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Staying Afloat Through the Flood

Contingent Business Interruption Insurance May Pay for Losses Caused by Supply-Chain Disruptions

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The Mississippi River floods in Spring 2011 proved to be among the largest and most damaging along the U.S. waterway in the past century, rivaling the major floods of 1927 and 1993. In addition to the massive property damage that the floods have caused, the floods also threatened to cause immense disruptions along one of the country's most important trade routes. In one instance, the Coast Guard temporarily closed a large section of the Mississippi River to both northbound and southbound traffic, and more closures might be on the horizon.

In past major Mississippi River floods, these types of trade disruptions resulted in companies incurring very large losses as they lost access to suppliers and could not get their products to market. Companies in virtually every industry can be affected. For example, the Mississippi River is the key waterway for U.S. grain exports, and multiple food companies rely on the Mississippi River as a relatively inexpensive transportation throughway. The Coast Guard's closing of 15 miles of the Mississippi River at the port of Natchez, MS, reportedly meant that several barges already were idled at Natchez, and many more ships might be stopped cold if more closures occur. Flooding also could shut down railways and highways, further disrupting distribution chains.

In addition to the potential insurance coverage companies may have for property damage that the floods have caused, companies also may have insurance that can pay for the losses that they incur from the flood-related transportation disruptions, even if the companies themselves have not sustained any damage to their own facilities. Specifically, most companies have, as part of their first-party property insurance policies, "contingent business interruption" coverage.

This coverage generally pays for losses that occur when a company loses profits due not to its own property damage, but rather to property damage sustained by its suppliers and/or customers. Contingent business interruption coverage applies when covered property damage to an insured's company's suppliers prevents the policyholder from obtaining necessary materials, ingredients or services, and when property damage to the company's customers prevents the policyholder from selling its products.

This article discusses key issues that companies should consider in pursuing contingent business interruption claims arising from the Mississippi River flooding. Although insurers often dispute the scope of the coverage by relying on the insurance policies' limitations or exclusions, with careful preparation, policyholders can avoid the pitfalls that insurers rely upon and maximize their insurance recoveries.

Contingent Business Interruption Coverage

Contingent business interruption insurance is a form of coverage that protects a company whose business is contingent or dependent upon the flow of goods or services between it and other businesses. Contingent business interruption insurance pays for a

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company's lost profits due to an interruption in the supply chain caused by damage to a supplier's or customer's property.

Contingent business interruption coverage is similar to regular business interruption insurance, which covers a company for lost profits resulting from business interruptions caused by damage to a company's own property. Unlike regular business interruption coverage, though, contingent business interruption coverage is triggered by damage to the property of a third party that is not itself insured under the policy, namely suppliers and/or customers of the insured. As one court described it, "[r]egular business interruption insurance replaces profits lost as a result of physical damage to the insured's plant or other equipment; contingent business interruption coverage goes further, protecting the insured against the consequences of suppliers' [or customers'] problems." *Archer-Daniels-Midland Co. v. Hartford Fire Ins. Co.*, 243 F.3d 369, 371 (7th Cir. 2001)

Contingent business interruption insurance may provide very important coverage to protect companies from the ripple effects of the Mississippi River floods. Indeed, one of the key cases involving contingent business interruption coverage resulted from an insurance claim by Archer-Daniels-Midland Co. arising from the 1993 Mississippi River flood. As a result of the 1993 flood, "[r]iver, road, and rail transportation systems were disrupted on a large scale." *Archer-Daniels-Midland Co. v. Phoenix Assur. Co.*, 936 F. Supp. 534, 536 (S.D. Ill. 1996).

Those transportation disruptions caused interruptions in the supply chain that required Archer-Daniels-Midland, a farm-product processor, to sustain increased costs in acquiring raw materials. Ultimately, Archer-Daniels-Midland looked to its contingent business interruption policies to pay for those increased costs. Companies affected by the 2011 Mississippi River flood similarly may seek contingent business interruption coverage for their losses and increased costs.

Be Prepared to Respond to Coverage Defenses

Given the magnitude of the potential insurance claims, insurers are likely to assert any defense to avoid their payment obligations. Policyholders should recognize that many of the arguments that insurers likely will make have been considered, and rejected, by courts addressing similar insurance claims in similar contexts. However, policyholders also should understand that there are very few cases that have addressed contingent business interruption coverage, and the language of contingent business interruption coverage can vary substantially.

Although insurers might assert a wide range of coverage defenses, the cases involving contingent business interruption generally address two principal coverage issues: 1) whether contingent business interruptions were caused by a supplier's or customer's covered property damage; and 2) whether the entity that incurred the property damage is in fact a "supplier" or "customer" that triggers contingent business interruption coverage.

