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SOME REINSURANCE PERSPECTIVES ON COVID-19

Abstract

Impact of the September 15, 2020 FCA test case on the reinsurance market; discussion of the issues of aggregation & the follow the settlement provisions in light of the coverage issues generated by the Covid-19 pandemic

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One hundred years after the Spanish flu pandemic, Marsh and Munich Re, in May 2018, launched an innovative parametric insurance product, PathogenRX. This provided insurance against business interruption caused by a pandemic. In October 2018, Marsh presciently observed in a paper entitled "Pandemic Readiness: Risk Finance and Mitigation Strategies":[1]

> *"Although recent pandemics and epidemics have been deadly, the mortality rates from these outbreaks are generally far lower than health crises of the past, owing in large part to advances in medicine and infrastructure. Yet the potential economic impacts of today's health crisis can be far greater in scope than earlier ones. The increasing reliance of businesses on technology, frequent and unrestricted travel, and far-reaching supply chains means that an outbreak in a single country can have global repercussions. The World Bank estimates that the cost of a severe flu pandemic could total as much as 5% of global GDP".*

Nevertheless, not a single policy was sold prior to the Covid-19 pandemic.

Looking to the future, the "Pandemic Re" steering group was launched in April this year to develop a public/ private risk financing mechanism for future pandemics. Chaired by Stephen Catlin, there are six working groups aiming to create a company along the lines of Pool Re, which applied a similar approach to terrorist risk. The concept has attracted widespread support in the industry. Members of the group include the CEOs of Aon UK, Marsh, Aviva, RSA, Pool Re, Willis Re, the Chairman of the Association of British Insurers (Jon Dye, CEO of Allianz Insurance) and former Home Secretary, Amber Rudd. Michael Dawson (of Nuclear Insurance), Chairman of the Project Committee, has commented:[2]

> *"We have a significant task ahead although we have received enormous levels of industry support. The insurance industry is collaborative by nature and with this highly experienced group, we hope to be able to deliver a structure in a relatively short time frame."*

However, for the present, those suffering losses from Covid-19 have to look at their traditional insurance policies for indemnity, if and to the extent that they provide cover. Insurers have been wary of providing pandemic cover, largely because of the scale of losses that might arise over multiple classes of business. As most direct insurances were not issued with pandemic cover in mind, most reinsurances were not designed and rated to cover them either.

In the USA, legislation has been proposed in a number of States that would require insurers to cover business interruption losses even when the policy only provides such cover (as do many UK policies) consequent upon physical damage. It is also reported that both the New York Mayor and the New Orleans Mayor have inserted language in their civil shutdown orders, stating that the Coronavirus outbreak is causing property damage (presumably in the full knowledge that under many business interruption wordings, indemnity will only be triggered if there is damage to property). A wave of litigation is expected, and indeed is underway in the USA, Canada and elsewhere. In Germany, the Regional Court of Mannheim ruled on April 29, 2020[3] that a primary property policy with business interruption covering losses caused in the event a competent authority closed down the insured business due to notifiable diseases or pathogens listed in the

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[1] Available on the Marsh & McLennan Companies website, last accessed October 21, 2020 https://www.mmc.com/insights/publications/2018/oct/pandemic-readiness.html

[2] As reported by Libatique, Roxanne, *Pandemic Re Steering Group Establishes Project Committee,* June 1, 2020, Insurance Business UK, https://www.insurancebusinessmag.com/uk/news/breaking-news/pandemic-re-steering-group-establishes-project-committee-223906.aspx, last accessed, October 21, 2020.

[3] Case No. 11 0 66/20, summarized in https://cgpa-europe.lu/wp-content/uploads/2020/05/In-France-and-Germany-two-first-court-decisions-on-Business-Interruption-insurance-and-Covid-19-are-shaking-up-the-insurance-industry.pdf (last accessed October 21, 2020).

Infection Protection Act (IfSG) applied to a case of voluntary closure. That Court reasoned that Covid-19 was a notifiable disease and the measures to control its spread resulted in *de facto* closure. In France, a business interruption claim on wording similar to that considered in Germany resulted in an interim indemnity payment when all dine-in services were prohibited by the central French government.[4]

The FCA Test Case: Financial Conduct Authority v Arch Insurance (UK) Ltd & Others [2020] EWHC 2448 (Comm))

In England, the Financial Market Test Case Scheme has, for the first time, been utilised by the Regulator (the Financial Conduct Authority – "FCA"), to endeavour to resolve uncertainty as to how various common provisions relating to business interruption cover should be applied in relation to Covid-19 claims. Insurers participating as Defendants in the test case were Arch Insurance (UK) Limited, Argenta Syndicate Management, Ecclesiastical Insurance Office, Hiscox Insurance Company, MS Amlin Underwriting, QBE, Royal & Sun Alliance Insurance and Zurich. In addition, there were two interveners: Hospitality Insurance Croup Action and Hiscox Action Group (both representing policyholders).

The 165-page judgment of a strong, two Judge, Court was handed down on 15 September 2020).[5] Although it relates to direct insurances, it is important to review it as its effect feeds through to the reinsurance market. The first thing to emphasise is that the case did not concern whether a policy that, on its face, provides business interruption cover only where there has been physical damage to property, can respond in the absence of such damage. Nor does it deal with policies that do not have a disease clause or a denial of access clause.

