THE JAPANESE EARTHQUAKE AND TSUNAMI OF 2011 AND CONTINGENT BUSINESS INTERRUPTION COVERAGE

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I. INTRODUCTION—WADING THROUGH MURKY TERRAIN

After the Japanese earthquake and tsunami of March 2011, many articles predicted coverage issues and potential disputes that would likely arise due to the catastrophe. But almost six years later, we are not aware of a single published opinion addressing the availability or scope of contingent business interruption (CBI) coverage (or of its cousin, contingent extra expense (CEE) coverage) for losses caused by that event. In fact, there is very little case law regarding CBI coverage in any context. Nevertheless, the magnitude of the tsunami's impact on international corporations operating in the devastated region caused business interruptions around the world, even for companies without Japanese operations themselves. Thus, despite the lack of case law arising out of the tsunami's effects, the tsunami provides a potent backdrop for consideration of CBI and CEE issues.

Because, as discussed below, these claims are often fact-specific and highly dependent on the policy language at issue, parties handling CBI claims must navigate through somewhat murky terrain. In this article, we endeavor to help create a path by outlining the factual and legal issues likely to arise in the context of a CBI claim for losses like those that resulted from the Japanese earthquake and tsunami.

Unlike traditional business interruption (BI) coverage, which allows a policyholder to recover for lost profits during the period its covered facility is being repaired (and often for a period of time thereafter while its operations ramp back up), CBI coverage applies to the suspension of the policyholder's operations caused by damage to the property of the policyholder's supplier or customer. That is, CBI claims involve damage to the property of a third party—not to the policyholder's premises.

As a threshold matter, a CBI claim must arise from a "loss of the type" covered by the policyholder's policy. In the context of a tsunami, which generally is defined as a large sea wave that results from an earthquake or volcanic eruption under the sea, disputes are likely to arise based on common policy exclusions for earthquakes, flood, or both. Case law addressing causation doctrines in the context of first-party disputes tends to vary widely, and, in some jurisdictions, the parties are not permitted to contract around the common law causation doctrines governing

multi-cause losses. Choice of law therefore may be dispositive on causation issues. Moreover, causation disputes tend to be very fact-specific (translation: expert-intensive and costly), which can be challenging in the context of any claim. Causation disputes tend to pose unique challenges in the context of a CBI claim because the parties typically do not have first-hand knowledge of, or direct access to, evidence regarding the cause or causes of the loss.

Additional challenges are posed by the paucity of case law addressing CBI coverage. More than a decade ago, one court observed that although few courts had construed CBI coverage provisions, this coverage "has doubtless become more common and significant as companies increasingly out-source component parts manufacturing and rely on so-called 'just in time' inventory systems."[1] Ironically, more than a decade later, only a dozen or so cases have construed CBI provisions. Other judges likewise have remarked on the relatively scant precedent in this area.[2] Parties litigating (and judges addressing) CBI claims thus have relatively little guidance from the courts.

Furthermore, CBI provisions tend to be far less detailed than BI clauses. Whereas some BI clauses span at least a full page, if not more, some CBI clauses are limited to a single sentence that contains only undefined terms. Indeed, in *Millennium Inorganic Chemicals Ltd. v. National Union Fire Insurance Co. of Pittsburgh, PA*,[3] the trial court's statement that the coverage question was "difficult" was based in part on its finding that the policy's CBI provision was "not a model of clarity." Because CBI clauses can vary quite a bit from policy to policy, the limited case law construing such clauses may not provide meaningful guidance.

Other hurdles are presented by the fact that CBI claims, by definition, arise from damage sustained by third parties. The fact that the damage did not occur on the policyholder's own premises frequently makes it harder to obtain evidence substantiating the claim and to prove (to the extent necessary) the existence, scope, and cause of the physical loss or damage that triggered the CBI loss. Additionally, the policyholder and/or its insurer and the third party and/or its insurer may have different views about causation, the recovery timeline, and related matters, all of which may affect the policyholder's insurance claim.

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

2. *See, e.g.*, Zurich Am. Ins. Co. v. ABM Indus., Inc., 397 F.3d 158, 168 (2d Cir. 2005) ("CBI coverage is a relatively recent development in insurance law and its scope has not yet been fully delineated by the courts."); Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 893 F. Supp. 2d 715, 728, 731 (D. Md. 2012) (finding coverage question at issue to be "difficult," in part because there was little case law on point—"only three [cases] shed significant light on the issues presented"), *rev'd*, 744 F.3d 279 (4th Cir. 2014).

3. *Millennium*, 893 F. Supp. 2d at 728.

As a final matter, the policyholder is not in control of the recovery decisions and timeline, and the policyholder and the third party that sustained the physical loss or damage may have different incentives and motivations with respect to repair/replace decisions and other decisions that will impact the recovery. For example, the third party might make business decisions that slow down the recovery process and the policyholder likely will not have any say in the matter or have any ability to expedite the recovery. And, of course, the third party, the policyholder, and their respective insurers may have very different views of what constitutes "due diligence and dispatch" under the circumstances.

II. FACTS

A. *Japanese Earthquake and Tsunami*[4]

On Friday afternoon, March 11, 2011, an earthquake with a magnitude of 9.0 on the Richter scale occurred in Japan. The earthquake's epicenter was approximately eighty miles east of the City of Sendai in the Tohuku region of northern Japan. Hundreds of aftershocks occurred in the days and weeks following the earthquake, and at least eighty-one of these aftershocks reached or exceeded a magnitude of 6.0. The earthquake was felt in several other countries, including Russia, Taiwan, and China. It is the fourth largest earthquake to occur since 1900, and one of the most powerful earthquakes ever recorded.

In addition to the damage caused by the earthquake, Japan suffered from a resulting tsunami. The tsunami swept in at speeds of almost 500 miles per hour and generated waves that reached a high point of more than 132 feet. Waves from the tsunami washed over approximately six miles of Japan's inland.

The earthquake and tsunami devastated Japan. Official estimates of those killed or identified as missing following the earthquake ranged from 18,500 to more than 20,000. Thousands more suffered injuries. The majority of the victims lived in the Miyagi prefecture, and more than half were sixty-five or older.

The earthquake and tsunami also caused extensive property damage throughout the country. The tsunami flooded and destroyed buildings

4. *See generally* Garrett Moore et al., *The Tohoku Earthquake and Tsunami*, Clyde & Co (Mar. 30, 2011), http://www.clydeco.com/uploads/Files/Publications/2011/The Tohoku Earthquake and Tsunami_2011.pdf; Garrett Moore et al., *The Tohoku Earthquake and Tsunami Second Report*, Clyde & Co (Aug. 2011), http://www.clydeco.com/uploads/Files/Publications/ 2011/Tohoku_Earthquake_Tsunami_Aug2011.pdf; *see also* John P. Rafferty & Kenneth Pletcher, *Japan Earthquake and Tsunami of 2011*, Encyclopaedia Britannica, www.britannica.com/event/Japan-earthquake-and-tsunami-of-2011 (last update May 13, 2016).

all along Japan's Pacific coastline and the earthquake damaged factories, refineries, roads, and infrastructure, such as rail lines, power stations, and water and sewage systems. More than 110,000 homes were totally destroyed and another 134,429 were at least half destroyed. Another 500,000 were partially destroyed. Insurance payments for claims arising out of the damage to these residences exceeded $13.7 billion.

In addition to this damage, the earthquake and tsunami destroyed hundreds of thousands of automobiles and tens of thousands of marine vessels. The Japanese Cabinet Office estimated that the total damage caused by these natural disasters ranged between $198 and $309 billion. To put these numbers in perspective, the costliest natural disaster prior to the Japanese earthquake and tsunami was Hurricane Katrina, which had an estimated economic impact of $125 billion.

