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Business Insurance Considerations Amid Conflict In Ukraine

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The conflict in Ukraine and actions taken by and against Russia continue to wreak havoc on global business operations, causing supply chain disruptions, interruptions in operations and the loss of assets located abroad. With these losses multiplying at a time of economic uncertainty, now is the time for an insurance checkup.

International retailers, manufacturers, service providers and technology companies have curtailed, discontinued or are in the process of discontinuing operations in Russia.

Losses reportedly exceed $59 billion. Russian entities that leased aircraft from international companies have failed to return the aircraft after lease terminations. Disruptions in the supply of strategic metals, including neon used in chip manufacturing, which is produced in Russia and refined in Ukraine, have caused losses to business partners across the supply chain.

Loss of agricultural outputs from Ukraine combined with the loss of agricultural inputs from Russia — such as potash — has put pressure on global grain supplies and is likely to impact agricultural products. Ukraine is planning a vast reconstruction effort to include investments in infrastructure, security, residential housing, and commercial and industrial rebuilding projects, as well as diversified energy resources and digitalization.

In this time of economic certainty, businesses should review the following insurance policies for coverages that may mitigate corporate losses.

Commercial Property Insurance

Commercial property insurance provides all-risk coverage for physical loss or damage to the insured's property. The insurance generally covers costs to repair or replace property, extra expenses incurred during a period of restoration and business income losses resulting from inability to use the insured's property that experienced loss or damage.

While coverage is generally subject to an exclusion for loss caused by war or hostile acts, some policies contain endorsements extending coverage for such causes of loss. Additional coverages available under commercial property insurance policies vary and may include the following types.

Contingent Business Interruption

Contingent business interruption coverage protects the insured from loss associated with supply chain disruptions caused by a third party's property loss or damage. The property loss or damage must be caused by a peril covered under the policy. For that reason, it is important to review the policy for potentially applicable exclusions to coverage.

While contingent business interruption coverage generally does not reach losses caused by war, political disruptions, road closures or bankruptcy of a partner or supplier, endorsements writing back the coverage exist. Sublimits are generally applicable to contingent business interruption coverage and may vary depending on whether a direct or indirect supplier suffers property loss or damage.

Extra Expense Coverage

Extra expense coverage covers extra costs incurred as a result of property loss or damage. Coverage generally includes increased transportation, labor and logistical costs. An insured seeking coverage for extra expenses should keep records of increased expenses incurred to support a claim for coverage, and review policies for applicable sublimits.

Dependent Property Coverage

Dependent property coverage provides coverage for property loss or damage at dependent properties specifically identified in the schedule of coverage. Coverage for dependent properties also may include coverage for loss of income and/or extra expense.

Additional Coverage

Coverage also may be provided for secondary contributing locations, which are unidentified locations that provide materials or services to contributing locations identified in the schedule, and miscellaneous locations. Policies should be reviewed for the terms of coverage and applicable sublimits.

Political Risk Insurance

Political risk insurance protects companies from loss caused by political events. Coverage varies and can encompass physical loss or damage caused by unrest, war and government action, or changes in policies, laws and regulations, and business interruption losses.

Examples of loss typically covered by political risk insurance include property lost, taken, affected, damaged or destroyed by invasion, war, hostilities, expropriation or nationalization, and the impairment or deprivation of assets and interests — such as contracts and loans — by government action.

Other examples include currency inconvertibility, and the loss of access to operations, goods or other insured assets as a result of forced abandonment, forced divestiture or other government action.

The specific coverage provided by political risk insurance should be reviewed to determine whether it reaches losses incurred as a result of actions taken by the insured's host country. If such coverage is provided, it broadens the protection provided to the insured.

In the context of the Russia-Ukraine conflict, the insurance would cover both actions taken by Russia — for example, the expropriation of property — and actions taken by the insured's home country — for example, required divestiture from Russian assets and operations.

In addition, coverage may exist for companies that have withdrawn operations by "choice," to be ahead of the imposition of sanctions by a home country or as a matter of risk management due to overall concerns for hostile environments in host countries.

Either circumstance presents such a so-called Hobson's choice that the choice to withdraw operations is arguably not a choice at all, and associated loss actually falls within the type of war or political risk that insurers contemplated covering.

Unlike commercial property insurance, political risk insurance may cover losses resulting from war or hostile acts.

Trade Credit Insurance

Trade credit insurance — sometimes referred to as accounts receivable insurance — protects an insured against a commercial customer's failure to pay for goods and services. Policies should be reviewed to identify the customers covered and any customer-specific sublimits.

Trade credit insurance generally covers an inability to pay caused by political instability or war. Exclusions should be analyzed to determine the limitations of coverage.

Aircraft Insurance

The loss of aircraft leased by international companies to Russian operators that have failed to return the aircraft following termination of lease agreements could result in billions of dollars in losses. The aircraft themselves are at risk as sanctions prevent the export of aircraft parts to Russia, making it difficult, if not impossible, for Russian operators to continue aircraft maintenance in accordance with international regulations.

The original leases generally required the lessee to obtain hull policies, which, inevitably, were issued by Russian insurers.

While those Russian insurers are unlikely to agree to reimburse international lessors for coverage claims, reinsurance provided by the London market may provide an alternative source of coverage. That is because the reinsurance agreements with the London market reinsurers generally include a cut-through provision that gives the international lessors the right to make claims directly under the reinsurance policies.