However, in a judgment dated 15 October 2020, the Commercial Court granted summary judgment to insurers against a café owner insured under a standard form business interruption policy, written on an "all risks" basis.[6] That Court held that the enforced closure and loss of use of the café did not constitute an insured "loss of property". It held that the policy does not respond to a mere temporary loss of use and is only triggered by the physical loss of property. The case confirms that, even in a case of "all risks" cover, conventional principles of contract interpretation should not be adapted or relaxed in response to the Covid-19 pandemic. On this basis, conventional damage-based business interruption wordings will not normally respond to Covid-19 losses.[7]

The FCA Test related to policies which provide BI cover in the event of disease and/or denial of access. Although I would commend the attached summaries of the judgment and its background, I will attempt a cursory run through some of the key findings for current purposes, as follows:

1. **Causation:** Insurers submitted that there was no cover as the loss had been caused by independent concurrent causes (relying on *Wayne Tank & Pump Co Ltd v Employers Liability Assurance*[8])' but the Court found that however many proximate causes there were, they were all insured. The proximate

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[4] *SAS Maison Rosang v. SA AXA France IARF,* Paris Commercial Court, (Tribunal de Commerce de Paris), May 22, 2020

[5] *The Financial Conduct Authority v Arch Insurance & Others,* [2020] EWHC 2448 (Comm). The full judgment can be found at https://www.bailii.org/cgibin/format.cgi?doc=/ew/cases/EWHC/Comm/2020/2448.htm, last accessed October 21, 2020/

[6] *TKC London Ltd v Allianz Insurance plc,* [2020] EWHC 2710 (Comm). The full judgment can be found at https://7kbw.co.uk/wp-content/uploads/2020/10/TKC-v-Allianz-judgment-151020.pdf, last accessed October 21, 2020.

[7] Contrary to *TKC London Ltd*., on October 21, 2020, the State of North Carolina General Court of Justice for the County of Durham rendered its decision in *North State Deli LLC et al. v. The Cincinnati Insurance Co. et al.*, case number 20-CVS-02569, stating that under the policies' "ordinary meaning," plaintiffs suffered a direct physical loss when they "were expressly forbidden by government decree" from accessing their property."

[8] [1975] QB 57.

cause of the business interruption was the composite peril of the business interruption following the occurrence of a notifiable disease, of which the individual outbreaks form indivisible parts, or, alternatively, each of the individual occurrences was a separate but effective cause of the national actions taken in response to the pandemic.

Certain sample policy wordings included a requirement that the business interruption or interference should "*follow*" the occurrence of disease. The Court found that the word "*follow*" in this context suggested a looser causal connection than proximate causation.

2. **Prevention of Access Clauses:** Where (i) an incident causes (ii) a competent authority to (iii) take action which (iv) prevents access to the insured's business premises, cover will depend on the precise policy wording. The Court addressed the specific terms in the policies before it:

   (a) **The incident:** Where the causative incident is defined, for example as an *"emergency in the vicinity", "danger or disturbance in the vicinity*", "*injury in the vicinity*" or *"incident Within 1 mile/ the vicinity*", it requires specific incidences happening at a particular time, and in the local area. This contrasts with the Court's interpretation of the term *"vicinity"* in disease clauses (see below). On this basis, the restrictions imposed by the relevant authority would have to be in response to a local occurrence of the disease.

   (b) **The Competent Authority:** *"Competent local authority"* means whichever authority was competent to impose the relevant restrictions in the locality on the use of the premises, and includes central government.

   (c) **The Government Actions:** Initial announcements by the Government were characterised as advice, rather than mandatory instructions, thus only potentially engaging clauses with "*advice*" wordings. On the other hand, it was held that *"action"* or an *"order"* which "*prevents access"* or restrictions which are "*imposed*' required the steps taken to have the force of law.

   There are seven categories of business referred to (set out at paragraph 53 of the judgment). To determine whether certain Government action may trigger cover, regard must be had to the precise terms of the policy wording and the actual effect of the Regulations on the specific insured business.

   (d) **Prevention of Access:** The precise terms of the prevention of access clauses differed across the sample wordings analysed by the Court. The Court found that *"inability to use"* premises meant what it said and was not to be equated with *"hindrance"* or "*disruption"* to normal use. There would not necessarily be an inability to use premises simply because an insured could not use all of the premises, nor by reason of any and every departure from normal use. The restrictions imposed did not have to be specifically directed at the insured or the insured's use of the premises.

   The word "*prevention"*, denotes impossibility. However, generally, actual physical prevention of access was not required; the insured had to demonstrate that there had been a closure of the premises for the purposes of carrying on the business or at least a fundamental change in the use of the premises. On the other hand, *"hindrance"* was found to denote a difficulty in the use/access of the insured premises but not impossibility.

   The Court also considered the interpretation of the term *"interruption"*, finding that this generally extends beyond complete cessation of the business so as to include disruption and interferences with the business (for example, if a restaurant was required to close but could still provide an existing takeaway service, this would amount to an "*interruption*" of the business because, whilst there was not a complete cessation, there was a disruption to the business). By way of exception, where the policy referred to *"interruption to your business caused by an incident"*, these words must bear their strict meaning of cessation.

3. **Disease Clauses:** Cover under this type of policy extension is generally triggered by the occurrence of a notifiable disease (which includes Covid-19) within a prescribed proximity to the insured business. Insurers submitted that as the UK Government's actions were not caused by a localised incident or occurrence, but were a result of the nationwide epidemic, these polices would not respond; actions outside the prescribed proximity that caused the closure of the insured business would not fall within the remit of an insured peril.

   The Court disagreed. Cover is triggered by a national response to the widespread outbreak of a disease. By their nature, notifiable diseases are likely to require such a national response. Cover is not limited to outbreaks wholly within the defined area. Infectious diseases spread with no regard to policy areas. If the insured can demonstrate that the wider outbreak of the disease extended within any specified radius, cover will be triggered.

