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INSURANCE COVERAGE FOR DROUGHTS, DUE TO CLIMATE CHANGE: THE CASE FOR “LOSS OF BUSINESS INCOME” AND “LOSS OF USE”

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I. Introduction

This article addresses the issue of insurance coverage for commercial enterprises as a consequence of the recent spate of droughts in the southwestern United States.² This almost two-decade long drought results from increasing temperatures and climate change. The article posits that damage or injury to property and lost profits caused by this wave of droughts may be covered by insurance policies. It focuses on businesses—including tourist attractions such as hotels, motels, boat rental facilities, and others—that are so critical to the economies of the southwestern states. I posit that when these commercial enterprises are, or will be, affected by droughts they may be able to recover their lost income and profits via two supplementary provisions or riders³ to their routinely contracted for Commercial General Liability (“CGL”)⁴ policies. The “Loss of Business Income” rider and the “Loss of Use” rider have covered losses under other circumstances, including hurricanes, but never for drought affected harms. This article is the first to explore the use of these riders in the context of droughts. However, such coverage has not been afforded to suspended business operations that lost income due to droughts. The article also analyzes the development of insurance coverage for the riders. Throughout the article I offer hypotheticals that demonstrate how courts and claims people may interpret the riders.

² Hannah Osborne, *Decades Without Rain: America Set for ‘Megadroughts’ Not Seen Since Medieval Times*, NEWSWEEK (July 24, 2019), <https://www.newsweek.com/megadrought-america-southwest-climate-change-1450864> (“America’s Southwest may soon be hit “megadroughts” that last for decades—the likes of which have not been seen since the Medieval period, scientists have said.”).

³ Riders are insurance policy provisions that add benefits to or amend the terms of a basic insurance policy. *See generally Glossary of Insurance Terms*, NAT’L ASS’N OF INS. COMMISSIONERS, https://www.naic.org/consumer_glossary.htm#R (last visited Jan. 12, 2020).

⁴ “A Commercial General Liability (CGL) policy protects your business from financial loss should you be liable for property damage or personal and advertising injury caused by your services, business operations or your employees. It covers non-professional negligent acts. Understanding this coverage is an important first step in managing CGL risks.” *Commercial General Liability Insurance*, INS. INFO. INST., <https://www.iii.org/article/commercial-general-liability-insurance> (last visited Jan. 12, 2020).

The article proceeds as follows: Part I introduces the framework for the article. Part II provides a brief historical description of the Southwest’s drought epidemic and defines what a drought is. Part III is a primer on the liability insurance coverage, which incorporates the two riders. Part IV discusses the impacts of Hurricane Katrina on the legal field concerning loss of business income and loss of use coverage. Finally, the article concludes with another hypothetical, and introduces a new product developed by the insurance industry that addresses business income. It closes with a discussion regarding the future of climate change and droughts.

A. A Severe Drought Occurs

Clearly drought and heat, just like snow, wind, or rain, are not insurable risks, as they are generally classified as Acts of God or a *Force Majeure*.⁵ Such a view, however, is a narrow interpretation of what is and is not insurable because weather drives commerce. Just as in flooding situations,⁶ some of the consequences that occur or result from droughts and excessive heat may be covered by commercial insurance. Weather is also a factor in insurance companies’ underwriting of policies for numerous types of businesses.⁷ Moreover, in the wake of climate change⁸ and the upsurge in episodic droughts,⁹

⁵ A “Force majeure,” or the Latin expression ‘vis major,’ is not necessarily limited to the equivalent of an act of God. The test is whether under the particular circumstances there was such an insuperable interference occurring without the party’s intervention as could not have been prevented by the exercise of prudence, diligence, and care.” *Pac. Vegetable Oil Corp. v. C. S. T., Ltd.*, 174 P.2d 441 (Cal. 1946). “The doctrine of supervening impossibility—or supervening force majeure, since for this as for many purposes impossibility and force majeure are treated alike . . .” *Comm. Edison v. Allied-General Nuclear Serv.*, 731 F. Supp. 850, 860 (N.D. Ill. 1990).

⁶ On insurance coverage for harm caused by flooding, *see generally* *Kane v. Royal Ins. Co. of Am.*, 768 P.2d 678 (Colo. 1989); *Safeco Ins. Co. of Am. v. Guyton*, 692 F.2d 551 (9th Cir. 1982).

⁷ *See, e.g.*, *Paul v. Virginia*, 75 U.S. 168, 183 (1869) (“[P]olicies are simple contracts of indemnity against loss . . . entered into between the corporations and the assured, for a consideration paid by the latter.”).

⁸ As used here, climate change is defined as follows:

Climate change in IPCC (Intergovernmental Panel on Climate Change) usage refers to a change in the state of the climate that can be identified (*e.g.* using statistical tests) by changes in the mean and/or the variability of its properties, and that persists for an extended period, typically decades or longer. It refers to any change in climate over time, whether due to natural variability or as a result of human activity.

A layman’s definition of climate change is as follows:

Climate change is the long-term alteration of temperature and normal weather patterns in a place. This could refer to a particular location or the planet as a whole. Climate change is currently occurring throughout the world as a result of global warming. Global warming is an increase in the planet’s overall temperature due to the burning of fossil fuels such as natural gas, oil, and coal. Burning these materials releases certain gases into Earth’s atmosphere. These

insurance carriers will seek to lower their financial exposure/payout as a consequence of swings in the weather cycle. They will also seek to limit their underwriting of policies in certain regions, for example drought, flood and hurricane prone areas. This will be particularly true for insurers who have big payouts for losses from hurricanes and other weather phenomenon.¹⁰

The CGL policy, like all insuring agreements, is either bare-bones or may contain greater coverage depending on the amount of premium that the insured—also called a risk by insurers—is willing to pay. The Business Income Interruption (“BI”) or Loss of Business Income (“LBI”) and Loss of Use (“LOU”)¹¹ policy provisions are additions or riders to the CGL policy and consequently the insured is required to pay more for these coverages. These riders are typically purchased as coverage that is above and beyond the general CGL policy. They are frequently triggered when a business cannot generate income, generally through some type

gases trap the heat from the Sun’s rays inside the atmosphere, causing Earth’s average temperature to rise.

The warming of the planet impacts local and regional climates. Climate is different from weather because it is measured over a long period of time, whereas weather can vary daily or yearly.

Climate Change, NAT’L GEOGRAPHIC, <https://www.nationalgeographic.org/encyclopedia/climate-change> (last visited Jan. 13, 2020).

⁹ *Climate Adaptation Science Centers, Ecological Drought Across the Country*, U.S. GEOLOGICAL SURVEY, https://www.usgs.gov/land-resources/climate-adaptation-science-centers/ecological-drought-across-country?qt-science_support_page_related_con=2#qt-science_support_page_related_con (last visited Jan. 13, 2020).

Droughts of the future will be hotter, longer lasting and larger than droughts of the past. Drought can lead to increases in wildfire and insect outbreaks, local species extinctions, forest diebacks, and altered rates of carbon, nutrient, and water cycling – all of which can have real consequences for ecosystems and human communities alike . . . Historically, drought has been viewed in terms of its agricultural, hydrological, and socioeconomic impacts. How drought affects ecosystems—and the services they provide human communities—is often not discussed. In response, the National Climate Adaptation Science Center (NCASC) is leading a national-scale initiative that’s addressing this gap in drought research. A new concept—*ecological drought*—was needed to capture this emphasis on how drought impacts ecosystems . . . **Ecological drought is:** *An episodic deficit in water availability that drives ecosystems beyond thresholds of vulnerability, impacts ecosystem services, and triggers feedbacks in natural and/or human systems.*

Id. (Emphasis added).

¹⁰ See Amy O’Conner, *Agribusiness Segment Stable, Yet Selective*, MY NEW MARKETS (Feb. 19, 2014), <http://www.mynewmarkets.com/articles/182039/agribusiness-segment-stable-yet-selective> (statement of Jim Henry, chief underwriting officer for MiniCo in Denver).

¹¹ Julia Kagan, *Business Interruption Insurance: What Is Business Interruption Insurance?* INVESTOPEDIA (Oct. 19, 2019), <https://www.investopedia.com/terms/b/business-interruption-insurance.asp>.

Business interruption insurance is insurance coverage that replaces business income lost in a disaster. The event could be, for example, a fire or a natural disaster. Business interruption insurance is not sold as a separate policy but is either added to a property/casualty policy or included in a comprehensive package policy as an add-on or rider.

Id.

of calamity, or because it is unable to use its premises due to some form of loss, for example following a fire or other disaster.¹² In the drought context, a business may lose income or profits under the following facts: Assume that a severe drought occurs and a boat rental facility that sits on Lake Powell or San Carlos Lake in Arizona is confronted with a shrinking water body due to a severe drought. Should the owners file a claim for LOU or BI, and if so when should they file it? Should they file a claim when the lake recedes 20% and there is a slight decrease in the number of rental customers? Alternatively, should they file it when the lake dries up completely and no customers at all show up to rent boats? A real-life example of the foregoing is Lake Mead in 2015.¹³ Before we wade into that subject, some history and a definition is in order.

II. The Southwest’s 19-Year Drought¹⁴

Human activity has already resulted in a 1.44° F warming above temperatures from pre-industrial periods.¹⁵ Moreover, a mounting body of

¹² The disaster, *e.g.*, a fire; a building collapse; someone driving a car into a store; or the rebuilding process following a disaster that is associated with the business’ closing. *See, e.g., Marsh Insights Property: Superstorm Sandy Causes Disruption and Damage Along US Eastern Seaboard*, MARSH (Fall 2012), file:///C:/Users/ulair/Downloads/Marsh-Insights-Property-Fall-2012.pdf.

¹³ *See generally* Sarah Tory, *Lake Mead watch: As the Colorado dries up, will tourism?*, HIGH COUNTRY NEWS (July 1, 2015), <https://www.hcn.org/articles/lake-meads-decline-could-tourism-soon-follow>; *see also* Kirk Siegler, *As Lake Mead Levels Drop, The West Braces For Bigger Drought Impact*, NPR (Apr. 17, 2015), <https://www.npr.org/2015/04/17/400377057/as-lake-mead-levels-drop-the-west-braces-for-bigger-drought-impact>.

“There are a lot of people, entities and critters that rely on this Colorado River water,” says Rose Davis, spokeswoman for the U.S. Bureau of Reclamation. Farther down the mountain, on a walkway next to the Hoover Dam, Davis points out the 10-story-high towers that used to be mostly underwater. The lake’s levels are nearing a critical trigger where the Bureau of Reclamation will start rationing water deliveries to Nevada, Arizona and parts of California. Agriculture would bear most of the biggest impacts first—an economic problem that’s not lost on Davis. “The southern part of California and the southern part of Arizona are the vegetable breadbasket of this country,” she says. “If you eat a salad for dinner tonight, chances are that salad came from California or the Yuma, Ariz., area.”

Id.

¹⁴ Ivany Villalobos, *Arizona’s 19-year Drought and Climate Change*, KYMA (Feb. 26, 2019), <https://www.kyma.com/news/arizona-s-19-year-drought-and-climate-change/1038225422>.

The desert southwest is known for its hot triple-digit summers, which may be tough to live through. . . . Between 2006 to 2016, about 1,193 people died from excessive heat in Arizona, this is according to the Arizona Department of Health Services. Arizona is also experiencing a 19-year drought that isn’t improving. Unlike wildfires and monsoon season, the drought may not be immediately visible.

