

CONTINGENT BUSINESS INTERRUPTION COVERAGE

Arnold F. Mascali Jr.

I. INTRODUCTION

It is a fundamental precept of property insurance that in order to trigger property insurance coverage, there must be *some* damage to physical property.¹ Business interruption coverage—that is, coverage for the lost income as a result of a covered peril—is triggered upon damage to the “insured’s” property. However, *contingent business interruption* (sometimes referred to hereinafter as CBI) protects a policyholder from income losses that result not from damage to its own property, but rather damage to property not owned or operated by the policyholder. Courts have recognized that CBI “extends” business income coverage, drawing a distinction between the two: “Regular business-interruption insurance replaces profits lost as a result of physical damage to the insured’s plant or other equipment; [CBI] goes further, protecting the insured against the consequences of suppliers’ problems.”²

Hurricane Katrina caused damage over a wide geographic region, impacting nearly every industry by her wrath.³ Insured losses alone are estimated at more than \$60 billion.⁴ Organizations that may have been spared direct, physical loss nevertheless may have had income losses resulting from property damage to key suppliers or customers. Insurers and industry com-

1. 10A COUCH ON INSURANCE § 148:46 (3d ed. 2005).

2. Archer Daniels Midland Co. v. Hartford Fire Ins. Co., 243 F.3d 369, 371 (7th Cir. 2001).

3. Phil Gusman, *Katrina: Devastation on the Gulf Coast*, 53 NAT’L UNDERWRITER 24–34 (2005) (noting that Hurricane Katrina’s winds extended more than 120 miles from the center of the storm and over 200 miles inland).

4. James Podgers, *Long Road to Recovery*, 92 A.B.A. 46 (2006) (referring to an early damage assessment by the Center for Business and Economic Research at Marshall University).

Arnold F. Mascali Jr. (arnold_mascali@aonhorizon.com) is the Senior Vice President and General Counsel of Aon Horizon Consultants, Inc., in New York, vice-chair of the Self-Insurers & Risk Managers Committee, and a member of the Property Insurance Law Committee. The author expresses appreciation to James R. Tortorella for his assistance in the research for this article.

mentators are expecting a variety of policyholders to bring CBI claims to collect income losses.⁵ In fact, business interruption claims are expected to account for an extraordinarily high percentage of the overall insured losses.⁶ These losses are not limited to the Gulf region, but rather reach to all corners of the nation (and beyond), as well as all sectors of the economy.⁷ The insurance industry and judicial system will be grappling with numerous intricate, unique, and first impression cases addressing and defining contingent business interruption coverage.

CBI has evolved as a necessary coverage component for many organizations whose business model depends upon outside suppliers, vendors, or critical customers.⁸ “Just in time” inventory and the proliferation of outsourcing manufacturing of component parts have made CBI a common and significant feature in property policies.⁹ In addition, organizations that depend heavily on another business entity or property to “attract” customers (e.g., a motel located in the vicinity of DisneyWorld) are particularly vulnerable to substantial income losses if the attraction property is damaged or destroyed.¹⁰ Despite the growing number of policies offering CBI coverage, there are relatively few reported decisions explaining the breadth and application of CBI.¹¹ A brief review of the development of CBI coverage, placed in context with examples of some large claims, might help predict how courts will apply this coverage in claims arising out of Hurricane Katrina.

II. CONTINGENT BUSINESS INTERRUPTION CLAIMS: HISTORICAL PERSPECTIVE

Although CBI provisions differ depending on the language of the policy, generally coverage is triggered under the contingent business interruption

5. Seth A. Tucker & Ann-Kelley Kemper III, *Wind Selected Insurance Issues After Hurricane Katrina*, 4 INS. COVERAGE L. BULL. (2005).

6. Dave Lenckus, *Storm Damage Raises Coverage Questions, Business Interruption Complications Expected*, 39 BUS. INS., Sept. 12, 2005, available at 2005 WLNR 14499485 (quoting an industry official as saying: “[B]usiness interruption losses could account for 40% of the \$40 billion to \$60 billion of insured losses that catastrophe modelers estimate Katrina has caused. That percentage would be higher than normal for a natural catastrophe.”).