   (a) **"Vicinity":** Where the covered area was described as the *"vicinity"*, defined as: "*an area surrounding or adjacent to an Insured Location in which events that occur within such area would reasonably be expected to have an impact on an Insured or the Insured's Business",* all occurrences of Covid-19 in England and Wales were considered to be within the relevant "*vicinity*". It would be difficult, if not impossible, to show that the local outbreak made a difference to the authorities' response. The argument that causality could not be proven in these circumstances would lead to the result that there would effectively not be any cover; a result which the Court considered would be anomalous.

   (b) **"Incident" or "event"** In two policy wording samples, QBE provided cover for *"loss resulting from interruption of or interference with the business ... in consequence of"* specific matters identified as *"events".* It was held that, under these clauses, cover was limited to matters occurring at a particular time, in a particular place and in a particular way. The Court referred to the dictum of Lord Mustill in *Axa Reinsurance v Field*[9] as to the meaning of *"event".* This intention was emphasised by the fact that the wording in QBE 3 covered a relatively small radius of only 1 mile, which the Court found to indicate that the parties had contemplated cover to be for specific, localised events. The Court found that, in relation to the sample policy wording referred to as the Hiscox NDDA clause, the term "*incident*" should be given the same essential meaning as "*event*".

   Therefore, insureds with these policy wordings would be required to demonstrate a case of Covid-19 within the prescribed radius of the insured business which caused the business interruption. If there were occurrences of the disease at different times and/or different places then these would not constitute the same "event" or "incident".

   (c) **"Occurrence" or "manifestation":** In wordings requiring an *"occurrence"* of the disease, a person within the specified radius must have been suffering from the disease, but did not have to be diagnosed. Conversely, the term *"manifestation"* required a diagnosed case of the disease.

   (d) **Hybrid clauses:** Certain policy wordings used by Hiscox and RSA combined the requirements for an occurrence of a notifiable disease and the inability to use the insured businesses due to the resulting local authority restrictions. The insurers' argument that only local outbreaks were covered was rejected, whereas the prevention of access wordings were interpreted narrowly so as to be triggered by the imposition of a mandatory restriction (as opposed to guidance).

   (e) **"Trends" clauses:** Under a "trends" clause, the indemnifiable BI loss is the difference between the profits which would have been made had the insured peril not occurred (the

9 [1996] 1 WLR 1026 at 1035

"counterfactual"), and the actual profits. Insurers relied on *Orient Express Hotels v Assicurazioni Generali SpA [2010] EWHC 1186 (Comm),* in which a New Orleans hotel was subjected to curfew in anticipation of a hurricane. The hotel and much of the city was badly damaged, forcing several months' closure. The Court construed the insured peril as limited to damage to the hotel, and the counterfactual therefore had to take account of effects on its business (as if it had been undamaged) of being located in the otherwise hurricane-damaged and evacuated city. As the hotel would have suffered the loss as a result of this anyway, losses were reduced to nil.

Insurers in the test case sought to equate the wider effects of the pandemic with the wider effects of the hurricane. However, the Court's finding (see above) that the insured peril was a composite one, meant that it could distinguish *Orient Hotels*. Nevertheless, the Court commented that had it been necessary to do so, it would have overturned *Orient Hotels*. The effects of this aspect of the judgment on the quantum of reinsured claims stretches well beyond claims relating to Covid-19.

The effect of the Court's construction of the various clauses under review is that many claims that were asserted by insurers not to be covered, actually are. Hence, the case has generally been hailed as a victory for insureds. However, both sides have been given leave to appeal. Normally, appeal from the High Court is to the Court of Appeal, but particularly important and urgent cases can be certified for a "leap-frog" appeal, direct to the Supreme Court, which is what has happened. The appeal will therefore be heard by the Supreme Court. However, two of the insurers, Zurich and Ecclesiastical, who were involved at the High Court level are not appealing, as they have stated that the court found in their favour. RSA is not appealing the decisions relating to certain of their clauses that were under consideration. QIC Europe, part of Qatar Insurance Company, failed in an 11th-hour bid to join the proceedings.[10]

Reinsurance Issues

Insurers' accumulation of losses is, of course, one of the driving forces behind reinsurance. Inevitably, insurers who agree claims[11]will look to their reinsurance programme for recovery. The question arises as to the extent to which reinsurance will provide cover for Covid-19 claims paid by insurers. According to the September 8, 2020 Standard & Poor report,[12] the top 20 global reinsurers had reported about $12 billion in Covid-19 losses. They forecast that cohort would generate a combined ratio of 103%-108% in 2020 and 97%-101% in 2021, with a return on equity (RoE) of 0%-3% and 5%-8% respectively. They consider sector capitalisation to be robust. In life reinsurance, they consider that the higher mortality losses are manageable. Put at its most basic, the pandemic losses whilst very high, are not considered to represent an existential threat.

When considering the basis on which reinsurance cover will apply, problems familiar to reinsurers arise, but applied to these new circumstances; issues of whether reinsurers have to follow their reinsured's settlement and of aggregation of claims. Of course, as ever, the application of each reinsurance contract to the circumstances of a claim will depend upon the particular wording of the contract and the particular facts involved. Without that information, it is not possible to be definitive. Even with it, that may be difficult! However, there are broad categories of common provisions, which constitute a good starting point for guidance.

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10 Gangcuangco, Terry, *FCA test case appeal-here's what you need to know*, October 5, 2020, Insurance Business UK, https://www.insurancebusinessmag.com/uk/news/breaking-news/fca-test-case-appeal--heres-what-you-need-to-know-235230.aspx, last accessed, October 21, 2020.

