Multi-Nation Specific Peril

A New Partnership of Carriers and Governments

by Ronald R. Robinson

Insurers seek to protect life and property, sustain one's sense of security, and provide freedom from fear. Terrorists seek to destroy life and property, end one's sense of security, and create fear. Thus, private insurance communities in each developed nation play a singularly valuable role in the war against this old, but newly dangerous, enemy, simply by covering the risk it poses.

This article is based on a more extended paper presented by the author at the World Jurist Association's Conference on International Terrorism in Madrid, Spain, April 14–17, 2002. Members of his panel in Madrid who contributed to, commented upon, or critiqued that paper included: James Seal and Ronald Greenberg of Berkes Crane Robinson & Seal LLP; Renny Hodgskin of Cambridge Integrated Services Group; and David Robb of the Hartford. Valued insight and concepts were also forthcoming from: the report of the proceedings of the Subcommittee on Oversight and Investigation, Committee on Financial Services, U.S. House of Representatives; the observations and analysis of Ellen Seidman, Senior Counsel, Democratic Staff, to the Committee on Financial Services, in her remarks to the 2002 World Insurance Forum in Bermuda; as well as a recent Swiss Re Focus Report, *Terrorism—Dealing with the New Specter.*

Yet, the potential magnitude of new terrorist attacks presents a clear threat to the solvency of insurers worldwide. Consequently, insurance coverage for terrorism cannot continue, let alone expand, unless individual governments and the nations of the world act together with their private carriers so that each can accept an appropriate portion of this risk.

The solution could be a tripartite partnership among the insurance companies in each developed nation, their respective governments, and the international community, acting together to underwrite a Multi-Nation Specific Peril Terrorism Coverage Program ("Program").

Historically, "all risk" policy forms—as opposed to "specific peril" forms—in place in the three basic lines of private insurance include this risk. However, an all risk policy simply does not provide the specificity that many analysts believe is now crucial to carrier solvency. Specific peril-based underwriting principles could easily be adopted to create a separate coverage section or endorsement that would serve to establish the proposed Program. Such an approach would clearly define and limit the risk undertaken by each partner. Thus, coverage for future terrorist losses could be expanded, quantified, and prudently insured.

Many of the carriers responding to September 11 losses are United States domestic companies. However, 60 percent of the covered losses will be paid by insurers with principal places of business outside of the U.S. Thus, the Program envisions an integrated multi-nation approach that mirrors the reality and scope of the terrorist threat.

The proposed Multi-Nation Program would encompass all three of the traditional basic insurance lines that respond to terrorist losses, including: 1) life, workers' compensation, health, and accidental loss policies ("personal lines"); 2) first-party policies for fire, property destruction, and business interruption loss ("property lines"); and 3) third-party policies for casualty claims and lawsuits ("casualty lines"). The Program would utilize these same policies, as rewritten for the terrorism risk, using separate coverage sections or endorsements based upon specific peril underwriting principles.

The Program would consist of three specific peril policy-based tiers of coverage. The private sector tier in each of the three coverage lines would be made up of primary, umbrella, and excess layers, constructed much like classic large risk programs. A government tier would attach above the limits of each line's private sector layers and "follow form" to the underlying policies. A multi-nation tier, consisting of a fund created by participating governments, would attach above the limits of a given partner nation's combined private and public tiers and, likewise, follow form to the private market policies. Such a fund could be chartered under the auspices of the United Nations and governed pursuant to whatever structure is acceptable to participating nations.

Traditional marketplace forces, working in tandem with sovereign politics, would create the Multi-Nation Program's partnership coverage mechanisms and fix the different limits and attachment points for the private, governmental, and U.N. Fund tiers of insurance in all three lines in each participating nation. Moreover, carriers worldwide would have an opportunity to create a private sector tier in those sovereign states that do not have insurance communities but seek to implement the Program.

Premiums ought to finance the Program at the private tier only, with treasury revenues and surpluses being used to fund each nation's governmental tier. Neither governments nor the U.N. Fund would receive premiums. Instead, each nation would fund its government tier losses and its *pro rata* share of a given loss that attached the U.N. Fund on a case-by-case basis. This approach is preferred because political pressures to misuse premium paid to the public partners for other entitlements, infrastructure programs, or general spending would be irresistible. Monies needed for any losses would be long spent, leaving the cupboard bare.

Thus, premiums are best left to funding only the private tier and should not be the source of the monies that directly support the national and international tiers. In any event, of the three proposed partners, the insurance community has the most efficient

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mechanism to collect premium from, and return it, to all segments of society through investments, payment of claims, awards and defense fees and costs, and the creation of jobs. Traditional private sector economic forces, bolstered by this premium mechanism, would in turn stimulate a given nation's economy, increase its treasury revenues, and fund the public tiers, nationally and internationally.

