

Coverage for the Thailand Floods: Learning Lessons From Earlier Catastrophes

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As the flooding news from Thailand drags on, businesses must look to the lessons that past disasters can teach us - the Sendai earthquake and tsunami last March (the "Sendai Event"), Hurricanes Katrina and Rita, and even 9/11. Thailand is a critical link in international supply chains, notably automotive and computer components. Thus, the current flooding will again focus policyholders' attention on the important role played by Contingent Business Interruption (or Contingent Business Income) ("CBI") insurance, as the Sendai Event did.

CBI insurance is designed to cover losses caused by damage to or destruction of the property of suppliers and customers of the policyholder, which the policies call "Dependent Properties." Of course, the insurance companies that sell this coverage try very hard to avoid paying CBI claims, particularly when they are faced with a large catastrophic event, like a natural disaster, which leads to a large number of similar kinds of significant claims. True to form, the insurance industry's response to CBI claims from the Sendai Event has been to push back aggressively to minimize coverage. Responses to early Thailand Flood CBI claims have been the same.

But policyholders don't have to take "no" for an answer. Reed Smith's Insurance Recovery Group has some of the most able and experienced counsel for CBI claims in the world. Depending on the situation, they can advise clients behind the scenes or, if needed, come to the forefront, litigating against insurers. Since insurers routinely work with their coverage counsel from the inception of major events like these, policyholders are well-advised to do the same.

Insurers have been making four primary arguments to evade the Sendai Event claims, all of which we can expect to see again for the Thailand Flood claims.

1. No Coverage for the "Supply Chain"

Some CBI provisions limit coverage to loss from specific, named locations. Such policies don't have a supply chain issue, because the damage either occurred at a named location or it didn't. Problems arise under policies that provide CBI coverage on a "blanket" basis, which vary widely and can be triggered by damage to property:

- Of "direct suppliers" or "direct customers"
- Of "suppliers" or "customers"

- Of customers or suppliers "of any tier"
- Of suppliers or "customers of customers," or
- That "directly or indirectly" prevents suppliers or receivers of goods or services from supplying or receiving goods and services

As can be seen from this wide variety of policy provisions, specific policy language is important.

Few cases interpret these provisions; however, the narrower the provisions of the policy, the more difficult it will be to obtain coverage, given the complexity of global supply chains. Having skilled counsel review your policy can save a great deal of money down the line.

2. No Coverage for Loss Stemming from Excluded Causes

CBI provisions typically cover loss from damage caused by "covered" or "insured" perils. Insurance companies responding to Sendai Event claims are taking the position that they don't have to provide any coverage unless the policyholder can prove that its CBI loss stemmed solely from covered causes. If a portion of the damage causing the loss can be attributed to excluded causes (in that case, possibly earthquake or radiation), insurers claim they need not cover any loss.

For those who fought the "wind vs. water" battles after Hurricanes Katrina and Rita, this is familiar ground. Courts focus on (a) the doctrine of concurrent causation - permitting coverage if both covered and excluded causes contribute to the loss and (b) the presence or absence of "anti-concurrent" causation language - which bars coverage if the excluded cause appears anywhere in the chain of causation. If the policy doesn't have an "anti-concurrent causation" clause, the damage resulting from concurrent causes should be covered. Even if the policy has an "anti-concurrent cause" clause, damage from overlapping causes may still be covered if the damage (a) took place as a result of a covered cause before the excluded cause began, or (b) would have taken place even if only the covered cause had happened and the excluded cause had never happened.

At a minimum, the policyholder should be entitled to allocate the losses between those attributable to damage from covered causes and those from excluded causes.

3. Loss from Property Damage Outside the Territorial Limits of the Policy

The next area of dispute arises from the "Coverage Territory" policy term. If it is anywhere in the world, the insurers don't have an argument. However, if it is limited, e.g., to the United States or North America, you can expect to get pushback from insurers, who will argue that the policy only provides CBI coverage for loss attributable to damage to property within the United States. Policyholders, however, should understand that, for a U.S. company, the CBI "loss" takes place within the United States, no matter where the damage in the supply chain took place.

This is an issue that our attorneys have litigated and won. If an insurance company wants to require that damage to property of a supplier take place within the coverage territory, it must write that limitation into the policy.

4. No Coverage for Loss Outside the Period of Restoration

The last argument - that CBI loss must be metered entirely in the Period of Restoration - is a problematic one. The Period of Restoration is generally understood to begin when the property is damaged and end when, with the exercise of due diligence, the property can be rebuilt, repaired or replaced. In a typical supply chain situation, a responsibly run business has some stock at the ready and can weather at least a short disruption in its supply chain. It is only when the disruption is extended that the policyholder suffers loss.

The Period of Restoration limit has generally been followed, although there are a few cases permitting policyholders with unusual businesses to claim loss occurring after the end of the Period of Restoration if attributable to events in the Period of Restoration. Note, however, that confining the measurement of the loss to the Period of Restoration can benefit policyholders without "pipeline" issues. For instance, some policyholders may have customers who simply postpone purchase of goods during an interruption, leading to a "spike" in sales after the interruption. To the extent an insurance company seeks credit for such sales, the policyholder can argue that calculation of its loss must be confined to the Period of Restoration; the later spike is irrelevant. The rule has to work both ways.

In sum, every large insurance claim has become a battle. With skilled counsel working behind the scenes in an advisory role or publicly in an adversarial role, policyholders can win those battles.

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