11 In other words, insurers who bring claims to a final determination.

12 Gharib, Taoufik et al *Black Swan Or Not, COVID-19 Is Disrupting Global Reinsurers' Profitability*, S&P Global, https://www.spglobal.com/ratings/en/research/articles/200908-black-swan-or-not-covid-19-is-disrupting-global-reinsurers-profitability-11639467, last accessed October 21, 2020.

1. Aggregation

Aggregation provisions in reinsurance contracts broadly fall into two categories; event based and cause based.

(a) **Event Based Clauses:** These provide for separately covered losses to be treated as a single loss by reference to the event, or occurrence, from which they arise. Typically, the clause will define a loss as *"each and every loss and/or occurrence and/or series of occurrences arising out of one event"* or similar wording. A clause may, for example, refer to *"each and every loss or series of losses arising out of one occurrence"*. In these examples, the unifying factor is the "event" or "occurrence". Both words appear commonly, and the Courts have concluded that, used as a unifying factor, they should be treated as synonymous, unless it is clear from the context that they are not intended to be (in this respect, the use of the word *"occurrence"* in the direct policies the subject of the FCA test case, is very different from its use in reinsurance aggregation, so comments of the Court on that are unlikely to be helpful).

In the absence of a specific "event" definition in the reinsurance contract wording, it is axiomatic that the starting point must be that the unifying factor must be something that can properly be called an event. Lord Mustill stated in *AXA Re v Field*[13] that:

> *"In ordinary speech, an event is something which happens at a particular time, at a particular place and in a particular way"*.

As seen above, Flaux LJ when considering the meaning of the words "incident" and "event" in the FCA Test Case, referred to Lord Mustill's words.

An event is therefore what has happened – not the reason it happened, which is the cause (as to which, more below). Lord Mustill's above comments were amplified in what has become known as the "unities test", first put forward in the "Dawsons Field" arbitration award, which the parties agreed to release into the public domain.[14] This award has been referred to in a number of Court judgments. The following words of the arbitrator, Mr Justice Kerr (who became Lord Justice Kerr), have been referred to in most aggregation cases since, so I make no apologies for the length of the quotation:

> "… [B]*oth sides gave numerous examples which would or would not in their view be regarded as loss or damage resulting from a single occurrence, such as damage resulting from an air raid, the losses of several ships in an attack on a convoy by a single submarine, a ship breaking loose from her moorings and colliding with a number of other ships, damage from an earthquake, or from the Fire of London, etc. etc. (the same examples were also used in the context of "arising out of one event"). On which side of the line each of these is to be placed depends in my view on the position in which the person who has to make the determination is placed and on the way in which he will therefore approach the question. The crews of a submarine and of ships which are attacked or sunk in a convoy would no doubt regard each attack and sinking as a separate*

[13] (1996) 2 Lloyd's Rep 233 (HL).

[14] In the month of September 1970, four aircraft bound for New York City and one for London, were hijacked by members of the Popular Front for the Liberation of Palestine (PFLP). Three of the aircraft were forced to land at Dawson's Field, located in a remote desert near Zarka, Jordan. Once the aircraft were emptied, the PFLP used explosives to destroy the empty planes. There was a total of 310 hostages, a majority of them freed on September 11, while 56 were kept in custody until September 30 in exchange for one of the hijackers and three PFLP members being held in a Swiss prison. The "Dawson's Field" award arose from a dispute between those who wrote the cover on two or more of the lost aircraft and their reinsurers over the interpretation of the aggregation provisions in the reinsurance contracts concerned. The award can be found at https://www.trans-lex.org/262110/_/-dawsons-field-and-cairo-excess-loss-reinsurances-april-1972/.

occurrence. An admiral at a naval headquarters might regard the whole attack and its results as one occurrence; an historian almost certainly would. An earthquake may have a number of tremors producing different damage at different times and in different places; the victims would no doubt regard each tremor as a separate occurrence, but others might not. Whether or not something which produces a plurality of loss or damage can properly be described as one occurrence therefore depends on the position and viewpoint of the observer and involves the question of degree of unity in relation to cause, locality, time and, if initiated by human action, the circumstances and purposes of the persons responsible."

Analysed strictly on the basis of the unities of cause, location, time and purpose (the latter only being applicable to the extent a loss is initiated by human action), it is problematic for Coronavirus or Covid-19 (the former being the virus that causes the latter disease) themselves to be unifying factors under an event based clause.

However, one does not approach the issue exclusively by strict scientific analysis. In the 2003 case, *Scott v Copenhagen Re,*[15] it was argued that the unities test was inappropriate to its particular circumstances (which related to aviation losses following the Iraq invasion of Kuwait). Rix J disagreed and applied the unities test, but made clear that the unities are aids to, rather than the sole analytical criteria of, construction:

"That question can only be answered by finding and considering all the relevant facts carefully, and then conducting an exercise of judgement. That exercise can be assisted by considering those facts not only globally and intuitively and by reference to the purpose of the clause, but also more analytically, or rather by reference to the various constituent elements of what makes up one single unifying event. It remains an exercise of judgement, not a reformulation of the clause to be construed and applied".

(b) **Cause Based Clauses:** The House of Lords in the 1996 case *AXA Re v Field,*[16] considered that whereas an event happens at a particular time, at a particular place and in a particular way, a *"cause"* is *"altogether less constricted"*. Hence, when a unifying factor is stated to be a *"common cause"* or *"the same cause"* or *"a single source*", or similar wording, the search for a unifying factor can be much wider, including, for example, a continuing state of affairs. Where the words *"originating cause"* were used, their Lordships considered it to open up the widest possible search.

The FCA test Case judgment refers on several occasions to Covid-19 as being a "*state of affairs*". Lord Justice Flaux, who is an experienced reinsurance lawyer, would have been aware that the word "*event*" is generally taken not to encompass a "*state of affairs*", but the word "*cause*" can do so.

