Some Basics on Contingent Business Interruption and Contingent Extra Expense Coverage

by Nicholas M. Insua and Anne E. Matthews

Companies with business interruption (BI) and extra expense (EE) insurance should also be familiar with related counterparts to those coverages—contingent business interruption (CBI) and contingent extra expense (CEE) coverage. Like BI and EE coverages, CBI and CEE coverages are extensions of first-party property insurance. Together, CBI and CEE are sometimes referred to as contingent time element coverage.

While BI and EE insure lost profits and extra expenses incurred due to an interruption of business resulting from damage to or destruction of the insured's property, CBI and CEE reimburse a company for lost profits and extra expenses incurred because of an interruption of business resulting from damage to or destruction of property of others.

A typical CBI clause provides:

> 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 "dependent property" at a premises described in the Schedule caused by or resulting from a Covered Cause of Loss. However, coverage under this endorsement does not apply when the only loss to "dependent property" is loss or damage to electronic data, including destruction or corruption of electronic data. If the "dependent property" sustains loss or damage to electronic data and other property, coverage under this endorsement will not continue once the other property is repaired, rebuilt or replaced. The term electronic data has the meaning set forth in the Coverage Form to which this endorsement applies.

The third-party property relevant to CBI and CEE claims is typically, but not exclusively, that of the policyholder's customer or supplier. The policy often will define the relevant properties, generally not as 'contingent' properties, but instead as 'dependent property,' with sub-types including contributing locations, recipient locations, manufacturing locations, and/or leader or attraction locations, to better identify the protected risk.

> 1. "Dependent property" means property operated by others whom you depend on to:
>   1. Deliver material or services to you, or to others for your account (Contributing Locations). But any property which delivers any of the following services is not a Contribution Location with respect to such services:
>   i. Water supply services;
>   ii. Power supply services; or
>   iii. Communications supply services, including services relating to Internet access to any electronic network;
>   2. Accept your products or services (Recipient Locations);
>   3. Manufacture products for delivery to your customers under contract of sale (Manufacturing Locations); or
>   4. Attract customers to your business (Leader Locations).

A policy may also, or in the alternative, include a schedule of specific properties to which CBI and CEE coverages apply.

Scope and Trigger of Coverage

Generally, to trigger CBI coverage there needs to be either: 1) damage to property that directly or indirectly prevents a supplier of goods and/or services to the policyholder from rendering its goods and/or services, or 2) damage to property that prevents a receiver of goods and/or services of the policyholder from accepting its goods and/or services. It is not generally necessary that the customer or supplier property be completely shut down.

Some examples of situations in which CBI coverage may be triggered are:

- when the policyholder depends on a single supplier or a few suppliers for materials
- when the policyholder depends on one or a few manufacturers or suppliers for most of its merchandise
- when the policyholder depends on one or a few recipient businesses to purchase the bulk of the policyholder's products
- when the policyholder counts on a neighboring business to help attract customers, known as a leader property

The seminal case of *Archer Daniels Midland Co. v. Phoenix Assurance Co. of N.Y.* provides an example of how CBI and CEE coverage protect a policyholder.[1] In that case, Archer Daniels Midland (ADM) was forced to transport raw material via more expensive rail transportation when the Midwestern floods during the summer of 1993 halted barge traffic on the Mississippi River.[2] ADM filed a claim with its CBI insurer for the increased transportation costs.[3] The Southern District of Illinois held that the Army Corp of Engineers, Coast Guard, and farmers who grew crops processed by ADM all qualified as suppliers.[4] In so holding, the court distinguished the Corp of Engineers and Coast Guard from the strictly regulatory Federal Aviation Administration and Department of Transportation on the basis of their significant physical improvements to the Mississippi River system.[5] The court also explained that the absence of direct contractual privity between farmers and ADM did not preclude coverage, because the policy did not limit coverage to direct suppliers.[6]

The case of *Pentair, Inc. v. American Guaranty & Liability Insurance Co.*, by contrast, offers an example of a situation where CBI coverage was not applicable.[7] There, an earthquake in Taiwan disabled an electrical substation that provided power to factories, which in turn prevented those factories from supplying products to Pentair.[8] When production resumed two weeks later, products were shipped via air freight to meet needs for the Christmas season.[9] Pentair submitted a claim for the increased costs of the air shipments.[10] The Eight Circuit, however, held that the electrical substation was not a supplier to Pentair, and the power outage did not cause any physical damage at the factories; therefore, Pentair's claim was not covered.[11]

Limits of Coverage

It is important to recognize that not all business interruption loss attributable to damage to third-party property will be covered by CBI or CEE insurance. For instance, such coverage will not be triggered by a utility service interruption of an off-premises power interruption, by a civil or military authority interruption, by a lack of ingress or egress interruption, by an interdependency or downstream business interruption, when damage at an owned location causes loss of revenue to another owned location, or by loss that results from a change in temperature due to damage to heating or cooling equipment.[12] Note, however, that while neither CBI nor CEE coverage would respond to such losses, they may be insured under other coverage parts.

When CBI coverage is triggered, it will apply, after any time deductible, for the period of restoration. That is, as with BI coverage, CBI coverage insures the time it 'should' take the dependent property to affect repairs or restoration 'with reasonable speed and similar quality' and resume normal operation. In other words, CBI will not cover additional time required because of repair delays (*e.g.,* because of decisions to improve, relocate, etc.) or any additional time it takes for the insured to resume normal operations.

