



# THE CLOCK IS TICKING

Recent case law, while limited, has served to highlight a number of key issues relating to contingent time element coverage, according to Richard Lewis and Jay Levin

**T**ime element' coverages are those where an event occurs and injury – in the form of lost business income or extra expense – is suffered over a period of time, often referred to as the 'Period of Restoration'. There are only approximately 1,100 time element cases – likely less than the number of cases addressing the pollution exclusion in liability insurance policies. Of those, only 35 address Contingent Business Income (CBI) or Contingent Extra Expense (CEE). CBI is designed to protect a policyholder for loss caused by damage to property of customers or suppliers; while CEE covers a policyholder for extra expenses incurred as a result of the same damage.

Despite this paucity of case law, certain principles of contingent time element coverage are evident. In this article, we will highlight seven of these principles:

## Stacking

A policyholder is entitled to 'stack' CBI and other time element coverages. Frequently, a large loss or an area-wide catastrophe may trigger coverage under a number of time element coverages. For instance, if a fire destroys the policyholder's factory and the neighbouring factory of its main customer, the policyholder may have both a business income loss and a CBI loss.

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policyholder to 'stack' the coverages. In this example, if the policyholder had an 18-month loss running at \$1,000,000/month, 12 months of business income coverage, and a \$5,000,000 sublimit on CBI coverage, courts would permit the policyholder to claim its loss as business income for the first year, then as CBI until the \$5,000,000 sublimit was exhausted.<sup>1</sup> Stacking is important because often CBI and other affected time element coverages are subject to low sub-limits.

## Relationship to suppliers and customers

A policyholder should pay close attention to the description of the suppliers or customers in the CBI provision. Coverage under CBI and CEE provisions varies widely, with some provisions limiting coverage to 'direct' customers or suppliers, and other provisions covering customers or suppliers 'of any tier' (i.e., customers of customers). One court construed 'direct' to mean the supplier in direct privity or relationship with the policyholder – a reseller of gas – and not the gas producer.<sup>2</sup> Another court, construing only the word 'supplier', concluded that a utility serving the policyholder's supplier was not a 'supplier' of the policyholder, because the policyholder did not consume the power produced by the utility.<sup>3</sup> Note, however, that a subsidiary company may constitute a 'direct supplier'.<sup>4</sup>

## Other contingent coverages

If the policyholder wants 'contingent' coverage for events other than property damage to its supplier or customer, it may have to purchase it. For instance, the policyholder's supplier may be unable to produce product because of earthquake damage to its power supplier. In cases limiting CBI coverage to damage or destruction of property of the supplier, the court will likely find no coverage in this situation.<sup>5</sup>

The claim in Pentair could be described as a Contingent Service Interruption claim. Similarly,



## Business interruption

another court denied Civil Authority coverage to an out-of-state policyholder for its inability to use a convention centre in New York City after the attacks of September 11, 2001 because the Civil Authority coverage was limited to the policyholder's premises.<sup>6</sup> The claim in Penton Media could be described as a Contingent Civil Authority claim. Note that some insurance companies have recognised these as legitimate exposures and it is now possible to buy 'extended' contingent coverage for Civil Authority, Ingress Egress and Service Interruption.



### Total cessation

There are a number of very poorly reasoned business interruption cases which conclude that there is no loss unless the property damage causes the policyholder's operations to come to a total cessation. As a result, many forms now make clear that they cover loss from a partial cessation or interruption; but where forms do not include this definition, there is a risk that the court will find a requirement of total cessation. Such results would be ridiculous for CBI provisions, as it is extremely unlikely that the loss of one customer or one supplier among dozens will cause the policyholder to cease operations entirely. The one CBI case on this issue resolves the issue in favour of the policyholder.<sup>7</sup>

### Coverage territory

Policyholders with international customers or suppliers may have policies with coverage territories limited to the US and Canada, for example. Under those circumstances, at issue may be whether the loss was within the coverage territory. One court found that the loss occurred where the financial loss was suffered.<sup>8</sup>

### 'Pipeline' damage

Some businesses have a significant 'pipeline' issue, meaning that, because of transport times or the amount of inventory they or their customers have, any loss from damage to the property of a customer or supplier will start to manifest itself months after the damage. Most policies confine CBI and CEE to the Period of Restoration.<sup>9</sup> However, as discussed above, insurance companies may be willing to sell 'extended' CBI which includes an extended Period of Restoration for CBI or CEE.