At para 231 of the FCA test case judgment, in finding against the FCA's contentions (i.e. the insured's positions), under a QBE policy, as to coverage, the Court observed:

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[15] [2003] EWCA Civ 688. In August of 1990, 15 aircraft belonging to Kuwait Airways Corp. were seized by Iraq as part of that country's invasion of Kuwait and Iraqi's policy to plunder Kuwait's resources. On February 27, 1991, a British Airways plane that had landed in Kuwait just before the Iraqi invasion remained in Kuwait due to the Iraqi capture of the airport. That aircraft was destroyed by Allied bombing during Operation Desert Storm. The issue in this case was whether on the reinsurance level the loss of the BA aircraft was to be aggregated with the loss of the aircraft belonging to Kuwait Airways Corp. It was determined that the loss of the BA aircraft was not to be aggregated with the loss of the Kuwauit Airways Corp. fleet. The quote is at para. 81 of the judgment which is available at https://www.casemine.com/judgement/uk/5b46f1fa2c94e0775e7ef4d1.

[16] *Axa Reinsurance (UK) Plc v. Field,* [1996] 2 Lloyd's Rep 223 (H.L.).

"In particular, the relevant clause has the following features. In the first place, the insuring clause itself identifies the matters in (a) to (f) as "events". This indicates that what is being insured is matters occurring at a particular time, in a particular place and in a particular way: see dictum of Lord Mustill in Axa Reinsurance v Field [1996] 1 WLR 1026 at 1035, as to meaning of "event"."

Lord Justice Flaux found in relation to a radius provision that it is the "event" which is constituted by the occurrence(s) of the disease within the 25 miles radius which must have caused the business interruption or interference. If there were occurrences of the disease at different times and/or different places then these would not constitute the same "event", and the clause provides no cover for interruptions or interference with the business caused by such distinct "events".

At para 398, Flaux LJ observed:

> *"Mr Gaisman QC agreed that an "incident" is to be equated with "an occurrence" and "an event" and submitted that Lord Mustill's dictum in Axa Reinsurance v Field at 1035 that: 'In ordinary speech, an event is something which happens at a particular time, at a particular place, in a particulate way' was equally applicable to "an incident"."*

He concluded (at para 404):

> *"In our judgment, the FCA's entire case on the NDDA clause founders on the requirement for "an incident". We agree with Mr Gaisman QC that this word should be given the same essential meaning as "an event": something which happens at a particular time, at a particular place, in a particular way."*

Looking for a single event or occurrence which happened at a particular time, at a particular place and in a particular way, which gave rise to all cases of Covid-19 is likely to be very challenging (even bearing in mind Rix J's bringing intuition into the equation). If the virus itself is not a unifying factor, identifiable events giving rise to multiple individuals contracting Covid-19, may be. Of course, identifying such events is itself likely to be problematic. Identifiable decisions made to contain the spread of virus may perhaps more readily be classed as events or occurrences. Questions of degree may arise, for example, in relation to event cancellation, is it the decision to cancel the event at a specific venue, or the decision to cancel a number of events over a period of time at the same venue, or at a series of venues in different places but in the same ownership/management or a more generally applicable governmental decision that prevents or hinders the putting on events throughout the country, or in particular areas?. It is fair to say that the more the limits of the unities are stretched by a potential unifying factor, the less likely it is actually is to be constitute an event.

However, in view of the approach to interpretation in the FCA test case, will Courts or Arbitration Tribunals adopt a broad view of the unities, whilst remaining within the constraints of the words used? In *IF P&C v Silversea Cruises (2003),*[17] a 9/11 claim under a direct policy, Mr. Justice Tomlinson took the view that:

> *"It would be wholly absurd to regard each State Department Advisory or similar warning by a competent authority as a separate occurrence for the purposes of the deductible. That would mean that if, for example, the Attorney General gave two separate Press conferences or Press briefings on the same day, each reiterating the theme to which I have already referred, it would be necessary either to attempt to distinguish between the two warnings in terms of their causal effect on bookings, which is obviously impossible, and/or to apply two deductibles possibly for no better reason than that there were two warnings notwithstanding that it is impossible to attribute the deterioration in bookings*

[17] [2003] EWHC 473 (Comm) (19 March 2003), judgment available at https://www.casemine.com/judgement/uk/5a8ff77160d03e7f57eac7dd . The quote is at para. 66.

> *to the one rather than the other. … Where there are multiple warnings arising out of a single defining event, at any rate one of the magnitude of the 11th September, it seems to me to accord with common sense and with what the parties' intention must have been to regard those warnings, or at any rate those within the immediate 6 months after the event where it is that 6 months in respect of which the claim is brought, as a single occurrence, since they all arise out of the same set of circumstances, both actual and threatened. Any other approach would be likely to render the cover unworkable"* (underlining mine).

It may be possible to draw on the concept that multiple warnings over a significant period of time, where they arise out of the same set of circumstances, may not be separate events.

In all cases, whether the unifying factor is event based or cause based, there has to be a significant causal connection between the event, or the cause, and the loss suffered.

Simmonds v. Gammell [2016],[18] is another 9/11 case that dealt with the claims of those involved in the response to and clean-up after the 9/11 attacks, who suffered respiratory disease over the ensuing weeks and months, as a result of being exposed to a toxic environment without proper personal protective equipment ("PPE"). The Aggregation Clause was event based. An arbitration tribunal found that all of the claims arose from the same event – the 9/11 attack on the World Trade Centre. The matter came before the Court by way of appeal under Section 69 of the Arbitration Act 1996. In appeals under the Arbitration Act, the Court does not have to find that it would have come to the same or a different conclusion than that reached by the arbitrators. The test on appeal from an arbitral award is whether it fell within the range of findings that the arbitrators could reasonably have reached.

