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Selected Insurance Coverage Issues: Contingent Business Interruption Losses in a Global Economy

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Introduction

In today's global economy, catastrophic events in one part of the world can and do interrupt the complex supply chains utilized by manufacturers located everywhere else in the world. In recent years, for example, record flooding in Thailand and the Tohoku earthquake, ensuing tsunami, and Fukushima nuclear reactor shutdown in Japan, resulted in massive economic losses to manufacturers whose businesses are located outside those regions, but whose products include parts manufactured, assembled, or distributed in the affected regions. Indeed,

> Almost without exception, companies of almost any size that manufacture or sell goods and products rely on foreign suppliers for all or part of the raw materials or parts they need to complete their own manufacturing process or the goods and products they sell. . . . [L]ocalized disasters can affect a worldwide supply chain and force the shutdown of factories on the other side of the globe.

Jay M. Levin, Esq., "Contingent Business Interruption Coverage: Is Your Supply Chain Covered?" available at the International Risk Management Institute, Inc. (IRMI) Risk & Insurance website,[1] August 2013.

To protect themselves against such losses, manufacturers typically purchase contingent business interruption (CBI) coverage as a component of first party commercial property insurance. CBI coverage is a form of "time element" insurance, which "pays for the loss of income" sustained by the insured, "resulting from damage" caused by a covered peril to "the premises of another organization on which the insured depends, such as a key supplier or customer."[2] Such coverage is often added to a commercial property policy by way of endorsement. It typically provides coverage for CBI losses incurred during an identified "period of restoration," which begins at the time of interruption and ends at the time it should reasonably take the affected supplier to complete the repair or restoration of its damaged property to service.

[1] *See* http://www.irmi.com/expert/articles/2013/levin08-property-insurance.aspx.
[2] *See Dependent Properties Time Element Coverage*, IRMI, http://www.irmi.com/online/insurance-glossary/terms/d/dependent-properties-time-element-coverage.aspx (last visited Jan. 22, 2015).

Determining coverage for CBI losses often involves extensive factual investigation and analysis. The process is often hampered by the fact that the supplier whose property has been damaged is often located at a great distance from the insured, and is not itself an insured. As a result, neither the insurer nor the insured may have access to all of the factual information needed to determine the existence and extent of any covered loss.

Under these circumstances, coverage disputes between the insured and insurer are not uncommon, requiring consideration of the following issues:

- What law will apply to the interpretation of the CBI coverage form?
- What is the policy language typically found in CBI coverage forms that may give rise to coverage disputes?
- Who is a "supplier" within the meaning of such CBI coverage forms, and how far back in the supply chain can property damage occur for there to be a covered CBI loss under such coverage forms?

We discuss each of these issues in turn, below.

What Law Governs?

Insurance policies may or may not contain a choice of law provision identifying the law selected by the parties as applicable to coverage disputes. In policies that insure risks located in multiple countries, such choice of law provisions may state, in essence, that the policy will be governed by the law of a particular country, and that disputes arising under the policy will be subject to exclusive jurisdiction in that country. If such a provision exists, it may eliminate disputes over the law applicable to substantive issues of policy interpretation. Such a provision, however, is intended to apply only "in those situations . . . that might involve a question of law to which the laws of a foreign nation may apply."[3] With respect to domestic U.S. insureds, such a provision does not assist in the determination of which state's substantive law will apply to coverage disputes arising under the policy, including disputes over coverage of losses caused by events outside the U.S.

Generally, where an insurance policy lacks an instructive choice of law provision, the policyholder and the insurer are free to commence legal

[3] *Aztar Corp. v. U.S. Fire Ins. Co.,* 224 P.3d 960, 966 (Ariz. Ct. App. 2010).

proceedings in any court where personal and subject matter jurisdiction may be established. If that court happens to be in the United States, the court will apply the choice of law principles applicable in that jurisdiction. Thus, if an insured commences a declaratory judgment action in a New York court, New York choice of law rules will apply.[4]

With respect to contract disputes generally, most jurisdictions in the United States apply a "center of gravity" or "grouping of contacts" analysis to determine which state has "the most significant relationship to the transaction and the parties."[5] Under this test, courts generally consider five factors:

1. the place of contracting;
2. the place of negotiation of the contract;
3. the place of performance;
4. the location of the subject matter of the contract; and
5. the domicile or the place of business of the contracting parties.[6]

