Why The Corrosion Exclusion Remains Strong: Part 1

By Philip Silverberg, William Wilson and Andrew Rice

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Corrosion exclusions have been commonplace in first-party property insurance policies for decades, as evidenced by the sheer number of jurisdictions and decisions addressing them. The exclusion is intended, in part, to prevent a contract of insurance from being converted to a warranty or maintenance contract on the life of property insured. At the same time, corrosion is a peril to be excluded no matter how or when it occurs, and many policies simply exclude “corrosion” without reference to its physical or temporal origins. Unfortunately, policyholder counsel often see a coverage declination under a corrosion exclusion as an invitation to argue that some other, more proximate cause or event was responsible for a loss, even though corrosion played a central role. Many courts have rejected these attempts to read the corrosion exclusion out of the policy.

At least one insured has argued, for example, “that the word ‘corrosion’ refers only to normal or natural corrosion,” such that the corrosion exclusion in its all-risk policy bore no relation to a roof collapse involving defective concrete that allowed for corrosion.[1] The insurer contended that the policy excluded from coverage any loss “due to corrosion,” regardless of the nature of its origin. In looking to the dictionary meaning of the word, the Tenth Circuit Court of Appeals determined that “[d]efinitions such as ‘eating away,’ ‘wearing away,’ and ‘alteration,’ ...make no distinction between corrosion occurring over the natural course of a building’s life and corrosion produced by defective design and/or construction.” On that reading, “the word ‘corrosion’ unambiguously refer[red] to all corrosion, however brought about.” The court did note, however, that the exclusion’s ensuing loss provision (“unless such loss results from a peril not excluded in this policy”) meant that, “[i]n effect, the corrosion exclusion applies only to naturally occurring corrosion.”

Rather than arguing that the term “corrosion” should be limited to “natural” causes, other insureds have argued that the term “corrosion” is, itself, ambiguous, or that it only applies to a process occurring over an extended period of time. These arguments likewise have been rejected.[2] One federal court suggested that “an ordinary person coming across the term ‘corrosion’ would not find it to be ambiguous.” Turning to dictionary definitions, the court observed that “[c]orrosion means ‘the action, process, or effect of corroding,’ [while] [c]orrode means ‘to eat away by degrees as if by gnawing ... wear away or diminish by gradually separating or destroying small particles or converting into an easily
disintegrated substance; esp: to eat away or diminish by acid or alkali reaction or by chemical alteration.”

The court took note of the insured’s argument “that corrosion must be gradual in the sense that corrosion takes a ‘long time,’” an argument the insured employed to suggest that corrosion over a period of days could not constitute excluded corrosion. The court rejected this concept outright:

Gradual does not mean a long time (assuming ‘a long time’ could be defined). Gradual means ‘proceeding by steps or degrees.’ One of the definitions of ‘corrode’ is ‘to eat away by degrees.’ These definitions contain no element of time. Something need not take a certain number of years to be gradual. If something is gradual, it proceeds step by step; it proceeds in regular increments. For example a stretch of highway may have a gradual incline. There is nothing about ‘a long time’ implicit in such a sentence.

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Not every metal corrodes in every solution at the same rate of speed. One solution may corrode steel much more quickly than another solution 2. A chemist would not say that the chemical reaction involving the first solution was not corrosion because it occurred more quickly than the chemical reaction involving the second solution. This case provides the perfect example. Pioneer believes that brine alone would take 414 years to corrode its metal pipes. However, after the pipes had been breached, the brine-chlorine mixture (a more caustic and acidic solution) took only a few days to corrode the steel elbow. How fast corrosion occurs depends on the solution and the metal involved.

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The chemical reaction which caused the perforations and the chemical reaction which caused the hole at the elbow were corrosion. Whether corrosion takes a matter of days, twenty-five years, or 100 years does not change the fact that it is corrosion. Whether corrosion is expected does not change the fact that it is corrosion.

