

# Global Insurance Litigation: In the Wake of the Japan Earthquake

July 7, 2011

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# Panelists



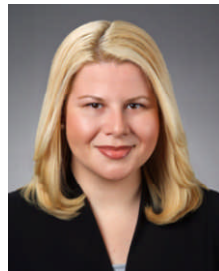
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- Background: Extent of Earthquake and Tsunami Damage (Willis Re)
- Insurance, Reinsurance and the Tōhoku Earthquake (Willis Re)
- Specific Coverages Implicated by Earthquake- and Tsunami-Related Losses
- Tips for Insurers in Assessing Whether Losses Are Covered
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# Background: Extent of Earthquake and Tsunami Damage (Willis Re)

# The Tōhoku Earthquake

## March 11, 2011

# March 10, 2011

## Tōhoku Region

- Population
  - Tōhoku 9.3M
  - Kantō 42.1M
  - Japan 127.4M
- Largest City
  - Sendai (Miyagi) 1.2M
- Economy
  - Agriculture, fishing, forestry, electric power, industry



source: Wikipedia Commons

March 10, 2011

## Eastern Kantō Region

- Population
  - Ibaraki, Chiba 9.2M
  - Kantō 42.1M
  - Japan 127.4M
- Largest City
  - Chiba City 1.0M
- Economy
  - Chemicals, machinery, steel, refining, shipping, agriculture, electric power



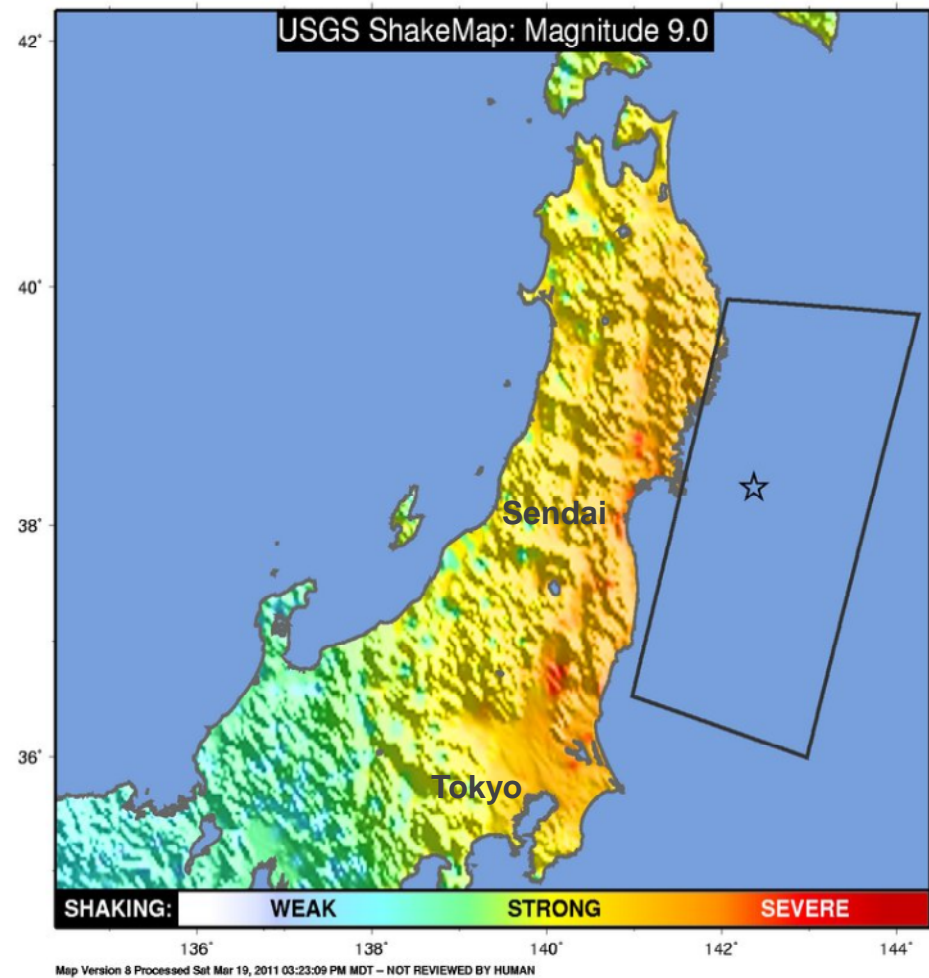
source: Wikipedia Commons



# The Tectonic Event

## Tōhoku Earthquake

- Date: March 11, 2011
- Location: Japan Trench, 80 miles east of Sendai
- Cause: subduction of Pacific plate under Japan
- Magnitude: 9.0 Mw
- Note: numerous significant fore- and after-shocks

