MANAGING SUPPLY-CHAIN RISKS THROUGH INSURANCE

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For most familiar with the ebbs and flows of the modern global supply chain, the concept of "supply-chain disruption" often brings to mind natural disasters, cyberattacks, geopolitical instability or unrest, or other localized events. Before 2020, very few people considered or planned for a global pandemic that would shut down countries and organizations around the world creating a ripple effect on the global economy with shortages of workers, higher costs, and delays. At the same time, consumer demand for certain products and services surged, creating a perfect storm of short supply and high demand.

This has led many organizations to rethink their supply chains and scramble to manage supply chain-related risks. One component of managing such risks is insurance. This article will look at various types of insurance policies and whether they are likely to provide coverage for supply-chain risks.

Business Interruption Coverage

Business Interruption (BI) insurance is often an add-on to a commercial property policy. BI insurance covers a policyholder's lost profits if the policyholder's operations are interrupted due to a covered peril such as a flood, fire, or other natural disaster. BI insurance provides coverage for lost earnings and may also cover expenses like rent, utilities, and employee wages.

BI insurance, however, only covers disruptions related to the policyholder's own property and often requires some sort of physical loss or damage to the policyholder's property. BI policies therefore will not cover losses arising out of physical loss or damage of a supplier's property or facility and, depending on the policy language, may not cover disruptive events that do not cause physical loss or damage, for example, geopolitical instability, strikes, etc. As such, BI insurance alone may not sufficiently protect an organization from supply-chain disruptions.

When it comes to COVID-19 and the resulting supply-chain disruptions, policyholders have argued that COVID-19 and the related government shutdown orders caused a physical loss of property triggering BI coverage to varying degrees of success. Courts in Ohio and across the county have grappled with whether a "physical loss" has occurred, focusing on the meaning of the word "loss" and whether it requires a tangible, permanent loss of property or if dispossession or deprivation of property's use is sufficient to trigger coverage. Firmer guidance is on the way, at least in Ohio, as this issue is currently under consideration by the Ohio Supreme Court in *Neuro-Communication Servs., Inc. v. Cincinnati Ins. Co.*, No. 2021-0130.

Extra Expense Coverage

Similarly, extra expense insurance is another add-on to a commercial property policy that covers certain additional expenses in excess of normal operational costs that a policyholder may incur, enabling the policyholder to continue operations while its property is repaired or replaced after a covered loss. For example, if there is a fire at an organization's facility that requires the organization to move to a temporary location, extra expense insurance may cover the cost of the move, the cost to set up the temporary location, and possibly overtime costs due to reduced efficiency or additional time required to transition the business. Extra expense coverage — like BI coverage — often requires some sort of physical loss or damage to the policyholder's property unless included as part of contingent business interruption coverage discussed below.

Contingent Business Interruption Coverage

Contingent Business Interruption (CBI) insurance helps cover a policyholder's financial losses related to disruptions of a covered supplier, partner, manufacturer, or major customer that negatively impacts a policyholder's ability to operate. As an illustration, if a supplier shuts down due to a fire at the supplier's facility and is therefore unable to deliver necessary products or materials to the policyholder that causes the policyholder to slow or stop production, then CBI insurance would be triggered. Again, a drawback of CBI insurance is that it often requires physical loss or damage to covered property. However, not all CBI policies have such a requirement, particularly foreign CBI coverage. For example, many policyholders obtain CBI coverage to cover civil unrest, government orders, etc.

Additionally, CBI insurers may require a policyholder to identify the specific property of the supplier, partner, manufacturer, or customer to be covered under the policy at the policy's inception, requiring the policyholder to identify potential weaknesses in the supply chain before they lead to a loss. Policyholders must therefore review their policies to ensure key suppliers and/or customers are covered and update their policies if there are changes.

With respect to COVID-19, CBI policies without a physical loss or damage requirement are more likely to provide coverage. For CBI policies that include a physical loss or damage requirement, coverage is dependent on whether COVID-19 results in a physical loss of property, as noted above. If COVID-19 and the related government shutdown orders result in a physical loss of property as some Courts have concluded, these CBI policies may cover a policyholder's financial loss if the supplier, partner, manufacturer, or major customer is forced to shut down due to COVID-19. Other considerations include whether the CBI policy has a virus/bacteria exclusion and whether the policy includes or excludes communicable disease coverage.

Supply-Chain Coverage & Other Specialty Policies

Supply-chain insurance is a specialty "all risk" insurance designed to protect policyholders from a failure in their supply chain. While in the past these type of policies generally required some sort of physical damage, increasingly they do not;

specialized supply-chain insurance now tends to cover events that do not result in a physical loss like labor strikes, road or bridge closures, a supplier's financial issues, and — depending on the language of the policy — a public health emergency like a global pandemic.

Additionally, other specialty-type insurance policies may be applicable to the extent an organization has such coverage. For example, organizations operating in foreign countries may have political risk insurance that, depending on the terms of the policy, may cover losses resulting from certain government actions such as shut down orders or regulations related to the pandemic. These specialty policies are often manuscript policies (*i.e.*, customized policies negotiated by the insured and insurer) combined to provide CBI coverage.

Understanding and Assessing Supply-Chain Risks

As organizations continue to navigate supply-chain disruptions and look to insurance as one component of managing such risks, organizations should:

- Understand the complexity of their supply chains. Organizations with complex supply chains, international suppliers, or suppliers in politically unstable areas are more likely to benefit from supply-chain coverage.
- Identify the current disruptions to your supply chain. There might be multiple points of disruption, including some that trigger coverage under one or more policies. A government order may require a key supplier to shut down while second tier suppliers may be experiencing staff shortages and production delays. Additionally, necessary materials or parts may be delayed at sea. Fully understanding all disruptions in the entire supply chain will best position an organization to assess potential coverage.
- Determine which suppliers and/or customers should be covered under an organization's insurance. The key here is to identify the suppliers or customers that would have the greatest impact on an organization's operations and finances.

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- Review existing insurance policies to understand what is covered and to identify any potential gaps in coverage. The terms, exclusions, and endorsements in BI, CBI, and other specialty type policies vary greatly and as noted above, may or may not require physical loss or damage to property.
- Document all potentially covered losses. Both the legal landscape and the economic risks keep evolving as both the pandemic and the supply-chain disruptions continue to wreak havoc. Whether a claim is covered is dependent on the specific terms, exclusions, and endorsements of the relevant policies and the circumstances of any potential claim.
- Assess whether additional coverage is needed to cover supply-chain disruptions.

While insurance may not completely alleviate supply-chain risks, it may help an organization weather the current supply-chain storm and be better positioned for future disruptions.

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