Policyholder Arguments

The first issue is whether the contingent business interruption actually was caused by physical damage to a supplier's or customer's property. Most policies require that the property damage incurred by the policyholder's supplier or customer be of the type that would be covered under the policy were the damage to the policyholder's own property. Thus, there could be disputes with insurers in situations where, for example, a supplier's or customer's property has not been physically damaged, but because of a lack of power or an inability to get personnel and/or materials in and out of the supplier's or customer's property, the supplier or customer cannot use the facility and thus cannot supply good to, or receive goods from, the policyholder.

Insurers might argue, for instance, that the closing of the Mississippi River to protect against future flooding might not constitute property damage at all. Similarly, insurers might assert that there is no property damage where a civil authority issues an order that renders a facility inaccessible or unusable, but where the facility was not itself physically damaged.

Policyholders, though, have strong counterarguments. For example, even where a direct supplier may not have incurred covered property damage, policyholders may be able to establish that a supplier or customer more remote in the supply chain did incur covered property damage. In addressing contingent business interruption coverage resulting from the 1993 Mississippi River flood, the court in the Archer-Daniels-Midland case held that covered property damage even to indirect supplier satisfied the property-damage requirement of the policies' contingent business interruption provisions.

Policyholders also may have coverage that does not require physical property damage. For example, "civil authority" coverage applies to business interruption losses caused by an order of a civil authority that prevents use of insured facilities, even where those facilities have not sustained physical damage. The

Coast Guard's order closing portions of the Mississippi River may implicate this coverage. Policyholders also might be able to rely upon other coverages in the property policy, such as "ingress/egress" coverage that applies to events that prevent entry into a covered facility. To be sure, insurers might argue that these coverages apply only where the civil authority's order or the situation preventing ingress/egress arises from property damage, and policyholders should review their policies closely to determine the scope of potentially available coverage.

Insurers also might attempt to rely on flood-related exclusions, which first-party property policies sometimes contain, to assert that there is no coverage for any of the contingent business interruption losses resulting from the Mississippi River flooding. Further, even where policies contain flood coverage, that coverage sometimes is subject to relatively small sub-limits of liability that insurers likely will argue should apply to restrict severely the coverage available for such losses.

Again, policyholders often have strong responses to the applicability of flood exclusions or sub-limits. Depending on the circumstances, a contingent business interruption might result from more than one cause, such as where the flood precipitated other covered events like fires or electrical outages that result in spoilage. Although some policies contain language that forecloses coverage for property damage caused by flooding regardless of whether other concurrent or intervening causes also exist, courts have taken varying approaches to the scope and enforceability of these policy provisions.

Even Remote Suppliers' Property Damage May Trigger Coverage

A second issue turns on the requirement in most contingent business interruption insurance that the loss that caused the interruption must have been suffered by a supplier or customer of the insured. In some instances, such as where flood waters destroyed a direct supplier's warehouse, policyholders should have little difficulty establishing that a direct supplier's property damage caused the interruption. In other instances, though, coverage may turn on whether the policy allows for the property damage to be far down the supply chain to companies or entities who may have only an indirect relationship to the policyholder.

For example, in the Archer-Daniels-Midland case, the policyholder incurred significant losses due to the 1993 Mississippi River floods because it could not move crops to its food processing plants by barge. Specifically, the floods had damaged docks and dams operated by the Army Corps of Engineers, and the Coast Guard had closed portions of the river. Ultimately, the court held that, under the policy language at issue, the contingent business interruption coverage applied because the Corps and the Coast Guard were "any supplier[s] of goods and services" under the policies, and because farmers who supplied corps to distributers, who in turn supplied Archer-Daniels-Midland, also were "any supplier[s] of goods and services" despite the absence any contractual relationship between them and Archer-Daniels-Midland.

In another recent case, Park Electrochemical Corp. v. Continental Casualty Co., 2011 WL 703945, at *2 (E.D.N.Y. Feb. 18, 2011), the court similarly held that interruptions caused by damage to indirect suppliers satisfied the policy's requirement based on ambiguity in the policy language. However, policyholders should be cognizant that not all courts have accepted that indirect suppliers qualify as a "supplier" under at least certain contingent business interruption policy language. See Pentair v. Am. Guarantee & Liab. Ins. Co., 400 F.3d 613, 615 (8th Cir. 2005). Policyholders should examine the definitions, if any, of suppliers and customers in their policies carefully, as they vary from policy to policy.

Damages

In addition to disputing that a policy covers a company's contingent business interruption, insurers also often dispute the amount of the company's covered loss and, in particular, the length of time during which the company may recover lost profits. Companies sometimes face difficult issues of proof in establishing the amount of their loss, and companies thus should be vigilant in maintaining records of the costs and losses they incur. Companies also should consider engaging a consulting expert early in the process to ensure that they are able to recognize and document all potentially covered costs and losses.

Conclusion

The Mississippi River flooding caused significant transportation disruptions. Companies that rely on the Mississippi River for receiving supplies and services, or for shipping products to customers, may now be exposed to substantial risks. Contingent business interruption coverage can provide important protection for companies facing those risks.