The question arose as to whether there was a close enough causal link between the 9/11 attack (for these purposes considered to be one event) and the injuries by respiratory disease. The Court found that it is necessary to look for *"significant"*, not *"proximate"*, cause. The Judge referred approvingly to the majority arbitrators' statement that they were satisfied that:

> *"On a broad and common sense view the unities were present to a sufficient degree to satisfy the test and believed that an informed observer would reach the same conclusion in viewing the rescue and clean up operation as part and parcel of the destruction of the Twin Towers following the terrorist attack …"*

The Court also observed:

> *"It can be readily said that from the perspective of PONY, the claims against it arose as a result of the attack on the WTC and the destruction of the Twin Towers with resultant debris and the exposure of people at the site at the time and following the event, to harmful toxic substances … without any clear dividing line as to time … the majority arbitrators could properly reach the conclusion that they did".*

The Court in *Simmonds* therefore found that for the purpose of the reinsurance contract, there was a significant casual connection with the attack on the WTC which justified aggregation. To question what would have happened if there had been no negligence (in failing to provide proper PPP), the Judge said would be *"to stray into the field of fact finding which is the province of the arbitrators"*. He concluded:

> *"The majority of arbitrators were therefore involved in an exercise of judgement as to whether or not there was a sufficiently significant causal connection and they found the casual link between the respiratory claims and the attack to be clear and obvious. Whether that is seen as a finding of fact or a mixed conclusion of law and fact matters not*

[18] [2016] EWHC 2515 (Comm.).

since this is well within the ambit of an exercise of judgement with which this court will not interfere."

The Judge commented that although one of the arbitrators dissented, as he was not persuaded that all the claims could be said to arise out of the same event, *"this merely illustrates the point that judgement is involved in applying the test set out in Scott to the facts of any particular case"*.

There have been a number of other decisions (which I will not delve into in detail here) as to whether different circumstances constitute an event or occurrence. For example, coordinated riots throughout Indonesia have been held by the English Courts not to constitute a single event.[19] However, depending on the tribunal, the jurisdiction, the nature of the policy and the class of business, the terrorist attacks on the Twin Towers in New York have been held, in different arbitral awards, and judgments arising from those awards, both to be one and two events.[20]

Not every re-insurance contract will fit into the events-based clause category or the cause-based clause category. For example, Property CAT XOL reinsurances may provide for aggregation on the basis of "…all individual losses arising out of and directly occasioned by one catastrophe". There is no English precedent as to what constitutes a "catastrophe". It seems unlikely that the drafter of the wording had disease in mind, but it will not be the first time that courts or tribunals will have had to apply coverage language to circumstances that the drafting did not specifically anticipate.

Arguments that may be put by reinsureds and reinsurers as to potential aggregation of Covid-19 related losses, will depend on the policy wording, the reinsurance contract wording and the circumstances of the losses concerned. However, I hope that the above will at least provide a useful starting point.

2. Follow the Settlements Provisions

The FCA test case makes follow issues more straightforward, in that its findings are (subject to appeal) conclusive as to the inwards liabilities of reinsureds. However, note that not all variants of the "disease" and "denial of access" wordings were considered in that case. Also, this is an international problem and the

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[19] *Mann & Anor* v *Lexington Insurance Company*,[2001] Lloyd's Rep IR 179, the full judgment is available on https://www.casemine.com/judgement/uk/5a938b3e60d03e5f6b82ba92. This case affirms that multiple losses which are separate in time and space will not be aggregated as a single occurrence or event simply because they may have a common underlying cause or arise as a result of a common intention or purpose. The relatively restricted interpretation of "event"/"occurrence" as compared with "cause" was thus given renewed emphasis. The case concerned attacks on 21 supermarkets at various times over at least two days in the course of Indonesian rioting in May 1998, the supermarkets being up to 80 km apart. The Sum Insured clause in the retrocessions read: "USD 5,000,000 per occurrence but in the annual aggregate separately for Flood and Earthquake." By contrast, the equivalent limit in the reinsurance was IDR 30 billion "each and every loss, each and every location." The reinsurers argued that each attack constituted a separate occurrence; the retrocessionaires contended that all the attacks amounted to only one occurrence because the rioting was allegedly orchestrated by the government. That issue determined the amount of cover available under the retrocessions.

Having reviewed the authorities, and based upon a construction of the retrocessions having regard to the terms of the underlying reinsurance, Waller LJ concluded that: "the occurrence has to occur at the particular locations, and cause loss and damage at the same to be an occurrence within the contemplation of this policy." He acknowledged that many of the insured perils (for example, volcanic eruptions or hurricanes) might loosely be characterised as single "occurrences", in the sense in which the term is used in property catastrophe excess of loss covers, even though they affect numerous locations. However, he held that in this contractual context, "occurrence" was location specific. Indeed, he endorsed the reinsurers' submission that even if a typhoon simultaneously damaged several supermarkets at different locations, there would be multiple occurrences because of the absence of unity of location. In any event, even if he was incorrect and "occurrence" was not in fact location specific, Waller LJ still rejected the retrocessionaire's argument that the alleged orchestration of the riots by the government was in itself sufficient to aggregate what would otherwise be losses separate in time and space into one occurrence.

Detail regarding this case is provided as it may have application to the reinsurance issues generated by the rioting and looting that occurred in the United States in 2020 in response to the death of George Floyd.

