CLYDE&CO

Nat Cat Losses – an A to Z of possible issues

Onshore Energy Practice

RESILIENCE

In 2008 we produced an A to Z of issues that may arise out of hurricane losses. That note was prompted by Hurricane Gustav, which was significantly smaller than the series of natural catastrophes seen in 2017.

From the earthquakes in Mexico, typhoons in Japan and Hurricanes Harvey, Irma, and Ophelia, the international downstream energy insurance and reinsurance market is faced with a myriad of claims arising from national catastrophes (Nat Cats).

In light of this we have revisited our 2008 A to Z note so as to draw together some of the problems and issues that may arise in the claims review process, and in particular drawing lessons from our prior experience of similar claims.

Rather than focus on a detailed consideration of specific provisions, the application of which usually turn on the relevant specific facts and wordings, we have set out an A to Z of common issues. These include specific policy clauses and possible loss scenarios.

By way of a formal disclaimer, the entries are a high-level summary of certain issues; the application of which will vary in each circumstance. The list should not be seen as a substitute for an analysis of each circumstance and policy wording.

The list is directed towards direct or facultative reinsurance placements for both onshore energy and construction risks and reflects the position under English law unless stated otherwise. Please direct US law queries to Robert Fisher, Partner in our Atlanta office or your regular contact, and Mexican law queries to Arturo Arista in our Mexico City Office.

A

AGGREGATION

The issue of aggregation (by which in this context we mean the accumulation of losses or damage into loss occurrences rather than the aggregate exposure of a placement) is likely to be significant in many Nat Cat claims. This is in respect of aggregate, or per-loss, limits and also the application of what are now often significant deductibles. Different issues arise for direct/facultative placements than for treaty exposures.

Even though there is now a large body of case-law interpreting the standard terms both in the US and England, disputes frequently arise. Even where apparently standard terms are used these can be the subject of unexpected interpretation in different jurisdictions. Equally, many policies on an XS level, or reinsurance, also now cede the ability to determine the application and allocation of the aggregation provisions in the wording to the cedant or primary layer. In such circumstances it would likely be difficult to dispute such a determination without proving fraud or bad faith.

See the separate entries for Occurrence and Seventy-Two Hours Clauses.

ALOP/LOPI

Advanced Loss of Profits (“ALOP”) and Loss of Production Income (“LOPI”) policies are specific forms of cover primarily for the Marine and Offshore Energy markets. The loss of revenue is historically usually based on an Agreed Value sum insured which determines a set amount paid on a daily basis consequent to any covered loss (in excess of the deductible/waiting period). This is to be contrasted with the Loss of Gross Profit or Revenue basis prevalent in most Business Interruption policies.

See the separate entry for a general review of Business Interruption issues.

B

BETTERMENT

Many claims will involve either bespoke equipment which will not be replaced on a like-for-like basis, or obsolete technology not capable of being replaced.

Where, as in most property policies, the measure of indemnity for damage to property is assessed against the costs of repair, reinstatement or replacement, the insured is almost inevitably to be left with improved and more valuable equipment. Betterment is to protect insurers against such an eventuality. In Marine polices there is a well-established English law principle, that a one-third deduction from the reasonable cost of repair can be made where a damaged vessel has been repaired (s.69 of the Marine Insurance Act 1906). This, however, is invariably overridden in modern policies, which adopt a ‘new for old’ basis and the response will turn on the detail of the policy wording.

BUSINESS INTERRUPTION

A Business Interruption (“BI”) cover is one of indemnity. For the BI cover, the insured peril is the occurrence of physical damage insured under the property section of a policy. The wording usually specifies that insured physical damage (“PD”) must be the proximate or predominant cause of the suspension of the business – see the separate entry for Proximate Cause. For a combined PD/BI cover it is not sufficient for an insured to show a Business Interruption loss due to the general or industry-wide impact of a hurricane.

The loss is usually calculated on an indemnity basis for lost revenue (net profit less fixed costs making an allowance for any floating costs saved) but other forms of cover, based on lost production, shipments or on agreed values can be provided.

