

# Client Alert

Insurance Coverage & Recovery Practice Group

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## **Broken Supply Chains, Lost Customers, and Property Damage: Insurance as a Resource for Losses Sustained After The 2011 Earthquake and Tsunami In Japan**

Nearly three months after the tragic 9.0-magnitude earthquake and tsunami in Japan, the full economic impact of this disaster remains unknown. Thousands of people have been confirmed dead, injured or missing, and millions more have been affected by lack of housing, electricity, water and transportation. The most recent estimates available suggest that the disaster caused at least \$35-55 billion in insured losses, and given the important role that Japanese industry plays in today's globalized world economy with respect to the manufacturing of critical components, the disaster continues to have ripple effects in the form of plant closures, supply chain disruptions, and lost revenue streams halfway around the world.

Even if your business is located thousands of miles from the disaster zone in Japan and did not suffer any property damage from the earthquake or tsunami, your commercial insurance policies may be a valuable asset to recover loss of business income stemming from the disaster. This Client Alert briefly summarizes the types of insurance coverage that may be available to your company under its existing property damage and business interruption policies, common policy exclusions insurers may attempt to rely upon to limit their coverage obligations, and strategies your business should pursue now to maximize its recovery and prepare for future natural disasters.

### **Types of Insurance Providing Coverage for Japan Disaster Losses**

The following provides a summary of the types of insurance coverage that may cover losses that your business has already sustained or may sustain as a result of the Japanese disaster. Of course, businesses should carefully review their policy contracts to determine available coverage, as the terms of insurance policies may vary greatly and may be broader than typical "summaries" of coverage that carriers often issue on the cover of the actual policies.

**Business Interruption Insurance:** Business Interruption (BI) coverage is standard in most corporate property insurance policies, and provides coverage for lost profits that a business would have earned but for the interruption resulting from an insured peril. To qualify for such coverage, most policies

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require (1) physical damage to, or loss of use of, property of the type covered under the policy (2) caused by a peril insured under the policies (3) resulting in lost profits associated with an interference or suspension of operations, and (4) with such lost profits occurring during a “period of restoration.” Companies with operations in Japan that suffered even nominal property damage after the earthquake should review their policies carefully to determine whether they may be covered for business interruption losses.

**Contingent Business Interruption Coverage:** Even if your business has no operations in Japan and suffered no property damage as a result of the disaster, your property damage policy may provide Contingent Business Interruption (CBI) coverage, which protects businesses against economic losses that arise from an inability to acquire parts or services from your suppliers, or an inability to deliver your products to customers. For example, if your supply chain was disrupted due to an inability to obtain a component part or other supplies for your operations from a Japanese manufacturer, or your business was unable to deliver your goods or services to customers in the disaster zone, then CBI coverage may be a valuable resource to protect those lost revenue streams.

**Service Interruption Coverage:** Service Interruption coverage may be available to cover any loss or expense caused by interruption of utility services that result from damages to a utility provider’s premises, such as the widespread power outages caused by the shutdown of the Tepco nuclear reactors, which impacted thousands of customers and businesses in northeastern Japan. This coverage frequently is provided through an endorsement to a property insurance policy and may establish a minimum amount of time that utilities must be down before coverage will apply.

**Civil Authority Coverage:** Civil Authority coverage protects businesses from losses sustained by an order by a government entity that restricts access to a business’s property. Unlike business interruption coverage, which typically requires property damage, this coverage may not require physical damage so long as a civil authority restricts access to a business’s property (for example, by ordering an evacuation of a particular area). Civil authority coverage may also provide coverage for losses that result from government shutdowns of airports, financial exchanges, roadways, ports, and other venues.

**Extra Expense Coverage:** Extra expense coverage may be available to cover a business for expenses necessary to resume normal operations and mitigate its losses. For example, if a U.S. manufacturer is unable to purchase semi-conductors from a Japanese manufacturer and is forced to “cover” by purchasing supplies from an alternate provider at a higher price, this coverage might apply. Covered extra expenses may also include costs for additional rent, overtime, temporary labor, advertising, and professional fees associated with quantifying losses.

**Ingress/Egress Coverage:** Ingress/Egress coverage may be available to pay for loss of business income caused by physical damage to third-party property that prevents a business from entering or exiting its premises.

Even if your company is unsure of the full extent of its losses, to maximize the recovery available under your company’s insurance program, it is critical to promptly locate all available insurance policies, assess the potential coverages available, and promptly notify the insurers.

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## Coverage Limitations to Consider Before Making a Claim

While your business's insurance policies may provide coverage for losses resulting from the Japanese disaster, insurance policies also typically contain exclusions, limitations, and conditions to coverage, which insurers may rely upon to avoid paying all or part of your company's claim. In reviewing your company's policies in connection with the Japan disaster, it is important to consider the following issues.

**Policy Exclusions:** Even for claims that are ultimately covered, insurers as a matter of course assert what they deem to be numerous "potentially applicable" exclusions to coverage. Because property damage policies provide coverage for "all risks" or for specified "insured perils," exclusions typically focus on the "cause" of the loss at issue. Thus, coverage may depend on the precise cause of the harm that gave rise to the loss for which an insured seeks coverage. But with respect to the Japanese disaster, a loss may be attributable to one or many causes including the 9.0 earthquake and related aftershocks, multiple tsunamis, flooding, fires, or radiation. The precise cause of the harm may determine the extent to which a policy covers the damages and likely will represent an area of potential dispute between your business and its insurer. Moreover, causation issues are hotly debated in insurance law, and may be resolved differently depending on the law that governs your insurance policy. Thus, businesses should seek guidance in framing their claims in a manner that focuses on covered causes, rather than excluded ones.