In the context of insurance coverage disputes, American courts typically apply the "law of the state which the parties understood was to be the principal location of the insured risk . . . unless with respect to the particular issue, some other state has a more significant relationship . . . to the transaction and the parties."[7] With respect to CBI and other time element losses, the "risk of loss" is typically considered to be the insured's "place of business."[8] The location of

[4] *See, e.g., Int'l Bus. Machines Corp. v. Liberty Mut. Ins. Co.*, 363 F.3d 137, 143 (2d Cir. 2004) ("Federal courts sitting in diversity look to the choice-of-law rules of the forum state."); *Locke v. Aston*, 814 N.Y.S.2d 38, 42 (N.Y. App. Div. 2006) ("Where a conflict of law exists between two states, courts look to the choice of law rules of the forum to determine which state's law applies.").

[5] *See, e.g., Zurich Ins. Co. v. Shearson Lehman Hutton, Inc.*, 642 N.E.2d 1065 (N.Y. 1994); *see also Appalachian Ins. Co. v. General Electric Co.*, No. 122807-1996, 2008 WL 2840354, at *1 (N.Y. Sup. Ct. July 17, 2008) (same); *Edwards v. U.S. Fid. & Guar. Co.*, 848 F. Supp. 1460, 1465 (N.D. Cal. 1994), *aff'd*, 74 F.3d 1245 (9th Cir. 1996) ("In a contract dispute where the parties have made no effective choice of law, California courts analyze 'relevant contracts' to appraise the governmental interests implicated in the action.").

[6] *Appalachian Ins. Co., supra*, 2008 WL 2840354 at *1.

[7] *Schwartz v. Liberty Mut. Ins. Co.*, 539 F.3d 135, 152 (2d Cir. 2008); *see also Axis Reinsurance Co. v. Telekenex, Inc.*, 913 F. Supp. 2d 793, 805 (N.D. Cal. 2012) ("Where a policy insures against risks located in several states . . . courts will often apply the law of the state of the principal location of the particular risk involved.").

[8] *Stradford v. Zurich Ins. Co.*, No. 02 Civ. 3628, 2002 WL 31819215, at *4 (S.D.N.Y. Dec. 13, 2002) (applying New York law to a claim for property damage and business interruption where the insured's place of business and, therefore, the risk of loss, were

the business that suffers the CBI loss, therefore, is likely determinative of the law applicable to disputes over coverage of such losses.

Insurers and policyholders should keep these principles in mind when determining the jurisdiction in which to commence CBI coverage litigation. Note, however, that there may be relatively little published authority regarding the very specific factual and legal issues that commonly arise in the context of coverage for CBI losses. Consequently, as to such issues, the choice of law analysis may be less significant than it would otherwise be with respect to issues on which the law is more developed.

CBI Insurance Policy Provisions

CBI coverage is commonly provided by way of endorsement to the insured's first party commercial property policy. The scope of such CBI coverage will be determined by the wording of the endorsement, which may be standard form, like the endorsements prepared by the Insurance Services Office, Inc. (ISO), or a form developed by the insurance company or broker, or manuscript form.

Standard ISO Form Wording

Currently, the broad form ISO wording for CBI coverage is fairly explicit. It includes a Schedule identifying the third party entities on which the insured's business relies and provides, in pertinent part, that:

> A. [The insurer] will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration." The "suspension" must be caused by direct physical loss of or damage to "dependent property" at the premises described in the Schedule caused by or resulting from a Covered Cause of Loss. . . .
> B. The provisions of the Business Income Coverage Form respecting direct physical loss or damage at the

located in New York); *R & R Sails, Inc. v. Ins. Co. of State of Pennsylvania*, 610 F.Supp.2d 1222, 1228 (S.D. Cal. 2009) (applying California law to a business interruption claim where the insured had its principal place of business in California).

> described premises, including the applicable Limit of Insurance, will apply separately to each "dependent property" described in the Schedule.[9]

The ISO form then defines "dependent property" to mean, in pertinent part:

> property operated by others whom you depend on to:
>
> a. Deliver materials or services to you, or to others for your account (Contributing Locations) . . .
> b. Accept your products or services (Recipient Locations); [or]
> c. Manufacture products for delivery to your customers under contract of sale (Manufacturing Locations) . . .[10]

Consequently, the broad form ISO wording summarized above provides CBI coverage for business income losses incurred by the insured, arising out of damage caused by a covered peril, to the property of a "first tier" supplier or customer—that is, a third party on whom the insured's business directly relies for, among other things, the delivery or acceptance of goods or services.

