
## FROM THE EDITOR

*When a business suffers damage from a fire, storm or similar disaster, its otherwise normal operations can be seriously disrupted. When the loss takes place while the business is being sold and bought, or recovering from a loss, disruptions of another type arise in the form of questions as to how and whose insurance will cover the damages.*

*In this issue of* Adjusting Today, *attorney Gary Thompson discusses the various factors that come into play in these situations. Among the important points he addresses are how business interruption and unrepaired property are affected, how assigning a claim works, courts' rulings in such cases, and the responsibilities insurers are obligated to uphold. Mr. Thompson has extensive experience representing policyholders in these matters.*

*It is a clear and concise summary of what is often a complicated subject. We hope you will enjoy and benefit from it.*

*Sheila E. Salvatore*
*Editor*

# The Effect of the Sale of a Commercial Property on a Pending Insurance Claim

*Gary Thompson*

The sale of commercial properties is an everyday occurrence. In the normal course, the risks associated with the property are passed from seller to buyer at the moment of sale. The buyer's insurance picks up where the seller's leaves off. But what happens when, at the time of sale, there is a pending insurance claim from a recent hurricane, flood, fire, or other calamity? Are sellers and buyers constrained by this situation? This is a common question fielded by insurance coverage lawyers for policyholders and insurers.

Under the language of most property policies, there are three simple rules:

- First, following a sale, the policyholder/seller can still collect business interruption (BI) proceeds *beyond the sale date* and through what would have been the end of the "theoretical" BI period. That is because the BI loss is determined at the time of loss and the insurers themselves employ a theoretical measure of the BI period based on "due diligence and dispatch," regardless of the actual repair period.


- Second, the policyholder/seller can also collect repair or replacement costs estimated but not yet actually spent at the damaged property as of the sale date, as most replacement-cost-value (RCV) policies permit an election to apply RCV proceeds to another insured location or to other capital expenditures unplanned as of the date of the loss.

- Third, in the alternative, the seller can simply assign all or part of a claim to a purchaser, which is the law in nearly every state. The "anti-assignment" clause in a typical policy means only that the *policy itself* cannot be assigned without insurer consent, but a post-loss *claim* is assignable notwithstanding the clause. The scope and nature of an assignment is negotiable between the seller and purchaser.

In other words, when properly documented and planned, the sale of a damaged property does not create a windfall opening for the insurer to escape from some or all of its insurance obligations, no matter how rights to insurance proceeds are negotiated and allocated between the seller and purchaser. This is fair and logical. Without the sale, the insurer is obligated to pay a certain amount to its policyholder/seller; with the sale, the insurer remains obligated to pay the exact same amount, no more or less. An insurer cannot take unfair advantage of a sale and artificially cut off its insurance obligation. The law prohibits such opportunistic claim adjustment.

These three rules are examined further below.

### 1. Business Interruption Past the Sale Date

The sale of an income producing property subsequent to an insured loss does not limit or end the seller/policyholder's own BI claim for that loss. A policyholder can enforce an insurer's contractual obligation to pay BI through the full "theoretical" BI period, provided that the policyholder had an "insurable interest" in the property at the time of the loss. An owner of a property that suffers a calamity obviously had a full insurable interest at the time of the loss in the property and its income stream.[1]

A federal court deep in the heart of the hurricane zone carefully considered this issue and came to the correct result. In *BA Properties v. Aetna Cas. & Sur. Co.,* the policyholder owned the Ritz-Carlton on St. Thomas when Hurricane Marilyn struck in 1995, causing damage to the hotel and a lengthy shutdown. In June 1996, during the middle of the BI period, BA Properties sold the hotel. The insurer refused to pay BA Properties for any BI loss after the sale date, despite the absence of any assignment of the claim to the purchaser. The court squarely rejected the insurer's blunting of the BI adjustment, vacating a prior ruling in the same case that favored the insurers (from a judge who later recused himself).