Id.

scientific evidence indicates that the level of warming may well significantly increase droughts around the world, including in North America. Indeed, 2016 was the hottest year since 1880, eclipsing 2015, which previously held that title.¹⁶ “September 2015 was the second hottest September since 1885,¹⁷ and the global temperature in March [2016] . . . shattered a century-long record and by the greatest margin yet seen for any month.”¹⁸

Weather scientists recognize that the current reason for the record-breaking heat is a resilient *El Niño* weather pattern which is situated over the Pacific Ocean. This phenomenon causes the ocean to release massive volumes of heat into the atmosphere.¹⁹ Scientists have compared the 2015 *El Niño*²⁰ to the

¹⁵ There is compelling evidence that the earth has gotten warmer. Analysis by scientists at “NASA’s Goddard Institute for Space Studies (GISS) indicates an increase of average temperatures of 0.8 degree Celsius (1.4 degrees Fahrenheit) since 1880, with two-thirds of this warming occurring since 1975. Moreover, the ten warmest years since 1880 have occurred since 2005.” James Stock, *Global Temperature and Human Activity*, ECONOFACT (Apr. 20, 2019), <https://econofact.org/global-temperature-and-human-activity>. “Global warming caused by human emissions has most likely intensified the drought in California by 15 to 20 percent, scientists said on Thursday, warning that future dry spells in the state are almost certain to be worse than this one as the world continues to heat up.” Justin Gillis, *California Drought Is Made Worse by Global Warming*, *Scientists Say*, N.Y. TIMES (Aug. 20, 2015), <https://www.nytimes.com/2015/08/21/science/climate-change-intensifies-california-drought-scientists-say.html>.

¹⁶ *2018 was the 4th Hottest Year on Record for the Globe: The U.S. Experienced 14 Billion-Dollar Weather and Climate Disasters*, NAT’L OCEANIC & ATMOSPHERIC ADMIN. (Feb. 6, 2019), <https://www.noaa.gov/news/2018-was-4th-hottest-year-on-record-for-globe>.

¹⁷ *Id.*

¹⁸ Damian Carrington, *March Temperature Smashes 100-Year Global Record*, THE GUARDIAN, (Apr. 15, 2016), <http://www.theguardian.com/environment/2016/apr/15/march-temperature-smashes-100-year-global-record> (“Compared with the 20th-century average, March was 1.07C hotter across the globe, according to the JMA figures, while February was 1.04C higher.”).

¹⁹ The heat is caused by the transference of thermal energy from the Pacific to the atmosphere:

Thermal energy can be transferred (*sic*) to other objects causing them to heat up. When you heat up a pan of water, the heat from the stove causes the molecules in the pan to vibrate faster causing the pan to heat up. The heat from the pan causes water molecules to move faster and heat up. So, when you heat something up, you are just making its molecules move faster.

What is Heat, INFRARED PROCESSING & ANALYSIS CTR., CAL. INST. OF TECH., <http://coolcosmos.ipac.caltech.edu/cosmicclassroom/lightlessons/thermal/heat.html>

[<https://perma.cc/4ULF-7NVU>]. “[M]easurements in several of the world’s ocean basins”, including the Arctic, Atlantic and Indian, have found that average surface temperatures have increased by over three degrees Fahrenheit above those in the 20th century. This increase is a considerable upsurge when computed over such extensive areas. Justin Gillis, *2015 Likely to Be Hottest Year Ever Recorded*, N.Y. TIMES, (Oct. 21, 2015), <https://www.nytimes.com/2015/10/22/science/2015-likely-to-be-hottest-year-ever-recorded.html>.

²⁰ Jordan Evans, *El Niño Predicted to Linger Through Summer, But What Does That Mean for Arizona?*, CRONKITE NEWS (Apr. 14, 2019), <https://cronkitenews.azpbs.org/2019/04/04/el-nino-prediction>.

El Niños, which occur every two to seven years, begin in the fall, peak that winter and normally dissipate by spring, the National Oceanic and Atmospheric Administration says. The name in Spanish means “the boy,” a reference to the infant Jesus. The opposite phenomenon is La Niña: when surface temperatures in the equatorial Pacific are cooler than normal. El Niño years typically result in a wetter than average winter for Arizona. The conditions usually deteriorate in

two recent ones, in 1997 and 1998, and have noted that this record-setting heat “would not be occurring without an underlying trend caused by human emissions of greenhouse gases.”²¹ “The bottom line is that the world is warming.”²² One thing is certain: high temperatures brings drought, and drought brings misery.²³

The combined effects of *El Niño* and greenhouse warming are already roiling weather patterns worldwide, probably contributing to dry weather and forest fires in Indonesia, to an incipient drought in Australia, and to a developing food emergency across parts of Africa, including a severe drought in Ethiopia. Those effects are likely to intensify in coming months as the *El Niño* reaches its peak and then gradually subsides.²⁴

On the flip side, on January 22–23, 2016, snowstorms that crippled the northeastern United States have also been blamed on the *El Niño*.²⁵ Loss of Use (“LOU”) and Business Interruption (“BI”) claims arising from this storm will likely be made by businesses—such as retailers and restaurateurs—in the near future.²⁶

the early spring, but in March, the Climate Prediction Center of the NOAA released an update on the current advisory.

John Schwartz, *El Niño May Bring Record Heat, and Rain for California*, N.Y. TIMES (Aug. 13, 2015), <https://www.nytimes.com/2015/08/14/science/signs-of-a-historic-el-nino-but-forecasters-remain-wary.html?action=click&module=RelatedCoverage&pgtype=Article®ion=Footer>. (“This year’s El Niño weather pattern could be the most powerful on record, federal forecasters said, while warning that the effects of the weather system are never certain.”).

²¹ *2015 Likely to Be Hottest Year Ever Recorded*, *supra* note 19.

²² *Id.*

²³ See, e.g., *Drought Deepens Haitian Misery*, PHOENIX REVOLUTION (Mar. 3, 2016), <http://www.phoenixrevolutioninc.com/news-1/2016/3/3/drought-deepens-haitian-misery> [<https://perma.cc/6U3Y-9R2W>]; Mark Koba, *Unsafe Drinking Water Adds to California's Drought Misery*, NBC NEWS (Oct. 24, 2014), <http://www.nbcnews.com/business/economy/unsafe-drinking-water-adds-californias-drought-misery-n233201> [<https://perma.cc/A9P9-8TMQ>].

²⁴ See *2015 Likely to Be Hottest Year Ever Recorded*, *supra* note 19.

²⁵ See Angela Fritz, *We Hereby Name This Winter Storm ‘Snowzilla’*, WASH. POST (Jan. 22, 2016), <https://www.washingtonpost.com/news/capital-weather-gang/wp/2016/01/21/poll-name-this-winter-storm/> [<https://perma.cc/9B9C-SKD6>] (“Snowzilla makes so much sense to us because of its perfect nod to this “Godzilla” *El Nino*. And quite frankly, this could be a Godzilla-sized winter storm.” (emphasis added)).

²⁶ See, e.g., Jessica Gresko & Seth Borenstein, *Storm Slams into Eastern US with Wet Snow, Strong Gales (Update)*, ASSOC. PRESS (Jan. 26, 2016), <https://apnews.com/968261698733469988b55782806dc3f2> (“The storm could easily cause more than \$1 billion in damage, weather service director Louis Uccellini said Thousands of track workers, power company employees, road crew members, firefighters, police, National Guardsmen and others mobilized to help out over the long weekend.”).

A. What is Drought?

Conceptually, drought is defined “as a protracted period of deficient precipitation resulting in extensive damage to crops, resulting in loss of yield.”²⁷ Droughts have also been characterized as “*an insidious hazard of nature.*”²⁸ Generally, droughts originate from a lack of precipitation over a protracted interval of time²⁹—frequently a season or beyond—causing water scarcity.³⁰ They are often referred to as a “creeping phenomenon,” and their impacts vary from region to region.³¹

Droughts can be challenging for people to comprehend; they are also equally difficult to define.³² What might be deemed a drought in a country such as Bali—six days without rain—would not be considered a drought in Libya, which has an annual rainfall of less than 7.4 inches.³³ In the United States, California, for instance, has been plagued by an expanding drought:³⁴

[As a matter of fact, o]ver the past three years (and indeed, for 10 of the past 14 years) California has experienced a particularly deep drought. How bad is the drought? . . . The current California drought is bad because for the first time ever, scientists from many

²⁷ *Drought Basics: What is Drought?*, NAT’L DROUGHT MITIGATION CTR. (Mar. 30, 2016), <http://drought.unl.edu/DroughtBasics/WhatisDrought.aspx> [<https://perma.cc/2D4Q-TR9Y>].

Conceptual definitions may also be important in establishing drought policy. For example, Australian drought policy incorporates an understanding of normal climate variability into its definition of drought. The country provides financial assistance to farmers only under “exceptional drought circumstances,” when drought conditions are beyond those that could be considered part of normal risk management. Declarations of exceptional drought are based on science-driven assessments. Previously, when drought was less well defined from a policy standpoint and less well understood by farmers, some farmers in the semiarid Australian climate claimed drought assistance every few years.

Id.

²⁸ *Id.* (emphasis added).

²⁹ *Arizona Drought*, ARIZ. STATE CLIMATE OFFICE, <https://azclimate.asu.edu/drought> (last visited Jan. 13, 2020).

Arizona is currently in our 21st year of a long-term drought. Drought in the West is a long-term concept where a single dry year does not constitute a drought. Since Arizona has an arid and semi-arid climate, extreme variability in precipitation is normal, and drought is characterized by a string of drier than normal years, often interrupted by a few wetter than normal years.

Id.

³⁰ NAT’L DROUGHT MITIGATION CTR., *supra* note 27.

³¹ *Id.*

³² *Id.*

³³ *Id.* The average number of days with rainfall between December and March is 20, with 27 in January alone and rainfall in that month amounting to 14 inches (34.5 centimeters). *Weather on Bali*, BALIGUIDE, <http://www.baliguide.com/bali-info/weather.html> [<https://perma.cc/S7L8-ES8N>] (last visited Jan. 13, 2020).

³⁴ Amel Ahmed, *Study: Climate Change Threatens Major Crops in California*, UNIV. OF CALIF., MERCED, SIERRA NEVADA RESEARCH INST. (Feb. 27, 2018), <https://snri.ucmerced.edu/news/2018/study-climate-change-threatens-major-crops-california>.

different fields see parallel lines of evidence for the influence of human-induced climate changes, including the fingerprints of higher temperatures and changes in the atmospheric circulation patterns.³⁵ *In short, climate change has made the current drought worse.*³⁶

B. Cost for Damages: Insurance and Insurability in Drought Situations

As noted at the outset, neither drought nor heat are generally insurable risks. Other than a loss to farmers from agriculture, lost profits from the suspension of one’s operations or works provides little effective insurance coverage for other drought-related losses.³⁷ For instance, crop insurance is governmentally subsidized.³⁸ It is a “safety net for farmers that saves them from getting wiped out by floods or drought.”³⁹ When policyholders take out low levels of insurance coverage, naturally, they must personally cover the excess damage amounts above and beyond the policy limits. This is especially true for farmers,⁴⁰ who either decide to gamble, or play the odds that a drought will not occur, or who are unable to afford to purchase greater coverage.

³⁵ Peter Gleick, *The Growing Influence of Climate Change on the California Drought*, PAC. INST. (Mar. 24, 2015), <http://www.californiadrought.org/the-growing-influence-of-climate-change-on-the-california-drought/> [<https://perma.cc/5VMQ-MJMC>] (emphasis added).

³⁶ *Id.*

³⁷ See *supra* notes 4-5 and accompanying text.

³⁸ See generally Sarah Tory, *Shepherders Get a Pay Raise*, HIGH COUNTRY NEWS (Feb. 22, 2016), <https://www.hcn.org/issues/48.3/far-from-home-the-wests-foregin-shepherders-get-a-pay-raise> [<https://perma.cc/JX7P-6F28>] (“[T]he sheep industry is one of the few agricultural sectors that does not receive subsidies through the Farm Bill.”).

³⁹ Dan Charles, *Who Paid for Last Summer’s Drought? You Did*, NPR (May 1, 2013), <http://www.npr.org/sections/thesalt/2013/05/01/180309788/who-paid-for-last-summers-drought-you-did> [<https://perma.cc/H2V9-SUVQ>].

But consider this: According to a new analysis, crop insurance allowed corn and soybean farmers not only to survive last year’s epic drought, but it also allowed them to make bigger profits than they would have in a normal year. A big chunk of those profits were provided through taxpayer subsidies. In fact, crop insurance has grown into the largest subsidy that the government provides to America’s farmers.

Id.