Under this broad form ISO wording, there may also be coverage for CBI losses caused by physical loss or damage to properties owned by "second tier" suppliers or customers—that is, third parties one step removed from the insured. The ISO form identifies these entities as "secondary contributing locations"[11] and "secondary recipient locations,"[12] and states, in pertinent part:

> C. Secondary Dependencies—Contributing and Recipient Locations

[9] (Form CP 15 08 10 12, © Insurance Services Office, Inc. 2011 at 2).
[10] *Id.* at 3.
[11] A "secondary contributing location" is defined to mean, in pertinent part, an entity which "[i]s not owned or operated by the Contributing Location identified in the Schedule" and which "[d]elivers materials or services to the Contributing Location identified in the Schedule, which in turn are used by that Contributing Location in providing materials or services to you." Form CP 15 08 10 12, © Insurance Services Office, Inc. 2011 at 3-4.
[12] A "secondary recipient location" is defined to mean, in pertinent part, an entity which "[i]s not owned or operated by the Recipient Location identified in the Schedule" and which "[a]ccepts materials or services from the Recipient Location identified in the Schedule, which in turn accepts your materials or services." *Id.* at 4.

1. If the Schedule shows applicability of coverage for a "secondary contributing location," then the following applies . . .:

   [The insurer] will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration." The "suspension" must be caused by direct physical loss of or damage to property at a "secondary contributing location," caused by or resulting from a Covered Cause of Loss, which in turn results in partial or complete interruption of the materials or services provided to you by the "dependent property" described in the Schedule, thereby resulting in the "suspension" of your "operations."

2. If the Schedule shows applicability of coverage for a "secondary recipient location," then the following applies . . .:

   [The insurer] will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration." The "suspension" must be caused by direct physical loss of or damage to property at a "secondary recipient location," caused by or resulting from a Covered Cause of Loss, which in turn results in partial or complete interruption of the acceptance of your materials or services by the "dependent property" described in the Schedule, thereby resulting in the "suspension" of your "operations."[13]

The wording of the broad form ISO endorsement thus provides coverage for business income losses incurred by the insured, arising out of damage caused by a covered peril, to the property of a third party on whom one of the

[13] *Id.* at 2.

insured's direct suppliers or direct customers relies, for, among other things, the delivery or acceptance of goods or service. Note, however, that the ISO form also limits CBI coverage to losses sustained by the suspension of operations at the insured location during the "period of restoration." That period is defined, in pertinent part, as:

> the period of time that:
>
> a. Begins seventy-two hours after the time of direct physical loss or damage caused by or resulting from any Covered Cause of Loss at the premises of the "dependent property" (or "secondary contributing location" or "secondary recipient location"); and
> b. Ends on the date when the property at the premises of the "dependent property" (or "secondary contributing location" or "secondary recipient location") should be repaired, rebuilt, or replaced with reasonable speed and similar quality.[14]

A thorough investigation of the alleged damage to the third party property and its repair or restoration is thus essential to any determination of coverage for the insured's CBI losses.

Company Form, Broker Form, and Manuscript Wordings

In contrast to the standard ISO form wording quoted above, the wording of CBI endorsements generated by insurance companies and brokers may be far less explicit. One major domestic insurance company's form, for example, states simply that:

> This policy, subject to all provisions and without increasing the limits of this policy, also insures against loss resulting from direct physical loss or damage to or destruction by causes of loss insured against, to:
>
> * * *

[14] *Id.* at 3.

> b) Contingent Time Element: loss, damage, or destruction covered herein to property that wholly or partially prevents any direct or second tier supplier of goods and/or services to the Insured from rendering their goods and/or services, or property that wholly or partially prevents any direct receiver of goods and/or services from the Insured from accepting the Insured's goods and/or services, such supplier or receiver to be located anywhere in the world as per policy territory wording….

This wording appears clear enough on its face, and is supplemented by other policy provisions which expressly impose a defined "period of restoration." Nonetheless, the form's failure to define the terms "direct supplier" and "second tier supplier" may turn out to be problematic once CBI losses arise.

Who is a Supplier?

Unlike the standard ISO form's express definitions for "dependent property," "secondary contributing location" and "secondary recipient location," undefined terms such as "direct supplier" and "second-tier supplier" may give rise to numerous questions affecting coverage. Even the defined terms used in the ISO form may not be clear enough to answer all the questions presented when the CBI loss at issue arises in the context of a complex supply chain populated by interrelated business partners or varying types of service providers.

