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Chilean Earthquake

On 27th February 2010 Chile was hit by its strongest earthquake since 1960, and the fifth strongest earthquake on record. Fortunately, casualties were relatively low, but the economic loss was high and has continued to grow, due principally to business interruption losses. More than 200,000 dwellings were lost and commerce ground to a halt in the wake of blackouts and power cuts. Subsequent public disorder and looting increased the loss and damage.

It is estimated that around 90% of the insured losses arising from the quake will be passed up to reinsurers. Estimates put insured losses at between US\$2billion and US\$8 billion. The following issues will be relevant to those who are considering reinsurance claims.

Aggregation

Although there was one principal earthquake, there were over 200 aftershocks over a period of several weeks after the quake, including one 7.2 magnitude aftershock on 11 March 2010. In addition to the aftershocks, there were also smaller earthquakes that were not related to the original quake. The initial earthquake also caused a tsunami which affected the islands and Southern coast of Chile.

Most property damage policies contain a 72 hour clause to deal with aggregation. Typically, all loss or damage occurring within 72 hours of the original earthquake or other disaster will be aggregated as one occurrence as regards the sum insured and the deductibles.

In the case of the Chilean earthquake, many of the aftershocks occurred well over 72 hours after the initial quake, as with the one recorded on 11 March 2010. Damage arising from these

may therefore constitute a separate loss or losses and new deductibles may apply. Losses from the tsunami may be able to be aggregated with the earthquake as the tsunami struck the Chilean coastal regions within hours of the earthquake. It will be essential for reinsurers to review the precise wording of their aggregation clauses when considering the losses and what caused them.

Cause of Loss

Issues may arise when reinsurers seek to confirm the proximate cause of the loss in order to ensure that it is covered by the policy terms. Not only is this a question of whether the proximate cause was the main earthquake, a separate quake, or an aftershock, but it also appears that some buildings may not have collapsed if they had been built according to the proper regulations. If that is the case, there may be an argument that it was the failure to comply with local building regulations, and not the earthquake itself, which was the proximate cause of the loss.

Losses may also have been caused by the tsunami and not the earthquake. Reinsurers will recall that in the case of Hurricane Katrina, many property policies excluded flood or water damage. The hurricane caused the levees to break and flood the city, and it was this flood that caused the damage. Therefore, policies that covered hurricanes but not water damage might not pay out as it was the water damage that was arguably the cause of the loss.

Similarly, Chilean property policies may cover earthquakes but not water damage, in which case losses caused by the flooding, caused by the

tsunami, caused by the earthquake, may not be covered.

Issues about the proximate cause of loss will be exacerbated by the shortage of Spanish speaking loss adjusters on the ground. Local regulations on the timing of the appointment of loss adjusters have also been causing difficulty as the physical conditions after the quake has made complying with the short timescales particularly challenging.

Business Interruption

The loss in economic activity resulting from the quake has been estimated at 4% of Chile's GDP with some coastal regions completely closing for business. Infrastructure was damaged by the quake, including roads, bridges, ports, mines and power stations, all of which will have knock-on effects on commerce and trade. Looting in the aftermath of the earthquake also caused significant losses to businesses. The long term outlook is good thanks to Chile's stable economic climate, but substantial business interruption claims ("BI") are inevitable and have already been notified.

BI cover is usually an adjunct to property cover and generally will only respond when the interruption is caused by a physical loss insured under the property cover. Reinsurers should pay close attention to the actual cause of the BI. An intervening cause that is not covered by the property section of the policy can sometimes

prevent an insured loss. For example, a government's decision to close a mine as unsafe or to evacuate an area may not be an event that is covered by the property policy, even though the decision was due to the earthquake or the tsunami, and any resulting interruption to business activity might also not be covered.

Claims Control and Claims Co-operation

Reinsurers exercising rights under claims control or claims co-operation clauses in their reinsurance contracts need to be aware that local policies will almost certainly be governed by Chilean law and that Chilean loss adjustment regulations will have to be followed. Similarly, local insurers would be well advised to seek advice on the scope and application of any claims control and claims co-operation clauses, as these may not be governed by Chilean law.

Summary

There are complex issues arising out of this earthquake for reinsurers to consider, as there are with any major catastrophe. Chadbourne & Parke LLP has a team of Spanish speaking lawyers who are experienced with property and financial losses in Latin America. Please call Christopher Cardona of the London office or Carey Child of the Washington D.C. office if you would like to discuss any of the above issues further.

Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:

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