⁴⁰ *Here’s What the California Drought Means for Insurance Professionals*, INS. BUS. (May 6, 2015), <http://www.ibamag.com/news/heres-what-the-california-drought-means-for-insurance-professionals-22411.aspx> [<https://perma.cc/2TPS-9PPL>] [hereinafter *California Drought*] (citing David Graves, manager for the American Association of Crop Insurers); See also Michael Hirtzer, *Incessant Rain Puts U.S. Farmers on Insurance-Deadline Watch*, BLOOMBERG (May 24, 2019), <https://www.bloomberg.com/news/articles/2019-05-24/unrelenting-rain-puts-u-s-farmers-on-insurance-deadline-watch> (“The Senate also passed a \$19.1 billion natural disaster relief package that includes \$3 billion related to the loss of crops in recent hurricanes, flooding and for seeds prevented from planting this year . . . Farmers unable to plant have been estimating which government-backed program might pay the most.”).

Indeed, a large number of California's farmers only purchase a catastrophic level of coverage insurance ("CAT policies") when they do purchase insurance.⁴¹ Even if a farmer purchases a CAT policy, she must essentially lose her entire crop to qualify for a CAT insurance payout, "and it only pays for a very minimal percentage of your loss. It could be as small as 25%."⁴² Why then would one purchase a CAT policy? Because they are generally less expensive than other policies available to farmers. This is particularly true for farmers who grow thousands of acres of high value crops, such as citrus or grapes, which require higher premiums to cover the large yields.⁴³ However, CAT policies may not remain popular due to their lack of coverage.⁴⁴

Having laid the groundwork for the remaining portions of the article, I will initially present a brief background on the liability insurance policy. Then, I will address the LOU and BI insurance policy provisions. These will be followed by recent case law and lessons learned from Hurricane Katrina and how these have further developed the LOU and BI body of law. Next, I will examine insurance and insurability for drought related injury. Finally, I will pose a number of hypotheticals that will demonstrate the applicability of the LOU and BI provisions in the drought context.

⁴¹ See *California Drought*, *supra* note 40; *Policies*, U.S. DEP'T AGRIC. RISK MGMT. AGENCY (2015), <http://www.rma.usda.gov/policies> [<https://perma.cc/E6VG-67J7>].

Dollar Plan policies provide protection against declining value due to damage that causes a yield shortfall. The amount of insurance is based on the cost of growing a crop in a specific area. A loss occurs when the annual crop value is less than the amount of insurance. The maximum dollar amount of insurance is stated on the actuarial document. The insured may select a percent of the maximum dollar amount equal to CAT (catastrophic level of coverage) or purchase additional coverage levels.

Id.

The Risk Management Agency runs the USDA's farm insurance programs. Both "yield" and "revenue" insurance are available to farmers to protect against adverse weather, pests, and low market prices. The RMA describes its mission as helping farmers "manage their business risks through effective, market-based risk management solutions." [Footnote omitted] The RMA has annual outlays of about \$4 billion, employs about 550 people, and its activities are far from "market-based."

Federal crop insurance policies are sold and serviced by 16 private insurance companies, which receive federal subsidies for their administrative costs and insurance risks. The firms operate like a cartel, earning excess profits from the high premiums they charge. [Footnote omitted] They get away with that because the government provides large subsidies for insurance premiums, such that farmers pay only about one-third the full cost of their policies. The cartel-like structure of the current system was made clear in 2005, when, under lobbying pressure from insurance companies, Congress derailed an attempt by a company to offer discount insurance policies to farmers [footnote omitted].

Chris Edwards, *Agricultural Subsidies*, CATO INST., DOWNSIZING THE FED. GOV'T (June 2009), <https://perma.cc/9T4M-Y3R7>.

⁴² See *California Drought*, *supra* notes 40.

⁴³ *Id.*

⁴⁴ See *id.*

III. Liability Insurance Coverage: A Primer

Liability insurance policies can take many forms.⁴⁵ For instance, there is the “personal lines” policy,⁴⁶ which covers a person’s wellbeing, including health, life, auto, home/property, or finances; and the commercial general liability (“CGL”) policy that is issued to business owners.⁴⁷ The latter covers a wide range of business liability involving third parties, for example a “slip and fall” on the business premises or loss of cargo.⁴⁸ This article focuses on the CGL business liability policy.

A. The Commercial General Liability Policy

Most businesses purchase CGL policies.⁴⁹ These policies use forms issued by the industry’s trade association, the Insurance Service Office (“ISO”). The forms are changed or updated every few years to incorporate recent revisions.⁵⁰

There are two types of CGL coverage. “Coverage A,” which covers liability for harm to person or property caused by an “occurrence,” generally defined as an “accident,”⁵¹ and “Coverage B,” which insures against claims of “personal and advertising injury.”⁵² The difference between the two is that the former covers physical injuries, while the latter covers economic ones.⁵³

1. The CGL’s “Loss of Use” and “Business Interruption/Loss of Income” Riders

Courts have used the terms LOU and BI interchangeably to describe the loss or damage caused to the insured's property by events covered under an insured's policy.⁵⁴ This has also been the case with “use and occupancy coverage”

⁴⁵ JEFFREY E. THOMAS & FRANCIS J. MOOTZ III, 3 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 16.02[2] (2015) [hereinafter “3 NEW APPLEMAN”].

⁴⁶ For a partial definition of the term, see *Krumme v. Mercury Ins. Co.*, 20 Cal. Rptr. 3d 485, 493 (1st Dist. Ct. App. 2004) (“[S]elling ‘any policy of personal lines automobile and/or homeowners insurance . . .’”).

⁴⁷ See *supra* note 4 and accompanying text; See also 3 NEW APPLEMAN, *supra* note 45, at § 16.02[3][a][i]. The focus here will be on the CGL policy’s “property” clause.

⁴⁸ 3 NEW APPLEMAN, *supra* note 45, at § 16.02[3][a][i].

⁴⁹ *Id.* at § 16.02[3][a][iii]. The CGL policy is also the subject of frequent litigation.

⁵⁰ *Id.*

⁵¹ “Standard property insurance covers physical damage and losses—furniture destroyed in a fire, a storm-damaged office building or stolen equipment. This coverage can help you pay the costs of rebuilding or replacing damaged property.” *Business Insurance, Covering Losses with Business Interruption Insurance*, INS. INFO. INST. (2019), <https://www.iii.org/article/covering-losses-with-business-interruption-insurance>.

⁵² *Id.*; see *Bruceton Bank v. U.S. Fid. & Guar. Ins.*, 486 S.E.2d 19, 22 (W. Va. 1997).

⁵³ 3 NEW APPLEMAN, *supra* note 45, at § 16.02[3][a][iii].

⁵⁴ JEFFREY E. THOMAS & SUSAN RANDALL, 5 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 42.04[1] (2019) [hereinafter “5 NEW APPLEMAN”].

and BI coverage provisions.⁵⁵ Although LOU—or “use and occupancy coverage”—riders by their very nature cover damage to private parties, for example homeowners or businesses, the BI coverage only applies to businesses.⁵⁶

BI coverage is designed to protect the commercial enterprise should its business be interrupted and to provide the owners with income as if there had been no interruption.⁵⁷ These policies were developed to protect the insured from the risk of loss of use or occupancy of its premises.⁵⁸ Indeed, the purpose of these policies is to indemnify the assured⁵⁹ for its inability to use its property.⁶⁰ Thus, unless the use of the covered property is either partially or totally unusable or blocked, an insured cannot recover for its lost income or profits.⁶¹ For instance, assume that in 2015, when Arizona and California suffered their most severe droughts, a hotel chain had numerous cancellations from people who sought to hike in the areas where the hotels operate, thereby reducing their occupancy, *but not* enough to totally suspend operations. As demonstrated *infra*, any loss from the reduction of the hotel’s occupancy may not be covered under the policy’s business interruption coverage, since there was only a partial reduction in the number of guests or services. However, the outcome will depend on the law of the particular jurisdiction. Indeed, a simple loss of profits as a consequence of the damage or loss to an insured property will generally not provide coverage under BI in the absence of some disruption in the use and occupancy entirely or a portion of the insured business property.⁶²

2. Loss of Use Damages

Until recently, LOU-covered damages were only recoverable where the property damage was temporary.⁶³ Today, however, the majority of jurisdictions allow damages for “permanent” destruction of property.⁶⁴ The “loss of use” of property is a separate interest from other policy or insuring provisions and is purposely insured.⁶⁵

⁵⁵ *Id.*

⁵⁶ *Id.* § 42.04[1], [3].

⁵⁷ *Id.* § 42.04[1]; *see* Omaha Paperstock Co. v. Harbor Ins., 596 F.2d 283, 288 (8th Cir. 1979). Examples of the foregoing include fire, the total breakdown of a supermarket’s cooling system, or the closure of a store or factory due to a crime that occurred in front of it and caused the police to close off the street to any traffic, human or vehicular.

⁵⁸ *See* 5 NEW APPLEMAN, *supra* note 54, at § 42.04.

⁵⁹ The terms insureds and assureds are used interchangeably.

⁶⁰ 5 NEW APPLEMAN, *supra* note 54, at § 42.04[2].

⁶¹ *Id.*; *see generally* Nat’l Children’s Exposition Corp. v. Anchor Ins., 279 F.2d 428, 428–31 (2d Cir. 1960) (holding that a snowstorm that did not interrupt the use of the insured premises did not constitute loss under the policy).

⁶² 5 NEW APPLEMAN, *supra* note 54, at § 42.04[2].

⁶³ JEFFREY E. THOMAS & FRANCIS J. MOOTZ III, 13 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 162.03[6] (2015) [hereinafter “13 NEW APPLEMAN”].

⁶⁴ *See, e.g.*, Gateway Foam Insulators, Inc. v. Jokerst Paving & Contr., 279 S.W.3d 179, 185 (Mo. 2009).

⁶⁵ As noted above, it is separate from the general property loss policy, which generally covers fire damage and requires a rider. *See, e.g.*, Polytech, Inc. v. Affiliated FM Ins., 21 F.3d 271, 275 (8th

Before further examination, one must define the term “property damage,” since there can be no loss of use of property without damage to that property. The standard CGL policy defines “property damage” as “*physical injury* to tangible property, including all resulting *loss of use* of that property. All such *loss of use* shall be deemed to occur at the time of the physical injury that caused it . . .”⁶⁶ Hence in *Polytech, Inc. v. Affiliated FM Ins. Co.*, the Court observed that “personal property includes both tangible personal property (*i.e.*, goods and chattels) and intangible personal property (*i.e.*, things in action).”⁶⁷

Moreover, coverage also exists as part of the policy for non-physical or economic damage. That provision states the following in pertinent part:

(b) *Loss of use* that is not physically injured. This includes all loss of use which may be deemed to occur at the time of the “occurrence” that caused it. *Loss of use* that is not physically injured. Despite the fact that the definition of “property damage” does not require that damage be to the property of a third party, some courts have read the property damage requirement in conjunction with the business risk exclusions to hold that damage to the work itself does not constitute property damage.⁶⁸

i. LOU and Deprivation of Business Information

Accordingly, a loss of use of pertinent business information can be considered a “loss of use that is not physically injured,” therefore falling within the ambit of coverage clause (b). Indeed, in *Cincinnati Ins. Co. v. Gage Center Dental Group, P.A.*,⁶⁹ coverage clause (b) was at issue. The underlying state court action in *Gage* involved two shareholders in a dental group practice—brothers Drs. Gregory Johnson and Eric Johnson—who sued the group in Kansas state court for allegedly reducing their access to patients.⁷⁰ Plaintiffs argued that they lost revenue as shareholders.⁷¹

Cir. 1994) (citing *Hudson Mfg. Co. v. New York Underwriters’ Ins.*, 33 F.2d 460 (7th Cir. 1929)) (business interruption insurance is a separate type of coverage which is outside of the scope of a valued policy statute).

⁶⁶ See EUGENE R. ANDERSON ET AL., *INSURANCE COVERAGE LITIGATION* §18-43 (2d ed. 1999) (2004 Supplement) (emphasis added).

⁶⁷ *Polytech*, 21 F.3d at 274 (citing *Norris v. Norris*, 731 S.W.2d 844, 845 (Mo.1987) (en banc)) (‘Personal property can be either tangible or intangible.’); *McDougal v. McDougal*, 279 S.W.2d 731 (Mo. Ct. App. 1955) (finding under predecessor definitional statute that term ‘personal property’ includes all property which is not real property).