B. *Impact on Businesses*[5]

The immense physical destruction and property damage caused by the Japanese earthquake and tsunami also impacted Japanese businesses. In Fukushima, for example, flooding from the tsunami affected cooling systems at two nuclear power plants. This damage to the cooling systems led to three explosions at one of the plants, which caused significant radiation leakage and required the evacuation of more than 170,000 people. In addition to this damage to Japan's nuclear power supply, five conventional power plants had to be shut down.

The overall loss of power and infrastructure damage significantly affected Japan's manufacturing industries, including the country's prized auto manufactures, steel manufactures, and paper mills. For example, the world's largest auto manufacturer, Toyota, saw its quarterly profits decrease by more than 75 percent following the earthquake and tsunami. The devastation from these natural disasters caused massive part shortages, which drastically slowed Toyota's production.

Other Japanese businesses were affected as well. Both Canon and Panasonic were forced to suspend operations at their facilities in Fukushima due to a lack of power and their employees' inability to access the facilities. Likewise, electronic manufacturer Sony suffered significant losses, along with major Japanese participants in the semi-conductor and petrochemical industries. The earthquake and tsunami even stopped beer pro-

5. *See generally* Peter N. Mahaley & Inesa M. Mirkin, *The Ripple Effect: Coverage for Contingent Business Interruption*, ORRICK (May 31, 2011), https://www.orrick.com/Insights/2011/05/The-Ripple-Effect-Coverage-for-Contingent-Business-Interruption; *see also Toyota Profit Slides on Japan Earthquake Disruption*, GUARDIAN, May 11, 2011, http://www.guardian.co.uk/business/2011/may/11/toyota-profit-hit-by-japan-earthquake; Hroko Tabuchi, *Sony Swings to Big Loss After Natural Disasters*, N.Y. TIMES, May 23, 2011, http://www.nytimes.com/2011/05/24/technology/24sony.html.

duction at some of Japan's most prominent breweries in Tohoku (e.g., Kirin, Sapporo, and Asahi).

Moreover, given Japan's international prominence, businesses across the globe felt the impact of the earthquake and tsunami. In the United States, for example, General Motors suspended its manufacturing operations in Shreveport, due to an automotive-part shortage, which resulted from damage to manufacturing facilities in Tohoku. In addition, Ford and Chrysler suspended orders from retail car dealers due to paint shortages caused by the disaster in Japan. Thus, the effects of the Japanese earthquake and tsunami were felt not only in Japan, but also by the interrelated businesses and industries spread across the globe.

III. COVERAGE ISSUES

Natural disasters like the Japanese earthquake and tsunami have the potential to impact business operations in the United States and elsewhere. Accordingly, these types of events can also trigger claims for CBI coverage. Although all CBI provisions provide coverage for interruption of the policyholder's business caused by damage to third-party property, the language used in these provisions varies greatly. Further, there is not yet a large and well-developed body of case law interpreting CBI policy language to guide insurers, policyholders, or their lawyers. Below we analyze several key coverage issues likely to arise in the context of a CBI claim.

A. *Was the CBI Loss Caused by "Direct Physical Loss or Damage" to a Customer's or Supplier's Property?*

One of the threshold showings that must be made in order to trigger CBI coverage is that the loss was caused by "direct physical loss or damage" to a customer's or to a supplier's property. Although many courts have analyzed a property policy's "physical loss or damage" requirement in a number of contexts, only a couple of cases have addressed this requirement specifically in the context of a CBI claim. These cases highlight the distinction between CBI coverage and other types of time element coverages triggered by third-party property damage.

In *Philadelphia Parking Authority v. Federal Insurance Co.*,[6] the policyholder sought coverage for losses arising from the Federal Aviation Administration's order grounding all civil aircraft after the attacks of September 11, 2001. The policyholder contended that the FAA's order grounding all civil aircraft effectively closed the Philadelphia International Airport and that because the policyholder depended on the airport to attract its customers, its business was interrupted as a result of the FAA

6. 385 F. Supp. 2d 280, 281 (S.D.N.Y. 2005).

order.[7] The carrier denied coverage, asserting, among other things, that there was no coverage under the policy's CBI clause (or under the policy's BI clause) because there was no "direct physical loss or damage" to the insured premises or the premises of a customer or supplier.[8]

In challenging the carrier's coverage denial, the policyholder unsuccessfully argued that the phrase "direct physical loss or damage" is ambiguous, reasoning that it is "unclear whether 'direct physical' modified 'damage' as well as 'loss'" and that the court accordingly should construe the phrase in its favor by ruling that "damage" includes "economic damage."[9] The court agreed with the carrier's assertion, however, that the phrase "direct physical" modified both "loss" and "damage," thereby foreclosing the policyholder's argument that "damage" includes "purely economic damage."[10]

In so ruling, the court reasoned that the phrase "direct physical loss or damage" is "unambiguous when read in the broader context of the Policy" and pointed to other words and phrases that also suggested or reflected that physical damage, rather than economic damage, is required to trigger CBI coverage.[11] For example, the terms "rebuild," "repair," and "replace," which appear in the policy's "period of indemnity" provision, "all strongly suggest that the damage contemplated by the Policy is physical in nature."[12] Additionally, the policy's "'period of indemnity' . . . begin[s] on the date of direct physical loss or damage . . . and continue[s] thereafter until such time as the covered property could have been repaired, replaced or restored. . . .'"[13] The court reasoned that if the "period of indemnity" began on the first date that the policyholder experienced economic damage, there would be no "logical termination" of it because there would be no lost or damaged property to repair, replace, or restore.[14] The court further reasoned that if "damage" included "economic damage," the policy would require a showing that the economic damage caused the interruption of the policyholder's business operations.[15] According to the court, this was problematic for two reasons. First, the court found it "difficult to imagine" a situation in which economic damage itself could cause interruption of the insured's business. Second, this had not happened in the case at bar.[16] The court thus held that the policy's CBI clause unam-

7. *Id.* at 282–83.
8. *Id.* at 283.
9. *Id.* at 286.
10. *Id.* at 286–89.
11. Phila. Parking Auth. v. Fed. Ins. Co., 385 F. Supp. 2d 280, 287 (S.D.N.Y. 2005).
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16. Phila. Parking Auth. v. Fed. Ins. Co., 385 F. Supp. 2d 280, 289 (S.D.N.Y. 2005).

biguously "requires that the claimed loss or damage must be physical in nature."[17]

The court in *Pentair, Inc. v. American Guarantee and Liability Insurance Co.*[18] likewise held that the policyholder had not satisfied the policy's "direct physical loss or damage" requirement. In that case, an earthquake in Taiwan had damaged and disabled a substation that provided power to two Taiwanese factories, which supplied a Pentair subsidiary. During the two-week power outage, these factories were unable to manufacture the products they supplied to Pentair's subsidiary.[19] When production resumed, Pentair incurred additional costs to ship the products via air freight in order to meet its customers' needs during the Christmas season.[20] Pentair submitted a CBI claim for these additional shipping expenses, which its carrier denied. The Eighth Circuit affirmed the district court's grant of summary judgment in favor of the insurance carrier on two grounds. First, it concluded that the electric substation itself, although physically damaged, was not a supplier of goods or services to Pentair.[21] Second, although acknowledging that this issue was "more difficult," it agreed with the district court's conclusion that the "power outages caused no injury to the Taiwanese factories other than a shutdown of manufacturing operations" and, therefore, "did not constitute 'direct physical loss or damage' to a supplier's property."[22]

In so holding, the Eighth Circuit disagreed with the policyholder's assertion that "its Taiwanese suppliers' inability to function after the loss of power constituted direct physical loss or damage."[23] The court reasoned: "Once physical loss or damage is established, loss of use or function is certainly relevant in determining the amount of loss, particularly a business interruption loss. But Pentair's argument, if adopted, would mean that direct physical loss or damage is established *whenever* property cannot be used for its intended purpose," a conclusion that the court found to be unsupported by Minnesota law.[24]