Uncertainties commonly arise in respect of the calculation of the loss and the application of the deductible or waiting period.

See the separate entry for ALOP/LOPI.

C

CIVIL AUTHORITY

Many onshore policies include an extension of cover for circumstances where an order from a Civil Authority causes a facility to be shut or otherwise made inaccessible resulting in a business interruption loss. These clauses are sometimes referred to as an Inaccessibility to Property clause; or a variant of which provides cover if there is Inaccessibility caused by damage to other property.

Many claims were made after Hurricanes Katrina, Gustav and Harvey for lost production due to periods where plants were closed following Mandatory Evacuation Orders issued by state and local governments in circumstances where there had been no damage to insured property or even to adjacent property. In recent Australian and US case law, the approach usually adopted by insurers has been broadly upheld; namely that the cover only applies in circumstances where there has been physical loss or damage to insured property, or to adjacent property owned by third parties, and the loss is exacerbated by the order of the Civil Authority. It does not act as a free-standing component of cover regardless of insured damage.

Whilst this is helpful and consistent with the views of most in the market, the application of such clauses is always dependant on the nature of a loss and the precise policy wording. It is also not necessarily an approach that will be adopted in every jurisdiction.

On this basis the use of clear and precise policy words can be crucial.

Effective Nat Cat preparation plans put in place after Katrina are perhaps likely to lead to earlier and prolonged shut-down periods, which may in turn lead to a greater number of claims under these and other similar provisions.

See also the separate entries for Mitigation, Shutdown Costs and Sue and Labour.

CUSTOMERS AND SUPPLIERS EXTENSIONS

The Gulf of Mexico is a prime example of the increasing interdependency of installations and corporations in the petrochemical industries. The use of shared distribution pipelines and other facilities is common, both on and offshore. As a function of this type of interdependency it is common to see Customers and Suppliers extensions in Business Interruption policies. The large number of claims under such covers due to the 2011 Japanese earthquake is an example of their increased usage.

The extensions usually operate to provide cover in circumstances where an insured suffers a loss of production or revenue due to the inability of a customer to receive the insured’s product or a supplier’s inability to provide the necessary feed or supplies for the insured to produce its end-product. Both are, however, usually contingent on the default of the customer/supplier being due to physical damage to its property of a type covered under the Insured’s policy. A common example would be where a distribution of oil is not able to be made to customer X because its pipeline or storage facility has been damaged. An alternative limitation is by geographical scope; that only damage to property within, say, two-miles of insured property is sufficient to trigger the cover.

This is evidently potentially a significant broadening of the cover and thus it is usually restricted to direct or ‘first-tier’ customers/suppliers, sometimes with a requirement for such customers/suppliers to be named and listed in the policy. In an increasingly complicated and inter-related market this is often difficult to apply – for instance in circumstances where the insured’s supply agreement is with Y but the damage has been caused by a pipeline used by Y (and others) but owned by X. One way around this is to include higher sub-limits for named or direct customers/suppliers as compared with lower sub-limits for indirect and unnamed customers/suppliers.

Other problems we have seen include difficulties in obtaining sufficient evidence of damage at the third party’s premises and establishing a direct causal link to the insured. Disruptions in supply may, for instance, be due to a customer/supplier favouring other more lucrative contracts.

CYCLONE

A cyclone is a large-scale atmospheric wind and air-pressure system characterised by low pressure at its centre and circular wind-motion counter-clockwise in the Northern Hemisphere, clockwise in the Southern Hemisphere). We foresee a number of difficulties in ascertaining the cause of interruption or delay, especially when insureds have been subject to more than one Nat Cat or undertook preparations in advance where no or limited loss was suffered.

D

DAMAGE

This is a pre-requisite of property claims in onshore policies which was lacking in many claims pursued after Hurricanes Rita and Katrina. Cover is provided for damage to insured property and not the impact of a hurricane generally on the industry or insured.

Damage is usually defined as a permanent alteration to property to its detriment, and its interpretation, especially where there is a combination of insured and uninsured property, is usually made on a common-sense basis by the English Courts.

