Who is The CBI Winner?

An Oil-Producing City Evacuated Must Mean a CBI Claim is Coming to Some Insurer: the Fort McMurray Wildfires

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The Fort McMurray (Canada) wildfires are reported to have caused economic loss to those involved in the area's oil sands industry.

Insurers may expect a variety of claims to arise from the disaster, including claims for Contingent Business Interruption ("CBI"), Business Interruption ("BI"), and Civil Authority coverage. Ingress/egress or Service Interruption claims are also likely to be presented. While each insurance contract is different.

WHAT HAPPENED?

If one looks at the pictures, videos and news accounts, one can without exaggeration say this was a fire loss of unprecedented geographic andeconomic proportions.

On May 1, 2016, a wildfire began near Fort McMurray in Alberta, Canada. Two days later, on May 3, the fire swept through the Fort McMurray community, destroying approximately 2,400 structures. Evacuations began with approximately 500 residents on May 1; by May 3, most if not all residents of Fort McMurray, which is the main center for Canada's oil sands region, were ordered to evacuate. As of early July, there still were some reported fires burning.

Fort McMurray is "the heart of Alberta's oil sands region," and the fire apparently affected Alberta's oil sands ventures. Several companies shut down or reduced oil sands operations "to evacuate workers and cope with supply disruptions or smoke that interfered with operations," resulting in a loss of up to one million barrels of crude oil per day.

After the fire appeared to recede from Fort McMurray, workers were permitted back into the area to restart operations. By May 11, Royal Dutch Shell plc and Syncrude Canada had restarted limited operations and Suncor anticipated that it could ramp up production fairly quickly when it "was safe to do so." There reportedly was some minor damage to the electrical systems, but that damage was not anticipated to stop the industry from ramping up.

On May 4, Enbridge, Canada's largest pipeline company, shut down its pipelines in and out of its Cheecham terminal located approximately 50 kilometers from Fort McMurray, affecting some 900,000 barrels per day of volume on its system, "due to the danger from the fire itself as well as upstream production outages." The pipelines were not damaged, but some

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above-ground valve sites were damaged and power outages "continued to be an issue" on May 12. Enbridge was permitted limited access to its sites late on May 15 and had resumed operations at its Cheecham terminal on May 11, with other sites following, although resumption of operations at one site was dependent on the company's ability to get permission to fly over the right-of-way corridor. On May 16, a wildfire had reached within one kilometer of its Cheecham terminal location, but some pipelines remained in operation.

May 16, 2016 Evacuations of Oil Sands Camps

On May 16, "[s]hifting winds turned Alberta's huge wildfire back toward Fort McMurray . . . menacing the city once more and prompting new evacuations as the out-of-control blaze headed for two major oil sands projects north of the city." As the fire shifted directions once again, between 500 to 600 people were evacuated from four small work camps. Additionally, for precautionary reasons, "an unknown number of employees at Syncrude and Suncor, two of the largest and oldest oil sands projects, were sent to camps further north."

On May 16, about 4,000 people had been working "in the area at strip mines, processing plants and other operations owned by the two companies." Oil sands facilities and work camps located north of Fort McMurray were ordered to evacuate on May 16; nineteen work camps and as many as 8,000 people were affected by this evacuation order. Just hours after the evacuations, the fires apparently destroyed the Horizon North Logistics camp.

Return of Workers to Oil Sands Camps and Residents to Fort McMurray

In total, approximately 90,000 people were reported as having been evacuated from Fort McMurray and certain oil sands camps. On May 21, 2016, the evacuation order had been lifted for seven of the camps; by May 23, the mandatory evacuation order was rescinded for the remaining camps. Residents in certain communities in Fort McMurray were permitted to begin returning in phases between June 1 to June 4. As of June 5, 2016, the fire was nearly 58 percent contained and was estimated to cover 581,695 hectares in both Alberta and Saskatchewan; the Fort McMurray wildfire was reportedly still "out of control" at that time.

Estimated Economic Ramifications

As of May 26, 2016, analysts estimated that "overall insured losses" could reach approximately $7 billion Canadian. Some analysts estimated that the wildfires were costing oil companies as much as $50 million a day in lost production.