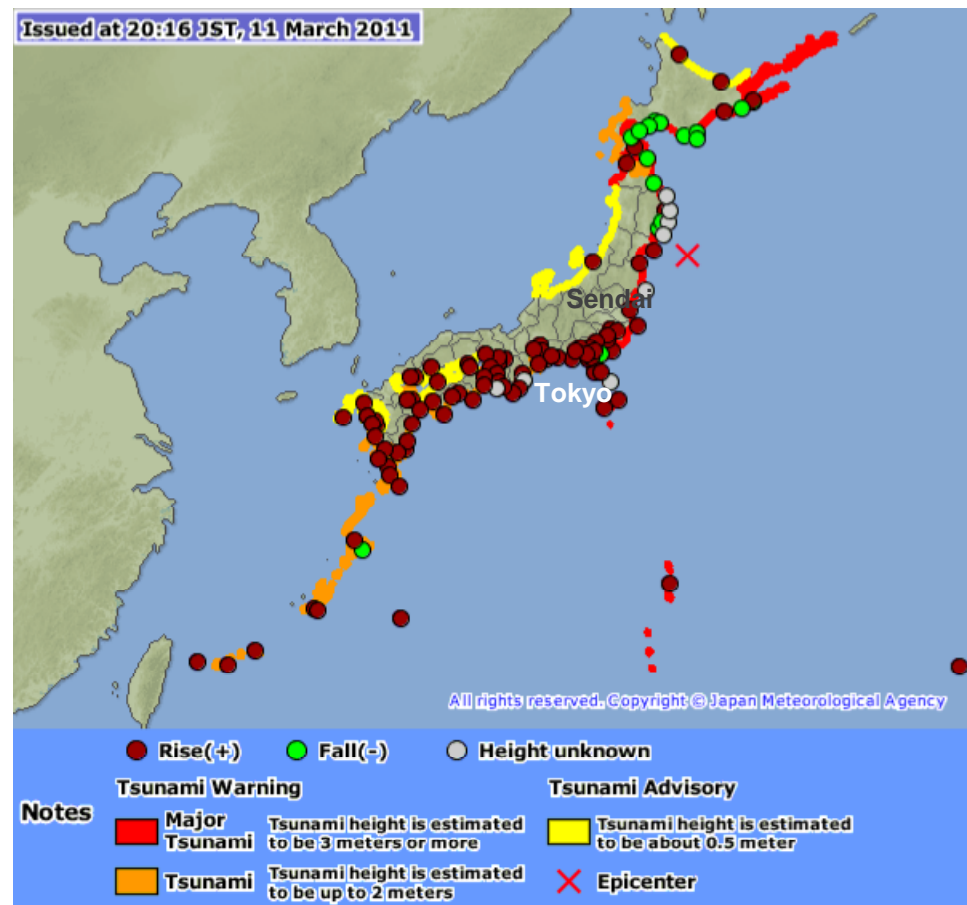


source: USGS

# The Tsunami Event

## Tōhoku Tsunami Event

- Date: March 11, 2011
- Location: east coast of Japan. Major tsunami from Hokkaido to Chiba Prefecture
- Cause: Tōhoku Earthquake

