UNDERSTANDING EXTRA EXPENSE

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I. INTRODUCTION

When fire or another casualty damages a commercial building, businesses may suffer financial hardship beyond lost income and costs to repair the property. In most situations, a prudent business owner is likely to incur expenses that fall outside the scope of those normally seen in the business's day-to-day operation. The nature of those expenses is as varied as the circumstances of each loss.

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Some expenses may arise in connection with the repair of the building. For example, a business may need to build temporary walls or walkways to continue business during reconstruction. It may need to hire security details to guard the property before permanent repairs are completed. Expediting expenses may be incurred to deliver equipment and building materials to the damaged property. In some cases, the business may need temporary power pending the restoration of its permanent source. Other expenses may relate solely to the company's efforts to resume business operations. The business owner may decide that it is prudent to incur the expense of purchasing products from a competitor or expediting supplier shipments in order to meet sales orders that would otherwise be lost. Temporary facilities may need to be rented to continue normal business activities.

Planning for the long-term future of the business may guide the insured's decisions. The business owner may decide that the repair work offers a perfect opportunity to expand or modernize the physical plant. The company may offer its customers significant discounts for goods and services as a way either to maintain business during the reconstruction period or to recapture its market share after the damage has been repaired and operations resumed.

The insured may incur many of these expenses with the intention of resuming business as soon as possible, only later to find that the expenses neither accelerated the resumption of operations nor reduced the amount of the loss. The insured, of course, always has the right to take whatever steps it deems prudent in the operation of the business. But which of these expenses are covered by insurance and to what extent?

The expenses that a business owner chooses to incur beyond the direct costs required to repair the physical loss may or may not qualify for "extra expense" coverage. Policies sometimes provide coverage only for expenses that prevent a greater insured loss of income. Even if they provide broader extra expense coverage, that coverage typically applies only to expenses needed to continue or resume operations or to make temporary repairs. After a loss, a commercial insured and its insurance carrier may disagree over which expenses are covered and which are not. Despite the best efforts of commentators and industry leaders,[1] policyholders and

1. Various commentators have tried to offer conceptual definitions and tests. One has written that extra expense coverage "provides for the payment of any extra expense incurred by the insured in order to continue the normal conduct of his business during the period of restoration[,] provided that the damage to the insured's property is by a risk insured against." 5 John Appleman & Jean Appleman, Insurance Law & Practice § 3121.25 (1st ed. 1970). Another has suggested that extra expense may be determined based on a four-part analysis: (1) whether the expense is related to the loss, (2) whether it is necessary, (3) whether it was incurred during the period of restoration, and (4) whether it was over and above normal

even courts sometimes misunderstand what is and is not a covered extra expense. This article explores insurance coverage for extra expense and examines case law to offer an understanding of the typical scope of this coverage.

To facilitate our discussion, we start at the beginning. We consider what constitutes a covered cause of loss that may trigger extra expense coverage.

II. DIRECT PHYSICAL LOSS BY A COVERED CAUSE

Extra expense coverage varies from policy to policy, but virtually all forms are subject to a condition precedent that there be a loss to covered property that interrupts the insured's normal business operations. The standard Insurance Services Office (ISO) form's definition of *extra expense* is typical of many; it provides generally that extra expense is any "necessary expense" that the insured incurs during a period of restoration that it would not have incurred if there had been no direct physical damage to its property.[2] An alternate approach, sometimes found in broker forms, defines *coverage* as the excess of total costs incurred during the period of restoration over the total costs that would have been incurred in the normal course of business. In many cases, the key elements for finding extra expense coverage are (1) that the expenditure be "necessary," (2) that it be incurred during the "period of restoration," and (3) that it would not have been incurred absent damage to the insured's property by a covered cause of loss.

Extra expense is ordinarily payable to an insured only when the loss meets all of the conditions of the coverage. Following the traditional rule of construction, courts commonly look to the entire policy, considered as a whole, when deciding if a particular claimed item qualifies as a covered extra expense.[3] This typically means that the extra expense must follow from a direct physical loss to the insured's property.

operating expense. In other words, had there not been a loss, the relevant metric is whether the expense would have been incurred anyway. *See* Susan B. Harwood, The Seven Lessons of Extra Expense: Business Interruption and Related Claims in the Wake of 9/11, at 4–5 & n.5 (Nov. 15, 2002) (unpublished manuscript, on file with authors).

2. Chris Boggs, Extra Expense Policy Comparison (last visited May 21, 2009), www.mynewmarkets.com/article_view.php?id=98023 (in the second paragraph of the article on the web page (Chris Boggs, Extra Expense Coverage—With or W/O BI (Feb. 23, 2009)), follow the hyperlink for the side-by-side comparison).

3. *See, e.g.*, Pel Hughes Printing v. Hanover Ins. Group, No. 07-4044, 2008 WL 1774288, at *4 (E.D. La. Apr. 16, 2008) (considering claim for utility interruption and associated extra expenses after Hurricane Katrina, coverage for the insured's claimed extra expense could be determined only by considering the "policy's provisions as a whole").

A. *Direct Physical Loss*

Policies typically require a "direct physical loss," that is, physical loss of or damage to insured property, as a condition precedent to coverage.[4] One of the earliest cases addressing extra expense coverage serves to illustrate this point. In *Port Murray Dairy Co. v. Providence Washington Insurance Co.*,[5] the New Jersey Superior Court found no coverage for a dairy that claimed extra expense owing to a strike.[6] When a number of farmers across New York, New Jersey, and Pennsylvania organized a guild to negotiate for higher dairy prices, Port Murray Dairy refused to have anything to do with them. The farmers called a milk strike against Port Murray and proceeded to block the entrances and exits to its plant, maintaining a presence of approximately fifty men armed with clubs, spiked planks, and cans of kerosene at all times. The pickets prevented the movement of any milk into or out of the dairy.[7] The strikers did not actually damage any of plaintiff's equipment or the plant; they just prevented it from operating.[8]

Following the resolution of the strike, the dairy submitted a claim to its property carrier, citing as its losses spoilage of the milk in the plant and the premium that it paid to purchase milk on the open market to supply its customers.[9] Finding that extra expense coverage was unavailable, the court noted that Port Murray had not suffered any direct physical loss to its property:

> The reason plaintiff had to go elsewhere to continue business operations was not because of any damage or destruction of its buildings or contents, but rather because the rioters had blockaded the plant. . . . The policy obviously refers to a situation where the insured's property, whether buildings or contents[,] has been damaged or destroyed by an insured peril, and it is that damage or destruction that causes the extra expense incurred in order to continue normal operations.[10]

4. *See, e.g.*, Boggs, *supra* note 2 ("Extra Expense means necessary expenses you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to property.").

5. 145 A.2d 504 (N.J. Super. Ct. Ch. Div. 1958).

6. The relevant extra expense provision in the policy was described by the court as follows: "What the policy does provide is that if there is any damage to or destruction of plaintiff's building or contents by any of the perils insured against (fire, vandalism, riot, and the like), the insurance company will pay the necessary extra expense incurred by the insured in order to continue the normal conduct of the insured's business during the period of restoration." *See id.* at 507.

7. *See id.* at 505.

8. *See id.* at 506.

9. *See id.*

10. *See id.* at 507–08.