More recently, the Court of Appeals for the Second Circuit affirmed a district court decision applying a corrosion exclusion in the first-party context.[3] Counsel for the insured, Lantheus Medical Imaging Inc. (“Lantheus”), argued that a pressure surge, rather than an accompanying form of rapid corrosion, caused a nuclear reactor leak and subsequent losses. A key tenet of the insured’s argument was that “corrosion” is a gradual process that takes place inevitably over the useful life of a machine and could not encompass the rapid thinning of the reactor vessel at issue. In a detailed analysis that the Second Circuit deemed “thorough and sound,” District Court Judge Katherine Polk Failla rejected the notion that the gradual process of corrosion cannot also occur rapidly. Judge Failla observed that corrosion generally “proceed[s] by steps or degrees,” but it does not necessarily do so slowly.” Accordingly, even the accelerated corrosion at issue — estimated to have taken approximately 29 days — still fell “squarely” within an unambiguous corrosion exclusion. Citing clear policy wording, anti-concurrent causation language and the absence of an ensuing loss, the district court granted Zurich summary judgment on the application of its corrosion exclusion, and the Second Circuit agreed.
The Lantheus Decision

Lantheus is a specialty pharmaceutical company with multiple product lines, including diagnostic medical imaging equipment. One of those products is the TechneLite Generator, which Lantheus manufactures at its facility in Billerica, Massachusetts, using Molybdenum-99 ("Moly-99"), a radioactive isotope. Lantheus normally receives its supply of Moly-99 from Nordion Inc., which is, in turn, supplied by the NRU nuclear reactor, operated by Atomic Energy of Canada Limited ("AECL") in Ontario, Canada. Lantheus’s Billerica facility also manufactures other products not reliant on Moly-99.

The NRU reactor contains uranium fuel rods and a heavy water cooling system housed in an aluminum alloy reactor vessel. The reactor vessel is surrounded by a light water reflector, and a six-inch gas-filled space called the “annulus” exists between the vessel’s outer walls and the reflector. By May 2009, “the wall separating the annulus and reactor vessel was weakening (or thinning) to varying degrees in several places.” [4] The court noted that two types of weakening were involved: a general corrosion that caused solids to accumulate near the base of the annulus, and a highly localized pitting and weakening that caused deep penetrations into the reactor vessel.

On May 14, 2009, the NRU reactor lost power and the reactor vessel experienced a significant drop in heavy water coolant. AECL worked to quickly restore the coolant levels by pumping heavy water into the reactor vessel, an act that Lantheus’s experts believe caused heightened pressure in the vessel. Once the reactor vessel was refilled, the vessel wall failed where the highly localized pitting and weakening had occurred. The result was a breach in the reactor vessel wall that allowed heavy water to escape into the NRU reactor facility. Ultimately, the NRU reactor was offline for 15 months during the subsequent investigation and repair process.

Lantheus’s experts attributed the highly localized pitting and weakening to an “electrochemical cell” or “differential aeration cell” that “resulted from the interaction of waters with two different electric potentials at the base of the NRU Reactor.” According to those experts, it was the electrochemical cell that caused the weakening of the reactor vessel at a rate greater than the general corrosion occurring elsewhere on the vessel wall. Ultimately, this accelerated thinning or weakening, in combination with the increased pressure from the heavy water pumped into the reactor vessel on May 14, is what Lantheus claims caused the reactor wall to fail.

During the shutdown of the NRU reactor, Lantheus received less Moly-99 and produced fewer TechneLite Generators during its usual weekend production runs. It also claimed it lost revenue and incurred extra expense to obtain an alternate supply of Moly-99. As the court observed, “instead of producing TechneLite Generators for approximately twelve hours each weekend, Lantheus produced TechneLite Generators for nine to eleven hours each weekend,” with no evidence of interruption to weekday production runs of any Lantheus products.

Zurich issued an all-risk property insurance policy to Lantheus for the period of Jan. 8, 2009 through Jan. 8, 2010. The policy included the Billerica facility in the Declarations Schedule and the NRU reactor as a “Contingent Property” for the purpose of its contingent business income loss ("CBI") coverage, subject to a $70 million sublimit. The CBI wording of the policy provided the following:

We will pay for the actual Business Income Loss you sustain and necessary Extra Expense you incur resulting from the necessary suspension of your business activities occurring at a premises described in the Declarations Schedule if the suspension is caused by direct physical loss of or
damage caused by a covered cause of loss to a Contingent Property (of a type insured) not owned, occupied, leased or rented by [Lantheus] or insured under this Policy and that property is located within the Covered Territory. We will pay no more than the applicable sub-limit of insurance.

