Katrina did not strike at all.' We reject this interpretation for the same reasons that we rejected it in *Catlin*. The jury was not to look at the real-world opportunities for profit post-Katrina, but instead was to decide the amount of money required to place Conco 'in the same position in which [it] would have been had [Katrina not] occurred.'"[12]

[D] Post-*Colleton* Cases Recognizing Post-Market Conditions

The opposite conclusion was reached in another hurricane case, *Stamen v. CIGNA Property & Casualty Insurance Co.*[13] In *Stamen*, the owner insured 35 convenience stores under the same policy. Hurricane Andrew damaged some of the stores, which were then closed for repairs. Most of the insured's stores that remained open, or that could re-open quickly, experienced increased income immediately after the hurricane. The insurance policy provided that "in calculating your lost income, we will consider your situation before the loss and what your situation would probably have been if the loss had not occurred." The insured argued that in measuring lost profits, the parties should consider profits the stores would have made if the hurricane had occurred but the stores were able to remain open. The insurer argued that the parties should only consider pre-hurricane profits in measuring the covered loss.

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[10] **US/MS**--600 F.3d at 516.

[11] **US/LA**--616 F.3d 422 (5th Cir. 2010).

[12] **US/LA**--616 F.3d at 432 (citations omitted).

[13] **US/FL**--No. 93-1005-CIV-DAVIS (S.D. Fla. June 13, 1994).

The *Stamen* court held that the policy required the insurer to consider what each insured store would have earned if it had been open after the hurricane. The decision criticized the *Colleton* majority's "windfall" argument, which the insurer had urged on the *Stamen* court:

> The insurance policy calls for [the insurer], in calculating business interruption losses, to consider what each Food Spot store would have profited had it been open after the hurricane. The fact that the Food Spot stores would have reaped greater profits in the aftermath of Hurricane Andrew and that [the insurer] therefore must pay higher business interruption losses is not accurately described as a windfall. Food Spot is seeking to recover its actual losses, which is exactly what the insurance policy requires [the insurer] to pay.[14]

Another case that looked to post-loss market conditions was *Levitz Furniture Corp. v. Houston Cas. Co.*[15] There, the insured's furniture store was closed as a result of flood water that damaged the insured's building and destroyed its inventory. When the insured was able to reopen, it experienced strong sales as a result of the flood. The insured argued that it was entitled to a recovery based upon the improved market conditions. The court agreed, although it rested its decision on the differences in language between the policy before it and the policies at issue in *Colleton* and other cases. The *Levitz* policy provided that the amount of loss was to be determined based upon the experience of the business before the interruption and "the [p]robable experience thereafter ... that would have existed had no interruption of production or suspension of business operations or services occurred."[16] The court allowed consideration of the post-loss environment to increase recovery.

As with the other approach, however, whether consideration of the post-loss environment minimizes or maximizes coverage will depend on the facts. For example, consider the coverage-minimizing decision of a federal district court in *Penford Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*[17] There, the court permitted the insurer to offer evidence that the actual loss sustained should be adjusted downward to account for the effect of a recession on post-loss demand for the insured's products. The *Penford* court distinguished the Fifth Circuit's reasoning in *Catlin*, holding that "unfavorable market conditions, such as a recession, would have affected Penford's earnings regardless of whether the flood ever occurred. Accordingly, they are relevant

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[14] **US/FL**--No. 93-1005-CIV-DAVIS, slip op. at 8 (S.D. Fla. June 13, 1994).

See also **US/LA**--Levitz Furniture Corp. v. Houston Cas. Co., No. 96-1790, 1997 U.S. Dist. LEXIS 5883, at *6-11 (E.D. La. Apr. 28, 1997) (allowing recovery for income that would have been earned due to increased demand following the flood that closed the insured's store).

[15] **US/LA**--No. 96-1790, 1997 U.S. Dist. LEXIS 5883 (E.D. La. Apr. 28, 1997).

[16] **US/LA**--1997 U.S. Dist. LEXIS 5883, at *7-8.

[17] **US/IA**--No. 09-CV-13-LRR, 2010 U.S. Dist. LEXIS 60083 (N.D. Iowa June 17, 2010).

to the question of what Penford's likely revenues would have been in the absence of a flood."[18] Similarly, another district court in a Katrina case considered the insured's post-loss market to deny recovery where the insured's business increased after resumption.[19]

Alternative policy language is available to specify a narrower method for calculating gross earnings. For example, one of the ISO forms specifically excludes from consideration income "that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses."[20]

> **Lexis.com Search:** To find cases discussing the "had no loss occurred" provision in business interruption insurance, use the Search by Topic feature: Click the Search tab and the Search by Topic or Headnote sub-tab. Click through the following topical hierarchy and select your jurisdiction. Search by Topic: Insurance Law > Business Insurance > Business Interruption Insurance . Under Option 1 "Search across Sources," > Select Source(s) > type in the search terms "had no loss occurred" without the quotation marks.

> **Cross Reference:** For further discussion of the issue of whether the post-loss environment should be considered or ignored in calculating business interruption insurance recovery, see Gregory D. Miller and Joseph D. Jean, *Effect of Post-Loss Economic Factors in Measuring Business Interruption Losses: An Insured's and Insurer's Perspectives,* NEW APPLEMAN ON INSURANCE: CURRENT CRITICAL ISSUES IN INSURANCE LAW (Winter 2010).

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[18] **US/IA--**2010 U.S. Dist. LEXIS 60083, at *32.

[19] *See*:

US/LA--B.F. Carvin Constr. Co., Inc. v. CNA Ins. Co., No. 06-7155, 2008 U.S. Dist. LEXIS 53678, at *10 (E.D. La. 2008) (disallowing recovery where damage due to Hurricane Katrina required business to shift from bidding on public contracts to smaller, residential projects, which proved more lucrative);

[20] ISO Form CP 00 30 06 95. This form has not been without its own issues.

See:

US/LA--Berk-Cohen Assocs., LLC v. Landmark Am. Ins. Co., No. 07-9205c/w07-9207-SSV-SS, 2009 U.S. Dist. LEXIS 77300 (E.D. La. Aug. 27, 2009);

TX--Rimkus Consulting Group, Inc. v. Hartford Cas. Ins. Co., 552 F. Supp. 2d 637, 642-643 (S.D. Tex. 2007).