7. The destruction of New Orleans, as well as the devastation in Biloxi, Mississippi, not only impacts the indefinitely sidelined local businesses, such as energy companies, agricultural businesses, hotels, casinos, and retailers. Many businesses elsewhere in the country also are sustaining contingent business interruption losses as a result of losing key suppliers or customers on the Gulf Coast. *Id.* See also Terry Carter, *Riding Out the Storm*, 92 A.B.A. 32 (2006) (noting how many solo and small firms sustained business interruption losses but did not have business interruption insurance).

8. Don A. Wilks, *Curbing Contingent Business Interruption Risks*, NAT’L UNDERWRITER PROP. & CAS.-RISK & BENEFITS MGMT., July 12, 1993, available at 1993 WLNR 3633273.

9. See *Pentair, Inc. v. Am. Guar. & Liab. Ins. Co.*, 400 F.3d 613, 615 (8th Cir. 2005).

10. *Id.*

11. Lenckus, *supra* note 6 (quoting Finley T. Harckham, Esq., in noting the lack of case law providing guidance on such situations). See generally Lorelie S. Masters, *First-Party Property Insurance*, 719 PLL/LIT. 309 (2005).

provision when there is damage to property “that directly or indirectly prevents a supplier of goods and/or services to the policyholder from rendering its goods or services, or damage to property that prevents a receiver of goods and/or services from the insured from accepting its goods and/or services.”¹² The term “contingent” is something of a misnomer and perhaps confusing, and current policies are more frequently using the terms “dependent property,” “leader or attraction property,” and “recipient property” to better identify the protected risk.¹³

As stated above, generally business interruption claims arise out of damage to *insured* property. Much more diligence is required, particularly in larger, global organizations, concerning income losses that may be covered by CBI because that coverage is based on damage to property owned or operated by others. Notice of property damage at a supplier’s remote or distant location may be delayed or not even reach the insured at all. For example, a company that provides products to oil refineries and petrochemical companies purchased CBI as part of its insurance program.¹⁴ An explosion at a vendor’s plant terminated that vendor’s production for a substantial period.¹⁵ The operation personnel made arrangements to secure raw material from another vendor to continue production of its own product but did not inform the risk management department of the vendor’s property damage, nor of the increased costs in obtaining the raw materials from another vendor.¹⁶ Once risk management became aware of the loss (more than two years after the explosion), the insurance company was notified and a claim submitted.¹⁷ Fortunately, the property policy at issue required the insured to notify the carrier “as soon as practicable” after the risk management department (as opposed to anyone else at the company) was informed of an insured event, and the CBI claim was adjusted and ultimately settled.¹⁸

This scenario is not uncommon, perhaps because CBI is not a well-understood protection afforded by commercial property policies even by sophisticated insureds. September 11th heightened organizations’ awareness of the absolute necessity for business continuity planning and focused risk management on trade disruption insurance.¹⁹ Astute risk professionals

12. Anthony Addino, *Drawing Distinctions Between Business Interruption Losses and Contingent Business Interruption Losses*, at http://www.aon.com/about/publications/focus/focus_2005_oct_03.jsp (Oct. 3, 2005).

13. Wilks, *supra* note 8.

14. Gloria Gonzalez, *Contingent Losses Require Careful Management, Supplier Losses Can Lead to Thorny Business Interruption Claim Disputes*, 39 *Bus. Ins.*, May 2005, available at 2005 WLNR 7000226.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. Carolyn Aldred, *War Highlights Critical Nature of Business Contingency Plans*, 37 *Bus. Ins.*, Mar. 31, 2003, available at 2003 WLNR 2204194. See also Joanne Wojcik, *Interruption*

now use CBI as a business continuity tool in order to minimize the impact of income losses, regardless of the property damaged or destroyed causing the loss.²⁰

As with many unique insurance coverage provisions, it took a large CBI claim to focus attention on the benefits provided by this coverage. In 2000, Ericsson Telecom A.B., a large telecommunication manufacturer, presented a contingent business interruption claim estimated in the hundreds of millions of dollars.²¹ That claim was based on a fire that damaged a Royal Philips Electronics plant in Albuquerque, New Mexico.²² Royal Philips supplied critical semiconductor components for Ericsson's mobile phones.²³ The fire caused Royal Philips to close the facility and Ericsson was forced to find secondary suppliers of the component part, halting Ericsson's mobile phone production for six weeks.²⁴ The income losses resulting from the production delay were substantial, and Ericsson turned to its property insurance program to recoup its losses pursuant to the contingent business interruption coverage.