Finding no direct physical loss to the insured's property, the court found that there was no coverage for the claim.[11]

Courts have refused to find coverage for extra expense where lost property was not owned by the insured. In *Mafcote, Inc. v. Continental Casualty Insurance Co.*,[12] an industrial manufacturer and distributor of paper products made such a claim. Two of Mafcote's subsidiaries were Royal Consumer Products and Miami Wabash. When subsidiary Miami Wabash's steam boiler failed, it was not able to produce enough paper to meet all of subsidiary Royal's needs, forcing Royal to buy paper on the open market at a premium of approximately $220,000. Royal attempted to tender a claim for the premium under Mafcote's extra expense coverage.[13] The court found that Royal had no claim to the coverage because the property that was damaged was owned by Miami Wabash, not Royal.[14]

Even where the insured actually owns the property at issue, care must be taken to ensure that the property in question is properly scheduled. In *Lavoi Corp. v. National Fire Insurance of Hartford*,[15] a commercial bakery was constructing a new plant in Dallas, Texas. A fire tore through the premises on January 13, 2005, roughly one month before the plant was to have opened.[16] Because the plant was not yet operational, the Dallas location had not yet been listed as a covered location on the relevant business interruption and extra expense policy.[17] The insured, which operated other facilities in Arizona and Georgia that were scheduled on the policy, nevertheless tendered an extra expense claim in the amount of $747,511.34 to its carrier.[18] The insured argued that the extra expenses were incurred by its Georgia and Arizona facilities as they struggled to supply customers that would have been served by the bakery in Dallas.[19]

The court began its analysis by looking to the policy's definitions. The policy defined *extra expense* as "necessary expenses you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered

11. *See id.* at 508.
12. 144 F. App'x 449, 450 (6th Cir. 2005).
13. In relevant part, the policy's grant of coverage provided thus: "We will pay you for your 'Actual Loss' and 'Extra Expense' during the 'Period of Restoration' provided all of the following requirements are met: a. The 'Actual Loss' and 'Extra Expense' must be caused solely by an 'accident' to an 'object'; b. The loss must be as a result of direct physical damage to Covered Property; . . . d. The 'object' that has the 'accident' must be . . . (2) At a 'location' shown in the Combined Business Interruption and Extra Expense Schedule." *See id.* at 452.
14. *See id.*
15. 666 S.E.2d 387 (Ga. Ct. App. 2008).
16. *See id.* at 389.
17. *See id.* at 390.
18. *See id.*
19. *See id.*

Cause of Loss."[20] It then looked at the general coverage form, which noted that coverage applies to the actual loss of business income sustained

> due to the necessary suspension of your "operations" during the "period of restoration" [where t]he suspension [is] caused by "direct physical loss of or damage to property" . . . at premises that are described in the Declarations and for which a Business Income Limit of insurance is shown in the Declarations.[21]

The court stated that the policy's declaration page showed "clearly and unambiguously that [the insured] purchased [business income and extra expense] coverage for the [Georgia] and [Arizona] properties, not the Dallas facility."[22] It further stated that the policy was "clear that the coverage applies in the event of loss or damage to the property at the premises described in the Declarations."[23] It affirmed the lower court's finding that no extra expense coverage was available for claims stemming from the fire at the Dallas facility.[24]

At its option, an insured often may purchase coverage for losses that result from damage to the property of others. Where a policy offers coverage for losses to such "dependent" property, it will include a separate provision or form extending the coverage. Where that coverage is not included in the policy, a court will not impose it.

Courts have refused to find coverage under extra expense provisions where there has been no direct physical loss even where the interruption of electrical service to an insured's suppliers results in a policyholder incurring extra expenses to maintain normal business operations. In *Pentair v. American Guarantee & Liability Insurance Co.*,[25] the subsidiaries of insured Pentair manufactured electrical products. Those subsidiaries contracted with various Taiwanese factories to supply certain portions of those products. In September 1999, an earthquake in Taiwan disabled a substation that supplied electricity to Pentair's suppliers. When production at the suppliers' factories resumed two weeks later, Pentair paid a premium of $634,731 to expedite shipping of those materials to the United States.[26] It subsequently filed an insurance claim, alleging that its premium freight charges should be covered as extra expenses.[27]

20. *Id.* at 391.
21. *Id.*
22. *See id.*
23. *See id.*
24. See *id.*
25. 400 F.3d 613 (8th Cir. 2005).
26. *See id.* at 614.
27. *See id.* The policy at issue provided coverage for "all risk of direct physical loss of or damage to property described herein." *See id.* One of the provisions in the coverage form extended the policy's business interruption coverage to extra expenses incurred by Pentair in order "to continue as nearly as practicable the normal operation" of its business following a loss caused "by the perils insured herein." *See id.*

The court found in favor of the property carrier, holding that a lack of electricity to the insured's supplier did not cause direct physical loss to the insured or to the supplier. The court noted that the lack of electricity merely resulted in a shutdown of Pentair's Taiwanese suppliers. Pentair had not presented any evidence that its suppliers' equipment had been damaged by the power failure. The court was unwilling to stretch contingent extra expense coverage to find that the foreign power company was a "supplier" of Pentair. Similarly, the court was unwilling to rule that "direct physical loss or damage is established *whenever* property cannot be used for its intended purpose."[28] Loss of use was not physical loss.

The issues may be more complex when a policyholder submits an extra expense claim arising from a loss of electronic data. In *Ward General Insurance Services, Inc. v. Employers Fire Insurance Co.*,[29] the court faced the issue of whether a loss of computer data is a physical loss. Ward was in the business of servicing policies and claims for insurance companies. In November 1999, human error caused Ward's database system to crash, destroying all of Ward's electronic data. There was, however, no visible or tangible damage to any part of the computer system. Ward hired a team of consultants who were able to restore the database, albeit at considerable expense. Ward subsequently claimed as extra expense approximately $53,500 incurred in the restoration effort.[30] The property carrier denied the claim,[31] Ward sued, and the trial court ruled for the property insurer.[32]

The appellate court began its analysis by noting that the policy did not provide any coverage unless the insured had suffered a "direct physical loss" to covered property.[33] Construing those words by giving them their plain and ordinary meaning, the court concluded that they imparted a "clear and explicit meaning in the context of the losses claimed" under the policy.[34] On the issue of physical loss, the court went on to state thus:

> We fail to see how *information*, qua information, can be said to have a material existence, be formed out of tangible matter, or be perceptible to the sense of touch. To be sure, information is stored in a physical medium, such as a magnetic disc or tape, or even as papers in three-ring binders or a file cabinet, but the information itself remains intangible. Here, the loss suffered by plaintiff was a loss of information, i.e., the *sequence* of ones and zeroes stored by

28. *See id*. at 616 (emphasis in original); *see also id*. at 615–18.
29. 7 Cal. Rptr. 3d 844 (Ct. App. 2003).
30. *See id* at 846.
31. The policy provided coverage for actual loss of business income and associated extra expense, provided that the "necessary suspension of the insured's operations during the period of restoration" was caused by "direct physical loss of or damage to property at the premises described" in the policy's declarations. *See id*. at 849 (internal punctuation omitted).
32. *See id*. at 846.
33. *See id*. at 849.
34. *See id*. at 850.

> aligning small domains of magnetic material on the computer's hard drive in a machine readable manner. Plaintiff did not lose the tangible material of the storage medium. Rather, plaintiff lost the stored *information*. The sequence of ones and zeroes can be altered, rearranged, or erased, without losing or damaging the tangible material of the storage medium.[35]

Dismissing Ward's claim, the court concluded that in the absence of any loss or damage to tangible property, there had been no direct physical loss within the scope of coverage.

In another computer-related loss claim decided that same year, a second court reached the opposite conclusion. *NMS Services, Inc. v. Hartford* involved a claim by a software development company against its property insurer for damages arising out of a computer attack.[36] In July 2000, NMS discovered that its computer systems had been hacked; the perpetrator had deleted certain computer files and databases that were necessary for the operation of the company's manufacturing, sales, and administrative systems.[37] The hacker was a disgruntled former employee who had installed various programs on NMS's computers prior to his termination that allowed him to override security codes and passwords, giving him ready access to the company's systems. The property insurer denied NMS's claim, and NMS sued for approximately $350,000 in damages.[38]

Reversing the trial court's grant of summary judgment in favor of the insurance company, the appeals court found that NMS had sustained the requisite direct physical loss to trigger extra expense coverage.[39] The court reasoned that NMS's computer systems were "not only damaged, but [were] completely destroyed" by the hacker's actions inasmuch as the systems were rendered inoperable by the deletion of key files.[40] Concurring, Judge Widener specifically noted that

> when the employee erased the data on NMS's [*sic*] computers, this erasure was in fact a "direct physical loss" under the requirements of the policy. Indeed, a computer stores information by the rearrangement of the atoms or molecules of a disc or tape to effect the formation of a particular order of magnetic impulses, and a meaningful sequence of magnetic impulses cannot float in space.