### Rebuilding time

Policyholders are often at the mercy of the conduct of their supplier or customer in rebuilding, with the insurance company confining coverage to the hypothetical period which should have been taken to rebuild rather than the time actually taken. One recent

case found that the policyholder could not be penalised by the conduct of its supplier, as that conduct was out of its control.<sup>10</sup>

### Burden of proof

Finally, courts have applied a reduced burden of proof for contingent claims, finding that the policyholder need not prove the cause of loss in relation to each customer or supplier.<sup>11</sup> Rather, CBI claims should be amenable to proof via the work of forensic accountants looking at the policyholder's overall loss.

While CBI and CEE-related case law may be in limited supply, what the instances that we have highlighted in this article clearly demonstrate is that organisations in possession of or seeking to purchase such insurance cover should apply the necessary due diligence procedures to ensure that the policy itself delivers the specific level of protection it is designed to provide.

### (Endnotes)

- Cli Carbon, L.L.C. v. Nat'l Union Fire Ins. Co.*, 918 So. 2d 1060 (La. App. Aug. 17, 2005); see also *Lion Oil Co. v. Nat'l Union Fire Ins. Co.*, No. 13-CV-1071, 2015 WL 6680899, at \*4 (W.D. Ark. Nov. 2, 2015) (permitting stacking of \$25 million in CBI and Service Interruption limits); *Audubon Internal Medicine Group v. Zurich Am. Ins. Co.*, No. 07-4874, 2008 WL 2718928 (E.D. La. July 10, 2008) (permitting stacking of 21 days of Civil Authority coverage and 30 days of CBI); *Archer-Daniels-Midland Co. v. Phoenix Assurance Co.*, 936 F. Supp. 534, 544 (S.D. Ill. 1996) (ADM I) (permitting policyholder to recover loss as both Extra Expense and CEE).
- Millenium Inorganic Chems., Ltd. v. National Union Fire Ins. Co.*, 744 F.3d 279 (4th Cir. 2014); see also ADM I, 936 F. Supp. at 544 (finding that farmers not in privity with policyholder were nonetheless "suppliers" in absence of limiting language).
- Pentair, Inc. v. Am. Guar. & Liab. Ins. Co.*, 400 F.3d 613, 615 (8th Cir. 2005).
- Park Electrochemical Corp. v. Continental Cas. Co.*, No. 04-CV-4916, 2011 WL 703945, at \*4 (E.D.N.Y. Feb. 18, 2011).
- Pentair*, 400 F.3d at 616 (denying coverage for loss attributable to power interruption to supplier).
- Penton Media, Inc. v. Affiliated FM Ins. Co.*, No. 06-4315, 2007 WL 2332323, at \*3 (6th Cir. Aug. 15, 2007)
- Archer Daniels Midland Co. v. Aon Risk Servs, Inc.*, No. 97-2185, 2002 WL 31185884, at \*2 (D. Minn. Sept. 27, 2002), *aff'd*, 356 F.3d 850 (8th Cir. 2004) (ADM II).
- Park*, 2011 WL 703945, at \*4 ("The loss covered is not physical damage to property but a financial shortfall, and that shortfall must occur within the territorial limits of the policy.")
- Pennbarr Corp. v. Ins. Co. of N. Am.*, 976 F.2d 145, 152-53 (3rd Cir. 1992) (finding policyholder, seller of typewriters, suffered no loss during the Period of Restoration from damage to supplier of typewriters as inventory on hand was sufficient to meet needs during the Period of Restoration).
- Lion Oil Co. v. Nat'l Union Fire Ins. Co.*, No. 13-CV-1071, 2015 WL 5305231, at \*4-5 (W.D. Ark. Sept. 10, 2015) (finding that where the supplier discovered a leak in its pipeline and instead of simply repairing it shut down the entire pipeline to test for further leaks the policyholder was not necessarily precluded from recovering for the length of the shutdown as it was not in control the supplier).
- ADM II, 2002 WL 31185884, at \*3 (holding grain seller did not need to prove farmers affected by flood); *Citadel Broadcasting Corp. v. AXIS U.S. Ins. Co.*, 162 So. 3d 470, 475 (La. App. Feb. 11, 2015) (holding radio station did not need to prove it, loss on a customer-by-customer basis).

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