⁶⁸ ANDERSON ET AL., *Supra* note 66.

⁶⁹ *Cincinnati Ins. Co. v. Gage Ctr. Dental Grp., P.A.*, No. 12-2387-KHV, 2013 WL 5913751, at *10 (D. Kan. Nov. 1, 2013).

⁷⁰ *Id.* at *3. “The Underlying Lawsuit On July 22, 2011, Drs. Gregory Johnson and Eric Johnson (the “Drs. Johnson”) filed suit in the District Court of Shawnee County, Kansas against Drs. Pleviak, Hall, Gardner, Loewen, Banks and Burkett (the “doctor defendants”) and Brenda Vink-Wilson (collectively, the “Gage defendants”).” *Id.*

⁷¹ *Id.* at *3–4.

Additionally, the Drs. Johnson also accused the defendants of holding secret board meetings where they were excluded, which was *ultra vires* to the group's corporate by-laws. Moreover, it was claimed that the defendants formed a secret unauthorized committee to investigate the plaintiffs' purportedly improper conduct.⁷² Cincinnati Insurance denied both its duty to defend and to indemnify the Gage defendants.⁷³ The insurer then filed a coverage declaratory action seeking a judicial affirmation of its denial of coverage.⁷⁴ However, the district court held for Gage, finding that Cincinnati issued the business policy, as well as an umbrella policy.⁷⁵ The business policy provided the following language:

Cincinnati will pay those sums that the insured becomes legally obligated to pay as damages because of . . . "property damage" . . . to which the insurance applies It further provides that it will defend the insured against any "suit" seeking those damages The insurance only applies if the "bodily injury" or "property damage" is caused by an "occurrence."⁷⁶

And, in turn both policies define "property damage" as

- a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
- b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the 'occurrence' that caused it.⁷⁷

"Tangible property" is not defined in the policy.⁷⁸ Therefore, the court turned to Black's Law Dictionary for a definition. Black's defines "tangible property" as "property that has physical form and substance and is not intangible. That which may be felt or touched, and is necessarily corporeal, although it may be either real or personal (e.g. a ring or watch)."⁷⁹

Accordingly, Federal District Judge Kathryn H. Vratil observed that the tangible property would include the loss of patients and loss of revenue. Furthermore, the court found that the secret board meetings, the unauthorized

⁷² *Id.* at *3–5.

⁷³ *Id.* at *11–12.

⁷⁴ *Id.* at * 1.

⁷⁵ For a definition of an umbrella policy, see *Umbrella Insurance Policy*, INVESTOPEDIA, <http://www.investopedia.com/terms/u/umbrella-insurance-policy.asp> [https://perma.cc/6EVJ-S4GY] (last visited Jan. 14, 2020) ("Extra liability insurance coverage that goes beyond the limits of the insured's home, auto or watercraft insurance. It provides an additional layer of security to those who are at risk for being sued for damages to other people's property or injuries caused to others in an accident.").

⁷⁶ *Cincinnati*, 2013 WL 5913751. at *4.

⁷⁷ *Id.* at *10.

⁷⁸ *See id.*

⁷⁹ *Id.*

committee, and its subsequent meetings, fell into the “loss of use that is not physically injured” provision, because as shareholders the Drs. Johnson were required to give their assent for the “adoption of inaccurate or incomplete written minutes of prior meetings.”⁸⁰ Consequently, the court found that the practice had a fiduciary duty to inform the Drs. Johnson about the information that was discussed and conveyed by the defendants during these secret meetings.⁸¹

Note the use of the term “occurrence” in both quoted paragraphs above. Occurrence is a term that is defined in most CGL or BOP policies as follows: “an event that results in a loss to a third party due to . . . property damage or destruction.”⁸² Here, the court reasoned that the loss of profits and information kept from the Drs. Johnson was equivalent to property damage. Finally, the Court held that a defense was owed until the plaintiffs’ suit against Gage was resolved in the state court and then this Court would determine if a duty to indemnify was owed.⁸³

B. Purely Economic Loss vs. Consequential Economic Loss

Insurers occasionally argue that a loss that is purely economic in nature does not fall within the definition of property damage of the CGL policy.⁸⁴ However, the same is not true for consequential economic losses that arise from, or are related to, property damage. Thus, in *Gage*, the court considered the secret board of directors’ meetings economic damages, since the loss of information cost the Drs. Johnson portions of the practice’s profits.

CGL policies also have been interpreted to cover consequential economic damages based on the language of the insuring agreement. The latter provides that

⁸⁰ *Id.* at *3.

⁸¹ The predetermined outcome of the investigation was that the Drs. Johnson were conducting their practice improperly or with malicious motives. The secret committee was not created to protect the interests of Gage Center, but to deprive the Drs. Johnson of their practice while retaining all of their patients in order to increase the revenue of the doctor defendants.

Id. at *4.

⁸² *Occurrence*, BUS. DICTIONARY, <http://www.businessdictionary.com/definition/occurrence.html> [<https://perma.cc/XM39-QSPR>] (last visited Jan. 15, 2020). A good example of an occurrence is an auto accident. In that instance the policy will define an occurrence as an accident. Most CGL policies stipulate that all losses resulting from the same general causes are considered as resulting from one occurrence, and are limited to the number of occurrences allowed in the insurance policy. *See, e.g., Occurrence Policy*, INS. SERVS. OFFICE, <https://www.irmi.com/online/insurance-glossary/terms/o/occurrence-policy.aspx> [<https://perma.cc/HU2N-7XJM>] (last visited Jan. 15, 2020). “Also, such losses are distinguished from accidents in that the loss does not have to be sudden and fortuitous, or expected or intended, and can result from continual or repeated exposure to the possibility of harm.” *Occurrence*, BUS. DICTIONARY, <http://www.Businessdictionary.com/definition/occurrence.html> [<https://perma.cc/5XFH-CJ7H>] (emphasis added).

⁸³ *Cincinnati*, 2013 WL 5913751, at *13.

⁸⁴ *See, e.g., Traveler’s Ins. v. Eljer Mfg.*, 757 N.E.2d 481 (Ill. 2001) (“As stated, the post-1981 policies do not provide coverage for economic loss claims against the policyholders.”).

“[w]e will pay those sums that the insured becomes legally obligated to pay as damages *because of* . . . ‘property damage.’”⁸⁵ That term has not been defined in the case law. Accordingly, this article posits that the words “because of” indicate that the damages must have their origin in physical injury to, or loss of use of, tangible property. In other words, it is posited that the two words “because of” mean the proximate cause of the damage.

Hence, once property damage has been established, the policy ought to cover economic losses that flow because of that harm.⁸⁶ For example, diminution in value in and of itself is a purely economic loss that would not constitute property damage because there is no property damage *per se*.⁸⁷ Diminution in value resulting from physical injury to tangible property, however, constitutes property damage as defined by the CGL policy, and should therefore be covered, for instance, damage to a structure that diminishes its value.

As for losses that implicate BI or LOU coverage, courts have found that LOU coverage is a separate benefit or interest, which as noted previously, may be insured by both a rider and an increase in premium, as the CGL policy does not protect the insured’s interest without the rider. On the other hand, such a rider or endorsement may not protect the insured for losses of its building’s contents including property as “raw stock.”⁸⁸ The development of non-physical injury to tangible property is examined next.

However, before proceeding, let’s assess the above and apply it to a drought situation. First, if a drought occurs and a rancher’s cows and chickens die due to the extreme heat and lack of drinking water for the cows—assuming that the rancher has the same coverage as Gage did—should that be considered a

⁸⁵ See, e.g., *Granite Outlet, Inc. v. Hartford Cas. Ins.*, No. 2:14-cv-00575-TLN-EFB, 2015 WL 300729, at *3–4 (E.D. Cal. Jan. 22, 2015) (emphasis added).

⁸⁶ Labeled an “occurrence”-based CGL policy since 1985, it is a common belief that an “occurrence” triggers coverage. A closer reading of the CGL insuring agreement reveals that the CGL only applies if the bodily injury or property damage is caused by an “occurrence” which takes place in the “policy territory,” but *only if the bodily injury or property damage occurs during the policy period*.

Craig F. Stanovich, *Some Common Coverage of the CGL Policy*, THE INT’L. RISK MGMT. INST. (Sept. 2018), <https://www.irmi.com/articles/expert-commentary/some-common-coverage-misconceptions-of-the-cgl-policy>; See also ISO PROPS. INC., COMMERCIAL GENERAL LIABILITY POLICY COVERAGE FORM CG 00 01 04 13 (2012), <https://www.northstarmutual.com/UserFiles/Documents/forms/policyforms/Current/CG%2000%2001%2004%2013.pdf>.

⁸⁷ See, e.g., *Traveler’s Ins.*, 757 N.E.2d 481 (incorporation of a defective component into the homes was not physical injury and, thus, not property damage; tangible property does not experience physical injury if that property suffers intangible damage, such as diminution in value); *But cf. Sturges Mfg. v. Utica Mut. Ins.*, 332 N.E. 2d 319, 322 (N.Y. 1975) *Sturges*, a manufacturer of ski straps that Americana incorporated into its ski bindings. Americana received numerous complaints about the bindings and refunded its customers payments. Americana then sued *Sturges* for breach of warranty and negligence in selling the allegedly defective straps. Moreover, Americana claimed that *Sturges*’ defective strap diminished the value of its binding, and caused consequential harm to the unit as a whole. The Court of Appeals found for Americana, holding that the *Sturges* component did indeed decrease the value of the ski binding. *Sturges*, 332 N.E. 2d 319.

⁸⁸ See *Am. Sw. Corp. v. Underwriters at Lloyds of London*, 333 F.Supp. 1333 (S.D. Miss. 1971) (emphasis added).

diminution in value resulting from physical injury to tangible property? Recall that the Cincinnati Insurance Company’s policy provisions declared:

- a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
- b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the ‘occurrence’ that caused it.

Recall also that Black’s Dictionary defines “tangible property” as “property that has physical form and substance and is not intangible. That which may be felt or touched, and is necessarily corporeal” Consequently, property damage, as defined by the CGL policy, should be covered, like damage to a structure that diminishes its value.

Clearly, given the above, the chickens and cows would be considered tangible property. Their deaths would likewise be construed as “[p]hysical injury to tangible property, including all resulting loss of use of that property.” Consequently, the rancher, under the *Gage* court’s logic, would have a policy payout.

As to the economic damages resulting from droughts, the fires that are raging in California offer a possible avenue for coverage. If we once again look at Judge Kathryn H. Vratil’s opinion in *Gage*, the court considered the secret board of directors’ meetings to be economic damages because the loss of information cost the Drs. Johnson portions of the practice’s profits. Assume that California adopts *Gage*’s rationale. Under that scenario, the drought-caused fires in the state would likely require an insured’s mandatory evacuation⁸⁹ of her business. She would therefore have no access to her computers, fax machines, and other tools that would allow her to access information related to the business. That loss of information could be considered a purely economic damage or injury in an action for policy benefits under the loss of business income and use and occupancy coverage.

⁸⁹ See, e.g., Colleen Shalby et al., *Kincade Fire Rages Toward Santa Rosa; Nearly 200,000 Are Evacuated*, L.A. TIMES (Oct. 28, 2019), <https://www.latimes.com/california/story/2019-10-27/blackouts-take-effect-across-northern-california-as-kincade-fire-grows-winds-kick-up> (“The Kincade fire had burned about 54,300 acres by Sunday night, forcing evacuations of more than 180,000 people. The blaze has destroyed 94 structures, damaged 17 and threatens an additional 80,000, officials said . . .”).

