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SPECIAL SECTION: FOOD & BEVERAGE

Contingent Expense and Business Interruption Risks Plague Supply Chains

Potential losses make appropriate insurance coverage more critical than ever

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Businesses in the food and beverage industry often obtain first-party property insurance to cover losses associated with damage to their own property. They can face significant risks associated with damage to key customers' or key suppliers' property – generally referred to as "dependent" or "contingent" property. Yet these businesses often have insufficient coverage, or none at all, for contingent business interruption (CBI) and contingent extra expense (CEE) losses, and nowhere is this more crucial than in the food and beverage industry, where a series of component parts or ingredients constitute the final product.

In this sector, contingent business interruption and contingent extra expense losses occur when a food or beverage company's supplier or customer experiences a loss that affects the supply chain and causes the policyholder to suffer harm.[1] Typically, contingent business interruption is loss of business income caused by damage to property of another (that key supplier or customer), while contingent extra expenses are those costs incurred to avoid or minimize contingent business interruption losses.

Given that food and beverage companies often rely on products and services from around the world, contingent business losses can be devastating. These contingent losses can occur when flooding in a foreign country damages a factory, making goods unavailable to manufacturers in the United States, or when crops are destroyed by drought, leaving companies everywhere without access to ingredients necessary for their products. Because of the growing global interconnectivity of product supply chains, CBI and CEE coverage may be the most important type of insurance coverage for businesses in the consumables industry.

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Simple hypotheticals demonstrate the importance of contingent business interruption and contingent extra expense coverage. For example, Business A sells candy that is packaged in a wrapper it purchases from a manufacturer. A storm damages the wrapper manufacturer's plant, forcing it to cease operations while the damage is repaired. Although Business A sustained no damage to its own plant, it now has to obtain its wrappers from a different source on short notice and at a great additional cost. Business A seeks insurance coverage for the additional expenditure related to buying substitute candy wrappers; however, Business A is not entitled to coverage for its losses under traditional extra expense coverage because extra expense insurance coverage is triggered only when there is damage to Business A's property. Business A will be left without insurance coverage for its increased business expenses if it does not maintain sufficient CEE insurance – high enough policy limits, and sometimes broad enough coverage.

Business B makes and sells popcorn to the two movie theaters in a small city. A catastrophic event damages both movie theaters, forcing them to close for an extended period of time, during which they need no popcorn, eliminating Business B's revenue stream. Business B's property did not sustain direct physical loss. Therefore, Business B cannot seek coverage under traditional business interruption insurance provisions and would have insurance coverage only for the losses sustained by its business if it maintains CBI coverage.

Existence and Scope of Coverage

Neither CBI nor CEE is included in every insurance policy, and businesses must carefully review their coverage to determine whether contingent losses are insured. Often CBI and CEE are added to a commercial property policy by endorsement.

A sample CBI coverage grant provides: "This policy covers against loss of earnings and necessary extra expense resulting from neces-

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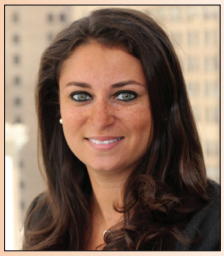

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sary interruption of business of the policyholder caused by damage to or destruction of real or personal property, by the perils insured against under this policy, of any supplier of goods or services which results in the inability of such supplier to supply an insured location."[2]

A sample CEE coverage grant provides: "We will pay for the necessary Extra Expense you incur due to the direct physical loss of or damage to property at the premises of a 'dependent property' described in the Schedule caused by or resulting from any Covered Cause of Loss."[3]

Generally, CBI or CEE coverage is triggered only if there is damage to property that directly or indirectly prevents a supplier from delivering its goods or services to the policyholder, as demonstrated in the example involving Business A, or when there is damage to property that prevents a customer from accepting the policyholder's goods or services, as demonstrated in the example involving Business B. The policyholder must also be able to demonstrate that the damage to the dependent property was the actual cause of its loss.[4]

Limitations on Coverage

The scope of CBI and CEE coverage is finite. Many policies contain sub-limits for contingent losses, potentially providing only a portion of the coverage available for noncontingent losses. Being aware of a policy's sub-limits is important to ensure your company has sufficient coverage to protect it in the event of a catastrophic supply-chain disruption.

In addition to restricting the amount of coverage available through the use of sub-limits, many CBI and CEE endorsements begin to provide coverage when the interruption occurs but cease coverage once the supplier or customer has had reasonable time to complete necessary repairs and resume business.[5] As such, the policyholder may be left without coverage if the supplier or customer is dilatory in its repair efforts or if the insurer determines the repair work is not being completed at a reasonable pace.

Some policies provide coverage only for losses sustained as a result of physical damage to "direct suppliers" or otherwise limit coverage to instances where the damaged entity has a direct contractual relationship with the policyholder.[6] For example, if Business C obtains processed wheat from a factory in Canada, but that factory is unable to process its wheat because its electrical supplier sustained massive physical damage, Business C may incur extra expenses or business interruption losses as a result of its inability to obtain processed wheat from its supplier. Business C may be without CBI or CEE coverage, however, depending on the language of the policy. Business C may have a restrictive CBI endorsement, which limits coverage to losses sustained as a result of physical damage to a direct supplier. In this circumstance, the electrical company would be considered a direct supplier for the wheat factory, but it would be only an indirect supplier for Business C. Some CBI endorsements require the policyholder to specifically list the locations that will be considered "suppliers" or customers for the purpose of determining coverage obligations. Reviewing your CBI endorsement to determine whether coverage applies broadly to all suppliers, or is limited only to losses arising out of damage to direct or named suppliers, is important to understanding the scope of available coverage.

Documenting a Loss

Properly documenting the losses associated with a CBI or CEE claim may be difficult, and insurance policies often provide insufficient information regarding the type and extent of required documentation. These complications can be compounded when the damaged entity is a great distance from the policyholder and is not insured under the policy, giving the third party little incentive to cooperate in the policyholder's investigation. The policyholder may have difficulty obtaining information to evaluate the scope of the loss and the repair work – information that is particularly important given that many policies provide coverage only until the dependent property reasonably "should be repaired, rebuilt, or replaced."[7] For this reason, policyholders should gather relevant information as soon as an interruption occurs and make every effort to work with suppliers or customers to gather the information necessary to maximize coverage.

Next Steps

CBI and CEE can be devastating to any company, particularly those in the food and beverage industry. Especially in light of the nature of present-day global supply-chain dependency, where entities rely on suppliers and customers from all over the world to keep their businesses in operation, these coverages are more critical than ever. Food and beverage companies should take the time to carefully review their insurance policies to determine whether they contain coverage for CBI and CEE and, if so, the amount of coverage available and any limitations on that coverage. If these risks are significant enough, policyholders should contact brokers or other professionals who have the expertise to advise them about what coverages and products are available in the marketplace, and what would be the best fit for their specific needs.

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