Again, however, a more expansive indemnity based approach may be taken in other jurisdictions.

See the separate entries for Sue and Labour, Mitigation and Shutdown Costs.

DELIBERATE DAMAGE

Normally an insurance policy will not respond to instances of deliberate damage. However, when in the midst of a storm/hurricane or impending storm/hurricane, the shutdown process may involve deliberate damage to property in order to minimise or mitigate a loss. This is an area heavily dependent on the specific policy wording and the factual circumstances, in particular the interplay with any subsequent Damage and Sue and Labour costs. Leaving aside those complications, as a matter of old established English insurance law principles (derived from *Marsden v. City & County Assurance Co (1865)*) damage directly incurred to avoid or mitigate a loss does not break the chain of causation and thus the damage, even though deliberate, would normally be covered and also fall within the wider loss for aggregation purposes. This may cover, for example damage to a window being boarded-up to prevent internal damage.

E

EARTHQUAKE

The requirement for damage for a policy to be triggered is not a difficult hurdle to overcome in the context of an earthquake. However, what becomes difficult is identifying the number of occurrences where there are significant aftershocks which cause separate, identifiable damage. See the separate entry for Successive Losses for a summary of case law following the 2011/16 New Zealand earthquakes.

Also, issues can arise where an earthquake (not excluded by the relevant policy) gives rise to a tsunami or flooding in circumstances where flood may well be an excluded peril.

See separate entry for Flood.

EXTRA EXPENSE

This cover can be provided under a Property Damage or Business Interruption cover and provides cover for additional costs incurred to maintain the business following insured damage. If provided under a Business Interruption cover it is very similar to an Increased Cost of Working clause (see separate entry). However, they are at times included within a Property Damage cover and relate to additional expenditure due to insured damage.

An example of an Extra Expense claim following a hurricane would be the costs of importing ethylene feed-stock into a chemical manufacturing facility due to the in-house ethylene manufacturing facility being damaged. The Extra Expense cover would reimburse the additional costs of the imported ethylene over the usual in-house production costs. Such clauses are sometimes hand-in-hand with a policy obligation on the insured to restore production as soon as possible.

F

FLOOD

The interpretation of a "flood" definition may be relevant to policy exclusions or limitations and is an example of how a governing law can impact the interpretation of a policy. There were a number of long-running disputes following Hurricane Katrina that sought to determine whether water damage caused by levee damage in New Orleans fell within various policy exclusions for "flood". An appeal decision in 2007 confirmed that such losses did fall within the exclusion. The Louisiana Supreme Court stated that the Court should consider the colloquial definition of a flood; "whether the event is a natural disaster or a man-made one in either case, a large amount of water covers an area that is usually dry". This decision also reflected recent federal appeals court rulings which found that "a flood is a flood". There have also been a number of judgments following Hurricane Sandy (2012).

The US definition of "flood" contrasts, to a certain extent, with the view of the English Courts. Perhaps unsurprisingly, the US Courts seem to favour more plain-talking interpretations of "flood".

The English Court of Appeal has examined the meaning of the word "flood" in two main cases.

In *Young v. Sun Alliance*, the policy covered damage caused by "storm, tempest or flood", but this was found not to cover seepage of water from a natural source. Flood was not given its ordinary colloquial meaning, because the accompanying words "storm and tempest" in the policy implied severe weather conditions.

In a separate decision the Court of Appeal held that a flood has to be the result of a natural occurrence, rather than for example caused by a negligent contractor. Conversely, in *Rohan Investments Ltd v. Cunningham*, the Court of Appeal commented that there was no reason to imply an additional precondition that a flood had to be caused by a natural phenomenon. In this case it was held that as the damage was caused by an abnormal rainfall, this was sufficient for the cause to be considered a "flood".

Each of these decisions reveals how fact and wording sensitive the application of such definitions are.