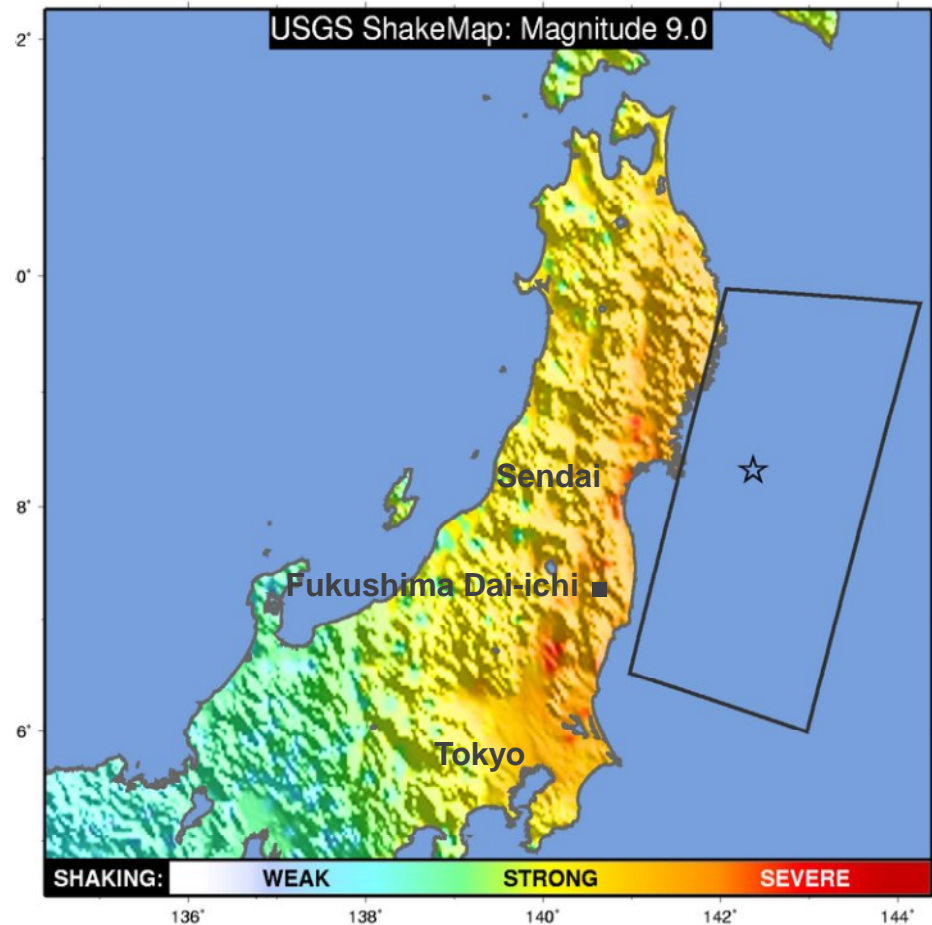


source: JMA

# The Nuclear Event

## Fukushima No 1

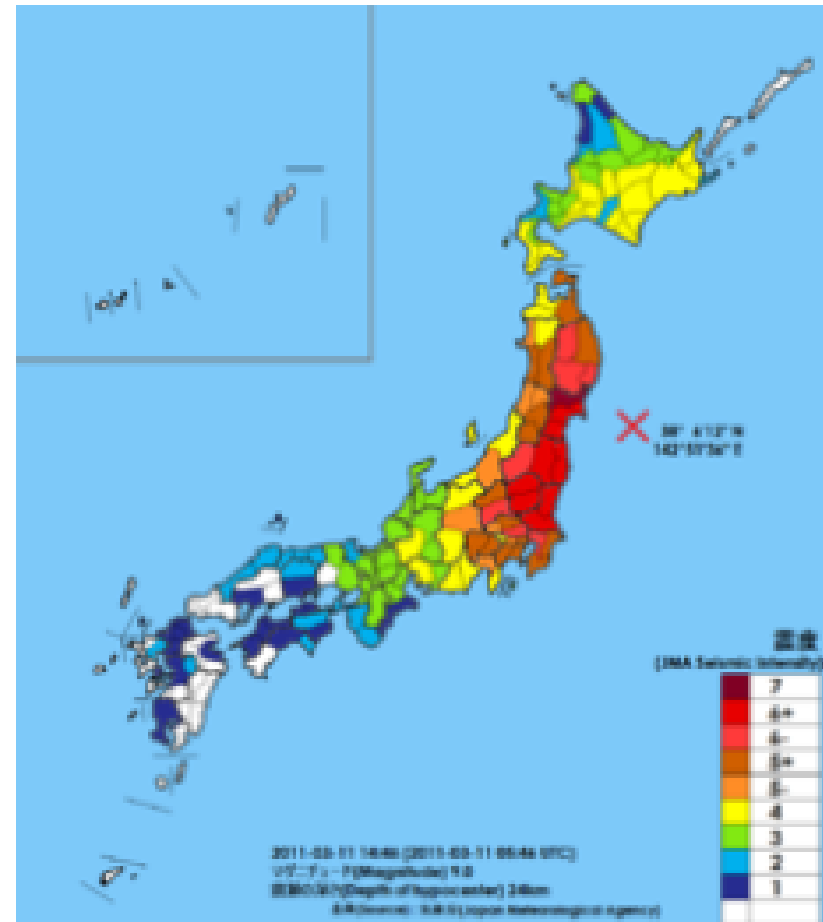
- Date: March 11- ongoing
- Location: Futaba/Okuma, Fukushima Prefecture
- Cause: damage to fallback diesel generators due to Tōhoku tsunami disrupts cooling and control systems
- Magnitude: category 7