Corporate Affiliates

A question that frequently arises is whether a corporate affiliate of the insured, on which the insured's business depends, is to be counted as a separate "tier" in the supply chain for purposes of determining CBI coverage. Assume, for example, that a U.S.-based insured purchases component parts for the products it manufactures from an unrelated third party in Thailand. The Thai supplier ships those parts not to the insured but to the insured's affiliate in Hong Kong. The affiliate then processes the Thailand-produced components further, assembling them with other parts, before shipping them to the insured. If the third party's factory in Thailand is damaged by a covered peril, is that damage

to a "dependent" property (*i.e.*, a direct/first-tier supplier) or to a "secondary contributing location" (*i.e.*, a second-tier supplier)? Also, what if there happens to be a second affiliate of the insured involved, such as an entity responsible for the storage and shipment of the fully assembled component parts from Hong Kong to the insured? The answers to these questions will likely be critical, because CBI coverage is typically limited to losses involving a limited number of "tiers" in the supply chain, and may be sub-limited to lower amounts of coverage where the damaged property causing the business interruption is owned by a second- or third-tier supplier.

CBI coverage forms may address this question by clarifying that they provide coverage for losses resulting from "direct physical loss or damage of the type insured against to properties not operated by the Insured."[15] To this end, the standard ISO form wording defines a "dependent property" to mean "property operated by others whom you depend on to . . .

> a. Deliver materials or services to you, or to others for your account (Contributing Locations) . . .
> c. Accept your products or services (Recipient Locations); [or]
> d. Manufacture products for delivery to your customers under contract of sale (Manufacturing Locations) . . .

Under this and similar wordings,[16] it appears that corporate ownership and control will determine the existence and extent of CBI coverage. Only entities that are ***not owned or operated*** by the insured may qualify as a supplier or recipient "tier" for purposes of determining CBI coverage. This is consistent with the generally understood purpose of CBI insurance

[15] *Zurich Am. Ins. Co. v. ABM Indus., Inc.*, 397 F.3d 158, 169 (2d Cir. 2005) ("By its express terms, the CBI provision of the policy covers business interruption due to loss or damage to properties 'not operated by the Insured,' that is to say, it insures against events that prevent entities from supplying goods to, or receiving goods from, the insured."); *see also CII Carbon v. Nat'l Union Fire Ins. Co. of La.*, 918 So.2d 1060, 1061, n.1 (La. Ct. App. 2005) (same).

[16] Similarly, the ISO form defines a "secondary contributing location" to mean, in pertinent part, an entity which "[i]s ***not owned or operated by*** the Contributing Location identified in the Schedule" and which "[d]elivers materials or services to the Contributing Location identified in the Schedule, which in turn are used by that Contributing Location in providing materials or services to you." Form CP 15 08 10 12, © Insurance Services Office, Inc. 2011 at 3-4 (emphasis added).

generally, which is to protect the insured "against the loss of prospective earnings because of the interruption of the insured's business caused by an insured peril to property ***that the insured does not own, operate, or control***."[17] Consequently, examination of the policy's "named insured" and "additional insureds" provisions may determine whether an entity is considered a "supplier" or "recipient" in the supply chain for purposes of CBI coverage.

However, what if the CBI coverage form does not define the terms "supplier" or "recipient," or contains no restriction limiting the phrase "any direct or second-tier supplier or recipient" to entities not affiliated with the insured? Such wording may give rise to disputes over the existence of coverage where CBI loss is caused by damage to the property of a "supplier" affiliated with the insured.[18]

Park Electrochemical involved the interpretation of a first party property insurance policy which contained a CBI coverage form stating, in pertinent part:

> [The Insurer] will pay for the loss resulting from necessary interruption of business conducted at Locations occupied by the Insured and covered in this policy, caused by direct physical damage or destruction to: (a) any real or personal property ***of direct suppliers*** which wholly or partially prevents the delivery of materials to the Insured or to others for the account of the Insured. . . .[19]

The policy also contained a provision entitled ""Time Element—Gross Earnings," which provided coverage for the insured's business interruption losses caused by physical damage to facilities owned by the insured.[20]

A dispute concerning the meaning of these provisions arose when the insured—a manufacturer of circuit boards—sought to recover indemnification for CBI losses resulting from the interruption of its business due to an