The policy defined “Covered Cause of Loss” to include “all risks of direct physical loss of or damage (including machinery breakdown) from any external cause unless excluded.” Separately, the policy outlined “Causes of Loss Not Covered,” in relevant part as follows:

We will not pay for loss or damage resulting from any of the following; such loss or damage is excluded regardless of any cause or event that contributes concurrently or in any sequence to the loss or damage, except as specifically provided.

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5. Developing, Latent or Other Causes

The effects or cause of:

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b. Deterioration, depletion, rust, corrosion, erosion, loss of weight, evaporation or wear and tear;

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But if any of these results in a covered cause of loss, this exclusion does not apply to the loss or damage caused by the covered cause of loss.

Lantheus presented a claim to Zurich under the policy, seeking the full $70 million sublimit for CBI losses it claimed to have suffered as a result of the reactor shutdown. Zurich denied coverage in early 2010, noting that “all of the available information indicate[d] that the shutdown of the NRU Reactor was because of corrosion, an excluded cause of loss,” and, as such, “Lantheus’s Contingent Business Income Loss and Extra Expense claim [was] not covered.” Lantheus initiated a declaratory judgment and breach of contract action against Zurich in the Southern District of New York in December of 2010. Following extended discovery — hampered by the sensitive nature of the reactor and its location in Canada — Zurich moved for summary judgment, arguing that the policy’s plain and unambiguous corrosion exclusion applied to Lantheus’s claim, and, in any event, Lantheus did not sustain a “necessary suspension” of its “business activities” as a result of the NRU reactor shutdown.

In support of its motion, Zurich cited extensive documentation from AECL and the Canadian nuclear regulatory body identifying corrosion of the reactor vessel wall as the “cause of the leak.” Moreover, Zurich put forth evidence from the AECL indicating that general nitric acid corrosion, occurring over a period of approximately 35 years, led to the leak. Most important, however, was Zurich’s argument that the anti-concurrent language of the policy excluded loss caused by corrosion “regardless of any cause or event that contributes concurrently or in any sequence to the loss or damage.” Zurich identified numerous authorities, from Massachusetts, New York and beyond, supporting the application of the anti-concurrent causation provision in similar circumstances. Finally, Zurich highlighted that there simply was no separate, covered cause of loss ensuing from the corrosion. Thus, Zurich argued, in the absence of a covered cause of loss or an ensuing loss, and a “necessary suspension” of Lantheus’s business
activities (rather than a mere decrease in production), it was entitled to summary judgment.

As noted above, Lantheus presented two expert opinions outlining alternative theories of the corrosion affecting the reactor vessel wall, all without acknowledging that an “electrochemical cell” causing accelerated thinning and weakening of the wall was, in fact, a form of corrosion. Lantheus instead argued that “the NRU Reactor broke down due to a pressure surge or ‘transient,’ removing the loss from the corrosion exclusion and placing it squarely within the Policy’s machinery breakdown coverage.”[5] Lantheus also argued that the corrosion exclusion applied only to “the inevitable corrosion or wear and tear that happens as [equipment] nears the end of its useful life,” and that somehow, despite the presence of the anti-concurrent causation language, the “ensuing loss provision restores coverage if corrosion further back in the causal chain combines with a fortuitous event to cause an accident.”

Notably, Lantheus argued at length that corrosion, as a gradual process, did not encompass the thinning and weakening of the vessel wall that its own experts claimed took at least 29 days, and possibly as long as several months. Instead, Lantheus asked the court to deny summary judgment in the hope that “a jury could reasonably find that this rapid [highly localized pitting and weakening] process [did] not constitute corrosion given its speed, and the absence of an acid, base, or wear and tear process.”[6]

Finally, Lantheus advanced the notion that its “repeated suspensions” of part of its overnight weekend business activities satisfied “even the ‘complete cessation’ requirement” outlined in the authorities cited by Zurich. Alternatively, Lantheus argued that a complete cessation was not required by the policy language, could never be necessitated by a shutdown of the reactor (as Lantheus manufactured products on weekends not reliant on Moly-99), and would not occur if Lantheus took steps to mitigate its losses by pursuing alternate supplies as required by the policy.