Under the Multi-Nation Program, insurance communities would not be called upon to assume more terrorist-related risk than they could safely underwrite alone. Instead, these private sector resources would be paired with the infrastructures and financial resources of the public partners to respond fully to the specified terrorist-caused losses. When the limits of the policies in all layers of the first tier of the relevant lines of private sector insurance could not pay a given loss, per event or in the aggregate, the government tier would step in for that loss. If a given loss, per event or in the aggregate, exceeded both the relevant private and government tiers, the U.N. Fund would serve as the Program's tier of last resort. As governmental and/or U.N. Fund tiers become involved in a given claim, however, the last private carrier directly handling such loss would continue to defend and administer the claim, with the monies necessary to pay the last parts of the loss coming first from a given government's tier and thereafter, if needed, from the U.N. Fund.

The independent creation of the Program in each nation would best proceed in the context of a coordinated worldwide examination of this global risk. The United Nations is the entity best suited to convene a conference of insurance professionals, coverage lawyers, state insurance regulators, and statesmen from all interested nations to discuss and coordinate creation of the various participating sovereign's elements of the Program as well as the ways and means to create and implement the U.N. Fund. When this same proposed Program was presented in four extensive white papers (including an expanded version of this article) at the World Jurist Association's Conference on International Terrorism in Madrid in April 2002, the WJA passed a resolution calling upon the United Nations to convene just such a conference. The U.N. has now received this request.

The Program would not require dramatic changes to the infrastructures of the participating insurance communities and nations or to the laws that govern them. The Program could simply be built by its partners "from the ground up" rather than imposed "from the top down." Each sovereign could, as the United States has just done in the Terrorism Risk Insurance Act of 2002, provide temporary stability and security while its private insurance market creates the Program's policy forms, illuminates underwriting choices, and fixes Program policy limits, attachment points, and private sector premiums. As the Program is implemented and matures, each nation's insurance community can replenish and protect its overall surplus and premium base.

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Moreover, creation of the Program need not be delayed pending resolution of myriad civil justice and public policy issues that now dominate insurance, tort, and government reform agendas. As these far-reaching questions are answered, the resulting solutions can simply be applied to the Program.

In addition to the protection and stability it could provide, if the Program is established in each nation, private market forces and geopolitical realities will soon disclose the true role played by a given sovereign in the war on terrorism. It simply will not long be feasible for any nation to foster or support acts of terrorism while being required to pay for the losses it helps to create throughout the world. This is the overriding benefit of the Multi-Nation Program, which seeks to combat fear, build a sense of security, and protect society from the acts of terrorists.

The Terrorism Risk Insurance Act and its Limitations

The Terrorism Risk Insurance Act was signed into law by President Bush on November 26, 2002. Its stated purpose is to "provide temporary financial compensation… while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance." P.L. 107-297, §101(a)(6). The Act is only a temporary three-year federal program based on "shared public and private compensation for insured losses resulting from acts of terrorism…." §101(b). Thus, the U.S. has provided a limited window within which to convene the U.N. Conference and build a Multi-Nation Specific Peril Terrorism Coverage Program. More importantly, it has adopted the Program's model to fund the private and public partnership that is at the core of the Act.

However, there are numerous aspects of the Terrorism Risk Insurance Act's temporary "stop loss" approach that, while serving the immediate needs of many consumers of property and casualty insurance for affordable and adequate terrorism loss cover, fall well short of providing the underwriting specificity, long term security, multi-nation scope, and comprehensive all-line coverage envisioned by the proposed Program. Unlike the Program, the Act does *not*: (1) create a specific peril based endorsement/section, but instead relies on existing all risk forms; (2) respond to per event aggregate losses under $5 million; (3) leave all premiums in the private sector, opting instead to collect a three percent surcharge on total property and casualty premiums from consumers specifically tied to terrorism cover; (4) include protection for personal and re-insurance lines; (5) provide $300 to $400 billion annually at the government tier, instead capping all federal protection at $90 billion (year 1), $87.5 billion (year 2), and $85 billion (year 3); and (6) have a multi-nation tier of coverage for what is clearly a global risk. Moreover, failure of an insured to pay the three percent surcharge permits the carrier to exclude it from the Act's protections.

The Act immediately pre-empts state court actions in favor of multi-district-based federal forums, and mandates use of traditional choice of law principles. While the Program also envisions federal jurisdiction, it proposes an immediate reliance on public ADR forums, with full appellate rights.

The Act permits all current and future punitive damages theories to apply in these now-federal actions, but does not insure them. The Program clearly limits the availability of punitive awards to circumstances of fraud or deceit. Other aspects and details about the Act relevant to the Program are addressed in the relevant sections below.

