

Extra Expense Coverage Does Not Apply To Increased Cost Per Pound

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Eighth Circuit Holds That Covered Extra Expense Under A Property Policy Must Come From An Actual Increase of Expenses, And Not Merely The Mathematical Increase That Results When Allocating Normally Incurred Fixed Costs To Diminished Production Volume

Zelle Hofmann partner, Tom Caswell, recently received a favorable ruling from the Eighth Circuit Court of Appeals providing welcome guidance on Extra Expense coverage, and reversing a prior ruling of the U.S. District Court for the Western District of Arkansas. The issue before the Eighth Circuit was whether an “increase” in the insured’s costs to operate its chicken processing plant at a reduced capacity following a covered loss constituted an Extra Expense. Of note, the “increase” in costs was not the result of additional out-of-pocket expenses being incurred by the insured. Instead, the “increase” was due to the insured’s accounting process which allocated its normally occurring fixed costs to the newly decreased production levels. Accordingly, the insured’s per-pound cost of processed chicken increased since the fixed costs were now being allocated over a smaller production volume.

The case arose from an electrical outage at a chicken processing plant owned by George’s, Inc. Allianz Global Risks US Insurance Company measured the loss and paid George’s its covered Time Element loss plus George’s actually incurred Extra Expenses, although denying the remaining uncovered portions of George’s claim. George’s brought suit seeking Extra Expense coverage for the cost “increase” that resulted when George’s fixed expenses were allocated to its post-loss decreased production volume. In particular, George’s argued that because the term “costs” was not defined in the Allianz Policy, the Extra Expense coverage could reasonably be understood to include an increase in the cost-per-pound of processed chicken. George’s further argued that this outcome was especially warranted since George’s accounting methodology of allocating costs to production volume had been disclosed during underwriting. The District Court for the Western District of Arkansas agreed with George’s

and ruled that since the term “costs” was not defined in the policy, and since the insured’s accounting methodology was disclosed during the underwriting process, the cost “increase” that mathematically resulted from allocating fixed costs to the lessened production volume was a covered Extra Expense.

Although the District Court agreed with George’s position, the Eighth Circuit reversed, holding that George’s chosen accounting methodology could not serve to alter the clear terms of the Policy:

We find George’s argument to be unpersuasive. A term in an insurance policy is not ambiguous simply because it is undefined. Looking only at the words themselves, the ordinary meaning of “costs” is distinct from the concept of “cost-per-pound,” which as its wording suggests, is an equation representing the relationship between cost and total production. A company’s overall expenditures do not necessarily increase simply because it experiences an increase in the per-unit cost of its product. But as George’s interprets the policy, it would incur an Extra Expense any time that it slowed or stopped production . . . Although it is undisputed that George’s uses a cost-per-pound allocation in its own accounting, that is not the language used in the contract. When, as here, the language of an insurance policy is clear, it is improper for a Court to “strain the construction of ordinary terms in the contract to create ambiguity where one does not appear.” 596 F.3d at 993.

The Eighth Circuit Court of Appeals reversed the trial court and remanded with instructions for judgment to be entered in favor of Allianz, thus concluding George’s claim.

Decisions on this issue (published or unpublished) are remarkably sparse, and we believe you may find this to be a useful published opinion to rely on where an Extra Expense claim is being driven by accounting manipulations rather than an actual increase in out-of-pocket costs. The full opinion from the U.S. Court of Appeals for the Eighth Circuit in the matter of George’s, Inc. v. Allianz Global Risks US Insurance Company may be found at 596 F.3d 989 (8th Cir. 2010).

Please feel free to contact Tom Caswell at (612) 336-9150, or tcaswell@zellelaw.com, should you have any questions about this topic, or any

other property insurance coverage issue.