

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 insureds 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 insureds accounting process which allocated its normally occurring fixed costs to the newly decreased production levels. Accordingly, the insureds 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 Georges, Inc. Allianz Global Risks US Insurance Company measured the loss and paid Georges its covered Time Element loss plus Georges actually incurred Extra Expenses, although denying the remaining uncovered portions of Georges claim. Georges brought suit seeking Extra Expense coverage for the cost increase that resulted when Georges fixed expenses were allocated to its post-loss decreased production volume. In particular, Georges 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. Georges further argued that this outcome was especially warranted since Georges accounting methodology of allocating costs to production volume had been disclosed during underwriting. The District Court for the Western District of Arkansas agreed with Georges

and ruled that since the term costs was not defined in the policy, and since the insureds 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 Georges position, the Eighth Circuit reversed, holding that Georges chosen accounting methodology could not serve to alter the clear terms of the Policy:

We find Georges 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 companys overall expenditures do not necessarily increase simply because it experiences an increase in the per-unit cost of its product. But as Georges interprets the policy, it would incur an Extra Expense any time that it slowed or stopped production . . . Although it is undisputed that Georges 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 Georges 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 Georges, 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.