The Eighth Circuit also looked beyond the policy provisions relied upon by the parties to support its conclusions: "In this age of massive electric power grids, occasional catastrophic blackouts, and broad business interruption coverages, we would expect the subject of power outage losses to be explicitly addressed in cases construing all-risk policies, and

17. *Id.*
18. 400 F.3d 613, 615 (8th Cir. 2005).
19. *Id.* at 614.
20. *Id.*
21. *Id.* at 615.
22. *Id.* at 615–16.
23. Pentair, Inc. v. Am. Guar. & Liab. Ins. Co., 400 F.3d 613, 615–16 (8th Cir. 2005) (citations omitted).
24. *Id.*

perhaps in the policies themselves."[25] Although the court "surprisingly" found no reported case law addressing whether a power outage alone constitutes property damage, it observed that the parties and the policy at issue had in fact addressed "whether and to what extent" the policy covered power failures resulting from covered perils such as earthquakes.[26] Although the policy "broadly" covered losses from power outages resulting from covered perils, regardless of whether the outage also caused "other physical property damage," this coverage was extended only to losses arising from damage to off-premises power stations "'furnishing electricity . . . to Described Premises,'" and the supplier factories did not qualify as "Described Premises."[27] The court thus held that the "direct physical loss or damage" requirement had not been satisfied.[28]

In a dissenting opinion, one of the judges stated that he was "persuaded" that "the Taiwanese factory suppliers suffered direct physical loss when power outages rendered them unable to perform their intended function of manufacturing products for Pentair."[29] Because this issue involved state, rather than federal, law, the dissenting judge declined to elaborate further on this point.[30]

B. *Was the Physical Loss or Damage Caused by a Covered, or an Excluded, Risk or Peril?*

To trigger CBI coverage, a covered peril must cause the damage to the supplier's or customer's property. If the policy provides only named-peril coverage, the policyholder must prove that one of the specific perils enumerated in the policy caused this third-party property damage. Under this type of policy, property damage caused by an unspecified peril is not covered.

But many commercial property policies provide coverage on an "open peril" or "all-risk" basis. That is, these policies insure against all risks of direct physical loss, unless otherwise and specifically excluded. The fact that a policy contains an all-risk insuring agreement, however, does not mean that it covers all losses: "all-risk does not mean all-loss."[31] Even all-risk policies remain subject to the "fortuity" principle, according to which, a policy does not provide coverage for a loss that was expected or intended to occur.[32] Traditionally, courts applied an *objective* standard

25. *Id.*
26. *Id.* at 617.
27. *Id.*
28. Pentair, Inc. v. Am. Guar. & Liab. Ins. Co., 400 F.3d 613, 615–18 (8th Cir. 2005).
29. *Id.* at 618 (Gibson, J., dissenting).
30. *Id.*
31. City of Burlington v. Indem. Ins. Co. of N. Am., 332 F.3d 38, 47 (2d Cir. 2003) (internal quotation marks omitted).
32. *See*, *e.g.*, Stephen A. Cozen & Richard C. Bennett, *Fortuity: The Unnamed Exclusion*, 20 FORUM 222, 222 (1984–85); Mellon v. Fed. Ins. Co., 14 F.2d 997, 1004 (S.D.N.Y. 1926)

to determine whether a loss was fortuitous. Under this standard, the policyholder must prove that an external cause (not a defect inherent in the property itself) caused the loss.[33] But under the more modern approach, courts look to the policyholder's *subjective* expectations, i.e., whether the policyholder knew of or expected the loss before it occurred.[34]

Commercial property policies often contain a wide range of exclusions. And some of these exclusions could apply in the context a loss caused by natural disasters similar to the Japanese earthquake and tsunami, although there might be arguments as to why they are unenforceable or otherwise inapplicable under the circumstances. For example, commercial property policies frequently exclude coverage for damage caused by earthquakes. Under one version of an earthquake exclusion, there would be no coverage for loss caused by earth movement:

(1) Earthquake, including any earth sinking, rising or shifting related to such event;

(2) Landslide, including any earth sinking, rising or shifting related to such event.

(3) Mine subsidence, meaning subsidence of a man-made mine, whether or not mining activity has ceased.

(4) Earth sinking (other than sinkhole collapse), rising or shifting including soil conditions which cause settling, cracking or other disarrangement of foundations or other parts of realty. Soil conditions include contraction, expansion, freezing, thawing, erosion, improperly compacted soil and the action of water under the ground surface.

This exclusion would thus typically apply to loss or damage caused by an earthquake or aftershock.

Likewise, commercial property policies commonly exclude coverage for damage caused by water.

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

(2) Mudslide or mudflow;

(3) Water that backs up or overflows from a sewer, rain or sump, or

(4) Water under the ground surface pressing on, or flowing or seeping through:

(a) Foundations, walls, floors or paved surfaces;

("[E]ven in an 'all risk' policy, there must be a fortuitous event—a casualty—to give rise to any liability for insurance.").

33. *City of Burlington*, 332 F.3d at 47–48.

34. *Id.* at 48–49.

(b) Basements, whether paved or not; or

(c) Doors, windows or other openings.

Under this provision, damage caused by flooding or tidal waves would typically not be covered.

Property policies also often exclude coverage for damage caused by nuclear hazard.

Nuclear reaction or radiation, or radioactive contamination, however caused.

Accordingly, damage caused by radiation or radioactive contamination would typically not be covered. Of course, none of these exclusions would apply if, for some reason, they were deemed unenforceable or otherwise inapplicable under the circumstances.

1. Common Law Causation Doctrines

But what if multiple perils cause the loss? For example, suppose a policyholder argues that unanticipated severe winds (a covered peril) and flooding (an excluded peril) combined to cause the loss. Does the flood exclusion operate to bar coverage?

In this situation, most courts apply the "efficient proximate cause" (EPC) doctrine to determine whether the policyholder's loss is covered.[35] The rule has been discussed and applied by various courts in the United States and in the United Kingdom for at least the last century.[36] According to the EPC doctrine, if multiple perils contribute to a loss, the predominant cause of the loss determines whether a first-party property policy provides coverage.[37] That is, if a covered peril predominantly caused the loss, the policy provides coverage. If an excluded peril predominantly caused the loss, the policy excludes coverage.

A minority of courts, however, have applied the doctrine of "concurrent causation" rather than the EPC rule.[38] Under this doctrine, if a covered peril combines with an excluded peril to cause a loss, the policy pro-

35. Mark M. Bell, *A Concurrent Mess and a Call for Clarity in First-Party Property Insurance Coverage Analysis*, 18 CONN. INS. L.J. 73, 80 (2011–12) (stating that the EPC rule is followed by the majority of U.S. jurisdictions).

36. *See*, *e.g*., Leyland Shipping Co. v. Norwich Union Fire Ins. Soc'y, [1918] A.C. 350, 369 (H.L. 1918); Lanasa Fruit S.S. & Importing Co. v. Universal Ins. Co., 302 U.S. 556, 567 (1938); *see also* Julie A. Passa, Comment, *Insurance Law—Property Insurance: Adopting the Efficient Proximate Cause Doctrine, But Saying No to Contracting Out of It*, 79 N.D.L. REV. 561, 564–67 (2003) (discussing historical origins of EPC rule).

37. *See*, *e.g*., Garvey v. State Farm Fire & Cas. Co., 770 P.2d 704, 707–08 (Cal. 1989); Am. Home Assurance Co. v. Sebo, 141 So. 3d 195, 201 (Fla. Dist. Ct. App. 2013).