C. Physical Injury to Tangible Property and Loss of Use of Tangible Property⁹⁰

In 1973, the insurance industry amended the explanation of “property damage” to require “physical injury to or destruction of tangible property.”⁹¹ The industry’s thinking behind the change, and that of the Insurance Service Office, was that the incorporation of the word “physical,” together with other exclusions in the policy, would likely eliminate coverage for claims for *harms*, including diminution in value of property that was not physically injured.⁹²

The case giving rise to the physical injury requirement was *Hauenstein v. St. Paul-Mercury Indemnity Co.* At issue in that landmark dispute before the Minnesota Supreme Court where the insured was a plaster distributor, Softone Acoustical Plaster.⁹³ At all relevant times of this coverage dispute, the insured, Hauenstein, was covered against liability for accidental property damage by an insurance agreement with the insurer, St. Paul-Mercury,⁹⁴ the defendant. Pursuant to that contract, the defendant agreed “[to] PAY any loss by reason of the liability imposed by law or contract upon the Insured *for damages because of injury to or destruction of property, including the loss of use thereof, caused by accident.*”⁹⁵

While the St. Paul-Mercury policy was in force, its insured, Hauenstein, sold the plaster to numerous persons, including a contractor who used it in a construction project at a hospital.⁹⁶ Following the plaster’s application, it shrunk and cracked, requiring the contractor to completely remove it and to replaster the walls and ceilings.⁹⁷ Given the contractor’s additional labor and costs to eliminate the cracked plaster and resurface walls, the contractor commenced an action against Hauenstein for breach of warranty.⁹⁸

Hauenstein filed a claim for coverage with St. Paul-Mercury, which denied coverage for the claims.⁹⁹ Consequently, Hauenstein filed an action for a declaratory judgment, seeking to fix St. Paul-Mercury’s liability for the claims made by the contractor, as well as claims made by other purchasers of the plaster.¹⁰⁰ The trial court held for the insurer. Consequently, Hauenstein appealed from that judgment to the Minnesota Supreme Court.¹⁰¹

⁹⁰ Much of the material that is discussed here is from Lee H. Shidlofsky, *Deconstructing CGL Insurance Coverage Issues in Construction Cases*, 9 J. AM. C. CONSTRUCTION LAWS. 2 (2015).

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Hauenstein v. St. Paul-Mercury Indemnity Co.*, 65 N.W.2d 122, 124 (Minn. 1954)

⁹⁴ *Id.*

⁹⁵ *Id.* (emphasis added).

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.* At the time, Minnesota did not have an intermediate court of appeals. The Minnesota Court of Appeals began on November 1, 1983. See generally *Minnesota Court of Appeals*, MINN.

The Supreme Court observed that the policy limited any coverage afforded by an exclusionary clause, “*which provides that the policy does not apply to any goods or products manufactured, sold, handled, or distributed by the insured.*”¹⁰² Hauenstein, however, asserted “that the plaster, after its application and use by the consumers, ceased to be goods or products and, by the law of accession, became a part of the realty.” The Court rejected “this ingenious theory.” Rather it found that the incorporation of the work caused to the building resulted in the consequential damage. Writing for the Court, Justice Matson observed that there was no doubt that the property damage to the building caused by the application of the defective plaster was “caused by accident” within the meaning of the insurance contract, since the damage was a completely unexpected and unintended result. Accident, as a source and cause of damage to property within the terms of an accident policy, is an unexpected, unforeseen, or undesigned happening or consequence from either a known or an unknown cause.

Although there is no liability for damage to the plaster itself as a product handled and distributed by the plaintiff, the insurer is liable under its insurance contract for accidental damage to property caused by the application of the defective plaster.¹⁰³

Moreover, the Court held that the application of the faulty plaster effectively lowered the building’s market value, which, in its judgment, constituted “property damage” under the terms of the insurance policy.¹⁰⁴ This created new law, in a case of first impression, and overruled the pre-*Hauenstein* definition of property damage, which did not consider diminution in value following the sale of a product as property damage. Indeed, the Minnesota Supreme Court held that the measure of the damage was “the diminution in the market value of the building, or the cost of removing the defective plaster and restoring the building to its former condition, plus any loss from deprivation of use, whichever [was] lesser.”¹⁰⁵

Thus, in its subsequent addition of the word “physical” to the definition of “property damage,” the insurance industry sought to exclude *Hauenstein*’s type of diminution and place it beyond the general scope of the CGL coverage.¹⁰⁶ Consequently, I posit that insureds would be required to purchase additional coverage, for which underwriters would calculate the cost of the risk of loss, and price these products and the subsequent riders accordingly.

Successive courts have adopted *Hauenstein*’s logic and have held that physical injury is not necessary for coverage to be afforded. For example, in *Hartzell Industries, Inc. v. Federal Ins. Co.*, the court noted that the policy at issue

JUDICIAL BRANCH (2019), <http://www.mncourts.gov/courtofappeals.aspx> (last visited Jan. 16, 2020).

¹⁰² *Hauenstein*, 65 N.W.2d at 125 (emphasis added).

¹⁰³ *Id.* at 126-27.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ See Shidlofsky, *supra* note 90.

defined “property damage” as the “loss of use of tangible property that *is not physically injured*.”¹⁰⁷

The previous section discussed how courts have construed the definition of property damage. *Hauenstein* and its progeny demonstrate the leap from tangible property damage to a definition that is shifting and requires no property damage. *Hartzell* demonstrates that courts now construe the term “property damage” to include damage to a business’ works. We next move to an analysis of property damage where tangible property, in fact, has not been physically injured.

D. Loss of Use of Tangible Property That Has Not Been Physically Injured

Thus far, I have examined the first prong of the CGL definition, which requires “physical injury” to tangible property. The second prong provides another definition for “property damage.” It addresses the “[l]oss of use of tangible property that *has not been physically injured*.” That prong of the CGL policy is a promise to pay damages for claims because a particular piece of tangible property cannot be used and incorporates the second definition of property damage, the impaired property exclusion.¹⁰⁸

For purposes of the CGL policy, an impaired property is someone else’s property that is unusable for her product or work and that is incorporated into the property because it is either defective or inadequate.¹⁰⁹ An example of the latter is where a property owner or the producer/builder alleges that his business sustained economic loss or property damage during the production process because a supplier’s product was defective. This, of course, is illustrated by the *Hauenstein* and *Hartzell* cases. Another example is a delay in the delivery of a product.

In the drought context, one possible scenario where coverage may be afforded is demonstrated by the following hypothetical: Assume that a golf course leases its food concession to an out-of-state food concessioner. Due to an oppressive drought, the course’s greens cannot be kept up as a consequence of the local or state government’s restriction on non-drinking water use. Accordingly, the course cannot be used and is closed. Assume also that the course owners fail to provide notice to the out-of-state concessioners of the limitation on water use prior to the latter’s opening. Uninformed and believing that all is copacetic, the concessioners order food, new furniture, and hire staff. Once their trucks with the food and staff arrive on the contractually agreed upon date, the concessioners’

¹⁰⁷ *Hartzell Indus. v. Fed. Ins.*, 168 F. Supp. 2d 789, 791–95 (S.D. Ohio 2001) (emphasis added).

¹⁰⁸ See Craig Stanovich, *The Impaired Property Exclusion*, INT’L RISK MGMT. INST. (Apr. 2010), <https://www.irmi.com/articles/expert-commentary/the-impaired-property-exclusion>.

Claims involving faulty work or defective products often introduce complex commercial general liability (CGL) coverage issues, particularly if the claim alleges only damage to property ‘[I]mpaired property’ is a defined term in the CGL policy. In overly simplistic terms, impaired property is someone else’s property that cannot be used because your work or your product, which has been incorporated into that property, is inadequate or defective.

Id.

¹⁰⁹ *Id.*

manager grasps that the club is closed and that the restaurant will not have any customers. Should the restaurant concessioners sue because their contract with the course was impaired, and if so, would they be awarded damages? Under *Hauenstein* and *Hartzell*, one would expect that the concessioners would prevail. Alternatively, under the second prong of the property damage definition—the impaired property exclusion—success is oftentimes problematic because of a bar in the policy.¹¹⁰

1. Further Language on the Loss of Use of Tangible Property

Despite the fact that the post-*Hauenstein* definition of “property damage” does not require that the damage occur to the property of a third party, some courts have read the property damage requirement in conjunction with the business risk exclusions to hold that damage to the work itself does not constitute property damage.¹¹¹ For instance, *Park University Enterprises, Inc. v. American Casualty Co. of Reading* sheds light on the meaning of “loss of use of tangible property.”¹¹²

There, Park University sent an advertisement fax to JC Hauling. JC Hauling contended that the fax was sent in violation of the Telephone Consumer Protection Act (TCPA), 47 U.S.C. § 227.¹¹³ It sued, asserting that the company

¹¹⁰ See, e.g., *Cogswell Farm Condo. Assoc. v. Tower Grp., Inc.*, 167 N.H. 245, 247 (N.H. 2015).

In 2009, Cogswell sued Lemery and others, alleging negligence, breach of contract, and negligent supervision in the construction of the units. Cogswell asserted that the “weather barrier” components of the units—including the water/ice shield, flashing, siding, and vapor barrier—were defectively constructed and resulted in damage to the units due to water leaks.

In 2011, Cogswell filed a petition for declaratory judgment against Tower, seeking a declaration that its claims against Lemery were covered under Tower’s policy. Cogswell later added Acadia as a party to the declaratory judgment action.

Id. at 246-247.

¹¹¹ Cf. *Park Univ. Enters, Inc., v. Am. Cas. Co.*, 442 F.3d 1239, 1244–47 (10th Cir. 2006) (holding that claims for loss of use of a third party’s business equipment are covered by policies which insure against loss of use of tangible property that is not physically injured and that a “duty to defend arises if a plaintiff contends that ‘loss of use of tangible property’ was caused by an ‘occurrence.’”).

¹¹² See *id.*

¹¹³ *Id.* at 1242–45.

The TCPA makes it “unlawful for any person . . . to use any telephone facsimile machine, computer, or other device to send an unsolicited advertisement to a telephone facsimile machine.” 47 U.S.C. § 227(b)(1)(c). It defines an “unsolicited advertisement” as “any material advertising the commercial availability or quality of any property, goods, or services which is transmitted to any person without that person’s prior express invitation or permission.” *Id.* § 227(a)(4). The act creates a private right of action that permits recipients of unwanted faxes to seek injunctions and damages, and allows courts to grant treble damages if they find a fax sender has acted “willfully or knowingly.”

lost the use of its fax machine, ink, and paper. Park University's insurer, American Casualty, agreed that sending the unsolicited fax could result in "loss of use of tangible property."¹¹⁴ Nevertheless, the insurer refused to offer Park a defense. Park University contended that American owed it a defense under two separate sections of its policy: "1) 'property damage' liability coverage; and 2) 'advertising injury' liability coverage."¹¹⁵ The court observed that American's policy issued to the University contained a property damage provision which stated that American Casualty's duty to defend would arise if the plaintiff asserted that "loss of use of tangible property" was triggered by an "occurrence."¹¹⁶

In its defense, the insurer argued that JC Hauling's loss of use of its fax line and machine did not fall into an "occurrence" definition since the University intentionally sent the fax. Consequently, Park's use of the "telephone facsimile machine . . . to send an unsolicited advertisement,"¹¹⁷ was not caused by an accident within the meaning of the policy.¹¹⁸ American also contended that under the law of Kansas, the situs of the dispute, public policy barred coverage for non-fortuitous losses or damages.¹¹⁹ Thus, the damage to JC Hauling should be "excluded under the policy's intentional act exclusion even if it could be considered an occurrence." The court was not persuaded by these arguments.¹²⁰

Indeed, it determined that for insurance purposes, "whether the damages resulting from an insured's acts were accidental and therefore an occurrence under a policy, the state of Kansas follows"¹²¹ a rule that an insured's intention to injure a party may be inferred "if the resulting injury, *from the standpoint of the insured*, is the natural and probable consequence of the act ultimately causing the injury."¹²² Here there was no finding of a specific intent to injure JC Hauling; for example, Park University could have sent the fax by mistake.¹²³

The court of appeals agreed with the district court that an "occurrence" could have taken place, since the purported property damage may have been an "accident and not the natural and probable consequence of Park University's intentional fax transmission."¹²⁴ Accordingly, as Park University assumed that it was transmitting a fax to a recipient who desired to "receive it (whether mistaken or not), one could not conclude it intended to injure the recipient Consequently, the alleged injury was potentially an occurrence within the meaning of the policy, requiring American to defend Park University."¹²⁵

Id.; 47 U.S.C. § 227(b)(3).