35. *See id.* at 851 (emphasis in original).
36. 62 F. App'x 511 (4th Cir. 2003).
37. *See id.* at 512.
38. *See id.* at 513.
39. The relevant extra expense coverage indemnified NMS against "costs incurred during the restoration period that would not have been incurred if there were no direct physical loss of or damage to the property." It was "only available if the damage was caused by or resulted from a 'Covered Cause of Loss.'" *See id.* at 514.
40. *See id.*

> It is the fact that the erasure was a "direct physical loss" that enables NMS to recover under the policy.[41]

In sum, in the case of electronically stored information, whether an insured has sustained a direct physical loss may not be as simple a question as it might first appear. With precedent on both sides, whether a policy provides extra expense coverage for a particular claim remains highly dependent upon the relevant facts of the loss, the law of the jurisdiction in which the claim has been made, and the language of the policy.[42]

B. *Covered Cause of Loss*

Insurance coverage for extra expense usually does not attach unless the insured's property damage was due to a covered cause of loss. The standard ISO form defines *extra expense* as "necessary expenses you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss."[43] Under standard all-risks policies, however, a covered cause of loss could include any fortuitous physical loss that is not specifically excluded. How far does the scope of coverage extend?

Courts have typically given a broad reading to the "covered cause of loss" clause in the grant of coverage. In *Cooper v. Travelers Indemnity Co. of Illinois*,[44] for example, a Lake Tahoe–area restaurant whose well had been contaminated with coliform bacteria was able to claim extra expense coverage for the costs of drilling a new well. Its policy was a traditional all-risks form.[45] The court, therefore, placed the burden of proving that the damage

41. *See id*. at 515 (Widener, J., concurring) (internal quotations and citations omitted).

42. Certain other courts have reached conclusions similar to the one in *NMS Services*. *See*, *e.g*., Se. Mental Health Ctr. v. Pac. Ins. Co., 439 F. Supp. 2d 831 (W.D. Tenn. 2006) (corruption of computer files constitutes direct physical loss for purposes of an all-risks property policy); Am. Guarantee & Liab. Ins. Co. v. Ingram Micro, Inc., 2000 WL 726789, No. 99-185 TUCACM (D. Ariz. Apr. 18, 2000) (loss of data constitutes physical damage to computer systems); Lambrecht & Assocs., Inc. v. State Farm Lloyds, 119 S.W.3d 16 (Tex. App. 2003) (where policy included damage to information on electronic media, loss of that data was covered as direct physical loss).

43. *See* Boggs, *supra* note 2.

44. No. C-01-2400-VRW, 2002 WL 32775680 (N.D. Cal. Nov. 4, 2002).

45. The policy generally provided that it would cover risks of direct physical loss of or damage to covered property at the insured's premises that had been caused by or resulted from a covered cause of loss, unless limited or excluded. *See id*. at *2. The extra expense clause provided coverage for any "necessary Extra Expense incurred during the period of restoration that would not have been incurred if there had been no direct physical loss or damage to property at the premises." *See id*. at *4. It defined *extra expense* to include expenses "incurred to avoid or minimize the suspension of business and to continue operations at the described premises" for up to twelve months after the date of loss. *See id*. (internal punctuation omitted).

to the restaurant was not caused by a covered cause of loss on the carrier.[46] The carrier did not meet its burden and was ordered to pay $18,000.[47]

Where the "covered cause of loss" language is absent, courts may even find independent coverage under extra expense provisions that is more generous than applicable direct coverage for damage to the insured's property. In *Wichita Realty, LLC v. Continental Western Insurance Co.*,[48] the Kansas Court of Appeals considered the case of a policyholder who operated a hotel and adjoining restaurant. During the relevant policy period, a sewage backup caused substantial damage to the policyholder's facilities. The policyholder submitted a $400,000 claim for damages.[49] The policy excluded damages resulting from "water that backs up or overflows from a sewer, drain or sump," but an endorsement granted limited coverage of up to $10,000 per building at the insured's premises for damage resulting from sewer backups.[50]

The court found that the policyholder could claim extra expense coverage up to the endorsement's per-building limits for expenses stemming from the sewer backup because the endorsement that described extra expense did not define it as following from a covered cause of loss. Rather, the policy defined *extra expense* as "necessary expenses incurred during a period of restoration that would not have been incurred if there had been no direct physical loss or damage to the property."[51] In its holding, the court held that the extra expense coverage was "independently covered" under the policy:

> The endorsement [granting extra expense coverage] does not utilize the more specific "Covered Cause of Loss" language in referring to covered losses for extra expenses but rather pays for extra expenses resulting from any loss or damage "covered by this policy." Because the endorsement provided coverage for sewer backup, albeit limited, we conclude that "extra expenses" resulting from sewer backup are independently covered under the endorsement.[52]

The court went on to find that the coverage was subject only to the per-building limit in the policy's declarations and not the lower sublimit for sewer backup.[53]

C. *Excluded Loss and Expense*

Extra expense coverage does not apply to all loss-related expense. Even in cases where direct physical loss arises out of a covered cause of loss to

46. *See id.* at *5.
47. *See id.*
48. 118 P.3d 715 (Kan. Ct. App. 2005).
49. *See id.*
50. *See id.*
51. *See id.* (internal quotations omitted).
52. *See id.*
53. *See id.*

insured property, there may not be coverage for an item claimed under a policy's extra expense provisions. The Delaware Superior Court's decision in *Nassau Gallery, Inc. v. Nationwide Mutual Fire Insurance Co*.[54] is illustrative. An art gallery sustained damage in a fire, which was a covered cause of loss.[55] The gallery submitted a claim of nearly $25,000 to Nationwide, the majority of which was categorized by the gallery as extra expense incurred during reconstruction.[56] Among the claimed expenses were lighting fixtures, lumber, decorative trim, paint, carpet, flooring, a security system, advertising, labor costs, and garbage removal.[57] Refusing to find extra expense coverage, the court wrote thus:

> [Extra expense coverage] protects an insured from specific losses; it is not a means to circumvent otherwise valid policy limitations. Reconstruction expenditures, such as the Gallery's, are related to the Policy's primary coverage, not the Extra Expense provisions. Nationwide is not responsible for the Gallery's failure to obtain adequate [property] insurance coverage nor for those losses exceeding the Policy's primary coverage limit, including reconstruction expenses related to carpet, lighting, paint, and drywall. Thus, the Gallery's reconstruction expenditures are not compensable Extra Expenditures. . . . A contrary finding would lead to the forbidden absurd result.[58]

The court found that only certain advertising costs (incurred to inform the public that the gallery remained open for business during the period of restoration) and garbage removal costs were compensable extra expenses.[59]

The *Nassau Gallery* court recognized that even though the loss arose out of a fire (a covered cause), extra expense coverage did not necessarily apply to all expenses that were claimed. The nature of the expenses was to be examined; and where those expenses were actually incurred to rebuild the damaged property rather than to continue normal business operations during the period of restoration, they were not covered under the extra ex-

54. No. Civ.A.00C-05-0304, 2003 WL 21223843 (Del. Super. Ct. Apr. 17, 2003).

55. *See id*. at *3.

56. The relevant policy provided thus: "Nationwide will pay necessary Extra Expense you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to property at the described premises caused by or resulting from a Covered Cause of Loss." *See id*. at *3 (internal punctuation omitted). *Extra expense* was further defined to mean expense incurred to "avoid or minimize the suspension of business and to continue 'operations' at the described premises; [t]o minimize the suspension of business if you cannot continue 'operations'; [or] [t]o repair or replace any property to the extent it reduces the amount of loss that otherwise would have been payable under this Additional Coverage or Additional Coverage f., Business Income." *See id*. (internal punctuation and numbering omitted).

57. *See id*. at *1.

58. *See id*. at *3.

59. *See id*. at *4.

pense provisions of the policy. Generally speaking, then, the policyholder must examine his coverage carefully because exclusions in one part of the policy may apply with equal force to the policy's extra expense coverage.[60] A covered cause of loss to insured property is a necessary condition to finding coverage under most extra expense policies, but the inquiry does not end there.

III. INTERRUPTION OF NORMAL BUSINESS OPERATIONS

Assuming that a loss to insured property follows from a covered cause, a policy will usually cover a necessary extra expense incurred after the loss has interrupted normal business operations. This section examines interruption requirements often appearing in extra expense coverage provisions.