For the past 15 months, the Federal Air Transportation Safety and System Stabilization Act has been the only federal response to terrorist losses. This effort, directed only to the casualties of September 11, 2001, provides a specific response that serves solely to: (1) cap the civil liabilities of the public agencies that responded to the attack, the airlines involved, and the owners of the attacked buildings and their tenants; and (2) cap recoveries by the families of the casualties of the attack.

While important and beneficial in the short term, neither of these stopgap legislative measures fully addresses the extent or scope of this risk. Moreover, the Terrorism Risk Insurance Act's $5 million "deductible," failure to protect re-insurers, and federal premium surcharge, may well serve to exclude many insureds from this coverage—most probably the "little guys" who need the protection the most. The Multi-Nation Specific Peril Terrorism Coverage Program, as proposed, has none of these defects, and provides for a multi-national response that serves to fully meet the true magnitude of this global threat.

Catastrophic Risks Not Covered Under the Act

In the United States, the scope of coverage for the three major lines of insurance is regulated separately in each state, the District of Columbia, and Puerto Rico (the "52 Regulatory Jurisdictions"), rather than on a federal basis. The Terrorism Risk Insurance Act leaves undisturbed this allocation of oversight responsibility. Property and personal lines have traditionally been required by these regulators to respond to terrorism losses under all risk policies. Even acts of nuclear, chemical, or biological terrorism are not excluded from most property and personal line policies. This is because "all risk," as opposed to "specific peril," coverages include neither war risk nor terrorism act exclusions. Casualty lines likewise use all risk forms (except for E&O, D&O, personal injury, and other specific peril policies), but these covers are liable for a terrorist loss only if it falls outside the definition of a war risk or other applicable exclusion or condition.

The total September 11 loss is estimated to be over $50 billion, none of it covered by the Act. Instead, about 80 percent of that loss will likely be covered by private carriers *alone* as follows:

- Workers' compensation carriers—approximately $5 billion;
- Life insurance carriers—approximately $6 billion;
- Property lines—approximately $12 billion; and
- Casualty lines—$18–$20 billion.

The remaining $7 to $9 billion will not be paid by any line of insurance.

Assuming the emerging consensus of a $50 billion loss, property and casualty lines will pay 60 percent ($30 billion). This figure represents 30 percent of the total current U.S. property and casualty policy surplus of $100 billion. To put the 30 percent figure in its full market context, about $125 billion of property and casualty re-insurance surplus is available in the United States. Consequently, the direct property/casualty and re-insurance market's shared loss of $30 billion is only 13.5 percent of that combined market's surpluses ($225 billion). This illustrates the impact on property/casualty insurers of any loss of re-insurance cover for this risk. Direct markets have over double the risk when acting alone, as opposed to the much lower exposure when acting with re-insurance resources. Yet, the Act excludes re-insurance policies, thus not protecting the latter's $125 billion surplus for future losses.

Market pressures already in play have put a few companies on a negative rating or credit watch as a direct result of the magnitude of their September 11th payments and/or future risk. While the primary, umbrella, and excess carriers in all lines responded admirably to the losses, few carriers can stay solvent, let alone have sufficient cash, if called upon to respond fully but alone to terrorist-caused losses after 2005, when the Act's protections ends (recall that it is a three-year temporary program).

The Threat to Exclude Terrorism Coverage

One of the major obstacles to continued, let alone expanded, terrorism coverage is the prospective threat of many re-insurers to refuse to "follow the fortunes" of their direct market policyholders for this specific terrorism risk. Re-insurers are considering adding war or terrorism risk limit caps or outright exclusions to their treaties and facultative contracts to reduce or deny future terrorist claims. The Terrorism Risk Insurance Act may well force them to do so, since it provides no protection for their policy losses. Without continued re-insurance, the direct market must act to exclude this risk—which it can no longer do—or obtain enough premium to remain solvent, should it have to cover terrorism's losses. This will serve to: drive premiums even higher; leave some insureds uncovered, if they cannot pay the federal surcharge; and perpetuate the instability in the market place the Act was intended to reduce, if not eliminate.

The Multi-Nation Program proposes to cover re-insurers and thus to reduce the premium burden on insureds, especially those who must otherwise "go bare" at higher rates.

Increased Insurance Premiums

The premium market had begun to "stiffen" about a year before the attack on the World Trade Center, generally raising policy pricing for the first time in ten years. In the absence of a specific terrorist exclusion in most direct market policies, premiums increased again after September 11th from as little as 10 to 20 percent, to nearly 200 percent, depending on the line of coverage and the perceived terrorism risk.