¹¹⁴ *Park Univ. Enters*, 442 F.3d at 1244–45.

¹¹⁵ *Id.* at 1243.

¹¹⁶ *Id.* at 1244.

¹¹⁷ *Id.* at 1242–45.

¹¹⁸ *Id.* at 1244.

¹¹⁹ *Id.* at 1245.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.* (citing *Harris v. Richards*, 254 Kan. 549 (1994)).

¹²³ *See id.*

¹²⁴ *Id.*

¹²⁵ *Id.* at 1245–46.

In the next section, the devastation caused by Hurricane Katrina provides examples of how the terms LOU and BI are currently interpreted in practice.

IV. Hurricane Katrina Category 5, August 2007

On August 29, 2005, Hurricane Katrina drowned New Orleans, Louisiana.¹²⁶ In the immediate aftermath, the New Orleans region was inundated by flood waters and buffeted by horrific winds.¹²⁷ Homes and businesses alike were destroyed and insurance policies implicated.¹²⁸ Insurers, naturally, looked to their policies’ limitations or exclusions to limit their payouts and to avoid payment of unfounded claims. Alternatively, insureds sought the greatest amount of coverage.

In the morass between insurers and insureds, the main issue was whether damage occurred due to water or wind.¹²⁹ Damage from water is not an insured peril.¹³⁰ Damage from wind is.¹³¹ One of the provisions of the CGL policies that was fought over was loss of business income due to the Hurricane. Loss of business income, as a result of Hurricane Katrina, would be covered if the loss was due to wind damage.¹³² If the business was shut down due to water damage, coverage would be denied. BI insurance policies generally provide the following language in pertinent part: “A. Coverage 2. Business Income: Business Income

¹²⁶ See, e.g., *Yount v. Lafayette Ins.*, 4 So. 3d 162, 164–65 (La. App. 4 Cir. 2009) (“On August 29, 2005, Hurricane Katrina made landfall causing catastrophic devastation to the City of New Orleans As a result of the storm, the building sustained extensive wind damage, and, due to the breaches in the City’s levee protection system, the first floor was inundated with seven to eight feet of water for approximately two weeks.”).

¹²⁷ Kim Ann Zimmermann, *Hurricane Katrina: Facts, Damage & Aftermath*, LIVE SCI. (Aug. 27, 2015), <http://www.livescience.com/22522-hurricane-katrina-facts.html> [https://perma.cc/E6H8-GHAS].

¹²⁸ See *id.*

¹²⁹ *Yount*, 4 So. 3d at 166. “. . . [S]ince flood waters were expressly excluded as a ‘covered peril’ under the policy . . . coverage was not implicated.” *Id.*

¹³⁰ See, e.g., *id.* at 165. “Approximately five weeks later, Mr. Yearwood directed a report dated December 4, 2005 to Lafayette indicating his inspection showed ‘visible windstorm damage to the office suite,’ but based on his review of the policy no coverage existed for such.” *Id.*

¹³¹ See, e.g., *id.* at 166–67. “[T]he trial judge granted a directed verdict in favor of the plaintiff finding that Dr. Yount produced sufficient evidence that the suite suffered direct physical damage caused by wind, which resulted in mold, and that there was coverage under the policy for such.” *Id.* See also *Maloney Cinque v. Pac. Ins.*, 89 So. 3d 12, 16 (La. App. 4 Cir. 2012) (“Hurricane Katrina-related claims for wind damage. . .”).

¹³² See, e.g., *Yount*, 4 So. 3d at 166.

4. Additional Coverages E. *Business Income*. We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration." The suspension must be caused by *direct physical loss of 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 any Covered Causes of Loss.

Id.

means the (a) Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred; and (b) Continuing normal operating expenses incurred, including payroll.”¹³³

The overall intent of the BI insurance is to safeguard the insured’s earnings, as though there was no disruption of its business. Loss of profits damages (“LOPD”) may not be speculative, but they only need to be proven within a reasonable confidence.¹³⁴ Indeed, “[b]road latitude is given in proving lost profits because this element of damages is often difficult to prove and mathematical certainty or precision is not required.”¹³⁵

Coverage 2. business income insurance policies also provide additional coverage for extra expenses. An extra expense is defined as the “necessary expenses you incur during the ‘period of restoration’ that one would otherwise not have incurred if there was no physical damage or loss to the covered property that resulted from or was caused by a cause of loss that was covered under the policy.” Typical form policy language is as follows:

(1) We will pay any Extra Expense to avoid or minimize the “suspension” of business and continue “operations” . . . (2) We will pay any Extra Expense to minimize the “suspension” of business if you cannot continue “operations” to the extent it reduces the amount of loss that otherwise would have been payable under this Coverage Form.¹³⁶

One of the seminal post-Katrina cases that addressed both BI and of LOU is *Yount v. Lafayette Ins. Co.*¹³⁷ There, Doctor Beverly Yount’s professional office building, owned by Tenet Mid-City Medical, L.L.C. (hereinafter, “Tenet”), was destroyed by both water and wind, including her individual office, much of its equipment, and some of her patients’ medical records.¹³⁸ Four weeks after the storm, when Dr. Yount initially attempted to enter the office building with her office manager, the two were confronted with humid, hot air, mold, mildew, and total darkness. Nevertheless, over a month after the storm, Tenet set up lights, and Yount and her office manager—required by Tenant to wear protective gear due to the mold growing on the interior of the building—were able to make a number of forays into her office and retrieve her patients medical records.¹³⁹ Tenet decided

¹³³ *Maloney Cinque*, 89 So. 3d at 24.

¹³⁴ *Id.* at 25 (citing *Cox Comm. v. Tommy Bowman Roofing*, 929 So. 2d 161, 166–67 (La. App. 4 Cir. 2006); *Lavigne v. J. Hofert Co.*, 431 So. 2d 74, 77 (La. App. 1 Cir. 1983)).

¹³⁵ *Id.* at 25 (citing *La. Farms v. La. Dep’t. of Wildlife and Fisheries*, 685 So. 2d 1086, 1105 (La. App 3 Cir. 1996)).

¹³⁶ *Id.* at 32.

¹³⁷ *See Yount*, 4 So. 3d at 167 (The “judge granted a directed verdict in favor of the plaintiff finding that Dr. Yount produced sufficient evidence that the suite suffered direct physical damage caused by wind, which resulted in mold, and that there was coverage under the policy for such.”).

¹³⁸ *Id.* at 164–65.

¹³⁹ *See id.* at 165.

not to rebuild or renovate the building.¹⁴⁰ Thus, Dr. Yount was unable to see patients and consequently she lost her ability to generate income.¹⁴¹

Yount’s CGL policy, issued by Lafayette, contained the following language, in part:

A. Coverage

We will pay for direct loss of or damage to Covered Property at the premises described in the Declarations caused by or resulting from any Covered Cause of Loss.

....

4. Additional Coverages

e. Business Income

We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your “operations” during the “period of restoration”. The suspension must be caused by *direct physical loss of 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 any Covered Causes of Loss.¹⁴²

Given the building and her medical office’s condition, and its necessary abandonment, Yount submitted a claim to her insurer under her CGL policy, asserting BI and LOU.¹⁴³ The claim was denied and Yount sued Lafayette, alleging “breach of contract for the recovery of insurance proceeds due to her under the business interruption provision of her commercial policy,” *i.e.*, asserting that the insurer’s denial of LOU coverage for her premises was wrongful.¹⁴⁴ Both the trial court and the appellate court found for Doctor Yount.¹⁴⁵

From the perspective of BI and LOU, the issue to consider is whether the court was correct in finding for Dr. Yount and against Lafayette Insurance. Temporary suspension of business may not be enough to trigger insurance coverage.¹⁴⁶ That was not the case here. Yount’s lessor, Tenet, informed her that

¹⁴⁰ *Id.*

¹⁴¹ *See id.*

¹⁴² *Id.* at 166.

¹⁴³ *Id.* at 165.

¹⁴⁴ *See id.* at 166.

¹⁴⁵ *Id.* at 174-75.

¹⁴⁶ Several courts have, indeed, acknowledged the principle that the suspension need not be absolute or complete. *See, e.g.*, *Am. Med. Imaging Corp. v St. Paul Fire & Marine Ins.*, 949 F.2d 690 (3d Cir 1991); *accord Buxbaum v. Aetna Life & Casualty Co.*, 126 Cal. Rptr. 2d 682 (Cal. Ct.

it was abandoning the building because that area of the city was not a government priority for reconstruction. Indeed, as of 2018, the Tenet building adjacent to the Charity Hospital was still abandoned.¹⁴⁷

Given the complete destruction and abandonment of the building, Dr. Yount was unable to continue her practice. Two months following Katrina, she joined another practice.¹⁴⁸ Since she was unable to see patients or generate any income at her old location,¹⁴⁹ the Court awarded Dr. Yount both LOU and BI damages.

Another post-Katrina case is *Maloney Cinque v. Pacific Ins. Co., Ltd.*¹⁵⁰ There, Maloney Cinque and a related entity owned truck stops in and around New Orleans which were inundated by Katrina's floods.¹⁵¹ Maloney Cinque sued its insurer, Pacific, for a host of claims.¹⁵² For our purposes, however, the claim at issue was for BI.¹⁵³ The appellate court observed that:

The general purpose of BI insurance is to protect the earnings which the insured would have enjoyed had no interruption or suspension occurred Moreover, as a general rule, damages for loss of profits may not be based on speculation and conjecture; however, such damages need be proven only within reasonable certainty.¹⁵⁴

App. 2002) (citing *Home Indem. Co. v. Hyplains Beef, L.C.*, 893 F. Supp. 987 (D. Kan. 1995)) In a case involving a business interruption policy, the court explained:

In order for business income coverage to apply, the Policy requires that there be a 'necessary suspension' of operations. This term is not defined in the policy.... [¶] Webster's Third New International Dictionary defines 'suspension' as 'the act of suspending or the state or period of being suspended, interrupted, or abrogated. 'Suspended' is defined as 'temporarily debarred, inactive, inoperative.' These definitions comport with what appears to be the common understanding of the term 'suspension', that is, that it connotes a temporary, but *complete, cessation* of activity. Thus, if one were to apply the plain, ordinary meaning to the use of the phrase 'necessary suspension' within the policy, in order for a claim to fall within the coverage provision it would require that any direct physical loss of or damage to property result in the cessation of [the insured's] operations. Further, in looking at the policy as a whole, the court does not find any other provisions that would indicate that the use of the phrase 'necessary suspension' in the coverage provision should be given anything other than its common, ordinary meaning.

Id.

¹⁴⁷ See Danny Monteverde, *8 Landmarks in New Orleans That Have Been Abandoned and Rotting for More Than a Decade*, 4WWL (Last updated Feb. 12, 2019), <https://www.wwtv.com/article/news/8-landmarks-in-new-orleans-that-have-been-abandoned-and-rotting-for-more-than-a-decade/289-da9da4cb-5b97-46b2-9bcb-8ada20aec2a4>.

¹⁴⁸ *Yount*, 4 So. 3d at 165.

¹⁴⁹ *Id.* at 175.

¹⁵⁰ See *Maloney Cinque v. Pacific Ins.*, 89 So. 3d 12 (La. Ct. App. 2012).

¹⁵¹ See *id.* at 16.

¹⁵² *Id.*

¹⁵³ See *id.* at 20.

¹⁵⁴ *Id.* At 25 (citing *Cox Comm'ns. v. Tommy Bowman Roofing*, 929 So. 2d 161, 166-67 (La. App. 2006)).

As in *Yount*, both trial and appellate courts agreed that the insurer was liable for BI payments.¹⁵⁵ Moreover, the inundation of truck stops—even if it caused a partial shutdown of the premises—could not be considered a temporary suspension of operations. Flooding of a building renders it uninhabitable, and if left operational would likely cause health department violations for unsanitary conditions.