A. *Suspension of Business*

The standard ISO form states: "We will pay Extra Expense (other than the expense to repair or replace property) to: (1) [a]void or minimize the 'suspension' of business and to continue operations at the described premises."[61] Courts sometimes disagree as to whether extra expense coverage attaches in the absence of a total cessation of the insured's business activities. Some courts refuse to find extra expense coverage once an insured's business is operational, even if it is still unable to resume "normal" business operations.

Illustrative is the court's decision in *American States Insurance Co. v. Creative Walking, Inc.*[62] The policy of the insured, Creative Walking, provided that it would pay for extra expenses incurred due to a "necessary suspension" of business operations during a period of restoration if the expenses tended to "avoid or minimize the suspension" of the business's operations.[63] In February 1996, a water main broke and flooded Creative Walking's premises, rendering the property untenantable. Creative Walking resumed operations from a temporary facility approximately two weeks later, and it subsequently decided to convert that facility into its new permanent headquarters.[64]

Following the loss, Creative Walking submitted a claim to its insurer in the amount of $94,000, contending that it was owed business interrup-

60. *See generally, e.g.*, Pel Hughes Printing v. Hanover Ins. Group, No. 07-4044, 2008 WL 1774288 (E.D. La. Apr. 16, 2008).
61. *See* Boggs, *supra* note 2.
62. 16 F. Supp. 2d 1062 (E.D. Mo. 1998).
63. *See id.* at 1063–64.
64. *See id.* at 1064.

tion and extra expense coverage for, among other things, an eighteen-week slowdown in its business operations following the flood.[65] Arguing that the policy did not cover slowdowns in business activity, the property insurer took the position that the policy required a total cessation of business activity before an insured may recover extra expense. The insurer argued that Creative Walking was entitled only to extra expenses incurred during the thirteen-day period between the date of the flood and the reestablishment of the business at its temporary location. It offered approximately $14,725 under the policy.[66]

The court agreed with the insurer's position, holding that the term *necessary suspension* as it was used in the grant of coverage referred "only to a total cessation of business activity."[67] The court observed:

> Under Missouri law, words in insurance contracts are given their ordinary meaning. Although ambiguities are to be construed in favor of coverage and against the insurer, an unambiguous policy will be enforced as written. The court must view the language in light of the meaning that would ordinarily be understood by the lay person who bought and paid for the policy.[68]

It went on to hold that

> the policy at issue in this case does not provide coverage for a "total or partial suspension" of business activity. Instead, the policy provides coverage only for a "necessary suspension of . . . operations." This otherwise unqualified language unambiguously refers to a total cessation of Defendant's business activities.[69]

Reinforcing its point, the court stated, "If the insured is able to continue its business operations at a temporary facility, it has not suffered a 'necessary suspension' of its operations."[70]

Other courts have found that extra expense coverage may attach as long as there is a disruption of normal business operations; it is not necessary that the insured's business totally cease before it may incur insured extra expenses. In *American Medical Imaging Corp. v. St. Paul Fire & Marine Insurance Co.*,[71] the insured's business provided ultrasound testing services. The actual imaging work was performed at contracted locations; the business utilized its headquarters to coordinate scheduling, marketing, billing, and other clerical activities.[72] When a fire damaged the headquarters premises

65. *See id.*
66. *See id.*
67. *See id.* at 1065.
68. *See id.* (internal citations omitted).
69. *See id.*
70. *See id.* at 1066.
71. 949 F.2d 690 (3d Cir. 1991).
72. *See id.* at 691.

in August 1988, the company rented space at an alternate site and reestablished operations within twenty-four hours, albeit with substantially fewer telephone lines. American Medical Imaging (AMIC) submitted a claim for the policy's $500,000 limits for lost income and extra expense premised on the period of restoration. St. Paul denied the claim, citing the fact that no suspension of business had occurred.

Reversing a trial court finding for St. Paul, the appeals court held that AMIC had established a suspension of business operations that triggered coverage under the policy's extra expense provisions.[73] AMIC's policy with St. Paul provided that it would cover lost business income and extra expenses incurred due to a "necessary or potential suspension" of business operations.[74] The court wrote:

> Under the district court's construction of the policy, the insured would have no motivation to mitigate its losses. Continuing in business at any level would bar recovery because the insured would be carrying on the same kind of activities that occurred at the covered location. We decline to accept the suggestion that this was the intent of the parties.[75]

The court concluded by stating that this "necessarily implies that the obligation to indemnify can arise while business continues, albeit at a less than normal level."[76] This illustrates an important lesson: the insurance professional must be mindful of the impact that slight variations in a policy's language may have on coverage issues. But for the presence of the word *potential* in the AMIC policy, the result may well have been different.

A single word can make a difference in analyzing extra expense coverage issues. Depending on policy wording, coverage may exist even where there has not been a suspension of business activities. One case illustrates a broader interpretation that courts may give to the word *interruption* versus *suspension*. In *Archer Daniels Midland Co. v. Aon Risk Services, Inc. of Minnesota*,[77] Archer Daniels Midland Company (ADM) claimed certain damages stemming from river closures due to extensive flooding across the Mississippi River system in 1993. ADM claimed the extra expense required

73. The policy provided thus: "We'll pay your actual loss of earnings as well as extra expenses that result from the necessary or potential suspension of your operation during the period of restoration caused by direct physical loss or damage to property as a covered location. . . . We'll pay your earnings and extra expense loss from the date the property is damaged until the earliest of the following: the date you resume normal business operations; as long as it should reasonably take to repair, rebuild or replace the damaged property, plus 30 consecutive days; or 12 months, regardless of your policy's expiration date." *Id.* at 692.

74. *Id.*

75. *See id.* at 692–93.

76. *Id.* at 693.

77. 356 F.3d 850 (8th Cir. 2004). It must be noted that this policy included coverage for dependent properties. This case may, therefore, not be applicable outside its narrow facts.

to secure substitute deliveries of corn for its processing needs and to cover increased transportation costs. ADM tendered its claim to its property carriers, each of whom had issued ADM a policy that insured "against loss of earnings and necessary extra expense resulting from necessary interruption of [ADM's] business."[78] Defending against a malpractice suit after ADM's claim was denied, ADM's broker took the position that ADM could not recover extra expense under any of its property insurance policies because it did not suffer any interruption of its business.[79] That is, the broker claimed that ADM did not establish that it had actually ceased production at its plants as a result of the flood.[80]

The U.S. Court of Appeals for the Eighth Circuit held that the phrase *interruption of business* as used in ADM's policies did not require ADM to show that its corn processing plants had stopped operations. The court did not require ADM to show that its production had even slowed. Rather, the court said that an "interruption of business means some harm to the insured's business, including the payment of extra expense, that would not have been incurred but for damage that an insured peril has caused to the property of any supplier."[81] The court claimed that its interpretation was based squarely "on the language of the policy as a whole and correctly embodies the parties' intent."[82]

ADM illustrates an important lesson, particularly with regard to extra expense: any claim to coverage ultimately rests on the language of the policy. The court acknowledged that "parties to an insurance contract can require a slowdown or cessation of business before extra expense coverage applies," but it could not find such an intent in its reading of the language before it.[83] Despite the court's explanation of its reasoning, *ADM*'s holding that a business that has not slowed operations may still have sustained an interruption is at best troublesome. In essence, the court found that the payment of the extra expense was itself the interruption.

In an effort to reduce uncertainty on this point, some editions of extra expense forms now define *suspension* to mean the "slowdown or cessation of [the insured's] business activities" or that "a part or all of the described

78. *See id.* at 852 & n.1 (brackets in original). The policy defined *extra expense* as "the excess, if any, of the total cost . . . chargeable to the conduct of the insured's business over and above the total cost that would normally have been incurred to conduct the business during the same period had no peril insured against and not excluded occurred." *Id.* at 855. Specifically excluded from that definition was any "extra expense in excess of that necessary to continue as nearly as practicable the normal conduct of the insured's business." *Id.*

79. *See id.* at 854.

80. *See id.*

81. *See id.* at 855.

82. *See id.*

83. *See id.* at 857.

premises is rendered untenantable," assuming that other coverage requirements also apply. For example, the ISO form added a definition in 2000 to make explicit the fact that a complete cessation of the insured's business was not required for extra expense coverage to attach, although it still required that a measurable impact on the insured's operations actually occur.[84] Other forms should be read carefully to determine whether *suspension* is a defined term.

