

# National Insurance Conference of Canada 2012

## Effectively Adjusting CAT Claims: Contingent Business Interruption Insurance

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Mark G. Lichty  
416.596.3961  
mlichty@blaney.com

Lori D. Mountford  
416.596.2889  
lmountford@blaney.com

# The Risk

- business losses on account of upstream (i.e. supplier) or downstream (i.e. customer) supply chain problem due to a natural (i.e. flood, earthquake) or man-made (i.e. major fire) catastrophic event

# The Risk

- volatile weather
  - March 2011 earthquake in Japan
  - July 2011 flooding in Thailand
  - February 2011 earthquake in New Zealand
  - April and May 2011 tornado events in Southern and Midwestern United States
  - May 2011 wildfires in Slave Lake, Alberta

# The Risk

- complex supply chains
  - outsourcing manufacture of parts globally
  - movement of production to low cost countries
  - just-in-time inventory

# The Risk

increasingly volatile weather  
+ increasingly complex supply chains

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increased vulnerability of Canadian businesses to  
contingent business interruption loss

# The Cover

- What is contingent business interruption insurance?
  - type of first-party property insurance
  - reimburses loss of earnings, profit or income resulting from necessary interruption of insured's business caused by loss or damage by perils insured against to property at premises of customer or supplier

# The Cover

- Sample wording #1 for analysis:

This Extension insures up to the limit of insurance shown in the Summary of Coverages for Contributing/Recipient Property for loss resulting from the necessary interruption of or interference with the business carried on by the insured caused by direct physical loss or direct physical damage by the perils insured against occurring during the term of the policy to “Building(s)”, “Equipment” or “Stock”:

- (1) at a recipient property(ies), being property to which the insured’s products are being shipped, which wholly or partially prevents the acceptance of products produced or sold by the Insured; or
- (2) at a contributing property(ies) being a supplier(s) of materials to the Insured, which wholly or partially prevents the delivery of materials to the Insured.

# The Cover

- Sample wording #2 for analysis:

The Loss of Gross Profits Rider under this policy is extended to cover loss directly resulting from physical damage of the type insured against by this policy to property of the type not otherwise excluded by this policy at Customer or Supplier location(s) with limits of liability as listed below:

<u>Customer or Supplier</u>	<u>Limit of Liability</u>
Named Direct Customers and Suppliers	As per Limits of Liability - Item X
Unnamed Direct Customers and Suppliers	\$ X

Coverage under this extension excludes losses as a result of Earthquake in California.

**Definition:** Customer or Supplier does not include entities supplying or receiving electricity, gas, water, fuel, steam, refrigeration, sewage or communications.



# The Cover

- Sample wording #3 for analysis:

Loss resulting from necessary interruption of business conducted by the Insured, due to loss or damage caused by perils insured against, to property at any contributing premises which supply goods or materials directly to the Insured or at any recipient premises which receive goods or materials directly from the Insured.

This extension shall apply only if business interruption coverage(s) is provided by this Insurance.

Limit of Liability: \$ X.

# The Legal Issues

1. Is the contingent business interruption caused by covered property damage?
2. Is the entity which sustained the property damage a “supplier”?

# The Legal Issues: covered property damage?

*Pentair, Inc v American Guarantee and Liability Ins. Co*, 400 F 3d 316 (8<sup>th</sup> Cir (Minn) 2005)

- earthquake in Taiwan disabled electrical substation that provided power to Taiwanese factories who were thereby prevented from supplying products to Pentair
- after production resumed, Pentair shipped orders by air to reach customers before Christmas
- Pentair claimed under Contingent Time Element provision for additional cost

## *Pentair, Inc.*

- held:
  - restriction of coverage to “all risk of direct physical loss or damage to property” applied to Contingent Time Element
  - no direct physical loss or damage sustained by insured’s suppliers, namely, the Taiwanese factories

# The Legal Issues: covered property damage?

## *Philadelphia Parking Authority v Federal Ins. Co,* 385 F Supp 2d 280 (SDNY 2005)

- groundstop order following September 11 terrorist attacks effectively shut down Philadelphia International Airport
- insured parking garage at airport claimed for loss of business income under Contingent Business Provision
- provision required the insurer to:

pay for the loss of Business Income and Extra Expense which you incur due to the actual interruption of your operations during the period of indemnity as a result of direct physical loss or damage caused by a covered cause of loss to property not otherwise excluded at contingent business premises.