Although the amount of the Ericsson claim was significant, the claim itself was fairly straightforward and not difficult to portend. Damage to a key supplier's facility could be as crippling to a policyholder's income stream as a loss of one of its own facilities. As companies modify and perfect "just in time" supply and delivery and supply-chain logistics, coupled with other advances in technologies, it is posited that these claims will become more frequent. Industry experts note that the demand for business interruption coverage, and specifically CBI, is increasing, particularly among more sophisticated companies that recognize and analyze business risk exposures.²⁵ It is upon this backdrop that courts will review and interpret the scope of contingent business interruption losses.

Claims Harder Away from Ground Zero, 36 Bus. Ins., Aug. 5, 2002, available at 2002 WLNR 1479159 (outlining the complexities of contingent business interruption claims and the caution with which insurers address these claims); Susanne Sclafane, *Business Interruption Insurers Expect "Ripple Effect" from Terrorist Attack Claim*, 105 NAT'L UNDERWRITER PROP. & CAS.-RISK & BENEFITS MGMT., Sept. 24, 2001, available at 2001 WLNR 9124936 (stating that insurers do not pay CBI claims "willy nilly" because of the "ripple" effect of these claims).

20. See generally DANIEL T. TORPEY ET AL., *THE BUSINESS INTERRUPTION BOOK: COVERAGE, CLAIMS, AND RECOVERY* 270-72 (2004) (describing the importance of contingent business interruption coverage).

21. Carolyn Aldred, *Ericsson Filing*, Bus. Ins., Oct. 9, 2000, at 1, available at 2000 WLNR 1264461.

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

III. COURTS' INTERPRETATION OF CONTINGENT BUSINESS INTERRUPTION COVERAGE

A. *Archer Daniels Midland Cases*

The leading cases discussing the nature and extent of contingent business interruption coverage arose out of the devastating flooding sustained by the Midwestern states in the summer of 1993.²⁶ Twenty million acres of farmland were damaged by those floods, leading to billions of dollars in crop damage.²⁷ Archer Daniels Midland Co. (“ADM”) was an international company that processed farm products. As a result of the widespread flooding, ADM sustained significant income losses because of increases in transportation and raw material costs.²⁸

ADM submitted claims to its insurance carriers for losses of income based on contingent business interruption coverage in its policy. The pertinent policy provision stated the following:

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].²⁹

ADM argued that the increases in transportation costs were covered by this CBI provision. The court noted that a substantial part of ADM's raw materials was transported across the Mississippi River. As a result of the flooding, barge traffic was halted on the river, requiring ADM to use rails instead, at a substantially greater cost.³⁰ ADM contended that the Army Corps of Engineers, which operated and maintained the Mississippi River system, and the U.S. Coast Guard were “suppliers of goods and services” as contemplated by the CBI provision.³¹ ADM buttressed its arguments by pointing to the “user charge” that it was required to pay for its use of the Mississippi River through an excise tax that it paid on fuel.

The court spent considerable time explaining the functions of the Coast Guard and the Corps of Engineers. The Coast Guard, the court noted, administered the U.S. Aids to Navigation Systems, assisting the “prudent mariner in the process of navigation.”³² Moreover, pursuant to the Flood

26. *Archer Daniels Midland Co. v. Phoenix Assurance Co. of N.Y.*, 936 F. Supp. 534 (S.D. Ill. 1996).

27. *Id.* at 536.

28. *Id.*

29. *Id.* at 540.

30. *Id.*

31. *Id.* The parties did not focus on the word “any” in the CBI provision, but the court noted in dicta that the word is defined as “one or another without restriction or exception.” *Id.* at 541.

32. *Id.* (quoting 33 C.F.R. § 62.1(c) (2005)).

Control Act, the Corps of Engineers is “charged with developing a flood control system on the Nation’s rivers.”³³ The court stated that both the Coast Guard and the Corps made significant physical improvements on the Mississippi, including building locks and dams throughout the river system.³⁴

The district court interpreted the CBI provision broadly, finding that both the Coast Guard and the Corps were “suppliers” of services for the purpose of section 13(Q) of the ADM policy. Specifically, the court stated that “[f]unding the construction and maintenance of the physical infrastructure of the Mississippi River through the fuel taxes imposed of [sic] the users of that system easily brings the Corps and the Coast Guard within the plain meaning of the term ‘any supplier of goods and services.’”³⁵ The court rejected the insurer’s analogy of the Corps and Coast Guard to the Federal Aviation Administration and the Department of Transportation. Unlike those agencies, which were limited to an “exclusively regulatory function,” the Corps and the Coast Guard made significant physical improvements in the Mississippi River system.³⁶