[17] *CII Carbon, supra*, 918 So.2d at 1061, n.1 (emphasis added).
[18] *See, e.g., Park Electrochemical v. Cont'l Cas. Co.*, No. 04-CV-4916 (ARL), 2011 WL 703945, at *1 (E.D.N.Y. Feb. 18, 2011).
[19] *Id.* at *4 (emphasis added).
[20] *Id.* at *4.

explosion that occurred at a manufacturing facility owned and operated by a corporate subsidiary.[21] The subsidiary manufactured a component part that was essential to the insured's circuit boards, and the interruption in its supply of such parts to the insured resulted in the insured's loss of a significant amount of business income.[22] The insured, therefore, sought coverage for its CBI loss under the CBI coverage provision. The insurer, however, denied the claim. It did so based on the argument that "subsidiaries of the insured . . . are not considered 'direct suppliers' under the policy," and consequently found that there could be no coverage for the insured's loss.[23]

After commencing a declaratory judgment action against its insurer, the insured moved for summary judgment based on the wording of the CBI coverage provision. The court, however, found that the CBI coverage provision was ambiguous because it was subject to two competing interpretations. On the one hand, "it could be read to include ***any*** supplier, regardless of whether the supplier is a subsidiary of the insured."[24] Alternatively, the CBI coverage provision "could [also] be read to exclude subsidiaries or sister companies of the insured," consistent with the policy's ""Time Element—Gross Earnings' provision [which] already covers business interruption losses caused by physical damage to [facilities owned by the insured]."[25] The court, therefore, concluded that it was necessary to consider extrinsic evidence of the parties' intent, including the insurance broker's claim preparation manual, insurance treatises, and the deposition testimony of the insurance broker.[26]

In addition, the court looked to the insurance broker's claim manual, which provided that the supplier/receiver implicated in a CBI claim "cannot be owned [by] or a subsidiary of the insured party."[27] The court concluded, however, that none of these extrinsic materials was probative of the parties' intent at the time of contracting.[28] Instead, the court "found it significant that the insurance policy lacked any . . . explicit limitation [which] distinctly

[21] *Id.* at *2.
[22] *Id.*
[23] *Id.* at *5.
[24] *Id.* at *13 (emphasis added).
[25] *Id.* at **13-14.
[26] *Id.* at **14-19.
[27] *Id.* at *18.
[28] *Id.* at *18-19.

suggest[ed]" that the term "supplier" necessarily excluded affiliates of the insured.[29] Consequently, the court ruled that the "question of whether subsidiaries may be 'direct suppliers'" under the policy wording at issue was a question of fact for a jury to determine,[30] "weighing the conflicting inferences that may be drawn from the common practice and customs of the insurance industry and, ultimately, the knowledge and intent of the parties at the time the policy was purchased."[31]

Another troublesome aspect of certain CBI coverage language is its use of the word "any" to modify the term "supplier" (*e.g.*, forms providing coverage where property damage caused by a covered peril "wholly or partially prevents ***any*** direct or second-tier supplier of goods and/or services to the Insured from rendering their goods and/or services"). The use of the word "any" may create ambiguity if the wording contains no definition of "supplier" and no express or implied restriction limiting "any direct or second-tier supplier" to entities unaffiliated with the insured. "Any" has been routinely interpreted by the courts as an adjective that implies a broad scope of coverage.[32] A policy's use of the phrase "***any*** direct or second-tier supplier" may thus be deemed proof that the parties intended it to include ***every*** direct or second-tier supplier of the insured, ***including*** its corporate affiliates. Consequently, as *Park Electrochemical* demonstrates, a thorough review of the relevant underwriting files, claims files, and broker communications may be required to determine whether there is any evidence the parties intended to impose a limitation on the meaning of the phrase "any direct or second-tier supplier."

Service Providers

In the absence of a definition for the term "supplier," another question that may arise is whether a service provider in the supply chain, such as a

[29] *Id.* at *19.
[30] The case was subsequently settled prior to trial. As a result, no jury determination was ever made.
[31] *Id.* at *20.
[32] *See, e.g.*, *Sitthiso v. Fire Ins. Exch.*, No. B154982, 2002 WL 31151628, at *7 (Cal. Ct. App. Sept. 27, 2002) ("*Webster* defines the word 'any' to mean 'one indifferently out of more than two'; 'one or another'; and 'one, no matter what one.' . . . From the earliest days of statehood we have interpreted 'any' to be broad, general, and all embracing . . . the 'word "any" means every . . . .").

distributor, retailer, shipper, or storage facility, is a "supplier" that should be counted as a separate "tier" in the supply chain. Published authority addressing this issue suggests that as long as a service provider comes into physical possession of the goods at issue at some point in the supply chain, it should be considered a "supplier" for purposes of the CBI "tier" analysis.

