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## Superstorm Sandy and Con Edison's Power Shutdown: Lessons from *Johnson Gallagher*

By Joseph D. Jean and Amanda H. Freyre

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*In the wake of Superstorm Sandy, property insurers have repeatedly denied coverage for business owners in lower Manhattan – arguing that ConEd intentionally cut off power to its networks and that flooding damaged ConEd's facilities. A recent Southern District of New York decision, *Johnson Gallagher Magliery, LLC v. Charter Oak Fire Ins. Co., No. 13 CIV. 866, 2014 WL 1041831, at \*1 (S.D.N.Y. Mar. 18, 2014)*, considered coverage for a policyholder's losses caused by ConEd's Bowling Green Network outage. The court partially denied the insurer's summary judgment motion because the insurer did not demonstrate that the service interruption during ConEd's post-restoration period was excluded by the policy.*

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*Johnson Gallagher* is an important decision because it is the first to examine the circumstances of the Bowling Green Network shutdown and the implications that sequence of events may have on insurance coverage for policyholder business interruption losses arising from that Network. The court considered: (1) the preemptive shutdown just prior to the storm; (2) the period of restoration resulting from physical damage to electrical systems caused by the storm; (3) and the delays in reopening the plaintiff's building as a result of New York City building authority orders, and the testing of systems by the building owners. Based on a very limited record, the SDNY concluded there was no coverage for the preemptive shutdown period due to lack of physical damage and that a broadly worded flood exclusion precluded coverage for the restoration period following Sandy's damage to the Bowling Green Network's electrical systems. But, importantly, the SDNY held that the water exclusion did not preclude coverage for the losses suffered during ConEd's post-restoration period, because the loss during that period was not caused by water damage or the pre-emptive shut down. Also significant is that the court did not consider damage to other ConEd networks (e.g. the widely reported fires and explosions at ConEd's 13th Street facility) or whether other aspects of the policy such as sewer backup coverage might apply. Presentation and consideration of these facts, as well as the particular circumstances of each policyholder's loss, could expand the possibility of insurance coverage for Sandy-related losses.

The Insured, Johnson Gallagher Magliery, is a law firm that occupies offices on the 14th and 15th floors of 99 Wall Street, a building in lower Manhattan. *Id.* at \*1. In anticipation of Superstorm Sandy, ConEd preemptively shut down three electric networks, including the Bowling Green Network, which supplied power to the law firm (the “Network”). *Id.* at \*3. The court determined that the Network did not incur any physical damage as a result of the preemptive shutdown. *Id.* at \*7. Instead, the court found that water from Superstorm Sandy caused extensive damage to the Network’s facilities. *Id.* ConEd did not re-energize the Network until 1:33 a.m. on November 3. *Id.* at \*4. Johnson Gallagher’s building, however, did not receive electricity until sometime on November 11. *Id.* Additionally, due to “continuing internal electrification efforts,” Johnson Gallagher’s landlord did not allow tenants to return until November 16, even though the City approved reentry to the building. *Id.* Telephone and internet services were not restored until January 7, 2013. *Id.*

Based on these facts, Charter Oak argued that Johnson Gallagher could not recover its business losses under the service interruption endorsement. *Id.* at \*6. First, the insurer argued that the “interruption must result from direct physical loss or damage by a Covered Cause of Loss” not on the described premises and claimed that, because ConEd preemptively shut down power, the service interruption did not result from “direct physical loss or damage.” *Id.* Although the court agreed that the preemptive shutdown did not cause physical loss or damage, the court determined that the Network did sustain direct physical loss or damage. *Id.* at \*7. In support of its finding, the court cited deposition testimony by a ConEd engineer and a report by ConEd establishing that water and contamination caused substantial damage that delayed resumption of power for several days as equipment needed to be cleaned, tested and sometimes replaced. *Id.* at \*9.

Second, the insurer claimed that the “acts or decisions” exclusion barred coverage because ConEd intentionally shut off power. The exclusion provided:

(3) We will not pay for loss or damage caused by or resulting from any of the following under Paragraphs a. through c. But if an excluded cause of loss that is listed in Paragraphs a. and b. below results in a Covered Cause of Loss, we will pay for the resulting loss or damage caused by that Covered Cause of Loss.

...

b. Acts or decisions, including the failure to act or decide, of any person, group, organization, or government body.

*Id.* at \*2–\*3.

The court held that the preemptive power outage did not bar recovery because the preemptive shut down caused no physical damage. *Id.* at \*7. Notably, even if physical damage had resulted from the intentional shutdown, the court reasoned that this exclusion would only apply for the few hours between the preemptive shutdown and the arrival of Sandy and the water. In fact, the court stated, “when the flood waters from Sandy entered the network, they damaged it and prevented it from being immediately restored,” and that the electrical service loss that followed “proximately caused the damage” to the Network. *Id.*

Finally, the insurer claimed that the “water” exclusion barred coverage because water caused the vast majority of damage to the Network and the policy expressly excluded water damage. The water exclusion stated:

(1) We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss. These exclusions apply whether or not the loss event results in widespread damage or affects a substantial area.

...

(g) Water

(1) Flood, surface water, waves, tides, tidal waves, overflow of any body of water, or their spray, whether driven by wind or not;

...

But if Water, as described in Paragraphs (1) through (4) above results in fire, explosion, or sprinkler leakage, we will pay for the loss or damage caused by that fire, explosion, or sprinkler leakage.

*Id.* at \*2.

The court agreed, in part, relying on a limited factual record and a report from ConEd on the cause of the ConEd damage to conclude that the record “indisputably support[ed] the position that Con Edison’s electrical system was damaged by flooding.” *Id.* at \*9. Although there was also testimony that crews faced environmental hazards including diesel fuel, kerosene, and raw sewage, the court determined that the hazards appeared only “because of the invasion of ‘sea water.’” *Id.* at \* 8.

Importantly, however, the court did not consider whether the ensuing loss provisions of the water exclusion applied following the widely reported fires and explosions that ensued after the water struck ConEd’s facility. But the Court disagreed that the policy excluded the post-restoration period after November 3 because the loss during that period was not caused by water damage.

The *Johnson Gallagher* decision is important for several reasons – most notably because it shows that insurers should not be able to completely avoid business interruption claims by asserting “flood” or “intentional acts” exclusions. But also, and perhaps more importantly, the decision makes clear that policyholders should be careful to consider all aspects of their insurance coverage as the facts and circumstances surrounding Sandy – and the devastating losses that it caused – have the potential to trigger coverage under various additional coverages. Thus, whenever there is a loss, every policyholder should carefully review their policies and all aspects of coverage – and retain experienced claims assistance – before submitting a claim and most certainly after an insurer denies coverage.

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If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Joseph D. Jean (bio)  
New York  
+1.212.858.1038  
joseph.jean@pillsburylaw.com

Amanda H. Freyre (bio)  
New York  
+1.212.858.1181  
amanda.freyre@pillsburylaw.com

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