The terms of the cut-through provisions — and the other terms of coverage and exclusions — should be carefully reviewed to identify any potential limitations placed on direct claims. Nevertheless, initial reactions from the London market reinsurers have been that that loss is not recoverable, which inevitably will lead to litigation or arbitration.

In some cases, international lessors also purchased aircraft all-risk coverage to cover aircraft hull and equipment, on either a possessed or a contingent basis. Many of those policies include endorsements covering loss or damage stemming from war, expropriation, nationalization, invasion, hostilities and similar risks. Depending on the particulars of each claim, those policies also should be reviewed for applicable coverage.

Marine Cargo Insurance

In 2021, the widely reported Suez Canal incident, coupled with backlogs at major ports, severely disrupted supply chains worldwide.

The conflict in Ukraine has interrupted the transport of goods from the Black Sea and snarled marine cargo operations worldwide. Global companies have incurred substantial drayage, storage, or delay charges for cargo stuck at ports, leading to several high-profile lawsuits.

Depending on the cause of loss, marine cargo insurance may be available as a possible offset to recoup such losses. Marine cargo insurance covers the risk of loss or damage to goods or merchandise in transit over the ocean and may extend coverage to loss incurred when goods are delayed at port or associated warehouses.

Marine cargo policies are written as both all-risk policies and specified peril policies. The all-risk policies provide broad-based coverage for all losses except those specifically excluded.

Like commercial property insurance policies, marine cargo policies generally exclude coverage for loss caused by war or hostile acts, but loss caused by war or hostile acts may be added back into the policy through an endorsement.

So, policy endorsements should be carefully reviewed. Marine cargo insurance policies also should be reviewed for provisions that extend coverage to cargo in storage or address how loss is calculated when cargo is abandoned, or blocked and trapped.

Supply Chain Insurance

Some insurers now offer specialty supply chain coverage. The coverage is not yet written on a standard form, which means that the terms of coverage will vary from policy to policy. Generally, supply chain coverage is written to provide all-risk coverage for lost profits and expenses caused by supply chain disruptions.

Events that may be covered by supply chain insurance include the following:

- Political instability;
- Production issues and industrial accidents;
- Financial problems, such as cash flow problems or bankruptcy; and
- Disruptions to transportation infrastructure

Cyberinsurance

The U.S. Department of Homeland Security's Cybersecurity and Infrastructure Security Agency has advised companies that cyberattacks could increase in the wake of Russia's invasion of Ukraine.[1]

Cyberinsurance covers losses from cyber events such as ransomware or malware attacks. Losses covered by cyberinsurance policies generally include the cost of responding to a cyber event including, for example, data recovery costs, data breach notification costs and the cost of paying a ransom.

Some cyber policies, like commercial property policies, provide business interruption coverage that covers losses from the interruption of the insured's business, contingent business interruption coverage that covers losses from the interruption of a supplier's business and extra expense coverage that covers increased costs of operations.

Like commercial property policies, cyberinsurance policies often contain war or hostile acts exclusions. Policies should be reviewed for this exclusion, other limitations on coverage, and endorsements that may add back coverages.

Directors and Officers Coverage

Corporate boards and executives are likely to see heightened scrutiny concerning how they address the Ukraine conflict.

Regulatory or third-party claims potentially covered under D&O policies may assert material decrease in shareholder value due to management's or the board's failure to:

- Anticipate the impact of Russia or Ukraine risks on the business;
- Timely withdraw from markets;
- Comply with sanctions or the changing legal landscape;
- Properly manage supply chains;
- Adequately implement cybersecurity and other security measures;
- Procure adequate and sufficient insurance to cover risks resulting from the conflict;
- Anticipate and account for losses caused by withdrawal from impacted markets; or
- Adequately mitigate and transfer risk or seek insurance recoveries.

Policyholders will want to scrutinize policy wording for broad grants of coverage and be mindful of exclusions and exceptions to exclusions in evaluating D&O coverage for any such claims.

Transfer of Insurance Rights

When reviewing coverage, companies will want to take into account the potential impact of any relevant corporate transactions. Whether coverage is available to predecessor or successor companies may depend on the timing of insured losses, the contract governing the transaction and deal structure, and the language of the relevant insurance policies.

For instance, many international companies closing or ceasing operations in Russia are transferring assets or selling or running off affiliated entities in the region. If insured losses have already occurred, the predecessor entity may wish to retain rights to seek insurance coverage. Alternatively, it may prefer to transfer insurance rights to the successor entity. Many policies require an insurer's consent to assignment of policies or policy rights.

For policies governed by U.S. law, however, the majority of U.S. courts — but not all — have held that policies can be assigned without insurer consent if the assignment occurs after the insured loss has occurred, even if that loss has not been reported to the insurer or litigated.

Courts have adopted this approach on the grounds that post-loss, a right to coverage already exists and assignment does not increase the insurer's risk of loss. The assignment provision, therefore, no longer serves its purpose of protecting the insurer and is not enforced.

With inflation and interest rates rising, markets falling and continued problems in global supply chains, companies will want to analyze all of the above coverages carefully.

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[1] https://www.morganlewis.com/pubs/2022/03/update-ukraine-conflict-has-implications-for-cyberinsurance-policies-including-war-exclusions.