The *BA Properties* court first framed the issue as whether the insured had an "insurable interest" at the time of the loss.[2] The court easily found the insured possessed an "insurable interest," noting that the Virgin Islands, like Florida and many other states, defines "insurable interest" as fixed "at the time of loss."[3] Based on this temporal fixation of the necessary insurable interest, the court then found that "any change in the insurable interest *after* the time of loss does not affect the *amount* that the insured can recover under the applicable insurance policy." Specifically, the court ruled that the insured could recover "for its business interruption losses for the time period *after* it sold the Hotel."[4]

The court specifically rejected the insurer's argument that the insured "did not sustain any actual losses after it sold the Hotel and its *expenses and profits* could not have continued after it sold the hotel."[5] Thus, the court allowed for continuing recovery of a theoretical BI loss, both as to the lost net profits that *would have* been earned and the continuing expenses that would have been incurred:

> Thus, the "actual loss sustained" limitation means only that an actual loss must be predictable from past business experience. The further restriction that only those expenses that continue during the business interruption are covered means that the Policy covers only expenses that the insured would have been able to pay had it continued in operation. . . . To construe this restriction as requiring that BA Properties continue to own the Hotel to be able to recover its continuing expenses would be to stretch it beyond its common meaning.[6]

Moreover, the insurer has no entitlement to a "credit" for the proceeds from the hotel sale against the amount it owes on the insurance claim. "Any receipt by BA Properties of money from any other source does not reduce the actual loss that BA Properties sustained as a result of Hurricane Marilyn for which the insurers must compensate it."[7] "Even if BA Properties benefited by the sale of the Hotel, the insurers cannot escape their own liability by claiming that benefit as their own."[8] Thus, under the law, the right to recover for BI loss is fixed at the time of the loss and extends to the full theoretical BI period notwithstanding the sale of the property.

> ***The 'anti-assignment' clause in a typical policy means only that the policy itself cannot be assigned without consent, but a post-loss claim is assignable notwithstanding the clause.***

The result in the *BA Properties* case is consistent with a very well settled line of cases holding that a policyholder is always entitled to collect BI based upon a full "theoretical" BI period even in circumstances where there is no actual business interruption.[9] So even if a property is not rebuilt and there is never any actual BI period, the policyholder remains entitled to what the BI loss would have been for the projected "theoretical" period of interruption.

Insurers agree. They frequently cite this same line of cases to support *reducing* a BI period by arguing that the policyholder failed to repair with "all due diligence and dispatch." They assert that the BI period is an abstract time period that floats free from what actually happens. For example, this was the measure of the 2001 World Trade Center loss, where a federal court allowed the insurers to define the BI period as the theoretical time period it "should" take to rebuild the complex, not necessarily how long it actually takes.[10] This same line of cases applies in the instance of a sale and should prevent a reduction in the "theoretical" BI period that defines the scope of the seller's BI recovery. Insurers cannot have it both ways — they cannot assert the "theoretical" BI period when it is shorter than the actual period (e.g., due to repair delays), but then ignore the "theoretical" BI period when it happens to be longer than the actual period (e.g., due to a sale).

There are a few off-point cases in the assignment context that insurers sometimes cite, which address the very different issue of whether a *purchaser* who has been assigned a claim can thereby assert its *own* BI loss. For example, in *Bronx Entertainment, LLC v. St. Paul's Mercury Ins. Co.,* the insured, Family Golf, experienced losses from severe weather and filed an insurance claim. Family Golf thereafter sold its assets to Bronx Entertainment, and specifically assigned its insurance claim.[11] The court correctly noted that the assignee received only those insurance rights that belonged to the assignor, and no more.[12] The assignee, Bronx Entertainment, however, attempted to assert not only the pre-sale BI losses of Family Golf, but *its own* post-sale BI losses. The court ruled, of course, that Bronx Entertainment, as assignee, could not assert *its own* BI losses.[13] In this regard, the court cited to and relied upon the superseded, earlier *BA Properties* ruling. Most importantly, the *Bronx Entertainment* court did not actually rule that the purchaser, as assignee, could not assert the rights of the *seller/assignor,* nor that the seller could not have held onto its own rights and made a claim for its own full BI losses, including beyond the sale date.[14]

Of course, calculating a theoretical BI loss beyond a sale date can be complex, given the absence of actual figures in the hands of the seller/policyholder, especially as to an extended BI period where the offset from actual sales may be unknown. The ultimate practical effect of a sale on the BI claim may be more a matter of proof, since the claim could become harder to track. Sellers that do not assign claims are advised to confirm the purchaser's cooperation in supplying information to assist with the insurance claim.