On May 17, 2016, a local newspaper reported that "[a] new assessment of the economic impact of the Fort McMurray wildfires says close to $1 billion of oil sands production has been lost." According to the Conference Board of Canada, the fire resulted in an estimated loss of "1.2 million barrels of oil per day for two weeks, translating into $985 million in lost gross domestic profit," which "represents about 0.33 per cent of Alberta's projected GDP this year and 0.06 per cent of Canada's projected GDP." This estimated loss was based on the statement that "[t]welve oilsands operations were shut down and several more curtailed output this month because of the wildfire that closed pipelines and forced the evacuation of more than 80,000 people from the area." These numbers were based on the assumption that most oil sands operations would be active again by the end of May, but the projections were made before the fire shifted back in the direction of Fort McMurray.

By June 11, 2016, it had been estimated that the cumulative production loss from the wildfires would reach approximately 40 million barrels, although the exact cost of that loss was difficult to ascertain. Wildfires were still burning and were causing additional isolated evacuations. As of July 1, 2016, approximately 350,000 barrels per day of production were still offline at the joint venture Syncrude project and Suncor Energy's Mackay River thermal plant.

Other industries affected by the wildfires and shutdown of the oil sands operations reportedly include rail and hospitality.

WHAT ARE THE KEY ISSUES ARISING IN THE WAKE OF THIS FIRE?

Given these press reports, the full extent of loss will not be known for some time. One anticipates that insureds in both Canada and the United States may submit first-party property damage claims as a result of the fire.

Today, more than ever, the insurance industry is global in its reach. Many of the policies issued to insureds headquartered in the United States provide coverage for loss or damage at insured locations across the world. Therefore, just limiting our thoughts to the United States, claims for this Canadian event are likely to be submitted to insurers based in the United States.

The wildfires may have an effect on businesses around the world that depend on delivery of oil from Fort McMurray, and this may lead to claims under CBI coverage. The availability of such coverage will require a careful review of the applicable policy language, including whether the supplier was located in a covered territory; whether the supplier sustained direct physical loss or damage; whether that direct physical loss or damage was the result of a covered cause of loss; and whether the supplier was a direct or indirect vendor to the insured.

CONTINGENT BUSINESS INTERRUPTION

One of the principal effects of the Canadian wildfires on U.S.-based businesses will probably be the loss of income resulting from the suspension of their Canadian suppliers' and customers' operations, including companies that do not own properties in the Fort McMurray area. Both Canadian and U.S. insureds will likely rely on CBI provisions in seeking coverage for

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business interruptions that may follow in the wake of the wildfires, which have disrupted the supply of oil.

As compared to BI coverage, case law interpreting CBI coverage is relatively scarce and not all policies include CBI coverage. When policies do include CBI provisions, the wording for CBI coverage will often be skeletal, or the coverage may be created by nothing more than a "sublimit" reference or an endorsement that focuses on listing the contingent properties that are covered. It is critical, therefore, for insurers adjusting claims arising from the wildfires to review their policies carefully.

The concept of CBI coverage is simple to express, but difficult to apply in view of the many different wordings one finds in policies. CBI extends time element coverage to situations in which the insured suffers a loss of income because of damage to someone else's property. A CBI clause found in some ISO policies provides:

> We 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 the direct physical loss of or damage to "dependent property" at a premises described in the Schedule caused by or resulting from any Covered Cause of Loss.

Thus, under this provision, for CBI coverage to apply there must be: 1) a necessary interruption of the insured's business; 2) resulting from direct physical loss or damage caused by a covered cause of loss; 3) where the direct physical loss or damage is to property of a type insurable under the policy; and 4) the direct physical loss or damage must prevent a supplier (or receiver) of goods or services from providing (or receiving) those goods or services. CBI coverage is usually limited to a Period of Recovery, typically ending when the supplier's damaged property could have been rebuilt, repaired, or replaced with due diligence and dispatch.

A. Definition of a "Supplier"

Usually, CBI provisions require damage to the property of a "supplier" or "customer." Very little case law discusses the meaning of a "customer," but several courts have addressed the meaning of "supplier."

In one preeminent case, the insured was a processor of farm products. Flooding of farmland on the banks of the Mississippi caused some of the farmers who supplied the insured with grain to suspend operations. Damage to the property of the Army Corps of Engineers ("Corps") prevented the Corps from keeping the Mississippi navigable, which increased the insured's transportation costs.