Under the new Act, the market must charge a separate terrorism cover premium of as much as three percent. Such an approach is viewed by most analysts as not being successful in the general, as opposed to the specialty, lines markets. The Multi-Nation Program, therefore, relies on the general premium mechanisms now in place for all risk policies. The "rule of large numbers" should serve to keep the general premiums in all lines at a level below that which will result from the Act's reliance on a separate three percent surcharge. Moreover, Program general premiums ought not to be exacerbated like those under the Act because the former will cover re-insurers.

The larger commercial property owners, lessors, and businesses with significant terrorist exposures are either facing huge premium increases and/or reduced limits under the Act, even assuming their specialty policies are available. This has a direct and adverse impact on the nation's economy. The Terrorism Risk Insurance Act was drafted to address this problem, but it will have only a limited impact on owners or builders of large complexes in major metropolitan areas. Each one of these buildings can have a total risk of anywhere from $100 million to $1 billion. The Act does not appear to have successfully addressed this part of the market. The Act provides only a $100 billion per event and aggregate limit per year, while the Program does fully cover these special risks because it triples the government tier cap to $300 plus billion, has a U.N. Fund tier above that cover, and includes re-insurance losses.

Under the Act, specialty carriers will have to increase premium, raise deductibles, and offer lower limits for this protection. The un-insurability of most of these large risks will continue to prevent the building, sale, transfer, or leasing of these properties almost across the board.

Covering Terror Losses Through a Government-Private Insurer Partnership

The underwriting principles for political risk coverage prove the viability of the proposed Multi-Nation Specific Peril Terrorism Coverage Program and can easily be adapted to create its governmental and U.N. Fund layers. Currently, private insurers and governments, separately or as partners, provide property line political risk insurance. A $50 million political risk specific peril property policy can cost from $500,000 to $2 million per year, compared to $50,000 to $200,000 for a traditional all risk property line policy. Using a "country risk" analysis, premium is calculated based upon the potential for corruption, civil unrest, revolutionary upheaval, civil wars, and other untoward political events that may seek to or actually shift the balance of power in a given nation. This analysis is then applied to an evaluation of the economic role played by a business seeking such protection in a given nation.

The question asked by underwriters is whether or to what extent the potential insured is a target for terrorist acts in this particular geopolitical context. This risk is then quantified, a premium is set, and coverage is put in place. Companies offering this coverage include Chubb, AIG, and Lloyds of London. Several European governments, as well as the World Bank, offer similar protections.

Other government-sponsored covers serve as additional underwriting models for the proposed Program. In the United Kingdom, Pool Re provides re-insurance coverage for losses that arise out of IRA terrorism no longer met by the international re-insurance market. Pool Re also provides limited primary and excess terrorism coverage. The government of the U.K. acts as the insurer of last resort to protect the assets of the re-insurance pool itself. In Spain, Consorcio de Compensacion de Seguros (CCS) is a governmental insurance facility that protects against terrorism as well as earthquakes, volcanic eruptions, floods, storms, and civil commotion. CCS is a partnership program, combining government funds with those of private sector carriers that collect premium on behalf of CCS. The South African Special Risk Insurance Association covers certain political risks. In Israel the Property Tax and Compensation Fund (PTCF) has been created to cover property losses arising from war and like events. Coverage for "politically motivated violence" and terrorists acts, excluded from private policies, is offered through the PTCF. A catastrophe loss re-insurance mechanism is also in place in the PTCF program.

The Role of Government in the Proposed Program

Sovereign states have the ability to act directly to prevent terrorist attacks. Interestingly enough, this is also a classic insurance role. The *sine qua non* of property and casualty carriers has always been "loss control." Carriers supply loss control experts who "walk the plant" of a given insured to find first-party and/or third-party coverage hazards that, if eliminated, prevent loss, lower the insured's risk, and reduce its premium rates. Only sovereigns can "walk the global plant" to find and eliminate terrorists. Thus, participating governments alone can play the critical loss control role in this Multi-Nation Program—prevention of or reduction in terrorist injury and destruction. Neither insurers nor insureds are equipped to perform this role, though they, and indeed all sectors of society, must do their part.

The second role of any government in the Program arises from its infrastructure, *i.e.*, its power to tax and its liquidity. Governments can respond to terrorist losses not covered by the private tier with cash payments on a scale not possible in the private sector. The insurance community's capital and private market investment capacity, as well as its claims handling expertise, when paired with the financial resources of government, can ensure an economically sound Program.

A governmental "guaranty fund," whose sole function is to "back-stop" any private insurer in the Program whose demise can be traced to terrorist caused losses, would be a third and most appropriate role for a sovereign to play. While the Terrorism Risk Insurance Act will permit the United States Government to perform the first two roles, it fails to address this critical function.