38. *See*, *e.g*., Safeco Ins. Co. of Am. v. Guyton, 692 F.2d 551, 555 (9th Cir. 1982); *see also* Michael C. Phillips & Lisa L. Coplen, *Concurrent Causation Versus Efficient Proximate Cause in First-Party Property Insurance Coverage Analysis*, 36 BRIEF 32, 33–34 (Winter 2007).

vides coverage.[39] The concurrent causation doctrine emerged in the third-party liability context but some courts have invoked the rule to interpret first-party property policies.[40] And some courts appear to erroneously conflate the EPC and concurrent causation doctrines.[41]

The insurance industry responded to the concurrent causation doctrine by adding "anti-concurrent causation" language to first-party property insurance policies.[42] A representative anti-concurrent causation provision introduces the policy's exclusions using the following language:

> **We** do not insure **you** against loss of or damage to covered property resulting from or caused by any of the causes of loss described below if that cause of loss either directly and solely results in loss or damage, or initiates a sequence of events that results in loss or damage, regardless of the nature of any intermediate or final sequence.

Under this language, loss caused by a combination of covered and uncovered perils is generally *not* covered, particularly where the damage cannot be allocated between loss caused by the covered peril and loss caused by the excluded peril.

Still, the effect of anti-concurrent causation language is unclear. Some courts have held that insurers cannot use anti-concurrent causation language to contract around the EPC rule.[43] Other courts, however, permit the parties to contract around the EPC rule by adopting anti-concurrent causation language.[44] In addition, even if a court is willing to enforce an anti-concurrent causation clause, it may nevertheless hold that the clause is ambiguous in the context of a particular case.[45]

In some jurisdictions, courts do not apply the EPC or concurrent causation doctrines to determine coverage for losses caused by a combination of covered and uncovered perils. In Texas, for example, if covered and uncovered perils combine to cause the policyholder's loss, "the insured is entitled to recover only that portion of the damage caused solely by the covered peril(s)."[46] "To this end, the insured must present some evidence upon which the jury can allocate the damage attributable to the covered

39. *Guyton*, 692 F.2d at 555.

40. *See* State Farm Mut. Auto. Ins. Co. v. Partridge, 514 P.2d 123, 130–31 (Ca. 1973) (applying concurrent causation doctrine to third-party liability policy); *see also* Michael E. Bragg, *Concurrent Causation and the Art of Policy Drafting: New Perils for Property Insurers*, 20 Forum 385, 389–91 (1985).

41. *See* Vision One, LLC v. Phila. Indem. Ins. Co., 276 P.3d 300, 309–10 (Wash. 2012); *see also* Bell, *supra* note 35, at 95–96 (identifying definitional problems concerning "concurrent causation").

42. Bragg, *supra* note 40, at 393–94.

43. *See* Safeco Ins. Co. of Am. v. Hirschmann, 773 P.2d 413, 416 (Wash. 1989).

44. *See* Kane v. Royal Ins. Co. of Am., 768 P.2d 678, 685–86 (Colo. 1989).

45. *See* Corban v. United Servs. Auto. Ass'n, 20 So. 3d 601, 615 (Miss. 2009).

46. Wallis v. United Servs. Auto. Ass'n, 2 S.W.3d 300, 303 (Tex. App. 1999).

peril."[47] Somewhat confusingly, however, Texas courts have referred to this allocation method as the "doctrine of concurrent causes."[48]

2. Exceptions to Policy Exclusions

Policy exclusions may also be subject to exceptions. Suppose, for example, that a large earthquake causes a gas leak that ultimately results in a fire, which, in turn, causes a covered building to burn down. As discussed above, commercial property policies often exclude coverage for at least some forms of earth movement, which would arguably bar coverage for the loss. In several standard ISO policy forms, however, the earth movement exclusion is subject to an exception:

> But if Earth Movement, as described [in this section] results in fire or explosion, we will pay for the loss or damage caused by that fire or explosion.

Thus, in the example above, although an earthquake caused the fire to occur, the exception to the earth movement exclusion reinstates coverage.

Also, some exclusions in property policies often contain more general "ensuing loss" or "resulting loss" provisions, which reinstate coverage for *any* covered peril that results from an excluded cause of loss. For example, some policy exclusions are introduced with the following language:

> We will not pay for loss or damage caused by or resulting from any of the following [exclusions listed below]. But if an excluded cause of loss that is listed [below] results in a Covered Cause of Loss, we will pay for the loss or damage caused by that Covered Cause of Loss.

Under this provision, if an excluded peril results in a covered cause of loss, as long as the resulting loss is not subject to another policy exclusion, the policy provides coverage for the damage caused by the resulting covered cause of loss.

C. *What Qualifies as a "Supplier" of Goods or Services?*

Although CBI coverage grants typically require proof that a "supplier" of goods or services to the policyholder sustained "direct physical loss or damage" that resulted in an interruption of the policyholder's business, policy language varies quite a bit in terms of exactly what type of "supplier" is required. For example, some policies require that physical loss or damage be sustained by a "*direct* supplier" of goods or services while other policies do not. Also, some policies provide different levels of coverage for "*named* suppliers" than for "*unnamed* suppliers." These differences in policy language are significant and should not be overlooked. Indeed, the importance of these distinctions is underscored in the cases discussed below.

47. *Id.*
48. *See id.* at 302–03.

1. "*Any* Supplier of Goods or Services" or "*A* Supplier of Goods or Services"

The court in *Archer-Daniels-Midland Co. v. Phoenix Assurance Co.*[49] examined a broad CBI provision, which required only that the policyholder's losses arise from damage to or destruction of property suffered by "*any* supplier of goods or services" to the policyholder.[50] In that case, severe flooding of the Mississippi River and its tributaries in 1993 impacted the business of Archer-Daniels-Midland (ADM), which involved the processing of farm products for domestic and international consumption. Specifically, ADM sought coverage for the extra expenses and business income losses it incurred due to: (1) increases in the cost of raw materials, i.e., grain; and (2) increases in the cost of transporting its raw materials.[51] Barge traffic was halted as a result of the flooding, and ADM thus had to arrange alternate, and more expensive, transportation by rail. The court agreed with ADM's argument that these increased costs and revenue losses were covered under its policy's CBI coverage because the Army Corps of Engineers, the U.S. Coast Guard, and Midwest farmers all qualified as "suppliers of goods and services" under the policy.[52]

First, in assessing whether ADM's increased transportation costs were covered, the court explained that the "key phrase" for purposes of its analysis was "'*any* supplier of goods or services.'"[53] After consulting dictionary definitions for the terms "any," "supply," and "supplier," the court explained that "the phrase 'any supplier of goods or services' denotes an unrestricted group of those who furnish what is needed or desired."[54] In holding that the Corps and the Coast Guard were suppliers of services, the court explained that the Coast Guard "maintains systems of marine aids to navigation consisting of visual, audible, and electronic signals which are designed to assist the prudent mariner in the process of navigation," and that by installing locks and dams, the Corps constructed "'physical improvements' . . . on the Mississippi River."[55]

The court also disagreed with the insurer's contention that these two agencies could not be considered "suppliers" of "services" merely because they are government entities.[56] In so concluding, the court explained that these two agencies "do not serve an exclusively regulatory function" and

49. 936 F. Supp. 534 (S.D. Ill. 1996).
50. *Id.* at 540 (emphasis added). The court also examined a contingent extra expense clause.
51. *Id.* at 540–41, 543–44.
52. *Id.* at 540–43.
53. *Id.* at 541 (emphasis added).
54. Archer-Daniels-Midland Co. v. Phoenix Assurance Co., 936 F. Supp. 534, 541 (S.D. Ill. 1996).
55. *Id.*
56. *Id.*

observed that "[g]overnment entities have been recognized as playing a dual role in commerce, that of 'regulator' and that of 'market participant.'"[57] The court also reasoned that the absence of a contract with the Corps or the Coast Guard did not matter because "the policies do not state that coverage is limited to principal suppliers or suppliers with whom ADM has a written contract, rather, they apply to '*any*' supplier."[58]

Next, the court analyzed ADM's claim for increased raw materials costs and agreed that Midwest farmers who grew the crops that ADM processed also qualified as "suppliers of goods and services," despite the fact that ADM bought the grain from licensed grain dealers, which had purchased the grain from the farmers, rather than buying directly from the farmers themselves.[59] The court agreed with ADM's argument that the policy "does not limit coverage to 'contractual suppliers,' 'direct suppliers,' or 'immediate suppliers'" or otherwise require "direct contractual privity between ADM and its suppliers."[60] It further observed that had the parties desired to "limit the coverage to 'direct' suppliers, they could easily have added language to that effect."[61]

2. "*Direct* Suppliers of Goods or Services" (and a Note About Named and Unnamed/Scheduled and Unscheduled Suppliers)

Some CBI coverage provisions require that the policyholder's economic losses arise from physical damage sustained by a "*direct* supplier of goods or services" to the policyholder. A few cases have addressed what constitutes a "direct" supplier for purposes of a CBI provision. While these cases certainly provide some guidance to others regarding the "direct supplier" issue, they also underscore the fact-specific and policy language-specific nature of the analysis.