## *Philadelphia Parking Authority*

- held:
  - no direct physical loss or damage to airport

# The Legal Issues: a “supplier”?

*Neste Canada Inc v Allianz Insurance Co of Canada*, [2006] AJ no 1660 (QB), aff'd [2008] AJ no 271 (CA)

- insured refined and manufactured MTBE using butane supplied by TransCanada and Kinetic
- TransCanada and Kinetic obtained the butane from Taylor Plant
- explosion at Taylor Plant damaged facility causing shutdown
- TransCanada had ownership interest in Taylor Plant whereas Kinetic did not
- insured reduced and then shutdown production of MTBE and claimed under CBI extension

# Neste

- CBI extension provided:

Subject to the sub-limit stated in the Declaration, this Section is extended to cover within the sum insured the loss resulting from interruption of business due to damage to or destruction of property of a type not excluded by this Policy by a peril insured thereunder of:

...

(b) the facilities of suppliers of the Insured;

...

which damage or destruction (1) prevents or delays delivery of materials upon which normal operation of the Insured's business is dependent ...

- Policy definition of "suppliers":

The term "suppliers" shall mean an entity not owned or operated by the Insured that delivers goods or services (other than purchased services) to the Insured or to others for the account of the insured.



## *Neste*

- held:
  - CBI cover where damage to property of the insured's supplier's supplier

# The Legal Issues: a “supplier”?

*Archer-Daniels-Midland Co v Phoenix Assur. Co of New York*, 936 F Supp 534 (SD III 1996)

- insured processed farm products for consumption, i.e. produced corn syrup and ethanol from corn
- flooding of Mississippi River damaged crops and disrupted river transportation systems
- insured claimed extra expense and loss of income in respect of increased costs for raw materials and transportation

## *Archer-Daniels*

- CBI cover provided:

This policy covers against loss of earnings and necessary extra expense resulting from necessary interruption of business of the insured caused by damage to or destruction of real or personal property, by the perils insured against under this policy, of any supplier of goods or services which results in the inability of such supplier to supply an insured locations [sic].

## *Archer-Daniels*

- held:

“any supplier of goods or services” included indirect suppliers with whom insured has no contractual privity

# The Legal Issues: a “supplier”?

*Pentair, Inc v American Guarantee and Liability Ins. Co*, 400 F3d 316 (8<sup>th</sup> Cir (Minn) 2005)

- also held:
- damaged substation which provided power to Taiwanese factories who, in turn, supplied product to the insured neither direct nor indirect supplier of insured where service provided not ultimately used by the insured
- *Archer-Daniels* distinguished on basis farmers supplied the grain which the dealer resold to the insured

# The Legal Issues: A Recent Decision

## *Park Electrochemical Corp v Continental Cas. Co,* 2011 WL 7034945 (EDNY 2011)

- Neltec manufactured circuit boards in Arizona
- Nelco, located in Singapore, supplied component for Neltec product
- Neltec and Nelco were subsidiaries of Park
- explosion at Nelco plant destroyed equipment necessary to produce component
- Neltec claimed for lost income under CBI provision when temporarily unable to produce product

## *Park Electrochemical Corp*

- CBI provision stated:

[Continental] will pay for the loss resulting from necessary interruption of business conducted at Locations occupied by the Insured and covered in this policy, caused by direct physical damage or destruction to:

a. any real or personal property of direct suppliers which wholly or partially prevents the delivery of materials to the Insured or to others for the account of the Insured ...

- named insured under policy included Park and subsidiaries
- Neltec's Arizona facilities were a named location
- territorial limits condition identified coverage territory as U.S. and Canada

## *Park Electrochemical Corp*

- held:
  - re covered property damage issue: where CBI provision did not require supplier (or damage to property of supplier) be within coverage territory of policy, it was sufficient that financial loss of insured occurred in coverage territory
  - re “supplier” issue: where CBI provision did not limit “direct suppliers” to suppliers not owned or operated by the insured, a subsidiary of insured can be a “direct supplier”



# The Lesson

- CBI coverage potentially quite broad unless specific limits imposed
- mechanisms for restricting coverage include:
  - CBI sublimits
  - scheduled suppliers and customers (with names and locations)
  - limitation to direct suppliers and direct customers within specified territorial limits
  - definition of “supplier” and “customer” to exclude companies owned or operated by the insured
  - exclusion of certain perils