[20] *Aioi Nissay Dowa Insurance Company Ltd. v. Heraldglen Ltd. & Ors*, [2013] EWHC 15 (Comm.) is the well-known judgment of the English Commercial Court which held that the determination by an arbitral panel that the loss of the twin towers in New York was two events was within the range of findings that it was reasonable for the panel to reach.

underlying policy or policies may not be subject to English law. Finally, some claims may be paid by insurers as a result of political pressure, rather than on the basis of legal liability.

At one extreme, if there are no follow the settlements provisions, the reinsured must prove its loss under both the original policy and the reinsurance contract. At the other extreme, some reinsurance wordings provide cover for ex gratia payments, for example by providing that all settlements *"including ex gratia and compromise settlements, provided the same are within the terms of this agreement, shall be unconditionally binding upon the reinsurers"*. This is very unusual. Most contracts will be subject to some form of follow the settlements provision which falls between these two extremes, the wording of which is key to establishing the extent to which the reinsurer must follow its reinsured's settlements.

Wordings of follow the settlements clauses may vary, but can be viewed as falling into two broad categories: full follow clauses and qualified follow clauses.

The full follow clause is essentially a simple proviso that the reinsurer should follow the settlements of the reinsured. The Courts have found that the effect of this is that the reinsured must satisfy two criteria. The first is a matter of fact – it must have acted honestly and in a reasonable businesslike manner. The second is a question of law – the claim, as recognised by the reinsured, must fall within the terms of the reinsurance contract. Hence, the reinsurer cannot go behind the settlement, absent fraud, but it can argue that the reinsurance contract itself does not actually cover the underlying loss as settled.

The qualified follow clause introduces another requirement. Typically, it may provide:

> *"All loss settlements by the reinsured shall be binding upon reinsurers provided that such settlements are within the terms and conditions of the original policies and within the terms and conditions of this policy …"*

This wording was considered in the 1996 case of *Hill v Mercantile & General.*[21] Its effect is that the reinsurer cannot be held liable unless the loss, as a matter of law, falls within both the original contract of insurance and the cover provided by the reinsurance. Each clause and original policy must be considered on its own merits against the circumstances of the claim or claims.

In the case of a retrocession, the *"loss settlements shall be binding"* provision refers to the immediate underlying loss settlement of the retrocedant. It is not necessary for the retrocedant to go into all of the underlying loss settlements, which could constitute a long chain.

The liability has to be shown on the balance of probabilities. When certain claims in the LMX Spiral[22] had been dealt with by a chain of underlying insurers and reinsurers, on an incorrectly aggregated basis, it was held in the 2009 case, *Equitas Ltd. v. R&Q Reinsurance Company (UK) Ltd.*[23], that in the absence of the ability to rework all of the underlying figures, coverage of the claims could be proven on the balance of probabilities using an actuarial model. Once liability was established in that way, the claimant syndicates did not have to prove correctly aggregated losses by precise calculation. They could recover what was the minimum amount that would have been paid after removing improperly aggregated claims, again using actuarial models to establish the figures on the balance of probabilities. Might, for example, similar methodologies be utilised in life reinsurance, if it is necessary to distinguish deaths that were deaths from

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21 *Hill v. Mercantile and General Reinsurance Co. plc*, [1996] 1 W.L.R. 1239 (H.L.).

22 For a quick explanation of the London Market Excess of Loss Spiral Calamity ("LMX Spiral"), see http://www.aida.org.uk/pdf/CB%20Summary%20LMX%20Spiral.pdf

23 [2009] EWHC 2787 (Comm). This includes a fascinating look at how the Lloyds' market dealt with the impact of the 1989 Exxon Valdez loss and the 1990 invasion of Kuwait which led to the loss of KAC airfleet (also dealt with in Scott v Copenhagen Re, *supra)*.

pandemic and those that were, for example, death by natural causes, in circumstances where it is not practically possible to do so?

The possibility of using actuarial type estimation methodology was touched on in the FCA test case judgment. The Court was of the view that techniques could be used to counterbalance potentially incomplete data, such as the use of averages and an "undercounting ratio", on the assumption that Covid-19 may have occurred more frequently or widely than the data collection methods were capable of accounting for. This suggests that the Courts would be open to the use of reliable methodologies to make up for deficiencies in underlying data.

As observed above, many London market reinsurance contracts cover inwards policies issued overseas and subject to a foreign law. In those circumstances, the reinsurer under English law will have to follow the decision of the foreign Court or tribunal as to insurers' liability for the underlying loss, even if that decision would have been different had it been considered by the English Courts.

Nevertheless, the reinsurer does not have to follow an underlying Court decision based on overseas law, if to do so offends a fundamental provision of the reinsurance contract itself. In *AGF & Wasa v Lexington*[24], the underlying policy was subject to a foreign law. There was a facultative reinsurance contract, subject to English law. It contained a period clause in substantially the same terms as the underlying policy, hence also covering losses occurring during the period 1/7/77 to 1/7/80. The applicable foreign Court (the Supreme Court of Washington, applying Pennsylvania law) broadly treated the period clause in the underlying policy as covering damage whenever it occurred, if some damage existed during the policy period. The cover provided by the reinsurance contract came before the English court. The House of Lords applied the English law interpretation of the period clause, with the result that even though the reinsured had been held liable under the underlying policy, for losses that occurred outside its policy period, the reinsurance only covered those losses which actually occurred (as interpreted by English law) during the period of the reinsurance contract.

Lord Phillips explained:

> *"… the 'full reinsurance' clause in this case, and follow the settlements clauses in general did not and do not have the effect of bringing within the cover of a policy of reinsurance risks that, on the true interpretation of the policy, would not otherwise be covered by it".*

It should also be borne in mind that many US policies, in particular, include "follow the fortunes" wording, rather than "follow the settlements" wording. These can impose a broader liability on reinsurers to follow underlying settlements, than an English law "follow the settlements" clause generally would. If a retrocedant is obliged under the local law to pay a claim under the "follow the fortunes" clause, then a "follow the settlements" clause in an English law retrocession will likely oblige the retrocessionaire to follow that settlement.