The court had a much easier time holding that Midwest farmers who grew crops (raw materials) ultimately sold to ADM to process as grain were “suppliers” of goods and services within the meaning of the policy. The fact that the farmers were not in direct contractual privity with ADM did not preclude coverage.³⁷ The policy did not limit CBI coverage to “direct” suppliers, and recognizing the farmers as *a* supplier was consistent with the overall purpose of the CBI coverage.³⁸

In a subsequent related case brought by ADM against its insurance broker, a district court in Minnesota concluded that ADM did not have to specifically identify each particular grain supplier who was unable to supply grain to ADM.³⁹ Because the language of the CBI provision referred to “any” supplier, the court defined “any supplier” to include those farmers in the Midwest who supplied or *could have supplied* grain to ADM.⁴⁰ This rationale, if accepted, could ease the burden on Hurricane Katrina policy-

33. *Id.* Pursuant to the Flood Control Act of 1936, 33 U.S.C. §§ 701–709(a), the Corps is charged with the responsibility to develop a flood system to prevent “the erosion of lands . . . impairing [and obstructing] navigation, highways, railroads, and other channels of commerce between the states.” *Id.* at § 701a.

34. *Archer Daniels Midland Co.*, 936 F. Supp. at 541

35. *Id.* at 542.

36. *Id.* at 541–42.

37. *Id.* at 544.

38. *Id.*

39. *Archer Daniels Midland Co. v. Aon Risk Servs. of Minnesota*, No. Civ. 97–2185 JRT/FLN, 2002 WL 31185884 (D. Minn. Sept. 27, 2002).

40. *Id.* at *3.

holders asserting CBI claims by relieving them of individually identifying each supplier or customer who sustained property damage.

However, in a more recent case, *Pentair, Inc. v. American Guaranty & Liability Insurance Co.*,⁴¹ the Eighth Circuit took a more restrictive view of the term “supplier” and rejected the policyholder’s contingent business interruption claim. In that case, an earthquake struck Taiwan, disabling an electrical substation that provided power to two Taiwanese factories.⁴² As a result, the two factories could not supply products to Pentair. When production resumed two weeks later, Pentair shipped orders from Taiwan via air freight in order to meet its customers’ needs for the Christmas season. Pentair sustained increased costs for the air shipments of \$634,731 and submitted a claim to its insurer for contingent-time-element losses in that amount.⁴³

Pentair advanced two theories of coverage, namely, that (1) the earthquake physically damaged the Taiwanese substation, and that substation was a supplier of goods or services to Pentair, and (2) the resulting power outage caused “physical damage” to the factory suppliers, thus triggering the CBI provision.⁴⁴

The Eighth Circuit rejected both arguments and denied CBI coverage to Pentair. The court dismissed Pentair’s contention that the electrical substation was a “supplier” to Pentair.⁴⁵ The analogy to the *Archers Daniels Midland* case did not save Pentair, the court distinguishing that case because the grain farmers supplied a product that ADM ultimately received.⁴⁶ Here, “the Taiwanese power company did not supply a product or service ultimately used by Pentair.”⁴⁷

The court further rejected Pentair’s claim that factories sustained “direct physical loss or damage” from the power outage. The power outage did not cause any physical damage at the factories, but Pentair argued that the suppliers’ “inability to function” after the power loss constituted direct physical loss or damage.⁴⁸ The court noted that Pentair cited no authority for this proposition, and concluded that, absent physical loss or damage, loss of function or use is not a relevant consideration.⁴⁹ A power outage alone is not physical loss or damage to property.⁵⁰

41. 400 F.3d 613 (8th Cir. 2005).

42. *Id.* at 614.

43. *Id.*

44. *Id.* at 615.

45. *Id.*

46. *Id.*

47. *Id.* The court noted that the electrical substation did not supply goods or services to Pentair, either “directly or indirectly.” *Id.*

48. *Id.* at 616.

49. *Id.*

50. *Id.* at 617. Significantly, the court noted that Pentair had procured business interruption

These two different interpretations of the term “supplier” presage the challenges for both policyholders and insurers faced with CBI claims from Hurricane Katrina.