G

GOVERNING LAW

The Governing Law clause in a policy sets out which law will be applied to the insurance by the courts/arbitration panel in the event of a dispute. It differs from the jurisdiction clause which determines which court/arbitration centre will host the dispute. The country of jurisdiction and governing law need not be the same. It is perfectly possible for a policy to be governed by the law of Texas but with English jurisdiction. Reinsurance policies covering Katrina and Rita losses were often governed by English law whilst the underlying policies were governed by US state law. Insurers should be mindful of the potential for differences in the interpretation of key policy terms under these different legal systems. In respect of 'back-to-back' reinsurances, however, the English House of Lords' decision in *WASA v. Lexington* usually serves so as to bind English law governed reinsurances to the determination of coverage issues made in respect of the underlying policy under a different governing law; even if such decisions run contrary to English law principles. Whilst subject to a number of provisions, *WASA v. Lexington* upholds the basic "back-to-back" principles.

Some Governing Law clauses draw a distinction between substantive and procedural law. Bermuda Form policies, which are often used for US property reinsurance policies, are governed by New York law with English arbitration jurisdiction and English procedural law. In such a policy, New York law will determine the key issues such as contractual interpretation whilst English law will determine procedural issues such as time limits and appeals procedure.

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H

HURRICANE

Hurricanes and cyclones are types of severe tropical storms with a windstorm greater than 74 mp/h (119 km/h). 'Hurricane' is the name given to such storms that occur in the North Atlantic, North Pacific and South East Pacific oceans. In other areas they are known as typhoons (North West Pacific) or cyclones (South West Pacific/ Indian). The definition of a storm may be relevant when considering an occurrence definition (see separate entry for Occurrence).

HURRICANE DEDUCTIBLE

Property insurance policies in areas regularly affected by hurricanes often contain a 'hurricane deductible'. These replace normal policy deductibles where the damage has been caused by a hurricane. Typically, homeowners' non-hurricane deductibles are a flat amount such as US$500. A hurricane deductible is generally far higher and is based on a percentage of the property's insured value. This percentage varies depending on the likelihood of hurricane damage, and is often regulated by state law. In some high risk coastal areas, hurricane deductibles may be as high as 25% of the value of the property. Washington DC, Alabama, Connecticut, Delaware, Florida, Georgia, Hawaii, Louisiana, Maine, Maryland, Massachusetts, Mississippi, New Jersey, New York, North Carolina, Rhode Island, South Carolina, Texas and Virginia all have hurricane deductibles.

The hurricane deductible only applies if the damage occurred during a hurricane named by the US National Hurricane Centre. For larger commercial risks a Seventy-Two Hours clause is more likely to be in place – see the separate entry.

I

INACCESSIBILITY TO PROPERTY

See the separate entry for Civil Authority.

INCREASED COST OF WORKING

This is an extension to a Business Interruption cover and indemnifies an insured for additional costs necessary to maintain its business and is similar to an Extra Expense clause (see separate entry). It would cover, for example, the cost of overtime or of provisional repairs. Two limitations normally apply to such clauses, first that the cover is limited to the amount of money that is saved by the additional expense (i.e. the amount of revenue that otherwise would have been lost), this is sometimes called the 'economic test' (although Additional Increased Cost of Working cover can be purchased without this economic test requirement); and secondly that it must relate to revenue lost as a result of insured damage.

Depending on the policy form the ICOW cover may also be subject to a standing charges provision pursuant to which insurers are only liable for the pro-rata share of the ICOW costs attributable to the lost revenue.

It is often difficult to draw a distinction between ICOW and Extra Expense clauses.

A further cover can also be provided by an Additional Increased Cost of Working cover which allows the insured to cover expenses aimed at reducing an insured's long-term loss without the cap on the reduction to the claim.

INGRESS/EGRESS

This is the usual US term for a Civil Authority or Inaccessibility to Property type clause (see those separate entries) and will provide cover where an insured is denied access to its property. The ambit of the cover will depend on its specific terms and the circumstances of a loss.