map source: USGS

# Physical Consequences

- Geographic extent
- Sources of damage
  - Earthquake
  - Tsunami
- Disruption of infrastructure
  - Power generation and transmission
  - Transportation
- Impact on economy
- Ongoing problems at Fukushima Dai-ichi



source: JMA

# Human Consequences

- Over 125,000 buildings destroyed or severely damaged
- Dislocation of up to 500,000 people
  - Approx. 250,000 homeless in Tōhoku region
- Evacuation of areas around Fukushima No. 1
- Disruption of transportation networks (including Tokyo)
- Shortages of food, water and power
  - Millions of households without water or power
  - Rolling blackouts to conserve power
- Radioactive contamination
- Aid resources overwhelmed

# Current Status

- Tokyo: “almost normal” ?
- Recovery
  - Monumental clean up
  - Shelter
  - Governmental policy
- Fukushima Dai-ichi
- Industrial and economic recovery
  - Production
  - Exports

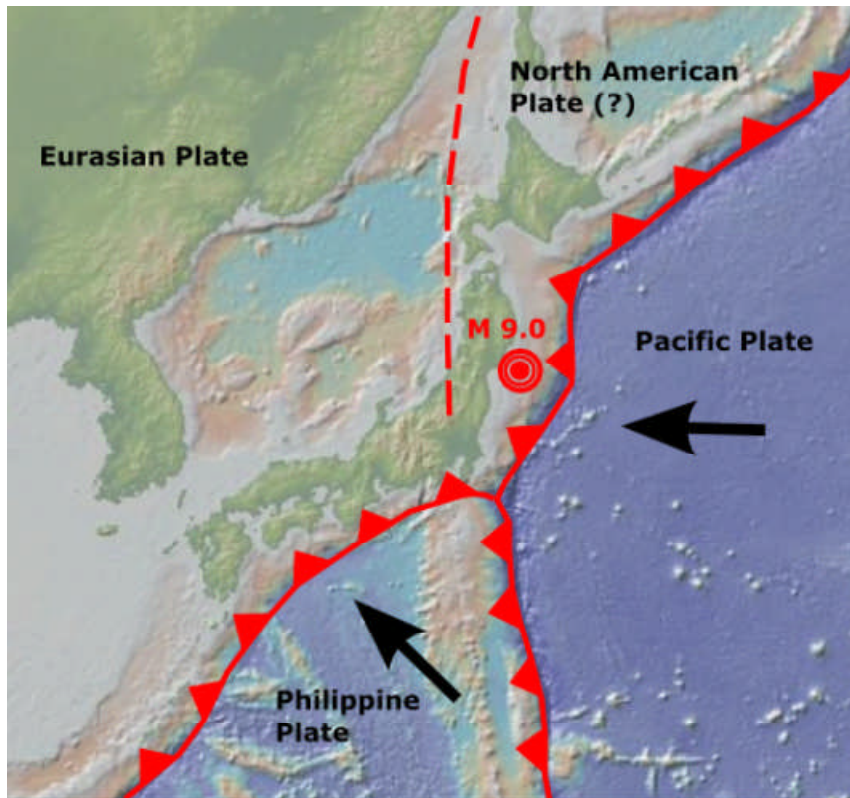
# The Problem of Power: Electricity in Japan



source: Federation of Electric Power Companies of Japan

- Japan electricity grid concentrates crisis on eastern Japan
  - 50 hz East, 60 hz West
- 15% reduction in demand:
  - Limiting industrial production
  - Rescheduling work week
  - Reducing air conditioning
- Alternate power sources

# Geological Theory: Tectonic Balance Sheet



*Scientific American, March 14, 2011*

- Earthquake research in Japan
  - 400 year historical record
- Safety standards
- Tectonic balance sheet
- March 11, 2011: release of seismic energy reserves