In *Park Electrochemical Corp. v. Continental Casualty Co.*,[62] the court considered, among other things, whether a subsidiary of a policyholder could qualify as a "direct supplier" within the meaning of the policy's CBI coverage provision.[63] One of Park Electrochemical's subsidiaries, Neltec, manufactured circuit boards and obtained component parts from another Park subsidiary, Nelco.[64] Damage resulting from an explosion at Nelco's facility in Singapore temporarily prevented it from manufacturing and supplying component parts to Neltec, which, in turn, prevented Neltec

57. *Id.* at 541–43.
58. *Id.* at 543.
59. *Id.* at 543–44.
60. Archer-Daniels-Midland Co. v. Phoenix Assurance Co., 936 F. Supp. 534, 544 (S.D. Ill. 1996).
61. *Id.*
62. No. 04-CV-4916 (ENV)(ARL), 2011 WL 703945 (E.D.N.Y. Feb. 18, 2011).
63. *Id.* at *1.
64. *Id.*

from producing circuit boards.[65] Neltec sought coverage under its policy's CBI coverage grant, which covered losses arising from business interruption caused by direct physical damage to "any real or personal property of direct suppliers which wholly or partially prevents the delivery of materials to the Insured. . . ."[66] Neltec's carrier, Continental Casualty, denied the claim, contending, among other things, that subsidiaries of the policyholder are not "direct suppliers."[67] Park and Neltec, on the other hand, challenged the denial, reasoning that the policy itself does not contain such a restriction.[68]

As an initial matter, the court noted that the policy did not define the term "direct suppliers" and concluded that both parties' proffered interpretations were reasonable.[69] Concluding that the language was "vague and ambiguous," the court considered extrinsic evidence. Continental Casualty asserted that its interpretation was in accord with industry custom and practice, case law, and treatises.[70] The court observed that notwithstanding references to industry norm, two cases cited by Continental Casualty concerned policies that expressly stated that CBI coverage was limited to loss caused by damage to entities not owned by the policyholder. Continental Casualty, however, had not included similar, limiting language in its policy.[71] The court thus found it "difficult to extrapolate an ironclad general rule" that a subsidiary cannot be a "direct supplier." The court found that other proffered extrinsic evidence likewise did not resolve the ambiguity and concluded that whether a policyholder's subsidiary could qualify as a "direct supplier" was a question for the jury to consider.[72]

In *Millennium Inorganic Chemicals II*,[73] the Fourth Circuit focused on the "legal relationship" between the policyholder and a natural gas supplier to analyze whether that supplier qualified as a "direct supplier" of goods or services. In that case, Millennium Inorganic Chemicals Ltd. processed titanium dioxide, a compound used for its white pigmentation.[74] The energy source for this processing operation was natural gas, which it purchased under a contract with a retail gas supplier, Alinta Sales Pty

65. *Id.*
66. *Id.* at *2.
67. *Id.* at *4.
68. Park Electrochem. Corp. v. Cont'l Cas. Co., No. 04-CV-4916 (ENV)(ARL), 2011 WL 703945, at *4 (E.D.N.Y. Feb. 18, 2011).
69. *Id.*
70. *Id.* at *5.
71. *Id.*
72. *Id.* at *6; *see also* Pennbarr Corp. v. Ins. Corp. of N. Am., 976 F.2d 145, 147–48 (3d Cir. 1992).
73. Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 744 F.3d 279 (4th Cir. 2014).
74. *Id* at 282.

Ltd.[75] Alinta, in turn, purchased the gas from various natural gas producers, including Apache Corporation, which, at the time, produced approximately 20 percent of the natural gas that Alinta sold to others.[76] After Apache processed the natural gas, it injected it into a pipeline.[77] The gas received from Apache was mixed with the natural gas that Apache obtained from other producers, "resulting in an amorphous mix of gas in a single pipeline."[78] Once the gas manufactured by Apache entered the pipeline, custody, title, and risk passed from Apache to Alinta.[79] Alinta retained sole ownership of the gas until the gas was delivered to Millennium, at which point title passed to Millennium.[80] Millennium's contract for the purchase of the natural gas was solely with Alinta, and the contract made no reference to Apache.[81] Millennium did not have a contractual or other business relationship with Apache.

After an explosion at one of Apache's facilities, its natural gas production operations ceased.[82] Millennium's gas supply consequently was curtailed, and it was forced to suspend its titanium dioxide manufacturing operations for several months.[83] Millennium sought coverage under its policy's CBI endorsement, which provided coverage for losses arising from physical damage to "contributing properties," the definition of which specified that "only a 'direct supplier of materials to the Insured's locations' can be a 'contributing property.'"[84] Millennium's carriers denied coverage based on their conclusion that Apache was not a "direct supplier" to Millennium.[85] In response, Millennium sued its carriers, contending that Apache was a direct supplier. According to Millennium, Alinta provided only a service, i.e., the delivery of natural gas, whereas Apache provided the actual gas itself.[86]

The district court concluded that Millennium was entitled to coverage. The court held that Apache was a "direct supplier" to Millennium and that Apache's natural gas production facility was a "direct contributing property."[87] The court reasoned that the term "direct," which the policy

75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 744 F.3d 279, 282 (4th Cir. 2014).
80. *Id.*
81. *Id.*
82. *Id.* at 282–83.
83. *Id.*
84. *Id.* at 282.
85. Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 744 F.3d 279, 283 (4th Cir. 2014)..
86. *Id.*
87. *Id.* at 284.

did not define, was "'ambiguous here, in the context of an entity that provides a direct physical supply of material to the insured, but has no direct contractual relationship with the insured.'"[88] The district court "concluded that 'the physical relationship between the properties is as or more important than the legal relationship between the property owners.'"[89] Millennium's "contract with Alinta had 'no effect on the physical realities of natural gas supply between [Apache] and [Millennium]'" because Alinta took title, but not physical possession, of the gas when it traveled through the pipeline.[90]

The Fourth Circuit reversed.[91] The court concluded that the term "direct" was clear and unambiguous as used in the policies.[92] It examined dictionary definitions of the term "direct" and concluded that for Apache to be deemed a "direct supplier," "it must have supplied Millennium with materials necessary to the operation of its business 'without deviation or interruption' from 'an intermediary.'"[93] The Fourth Circuit concluded that Apache was not a "direct supplier" because "neither Apache nor Apache's facilities had a direct physical relationship with Millennium."[94] Finding Apache to be only an "indirect contributing property," the court further explained:

> Whatever the relationship between Apache and Millennium, it was clearly interrupted by "an intermediary," Alinta, who took full physical control of Apache's gas before delivering indistinguishable comingled gas to Millennium. That relationship was also interrupted by an intervening step, the physical insertion of the gas into the DB Pipeline, at which point Apache relinquished all physical control over that gas.[95]