For example, in *Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of N.Y.,* the court construed the phrase "any supplier" broadly. The CBI loss in that case arose out of flood damage to property owned by farmers who grew crops purchased by the insured through a reseller. The court found that the phrase "any supplier of goods or services" applied to "an ***unrestricted group* of *those who furnish what is needed or desired***."[33] Even though the insured had no direct relationship with the farmers, the court held that the farmers were "suppliers" to the insured of the goods they produced, for purposes of CBI coverage.[34]

Although a direct relationship with the insured may not be necessary to be considered a supplier, the entity must, nonetheless, provide goods or services ***"to the Insured."*** Thus, for example, where an entity's goods or services merely provide an incidental benefit to the insured, courts have found that such entities should ***not*** be considered suppliers.[35] In addition, it appears that to be deemed a "supplier," some courts have held that an entity must come into physical possession of the goods at issue at some point in the supply chain.[36] In *Millenium Inorganic Chemicals v. National Union Fire Insurance*, for example, the trial court construed the term "supplier" in favor of the insured and found that a producer of natural gas was a "direct supplier" to the insured for purposes of CBI coverage, despite the presence of an economic "middleman" in the supply chain between the gas producer and the insured.[37] In that case, the insured, Millennium, relied on a supply of

[33] *Archer-Daniels-Midland Co. v. Phoenix Assurance Co. of NY,* 936 F. Supp. 534 (S.D. Ill. 1996).
[34] *Id.* at 544.
[35] *See, e.g., Pentair, Inc. v. Am. Guarantee & Liab. Ins. Co.*, 400 F.3d 613, 614-15 (8th Cir. 2005) (where the insured sought CBI coverage arising out of physical loss or damage to a power company, which caused suppliers of the insured to shut down production, the court held that the power company was not a "supplier" as it "did not supply a product or service ***ultimately used by Pentair*** [and, accordingly] supplied no goods or services to Pentair, directly or indirectly") (emphasis added).
[36] *See, e.g., Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA,* No. ELH-09-1893, 2012 WL 4480708, *18-19 (D. Md. Sept. 28, 2012), *rev'd on appeal*, 744 F.3d 279 (4th Cir. 2014).
[37] *Millennium Inorganic Chems. Ltd.*, 2012 WL 4480708, at *19. *Id.* at *18.

natural gas to operate its titanium dioxide manufacturing facilities.[38] It purchased natural gas through an intermediary, Alinta, which purchased gas from various producers, including Apache, and then sold the commingled gas product to the insured.[39] After an explosion at Apache's production facilities, the supply of natural gas to Millennium was disrupted, causing Millennium to shut down production and lose $10 million in titanium dioxide sales.[40] A coverage dispute ensued between Millennium and its CBI insurer over the question of whether Apache was a "direct supplier" of natural gas to Millennium (in which case the CBI loss was covered), or an indirect/second-tier supplier by virtue of Millennium's contractual relationship with Alinta, the intermediary (in which case the CBI loss was not covered).[41]

The court found that the term "direct supplier" was ambiguous and concluded that "the physical relationship between the properties" identified in the CBI coverage provision "is as or more important than the legal relationship between the properties' owners."[42] Reasoning that the intermediary, Alinta, never took "physical possession of the gas" and performed only the "purely economic task of supply and demand aggregation" in its role as a reseller, the court held that the gas producer, Apache, was a "direct supplier" to Millennium for purposes of the CBI coverage endorsement.[43] The court further found that the intermediary, Alinta, was not a "direct supplier" for purposes of the CBI endorsement.

The insurer, however, challenged this ruling and the Court of Appeals for the Fourth Circuit reversed it.[44] The appellate court held that the term "direct," as used in the phrases "direct supplier" and "direct contributing properties" under the CBI endorsement, meant "proceeding from one point to another in time or space without deviation or interruption."[45] As such, the appellate court found that because Alinta was an intermediary in the process, buying the gas from Apache and selling it to the insured,

[38] *Id.* at *1.
[39] *Id.*
[40] *Id.*
[41] *Id.* at *11-12.
[42] *Id.* at *17.
[43] *Id.* at *19.
[44] 744 F.3d at 286.
[45] *Id.* at 285.