### 2. Unrepaired Property

To the extent that the Seller has already incurred repair or replacement costs, such costs are reimbursable under the policy. If there are certain permanent or other repairs estimated but yet to be made at the time of sale, those estimated costs remain recoverable notwithstanding the sale. There generally are four options for adjustment on the property side:

A. Receive the cost for the actual repair or replacement at the *same site* (materials of like size, kind and quality). This option requires the actual repairs to be made by the policyholder, its buyer, or any other party (as long as they are made).

B. Receive the same RCV but with the proceeds applied to *another site,* obviously not to exceed the costs that would have applied to the damaged site. In other words, use the same money to fix up another policyholder property.

C. Receive RCV applied neither to the same nor another site, if the proceeds of such loss settlement are expended on *other capital expenditures* related to the Insured's operations "within two years from the date of the loss." The usual condition is that any such expenditure must not have been planned as of the date of the loss and must be made at a location insured under the policy.

D. Receive Actual Cash Value (ACV). Many policies make this the default option if none of the above approaches are selected within a "reasonable" time period or at least two years from the date of the loss.

Thus, by the express terms of a typical policy, if there are repair or replacement costs yet to be expended at the actual site, they remain collectible after a sale from the insurer. Option one requires someone to make the actual repairs to the damaged site. Option two requires actual expenditure of the equivalent RCV at another site. Option three requires only application of the equivalent RCV to "other capital expenditures," as described.

At a minimum, ACV would be the measure for any losses if repair or replacement does not take place and there is no application of proceeds to another site or to other capital expenditures. Under some policies, ACV is defined as "cost to repair or replace insured property, on the date of loss, with material of like kind and quality, with proper deduction for obsolescence and physical depreciation." Under other policies, the definition of ACV can differ.[15]

> ***If there are certain permanent or other repairs estimated but yet to be made, those estimated costs remain recoverable notwithstanding a sale.***

Most recently, this issue was considered by the Seventh Circuit in *Edgewood Manor Apartment Homes, LLC v. RSUI Indemnity Co., 733* F.3d 761 (7th Cir. 2013). There, the policyholder sold an apartment complex damaged by Katrina but before repairs had been completed. It did not assign the insurance claim to the buyer. The court addressed the question: "Does a claim for 'replacement cost' proceeds under a property-insurance policy survive the insured's sale of the damaged property in its unrepaired state?" The court said yes, the policyholder seller could still collect RCV even though it was the buyer who completed the actual repairs. That is because "insurable interest" is measured at the "time of loss" and the seller need not hold the property through the completion of all repairs to qualify for receipt of full RCV proceeds. Such a formal requirement, said the court, "would be hard to justify" as it would artificially constrain policyholders to keep damaged property until fully repaired. Instead, a policyholder can sell a damaged property — and take a hit in the sale price — and then itself collect RCV proceeds when the buyer completes the actual repairs.

Of course, a more certain process for insurance collection might be through an assignment to the buyer, but a policyholder/seller has both options: (a) take a reduced sale price based on damage and collect RCV; or (b) take a full sale price (as if the property were not damaged) and provide an assignment to the buyer.

Depending on the policy language, in the absence of an assignment, code upgrade costs are a possible exception to the rule that a sale does not cut off an insurance claim by the seller for incomplete repairs. In a typical policy, the code upgrade coverage section provides that such coverage is not available unless the damaged "property is repaired or replaced," and the coverage is limited by the "actual cost incurred." Under some policies, upon the sale of a property, the seller cannot claim recovery of what would have been the code upgrade costs if the property had not been sold and repairs proceeded. Such a claim can, however, be assigned and continue to be asserted.

### 3. Assignment of Claim

The general rule is that an insurance claim can be assigned, even if a full policy cannot. This is the rule in statutes and cases around the country, including the Gulf Coast states, New York, and elsewhere.[16] Most insurance policies contain an "anti-assignment" clause stating that the "policy" cannot be assigned absent insurer consent. Such an anti-assignment clause only applies to assignments of the *policy* made before a loss, not to *claims* made after a loss. The law in Florida is typical:

> After the occurrence of the event insured against, the claim to recover the loss may be effectively assigned by the insured, even without the consent of the insurer, so as to vest in the assignee the absolute right to the insurance, provided, of course, the insured himself had that right at the time when the loss was incurred, and the assignment itself was otherwise valid.[17]

The common explanation was repeated by the *World Trade Center Properties* court: "'Before loss, the insurer is subjected to a risk which the insurer may exempt from assignability except upon its own

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consent. Upon loss, however, the risk disappears and nothing remains except the assured's right to payment — a mere chose in action which may be assigned without the limitations of any other chose in action.'"[18]

As noted above with respect to *Bronx Entertainment* and other cases, the purchaser cannot assert new rights *of its own* that did not belong to the seller/assignor. But whatever the extent of the *seller's* claim — it is fully assignable, in whole or in part. The assignee/buyer can then collect the value of that seller's claim against the insurer.