The dissenting opinion found the term "direct" to be ambiguous, concluding that the majority opinion and the district court both articulated reasonable interpretations of the policy language.[96] The dissent also pointed to another dictionary definition of "direct," i.e., "from the source or the original without interruption or diversion," under which Apache would be deemed a "direct" supplier.[97] It explained that regardless of which entity Millennium contracted with, the natural gas still would

88. *Id.*
89. *Id.*
90. *Id.* at 284.
91. Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 744 F.3d 279, 280 (4th Cir. 2014).
92. *Id.* at 285.
93. *Id.*
94. *Id.* at 286.
95. *Id.*
96. *Id.* at 287 (Wynn, J., dissenting).
97. Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 744 F.3d 279, 291 (4th Cir. 2014) (Wynn, J., dissenting).

flow directly from Apache's facility through the pipeline to Millennium's facility.[98]

One final point about the *Millennium Inorganic Chemicals* case is worth noting. At the time it procured the policies at issue, Millennium had had the opportunity, but declined, to list in a schedule to each of the policies, any "contributing property" that created a risk of business interruption.[99] Scheduled "contributing properties" were subject to a $25 million sublimit; unscheduled "contributing properties" were subject to a $10 million sublimit.[100] Had Millennium listed Apache's facility in the schedule, this particular dispute could have been avoided.

Recently, in *DIRECTV v. Factory Mutual Insurance Co.*,[101] a federal court sitting in California addressed the meaning of the term "direct supplier" in the context of a CBI provision. The insured, DIRECTV, distributes digital entertainment to consumers. For a DIRECTV customer to receive this programming, a satellite dish receives satellite signals, which it transmits through a receiver, known as a set-top box (STB), which transmits the signals to the customer's television.[102] All four manufactures that supplied STBs to DIRECTV utilized hard drives made by two companies—Western Digital Technologies and Seagate Technology—as a component part of each STB.[103] DIRECTV did not purchase hard drives directly from, or have a contractual relationship with, Western Digital or Seagate.[104]

Monsoons damaged two of Western Digital's manufacturing facilities in Thailand.[105] DIRECTV alleged that this damage reduced the supply of available hard drives and that the resulting price increase in Western Digital's hard drives (and expenses associated with obtaining substitute hard drives from Seagate) resulted in losses and extra expenses exceeding $22 million.[106] DIRECTV subsequently sought coverage under a policy issued by Factory Mutual, which denied the claim on the ground that Western Digital did not have a "contractual relationship" with DIRECTV and therefore was not a "direct supplier."[107]

A lawsuit ensued, and the court granted summary judgment in favor of Factory Mutual.[108] The court rejected DIRECTV's argument that the

98. *Id.* at 291–92.
99. *Id.* at 282.
100. *Id.*
101. 160 F. Supp. 3d 1193 (C.D. Cal. 2016).
102. *Id.* at 1195.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. DIRECTV v. Factory Mut. Ins. Co., 160 F. Supp. 3d 1193, 1195 (C.D. Cal. 2016).
108. *Id.* at 1199.

phrase "direct supplier" should be defined according to its usage in the insured's industry.[109] The court reasoned that the policy included specialized definitions of many terms and the "fact that 'direct supplier,' in contrast, is not defined anywhere in the policy suggests that the parties did not intend the term to carry any technical or specialized meaning."[110] The court thus concluded that "without recourse to electronics supply industry jargon, any definition of 'direct supplier' to mean 'customer-controlled component supplier' would not be reasonable."[111] According to the court: "Despite DIRECTV's Herculean efforts to stitch together various dictionary definitions of 'direct' and 'supplier,' no ordinary and popular meaning of 'direct supplier' could possibly encompass its relationship with Western Digital."[112]

DIRECTV has appealed the district court's ruling to the U.S. Court of Appeals for the Ninth Circuit.[113] At this time, the Ninth Circuit has not yet issued its decision on DIRECTV's appeal.

3. Suppliers of "Goods or Services *to the Insured*"

It is important to note, however, that even where the policy language allows for the physical loss or damage to be sustained by an indirect supplier of goods or services, the supplier must directly or indirectly supply "goods or services" *to the policyholder*. This requirement was addressed in *Pentair, Inc. v. American Guaranty and Liability Insurance Co.*[114] In *Pentair*, Pentair incurred extra shipping costs after an earthquake in Taiwan disabled a substation that provided power to two Taiwanese factories that supplied Pentair with products it sold to others.[115] In addition to finding that Pentair's suppliers did not suffer "direct physical loss or damage" as required by the policy, the court also found that the damaged power substation was not a "'supplier of goods and/or or services' *to Pentair*" within the meaning of the policy.[116] In so concluding, it distinguished *Archer-Daniels-Midland Co.*,[117] explaining that in that case "each farmer supplied a product (grain) that a dealer then resold to the insured, ADM."[118] In the case before it, by contrast, the court explained that although "the substation supplied power to the Taiwanese factories, the Taiwanese power com-

109. *Id.* at 1197.
110. *Id.*
111. *Id.* at 1198.
112. *Id.*
113. DIRECTV v. Factory Mut. Ins. Co., No. 16-55313 (9th Cir. filed Mar. 1, 2016).
114. 400 F.3d 613, 614 (8th Cir. 2005).
115. *Id.*
116. *Id.* at 615 (emphasis in original).
117. 936 F. Supp. 534 (S.D. Ill. 1996).
118. *Pentair*, 400 F.3d at 615.

pany did not supply a product or service ultimately used by Pentair."[119] Because the power substation "supplied no goods or services to Pentair, directly or indirectly," the court held that it was not a "supplier" for purposes of the policy's CBI coverage provision.[120]

D. *Where Did the "Loss" Occur?*

Commercial property policies sometimes limit coverage to losses that occur within a specified coverage territory. With respect to CBI coverage, however, the policyholder seeks to recover for the interruption to its business based on physical damage that occurred at a supplier's or customer's property—not at the policyholder's own premises. Some CBI provisions specifically limit coverage to loss that arises from physical damage to property that occurs within the coverage territory. But what is the effect if the policy does not contain this specific limitation?

The court addressed this issue in *Park Electrochemical Corp. v. Continental Casualty Co.*[121] In *Park Electrochemical*, the policyholder, Park, sold circuit boards, which were manufactured in Arizona by one of its wholly owned subsidiaries, Nelco.[122] Nelco produced a vital component to these circuit boards in its Singapore facility, where an explosion halted circuit board production.[123] Park submitted a claim for CBI coverage to its insurer, Continental Casualty, which declined coverage.[124]

Park sued Continental Casualty, and the parties filed cross motions for summary judgment. In its motion, Continental Casualty argued, in part, that because the Singapore facility fell outside the policy's coverage territory, the policy did not provide CBI coverage.[125] But the district court disagreed. According to the court, with respect to CBI coverage, "[t]he loss covered is not physical damage to property but a financial shortfall, and *that shortfall must occur* within the territorial limits of the policy."[126] The court further reasoned that "[i]f Continental wished to place a territorial limit on where 'direct suppliers' must be located in order for coverage to attach, it could have included explicit language to that effect."[127] Because the policy contained no such limiting language, the court granted summary judgment in favor of Park.[128]

119. *Id.*
120. *Id.*
121. No. 04-CV-4916 (ENV) (ARL), 2011 WL 703945 (E.D.N.Y. Feb. 18, 2011).
122. *Id.* at *1.
123. *Id.*
124. *Id.* at * 2.
125. *Id.*
126. *Id.* at *4 (emphasis added).
127. Park Electrochem. Corp. v. Cont'l Cas. Co., No. 04-CV-4916 (ENV) (ARL), 2011 WL 703945, at *4 (E.D.N.Y. Feb. 18, 2011).
128. *Id.*

E. *Determining the Period of Recovery/Restoration*

First-party policies typically state that a policyholder can recover time element losses that are sustained during the period of recovery (also known as the period of indemnity, the period of interruption, or the period of restoration). The fact that CBI claims necessarily involve physical damage sustained by, and to be repaired by, third parties adds a few additional wrinkles to the analysis of how a policy's period of recovery provision applies to CBI claims. For one thing, there may be a lag time between the supplier's production of a component part or a product and the policyholder's ultimate sale of it. Additional difficulties may arise from the fact that a third party sustained the physical damage and the policyholder likely will not have any control over the restoration process or time line.