Some argue that governments should assume this entire risk alone, but most sovereigns are ill prepared or equipped to handle claims or manage their defense. The insurance community is the more capable partner for that task. Its claims handling mechanisms are in place and fully funded. Government claims handling would have to be created anew to respond to this kind of loss. This is neither efficient nor practical. The Act did not make this mistake. However, the Act's claims oversight powers, vested by law in the Secretary of the Treasury, raise troubling questions on this score.

Several pitfalls must be avoided when

creating governmental tiers of coverage under the proposed Multi-Nation Program, including at least the following:

- Degeneration of a governmental tier into an anti-market "bailout."
- Delays in Program implementation due to renewed debates over tort and litigation reforms. Just as the Act tabled these issues, when they are addressed, any resulting solutions can be applied to the Program.
- Delays due to the question of a national regulatory scheme for this new cover, standing separate and apart from the current 52 Regulatory Jurisdictions. As in the Act, these questions should be addressed later.
- Exorbitant government fees that often attend catastrophic loss claims handling indemnity payments. To avoid these, the Act and the Program ask the private sector to control actual claimant payments from the government tier.

The Program's Partnership of Nations

As a key component of the proposed Multi-Nation Program, the United Nations Fund ought to be created in a manner that is instantly compatible with the existing infrastructures of participating governments and carriers. Any attempt by the U.N. (or any sovereign, for that matter) to make major and/or immediate private or public tier infrastructure changes or to implement the Program "from the top down" will only serve to delay, if not derail, the proposal. The governance and operation mechanisms of the various national programs and the U.N. Fund need not disrupt any existing commercial, public, or civil justice systems. Instead, the Program elements should be created and administered in harmony with the existing geopolitical and economic realities of the participating partners. Implementation should proceed based on cooperation and responsible participation by each partner, using its existing, but independent, infrastructures and economics. The Terrorism Risk Insurance Act adopts this core principle at the federal tier of its proposed solution, but fails to take the multi-nation step so critical in the global fight against terror.

Program Limits, Layer Attachment Points, and Funding Mechanisms

The proposed Multi-Nation Program would require, by law, coordinated and fair per event and aggregate limits. For example, these limits could jointly or severally be safely fixed at or below 10 percent of a given carrier's annual insurance surplus or premium collections. All companies could remain economically viable and competitive at the selected percentage levels because the risk of insolvency would be quite low. Moreover, the use of these percentages will make it impossible for one company to manipulate a relevant market advantage by "scamming" the Program through an anticompetitive diversion of extra risk to higher-level carriers in the private or government tiers. The Act relies on a similar percentage share approach.

The insurance community can neither be unprepared for the massive losses attendant to terrorist attacks nor be put in a position of paying for losses that it never agreed and planned to cover.

A given sovereign's per event and/or aggregate limit for its program's governmental tier could likewise be based on a coordinated, fair, and objective figure, such as total policy surplus or total annual premiums of all carrier participants in the Program for that country. In the United States, this would mean a governmental tier of approximately $300 billion, if based on total policy surplus, or $300–400 billion, if based on total annual premiums. In the alternative, a set percentage of each nation's gross domestic product could serve as the limit. The Act provides less than $100 billion for each of its three years. This is not adequate, especially when one considers the absence of reinsurance coverage from the Act.

The U.N. Fund tier's actual dollar attachment point would, of necessity, be different for each participating nation, because it would be based on a set percentage of a given nation's gross domestic product, total insurance surpluses, or total insurance premiums. A loss call for a given claim that attached the U.N. Fund tier would be paid on a "share" contribution basis by all member sovereign states. A nation's share would be computed by using its gross domestic product percentage, total insurance surplus, or total insurance premium dollar figure as the numerator, and the total of all the participating nations' like dollar figures as the denominator. It should not be difficult to further adjust the resulting nation's share dollar amount by using a "country risk analysis factor" based on underwriting principles developed and proven in political risk property loss covers over the past few years, if desired and appropriate.

For any given loss, each sovereign's U.N. Fund share would thus be determined by classic market forces and geopolitical realities relevant to that nation's terrorist risk. Because contributions would be paid on a case-by-case basis, premiums would be unnecessary. Contributions to pay the administrative expenses of the U.N. Fund could likewise be based on an annual sovereign share assessment.

Funding for the Multi-Nation Program's private sector layers of primary, umbrella, and excess cover would, as noted above, come from general all risk premiums and would not be separately rated or paid. A sovereign's treasury and surplus, not premium collected from Program insureds, would fund a government's Program obligations. Likewise, no premium would be paid to the U.N. Fund. This third tier of cover would be financed, as needed, by participating sovereigns using the above noted share system to respond to a given loss.