This all makes perfect sense and it is fair. On the one hand, if a seller owns a damaged property that will cost $500,000 to fix, with $500,000 in BI during the repair period, and the seller conveys the property without a claim assignment, such that the buyer has to come out of pocket to complete repairs and incur the BI loss, the buyer will reduce its purchase price by $1 million. The seller's $1 million discount in the sale price is balanced by the seller's right to collect $1 million in insurance (and the insurer pays the same $1 million it was obligated to pay absent the sale). On the other hand, if the seller conveys the damaged property *with* a claim assignment, all other things equal, the buyer pays to the seller the same fair market value price it would pay absent the assignment, makes the repairs themselves, and then collects the same $1 million (and again, the insurer pays the same $1 million it was obligated to pay absent the sale). In either case, the insurer always pays the same amount.

To conclude, when a commercial property is sold in the middle of a claim, insurers sometimes try to cut off a claim. But there is nothing about the sale of a property that provides an insurer with the opportunity to sidestep its payment obligations. Parties to the transaction should be careful with the insurance-related language in an assignment, a purchase and sale agreement, and other documents related to the transaction.

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1 See, e.g., BA Properties, Inc. v. Aetna Cas. & Sur. Co., 273 F.Supp.2d 673 (D. Virgin Islands) ("BA Properties") (seller had "insured interest" in hotel at time of hurricane loss and before sale date); Cigna Prop. & Cas. Ins. Co. v. Verzi, 684 A.2d 486 (Md. Ct. Spec. App. 1996) (policyholder entitled to fire insurance proceeds when building was destroyed by fire despite contingent contract to demolish building because policyholder had insurable interest in the full value of the building at the time of loss); Morgan v. American Security Ins. Co., 522 So.2d 454, 455 (1st Dist. Fla. 1988) (rule is the same in Florida: "the insurable interest of the parties to an insurance contract is determined by the facts existing at the time of the loss"); Fl. St. § 627.405 ("No contract of insurance of property or of any interest in property or arising from property shall be enforceable as to the insurance except for the benefit of persons having an insurable interest in the things insured as at the time of the loss." [emphasis added]).

2 BA Properties, 273 F.Supp.2d at 681.

3 BA Properties, 273 F.Supp.2d at 681-82, citing Florida Statute § 627.405. See note 1.

4 BA Properties, 273 F.Supp.2d at 683 (emphasis added).

5 BA Properties, 273 F.Supp.2d at 681-82 (emphasis added).

6 BA Properties, 273 F.Supp.2d at 683 (citing Hampton Foods, Inc. v. Aetna Cas. and Sur. Co., 787 F.2d 349, 354 [8th Cir. 1986]).

7 BA Properties, 273 F.Supp.2d at 684 (citations omitted).

8 BA Properties, 273 F.Supp.2d at 684 (citations omitted).

9 See, e.g., Steel Products Co. v. Millers Nat'l Ins. Co., 209 N.W.2d 32 (Iowa 1973) (where "for one reason or another, an insured does not repair, replace, or rebuild the insured premises . . . courts have consistently held the reduced earnings computation is based on the theoretical period it would have taken to repair, replace or rebuild the premises with due diligence"); Beautytuft, Inc. v. Factory Ins. Assoc., 431 F.2d 1122 (6th Cir. 1970) (the insured recovers the full "theoretical" time period it would have taken to rebuild the destroyed plant even if not rebuilt); Hawkinson Tread Tire Serv. Co. v. Indiana Lumbermans Mut. Ins. Co., 245 S.W.2d 24 (Mo. 1951) (same); Anchor Toy Corp. v. American Eagle Fire Ins. Co., 155 N.Y.S.2d 600 (N.Y. Cty. 1956) (where the insured did not rebuild, the BI claim remained defined by the theoretical rebuilding time at the insured site); Grand Pacific Hotel Co. v. Michigan Commercial Ins. Co., 90 N.E. 244 (Ill. 1909) (the insurer paid the BI claim through the date that it would have taken to rebuild a destroyed hotel).