The inability to generate any income whatsoever falls within the penumbra of the general purpose of the CGL policy’s BI insurance. Its aim is to protect the insured’s earnings in an equivalent manner as though there was absolutely no interruption. *Cinque* was likewise not speculative or conjectural; rather the insured submitted fairly exact figures for its losses, falling within the rule that such damages need only be established within reasonable certainty.¹⁵⁶

Finally, one of the conundrums that insureds face when they need to file BI claims is that they do not purchase enough insurance to cover all losses.¹⁵⁷ It is generally the broker’s job to assess the amount of insurance an insured requires.¹⁵⁸ For example, a recent case involved a metals manufacturer that experienced a fire loss to machinery essential to its manufacturing process.¹⁵⁹ While the business was disrupted, the manufacturer sustained more than \$1.5 million in lost earnings and other outlays.¹⁶⁰ Fortunately, the manufacturer followed the advice of its broker and purchased sufficient BI insurance prior to the destructive fire, which covered its losses.¹⁶¹

Having laid down the principals of BI and the basic framework of LOU insurance, we are now ready to delve into an exploration of the focus of the present work: insurance coverage for drought. We will undertake this analysis from a number of perspectives.

A. A Hypothetical to Ponder

Let us return to the hypotheticals posed earlier, as well as some others that demonstrate whether a party who pays for BI and LOU coverage would recover.

¹⁵⁵ The trial court awarded \$290,903 in extra business expenses and consequential damages of \$335,170. The appellate court reversed awarding \$290,903 in extra business expenses and a 25% penalty of \$72,725.75. This resulted in a difference in consequential damages of \$262,444.25. *Id.* at 33.

¹⁵⁶ *Id.* at 25.

¹⁵⁷ See *Business Income Insurance: Having and Understanding this Coverage Can Be Essential to a Company’s Survival*, ADJUSTING TODAY (Aug. 18, 2014), <http://adjustersinternational.com/publications/adjusting-today/business-income-insurance-coverage/0/> [<https://perma.cc/WQT8-NKXB>].

¹⁵⁸ See *id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ *Id.*

Hypothetical 1:

Assume that the region encompassing a hotel on a beautiful expansive lake is hit by a severe drought and that more than 60% of its soil lacks water. About one-third of the area's wheat crop has withered due to the drought and the lake has shrunk. Therefore, the hotel experiences numerous cancellations thereby reducing its occupancy. If this reduction of occupancy was *not* enough to totally suspend operations, making it only a partial suspension, would that loss of profits be covered the hotel's BI policy?

Of course, should the hotel's operations be partially suspended, the language of its policy will control the coverage. Accordingly, if "suspension" is defined in the policy, the hotel may recover dependent on the definition of suspension in the policy. Historically, many business interruption riders did not define "suspension." Consequently, courts have had to insert their own definitions and have arrived at a "complete shutdown."

As noted above,¹⁶² in California, *Buxbaum v. AETNA Life & Cas. Co.*,¹⁶³ is the precedential case. It held that a "necessary suspension" of operations "connotes a temporary, but complete, cessation of activity."¹⁶⁴ Similarly, New York has adopted *Buxbaum's* logic. Thus, in a 9/11 loss case, the amount of lost business income a building owner was able to recover from its insurer was bound by the time that the building's tenants were permitted to reuse their apartments.¹⁶⁵ There, the court found that the term "suspension" was not defined.¹⁶⁶ Consequently, it held against the insurer, finding that Broad St., LLC, the insured, must have suffered a "total interruption or cessation" of its operations.¹⁶⁷

Pennsylvania's federal courts have also embraced the foregoing logic. In *American Med. Imaging Corp. v. St. Paul Fire and Marine Ins. Co.*,¹⁶⁸ the Third Circuit Court of Appeals was requested to overturn the trial court's denial of coverage to American Medical Imaging ("AMIC") under its business interruption policy. AMIC provided ultrasound testing facilities to individual doctors and to area health care establishments. Its headquarters building incurred damage from a fire. These quarters were temporarily unusable, specifically due to the interruption of AMIC's telephone system, which it employed in scheduling of ultrasounds, ordering supplies, preparing test reports for its existing clientele, and for procuring new clients.

AMIC sought new temporary quarters. However, it was unable to resume full telephone operations at that location. Consequently, AMIC could only function at a reduced level due to the interruption in its telephone system at a provisional location. As a result, AMIC lost business and new clients. It submitted a claim for BI coverage under its policy. Indeed, AMIC specifically sought

¹⁶² *Supra* note 151 and accompanying text.

¹⁶³ *Buxbaum v. Aetna Life & Casualty Co.*, 126 Cal. Rptr. 2d 682 (Cal. Ct. App. 2002).

¹⁶⁴ *Id.* at 688.

¹⁶⁵ *Broad St., LLC v. Gulf Ins.*, 37 A.D.3d 126, 132-33 (N.Y. App. Div. 2006).

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Am. Med. Imaging Corp. v. St. Paul Fire & Marine Ins.*, 949 F.2d 690, 691 (3d Cir. 1991).

coverage for the lost earnings and extra expenses incurred as a result of the fire, and chiefly the disruption of its telephone system. AMIC’s insurer, St. Paul’s, declined coverage and AMIC brought suit for the following:

[P]roperty damage coverage, the policy[‘s] covered ‘lost earnings’ and ‘extra expenses’ incurred during a business interruption. The maximum amount recoverable for lost earnings and extra expenses under this provision was \$500,000. . . AMIC represented that its lost earnings amounted to nearly \$1 million. The proof of loss also indicated that AMIC’s extra expenses as a result of the relocation were \$20,350.20. After St. Paul refused to honor the lost earnings and extra expenses claim, AMIC brought this action for \$500,000 and for punitive damages under the Pennsylvania Unfair Insurance Practices Act.¹⁶⁹

The district court ruled in favor of the insurer, and AMIC appealed. The appellate court rejected the district court’s interpretation of Pennsylvania’s law—as well as the insurer’s argument “that coverage was precluded because the policyholder would be carrying on the same kind of activities [elsewhere] that occurred at the covered location.”¹⁷⁰ Moreover, in its judgment, the court of appeals held that under the district court’s logic “the insured would have no motivation to mitigate its losses [as c]ontinuing 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.”¹⁷¹ Additionally, that court observed that under its stance, St. Paul’s policy would require “an affirmative duty [on the policyholder] to mitigate its losses.”¹⁷² Consequently, St. Paul’s “obligation to indemnify continues until the resumption of ‘normal business operations,’” [moreover, as such,] “the obligation to indemnify can arise while business continues, albeit at a less than normal level.”¹⁷³ Accordingly, under this line of cases, the hotels affected by the 2015 drought, when Arizona and California suffered their most severe drought, would likely recover their lost income pursuant to their BI policy. Thus, a hotel chain that experienced numerous cancellations from people who sought to hike in the areas where the hotels operated would also recover its lost income pursuant to its BI policy, even though it only experienced a partial suspension or, reduced occupancy.

Alternatively, in other jurisdictions, insureds who contracted for policies where the term “suspension” is not defined in the policy, courts have held for the insurers and denied recovery by insureds for partial suspension or interruption of

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 692.

¹⁷¹ *Id.*

¹⁷² *Id.* at 693.

¹⁷³ *Id.*

operations.¹⁷⁴ One such case involved the 1980 eruption of Mt. St. Helens, located in Skamania County, Washington, near the town of Castle Rock.¹⁷⁵ In that case, a hotel adjacent to the volcano had to shut down temporarily due to the months long eruptions, and the appellate court rejected the hotel's claim for losses due to interruption of business and earnings.¹⁷⁶

V. Conclusion

Assume the following drought-caused hypothetical. We are well aware that crops may not grow, or in fact may wither or shrivel away due to a drought's high heat and lack of precipitation. Crops including lettuce and alfalfa in Arizona, oranges and avocados in California, and other crops in adjacent, or faraway states are certainly tangible property, just like chickens and livestock. Would a farmer who suffers drought-induced crop losses be able to make a successful claim for LOU and BI coverage? We have suggested that pursuant to many policies, and in several courts, there may be recovery. Alternatively, there is a distinct possibility that an insurer will argue a drought is not an occurrence under the terms of the

¹⁷⁴ See, e.g., *Keetch v. Mutual of Enumclaw Ins.*, 831 P.2d 784 (Wash Ct. App. 1992).

Mutual insured the Colwell Motel. Its policy included a *loss of earnings endorsement* which provided:

1. [T]his policy is extended to insure against loss of earnings resulting directly from necessary interruption of business caused by the perils insured against damaging or destroying ... real or personal property . . . at the premises . . .

2. The Company shall be liable for:

a. [T]he actual loss sustained by the insured resulting directly from necessary interruption of business ... for only such length of time as would be required with the exercise of due diligence and dispatch to rebuild, repair or replace such part of the property herein described as has been damaged or destroyed . . . Due consideration shall be given to the continuation of normal charges and expenses . . . to the extent necessary to resume operations of the insured with the same quality of service which existed immediately preceding the loss; and

. . . .

4. Resumption of Operations: It is a condition of this insurance that if the insured could reduce the loss resulting from the interruption of business:

a. by complete or partial resumption of operation of the property herein described, whether damaged or not . . .

. . . .

[s]uch reduction shall be taken into account in arriving at the amount of loss hereunder.

Id.

¹⁷⁵ *Volcano Hazards Program, Mt. St. Helens*, U.S. GEOLOGICAL SURVEY, https://volcanoes.usgs.gov/volcanoes/st_helens (last visited Jan. 17, 2019).

¹⁷⁶ *Keetch*, 831 P.2d 784.

insuring agreement. Consequently, the insurer may assert that weather generally, and drought in particular, is a *force majeure*, and therefore, no coverage should issue. Indeed, as noted above, in the future insurers may altogether exclude coverage for extremely hot weather and droughts.

Nevertheless, until courts or legislatures resolve the issue, there will be substantial economic disruptions throughout the supply chain. Not only will farmers be impacted but so will silo operators who will not be able to put grain into their silos, as their client-farmers have none to store. Each of these businesses will likely file claims for LOU and BI coverage with their insurers. Similarly, other businesses, including railroads and truckers who transport grain and crops for processing or to markets, may also have to contend with LOU and BI coverage issues.

Under a line of cases in some states, farmer and associated businesses will likely be denied coverage. However, crops and faunae are property under coverage A. Given that their deaths reduced the income that a farmer is able to earn, I posit that, at least at this juncture, under these facts she will likely recover under her BI policy because of the tangible loss. Moreover, as in the AMIC case, the insured would certainly be motivated to mitigate her losses because not doing so would risk destroying the business. In fact, most business owners want to concentrate their energy on improving their enterprise, rather than fight with an insurer over the meaning of terms, as was the case in Buxbaum.

In 2007, the Insurance Services Office (“ISO”) issued a new form/rider, CP 00 30 06 07, the Business Income (And Extra Expense) Coverage Form¹⁷⁷ that defines Business Income as follows:

Business Income means the: a. Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred; and b. Continuing normal operating expenses incurred, including payroll. For manufacturing risks, Net Income includes the net sales value of production. Coverage is provided as described and limited below for one or more of the following options for which a Limit of Insurance is shown in the Declarations: (1) Business Income Including “Rental Value”. (2) Business Income Other Than “Rental Value”. (3) “Rental Value”¹⁷⁸

Furthermore, actual loss of Business Income is defined as follows:

If Limits of Insurance are shown under more than one of the above options, the provisions of this Coverage Part apply separately to each. We will pay for the actual loss of Business Income you

¹⁷⁷ *Business Income (And Extra Expense) Coverage Form*, ISO PROPS. INC. (2007), <https://www.propertyinsurancecoveragelaw.com/files/file/CP%2000%2030%2006%2007.pdf>.

¹⁷⁸ *Id.* at 1.

sustain due to the necessary “suspension” of your “operations” during the “period of restoration”. *The “suspension” must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss.* With respect to loss of or damage to personal property in the open or personal property in a vehicle, the described premises include the area within 100 feet of the site at which the described premises are located.¹⁷⁹

Suspension is defined at page 9 of 9 under section F. Definitions as follows:

6. “Suspension” means:

a. The slowdown or cessation of your business activities; or b. That a part or all of the described premises is rendered untenable, if coverage for Business Income Including “Rental Value” or “Rental Value” applies.¹⁸⁰

Given the 2007 ISO Business Income (And Extra Expense) Coverage Form’s definition of “suspension” there should be little confusion regarding that term.

