RECOVERY FROM FLOOD: Commercial Concerns and Insurance Coverage

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Seminar Overview

- Commercial Issues
  - Remedies for the inability to meet contract obligations
- Insurance Coverage for Property Damage
- Insurance coverage for Business Interruption Loss
Impact of Flooding on Contractual Obligations

- Contracts are not automatically terminated
- Restatement (Second) of Contracts states:
  - Contract liability is strict liability. It is an accepted maxim that *pacta sunt servanda*, contracts are to be kept. The obligor is therefore liable in damages for breach of contract even if he is without fault and even if circumstances have made the contract more burdensome or less desirable than he had anticipated.
- Parties’ obligations governed by:
  - Contract terms
  - Common law
  - Sale of goods - the UCC
• Force majeure clause may relieve the parties of their legal duties in the event of extraordinary events
  – Wars
  – Riots
  – Natural disasters
• A reviewing court will first interpret the contract at issue
• For farmers, may not include:
  – Flood
  – Drought
  – Disease
• To a significant degree, interpretation is contract specific
• Case by case
• Restatement (Second) of Contracts, § 261, cmt. a.
  – “Even though a party, in assuming a duty, has not qualified the language of his undertaking, a court may relieve him of that duty if performance has unexpectedly become impracticable as a result of a supervening event.” The general rule governing impracticability of performance is stated in § 261, and three common specific instances of impracticability are addressed with in §§ 262, 263 and 264.

• Section 261
  – Discharge by Supervening Impracticability
    Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.
The Common Law –
The Restatement (Second) of Contracts (cont.)

- Section 261 simply states a broadly applicable principal to all types of impracticability and it "deliberately refrains from any effort at an exhaustive expression of contingencies" Section 261, cmt. a (quoting Comment 2 to Uniform Commercial Code § 2-615).
- The principle of Section 261, and its companion Sections 262-265, yields to a contrary agreement by which a party may assume a greater as well as a lesser obligation.
  - Section 262 - supervening death or incapacity of a person necessary for performance
  - Section 263 - supervening destruction of a specific thing necessary for performance
  - Section 264 - supervening prohibition or prevention by law
• Contracts for the sale of goods are governed by the UCC.
• Within the UCC, impracticality of performance is addressed by Section 2-615, which states:
  – Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:
  – a. Delay in delivery or nondelivery in whole or in part by a seller who complies with paragraphs “b” and “c” is not a breach of the seller's duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.
– b. Where the causes mentioned in paragraph “a” affect only a part of the seller's capacity to perform, the seller must allocate production and deliveries among the seller's customers but may at the seller's option include regular customers not then under contract as well as the seller's own requirements for further manufacture. The seller may so allocate in any manner which is fair and reasonable.

– c. The seller must notify the buyer seasonably that there will be delay or nondelivery and, when allocation is required under paragraph “b”, of the estimated quota thus made available for the buyer.

Iowa Code § 554.2615
The UCC identifies several specific instances in which substituted performance should be made:

1. Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

2. If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory.
Section 2-614 may be appropriate in the case of certain storable commodities, such as grain, were the intended point of delivery is unavailable but nearby storage is available.
• Force majeure clause will not be interpreted in isolation.
• If a contract performance possible through alternative means, the frustration of one method of performance will not discharge a parties’ obligation.
• See Glidden Co. v. Hellenic Lines, 275 F.2d 253, 257 (2d Cir.1960) (involving an alternative performance with force majeure clause; contract provided that shipper could deliver by way of the Suez Canal, the Cape of Good Hope, or the Panama Canal; holding that force majeure clause did not excuse shipper from using Cape of Good Hope or Panama Canal when war prevented shipper from using Suez Canal, the most economical route); see also Restatement (Second) of Contracts, § 261.
Liquidated damages and alternative performance.

See *American Soil Processing, Inc. v. Iowa Comprehensive Petroleum Underground Storage Tank Fund Bd.*, 586 N.W.2d 325, 327 (Iowa 1998) (reversing district court’s determination that the liquidated damages provision at issue was a means of alternative performance only after extensive discussion and a detailed interpretation of the agreement).
Beware of Trade Rules

- Trade rules govern some contracts.
- Example - NGFA.
- Except in limited circumstances, NGFA rules do not directly address issues of impracticality.
- NGFA Grain Trade Rule 28.
- Buying-in or selling-out.
- Commodity contracts and alternative obligations.
- Force majeure clause will control.
Evaluation of your coverages:

- **What is available?** Early assessment of available coverages
- **What is needed to prove up claim?** Documentation and hiring of experts (local angle? photos? video?)
- **Proof of loss?** Timing and content

**SOURCES OF RECOVERY:**

1. **National Flood Insurance Program (NFIP)** since 1968 provides coverage for water damage
   -- FEMA administers approx. 4.5 million policies under NFIP (private insurers market the majority of flood policies and premiums deposited in Flood Insurance Fund that will pay legitimate claims).
   --Not a lot of NFIP coverage in region – e.g. fewer than 700 NFIP policies in Cedar Rapids
   --NFIP claims are made through agents selling policy (60 days after event to submit claims).