# Insurance, Reinsurance and the Tōhoku Earthquake (Willis Re)

# Insurance, Reinsurance and the Tōhoku Earthquake

- Japan hallmarked by significant retention of catastrophe risk
  - Under-insurance of commercial and personal-lines policyholders
  - Insurers
    - Substantial catastrophe deductibles
    - High per risk retentions
  - Government holds significant catastrophe insurance risk

# Market Conditions

- Limited penetration of insurance for earthquake and tsunami
  - Earthquake and tsunami insurance neither compulsory nor automatic
    - Greatest penetration is for mortgage financed dwellings
  - Commercial, industrial risks normally incompletely insured
    - High deductibles, significant co-insurance
    - Business interruption often not purchased
  - Vehicles generally not covered
  - Marine hull and cargo only comparatively better

# Earthquake and Tsunami Reinsurance in Japan

- Personal lines dwelling risks
  - Non-life companies: government scheme (Japan EQ Re)
    - Risk fully retained: no direct commercial reinsurance
  - Mutual companies are outside the government scheme
    - Substantial catastrophe XL covers after high insurance company deductibles
- Commercial and industrial risks reinsured pro-rata and excess
  - Significant retentions
- Life-related exposures similarly reinsured (high cat retentions)

# Nuclear Risk in Japan

- Japan Atomic Energy Insurance Pool
  - No insurance coverage provided by private market
    - JAEI Pool reinsured by global market and reciprocity
- Japan nuclear energy liability compensation law
  - Requires first ¥120B to be secured (e.g. through Pool)
  - If “grave natural disaster,” responsibility to government

# TEPCO Compensation Plan

Per May 12, 2011, ministerial conference:

- Compensation to victims of Fukushima Dai-ichi disaster
  - TEPCO to cover entire cost of compensation
  - Government to provide financing vehicle
  - Interim compensation payments began in late May
  - Plan includes provisions for insurance for TEPCO

# Japan Extreme Event Exposure in Context

Comparative Catastrophe Losses					
	Kobe EQ 1995	Katrina 2005	Chile EQ 2010	New Zealand EQ 2011 (2)	Tōhoku EQ 2011
<b>Economic Loss</b>	\$100	\$125-\$150	\$30	?	\$300
<b>Insured Loss</b>	\$3	\$65-\$75	\$10	\$16	\$30-\$36
<b>Reinsurance Loss</b>	?	\$28-\$30	\$9	\$14	\$6-\$8

*in US\$ billions*

*losses are currently available estimates drawn from several sources*

In comparison with other countries, Japan relies heavily on its own resources to meet the challenge of extreme events.

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# Specific Coverages Implicated by Earthquake- and Tsunami-Related Losses

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# Nuclear Exclusion

- Nuclear exclusions in different coverages
  - **Property:** Standard exclusion in nearly all property policies; eliminates coverage for loss or damage from nuclear reaction, radiation or radioactive contamination
  - **Liability:** Excludes coverage for all radiation injuries or radioactive contamination caused by “nuclear material ... at any nuclear facility owned by ... an insured or ... that has been discharged or dispersed therefrom”
  - **Reinsurance:** Excludes “any ... liability, loss, cost or expense of whatsoever nature directly or indirectly caused by ... nuclear reaction, nuclear radiation or radioactive contamination regardless of any other cause contributing concurrently”
- Actions of Japanese government have largely trumped coverage issues

# Specific Coverages Implicated by Earthquake- and Tsunami-Related Losses

- Standard property coverage in place for damage to structures
- Other types of coverage offered by P/C insurers (often as part of property policies) that may cover lost income or extra expenses
  - For those with operations in Japan
    - Business Interruption Coverage
      - Traditionally, BI coverage not purchased in Japan
    - Extra Expense Coverage (US) / Increased Cost of Working Coverage (HK/UK)
    - Utility Service Interruption Coverage

## Specific Coverages Implicated by Earthquake- and Tsunami-Related Losses (cont.)

- Other types of coverage for insureds with operations in Japan
  - Civil Authority Coverage
  - Ingress/Egress (US) / Denial of Access Coverage (UK/HK)
  - Loss of Attraction (UK/HK)
- Types of coverage involving insureds that do business with Japanese suppliers
  - Contingent BI Coverage
  - Contingent Extra Expense Coverage
  - Trade Disruption Coverage