A. A Shrinking Insurance Market?

The loss of the family farm in Arizona¹⁸¹ and elsewhere,¹⁸² means that sales of insurance policies, particularly non-CAT ones like automotive and property, will decrease, or at best flatten out. Moreover, given the extent of the current drought cycle in the Southwest and states such as Idaho and Washington,¹⁸³ as

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* at 9.

¹⁸¹ Joshua Bowling, *Family Farms Made Phoenix Livable, So Why are so Many Going Away?*, ARIZ. REPUBLIC (Feb. 17, 2019), <https://www.azcentral.com/story/news/local/surprise/2019/02/17/phoenix-family-farms-disappearing-development-taking-their-place/2771136002> (“In 2000, Maricopa County had 510 square miles of agricultural land and 180 square miles of residential land west of Interstate 17. By 2017, farmland had dropped to 350 square miles while residential land grew to cover 280 square miles, according to the Maricopa Association of Governments.”).

¹⁸² Alana Semuels, *They’re Trying to Wipe Us Off the Map.’ Small American Farmers Are Nearing Extinction*, TIME (Nov. 27, 2019) <https://time.com/5736789/small-american-farmers-debt-crisis-extinction>; See also Phil McCausland, *Best Advice to U.S. Dairy Farmers? ‘Sell Out as Fast as you Can’*, NBC NEWS (June 30, 2018), <https://www.nbcnews.com/news/us-news/best-advice-u-s-dairy-farmers-sell-out-fast-you-n887941>.

¹⁸³ *Drought—June 2019*, Nat’l CTRS. FOR ENVTL. INFO., NOAA (July 11, 2019) <https://www.ncdc.noaa.gov/sotc/drought/201906>.

well as the fact that “[c]onditions have also been particularly dry through July west of the Continental Divide, farmers are suffering losses of crops and making the agricultural segment of the economy particularly vulnerable.¹⁸⁴ However, given a smaller policy-holder base, insureds in these areas who have been hard-hit by this wave of droughts may anticipate rate hikes and coverage changes¹⁸⁵ as insurers attempt to recoup the losses that they will suffer from their payouts.

The situation is no different in other countries. For example, in Israel, although the government provides financial subsidies to farmers, including special packages, the Yaron Solomon, head of the settlement department and the coordinator of the economic, finance, and agriculture committee of the Israel Farmers Union has argued that the government’s subsidies should include assistance with insurance premiums.¹⁸⁶ He has also observed the following with regards to weather trends:

I think that the world is going berserk weather wise
 Something is really going wrong with the weather throughout the whole world. Just because of the fact that that’s happening, year after year, in different parts of the world and different parts of the country—that’s why I claim that they have to find some sort of insurance coverage that will help the farmers through the hard years.

Moreover, without the possibility of business growth in those regions that have been hard-hit by droughts (and floods),¹⁸⁷ insurers will likely maintain renewal rates but may not be able to write new policies due to lack of demand.¹⁸⁸ This situation may also cause increased rates, higher deductibles, and restricted coverages.¹⁸⁹ Indeed, the agribusiness insurance products may slowly become a

¹⁸⁴ Yusuke Kuwayama, *The Economic Impacts of Drought on US Agriculture*, RES. (Mar. 13, 2019), <https://www.resourcesmag.org/archives/economic-impacts-drought-us-agriculture>.

Below-average precipitation along with diminished surface water and groundwater supplies can reduce crop yields and affect irrigation and livestock watering. Above-average temperatures, which are also associated with droughts, can impose additional stress on crops and animals. These hydrologic and biophysical impacts, in turn, can lead to decreases in crop and livestock sales, increases in production costs, or both.

Id.

¹⁸⁵ See O’Conner, *supra* note 10.

¹⁸⁶ Sharon Udasin, *Israel Experiencing Unprecedented Drought Conditions*, THE JERUSALEM POST, ENVIRO TECH (Feb. 10, 2014), <http://www.jpost.com/Enviro-Tech/Israel-experiencing-unprecedented-drought-conditions-341003> [<https://perma.cc/B9SK-H9GG>].

¹⁸⁷ Dennis Romero, *Flooding That’s Been Tormenting Midwest Will Only Get Worse This Spring, Forecasters Warn: “We expect the flooding will get worse and become more widespread,” a National Weather Service official said*, NBC NEWS (Mar. 21, 2019), <https://www.nbcnews.com/news/weather/flooding-s-been-tormenting-midwest-will-only-get-worse-spring-n986116>.

¹⁸⁸ See O’Conner, *supra* note 10.

¹⁸⁹ *Id.*

mirror image of environmental pollution policies, which in the 1980s began to restrict coverage and eventually wrote absolute pollution exclusions.¹⁹⁰

Agribusiness insurance notwithstanding, other types of risks also exist. In 2015, the National Interagency Fire Center placed much of California in “extreme to exceptional drought conditions with ‘above normal’ potential for wildfire.”¹⁹¹ Moreover, the fires caused by droughts in 2019 have caused insurance rates to rise.¹⁹² Indeed, in 2019 California imposed a “one-year moratorium preventing insurers from dropping customers in or alongside ZIP codes struck by recent wildfires.”¹⁹³

Given the amount of stressed vegetation and elevated temperatures, wildfires have been rampant,¹⁹⁴ and their potential for destruction in “high-risk” zones is estimated at approximately \$237.3 billion in property damage.¹⁹⁵ Indeed,

¹⁹⁰ With regards to the absolute pollution exclusion, see generally Kathryn M. Knight, Note, *Total and Absolute Pollution Exclusions Are Neither Total Nor Absolute, at Least for Now: Doerr v. Mobil Oil Corporation*, 47 LOY. L. REV. 1153 (2001); Jeffrey W. Stempel, *Reason and Pollution: Correctly Construing the “Absolute” Exclusion in Context and in Accord with its Purpose and Party Expectations*, 34 TORT & INS. L. J. 1 (1998).

¹⁹¹ *California Drought*, *supra* note 40. Changing weather could put insurance firms out of business.

¹⁹² David Lazarus, *Column: California Fires Will Result in Higher Insurance Rates for Homeowners*, L.A. TIMES (Oct. 31, 2019), <https://www.latimes.com/business/story/2019-10-31/fire-insurance-david-lazarus-column>.

But the trend is clear: Things aren’t getting any better—and thanks to climate change and our eagerness to build in areas susceptible to wildfire, the situation almost certainly will grow worse. That means the cost to homeowners for coverage will keep rising.

Mark Sektan, vice president of the American Property Casualty Insurance Assn., didn’t want to say that so bluntly, regardless of how many time I rephrased the question.

But he acknowledged that, for many homeowners, rates are going up. In some cases, that can mean a doubling or even a tripling of premiums.

“Insurers will continue to reflect risk in their rates,” Sektan said. “As risk increases, so will rates.” He noted that “we’ve had three historically bad years for wildfires. Rates going forward have to reflect past losses.”

Id.

¹⁹³ Christopher Flavelle & Brad Plumer, *California Bans Insurers From Dropping Policies Made Riskier by Climate Change*, N.Y. TIMES (Dec. 5, 2019), <https://www.nytimes.com/2019/12/05/climate/california-fire-insurance-climate.html>.

California’s wildfires have grown so costly and damaging that insurance companies—a homeowner’s last hope when disaster strikes—have increasingly been canceling people’s policies in fire-prone parts of the state.

On Thursday, however, California took the highly unusual step of banning the practice, a decision that exacerbates the insurance industry’s miscalculation of the cost of climate change.

Id.

¹⁹⁴ Jon Mooallem, ‘*We Have Fire Everywhere*’, N.Y. TIMES (July 31, 2019), <https://www.nytimes.com/interactive/2019/07/31/magazine/paradise-camp-fire-california.html> (“The fire was already growing at a rate of one football field per second when Tamra Fisher woke up on the edge of Paradise, Calif., feeling that her life was no longer insurmountably strenuous or unpleasant and that she might be up to the challenge of living it again.”).

¹⁹⁵ *California Drought*, *supra* note 40.

changing weather patterns and the large payouts caused by them may place many insurers in very a tenuous economic condition, with some of them having to go out of business.¹⁹⁶ The trend is clear: things aren’t getting any better—and thanks to climate change and our eagerness to build in areas susceptible to wildfire, the situation almost certainly will grow worse. That means the cost to homeowners for coverage will keep rising.

These risks have also caused insurance brokers and agents to reexamine coverages for business and personal line clients. Indeed, newly constructed businesses and homes are causing concerns for agents, brokers, and insurers, because in fire-prone areas, these buildings pose a high risk, and rating them for insurance coverage is more challenging.¹⁹⁷ With insurance rates “tripling for some homeowners,” members of the California’s department of insurance have grave concerns.¹⁹⁸ The question for insurers, their brokers and agents is: how does one price such high risks without foreclosing the marketplace?

This is one area where the insurance industry can use its power to dissuade construction in high-risk areas. By refusing to insure structures in such areas, the industry will defeat developers’ rush to build anywhere they can.¹⁹⁹ Where drought is concerned, however, the issue before the industry is how to price policies where the risk of drought-caused fires is extremely high, and whether to insure at all.²⁰⁰

However, what is truly alarming is that current forecasts for future global warming could cause more serious drying out in the United States.²⁰¹ “And a

¹⁹⁶ *Changing Weather Could Put Insurance Firms Out of Business*, THE ECONOMIST (Sept. 19, 2019), <https://www.economist.com/finance-and-economics/2019/09/19/changing-weather-could-put-insurance-firms-out-of-business>.

¹⁹⁷ See, e.g., Assoc. Press, *86,000 Homes to be Built in Fire-Prone SoCal Areas*, USA TODAY (Nov. 11, 2007), http://usatoday30.usatoday.com/weather/wildfires/2007-11-11-fire-prone_N.htm [<https://perma.cc/ZX28-DA8U>] (discussing the Santa Clarita fire’s destruction of over 800 square miles, death of nine people and the charring of over 2,100 homes, and where developers are proposing the construction of over 60,000 homes).

¹⁹⁸ Lazarus, *supra* note 192.

¹⁹⁹ See generally Kevin Brass, *San Francisco: Bubble Fears Fail to Curb Rush to Build New Condos*, FT.COM (Feb 16, 2016), <http://www.ft.com/cms/s/0/055db7f4-d016-11e5-831d-09f7778e7377.html> [<https://perma.cc/8QKC-EVNC>] (examining developers’ rush to build); Eric Marks, *Councilman to Slow Developers’ Rush to Build in Rezoned Areas*, THE REAL DEAL: THE N.Y. REAL ESTATE NEWS (Nov. 28, 2007), http://therealdeal.com/issues_articles/councilman-to-slow-developers-rush-to-build-in-rezoned-areas [<https://perma.cc/4QPM-4BN7>].

²⁰⁰ See, e.g., Don Jergler, *California Blazes Destroy 2000-plus Home, Curb Insurers Appetites*, INS. J. (Sept. 23, 2015), <http://www.insurancejournal.com/news/west/2015/09/23/382604.htm> [<https://perma.cc/K2TA-495W>]; Cody Drabble, *California Wildfires Drive Up Insurance Costs for Homeowners*, CAPITAL PUB. RADIO (Sept. 17, 2014), <http://www.capradio.org/articles/2014/09/17/california-wildfires-drive-up-insurance-costs-for-homeowners> [<https://perma.cc/ZZ2F-3NMB>] (homeowners insurance jumped from \$2,300 in 2012 to \$7,200 in 2014).

²⁰¹ Brad Palmer, *How Droughts Will Reshape the United States*, WASH. POST (July 17, 2012), <http://www.washingtonpost.com/news/wonkblog/wp/2012/07/17/how-droughts-will-reshape-the-united-states> [<https://perma.cc/9WBX-G8EV>].

growing body of scientific evidence suggests that [the] level of warming could drastically increase droughts around the world, including in North America.”²⁰² Indeed, those people who have lived through the current 19 year drought in the southwestern United States, or earlier droughts, know well what the consequences are and will be. The question then, for both insureds and insurers, is how will they address the spin-off results in the new era of climate change?

²⁰² *Id.*