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Client Alert

Insurance Coverage & Recovery Practice Group

June 12, 2012

As the Insurance Industry Responds to Recent Catastrophic Losses, is Your Business Prepared to Weather the Perfect Storm?

Tips for Managing Emerging Catastrophic Risks and Supply Chain Disruption

2011: A Record Breaking Year for Property and Business Interruption Losses

Catastrophic events in 2011 caused an estimated $380 billion in global economic losses. These losses were nearly two-thirds higher than the $220 billion in losses incurred in 2005, the previous record set after Hurricane Katrina. Insurers currently estimate they suffered $116 billion in insured losses in 2012—the second highest figure on record. In addition to some of the worst U.S. tornadoes on record in Joplin, Missouri and Tuscaloosa, Alabama, natural disasters also struck in unlikely locations in 2011, including Hurricane Irene in New York, a 5.8 earthquake near Washington D.C., and tornados in Western Massachusetts. Far greater losses resulted from events abroad including earthquakes in New Zealand, floods in Thailand, and the Fukushima earthquake and tsunami in Japan—events which triggered catastrophic property losses and significant global supply chain disruptions. Man-made disasters such as plant explosions and political instability also caused billions of dollars in insured losses in 2011 throughout the world.

2012 is also shaping up to be a significant year for catastrophic losses. So far, businesses have dodged radiation from solar flares, earthquakes in Indonesia, Italy, and Mexico, tornadoes near downtown Dallas, and two named storms before the official start of the Atlantic Hurricane Season. To make matters worse, in March, an explosion at a German facility responsible for half of the world’s nylon-12 production—a critical component in automobile fuel and brake lines—is raising the prospect of significant contingent business interruption losses for global auto manufacturers. Given the globalization of supply chains and the inability to predict where catastrophes will strike next, businesses should assess whether they have adequate insurance coverage in the event of a catastrophic loss or supply chain disruption.

What Should Your Business do to Prepare?

Insurance companies are responding to recent catastrophic events by raising premiums (30-40% on average this year), dropping high-risk policy holders, and inserting new limitations and exclusions in their policies. In addition, as demonstrated by the record $67 billion shareholder claim against Tepco and certain of its directors and officers alleging inadequate tsunami barriers at the

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Fukushima nuclear reactor, as well as similar claims against energy companies following the 2010 Deepwater Horizon disaster, recent litigations have raised the stakes for boards when addressing their risk management programs. Risk managers and in-house counsel need to take steps now to review their coverages, identify vulnerabilities in their global supply chains, and be prepared in the event of loss. At a minimum, it is critical for companies to engage coverage counsel to review their coverages and ensure that adequate insurance is provided for known and potential risks.

Moreover, supply chain interruption following the 2011 disasters in Thailand and Japan has focused renewed attention on the importance of purchasing adequate contingent business interruption (CBI) coverage. Usually purchased as an add-on to traditional commercial property damage policies, CBI coverage protects against supply chain losses even if your facility is not damaged by a disaster, and even if that disaster affects a supplier located halfway around the globe.

Tips When Negotiating First-Party Property and CBI Coverage:

- Policy language is negotiable: Negotiate manuscript policies designed to protect the unique risks associated with your business.
- When purchasing CBI coverage, it is critical that companies review their policies to ensure they afford coverage when catastrophic events strike key customers, manufacturing locations owned by business partners, direct and indirect suppliers, and leader locations that attract customers to your business.
- Pay attention to coverage territory definitions that may preclude CBI coverage outside the United States.
- Involve legal counsel: In the event of a disputed claim, conversations with your broker and in-house team should be privileged.
- Focus on any sub-limits that may provide limited coverage depending on geographical location, type of scheduled property, or cause of loss.
- When negotiating M&A transactions: Review adequacy of target's insurance program and negotiate endorsements to your existing policies to ensure acquired properties are scheduled and new risks are not excluded.
- Seek additional insured status during transactions with business partners - don't rely on certificates of insurance as proof of coverage.
- Align contractual indemnity and other risk transfer provisions in your contracts with your insurance program.

Dealing with Multiple Causes of Losses

Recent catastrophes also have demonstrated that catastrophic losses often involve multiple causes of loss—some of which may be covered under your policy, and some of which are not. For example, last year after the Japan earthquake, businesses may have suffered losses caused in part by the earthquake, the tsunami, nuclear radiation, fires, power service interruption, and numerous other causes. Similarly, losses from a hurricane may relate in part to wind damage, water damage, and mold. Inevitably, some of these causes of loss may be covered under a particular policy, while others are not. Although courts have provided guidance concerning the identification of covered and uncovered losses in cases involving multiple contributing causes of loss, the law varies across jurisdictions. Moreover, insurers are increasingly inserting anti-concurrent causation exclusions and sub-limits for certain losses in their policies in an effort to limit their exposure to certain categories of risks, which again are subject to different interpretations depending upon which state law applies to the claim. Therefore, determining the cause of a catastrophic loss can require a complex analysis that necessitates the use of legal counsel and expert consultants when attempting to maximize coverage.

Tips for Dealing with Complex Causation Issues:

- Anti-concurrent causation clauses are often negotiable—seek the best available language when negotiating policy exclusions and coverage limitations.
- After a catastrophic event, avoid premature public statements about the cause of loss that could be construed as coverage-defeating admissions.
- Include legal counsel when investigating the cause of loss, assessment of damages, and presentation of the claim to ensure compliance with required policy provisions and to protect confidentiality of information prepared in anticipation of disputes with your insurers.
- Carefully consider choice of law issues when negotiating your policy and when making a claim involving multiple causes of loss—jurisdictional issues can make or break coverage.

Other Tips for Submitting Claims and Maximizing Coverage:

Finally, there are many strategies your business can employ to more effectively prove your loss and maximize insurance coverage in the event of a catastrophic loss. Tips for preparing your claim include:

- Always provide notice of a claim as specified in your policy (some policies required "immediate" notice), keeping in mind that different jurisdictions have varying laws governing the timeliness of notice.
- Ensure that you meet all deadlines for filing a proof of loss and negotiate tolling agreements if necessary.
- Prepare your claim with counsel and damage consultants before submitting a proof of loss so that particular attention is given to covered causes of loss and sub-limits.
- Reserve the right to supplement your proof of loss with additional information.
- Coordinate with contractors to ensure the accuracy of the work being described in invoices, which also can affect coverage.
- Take care to meet other policy reporting requirements, keeping in mind that policies may specify individuals to whom notice and proofs of loss must be directed, and that provisions for filing suit can be much shorter than the usual statutes of limitations.
- Document all mitigation efforts.
- Respond in writing to all communications from the insurance company and comply with all reasonable requests for information and documents.
- Don't forget alternative sources of both first and third-party coverage such as indemnity agreements or insurance policies listing your business as an additional insured.

We work closely with our clients and their risk managers to ensure their insurance affords adequate protection in the event of catastrophic claims. We also have helped many businesses collect from their insurers for losses arising from these types of property damage and business interruption claims.