This is the end of the first part of this article. Part 2, detailing the court’s decision and key takeaways, will follow tomorrow.

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[4] The District Court’s March 25, 2015, Opinion and Order, cited here and throughout unless otherwise noted, contains extensive detail regarding the NRU Reactor breakdown, the parties’ positions, and the supporting factual information.


[6] Id. at 17. Lantheus asked the court to apply the interpretive cannons of noscitur a sociis (wherein a word is “known by the company it keeps”) and reverse ejusdem generis (wherein each word in a list is “of the same kind” and, in this instance, corrosion would be defined by the more general “wear and tear” appearing at the end of the list).
Why The Corrosion Exclusion Remains Strong: Part 2

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This is part 2 of this article. You can find the first part here.

On March 25, 2015, the district court issued an extensive opinion and order, granting Zurich’s motion for summary judgment. The 43-page discussion first addressed whether Lantheus experienced a “necessary suspension” of its “business activities,” as required for coverage under the policy’s CBI provision. The court noted that Zurich’s cited authorities stood for the proposition that courts in New York and across the country had found that business income coverage traditionally required a total cessation of an insured’s business activities. Moreover, because Lantheus’s business activities at the Billerica Facility “concededly did not” cease completely, the court mused that “Zurich would appear to be entitled to summary judgment.” Ultimately, though the court found “cogent reasons for and against interpreting the CBI provision to require a total cessation of operations at the Billerica Facility,” it declined to resolve the issue, noting that coverage was precluded, in any event, by operation of the corrosion exclusion.[1]

The court stated at the outset of its opinion that Zurich met its burden by establishing “that ‘corrosion’ was unambiguous as used in the policy, and that the only reasonable interpretation of ‘corrosion’ include[d] the [highly localized pitting and weakening] that occurred” at the NRU reactor. Moreover, the court noted that Zurich had “the better of the argument” with respect to Lantheus’s claim of machinery breakdown, pointing out that machinery breakdown under the policy was a type of covered “physical loss or damage,” not a separate cause of loss triggering coverage on its own or under the ensuing loss provision.

Inasmuch as the term “corrosion” was not defined in the policy, the court looked to a dictionary definition to import the term’s common, rather than scientific, meaning. As the court observed, Webster’s defines “corrosion,” in part, as “typically: a gradual wearing away or alteration by a chemical or electrochemical essentially oxidizing process (as in the atmospheric rusting of iron).” Next, the court rejected Lantheus’s misguided arguments that the pressure surge was a “predominant cause” of the loss or that the ensuing loss provision restored coverage “if corrosion further back in the causal chain combines with a fortuitous event to cause an accident.” Accepting, for the sake of argument, Lantheus’s position that the through-wall breach occurred because of a “pressure
surge...act[ing] upon an already weakened point,” the court went on to ask — in light of the anti-concurrent causation provision — “what process caused the vessel to be ‘already weakened.’”

It was here that the court parted ways with Lantheus on “the crucial point of whether ‘corrosion’ contributed to the loss.” While Lantheus argued that the highly localized pitting and weakening that contributed to the loss was not sufficiently gradual to constitute “corrosion” under the policy, the court disagreed, choosing to join other courts that “have rejected analogous attempts to narrow the definition of ‘corrosion.’” According to the court, a “‘gradual’ process ‘proceed[s] by steps or degrees,’ but it does not necessarily do so slowly.” Adopting the 29-day estimation put forth by Lantheus’s experts, the court found that “even ‘rapid’ corrosion falls within the scope of this Policy’s exclusion.” Indeed, “[t]hat the progress of the electrochemical cell’s effect on the wall can be measured by such increments is, in and of itself, evidence that it was a gradual process.”