**Nuclear Exclusions:** To the extent that a business suffers a loss caused by radiation releases from the Fukushima Dai-ichi nuclear power plant, or any other nuclear plant, the business should be aware that most insurance policies provide an exclusion for losses caused by nuclear disasters. Insurers may wrongly cite the fact that a nuclear incident occurred after the earthquake and tsunami as a basis for denying coverage. It is important to consult with counsel before debating the applicability of this exclusion, and to avoid making any references to radiation if your business's loss did not result from radiation damage.

**Flood and Earthquake Exclusions:** Many property insurance policies exclude coverage for loss resulting from "earth movement" and damage by flood. However, such exclusions often have exceptions, such as coverage for fires resulting from an earthquake. Additionally, businesses may have specialty policies or policy endorsements that provide for such coverage.

**Sub-Limits:** While a policy generally contains an aggregate coverage limit, it also may contain sub-limits for losses caused by particular occurrences, such as earthquakes or flood. Insurers may attempt to limit their liability by characterizing a claim as one that is subject to a sub-limit rather than the aggregate coverage limit. An insured business should confer with coverage counsel to ensure that it properly characterizes its claims to maximize coverage under its policies.

**Multiple Occurrences vs. Single Occurrences:** Insurance policies typically provide for a deductible or retention for each "occurrence" that results in a loss. With respect to the Japanese disaster, there have been multiple earthquakes, a tsunami, and explosions and radiation releases at the Fukushima Dai-ichi nuclear power plants, which may generate claims by insurers that policyholders' losses arose from multiple separate occurrences, thereby implicating multiple retentions to be paid. Businesses should consult with coverage counsel before making a claim in anticipation of such disputes and in order to minimize the amount of retentions paid by the insured.

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## Other Steps to Maximize Coverage

When making a claim following a natural disaster, it is essential for businesses to be proactive in assessing and documenting their losses, evaluating their insurance coverage, and acting promptly to comply with any contractual conditions that are necessary to coverage. The following is a summary of some of the essential steps that your business should take in order to ensure that it benefits from the insurance coverage that it has in place.

**Gather All Policies and Closely Review Their Terms:** If your business has not done so already, it should immediately gather and review all potentially applicable insurance policies. As policy terms vary and may be subject to different interpretations, consult with coverage counsel to assist in evaluating coverage.

**Provide Prompt Notice of All Claims and Potential Claims:** Coverage may depend on prompt notice of losses, or potential losses, as policies frequently require that an insured notify the insurer “immediately,” “as soon as possible” or “as soon as practicable” after the insured becomes aware of a potential claim. The effect of failure to provide notice in accordance with the policy terms differs depending on the policy language and the jurisdiction, but the consequences of failure to comply with notice provisions may be severe and may preclude coverage. Insurers are often willing to toll the deadlines for reporting a claim, particularly following a fluid situation like a large-scale natural disaster. Therefore, even if your business is uncertain as to whether it has sustained losses as a result of the Japanese disaster, it should notify its insurer of any possible losses out of an abundance of caution.

**Collect and Preserve Evidence of Business Losses and Damages:** It is important to record all costs, expenses, and damages for which you might seek coverage. If your business sustained direct property damage, take photos and videos of property damage and business interruptions to the extent possible and retain damaged property and equipment. To ensure full coverage under BI and CBI insurance for lost profits, businesses should document their losses by maintaining proof of business performance prior to, during, and following the disaster. Many policies also provide coverage for the expenses associated with such claim-related activities.

**Be Careful About Internal and External Communications Regarding the Loss:** Businesses should be careful about what they say with respect to insurance coverage in internal and external communications. In the event that litigation over insurance coverage becomes necessary, insurers may gain access to internal communications such as emails and memoranda regarding a business’s claims for insurance. The manner in which the loss is characterized in such communications may be used by an insurer to deny coverage. Businesses should be aware of this possibility when communicating about a loss. Involving coverage counsel in these communications may ensure that such communications are protected as privileged in the event of litigation over coverage.

**Coordinate Mitigation Efforts With Insurer:** While it is important to mitigate losses, it is also important to communicate with insurers regarding such efforts when possible. This will minimize the chances that the insurer will apply hind-sight to second-guess the reasonableness of the mitigation procedures that a business puts in place.

**Review your Business’s Insurance Program to Ensure Natural Disaster Coverage is Adequate:** Even if your business was not impacted by the earthquake and tsunami in Japan, other recent natural disasters like the destructive tornadoes that have ravaged wide swaths of the United States, massive flooding in Australia, and record-setting floods on the Mississippi River, coupled with the onset of the Atlantic hurricane season, counsel in favor of reviewing your

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company's insurance program to ensure its coverages are adequate. Moreover, insurers may attempt to quietly include endorsements with stricter policy terms at upcoming renewals following record property and casualty line losses.

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