Unlike the Act, the Program's elimination of private premium payments to a given sovereign or to the U.N. Fund keeps these dollars in the private marketplace. If separate Program premiums are paid to a government (three percent under the Act) or to the U.N. Fund by insureds, demands therefore would be unrelenting and government/U.N. collected premiums soon would be argued by many to be government/U.N. "surplus revenue." Monies designed to protect against catastrophic loss might well be diverted to pay for budget deficits, programs, entitlements, grants, and the like. Attempts might also be made to divert premiums to rebuild public infrastructures, rather than to protect the businesses and the people who paid them and who are directly impacted by a terrorist attack. The lack of premium accumulation at either the government or the U.N. layers will eliminate any potential for this result and keep private dollars in the private sector, where they can stimulate the economy and, in turn, fund the public layers of the Program.

Underwriting Principles for Specific Peril Terrorism Coverage

The drafting and imposition of uniform policy provisions for the proposed Multi-Nation Program's separate sections or endorsements is neither practical nor necessary. Endless time-consuming debates over the superiority of one provision over another must be avoided. Nations and carriers need only agree on the scope of the grant of coverage, *i.e.*, the specific perils insured. Otherwise, nations and/or carriers could vary the losses covered and "lay off" risk on other higher-level layers or tiers. Financial stability for this cover does require, however, at the very least, a uniform starting point—the scope of the perils covered—but not more.

Unlike the Terrorism Risk Insurance Act, the Program envisions that the relevant existing all risk policies in all lines will add a stand-alone section or an endorsement to provide the proposed insurance. The grant of coverage provision that serves as the core of the Program should define a terrorist loss by reference to both the consequences and the purposes of the act that produces it. Following is a proposed specific peril coverage grant, adaptable for *first party* or *third party* policies:

> Protection is hereby afforded for [the insured's *direct losses* (*first part*) or, *damages imposed by law* (*third party*)] arising solely from a Terrorist Act. A "Terrorist Act" means: bodily injury, death, tangible or intangible property damage and/or the interruption, disablement or destruction of personal, business, or governmental affairs, operations, and/or infrastructures, all as are further specified herein, that are caused, aided or abetted by an individual, a group of individuals, and/or a sovereign state, in order to, or attempt to, coerce individuals, entities, or governments and/ or to coerce, influence, disrupt, or eliminate a nation's economic stability, its citizens' conduct, its business or governmental operations or infrastructures and/or its political policy positions and doctrines, whether such a result directly attends or simply arises from such an event.

Short of armed force by a free people, the proposed Program is one of the most effective financial weapons available to directly combat fear, build a sense of trust and security, and protect society from the acts of terrorists.

The specific losses and other necessary provisions of a Program policy section or endorsement that serve to define, limit, and implement the coverage grant need not be uniform initially, but must, at the outset of drafting, be governed by the scope of the grant and two core principles. First, these provisions must take into account the existing infrastructures and historical roles of all three Program partners, so as to not "re-create" the way each tier will function. Second, these provisions should be developed through a cooperative but independent effort by the various participating carriers, working separately but with traditional drafting and regulatory entities (see *infra*). Over time, classic market forces, loss experience, and participant cooperation will result in the evolution of fairly uniform provisions for a Specific Peril Terrorism section or endorsement.

Drafting the Program's Coverage Provisions

The least disruptive way to establish the Program is to provide its coverage either as a separate section or as an endorsement in current all risk policies in all relevant lines. Care must be taken to ensure that the language of the existing all risk coverage grants in each policy in each line clearly exclude the protections provided by the Program. Moreover, the language of the all risk policy's and of the Program's provisions must not be susceptible to arguments of ambiguity between or within either coverage grant.

Each company will, of necessity, initially develop its own Program provisions. In the United States, these provisions will be approved in each of the 52 Regulatory Jurisdictions that currently, and under the Act, govern U.S. policyholder and carrier rights and obligations. However, nothing need preclude cooperation and coordination in the drafting of these new provisions. Traditional drafting entities such as Insurance Services Office, the National Association of Insurance Commissioners, and senior insurance professionals and coverage counsel should work together to draft the provisions that support the agreed upon specific perils that define the ultimately adopted grant of coverage.

Thus, the sections or endorsements in private sector primary, umbrella, and excess layer policies in the Program's first tier would not start out as uniform products. Instead, market pressures, loss experience, and cooperation would lead to a standard provision approach nationally and, eventually, internationally. This is an important goal of the Program, as consistent application of policies to claimed losses in every sovereign nation is essential.

The underwriting decisions that drive the drafting of Program policy language need not be directed in any way by governments or the United Nations. These public layers of cover will simply "sign on" to market-created private sector policies at the appropriate attachment points. Thus, the public sector tiers will pay claims for an individual loss, as determined solely by the scope of coverage and the provisions of the Program's policies. In short, market forces in each sovereign state shape the underwriting of the private layers, to which the public government and U.N. Fund tiers simply follow form.