The opinion concluded with a succinct analysis of the policy’s ensuing loss provision, which the court properly observed did not restore the coverage precluded by the corrosion exclusion. Here again, the court gave Lantheus the benefit of the doubt, but noted that, “[e]ven under Lantheus’s theory of the case, the aeration cell operated in tandem with the hydraulic transient to cause the through-wall breach — there was, therefore, no ‘ensuing loss.’” Key to this holding was the policy’s anti-concurrent causation language, which obviated a causation analysis and laid bare Lantheus’s arguments that “machinery breakdown” was, itself, the ensuing loss.[2]

Dissatisfied with the district court’s ruling, Lantheus appealed the decision to the Second Circuit and filed its opening brief in late 2015. Lantheus refused to alter its central argument — that the highly localized pitting and weakening was simply too rapid (or not gradual enough) to constitute corrosion — but abandoned its claim that “machinery breakdown” constituted an ensuing loss. Instead, Lantheus attacked Judge Failla’s thorough and sound analysis as having applied the “wrong interpretive methodology” for assessing the policy’s corrosion exclusion. Notably, Lantheus posited that the section heading, text, and broader context of Exclusion 5b (in which “corrosion” appeared) supported its thoroughly debunked argument that corrosion and its neighboring exclusions were intended to apply only to “damage occurring gradually and inevitably over an object’s useful life or resulting from an object’s inherent qualities or defects.” In advancing this argument, Lantheus relied almost exclusively on the Second Circuit’s 2003 decision in City of Burlington, which, of note, applied Vermont law and dealt with a latent defect, rather than corrosion.[3]

On appeal, Zurich adhered to its original arguments, including one adopted by the district court’s opinion, that “corrosion may be gradual, regardless of whether it is more accelerated (i.e. less gradual) in one particular instance than in another.” Zurich also distinguished the Burlington case, arguing that it was inapplicable to the Lantheus matter. Furthermore, Zurich noted the obvious fact, overlooked or ignored by Lantheus, that the heading under which the “corrosion” exclusion appeared was titled “Developing, Latent and Other Causes,” fundamentally undercutting much of Lantheus’s “contextual” argument. Also, although the district court declined to rule on the “necessary suspension” arguments below, Zurich again offered support for why the production slowdowns Lantheus experienced were incapable of triggering the policy’s CBI coverage.

On May 25, 2016, the Second Circuit issued a summary order, affirming the district court’s grant of summary judgment to Zurich.[4] While reviewing the grant of summary judgment de novo, the circuit court recognized Judge Failla’s analysis as “thorough and sound,” noting that the district court had drawn “all inferences in favor of Lantheus,” and “specifically declined to resolve certain outstanding factual ambiguities that were not necessary to decide Zurich’s summary judgment motion.” Beyond this,
the court offered a concise overview of the parties’ arguments, and the basis for affirming summary judgment in Zurich’s favor. The court expressly held that “it was not error for the District Court to draw the factual conclusion that ‘the [highly localized pitting and weakening] contribute[d] concurrently or in any sequence to the...damage,’” especially when the district court was relying on Lantheus’s own experts. Indeed, “[t]aking the facts in the light most favorable to Lantheus, the [highly localized pitting and weakening] of the reactor vessel took approximately twenty-nine days to occur and was caused at least in part by the differential aeration cell.” Accordingly, there was “no question of material fact that the NRU Reactor shutdown falls into Exclusion 5b, even accepting Lantheus’s proposed version of events.”

Like the district court below, the Second Circuit declined to rule on whether the policy’s CBI provision, requiring a “necessary suspension” of the insured’s “business activities,” meant a “total cessation of the operations at the Billerica Facility.” The circuit court echoed Judge Failla’s sentiments that this newer form of CBI coverage had not yet been “fully delineated by the courts,” and differed from the well-established and thoroughly applied business interruption coverage.

Key Takeaways

The Lantheus decision represents a strong rebuke of the narrow definition of “corrosion” advanced by some in the insurance industry. The cases cited herein, along with Judge Failla’s thoughtful and reasoned analysis, present a reading of the corrosion exclusion that honors its meaning and recognizes the varied nature of corrosion.

Equally important is the principle, reinforced by the district court and Second Circuit in Lantheus, that anti-concurrent causation language means what it says and, in the field of policy application, precludes a causation analysis.

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[1] The district court, like the Second Circuit after it, assumed for the purposes of the summary judgment motion that Lantheus was entitled to claim under the CBI provision.

[2] As previously noted, the court already had distinguished “machinery breakdown” as a type of loss or damage, not a covered peril.


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