J

JURISDICTION

The jurisdiction clause in a policy sets out which State will host proceedings in case of a dispute. The clause also dictates whether disputes shall be heard in courts or by way of arbitration. If the jurisdiction clause simply states a country, then the default position is usually that the dispute shall be heard in the courts of that country rather than by arbitration. The jurisdiction can be crucial in a dispute; for instance a trial by jury in a country or city dominated by the insured would probably be very different from the decision of a panel of insurance industry professionals in London.

The jurisdiction of underlying US property insurance policies in Hurricanes Katrina and Rita tended to be the state where the property was located, such as Texas or Louisiana, although we have seen cases where the state of the domicile of the insured company has accepted jurisdiction even if not the state of the loss (for example Michigan). The reinsurance jurisdiction for most Katrina losses was generally England and Wales. Reinsurance policies were evenly split between court litigation and arbitration.

Many jurisdictions in Latin America make it mandatory for a policy to be subject to local jurisdiction (whether count or arbitral).

K

KATRINA

The largest single loss event the energy insurance market has had to respond to and which mostly, was successfully dealt with. Insurance responded to 47% of overall losses. Additional improvements in underwriting methodology and discipline appear to be bearing fruit.

L

LOSS PREVENTION

See the separate entries for Mitigation and Sue and Labour.

LOPI

See the separate entries for ALOP/LOPI and Business Interruption.

M

MANDATORY EVACUATION ORDERS

Many onshore claims arising out of Hurricanes Katrina and Rita consisted of large Business Interruption claims for the downtime during periods where state and local governments ordered evacuation of whole areas. See the separate entry for Civil Authority and Ingress/Egress clauses.

This was particularly for Rita due to an understandably heightened state of alert in the weeks following Katrina. As discussed, in respect of Civil Authority clauses losses due to such orders are not normally sufficient to trigger cover without damage to some property (even if not insured property). However, if there has been insured damage which would have resulted in a Business Interruption loss as well as a concurrent MEO preventing access to the plant/facility the losses may be covered.

See the separate entry for Proximate Cause.

MARINE/NON-MARINE

Whether a policy is a marine or non-marine policy is an issue that can arise on energy risks and will have an impact on the applicability of a number of insurance principles. For instance, the principle of Average (i.e. where the subject matter insured is under-insured) is automatically incorporated into a marine policy but not a non-marine policy. Equally, as we have seen above, there is an imposed obligation on an insured to mitigate or prevent an insured loss under s.78 (4) of the marine Insurance Act 1906 but which does not apply expressly to non-marine policies absent policy wording to the contrary. There are also a small number of other differences relating to the valuation of a loss and the formation of the contract.

A marine policy is defined under English law as one that provides insurance against "marine losses, that is to say, the losses incident to marine adventure" (s.1 of the marine Insurance Act 1906). This includes shipping and also maritime structures (e.g. rigs) and can include cover of non-marine risks under a predominantly marine policy. However, describing a risk as a marine risk is not conclusive if the risk is not in fact marine.

For an offshore risk the cover will ordinarily be a marine risk. Where there is a mixture of on and offshore risk, the classification will depend on the circumstances and the primary coverage afforded by the policy (*see Wunsche International v. Tai Ping Insurance (1998)*).

MITIGATION

The issue of an insured's duty to mitigate a loss arises in many storm claims where it is not always clear if or when a storm will cause damage but reasonable and sensible preventative steps are taken. For instance, many offshore rigs were evacuated in advance of the possible arrival of Hurricane Gustav.

Absent a specific clause (see the separate entry for Sue and Labour clauses) it is unlikely that as a matter of English law the courts would imply a duty for an insured to mitigate its insured loss into non-marine policies. For marine policies the duty is incorporated by statute (s.78 (4) of the Marine Insurance Act 1906).

However, the issue can be relevant to proximate cause in circumstances where an insured has acted recklessly so as to fail to prevent a loss or to reduce a loss once it has occurred/commenced. In such circumstances it could be argued that the proximate cause (see separate entry) of the loss or the additional loss is the insured's recklessness or wilful act. This would very much turn on the facts of a case and is likely to be difficult to prove but it could apply to circumstances where an insured has taken no preventative steps at a facility despite the likelihood of hurricane damage.