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# Tips for Insurers in Assessing Whether Losses Are Covered

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# Considerations When Construing Exclusions

- Review of the terms of the particular exclusion is crucial
  - Law sometimes requires courts to give terms their “generally prevailing” and “ordinary and popular” meaning
  - Law sometimes requires exclusions to be narrowly construed

# Tips for Insurers in Assessing Whether Losses Are Covered

- Broad Act of God exclusions could prevent coverage
- Flood or water damage exclusions could prevent coverage
  - US case law emanating from Hurricane Katrina suggests that tsunami damage and any related loss of income claims would not be covered where flood damage is excluded from property coverage under typical broad exclusion language

## Concurrent Causation Approaches (UK)

- Refers to a loss brought about by two or more potential causes acting at the same time or in sequence
- Settled principle that where there are two concurrent proximate causes of a loss, one of which is an insured peril and the other is expressly excluded, then the insured cannot recover
- Courts have recognised this principle where two proximate interdependent causes operate, where neither cause of itself would have caused the loss but where one cause was an insured peril and the other was not expressly excluded.
- Provisos to the exclusions sections of many property policies reflect this and provide that subsequent damage resulting from an ensuing cause is covered, unless expressly excluded.



# Concurrent Causation Approaches (US)

- Approaches to concurrent causation differ from jurisdiction to jurisdiction
  - “Efficient Proximate Cause” or “Dominant Cause” Approach
    - If the “most responsible” cause is covered, the loss also will be covered
    - Predominant approach in the United States, though states vary
  - “Conservative” Approach
    - Exclusions trump; no coverage where one loss is covered and one is excluded
  - “Liberal” Approach
    - If any cause in the causal chain is covered, the entire loss will be covered

# Anti-Concurrent Clauses (ACC) (US)

- ACC clauses bar coverage where an excluded peril is one of two or more causes of the damage
  - *E.g.*, in the context of a Hurricane Katrina claim where a family had coverage for wind and rain, but not for flood, a dwelling that lost its roof in high winds and also suffered water damage could recover nothing if the ACC clause in the family's policy is enforced
- To the extent that there are multiple independent causes of any damage, ACC clauses may otherwise turn a covered loss into a non-covered loss

## Anti-Concurrent Clauses (ACC) (US) (cont.)

- Some ACC clauses are broader than others
  - The least restrictive type bars coverage whenever an excluded peril directly or indirectly causes damage
  - A more problematic type extends the exclusion beyond causes of loss to certain “events” that may be the result of a covered cause
- In many areas, damage was inflicted both by the earthquake and the tsunami
  - If coverage excludes floods but provides earthquake coverage, coverage may be denied entirely if ACC clause applicable
  - ACC may not apply if separate losses separately caused in sequence, as opposed to concurrently

## Occurrences/Events

- Number of occurrences or events
  - Amount of coverage could hinge on characterization of earthquake and tsunami as one occurrence/event or two
  - Could have gap in reinsurance coverage if terms contain different definition of occurrence/event
- Aggregation of occurrences/events
- Effect of “hours clauses”
  - EQ and other perils may fall under an hours clause
  - EQ and tsunami may be considered one occurrence/event
  - Consider treatment of aftershocks, especially outside hours-clause time period

# Business Interruption Coverage

- Compensates insured for lost income that otherwise would have been earned had a covered loss event not occurred
- Loss must result directly from covered peril that causes physical damage to covered property
  - But if no material damage to insured's property, insured may look to additional types of coverage – including Ingress/Egress coverage, Civil Authority coverage, or loss of utility services – depending on particular policy provisions
- Most BI coverage requires actual suspension of operations, not simply diminished volume in business
  - Physical loss must cause the suspension of operations
- Difficulty calculating amount of BI loss; pre-set values vs. open amounts, burden on insured to establish loss amount

## Exclusions and Limitations for BI Claims

- Exclusions will be critical, and could foreclose BI coverage
  - Act of God, Flood, Nuclear Event
- Critical issue: length of “period of recovery” during which BI coverage will apply
  - For most policyholders, BI period ends when damaged property is physically repaired and returned to operations under the same conditions that existed prior to the disaster
  - Courts will look to the terms of the particular provision, as well as the nature of the insured’s business
  - When an insurer intentionally prolongs the BI period by failing to make sufficient partial payments or when a third party fails to perform work, the delay may be included in BI period