Preventing Past Distortions of Underwriting Intent

Many United States court decisions in the 1980s and 1990s distorted casualty line policy language and/or simply rewrote the underwriting intent of this coverage. These opinions created insurance for asbestos, toxic tort, and environmental losses where none in fact had ever existed or was intended. This, in turn, led to the bankruptcy of many insurance companies that did not have the resources to cover risks never underwritten.

The insurance community can neither be unprepared for the massive losses attendant to terrorist attacks nor be put in a position of paying for losses that it never agreed and planned to cover. To protect the financial security of the tripartite partnership, in general, and the solvency of the private sector layers of coverage, in particular, care must be taken to provide that:

- Appropriate single event and aggregate limits are created at every attachment point for every partner in every private layer and public tier in the Program.
- The time limits in which claims can be made are clearly defined, *i.e.*, policy-based statutes of limitation.
- Policy forms specify the exact period of time that is to transpire between "events" and how these periods are to be measured.
- Only one policy period is triggered for any one event, with no multiple policy period losses, *i.e.*, no "continuous" or "double/triple/multiple triggers."
- The two or more Program policies, triggered in one period by one event, cannot be "stacked" for a given loss so that congruent coverages result in multiple tier limits.
- Numerous losses resulting from a single event cannot be interpreted as multiple events, thus attaching a single "limit" to each event.
- Business and infrastructure loss and interruption perils must specify the physical and intangible losses covered, define and limit any loss of gross earnings that results from interruption of or interference with operations, and be clearly defined and limited.
- Coverage for intangible property damage, such as a loss of suppliers, clients, customers, other disruptions in commercial life, and replacement for losses of electronic equipment, furniture, business documents, and data have separate limits.
- Separate Program limits are stated for biological, chemical, or nuclear attacks. Moreover, these special caps will have to be re-insured by the government and U.N. Fund layers, until such time as private reinsurance includes this particular cover.

Program exclusions should address at least the following issues:

- Misrepresentations to underwriters.
- Losses caused intentionally by a third-party claimant or an insured.
- Fraud and collusion.
- Non-terrorist related criminal acts (only criminal acts that specifically meet the definition of a terrorist act would be covered).
- Losses flowing from a "credible terrorist threat warning" by government officials or agencies. Significant problems of proof arise for damages flowing from a threat warning. For example, does each credible threat warning constitute a separate event? How does one compensate for, let alone verify, "threat defense" as opposed to usual and customary "preparation expenses?"
- Replacement damages. All such losses should be subject to "set-offs" based upon residual or already amortized property values in place at the time of the loss.

Limitations on Punitive Awards

Bad faith, treble, exemplary, or other like extraordinary damages ("punitive awards") present difficult questions. United States courts have been incredibly unsuccessful in bringing rhyme or reason to the imposition of punitive awards, which are supposed to deter horrific acts by carriers, not provide unjustified and exorbitant windfalls to such claimants and their counsel.

To the extent that punitive awards are requested by claimants as against an alleged insured tortfeasor, public policy should and generally does bar coverage of such damages by insurance. These awards ought to flow only from a wanton and/or willful, if not intentional, disregard for life and property. Why protect and thus encourage such conduct by providing insurance for it? Punitive awards against insureds should not be part of the Program.

However, policyholders may also demand that punitive awards be available against a Program carrier, participating government, or the U.N. Fund for "failure to honor a claim" or "for claims handling or coverage litigation misconduct" and similar claims. The Program should permit a punitive award against partners only for actual fraud or intentional deceit. No punitive awards should be available for or arise from the conduct of coverage litigation or claims handling errors or problems. The threat of punitive awards for this and other perceived wrongs serves mainly to cripple traditional defense advocacy, to hamper and/or outright inhibit a carrier's assertion of its positions on legal issues or factual questions, and to create an unfair litigation advantage for the policyholder's advocate, rather than to protect an aggrieved policyholder or to prevent like abuse in the future.

The losses expected in a terrorist event are on such a scale that there simply is not enough money to cover punitive awards or permit windfalls for error, mistake, neglect, and a difference of opinion on law or fact or improper advocacy. Existing lesser sanctions available to courts are sufficient to "punish and deter" such conduct. Neither courts nor regulatory agencies should be permitted to add other specific acts or general conduct categories that will permit a punitive damage award under the Program's "policies."

Protecting Carrier Solvency through Mandatory Risk Spreading

The Multi-Nation Program, unlike the Terrorism Risk Insurance Act, should be mandatory in the personal as well as in the property and

continued on page 51

ages. One manufacturer of heavy equipment justifies its extensive and costly safety program on the belief that no jury will ever make an award of punitive damages against it.