A related issue is whether, having taken steps to mitigate or reduce its loss, an insured is entitled to recover its expenses of doing so. See the separate entry for the position in respect of a Sue and Labour clause. In the absence of express wording or a Sue and Labour clause, however, an insured is generally not entitled to recover the costs of mitigation under English law. This is the case in respect of liability (*Yorkshire Water v. Sun Alliance (1997)*), property and business interruption covers (*Gerling General Insurance v. Canary Wharf (2006)*).

This may seem harsh in circumstances where insurers directly benefit from the mitigation steps undertaken and in many jurisdictions the insured would be able to recover such costs. It may not, for instance, be an argument likely to carry much credence in a jury-trial in some US states.

MODELLING

Modelling is now an established part of the risk management process for both insureds and insurers. It plays an integral role in the assessment and management of exposures on direct and facultative and treaty reinsurances. As is apparent from recent experience modelling is an art and not a science.

However, what is the situation where the results of models are provided and relied on during the placement of a risk, but they prove to be inaccurate? Unless expressly provided otherwise the data is usually stated to be the output from the specified model and not as a representation of the accuracy or otherwise of the model. Absent a drastic mistake in the data inputted into the model or clear representations to the contrary insurers/reinsurers are, therefore, unlikely to have any remedy against an insured/reinsured for modelling data that proves to be inaccurate.

N

NEGLIGENCE

As a matter of English law, and most US states, the negligence of an insured is a covered peril. Thus, if in response to an imminent hurricane an insured negligently causes damage to property in an effort to safeguard it, that damage would ordinarily be covered. However, were the actions of the insured to constitute recklessness or a 'wilful act' leading to damage there will likely not be cover.

NOTIFICATION

Most policies require prompt notification of a claim or circumstances that may lead to a claim. The consequences of the breach of such a provision will depend on the applicable governing law.

English case law confirms that it is not open to an insured to make a blanket notification of circumstances or notify a specific set of circumstances and then simply rely on that notification even if what is in effect a new and materially different claim materialises. These issues may become relevant in circumstances where an insured notifies the impact of a hurricane generally, or a specific loss, but the circumstances develop into a loss of a materially different nature and which merit a full investigation.

O

OCCURRENCE

The word 'occurrence' is often used in an aggregation (see separate entry) context to delineate what constitutes an insured loss for the application of deductibles and policy limits. Sometimes it is a properly defined term, sometimes it is just simply stated to be "per occurrence" without further explanation. By way of example of a more descriptive term, occurrence has been defined in a construction/operational policy as, *"...an event which during the Period of Insurance causes loss, damage or liability indemnifiable under this Insurance"*.

The usage of the word "event" to define an occurrence is commonplace. In fact, the two terms are, as a matter of English law, treated as being synonymous and thus the principles used to define event usually apply to the bare use of the word "occurrence".

An 'event'/'occurrence' is a definite happening of something at some time. In the context of first-party property losses, the 'unities' of time, location, cause and (if applicable) human intent will apply to determine the relevant 'event'/'occurrence'. The 'unities' may also apply where the issue is an aggregation of losses arising out of liability to third parties. Whether or not something which produces a plurality of loss or damage can properly be described as one 'occurrence' or 'event' also depends on the position and viewpoint of the observer in the position of the insured. An 'event'/'occurrence', in other words, must be something identifiable that has happened (thereby giving rise to losses), as opposed to something explaining why those losses have happened (where the expression 'cause' is much more apt). There is no single definition of an 'occurrence' or 'event' and the various tests have to be applied to the facts of the claim. The question of what the relevant occurrence/event might be and whether the losses/ liability in question are directly enough connected to it, must be assessed both analytically and as a matter of intuition and common sense.

Other words used frequently in occurrence definitions include "arising out of one event". Where losses are to be aggregated on an 'arising out of one event' basis, there must be (i) something specific that happens (ii) which makes the original insured liable and (iii) which bears a strong causal connection to each of the losses sought to be aggregated.