B. Louisiana Law on Contingent Business Interruption

Given the impact that Hurricane Katrina had on the Louisiana economy, one might expect the Louisiana judicial system to become very intimate with CBI coverage in the future. Just weeks before the storm hit the Gulf Coast, a Louisiana Court of Appeal had the opportunity to consider the application of CBI. In *CII Carbon, L.L.C. v. National Union Fire Insurance Co. of Louisiana, Inc.*,⁵¹ the plaintiff owned and operated a coke-processing facility. The heat-treated coke was sold to the plaintiff’s customers, and the heat generated from the coke processing was captured and used to operate a boiler that generated steam.⁵² The plaintiff sold the steam to a neighboring plant owner, Kaiser Aluminum.⁵³

In 1999, a massive explosion occurred at Kaiser’s plant.⁵⁴ The explosion damaged the plaintiff’s facility only minimally, but the neighboring plant sustained extensive property damage.⁵⁵ The plaintiff’s property policy contained a contingent business interruption endorsement with the following pertinent language:

Loss directly resulting from the necessary interruption of business conducted on the premises occupied by the Insured, caused by damage to or destruction of any real or personal property, not otherwise excluded by the policy, and referred to as CONTRIBUTING PROPERTY(IES) and/or RECIPIENT PROPERTY(IES) and which is not operated by the Insured, by peril(s) insured against during the term of this Policy, which wholly or partially prevents delivery of materials to the Insured or to others for the account of the Insured and results directly in a necessary interruption of the Insured’s business, and/or which wholly or partially prevents the acceptance of product(s) produced by the Insured and results directly in the necessary business interruption of the Insured’s business.⁵⁶

Under this provision, the court found that the Kaiser plant was a “recipient property” that could not “accept” steam from the insured.⁵⁷ Dam-

coverage for losses from power outages resulting from covered perils for power stations that provided electricity to “Described Premises.” *Id.* The court concluded that the parties intentionally limited the power outage extension of coverage to known, identifiable locations, and did not extend coverage for power outages at unknown, third-party locations. *Id.* at 617–18.

51. 918 So. 2d 1060 (La. Ct. App. 2005).

52. *Id.* at 1061.

53. *Id.*

54. *Id.* at 1062.

55. *Id.*

56. *Id.* at 1064.

57. *Id.* at 1067.

age sustained to the plant, which was neither owned nor operated by the insured, resulted in business income losses to the insured.⁵⁸ Those losses were “exactly the type of loss that the contingent business interruption insurance is designed to cover.”⁵⁹

Contingent business interruption claims arising out of Hurricane Katrina will need to meet the initial threshold of whether coverage is triggered by first determining whether damage was caused by wind or flood. That finding is critical: CBI provisions require that the peril causing property damage sustained by the dependent, supplier, or recipient property be of the type that would have been covered under the policyholder’s own policy.⁶⁰ In the *Archers Daniels Midland* case, for example, ADM had coverage for the peril of flood in order to recover for the flood damage sustained by its suppliers.⁶¹ Similarly, CII insured against the perils of fire or explosion under its own policy, and thus was covered for fire or explosion at its customer’s facility.⁶²

Many businesses are insured against the peril of hurricane or windstorm, but not flood.⁶³ Thus, before Hurricane Katrina contingent business interruption coverage can be triggered, the policyholder must first demonstrate that its policy covered the peril insured against.⁶⁴ Lawsuits have already been filed to prevent the insurers from asserting that the vast damage to the Gulf was caused by the peril of flood, rather than windstorm.⁶⁵

Moreover, even under “all risks” policies, the insured must demonstrate that the loss or damage also was covered. For example, in *Tower Automotive*

58. *Id.*

59. *Id.*

60. See, e.g., LINDA G. ROBINSON & JACK P. GIBSON, *Commercial Property Insurance*, INT’L RISK MGMT. INST. 10–16 (2003).

61. *Archer Daniels Midland Co. v. Phoenix Assurance Co. of N.Y.*, 936 F. Supp. 540 (S.D. Ill. 1996).

62. *CII Carbon, L.L.C. v. Nat’l Union Fire Ins’ Co. of Louisiana, Inc.*, 918 So. 2d 1060, 1064 (La. Ct. App. 2005).

63. Steve Seidenberg, *Insurance: No Sure Thing*, 92 A.B.A. 51 (2006) (stating that “[w]hile homeowners and property insurance policies will pay for damages caused by the wind and rain of hurricanes, these policies usually exclude damages caused by floods. That is covered only by flood insurance, which many homeowners and businesses didn’t have.”).