B. *Period of Restoration*

Complementing the notion of a suspension of business is the temporal element of the period of restoration. Virtually all extra expense insuring agreements state that coverage will be extended for necessary expenses that the insured incurs during the "period of restoration." The period of restoration in the standard ISO form begins "[i]mmediately after the time of direct physical loss or damage" arising out of a covered cause of loss at the insured premises.[85] Generally, where there is no "period of restoration," there can be no coverage for extra expense. The court explained that point in the unusual case of *Winters v. State Farm Fire & Casualty Co*.[86] In *Winters*, the policyholder was an attorney whose client claimed personal injury resulting from the use of an electric handsaw.[87] The attorney kept the saw in his office, along with five other exemplar saws.[88] Prior to trial, a thief broke into the attorney's law office and stole the saws, which were never recovered. The attorney proceeded to trial without this evidence, and the trial ended in a verdict for the defense.[89] The attorney subsequently filed a theft claim with his property insurer. That attorney claimed that without the saws he lost his case, losing income and incurring extra expense.[90] Affirming the insurer's denial of coverage, the court reasoned that the attorney's law practice continued, uninterrupted, despite the loss of the saws. Finding no interruption and no period of restoration to measure, the court

84. *See* Int'l Risk Mgmt. Inst., Commercial Property Insurance, V.N.22 (2007).

85. *See* Chris Boggs, Business Income's 'Period of Restoration'! How to Estimate the Time Required (Jan. 29, 2009), www.mynewmarkets.com/article_view.php?id=97390.

86. 73 F.3d 224 (9th Cir. 1995).

87. *See id*. at 226.

88. *See id*.

89. *See id*.

90. The relevant provision in the policy provided thus: "This policy covers the following losses which result from suspension of 'operations' at the premises shown in the Declaration caused by direct physical loss of or damage to property resulting from a Peril Insured: 1. loss of 'business income' sustained by an insured during the 'period of restoration'; 2. any necessary 'extra expense' incurred to avoid or minimize the interruption of business and to continue 'operations': a. at the described premises; or b. temporarily at other locations including relocation expenses and costs to equip and operate the temporary locations; 3. any necessary 'extra expense' incurred to minimize the interruption of business if 'operations' cannot continue." *See id*. at 228.

determined that the attorney could not make out a claim for extra expense coverage.[91]

Courts rarely have trouble identifying when a period of restoration begins. Often, the period commences at the moment that the loss happens. For instance, a Pennsylvania court examining a long-running insurance coverage dispute arising out of a building fire had little trouble finding that the period of restoration commenced on the date of the fire in January 1996.[92] Similarly, a New York court considering an extra expense claim arising out of the September 11, 2001, destruction of the World Trade Center determined that the period of restoration began on that date.[93]

Determining when a period of restoration ends is another matter. The standard ISO form states that the period of restoration ends on the earlier of either the date when the insured's damaged property "should be repaired, rebuilt or replaced with reasonable speed and similar quality" or the date when "business is resumed at a new permanent location."[94] Note that actual repair of the premises is not necessary to terminate the period of restoration. Policies often provide two or three methods to measure the period: the time actually required to restore the property, the time in which the property should be repaired using due diligence and dispatch, or the time that it takes the insured to resume operations at an alternate facility. Policies usually provide that the period of restoration ends at the earliest date provided by any of the enumerated methods. Most policies state that the policy's expiration date does not operate to cut short the period of restoration.

The end date of the period of restoration generally cuts off the loss of income and extra expense claims. Therefore, even in cases where the insured's property can be restored, the parties may not agree when the period of restoration ends. In the New York case, the court found that the residential apartment building that had been damaged on September 11, 2001, was able to reopen and resume operations as of September 18, 2001.[95] The court specifically noted that the complex had "cleaned most of the debris

91. *See id*. The policy defined *period of restoration* as "the period of time that: a. begins with the date of direct physical loss or damage caused by or resulting from any Peril Insured at the premises shown in the Declarations; and b. ends on the date the damaged property could be repaired, rebuilt or replaced with reasonable speed and similar quality." *See id*. at 229.

92. *Cf*. F.P. Woll & Co. v. Valiant Ins. Co., 226 F. Supp. 2d 688, 690–92 (E.D. Pa. 2002). The policy defined *period of restoration* with substantially the same words as the policy in *Winters*.

93. *See* Broad Street, LLC v. Gulf Ins. Co., 832 N.Y.S.2d 1 (App. Div. 2006). Again, the policy defined *period of restoration* with substantially the same words as the policy in *Winters*.

94. *See* Boggs, *supra* note 85.

95. *See Broad Street*, 832 N.Y.S.2d at 2.

from the September 11 attacks, changed the building's air filters, reestablished all utilities and allowed tenants to return" by that date.[96] Despite these facts, the insured claimed a longer period of restoration. The court held that as of September 18, the insured was no longer suffering from a necessary suspension of its business; under the policy, no extra expense could be recovered for the period after September 18.[97]

Most policies require the insured to execute repairs with "reasonable speed" or "due diligence and dispatch." This is important in cases where the end date of the period of restoration is at issue. A court may find that the period of restoration ends before repairs are complete if the insured has delayed the work.

The U.S. Court of Appeals for the Fourth Circuit considered this requirement in *Millville Quarry v. Liberty Mutual Fire Insurance Co*.[98] A West Virginia quarry operator maintained a system of four water pumps to remove natural accumulations of water. The pumps were affixed to a permanent platform that had been built approximately twenty-five feet above the quarry floor.[99] The property insurance policy covered only the pumps and the platform, not the entire quarry.[100] In April 1997, the quarry flooded due to a breach in the surrounding limestone formations; the pumps could not cope with the water and were lost. In an attempt to preserve the quarry, the operator rented a number of additional pumps, including four that were identical to the previous ones. It then floated those four pumps on a barge on May 19, 1997, by which time the water had peaked at a level some eighty-five feet above the quarry floor.[101] The quarry operator later rented additional pumps, floated a second barge, and managed to stabilize the quarry so that mining operations could resume by late October 1997.[102] The operator then hired hydrologists, who discovered the changes in the limestone formations and undertook an extensive operation to grout the breaches, which finally cured the flooding problem.[103] The quarry operator subsequently filed a $9 million extra expense claim with Liberty Mutual.[104] Liberty Mutual advanced $450,000 to the quarry operator to pay for the cost of pumping activities, but it denied the balance of the claim.[105]

96. *See id*. at 7.
97. *See id*. at 1, 4, 7.
98. 31 F. App'x 116 (4th Cir. 2002).
99. *See id*. at 117.
100. *See id*. at 118.
101. *See id*. at 117.
102. *See id*. at 118.
103. *See id*.
104. *See id*. at 119.
105. *See id*. The policy contained an "additional expense" provision, which indemnified against the "actual and necessary 'additional expense' " that the insured incurred "due to 'loss,' caused by or resulting from" a covered cause of loss to covered property. It defined *additional*

Affirming the lower court's grant of summary judgment in favor of Liberty Mutual, the court reasoned that the period of restoration imposed a "temporal rather than substantive limitation on the" policy's extra expense coverage.[106] The court specifically noted that the period of restoration ended on May 19, 1997, when the quarry operator floated a barge containing pumps that were identical in number and pumping capacity to the four that had been destroyed by the flood.[107] Although the pumps were not operational on that date due to an electrical problem, the court cited policy language to the effect that the pumps should have been replaced with reasonable speed and similar quality by that May 1997 date; any delay in making the replacement pumps operational did not arise out of the flood or any damage to the lost pumps.[108] Costs incurred beyond May 19, 1997, including costs for additional pumping activities, the construction of the second barge, the hydrology investigations, and the limestone grouting work, were therefore not covered because they were incurred outside of the period of restoration.[109]

Sometimes the date on which the period of restoration ends cannot easily be discerned. Where claims for extra expense extend past the termination of a policy period or involve temporary facilities that become permanent, a judge may be reluctant to substitute his or her judgment for that of the jury. For example, in *F.P. Woll & Co. v. Valiant Insurance Co.*,[110] a fire damaged one of the insured's buildings in Philadelphia in January 1996. The insured sought to resume temporarily its business of manufacturing cushioning products by leasing another building elsewhere in the city. The lease included an option to purchase, contingent upon the level of environmental contamination found at the site. In due course, the insured purchased the property and constructed various additions to add both office and warehouse space.[111]

The insured tendered an extra expense claim that included legal and negotiation fees associated with the lease, the cost of environmental testing, and even architectural fees and construction costs for the new office space.[112] The insurer, Valiant, denied the claims, arguing that the costs

expense as "all expenses that exceed the 'normal' operating expenses" of the insured's "'operations' during the 'period of recovery.'" Finally, it defined *period of recovery* as the "period between the date of the direct physical loss" and the date on which the property "should be repaired, rebuilt or replaced with reasonable speed and similar quality." *See id*. at 118.

