

Interdependencies, Contingencies of Business-Interruption Coverage Most Standard Forms Leave Judicially Sanctioned Gaps

By Michael A. Rossi

Troop Meisinger Steuber & Pasich LLP
Los Angeles

Assume your client asks you to insure it for business-interruption risks. So you obtain the standard type of business-interruption coverage. Now, what happens when one of your client's supplier's operations is destroyed by fire, so that the supplier cannot deliver to your client certain of the raw materials needed to manufacture your client's product? Because your client cannot manufacture its product, it sustains a business-interruption loss.

Is such a loss covered by the standard business-interruption insurance you procured? The answer likely is no unless you expressly added coverage for that risk.

Taking another hypothetical, assume that your client was the parent company of several separate subsidiaries, some of which were suppliers to, and

therefore customers of, each other. Assume that one of the customer, or buyer, subsidiaries' operations is destroyed by fire, so that the subsidiary supplying the now fire-damaged subsidiary with goods is deprived of a buyer for its goods. As a result, the supplier subsidiary suffers a business-interruption loss.

Is the loss covered by the standard business-interruption insurance you procured? The answer is no depending on which state's law interprets the policy, unless you otherwise specifically added coverage for that risk.

What I am addressing through these hypotheticals is the issue of "interdependent" and "contingent" business-interruption risks.

Most Forms Don't Cover

In my last article in *InsuranceWeek*, I discussed the problem created by some insurers' interpretation of the standard phrase "necessary interruption of busi-

ness" that is used in the majority of business-interruption coverage forms. In this article, I address another issue that must be examined when placing business-interruption coverage for your client, lest you construct a program that does not meet your client's needs and expectations.

The issue here is that most standard business-interruption forms do *not* cover interdependent and contingent business-interruption risks.

Many companies of substantial size face interdependent business-interruption risks, especially if such companies' subsidiaries are suppliers to and/or customers of each other. Many large companies with several subsidiaries and affiliated companies procure property and business-interruption coverage with one insurance policy, where the parent and all subsidiary and affiliated companies are listed on the policy as named insureds.

When one named insured is a supplier to and/or customer of another named insured on the policy, there exists an interdependent business-interruption risk because a loss at one subsidiary can cause a loss of income or increase in operating expense at another subsidiary.

Are interdependent business-interruption risks covered under standard business-interruption forms? The answer depends on which state's law applies to the policy at issue.

Some courts have concluded that standard insurance forms do *not* cover interdependency risks. Such courts analogize such risks to contingent business-interruption risks, and reason that such risks can be covered only if the policy at issue uses language that clearly states that interdependencies are covered.

Judicial Differences

By contrast, other courts have ruled that coverage for interdependent risks is included in standard business-interruption insurance as a matter of law, regardless of whether the term "interdependencies" is used anywhere in the policy. Such courts believe that if a parent company and all of its subsidiary and affiliated companies are named on the policy as insureds, then coverage for interdependencies would be expected. Applying the doctrine of the reasonable expectations of the insured, such courts rule that the coverage is provided as a matter of law.

Any company, whether or not it has subsidiaries, faces contingent business-interruption risks. If a loss occurs at a supplier operation, it could cause a loss of income or increase in operating expense for the company. The reason why such a risk of loss is labeled "contingent" rather than "interdependent" is because the supplier is not related by common ownership to the company that suffers the business-interruption losses caused by the supplier's difficulties.

Most courts rule that, unless the policy at issue expressly states that it provides coverage for contingent business-interruption risks, standard business-interruption forms do not provide coverage for contingent risks. Such forms typically are easy to spot because they contain an express prerequisite to coverage that says the loss of income or increased operating expense at issue must be caused by damage to property on the insured's premises or within a small distance (such as 90 feet) from the insured's premises.

What can you do to avoid obtaining business-interruption coverage for your client that comes up short in regard to interdependent and contingent risks? In my opinion, you should include express language in the contract