64. See, e.g., *Yale Univ. v. Cigna Ins. Co.*, 224 F. Supp. 2d 402, 411 (D. Conn. 2002) (stating that the burden is on the policyholder to demonstrate that the loss falls within the terms of the policy).

65. See, e.g., Jim Hood, Attorney Gen. for the State of Miss. v. Miss. Farm Bureau Ins., et al., Case No. 3:05-CV-00572-TSL-AGN (pending case, removed to S.D. Miss. on Sept. 16, 2005). See also Press Release, Office of the Attorney General of Mississippi, Attorney General Jim Hood files complaint and motion for temporary restraining order against insurance industry to protect Mississippi’s victims of Hurricane Katrina (Sept. 15, 2005), available at <http://www.ago.state.ms.us/insurance.pdf> (stating that the complaint asked the court to enter a Temporary Restraining Order to stop insurance companies from asking property owners to sign documents stating that their loss was caused by flood as opposed to wind and to stop using water exclusion to reduce coverage for hurricane damage).

v. American Protection Insurance Co.,⁶⁶ the policyholder, Tower Automotive, manufactured automobile parts. One of Tower's presses suffered a failure, and production of certain truck parts for Ford Motor Company, Tower's prime customer, was delayed. Ford advised Tower that the delay resulted in idle labor and lost production costs, and requested compensation from Tower. After negotiations and some compromise, Tower paid Ford \$600,000 for the delay.

As part of its business interruption claim, Tower sought to collect the \$600,000 that it credited to Ford. The court found that this type of loss was not intended to be covered by Tower's property policy.⁶⁷ The voluntary payment to Ford was not a "loss" sustained by Tower within the meaning of the property policy.⁶⁸

C. Business Interruption versus Contingent Business Interruption

The vast devastation wrought upon the Gulf by Hurricane Katrina undoubtedly will raise unique business interruption claim scenarios. In a matter of hours, companies may have lost income as a result of their own property damage (business interruption), property damage to customers (recipient property), property damage to suppliers (dependent property), and property damage to attraction properties located in the vicinity of the insured's property (attraction or leader property). Allocating the losses covered by each provision could be crucial; many policies have limits or sublimits applicable to each coverage that could impact the recoverable amount.

Several September 11th cases provide guidance on the complexity of applying different coverage provisions to the same loss. In *Zurich American Insurance Co. v. ABM Industries, Inc.*,⁶⁹ the policyholder was the engineering and janitorial services company for the World Trade Center complex. In addition to operating the physical plant of the buildings and maintaining the common areas, ABM secured service contracts with nearly all of the tenants of the World Trade Center.⁷⁰ ABM created a call center to handle tenant complaints and problems, and its engineers tracked the equipment at the complex. ABM had more than 800 people employed in the buildings and had office and storage space throughout.⁷¹

66. 266 F. Supp. 2d 664 (D. Mich. 2003).

67. *Id.* at 671. The court noted that although there was not a contractual penalty clause requiring Tower to pay Ford, it did so presumably out of goodwill to an important customer. *Id.*

68. *Id.*

69. 397 F.3d 158 (2d Cir. 2005).

70. *Id.* at 161.

71. *Id.*

Following the terrorist attacks and the collapse of the World Trade Center, ABM sought insurance coverage from Zurich. ABM had procured a property and business income policy with a blanket limit of more than \$127 million.⁷² The business interruption provision insured against “loss resulting directly from the necessary interruption of business caused by direct physical loss or damage, not otherwise excluded, to insured property at an insured location.”⁷³ This provision was only subject to the blanket policy limits of \$127 million.⁷⁴ The scope of the business interruption coverage was defined as “[t]he interest of the Insured in all real and personal property including but not limited to property owned, controlled, used, leased or intended for use by the Insured.”⁷⁵

ABM also had contingent business interruption coverage that extended coverage for “actual loss sustained due to the necessary interruption of business as the result of direct physical loss or damage of the type insured against to properties not operated by the Insured which prevents . . . any direct receiver of . . . services from the Insured from accepting the Insured’s . . . services.”⁷⁶ ABM’s policy had a sublimit of \$10 million for contingent business interruption losses.⁷⁷ Thus, determining the correct provision under which to measure ABM’s losses was the difference in \$117 million of insurance coverage.