## Period of Restoration for BI Claims

- Other cases have held that period of restoration is tied to the theoretical time to replace an entire commercial complex – not simply the insured property
- Courts have extended the period of BI coverage until the insured recovers its pre-loss level of business
- BI coverage also may include Extra Expense coverage for necessary expenses incurred at damaged property during period of restoration

# “Special Circumstances” Clauses

- “Trends” or “special circumstances” clauses could be highly relevant because they allow the adjuster to take account of the upward or downward trends of the business (and possibly the business of the insured’s peer grouping) when arriving at a settlement
  - *E.g.*, if an insured were in a rapidly expanding business with a clearly demonstrable growth potential, such as technology, and assuming the limits had been correctly arranged, the insured could expect a settlement based on a figure far higher than its current turnover
  - On the other hand, a declining trade, perhaps UK mass-market car manufacturing, could expect a settlement based upon a reduced turnover from that currently being earned



## Contingent BI Coverage (US) / Supplier Extension Coverage (HK/UK)

- Extension of coverage to cover lost income due to property loss at supplier or customer location
- Many of the same general BI coverage issues apply
- Coverage may be limited to named suppliers
  - May cover a peril for the supplier's premises that is not covered at insured's premises
- May require actual damage to the supplier's property
  - Consider whether radiation results in actual damage

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# Panelist Profiles

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Warren is a member of the Willis Re Analytics team and a reinsurance broker with Willis Re, handling complex accounts, unusual coverages and alternative risk transfer, including weather-risk-related business and crop business in the United States. He is also FINRA qualified as a registered representative of Willis Securities, Inc., the Willis-owned U.S. broker dealer.

Warren joined Willis Re in 1996, bringing with him 18 years of reinsurance experience at the Home Insurance Company (Vice President, Ceded Reinsurance), CIGNA P&C Reinsurance (General Manager of their U.S. office for International Reinsurance) and AFIA Re, for which he was Managing Director of AFIA Re's London Branch, after serving as Regional Manager of AFIA Re's Latin America office in Coral Gables.

Warren also has been an active member of the Weather Risk Management Association, serving as a member of the Board and an officer of the Association for several years.

**Education**

Yale University, M.Phil • The Johns Hopkins University, BA

# Panelist Profiles



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Tow Lu Lim is a partner of Mayer Brown JSM. He is experienced in all aspects of contentious and non-contentious insurance matters including advising on coverage issues, drafting of policy wording and defence of property damage, personal injury, product liability and professional liability claims.

His professional indemnity experience includes advising insurers on coverage issues with respect to claims under professional indemnity and Directors & Officers' policies. His experience also includes handling the defence of claims against solicitors, architects, engineers, project managers, directors and officers, and surveyors. He has also assisted insurers with policy wording reviews for professional indemnity and Directors & Officers' policies.

Tow Lu was named an Up-and-Coming Insurance Lawyer by *Chambers Asia Pacific* (2010-2011). *Chambers Asia Pacific* 2011 praised him as "a rising star in the area of professional indemnity". He was also "highly praised for protecting clients interests as well as reputations" by *The Legal 500 Asia Pacific 2010/2011*. He is the co-author of the textbook *Insurance Law and Practice in Hong Kong*.

## Education

Macquarie University, LLB • Macquarie University, BEcon

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Andrew McGahey has extensive experience advising insurers on policy matters relating to financial institutions insurance, including high-profile and complex first-party loss and third-party misselling claims within the English jurisdiction and overseas. These have included the split-capital investment fund crisis and, more recently, claims arising from the “credit crunch.”

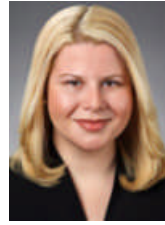
Andrew also has significant experience involving Directors and Officers (D&O) insurance and has advised insurers on policy coverage issues relating to claims worldwide. In addition, he advises professional indemnity insurers on claims brought by a variety of professionals including solicitors, accountants, surveyors, planned preventative maintenance service providers, insurance brokers and trustees both in the United Kingdom and offshore. A significant part of that advice relates to policy coverage issues as well as conducting the defence of third-party claims.

Andrew joined Mayer Brown in 1998 and was promoted to partner in 2009. His time with the firm has included seven months as an Assistant to the European General Counsel to the Lear Corporation in Frankfurt, and a four-month secondment to AIG.