106. *See id*. at 121.

107. *See id*. at 121–22.

108. *See id*.

109. *See id*. at 122.

110. 226 F. Supp. 2d 688 (E.D. Pa. 2002).

111. *See id*. at 690.

112. In relevant part, the extra expense provision covered "necessary expenses that [the insured] incur[s] during the 'period of restoration' that [it] would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered

and fees were not within the scope of the policy's extra expense coverage. Valiant argued that these were building-replacement claim items incurred after the period of restoration ended.[113]

The policy's extra expense provision defined the period of restoration as beginning on the date of direct physical loss and ending "on the date when the property . . . should be repaired, rebuilt or replaced."[114] Valiant moved for summary judgment, arguing that the claimed extra expenses had been incurred outside the period of restoration. Denying Valiant's motion, the U.S. District Court for the Eastern District of Pennsylvania observed that there was considerable "uncertainty surrounding what precisely the 'period of restoration' would have been" for the insured and what expenses would be "necessary" within the meaning of the policy. It stated that the policy provisions could "at least conceivably" cover the expenses that the insured undertook in ensuring that it had suitable replacement facilities.[115] The court left the issues for jury determination.

Elsewhere, in *Zurich American Insurance Co. v. ABM Industries, Inc.*,[116] a janitorial company that held a contract to clean the World Trade Center submitted a claim to its carrier, Zurich American, in the aftermath of the September 11 attacks. Among the claimed extra expenses were (1) increased salary costs that resulted because the janitorial company was required to bump junior employees at other locations with more senior employees displaced from the World Trade Center, (2) increased unemployment insurance assessments levied by the State of New York after dozens of the company's workers filed for benefits, and (3) costs associated with the termination of engineers whose services were no longer necessary following the destruction of the buildings. The policy defined the period of restoration as the length of time that does not exceed what "would be required with the exercise of due diligence and dispatch to rebuild, repair, or replace the property that had been destroyed or damaged."[117]

Cause of Loss." It further defined *period of restoration* as "the period of time that: a. Begins with the date of direct physical loss or damage caused by or resulting from any Covered Cause of 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." *See id.* at 691.

113. *See id.* at 690–91.

114. *See id.* at 691.

115. *See id.* at 692.

116. No. 01 Civ. 11200(JSR), 2006 WL 1293360, at *3 (S.D.N.Y. May 11, 2006).

117. *See id.* at *2. The policy provided coverage for "extra expenses incurred resulting from loss, damage, or destruction as covered herein . . . to real or personal property as described in" the declarations. *See* Zurich Am. Ins. Co. v. ABM Indus., Inc., 397 F.3d 158, 162 (2d Cir. 2005) (ellipsis in original). *Extra expense* was defined as the "total cost chargeable to the operation of the insured's business over and above the total cost that would normally have been incurred to conduct the business had no loss or damage occurred." *Id.*

Following remand from the U.S. Court of Appeals for the Second Circuit,[118] the district court held, contrary to some other World Trade Center tenant decisions, that "restoration of the World Trade Center itself [was] necessary for ABM to resume its operations."[119] The district court refused to set a specific date for the end of the period of restoration, holding only that the "appropriate period of recovery [i.e., restoration] is the hypothetical length of time required to rebuild the W[orld] T[rade] C[enter]."[120] The result of the court's decision was to leave the period of restoration to be determined by a jury at trial. In so doing, the court potentially placed the policy's entire $50 million extra expense limit in issue.[121]

IV. EXTRA EXPENSES: NECESSARY AND INCURRED

As we have seen, covered extra expenses typically arise only when there is an interruption of business caused by a covered cause of loss. In this section, we look more closely at business expenses that may be related to a loss but not covered as extra expenses because they either were unnecessary or never incurred. We also address cases that discuss whether extra expense claims may be assignable, at least in part.

A. *Necessary*

Extra expenses are covered only to the extent that they are "necessary." The standard ISO form states that extra expenses are "*necessary* expenses you incur."[122] In the absence of further definition, a number of state and federal courts have been called upon to construe the word *necessary* in this context.

One of the leading cases is *Butwin Sportswear Co. v. St. Paul Fire & Marine Insurance Co*.[123] The insured, Butwin, hired a public adjuster to assist with its insurance claim. After the claim was settled, Butwin sued for the public adjuster's fee, claiming that it qualified as a covered extra expense.[124] The court

118. *ABM*, 397 F.3d at 158.

119. *See ABM*, 2006 WL 1293360, at *2 (internal quotations omitted).

120. *See id*. at *3.

121. *Cf. ABM*, 397 F.3d at 162 (stating policy limits). As stated, the district court's decision in *ABM* is contrary to a number of other cases arising out of the World Trade Center attack. *See, e.g.*, Duane Reade Inc. v. St. Paul Fire & Marine Ins. Co., 411 F.3d 384 (2d Cir. 2005) (period of restoration ends when insured may resume its operations in a permanent location elsewhere); *In re* Cosmetics Plus Group, Ltd., 379 B.R. 464, 471 n.7 (Bankr. S.D.N.Y. 2007) (World Trade Center site was not the subject of insured's policy, nor was it expressly provided for in the calculation of the period of restoration as might be expected had the parties intended to single out a store at that site in a policy that covered all of the insured's various locations).

122. *See* Boggs, *supra* note 2.

123. 534 N.W.2d 565 (Minn. Ct. App. 1995).

124. *See id*. at 566.

first observed that extra expenses are "necessary expenses that would not have been incurred had there been no physical loss or property damage."[125] Noting that the policy did not define *necessary*, the court gave the term its "plain and ordinary meaning."[126] It concluded that a necessary expense is one that is "essential."[127] So read, the court held that Butwin could not claim coverage for the adjuster's fee because his help was not essential: "St. Paul might well have paid all covered losses without [the adjuster's] involvement. Butwin engaged [the adjuster] primarily in anticipation of conflict and to assure itself a maximum recovery, not out of necessity."[128] The court refused to find that the public adjuster's fee qualified as an extra expense.

The *Butwin* court's reasoning is repeated in decisions that consider whether customer goodwill gestures after a loss are necessary within the meaning of extra expense coverage. In *Tower Automotive, Inc. v. American Protection Insurance Co.*,[129] for example, the court refused to characterize a debit issued by the insured in favor of Ford Motor Company as a necessary expense,[130] finding that the payment did not result from the failure of the insured's equipment. The case stemmed from a commercial transaction between Ford and its parts supplier, Tower Automotive. When Tower's presses failed, it was unable to deliver certain parts when Ford wanted them. Ford and Tower subsequently negotiated a $600,000 debit in favor of Ford as compensation. Tower then tendered a claim in that amount to its insurer American Protection, arguing that the payment was necessary to preserve the business relationship with Ford. American Protection denied the claim, and Tower sued. The court agreed with American Protection, writing that "[e]ven if agreeing to the debit was good business judgment, it was, nevertheless, a business decision. As such it was a [non-covered] voluntary payment."[131] Other cases have used the same reasoning to reach similar results.[132]

125. *See id*. at 567.
126. *See id*.
127. *See id*.
128. *See id*.
129. 266 F. Supp. 2d 664 (W.D. Mich. 2003).
130. The policy, in relevant part, defined *extra expense* as the "necessary Extra Expense incurred by the Insured in order to continue as nearly as practicable the Normal operation of the Insured's business following physical loss or damage to covered property by any of the perils covered herein during the term of this policy." It went on to state that extra expense "means the excess of the total cost during the period of restoration of the damaged property chargeable to the operation of the Insured's business over and above the total cost that would normally have been incurred to conduct the business during the same period had no loss or damage occurred." Extra expense coverage did not insure against loss of income. *See id*. at 669 n.2.
131. *See id*. at 671.
132. *See, e.g.*, St. Paul Fire & Marine Ins. Co. v. The Nolen Group, No. 02-8601(L), 2006 WL 2468680, at *3 (E.D. Pa. Aug. 21, 2006) (bonuses paid to employees who helped