The district court ruled that ABM could only obtain business interruption coverage for the losses that it sustained resulting from the destruction of the World Trade Center space that it occupied or the destruction of its supplies and equipment located at the buildings.⁷⁸ The court reasoned that the common areas and the tenants’ premises at the World Trade Center did not constitute insured property as defined by the policy.⁷⁹ According to the court, ABM neither “used” nor “controlled” these areas of the buildings.⁸⁰ The court further held that ABM could not recover contingent business interruption losses.⁸¹

The Second Circuit rejected much of the district court’s reasoning and concluded that ABM sustained business income losses that were properly calculated pursuant to the business interruption provision, not the contingent business interruption clause.⁸² The court held that ABM “used” and

72. *Id.* at 162.

73. *Id.*

74. *Id.*

75. *Id.* at 165.

76. *Id.*

77. *Id.* at 168.

78. *Zurich Am. Ins. Co. v. ABM Indus., Inc.*, 265 F. Supp. 2d 302, 305 (S.D.N.Y. 2003).

79. *Id.*

80. *Id.* at 305–06.

81. *Id.*

82. *Zurich Am. Ins. Co.*, 397 F.3d at 158, 169–70.

“controlled” the common areas and tenant premises in that these were “vital to the execution of ABM’s business purpose.”⁸³ This insurable interest in the common areas and tenants’ premises triggered the business interruption provision.

The court dismissed the insurer’s contention that ABM was limited to contingent business interruption coverage because its losses flowed from the loss or damage to property not “operated” by the insured.⁸⁴ The insurer argued that ABM did not operate the common areas of the buildings or the tenants’ premises, and, therefore, losses related to those properties should be construed under the CBI provision. The Second Circuit disagreed, stating that ABM “effectively ran the entire physical plant” at the World Trade Center.⁸⁵ ABM handled the maintenance of the infrastructure, including the tenants’ premises and common areas, and developed technologies and systems to ensure that the complex ran smoothly.⁸⁶ In short, ABM caused the properties to function, and the policy only required ABM to “operate” the *property*, not the tenants’ *businesses*.⁸⁷ Therefore, because ABM operated the properties within the meaning of the policy, CBI did not apply and the larger business interruption limit was available to ABM.⁸⁸

In another September 11th case, *Southern Hospitality, Inc. v. Zurich American Insurance Co.*,⁸⁹ the policyholder claimed coverage based on two different provisions of its policy: civil authority and business income from dependent properties. The plaintiff claimed income losses when the Federal Aviation Administration suspended flights following the terrorist attacks.⁹⁰ The provision related to dependent properties stated, “[t]he suspension [of operations] must be caused by direct physical loss or damage to ‘dependent property.’ . . .”⁹¹ In rejecting the contingent business interruption claim, the court found that there was no evidence presented by the plaintiff that a “dependent property” sustained any physical loss or damage.⁹² The court never had to reach the more difficult question of whether the airports could be considered “dependent properties” under this policy.

83. *Id.* at 165–66.

84. *Id.* at 169–70.

85. *Id.* at 169.

86. *Id.*

87. *Id.*

88. *Id.* at 169–70.

89. No. Civ. 02–923–C, 2003 WL 23416117 (W.D. Okla. Sept. 30, 2003).

90. *Id.* at *1.

91. *Id.* at *3.

92. *Id.* Similarly, in an unpublished decision set forth in *Air Liquide Am. Co. v. Prot. Mut. Ins. Co.*, No. 96–16661, 1997 WL 781688 (9th Cir. Dec. 18, 1997), an explosion occurred at a chemical plant adjacent to the policyholder’s property, damaging both the chemical plant and the policyholder’s facility. *Id.* at *1. The court held that the business income loss was barred by an “idle periods” exclusion, and further noted that contingent business interruption would have “provided the very coverage sought here by” the policyholder, had it chosen to purchase such coverage. *Id.* at *3.