Apache could ***not*** be deemed a "direct supplier" or "direct contributing property" for purposes of CBI endorsement.[46]

In addition, even if it had not been reversed on appeal, the *Millennium* trial court decision appears to have been based on factors that might render it inapplicable to some forms of contract language. For example, the coverage provision in the *Millennium* policy applied ***only*** when "the ***delivery*** of materials to the Insured" was interrupted.[47] The phrase "delivery of materials" necessarily implies the physical movement of goods, which may explain the trial court's focus on "physical possession" of the goods in that case. Policy language that refers to an interruption of the "rendering of goods ***and/or services*** to the Insured" is much broader and may encompass, as a "supplier," intermediaries which are never in physical possession of the goods at issue, but which are nonetheless involved in the procurement or delivery of goods to the insured.

Collapsing Related Entities Into a Single Tier

Given the complexities of global manufacturing and corporate interdependence, there may be instances in which the insured seeks to "collapse" related entities in the supply chain into a single supply "tier" for purposes of CBI coverage. The insured may argue, for example, that if three subsidiaries of the same supplier perform separate functions with respect to assembling a single product, all of those subsidiaries should be viewed together as occupying a single "tier" level for the purpose of a CBI tier analysis.

Although it appears that there is no published authority to support such a position, it does have logical appeal. If, for example, the various supplier entities are, in form, separate legal entities but, in substance, part of the same business unit and financially interdependent, it does not make sense to treat a product passing through each of those entities as passing through three separate suppliers. The concept is analogous to business interruption "interdependency" coverage, which provides coverage for business interruption to an insured entity arising out of physical loss or damage to a different insured entity under the same policy.[48]

[46] *Id.* at 286.
[47] *Id.* at *4 (emphasis added).
[48] *See, e.g., Arthur Andersen LLP v. Fed. Ins. Co.,* 3 A.3d 1279 (N.J. Sup. Ct. App. Div.

Again, this argument may not be supported by policy language, and to date, there appears to be no published authority to support it. Nevertheless, where a CBI coverage form fails to define the term "supplier," it is possible that a court might find this argument appealing. It elevates substance over form, and therefore, may lend itself to analyses which aim to enforce the intentions of the parties at the time they entered into the policy providing the CBI coverage.

Client Strategies

The most effective strategy for dealing with CBI coverage issues is for policyholders and insurers to clarify their intentions regarding the scope of coverage before losses occur. This may be accomplished through unfettered disclosure by the insured of comprehensive supply chain information for all insured manufacturing divisions and product lines, well-documented and careful underwriting, and ultimately, unambiguous policy language. Whether broad form ISO wording or individual broker or insurer forms are used, parties would be well-advised to consider the inclusion of a choice of law provision and clear definitional terms.

Conclusion

In today's global economy, CBI coverage is an essential form of first party property insurance for manufacturers, distributors, retailers, and others. It is also frequently the source of multi-million dollar coverage disputes involving parties affected by catastrophic events, property damage, and economic damage occurring at opposite ends of the globe. Although extensive factual investigation and analysis is always required to assess coverage for such claims, clear policy language that contains express definitions for key terms will go far to reduce the frequency and scope of such disputes.

Key Takeaways

- Determining coverage for CBI losses often involves extensive factual investigation and analysis—and neither the insurer nor the

2010) (finding that the policy provided business interruption coverage to the insured for losses arising out of damage to insured facilities located anywhere in the world under the policy's "Interdependency" provision).

insured may have access to all of the factual information needed to determine the existence and extent of any covered loss.

- CBI disputes frequently arise over the choice of applicable law, the definition of a "supplier," and how far back in the supply chain property damage can occur for there to be a covered CBI loss under the policy wording.
- Examination of policy's "named insured" and "additional insureds" provisions may determine whether an entity is considered a "supplier" or "recipient" in the supply chain for purposes of CBI coverage.
- Although published authority is scant, it appears a service provider coming into physical possession of goods at some point in the chain may be considered a "supplier" for purposes of a CBI "tier" analysis.
- Even though extensive factual investigation and analysis is always required to assess coverage for CBI claims, clear policy language that contains express definitions for key terms will go far to reduce the frequency and scope of such disputes.

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