What is necessary, however, depends on the facts of a given case. In *Seward Park Housing Corp. v. Greater New York Mutual Insurance Co*.,[133] the issue involved a parking garage in New York City. A portion of the garage's upper level had been covered over with turf to create a park for Seward Park's residents. In January 1999, the garage collapsed. The New York City Department of Buildings subsequently ordered that the garage be demolished. Seward Park spent four years rebuilding the parking garage, which finally reopened in October 2003. During reconstruction, Seward Park paid approximately $641,000 in interest on the amounts that it withdrew from a line of credit to finance the construction.[134] The court surprisingly held that the finance charge was a covered extra expense under the policy because it allowed Seward Park "to rebuild the garage and resume receiving rental income before the outcome of" the coverage litigation, which "indisputably reduced [Seward Park's] loss."[135] In other words, the expense was deemed necessary.

A close question was presented in *Bliss Day Spa v. Hartford Insurance Group*.[136] A day spa moved into temporary facilities two blocks from its premises following a fire. It then spent tens of thousands of dollars on an advertising campaign to inform its customers that it would be open at the temporary facility pending repairs to its main building.[137] The property insurer argued that the expense was excessive and unnecessary. Denying the

clean premises after tropical storm were goodwill payments and not covered extra expense); Thrift Mart, Inc. v. State Farm Fire & Cas. Co., 558 N.W.2d 531 (Neb. 1997) (no coverage under extra expense provision where a liquidation of product was used to facilitate a company's going out of business rather than expediting the resumption of business); Thompson v. Threshermen's Mut. Ins. Co., 493 N.W.2d 734 (Wis. 1992) (no extra expense coverage for insured's decision to construct a new building when landlord of damaged premises elected not to rebuild); Learfield Commc'ns v. Hartford, 837 S.W.2d 299, 302 (Mo. Ct. App. 1992) (insured purchased small satellite dish to prevent suspension of business operations, but court found no coverage because the "dish was never needed, was never used, and [the insured] did not appear to suffer any 'business income' losses from a suspension of operations due to the destruction of the large dish"); Travelers Indem. Co. v. Pollard Friendly Ford Co., 512 S.W.2d 375, 381 (Tex. App. 1974) (court characterized lengthy extra expense provision as covering "necessary emergency expenses" and, where insured had always planned to apply for a loan, court found no coverage for legal and accounting services in connection with obtaining the loan following tornado).

133. 836 N.Y.S.2d 99 (App. Div. 2007).

134. *See id*. at 101.

135. *See id*. at 103. The policy covered "any extra expense incurred," "provided that such an extra expense minimized the amount of loss" that would otherwise have been payable. *See id*.

136. 427 F. Supp. 2d 621 (W.D.N.C. 2006).

137. The policy provided, in pertinent part, that "[w]e will provide necessary Extra Expenses you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to the described premises. . . . Extra expenses means expenses incurred: (1) To avoid or minimize the suspension of business and to continue 'operations.'" *See id*. at 631, n.1.

carrier's motion for summary judgment, the court noted that the spa and its carrier disagreed as to whether the advertising expenses were necessary within the meaning of the policy; the court refused to make a finding.[138] Whether an expense is necessary, then, may be a question for the jury in close cases.

Another case involving a voluntary payment is *Chatham Corp. v. Dann Insurance*.[139] Chatham operated a service that sterilized medical equipment. An explosion in June 1997 shut down Chatham's facility for a period of seven months. During that time, Chatham could not sterilize equipment for one of its main customers, Maxxim Medical, Inc. Pursuant to its contract, Chatham was obligated to arrange for alternative sterilization of Maxxim's equipment and pay the cost of shipping Maxxim's unsterilized goods from Chatham's facility to the alternate facilities.[140] The contract did not require Chatham to pay for shipping the sterilized equipment back to Maxxim's customers, but Chatham subsequently tendered a claim that included those return shipping costs.

Chatham sought coverage for those return shipping costs under its policy's extra expense provisions.[141] Rejecting Chatham's claim, the Illinois court first looked to the meaning of the word *necessary* in the coverage grant. Although the word was not defined in the policy, the court noted that *necessary*

> is not ambiguous and has a plain, ordinary, and popular meaning of "being essential, indispensable, or requisite." This commonly-understood meaning encompasses expenses that the named and additional insured to the policy . . . were required to incur during the reconstruction of the sterilization facilities. It does not encompass expenses that the insureds may have wanted to incur on a gratuitous or voluntary basis, which would have been the opposite of "necessary."[142]

Whether an expense is necessary, then, may depend on a showing that the expense was contractually required or needed to continue the business or reduce a loss of business.

Courts look closely at the purpose of the expense as they attempt to ascertain whether it is, in fact, necessary. One court recently found that

138. *See* 427 F. Supp. 2d at 631.
139. 812 N.E.2d 483 (Ill. App. Ct. 2004).
140. *See id*. at 486.
141. *See id*. The policy defined *extra expense* as "necessary expenses you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to [covered] property." *See id*. (brackets in original). It did not define either *necessary* or *incur*. *See id*.
142. *See id*. at 488–89 (citations omitted).

a necessary temporary replacement expense is any that replaces the function of damaged property. In *R.D. Offutt Co. v. Lexington Insurance Co.*,[143] the insured owned a large tract of land in Oregon, which it leased to various farmers who promised to raise particular crops. The leases required Threemile Canyon Farms LLC to supply water for irrigation during the growing season, an obligation that Threemile met by constructing a pumping station to divert water from the Columbia River.[144]

In June 2002, the switchgear that directed electricity to the water pumps failed. It was quickly determined that it would take at least several weeks to replace the switchgear, so Offutt's management purchased a supply of diesel fuel and rented temporary generators to provide power to the water pumps.[145] Offutt's personnel testified at deposition that the company expended approximately $265,000 on the generators, fuel, and related labor and freight charges. They also testified that without the generators, the leaseholder's crops would have died, exposing Offutt to extensive liability claims.[146] When Offutt submitted its claim under its own policy's extra expense coverage,[147] Lexington refused to honor it because Offutt's costs were not necessary to repair or replace the damaged switchgear.[148]

The policy covered temporary replacement as an extra expense. The court's decision turned on its construction of the word *replacement*. Relying on definitions taken from the dictionary, the court held that the term embraced a functional replacement as well as an exact replacement; that is, as long as something replaced the function of the damaged property, it would qualify for coverage as if it were an exact replacement.[149] Looking to the extra expense clause, the court stated that the provision insured property in order to protect Threemile's business operations, namely, providing water to the tenants so that they could grow crops.[150] "Because the generators and fuel temporarily replaced the instrumental value of the switchgear, the cost of the generators and fuel" was found to be covered under the policy.[151]

143. 494 F.3d 668 (8th Cir. 2007).
144. *See id*. at 670.
145. *See id*.
146. *See id*.
147. The policy insured against "loss resulting from necessary interruption of business conducted by the insured, and caused by the loss, damage or destruction of covered property." It further insured Threemile against "extra expense incurred resulting from loss, damage, or destruction" to covered property. *See id*. at 674. The relevant extra expense (here, termed *expediting expense*) provision covered "the reasonable extra cost of temporary repair and/or replacement and/or expediting the repair and/or replacement of damaged property insured" under the policy. *See id*. at 670.
148. *See id*. at 672.
149. *See id*. at 673.
150. *See id*. at 674.
151. *See id*.

B. *Incurred Expense*

The standard ISO form goes on to state that it will provide coverage for a particular extra expense only if that expense is actually incurred. More precisely, the coverage is defined as a necessary expense that "you [the insured] incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage."[152] Note that, for purposes of extra expense coverage, when a particular expense is incurred is often just as important as the fact that it is incurred at all. In most cases, the grant of coverage expressly states that extra expense is limited to those costs actually incurred by the insured itself during a period of restoration.