In contrast, the phrase 'arising from one originating cause' has consistently construed as less restrictive than an 'event', and can include a continuing state of affairs. The word 'originating' has been held in English law to open up the widest possible search for a unifying factor in the history of the losses which it is sought to aggregate.

ONSHORE OR OFFSHORE

The physical nature and location of a risk, regardless of the description of a policy, are relevant to the proper classification of a policy.

With sophisticated group covers, or covers in respect of more than one location, the classification of property between on and offshore may be relevant to the application of sub-limits and/or retentions and the nature of the cover provided. Problems that arose in respect of classification of risks post-Katrina include a number of inland floating casinos.

See the separate entry for Marine/ Non-Marine.

P

PIPELINES

Many predominately onshore risks include sections of cover for offshore risks (for example inlet pipeline systems or jetties/piers). One of the areas of real safety improvements for on and offshore risks is in respect of pipelines, in particular the ability to disconnect and drop a pipeline to the seabed for protection at short notice. However, it is often not for some weeks after a storm event, and only once production (often from a number of sources) is back to full capacity that problems are identified. As also discussed in the separate entry for Customers Extension, the increasingly complicated distribution and cooperation networks often lead to disputes as to responsibility.

A further frequent issue that arises following hurricane or storm events, and especially where there has been a hurried pre-hurricane shutdown, is whether a blocked pipeline constitutes insured damage. The answer will depend on the factual circumstances and the applicable governing law.

PROXIMATE CAUSE

Difficulty arises where losses are attributable to insured and uninsured physical damage and it is impossible to determine the dominant cause, or to separate two concurrent causes. This can have a significant impact on coverage. For instance, if damage is caused by a combination of Flood and Wind damage, and where one peril is covered but the other not.

The English Courts have held that in such a situation, the loss that is attributable to the loss of the insured property is recoverable, even if it is concurrent with uninsured loss – i.e. if it is impossible to determine which of the two causes is the dominant factor. However, the same analysis does not apply where there are two causes of loss of equal efficiency but where one is covered under the policy and the other is expressly excluded. In those circumstances, as a matter of English law, the loss would not be covered. This is to be contrasted with the position in most US states where such a loss would likely be covered.

Although not expressly tested in case law, we believe the same rationale would apply to Business Interruption losses. As an example, we were involved in a claim for physical damage and business interruption and/or extra expense arising from Hurricane Katrina. The insured began implementing its plans for an emergency shutdown of its plants in Louisiana days before the hurricane made landfall on the Gulf Coast, and then claimed business interruption losses from when the plant was shut down prior to the hurricane. Those pre-damage Business Interruption costs were not covered as the Business Interruption claim needed to be caused by indemnifiable physical damage either to the insured's own property or to that of its suppliers and/or customers. The insured also suffered the post-damage Business Interruption losses which could also be attributed to the general impact of Hurricane Katrina in the region (which meant the plant would have been out of operation even without the damage)?

Applying the principles of causation set out above, all of the BI losses caused by the insured damage were recoverable even though they were concurrently caused by the general impact of Katrina.

Q

QUANTUM

This may be an obvious entry, however, it is important at the outset of a claim to try and establish an early agreed response to issues of quantum. This also relates to reserving an event of unusual magnitude occur, there is obvious pressure for early and accurate reporting, both internally and externally.

R

REINSURANCE

Ascertaining the detailed nature of the cover, and in particular the contractual framework of any reinsurance formats will be crucial in determining the appropriate response to a claim.

See the separate entry for Governing Law for a discussion of back-to-back principles.

S

SEVENTY-TWO HOURS CLAUSE

Many property policies with an expected storm exposure will have an aggregation wording (see the separate entries for Aggregation and Occurrence) tailored to storm risks; usually by way of a Seventy-Two Hours clause. A typical clause, part of a wider Occurrence clause, reads as follows:

"In respect of losses hereunder arising from tornado, cyclone, hurricane, windstorm or hail, the term "occurrence" shall mean the sum total of all the Insured's losses sustained during any one period of seventy-two (72) consecutive hours commencing within the term of this Policy."