Pennbarr Corp. v. Insurance Co. of North America[129] is a good example of a case illustrating the challenges created when there is a significant lag time between a supplier's production of a product and the policyholder's ultimate sale of that product. In that case, the policyholder sold electromechanical typewriters that were manufactured at two of its wholly owned subsidiaries. Production of typewriters temporarily was suspended when two earthquakes struck one of the typewriter manufacturing facilities in November 1980 and January 1981.[130] The policyholder attempted to mitigate its losses by continuing to sell typewriters until its inventory was depleted.[131] After the typewriter factory resumed normal operations, the policyholder lost sales due to its depleted inventory and submitted a claim for losses arising from physical damage to a contributing property.[132] The carrier denied coverage because the losses were not incurred until after the typewriter factory resumed operations and thus were outside the recovery period, and the policyholder filed a lawsuit.[133]

The district court denied the carrier's summary judgment, finding that the policy's period of indemnity provision was ambiguous.[134] The district court based its conclusion on "the unique nature of [the policyholder's] typewriter business: a long production pipeline and shipping time which resulted in a significant lag time between production and sales and necessitated the maintenance of a substantial inventory."[135] The district court thus found it reasonable to interpret the indemnity period as

129. 976 F.2d 145 (3d Cir. 1992).
130. *Id.* at 148.
131. *Id.*
132. *Id.*
133. *Id.*
134. Pennbarr Corp. v. Ins. Co. of N. Am., 976 F.2d 145, 149 (3d Cir. 1992).
135. *Id.*

beginning with the interruption of the sale of typewriters, rather than at the point of interruption of the supply of the contributing plants.[136]

The Third Circuit reversed, endorsing the insurer's position that the lost sales must occur simultaneously with the interruption of manufacturing activity in order to be covered.[137] The court further noted that the policy's "resumption of operations" clause required the policyholder to use supplemental inventory acquired from other sources to mitigate its losses,[138] a requirement that arguably created a Catch-22 for the policyholder: failing to use extra inventory to meet sales orders could be deemed a failure to mitigate resulting in a forfeiture of coverage. Alternatively, using extra inventory to fill sales orders until the policyholder depleted its inventory would defer the policyholder's losses until after the period of indemnity expired. This rule and result could be particularly problematic in situations where there is a substantial lag time between the time a supplier's operations are impaired and the time the policyholder sells products incorporating components manufactured by the supplier.

Additional challenges also may be presented by the fact that a third party, rather than the policyholder, is in charge of decisions regarding the repair or replacement of the damaged or destroyed property. Although there do not appear to be cases addressing this issue in the context of a CBI claim, there are cases addressing the period of recovery in the context of traditional BI claims in which courts have held that delays caused by third parties can extend the period of recovery. In light of the differences between CBI and traditional BI coverage, insurers and insureds will likely debate whether these cases, which address traditional BI coverage, should inform a court's analysis in the context of CBI claims.

For example, in *Anchor Toy Corp. v. American Eagle Fire Insurance Co.*,[139] the court held that the period of recovery should include additional time to account for contingencies beyond the policyholder's control. Despite concluding that it would have taken thirty-eight weeks to rebuild the policyholder's factory if the construction were performed by the "experts in the courtroom," the court recognized that "buildings seldom are."[140] It further reasoned: "In the field it snows, and men fall off girders, and the wrong size window glass is delivered."[141] The court thus added eight additional weeks to the recovery period to account for "these contingencies."[142]

136. *Id.*
137. *Id.* at 150, 152.
138. *Id.* at 152.
139. 155 N.Y.S.2d 600, 604 (N.Y. Sup. Ct. 1956).
140. *Id.*
141. *Id.*
142. *Id.*

Likewise, in *American National Bank & Trust Co. of Chicago v. Continental Casualty Co.*,[143] the insurer contended that the policyholder had not acted with "due diligence and dispatch" simply because the repairs to the damaged property were not completed within the time period specified in the repair contract. The court noted that an independent contractor performed the work and "there was little that the plaintiffs could do to control the work."[144] The court further reasoned that "[t]he disparity between the times within which construction is scheduled to be done and is in fact done is part of the experience in life of most people" and that the jury could "consider those experiences in determining whether or not the plaintiffs had acted with due diligence in rebuilding and repairing the building."[145] Again, insurers and insureds will likely debate whether these and similar cases provide analogous support in the context of CBI claims.

F. *Measuring/Substantiating the CBI Loss*

Policyholders also face the challenge of substantiating their CBI losses. In *Wyndham International, Inc. v. ACE American Insurance Co.*,[146] for example, the policyholder, Wyndham, argued that the attacks on September 11, 2001, caused a loss of more than $66 million.[147] Wyndham alleged that governmental orders restricting travel, increased security measures, and the reaction of the world's population to the attacks inhibited the public from using its 163 hotel and resort properties.[148] To substantiate this loss, Wyndham offered the testimony of a certified public accountant, David Borghesi.[149] The trial court excluded Borghesi's testimony under the Texas Rules of Evidence, and Wyndham appealed.[150]

The Texas Court of Appeals affirmed the trial court's decision. According to the appellate court, Borghesi: (1) based his calculations on unreliable monthly forecasts of Wyndham's hotel revenues; (2) incorrectly extrapolated revenue projections for sixty-two of the Wyndham properties by relying on revenue forecasts that applied only to 101 of Wyndham's properties; and (3) failed to address other relevant evidence, e.g., such as whether cancelled reservations following the attacks were later rebooked.[151] For these reasons, the court concluded that Borghesi's opinions were based on an

143. 434 N.E.2d 321, 323–34 (Ill. Ct. App. 1982).
144. *Id.* at 324.
145. *Id.*
146. 186 S.W.3d 682 (Tex. App. 2006).
147. *Id.* at 684.
148. *Id.*
149. *Id.*
150. *Id.*
151. *Id.* at 686–89.

unreliable foundation and therefore could not be used to substantiate Wyndham's claim for CBI coverage.[152]

G. *Losses at Adjacent Locations—Determining Whether the Loss is a CBI Loss, a BI Loss, or a Combination of the Two*

Although in theory it seems easy to grasp the difference between a traditional BI claim and a CBI claim, the line between the two can seem blurry where a policyholder and its customer or supplier occupy adjacent locations and both were damaged by the same peril or occurrence. Even where a policy provides both BI and CBI coverage, analyzing how a given claim should be characterized is more than just a philosophical debate—particularly when different deductibles and limits apply to these different coverages. Sometimes it is an either/or proposition; other times, both coverages may apply (either consecutively or concurrently). These issues were addressed in the two cases described below. In the first case, the appellate court held that only one of the coverage provisions—the BI clause—applied. In the second, the court held that both BI and CBI coverages applied, albeit at different points during the overall recovery timeline.