Because most policies do not define the term *incur*, the courts have been called upon to construe the word. One of the more detailed discussions of the issue is found in *Chatham*.[153] There, the Illinois court held that there was no coverage for the costs of shipping products from an insured's alternate facilities to the insured's customers, reasoning that the insured, Chatham, had not itself incurred those expenses:[154]

> [The term *necessary*] also does not encompass expenses that other, nonparties to the contract were required to incur during the facility reconstruction period. The only party required to pay for the cost of shipping sterilized products away from the alternate sterilization facilities was [the customer] itself, not Chatham. . . . In addition, Chatham has failed to address the unambiguous requirement that Chatham . . . actually "incur" the expenses Chatham now seeks to "recover." "Incur" is another term that was not defined in the contract, but it has a plain, ordinary, and popular meaning of "to become liable or subject to through one's own action; [to] bring or take upon oneself." Chatham never became liable or subject to the expense of [the customer]'s outbound freight. [The customer] did.[155]

The court went on to provide useful commentary on the permissibility of claiming expenses incurred by a third party:

> [W]e cannot read a provision into Chatham's insurance contract with Zurich that requires Zurich to pay expenses incurred by a third party. We cannot conclude from the language of the contract that at the time of contracting Chatham intended to obtain coverage for third parties that it did business with, or to undertake the expense for their coverage, or that Zurich intended to undertake the risk of extending coverage to unknown third parties. Even though [the customer]'s outbound freight expenses were a consequence of the

152. *See* Boggs, *supra* note 2.
153. 812 N.E.2d 483 (Ill. App. Ct. 2004).
154. *See id*. at 489.
155. *See id*. (one bracket in original; internal citation omitted).

> explosion at the Virginia sterilization facilities, they were not covered by the insurance contract at issue.[156]

Chatham's claim for the return shipment expense failed to meet the policy's requirement that the expenses necessarily be incurred by the insured, not by a third party that is not an insured.[157]

C. *Effect of Assignment*

When a policyholder sells its business during the period of restoration, questions may arise as to whether the new entity may claim extra expense coverage under a claim assignment from the policyholder. Courts have sometimes held that only the policyholder has an interest in the coverage,[158] but the rule is not absolute.

Consider the case of *Bronx Entertainment, LLC v. St. Paul's Mercury Insurance Co*.[159] The case arose out of a bankruptcy filing by Bronx Family Golf Centers (Family Golf). Prior to seeking the bankruptcy court's protection, Family Golf operated a driving range, a miniature golf course, and a number of batting cages. It also owned a first-party policy with extra expense coverage.[160] In March 2001, with the permission of the bankruptcy court, Family Golf sold its entire business operation to an unrelated business entity, Bronx Entertainment.[161]

> Just prior to the sale, on March 4, 2001, severe weather damaged the netting around the driving range, tearing it from its support poles. Family Golf promptly submitted a claim to St. Paul Mercury for the cost of repairing the netting and for the anticipated damages that would result from its inability to operate the driving range.[162] On March 19, 2001, in contemplation of the actual transfer of the property, Family Golf executed an assignment of its insurance claim to Bronx Entertainment.[163] St. Paul Mercury later denied the claim on grounds that the netting was damaged due to faulty design of the netting system coupled with normal wear and tear. The lawsuit followed; and, after discovery, St. Paul Mercury moved for summary judgment.[164]

156. *Id*.
157. *Id*.
158. *See*, *e.g*., Mafcote, Inc. v. Cont'l Cas. Ins. Co., 144 F. App'x 449, 450 (6th Cir. 2005).
159. 265 F. Supp. 2d 359 (S.D.N.Y. 2003).
160. *See id*. at 359–60. The policy provided that the insurer would pay Family Golf's "actual loss of earnings as well as extra expenses that result from the necessary suspension of your operations during the period of restoration caused by direct physical loss or damage to property at an insured location." *See id*. at 361.
161. *See id*. at 359.
162. *See id*. at 360.
163. *See id*.
164. *See id*.

St. Paul Mercury contended that Bronx Entertainment was a stranger to the policy that St. Paul Mercury had issued to Family Golf and, therefore, that Bronx Entertainment had no enforceable rights under the policy, except to the extent of its assignment.[165] St. Paul Mercury moved to dismiss Bronx Entertainment's claim to the extent that it sought to recover for damages to its own business operations following the transfer of ownership.[166]

The court held that Bronx Entertainment could not recover any extra expense benefits under the policy in its own right. Granting summary judgment in favor of the carrier, the court stated:

> Family Golf assigned this claim to plaintiff [Bronx Entertainment] in connection with the sale of the Golf Center. Thus plaintiff became an assignee of the insurance claim, taking the claim subject to whatever limitations it had in the hands of Family Golf, the assignor. . . . After about March 21, 2001, when Family Golf sold the Golf Center to the plaintiff, it no longer experienced business losses as a result of the wind damage. Pursuant to the Policy therefore, Family Golf could only maintain a claim for those business losses sustained before its sale of the Golf Center to plaintiff. Plaintiff as an assignee of the insurance claim, "standing in the shoes" of Family Golf can exercise only the rights it inherited from the assignor. Consequently, plaintiff can maintain a claim for only the business losses Family Golf sustained and cannot assert a claim for its own losses.[167]

The court barred plaintiff from pursuing a claim for damages beyond March 21, 2001, the date when Family Golf ceased to have an insurable interest in the property.[168] The assignment, however, was deemed valid (although it must be added that St. Paul Mercury did not challenge the assignment itself).

Even where the policyholder is the entity making an extra expense claim, it is not always clear that the policyholder "owns" the extra expense loss. Consider the matter of *Olde Colonial Village v. Millers Mutual Insurance*.[169] The Delaware Superior Court rejected an extra expense claim from a condominium management company, which had organized an evacuation of residents from its complex following its condemnation and paid for their

165. *See id*. at 361.

166. *See id*.

167. *See id*. at 361–62 (internal citations and quotations omitted).

168. Assignment cases involving other coverage provisions and varying types of business sales demonstrate that courts are divided over the effect of a sale of the business after a loss has occurred. *Compare, e.g.*, SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props., 375 F. Supp. 2d 238 (S.D.N.Y. 2005), *and* BA Props., Inc. v. Aetna Cas. & Sur. Co., 273 F. Supp. 2d 673 (D.V.I. 2003) (both allowing recovery after assignment), *with* Globecon Group v. Hartford Fire Ins. Co., 434 F.3d 165 (2d Cir. 2006), *and* Holt v. Fid. Phoenix Fire Ins. Co., 76 N.Y.S.2d 398 (App. Div. 1948) (denying recovery after assignment).

169. No. CIV.A.99C-06-187-FSS, 2002 WL 1038825 (Del. Super. May 17, 2002).

moving costs.[170] The court found that there was no coverage because the management agency was only in the "business" of governing the condominium association:

> Its operations presumably include adopting by-laws, enforcing rules, keeping books, providing ordinary maintenance to the building and grounds, hiring and supervising necessary help, and so on. If the Council rented a temporary office after the condemnation, the damage award should include reasonable reimbursement for that expense. But the unit owners cannot look to the Council's business insurance to cover their personal moving expenses.[171]

As in *Bronx Entertainment*, third parties who were strangers to the Millers Mutual policy, i.e., the condominium residents, were ineligible for coverage; and the condominium management company could not claim coverage because the expenses were not necessary to or incurred in the course of its business.[172]

V. CONCLUSION

Extra expense coverage is defined and limited by its terms and conditions. The intent of extra expense clauses is to provide coverage for those necessary additional expenses that a commercial insured incurs to operate its business during the period of restoration following direct physical loss. Insurance carriers, policyholders, and counsel alike must take care to analyze their own extra expense clauses carefully to learn what a particular policy covers and what it does not. Most questions about whether coverage applies can be answered in the first instance by a careful comparison of the claim against the terms of the policy.

170. The policy provided thus: "(1) We will pay necessary Extra Expense you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to property at the described premises, including personal property in the open (or in a vehicle) within 100 feet, caused by or resulting from a Covered Cause of Loss." *See id*. at *1, n. 3.

171. *See id*. at *1.

172. *See id*.