Sublimits, Exclusions, and Other Limitations for Coverage

Policyholders should also be aware that their CBI coverage may be subject to specific sublimits and/or exclusions. A recent Ernst & Young survey of risk managers completed in conjunction with *Risk & Insurance* found:

- 54 percent had a defined amount CBI sublimit
- 36 percent had a CBI duration sublimit
- 31 percent had CBI specific exclusions
- 33 percent had a CBI limit by identified locations[13]

CII Carbon, LLC v. National Union Fire Ins. Co. of Louisiana, Inc. illustrates how such sublimits can impact an insured's coverage.[14] In that case, CII owned and operated a coke plant in a complex that also included a Bayer plant and a powerhouse owned by Kaiser, as well as a chemical plant owned by La Roche.[15] CII contracted to sell steam produced by its coke plant to Kaiser for use in its Bayer plant.[16] The boiler that produced the steam was located on the grounds of CII's coke plant, but CII subleased certain equipment in Kaiser's powerhouse necessary to operate the boiler.[17] In July 1999, a massive explosion occurred at Kaiser's Bayer plant, causing extensive damage.[18] The subleased equipment was restored by Nov. 1999, but the Kaiser Bayer plant did not resume normal operations until Dec. 2000.[19] Only on the latter date could CII resume selling steam to Kaiser.[20]

The Louisiana Appellate Court held CII's BI coverage ended in Nov. 1999, when "*such part* of the property…as [had] been damaged or destroyed" was repaired.[21] CII's CBI coverage then picked up and covered the period until

Dec. 2000, when the "recipient property" was restored.[22] The court further held CII's recovery for the latter period was, therefore, subject to the $500,000 CBI sublimit, and not the greater limit afforded for BI coverage.[23]

Another example of this issue is found in *Zurich American Insurance Co. v. ABM Industries, Inc*.[24] ABM provided janitorial and engineering services to World Trade Center tenants and sought BI coverage from Zurich after the Sept. 11 attacks destroyed the buildings.[25] Zurich argued ABM's loss constituted CBI and was, thus, subject to a $10 million CBI sublimit and not the blanket limit of $127,396,375 applicable to the BI coverage.[26] The Second Circuit held ABM had coverage under the BI provisions and was not subject to CBI sublimit.[27]

The court explained that although ABM did not own or lease the common areas or tenants' premises, it did "control" and "use" them, as required by the BI coverage.[28] "[T]he existence and configuration of the common areas and tenants' premises were vital to the execution of ABM's business purpose," and were the means by which ABM derived its income.[29] Therefore, "[t]o deny ABM's loss-of-income coverage simply because its income is derived from labor that occurs outside of its own cubicles and offices artificially excludes service providers when the contract itself does not limit coverage is such a manner."[30]

Some Basics on CEE Coverage

CEE coverage, which reimburses an insured for extra expenses incurred because of a contingent loss, follows many of the same 'rules' as CBI coverage. CEE similarly applies where there is interruption of business at a dependent property. Like EE coverage, CEE insurance may be issued in one of two basic forms: extra expense to reduce loss or 'pure' extra expense. The former is the more common coverage, insuring only against extraordinary costs incurred to minimize or prevent a CBI loss. A typical CEE coverage grant provides: "We will pay for the necessary Extra Expense you incur due to the direct physical loss of or damage to property at the premises of a 'dependent property' described in the schedule caused by or resulting from any Covered Cause of Loss."

Conclusion

If a company finds itself with either a CBI or CEE claim, providing appropriate documentation of the loss will be key. This can be tricky, since policies rarely define the exact documents required to support a claim. Insurers typically request:

- monthly profit and loss statements
- monthly and daily production reports
- monthly inventory
- monthly cost accounting reports
- invoices and purchase orders[31]

The company will want to meet with the adjuster and their accountants, and ask them for a written document request.[32] The company should also consider hiring an independent accountant to help prepare the claim.[33] Doing the necessary legwork up front can ensure the efficient and proper payment of the claim. ⚖

Endnotes

1. 936 F. Supp. 534 (S.D. Ill. 1996).
2. *Id*. at 540-41.
3. *Id*. at 536.
4. *Id*. at 541.
5. *Id*. at 541-42.
6. *Id*. at 543-44.
7. 400 F.3d 613 (8th Cir. 2001).
8. *Id*. at 614.
9. *Id*.
10. *Id*.
11. *Id*. at 616-18.
12. Daniel T. Torpey, *Contingent Business Interruption: Getting All the Facts*, May 2003, available at www.irmi.com/expert/articles/2003/torpey05.aspx.
13. Matthew Brodsky, Beware of the Spike, *Risk & Insurance,* July/Aug. 2011, at 22.
14. 918 So. 2d 1060 (La. App. 4 Cir. 2005).
15. *Id*. at 1061-62.
16. *Id*. at 1062.
17. *Id*. *See also* inset figure. *Id*. at 1069, appd'x.
18. *Id*. at 1062.
19. *Id*.
20. *Id*.
21. *Id*. at 1066.
22. *Id*. at 1067.
23. *Id*. at 1067-68.
24. 397 F.3d 158 (2d Cir. 2005).
25. *Id*. at 161.
26. *Id*. at 162.
27. *Id*. at 168-70.
28. *Id*. at 165-66.
29. *Id*.
30. *Id*. at 166.
31. Daniel T. Torpey, *Beyond the Policy: Documenting a Business Interruption Claim*, Feb. 2001, available at www.irmi.com/expert/articles/2001/torpey02.aspx.
32. *Id*.
33. *Id*.

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