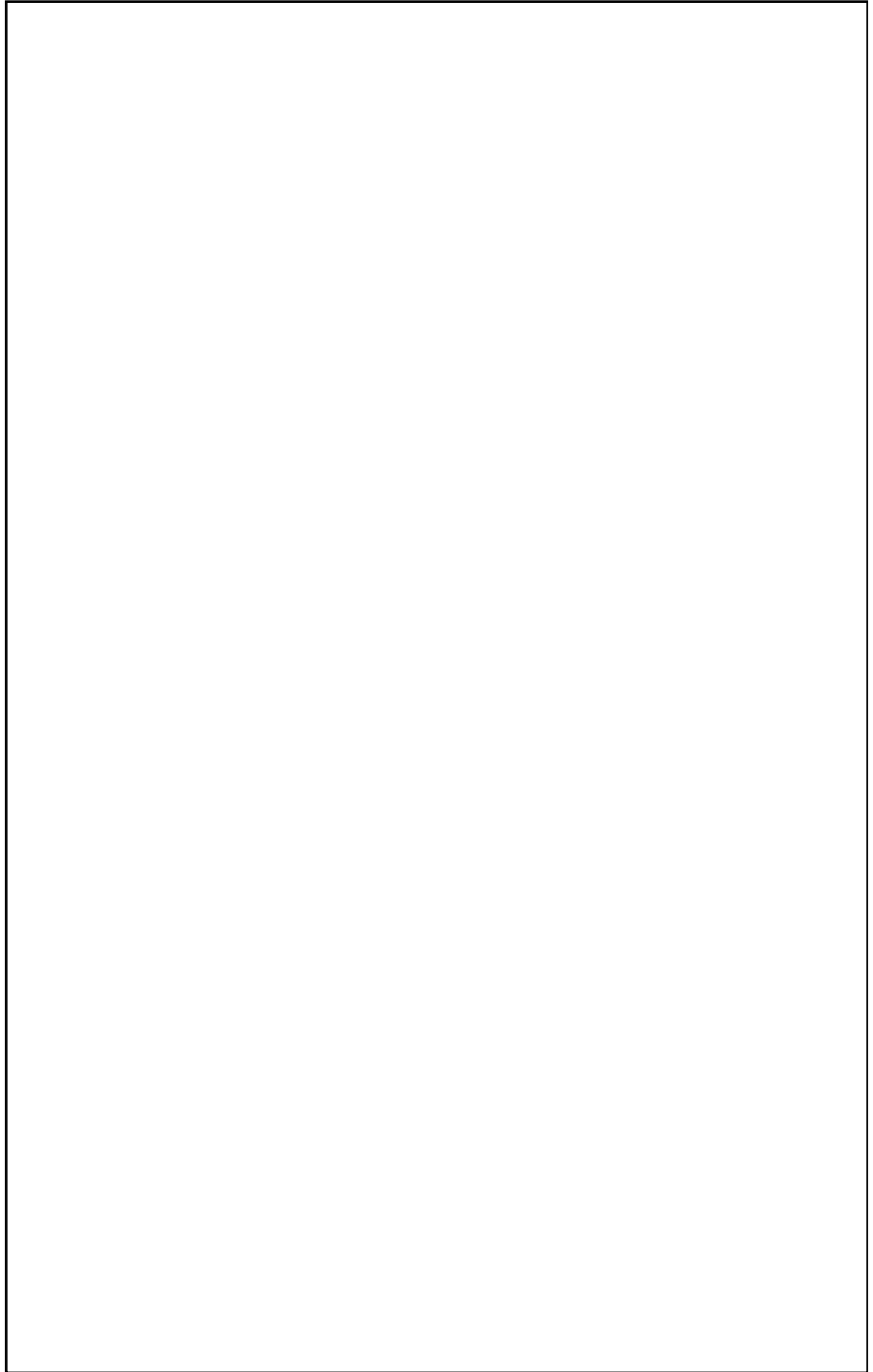
that addresses both issues. Policies have been written to deal with such issues in a variety of ways.

An example of forms on the market that address these issues include Chubb's Business Income (Without Extra Expense) Form 80-02-1005 (Ed. 4-94) and Chubb's Extra Expense Form 80-02-1018 (Ed. 94). Some of the relevant language from the Business Income (Without Extra Expense) form is quoted below (the language in the Extra Expense Form is similar):

Dependent Business Premises [Coverage]

We will pay for the actual **business income** loss you incur due to the actual impairment of your **operations** during the **period of restoration...**

This actual impairment of **operations** must be caused by or result from direct physical loss or damage by a **covered peril** to **property** or **personal property of a depen-**
continued on page 35



continued from page 33

dent business premises at a **dependent business premises**.

This additional coverage does not apply to any **dependent business premises** within any country on which either the United States government or Canadian government have imposed sanctions, embargoes, or any similar prohibitions.

Dependent Business Premises

Dependent business premises means premises operated by others on whom you depend to:

- * deliver materials or services to you or to others for your account;
- * accept your products or services;
- * manufacture products for delivery to your customers under contract of sale; or
- * attract customers to your business.

Coverage Territory

The coverage territory...for Dependent Business Premises coverage...is worldwide, unless otherwise stated.

Foreign Operations Included

Some comments regarding the forms quoted above are in order. First, note that the language quoted covers foreign operations on which an insured located in the United States depends. That should eliminate the need to have to buy a foreign property policy to insure contingent business-interruption risks where the insured's operations are located exclusively in the United States but some or all of the insured's suppliers and customers are located outside of the United States.

Second, the reference to "premises operated by others" raises a question of whether Chubb intends to insure interdependencies or just contingencies. Anyone making a placement using such language should seek clarification on this issue; coverage for interdependencies should be included.

Third, please do not take my favorable comments regarding Chubb's forms to mean that I recommend that anyone buy them. If they are coupled with Chubb's General Liability Form 80-02-2000 (Ed. 4-94), which they usually are, I would advise clients to run away from the policy as fast as possible. That Chubb liability form contains very nasty "Expected or Intended Injury" and "Intellectual Property" exclusions.

I commented on a form of such "Expected or Intended Injury" exclusion in my first article for *InsuranceWeek* more than a year ago. I have yet

to comment on the "Intellectual Property" exclusion contained in the Chubb form (and more and more other commercial general liability forms issued by other insurers), but suffice it to say that it severely limits the breadth of coverage afforded by a CGL policy for claims such as infringement of trademark, copyright, trade secret, trade dress, trade name, service mark, etc.

In the final analysis, interdependent and contingent business-interruption risks should be addressed by every agent or broker advising his or her client on business income, extra expense and other time-element risks.

Failing to expressly include language in property policies to insure such risks could lead to an uncovered loss, an unhappy client and, perhaps, an errors-&omissions claim.

Michael A. Rossi is an attorney in the Los Angeles law firm of Troop Meisinger Steuber & Pasich LLP. He works with agents and brokers to provide legal advice to policyholders from all over the world with respect to insurance-program reviews and audits, initial placements and renewals, and coverage disputes. He can be reached by phone at (310) 443-7664 or by email at marossi@inslawgroup.com.