September 11th produced a myriad of complex income losses. Some of these losses produced claims where the business interruption provision overlapped the contingent business interruption clause. For example, a hypothetical restaurant near Ground Zero sustained property damage as a result of the collapse of Seven World Trade Center. The restaurant's property damage triggered the business interruption provision. The income claim commenced on September 11th and continued through the "period of restoration," that is, the length of time that would be required, with the exercise of due diligence and dispatch, to repair or replace the damaged restaurant property. At the same time, the restaurant had a contingent business interruption claim based on the loss of the World Trade Center, which "attracted" customers to the vicinity of the restaurant. The business interruption claim would terminate with the restaurant's repair, but the CBI claim would extend until the *attraction property* should have been rebuilt. Clearly, that CBI claim would be the more significant insured exposure.⁹³

IV. ISSUES FACING POLICYHOLDERS ARISING FROM HURRICANE KATRINA

Hurricane Katrina litigation probably will expand the paucity of reported cases addressing contingent business interruption claims. A major American city was devastated by the storm, profoundly stressing the American economy. Property and business interruption policies will be tested. The ability of a company to collect under CBI provisions will depend on the specific words used in the policy.

Key issues likely will include the meaning of "suppliers and customers" as illustrated by *ADM* and *Pentair*. For example, if the policy limits coverage for "direct" suppliers or customers, those not in privity may not be encompassed by the CBI provision. However, if the policy is broader in its terms, for example, extending coverage to suppliers or customers "of any tier," more remote and distant suppliers customers, or both can fit within the accepted coverage sphere.⁹⁴ With such expansive language, courts may con-

93. Of course, it is axiomatic that the restaurant would need to prove that it actually sustained income losses during the applicable period of restoration. See *Admiral Indem. Co. v. Bouley Int'l Holding, LLC*, No. 02 Civ. 9696(HB), 2003 WL 22682273 (S.D.N.Y. Nov. 13, 2003).

94. Some policies permit recovery for damage to property of suppliers or customers, whether "direct or indirect." These policies should provide coverage for suppliers who generate a product or service that ultimately ends with the policyholder, no matter how far removed. In addition, the term "tier" generally is not defined by property policies. Couch notes that some statutes define "subcontractor" to include a "second tier" subcontractor as a "subcontractor of the general contractor's own subcontractor." 11 *COUCH ON INSURANCE* § 165:23 (3d ed. 2005). Perhaps this analogy could guide courts construing the term "tier" in connection with CBI claims. *But see* 41 *AM. JUR. 3D Proof of Facts* § 319 (2005) (asserting that courts tend to interpret business interruption clauses "quite strictly").

sider a person or company a “customer” even if that person or company did not actually pay for the goods or services provided. The term “customer” (and “supplier” for that matter) is not defined by the policy, and thus will be subject to interpretation, either in the adjustment process or by a court in litigation. Courts may rely on the doctrine of *ejusdem generis*⁹⁵ to construe the intent of the parties, and, therefore, each policy will need to be interpreted according to its own language and under the particular facts presented by each claim.

It is not hard to imagine the enormous scope of CBI claims that Hurricane Katrina potentially spawned. If, for example, the term “recipient property”⁹⁶ is substituted for “customer” in the CBI provision, even broader intent can be read into the policy, demonstrating that the parties’ contemplated coverage would apply whenever any “receiver” of the policyholder’s goods or services sustains property damage. For example, a damaged household property that “received” broadcast transmissions can be viewed as a “recipient property” of a broadcaster’s “services,” thus triggering the broadcaster’s contingent business interruption policy.

Other examples abound: an importer/exporter may have significant contingent business interruption losses if it depended on the “operation” of the Port of New Orleans to move its products; hotels have tremendous CBI exposures based on, *inter alia*, the damage to the New Orleans Convention Center, a “leader” property; food vending companies have similarly large CBI claims for the damage to the New Orleans Superdome, a “dependent” property. Extrapolating these examples to every industry, it is easy to see why experts conclude that Hurricane Katrina will clearly be the most expensive insured event to date.

V. CONCLUSION

The contingent business interruption provision was intended to protect a policyholder against risk of loss or damage to property upon which it depends. That provision has not been examined by many courts across the country, and thus great latitude exists for good faith arguments for its application or rejection. Hurricane Katrina business interruption claims will be the largest that the insurance industry has ever faced from one event, and practitioners and insurance experts alike are cautioned that they are literally entering uncharted territory without a judicial beacon.

95. Rule of statutory construction under which “general words are construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.” *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 114–15 (2001).

96. *See, e.g., CII Carbon, L.L.C. v. Nat’l Union Fire Ins. Co. of Louisiana, Inc.*, 918 So. 2d 1060, 1064 (La. Ct. App. 2005) (noting that the definition of “recipient” property was that it “was not operated by the insured”).