2. **FEMA disaster relief** information and claims process at [www.fema.gov](http://www.fema.gov)
   --Possible disputes with FEMA re: landowners’ entitlement to relief funds (immunity issues)
   --Possible disputes if condemnation decisions are made on property by FEMA or eminent domain (Grand Forks flood 1997 took 10 years to sort through issues)
   --Possible Relocation Act claims if individuals and businesses are condemned and forced to move re: flooding
3. Commercial property policies/homeowners policies:
   -- Primary and excess coverages
   a. Notify all potentially implicated
   b. Evaluate differences b/w primary and excess layers
   c. Identify possible coverage limitations:
      - Flood exclusion
        • Wildly different definitions or no policy definition – look to case law
        • Natural disaster vs. man-made disaster (levee failure) ambiguity arguments
        • Wind-driven water or covered storms vs. flood – e.g. broad vs. narrow definitions (broad example: general and temporary condition of partial or complete inundation of normally dry land areas from overflow of inland or tidal waters; unusual and rapid accumulation or runoff of surface waters from any source; mudslide or mud flow caused by accumulation of water on or under the ground; and the release of water impounded by a dam.)
Property Coverage/Valuation Issues

- **Erosion exclusions**
  - “Forces of nature”/fortuitous losses vs. “wear and tear” erosion
  - Avulsion vs. erosion issues in land loss

- **Mold exclusions**

- **Sublimits**
  - Flood sublimit vs. Windstorm sublimit vs. Named Storm sublimits

- **Deductibles**
  - Often expressed in % of property damage value pre-loss
  - Multiple deductibles and which applies

- **Covered property limits**
  - Limits on valuation of specific property as scheduled
  - Possible total loss under ‘valued’ policy/state statutes may fix at valued amount

- **Co-insurance** --% contribution to loss

- **Timing issues for rebuild or replacement**

- **Property damage valuation issues**
  - Replacement Cost (e.g. Katrina effect & questions about where rebuild)
  - Actual Cash Value (replacement minus deductible depreciation)
  - Appraisal process timing/request
Dealing with Adjusters

• Providing information
  – Accurate
  – Timely
  – Complete

• Relying on adjuster statements
  – Apparent authority?
  – Establishing what was said
• Discussions with brokers
  – Evidentiary issues
  – Broker’s statements regarding coverage
• Brokers status: independent or an agent?
  – Consequences of broker’s coverage beliefs
  – Consequences of broker’s role in negotiating coverage
• Sue and Labor clause
  – Purpose: to create incentive to mitigate loss
  – Read the clause
    • Apply to mitigation efforts only after covered loss occurs? (Swire Pacific – $4.5 million spent to prevent collapse; no coverage)
    • Broader clause – general duty to mitigate (Witcher Constr. – discusses general sue and labor clause as requiring action before covered loss occurs)
    • Separate indemnity grant and policy exclusions do not apply (Witcher)
  – Common law duty to mitigate (Witcher – insurer responsible to reimburse)
Business Interruption Coverage

• Common time element coverages
  – Traditional BI
  – Extra Expense
  – Contingent BI
  – Civil Authority
  – Egress/Ingress
  – Service Interruption
Elements of BI Coverage

- Physical damage from a covered cause of loss to covered property
  - Defective design and other excluded perils
- Interruption caused by the physical injury to the covered property
  - Area-wide disruption
  - Extent of disruption (partial or complete)
- Actual loss directly resulting from the interruption
  - Gross earnings vs. profit
  - Make-up sales
- Loss occurs within the indemnity period
  - Extended indemnity periods
  - Period of restoration
Extra Expense

- Reimbursement for reasonable and necessary expense incurred during indemnity period
  - To continue operations in spite of loss; or
  - To minimize covered business interruption loss
- What is a necessary expense?
  - Not defined (advertising?)
- Expediting expense
- Overtime
- Temporary repairs
Contingent BI

- Physical damage to third-party property affecting insured’s business:
  - Suppliers
  - Customers
  - Leader properties (e.g., anchor tenants)
- Other BI conditions (e.g., causation, covered cause, actual loss sustained) apply
- Sublimits
Civil Authority Coverage

- **Business loss resulting from order of a civil authority**
  - Actual order?
  - Physical injury to insured’s property?
  - Covered cause of loss
  - Causation
  - Extent of interruption
  - Waiting period (24-48 hours)
  - Duration limits (days or weeks – not “restoration period”)

- **Ingress/egress coverage**
  - Like Civil Authority with necessity of a civil order

- **Service interruption**
  - Business loss due to lack of (1) incoming electricity, gas, water, etc., or (2) outgoing sewer
    - Covered cause of loss
    - Sublimits and waiting periods