10 SR International Business Ins. Co. Ltd. v. World Trade Center Properties et al., 2005 U.S. Dist. Lexis 13001 (S.D.N.Y. 2005).

[11] Bronx Entertainment, LLC v. St. Paul's Mercury Ins. Co., 265 F.Supp.2d 359 (S.D.N.Y. 2003) ("Bronx Entertainment").

[12] Bronx Entertainment, 265 F.Supp.2d at 361.

[13] Bronx Entertainment, 265 F.Supp.2d at 361.

[14] Likewise, in Holt v. Fidelity Phoenix Fire Ins. Co., 76 N.Y.S.2d 398, 400 (3d Dep't 1948), the court ruled that an assignee could not recover for its own business interruption loss, but noted that had the seller "not already been paid for its own losses," it could have recovered BI past the sale date or assigned to the purchaser such claim to recover the seller's BI losses. Another off-point case is SR International Business Ins. Co. Ltd. v. World Trade Center Properties, LLC et al., 394 F.Supp.2d 585 (S.D.N.Y. 2005), which also dealt with the issue of whether an assignee could assert its own ongoing rental income losses. The court held that an assignee can assert its own ongoing rental income losses (and did not reach the issue of whether the assignee could assert its own ongoing BI loss). With respect to the issue of whether the seller/policyholder, having not assigned its claims, can recover for the full "theoretical" BI loss past the sale date, there is only one court that to date has ruled on that issue, and for the policyholder – BA Properties.

[15] To the extent there is any uncertainty regarding the valuation, in determining ACV, New York, Florida, and other state courts follow the "broad evidence rule." See New York Cent. Mut. Fire Ins. Co. v. Diakas, 60 So.2d 786, 788-89 (Fla. 1954); McAnarney v. Newark Fire Ins. Co., 247 N.Y. 176 (1928); Worcester Mutual Fire Ins. Co. v. Eisenberg, 147 So.2d 575, 576 (Fla. App. 1962). Under the broad evidence rule, any evidence logically tending to establish a correct estimate of the value of the damaged or destroyed property may be considered by the trier of facts to determine the "actual cash value" at the time of the loss. 147 So.2d at 576. The rule "permits any evidence which logically tends to establish a reasonable approximation of the value of the property destroyed." Id. Courts have considered "replacement value," "wholesale value," and the owners' experience and testimony to determine ACV value. Id.

[16] See, e.g., Fla. Stat. § 627.455 ("a policy may be assignable, or not assignable, as provided by its terms"); Globecon Group, LLC v. Hartford Fire Ins. Co., 434 F.3d 165 (2d Cir. 2006) (policyholder could assign a claim to a successor corporation); SR International Business Ins. Co. Ltd. v. World Trade Center Properties et al., 394 F.Supp.2d 585 (S.D.N.Y. 2005) (permissible 2003 assignment of 9/11/2001 property claims from owner of World Trade Center retail leases to the Port Authority).

[17] Fla. Jur. 2d (Feb. 2005) § 1562 ("Assignment After Loss"). See also, e.g., Professional Consulting Svcs., Inc. v. Hartford Life & Acc. Ins. Co., 849 So.2d 446, 447 (Fla. 2d Dist. 2003) (allowing assignment); Better Constr. Inc. v. National Union Fire Ins. Co., 651 So.2d 141, 142 (Fla. 3d Dist. 1995) (an insured may assign insurance proceeds to a third party after a loss); Gisela Inv. N.V. v. Liberty Mut. Ins. Co., 452 So.2d 1056, 1057 (Fla. 3d Dist. 1984) (anti-assignment clause does not prevent the assignment of a post-loss claim or interest in insurance money).

[18] SR International Business Ins. Co. Ltd. v. World Trade Center Properties, LLC, et al., 394 F.Supp.2d at 593, citing Beck-Brown Realty Co. v. Liberty Bell Ins. Co., 241 N.Y.S. 727 (Sup. Ct. Kings Cty. 1930).

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