In *Zurich American Insurance Co. v. ABM Industries, Inc.*,[153] ABM provided engineering and janitorial services to tenants of the World Trade Center and sought BI coverage after the September 11, 2001, attacks destroyed the Twin Towers. Zurich argued that ABM's losses arose from damage to and destruction of its customers rather than its own premises and thus constituted a contingent business interruption loss subject to a $10 million sublimit, rather than a business interruption loss subject only to the policy's $127,396,375 blanket limit.[154]

Although the district court had held that the claim was one for CBI coverage, capped by the policy's $10 million CBI sublimit, the Second Circuit disagreed, holding the policy's BI coverage and the blanket limit applied to ABM's claim.[155] In so ruling, the appellate court explained that the policy's BI clause applied to losses arising from business interruption caused by damage to insured property at an insured location, and insured property was defined to include property "'owned, controlled, used, leased or intended for use by the Insured.'"[156] The court concluded that ABM "'used' the common areas [of the World Trade Center] and the premises of the other tenants in the WTC" and thus was entitled to summary judgment on the issue.[157] Applying the district court's definition of

152. Wyndham Int'l, Inc. v. ACE Am. Ins. Co., 186 S.W.3d 682, 689 (Tex. App. 2006).
153. 397 F.3d 158, 161 (2d Cir. 2005).
154. *Id.* at 163.
155. *Id.* at 163–64.
156. *Id.* at 165.
157. *Id.*

"use" as "to carry out a purpose or action by means of," the appellate court reasoned that the "plain meaning" of "use" unambiguously encompassed the situation for which coverage was sought: "The existence and configuration of the common areas and tenants' premises were vital to the execution of ABM's business purpose. These areas and premises were the means by which ABM derived its income and were as essential to that function as ABM's cleaning tools."[158]

The appellate court also found that ABM's claim expressly fell outside the scope of the policy's CBI clause, which extended to loss arising from business interruption caused by loss or damage to property "'not operated by the Insured.'"[159] Because ABM "operated" the properties at issue (maintenance of the HVAC system and freight elevators) and essentially ran the physical aspects of the complex, including the upkeep and maintenance of the common areas and tenanted spaces, the court further concluded that policy's CBI provision did not apply to ABM's losses.[160]

In *CII Carbon, LLC v. National Union Fire Insurance Co. of Louisiana, Inc.*,[161] the court held that a policyholder suffered consecutive BI and CBI losses. In that case, the policyholder, CII Carbon, owned and operated a coke processing plant that was located in an industrial complex that also included, among other things, a Bayer plant owned by Kaiser. Pursuant to a series of contracts: (1) CII Carbon sold Kaiser the steam produced by CII Carbon's coke plant; and (2) CII Carbon subleased certain equipment located in Kaiser's powerhouse that was necessary for CII Carbon to operate the boiler that produced the steam that CII Carbon sold to Kaiser.[162]

A massive explosion at Kaiser's Bayer plant in 1999 caused extensive damage to Kaiser's Bayer plant, including some damage to the equipment that was subleased to CII Carbon, as well as minor damage to CII Carbon's coke plant.[163] The damage sustained by the coke plant was repaired, and the plant was able to resume operations "shortly" after the explosion.[164] Additionally, the equipment leased to CII Carbon was repaired by November 1999; however, CII Carbon was not able to sell its steam to Kaiser until the Kaiser Bayer plant resumed full operations in December 2000.[165]

158. *Id.* at 165–66.
159. Zurich Am. Ins. Co. v. ABM Indus., Inc., 397 F.3d 158, 169 (2d Cir. 2005).
160. *Id.*
161. 918 So. 2d 1060 (La. Ct. App. 2005).
162. *Id.* at 1062.
163. *Id.*
164. *Id.*
165. *Id.*

The court held that the policy's BI coverage applied only until the subleased powerhouse equipment was repaired, which was no later than November 15, 1999.[166] At that point, the policy's CBI coverage, which was subject to a $500,000 sublimit, applied to the losses suffered by CII Carbon until December 2000, when the "recipient property," i.e., the Bayer plant, was repaired and was fully operational and thus could begin accepting steam from CII Carbon.[167]

IV. RECOMMENDATIONS

Although adjusting or litigating a CBI claim might require the parties and their lawyers to navigate murky terrain, the good news is that there are steps that policyholders and insurers can take that can better protect their interests and lead to more predictable outcomes.

A. *Recommendations for Policyholders*

Although the case law construing CBI provisions is relatively scant, and the cases tend to be fact-specific and policy language-specific, policyholders can take steps that should increase the likelihood that losses arising from disruptions in their supply chains will be covered. These steps include the following:

- Understand risks posed by your business's supply chain and clearly communicate them to your broker.
- Carefully read the policy language at the time of procurement. While reading insurance policies may be tedious, the cases discussed above illustrate how variations in policy language can significantly impact the scope of coverage available for supply chain losses. Make sure you understand what the scope of coverage is and how it will apply to potential losses arising from risks within your supply chain. Request, or shop the market for, broader coverage, if necessary.
- Consider requesting that language be included in your policy to clearly define terms that have been the subject of dispute in the cases discussed above, such as "direct supplier," or which otherwise seem vague.
- Schedule locations and suppliers on which your business relies that create a risk of business interruption. As noted above, at the time it procured the polices at issue in the *Millennium Inorganic Chemicals* case, Millennium had the opportunity, but declined, to schedule

166. *Id.* at 1067–68.

167. CII Carbon, LLC v. Nat'l Union Fire Ins. Co. of La., Inc., 918 So. 2d 1060, 1067–68 (La. Ct. App. 2005).

any "contributing property" that created a risk of business interruption.[168] Scheduled "contributing properties" were subject to a $25 million sublimit; unscheduled "contributing properties" were subject to a $10 million sublimit.[169] Had Millennium listed Apache's facility in the schedule, the dispute with its insurer could have been avoided.

- If there is a lag time between when a supplier manufactures and sells your component parts or products and the time you sell those products, request a "period of recovery" clause that takes this lag time into account.
- Include provisions in contracts with your key suppliers and customers that require them to provide you with information and otherwise cooperate with you in the event that their operations are suspended and they are unable to supply/receive goods or services to/from you. These provisions should require them to provide you with enough information and to take other steps that will allow you to meet your obligations under your insurance policy.

B. *Recommendations for Insurance Carriers*

Like many coverage issues, insurers can best address the challenges presented by claims for CBI coverage through careful policy drafting. Insurers should review the CBI provisions used in their policy forms to ensure that the following issues are adequately addressed:

- Does the policy limit coverage to business interruption caused by physical damage to the property of a "direct supplier," which has a contractual relationship with the policyholder?[170]
- Does the policy state whether a subsidiary of the policyholder can be a "direct supplier?"[171]
- Does the policy limit the period of restoration to the period during which production is suspended, as opposed to the period during which the policyholder's sales are suspended?[172]

168. Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 744 F.3d 279, 282 (4th Cir. 2014).

169. *Id.*

170. *See id.* at 286; Archer-Daniels-Midland Co. v. Phoenix Assurance Co., 936 F. Supp. 534, 544 (S.D. Ill. 1996).

171. *See* Park Electrochem. Corp. v. Cont'l Cas. Co., No. 04-CV-4916 (ENV) (ARL), 2011 WL 703945, at *6 (E.D.N.Y. Feb. 18, 2011).

172. *See* Pennbarr Corp. v. Ins. Co. of N. Am., 976 F. 2d 145, 155 (3d Cir. 1992).

- Does the policy require physical damage to a supplier's or customer's property caused by a covered cause of loss?[173]
- Does the policy state whether CBI coverage—rather than traditional BI coverage—applies to property the policyholder merely operates, but does not own or lease?[174]
- Does the policy specify whether the loss of a utility service, such as power or water at a policyholder's supplier, can trigger CBI coverage?[175]
- Does the policy state whether physical damage to supplier's or customer's property must occur within the policy's territorial limits?[176]

173. *See* Phila. Parking Auth. v. Fed. Ins. Co., 385 F. Supp. 2d 280, 289 (S.D.N.Y. 2005).

174. *See* Zurich Am. Ins. Co. v. ABM Indus., Inc., 397 F.3d 158, 169–70 (2d Cir. 2005); s*ee also* CII Carbon, LLC v. Nat. Union Fire Ins. Co. of La., 918 So. 2d 1060, 1067–68 (La. Ct. App. 2005).

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

176. *See Park Electrochem.*, 2011 WL 703945, at *4.