## **Education**

The College of Law, Guildford, LPC • Durham University, LLB (Hons), 1997

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Bronwyn Pollock is an experienced litigator who has appeared before numerous federal and state courts and arbitrators. Her practice is focused on complex civil litigation, particularly class-action defense, employment counseling and litigation, and real estate and insurance matters. She has represented clients in a wide array of industries, including financial services, real estate, retail, health care, media, advertising, insurance, telecommunications, and education.

Bronwyn advises and defends employers in many areas of employment law, including wage-and-hour compliance, privacy, wrongful termination, discrimination, sexual and other forms of unlawful harassment, retaliation, reductions in force and business closings, unfair business practices, and noncompete and nonsolicitation provisions.

Real estate is another significant focus of Bronwyn's practice. She advises and defends financial institutions, lenders, property owners, asset managers, developers, and school districts in real property matters, including partnership, leasing, foreclosure, construction, receivership, attachment, insurance, and ADA disputes. Her clients have included ING Clarion, Prudential Real Estate Investors, TIAA-CREF, KBS, Westfield America, Inc., Aetna Life Insurance Company, UBS Realty Investors LLC, Wachovia Capital Finance, ORIX Real Estate Capital, and a number of California school districts.

## **Education**

Georgetown University Law Center, JD, 2000; Senior Editor, Georgetown Journal on Poverty Law and Policy • University of Southern California, BA, cum laude, 1996; Dean's List

# Panelist Profiles



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Cliff Schoenberg has more than 30 years of insurance and reinsurance experience. He has handled many large and complex “bet the company” cases that extend beyond the traditional reinsurance arbitration and litigation realm, where he obtained one of the largest arbitral awards for compensatory damages (\$1 billion) and punitive damages (\$100 million) in US history. For example, Cliff represented Swiss and US reinsurance companies and individuals in the SEC’s finite reinsurance investigation; he represented a former CEO of a major reinsurance company in the highest profile criminal case in reinsurance industry history; and he represented a large Japanese pool member in one of the largest audit malpractice cases in U.S. history arising out of a finite reinsurance fraud. Cliff also was retained to put together a team of corporate, bankruptcy and reinsurance attorneys to handle the successful financial restructuring of a monoline insurer. Cliff has acted as coordinating and supervising counsel for federal and state class action lawsuits against insurers, including a large number of actions in the State of Alabama involving significant punitive damage claims. More generally, he has represented insurers, reinsurers, brokers, underwriting agents and other industry participants in arbitrations and litigations (including class actions) that have involved virtually every critical issue that has arisen in this specialized field.

In the transactional and regulatory arena, Cliff has represented reinsurers, banks, investment banks, hedge funds and private equity funds in negotiating and structuring complex reinsurance and hybrid insurance/capital markets products such as sidecars and industry loss warranties. He has advised on matters including life settlements, premium finance and other insurance/capital markets products, and has served as lead counsel on various significant insurance company mergers, acquisitions and divestitures. Cliff also has significant experience relating to the rehabilitation and liquidation of insurance companies. He has litigated direct insurance coverage actions, been retained as an arbitrator and expert in reinsurance arbitrations, and represented insurance companies in regulatory matters before the New York State Insurance Department.

*Chambers USA* 2011 notes that Cliff is a “top-flight lawyer— one of the brightest guys out there.” In 2010, *Chambers USA* notes that clients refer to him as “the smartest reinsurance lawyer in the business” whose “analytical skill and ability to think on his feet are unparalleled.” Cliff is also listed in *Euromoney's Guide to the World's Leading Insurance and Reinsurance Lawyers*, *The Lawdragon 3000 Leading Lawyers in America*, *The International Who's Who of Insurance and Reinsurance Lawyers*, the Manhattan and Corporate Counsel editions of *New York Super Lawyers*, *The Best Lawyers in America*, and in *New York Magazine's* "Best Lawyers" edition. Most recently, *Expert Guides* named him to the “Best of the Best USA 2009” list. He has written numerous articles and lectured extensively on reinsurance topics. He currently serves on the editorial board of *Harris Martin's Reinsurance Disputes*.

## Education

Boston University School of Law, JD, magna cum laude, 1975 • Dickinson College, BA, summa cum laude, 1972; Phi Beta Kappa

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