The above are some of the factors that may feed into the recovery of claims relating to Covid-19 under reinsurance contracts. I would again emphasise that there are a variety of clauses, a wide range of classes of business, original wordings and circumstances potentially involved in such claims. Whilst it is not unduly helpful to repeat the old mantra that each case will be considered on its merits, there is, unfortunately, no escaping it.

Nevertheless, it is fair to say that insurers proposing to pay claims that do not in law fall within the insurance cover of their inwards policy, need to be wary of their ability to recover on reinsurance. It may

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24 Reference is made to the conjoined appeals heard by the House of Lords, *Wasa v. Lexington and AGF v. Lexington*, [2009] UKHL 40, which dealt with reinsurance coverage for pollution damage sustained at numerous of Alcoa's sites in the United States and elsewhere between 1956 and 1985. The judgment in these appeals can be found at https://publications.parliament.uk/pa/ld200809/ldjudgmt/jd090730/lexing-1.htm.

well be wise, if practicable to do so, for reinsureds to liaise with their reinsurers before entering into such settlements. It may be the case that the reinsurance contracts contain claims cooperation clauses or even claims control clauses, giving reinsurers rights to be involved in, or to control, the settlements of their reinsured. Where this is the case, it should go without saying that it is particularly important for the reinsured to work with its reinsurers before entering into settlements.

Of course, other potential issues may also emerge. For example, the use of the words "other perils", especially in cat bond arrangements, has increased over recent years, expanding coverage to natural perils beyond those actually named. Questions have arisen as to whether this may include a pandemic.

What does the Future hold?

From whatever perspective one looks at it, there is clearly the potential for both misunderstanding and dispute between reinsurers and reinsureds as to the payment of original claims, their coverage under reinsurance and, if covered, the way in which they may be aggregated. As specific scenarios play out, these areas of dispute will become clearer and no doubt, there will be significant decisions either in the Courts or in arbitration. Many reinsurance contracts are subject to arbitration provisions, but it is distinctly possible that the legal issues involved and their importance are such that the Courts may be called upon by way of appeal from arbitral awards which deal with key issues of law, under Section 69 of the *Arbitration Act 1996* (referred to above).

Governmental restrictions on movement and decreased economic activity have meant that traditional property/liability claims should show a reduction.

Many companies have successfully embraced working remotely, including in the professional services, insurance and financial industries. The question arises whether this will herald a decrease in the use of office space. The unavailability of high street retail has created a huge increase in online purchasing, with potentially long-lasting effects on supply chains. All of this may also increase exposure to cyber risk.

All of these factors may affect the frequency and types of claims, which would inevitably in turn feed through to reinsurers. The Chief Claims Officer of Allianz Global Corporate & Specialty, Thomas Sepp, is quoted as saying:[25]

> *"The coronavirus outbreak has reduced risk in some areas while, at the same time, changing and heightening it in others. The wider changes in society and industry brought about and accelerated by the pandemic are likely to have a long-term impact on claims patterns and loss trends in the corporate insurance sector".*
>
> *"The growing reliance on technology, shift to remote working, reduction in air travel, expansion of green energy and infrastructure and a rethinking of global supply chains will all shape future loss trends for companies and their insurers."*

Standard & Poor reports a hardening of reinsurance pricing over the past 18 months and that this is further supported by Covid-19. They observe that alternative capital capacity has also been impacted as Covid-19 losses come on the back of preceding underperformance.[26]

Standard & Poor conclude that

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25 The full October 6, 2020 interview can be found at https://www.agcs.allianz.com/news-and-insights/expert-risk-articles/covid19-claims-thomas-sepp.html, last accessed October 21, 2020.

26 Reference is made to Gharib, Taoufik et al *Black Swan Or Not, COVID-19 Is Disrupting Global Reinsurers' Profitability*, S&P Global, https://www.spglobal.com/ratings/en/research/articles/200908-black-swan-or-not-covid-19-is-disrupting-global-reinsurers-profitability-11639467, last accessed October 21, 2020.

"… if there is one thing that is certain in this environment, it is uncertainty. Therefore, we expect underwriting conditions will tighten with pricing momentum firmly in place as the 2021 reinsurance renewals approach."

I leave the last words with Huw Evans, Director General of the Association of British Insurers, who elegantly summarised the need for a "Pandemic Re" style solution:[27]

"… Even in the UK, providing widespread insurance cover against pandemics will be virtually impossible without state support, because the amount of capital insurers would have to hold against the risk would result in completely unaffordable prices for customers. Last year, UK companies turned over £4.1trn and employed 27 mn people. Insuring these businesses for pandemics is impossible using the normal model, given UK insurers hold total assets of £2.2trn …

That is why we need to start thinking about new solutions. Partnerships between governments and insurance markets to help solve big problems are nothing new; so called 'protection entity' schemes exist round the world, most commonly for flooding, terrorism and earthquakes. Here in the UK, we have Flood Re, which I helped set up, as well as Pool Re, while other examples include the California Earthquake Authority, the CRC in France and the Earthquake Commission in New Zealand. Each is structured with different levels of state involvement but all seek to enable insurance protection for risks that would otherwise be uninsurable"

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27 Sourced from Mr. Evans' written comments dated March 30, 2020, found on the ABI website, https://www.abi.org.uk/news/news-articles/abi-we-need-to-talk-about-pandemic-insurance/