In sum, where a CBI provision does not define or limit "supplier," courts have construed these terms broadly.

That court defined "supplier" as "an unrestricted group of those who furnish what is needed or desired." The court agreed with the insured that the Corps was a "supplier" to the insured inasmuch as the Corps's construction of physical improvements on the Mississippi River was a "service" that it provided to the insured despite the absence of a contract between the Corps and the insured. The court further ruled that the local farmers were "suppliers" to the insured, even though the insured purchased the grain from intermediary grain dealers. The policy, it observed, did not limit the CBI coverage to "direct" suppliers. The court concluded that if the insurer had wanted to limit CBI coverage to "direct" suppliers, it could have included wording to that effect.

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A Canadian court reached a similar conclusion, holding that where the insurance policy covers interruptions caused by property damage to facilities used by a supplier to obtain product for an insured, there is no requirement that the supplier actually own the facilities. A court in Alberta stated that "'[f]acilities of suppliers' would commonly be understood to include facilities used for the purpose of providing supply to an insured irrespective of whether the supplier owned the facilities." "Supplier" in that case was defined in part as "an entity not owned or operated by the insured that delivers goods or services." While the Alberta court did not expressly discuss the issue in terms of whether there was coverage for "direct" or "indirect" suppliers, it generally agreed with the rationale provided by the trial court, which had held that "[d]rawing a distinction between direct and indirect suppliers would lead to an absurd result."

While we have seen some courts take a broad view of what is meant by a supplier, courts will impose some limitations. For example, where the insured was a manufacturer, and the alleged "supplier" was a substation that provided electric power to a Taiwanese factory that supplied products to the insured, the court held that "the power substation [is] not a 'supplier of goods and/or services' to [the insured] within the plain meaning of [the policy wording]." The court noted that the substation at issue supplied power to the factory but "supplied no goods or services to [the insured], directly or indirectly."

Another U.S. Court of Appeals recently rejected one insured's attempt to conflate a direct supplier with an indirect supplier. In that case, the appellate court dismissed the insured's argument that a natural gas producer could qualify as a direct supplier (or direct contributing property, as stated in the policy in that case) because gas flowed through a pipeline directly from the gas producer to the insured, even though the insured did not have a direct contractual relationship with the gas producer. In reaching its holding, that court held that the term "direct" was unambiguous and meant that for the gas producer to be considered a direct contributing property, it must

have supplied the insured "with materials necessary to the operation of its business 'without deviation or interruption' from 'an intermediary,'" which the producer did not.

A California federal court recently reached a similar holding, holding that a hard drive supplier that manufactured hard drives incorporated into products manufactured by another supplier was not a "direct supplier." Although the hard drives were manufactured to the insured's specifications, the insured did not receive components directly from or have any contract with the hard drive manufacturer.

In sum, where a CBI provision does not define or limit "supplier," courts have construed these terms broadly. Nevertheless, the insured must still show that there is a relationship between it and the property that was damaged, such that the insured would suffer a direct pecuniary loss if the property were damaged.

B. The Requirement of Direct Physical Loss to a Supplier's Property

CBI coverage exists when the supplier suffers direct physical damage to its property as a result of the type of peril that is covered by the insured's policy.

In the CBI context, the requirement of direct physical damage was central to one court's decision in a case where the insured was in the business of operating trade shows. It was covered by a CBI provision that extended its BI coverage to "loss . . . resulting from direct physical loss or damage insured by this policy occurring at each supplier and customer location(s)." The insured suffered a loss of income when one of its trade shows, at Manhattan's Javits Center, was postponed because the Javits Center was being used for disaster relief operations related to the September 11, 2001 terrorist attacks. The court held that this loss of income was not covered by CBI, because the Javits Center did not itself suffer direct physical loss or damage.

If required by the policy, there must be actual physical loss or damage to the supplier's property. This may be an issue with respect to the wildfires, to the extent that companies either voluntarily evacuated employees or their employees were mandatorily evacuated, and the plants were shut down for that reason, as opposed to a shutdown caused by physical damage to a supplier or customer of the insured.

C. The Requirement that the Damage Result from a Covered Peril

CBI coverage further requires that the damage to the supplier's property result from a covered peril. For example, in one case, the insured manufactured steel, for which it required a steady supply of carbon coke,

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