As companies better organize themselves for the world-wide challenges of providing safe products, the bar will be raised. Companies who do not follow the lead will be at great risk of further product safety, product liability, and regulatory problems, in the United States, in Europe, and in other foreign countries. The techniques are well-known; the difficult part is to analyze what is appropriate and then incorporate it into the company's organization, culture, and processes. Doing so should pay for itself, either by preventing future problems that could arise or giving the manufacturer a much better defense if accidents do occur. FD

A New Partnership, from page 15

casualty line all risk policies that traditionally have covered terrorist losses. If all policyholders pay a market-set general premium for both the all risk and the new specific covers to the private insurance community, the "rule of large numbers" should protect each carrier for the terrorist risk assumed. In this way, no single economic sector of society will be asked to unfairly subsidize another for coverage of this risk. The available specialty market terrorism coverage can continue as separate cover sold in parallel with other policies in the Program. Obviously, the general and specialty markets should coordinate their products and premiums within the Program.

Those who choose not to purchase Program policies in a given line of insurance or who do not receive some of the benefit of new coverage through their employment will not have this protection. Assuming an individual or business has a choice to use its resources to enter the Program, this is not an inequitable result. However, careful thought must be given to the critical question of how to protect persons or businesses with no ability to purchase Program policies because of limited financial resources. The Act fails to address this very real need, further exacerbated by its premium surcharge.

How do we ensure an adequate and complete safety net of insurance for all citizens? Once the Program is in place, each sovereign must respond to the question of equal access to the protections of the Program. Whatever the solution for this problem in insurance markets generally, it can likewise serve as the solution for Program policies. Implementation of the Program cannot await this resolution, but it is equally true that the debate on the solution not be delayed while the Program is put into place.

Program Dispute Resolution and Choice of Law Options

Existing federal and/or international law forums can handle disputes at the U.N. Fund tier, as is determined by the participating nations. The Terrorism Risk Insurance Act has placed U.S. claims in the federal civil justice system to end the problem of conflicting state court policy interpretations. However, the Act's reliance on traditional choice of law principles does not bode well for the goal of uniformity of decisions and policy interpretation. Careful consideration should be given to a federal law solution to ensure that the application of Program policies is consistent.

Whether underlying claim or policyholder disputes or litigation could all be handled in alternative dispute resolution forums presents an interesting option. ADR forums are usually more efficient and also have the benefit of specialized mediation and arbitration expertise that could well serve this high risk and complex array of claim and coverage disputes. ADR mechanisms and forums in each nation and in the international community have been proven fair, consistent, and economical. ADR could, in fact, become the sole forum for all disputes, once the Program is up and running.

It would be essential, however, to include the traditional basic protections of the civil justice system in any ADR mechanism. These safeguards include: evidentiary and procedural standards and rules; formal discovery; formal briefing; written findings by the arbitrator based on the applicable law; and the same rights and mechanisms of appeal available to litigants in the public civil justice system. All ADR forums should be open to the public.

Conclusion

Private sector insurance performs an essential function in free societies because it supports, in great measure, the sovereign's civil justice systems. It is insurance that more often than not pays the settlement or the award that makes the plaintiff whole (while paying the plaintiff's lawyer), and insurance that pays the defendant's attorney and protects the insured from loss. In a very real sense, most citizens and businesses would not have access to or the protections of a civil justice system without the presence of a viable insurance community.

The continued viability of this critical infrastructure requires that carriers in the various nations of the world not be called upon to bear an unrealistic or destructive share of terrorism losses. The governments in each nation should bear their fair share of this risk—that which is above and cannot be covered by the private sector. Governments are also equipped to share this risk on an international basis when necessary. Sovereigns can mandate a terrorism insurance program in harmony with their existing financial, governmental, and civil justice systems. They can and ought also provide protections to the private re-insurance community's terrorist loss market, so it too can be stabilized and have a playing field level with its direct carrier insureds.

It is folly to plan to muster one's full economic forces after the next attack. This is a worldwide risk that should be spread among each nation in the international community. Short of armed force by a free people, the proposed Multi-Nation Specific Peril Terrorism Coverage Program described in this article is one of the most effective financial weapons available to directly combat fear, build a sense of trust and security, and protect society from the acts of terrorists. The time to engage in the debate on this proposal is now, before the valuable window created by the Terrorism Risk Insurance Act closes. FD

Writers Corner, from page 49

as a verb meaning "to bring about, accomplish."

- The ruling did not affect him.
- The ruling had no effect.
- The ruling effected a change in the law.

Imply/Infer

Imply means "to suggest," while *infer* means "to deduce."

- From the legislative history, the court inferred Congress's intent.
- The legislative history implies that Congress meant something else.

Of course, the preceding list merely scratches the surface. For more complete treatment, consult any of Bryan Garner's books, such as *The Redbook, A Manual on Legal Style*. FD