Thus it serves to act as both an aggregation of what might otherwise be deemed separate events into one 'storm occurrence' and also to place a temporal cap on such losses. Any loss/damage occurring outside of the seventy-two hour period will be covered but constitute a separate occurrence and attract a fresh deductible. For treaty accounts this may impact limits and reinstatement provisions.

SHUTDOWN COSTS

The specific policy wording needs to be considered in respect of each risk but it is generally unlikely that cover would be provided for the costs incurred in a precautionary shutdown of an onshore facility in advance of a hurricane which does not in fact impact. This is certainly the case for Business Interruption costs although issues of "imminency" may be relevant when construing a Sue and Labour clause.

Again, however, caution may be required when reviewing the position under some legal systems. We have seen positions adopted in respect of onshore losses that shutdown costs are recoverable as and when the hurricane makes landfall as long as there is a subsequent loss.

See the separate entries for Sue and Labour and Mitigation.

STORM SURGE

Arguably the most dangerous and physically damaging aspect of any hurricane, a storm surge (or storm tide) is the name given to the rising of the sea level caused by hurricanes as they make landfall. Generated many miles offshore, the low pressure, high winds and high waves associated with hurricanes pile seawater up into a water dome which is then dragged along beneath the hurricane. Whilst out in deeper waters, the dome is able to sink and the water dissipates out into the ocean. However, as the hurricane nears land, the ocean floor rises blocking the seawater's escape, causing the body of water to rise up and come ashore as a storm surge.

In August 2005, the storm surge generated by Hurricane Katrina was reported to have been 8 metres high in places, and it was responsible for much of the physical damage and loss of life resultant from the hurricane.

See the separate entries for Flood and Windstorm for a consideration of definitions within an insurance policy. How a policy responds will be determined by the detail of the wording.

SUE AND LABOUR

This topic is often clouded with myth and uncertainty. The central tenet is that an insured is obliged to take steps or incur expenditure aimed at preventing or reducing damage to insured property. The obligation only arises where there is an express provision in the policy; it will not be implied. Sue and Labour type clauses are sometimes headed "Loss Prevention" clauses.

Cover is usually only provided in instances where an insured loss has occurred or is "imminent". Some clauses provide that cover is only in place if in fact there is an insured loss.

A Sue and Labour clause usually sets out to what extent an insured can recover the costs of taking such steps. This can lead to difficulties especially in instances where preventative steps are taken in the face of an expected hurricane that does not in fact hit the insured property; raising questions as to whether a loss was "imminent" or not.

If not specified by the policy the costs will be recoverable under a traditional Sue and Labour clause in a Marine risk (s. 78(1) of the Marine Insurance Act 1906), but the position is less clear for a non-Marine risk or under a Loss Prevention type clause. Louisiana law, as an example, adopts a similar approach to Sue and Labour covers, with prudently incurred costs being recoverable.

Traditionally Sue and Labour costs are seen as anadditional head of cover separate to the policy limits. The clauses also usually specify that the costs are to be borne by the insured and insurer in respect of their respective interests: Leaving aside the deductible, it is not always clear how such a provision should operate.

See the separate discussion of Mitigation for circumstances where there is no Sue and Labour or Loss Prevention clause.

SUPPLIERS EXTENSION

See the separate entry for Customers Extension.

T

TIME-LIMITS

The potential application of time-limits is not ordinarily a cause of concern early on in a claim investigation. However, in claims concerning different jurisdictions and governing laws the application of time-limits may be relevant to the making of a claim; the denial of a claim; and potential subrogation claims. For the latter, it would not be unusual for contracts with the relevant suppliers of equipment and/or services to seek to compress the timetable within which a claim must be made. That would not always sit easily with the timetable for a review of a claim with a multi-layer and multi-party insurance placement.

U

UMBRELLA POLICY

'Umbrella Policy' is a term applied in many different circumstances. However, it most commonly denotes a cover taken out to provide an extra layer of cover; often at high limit levels and in conjunction with existing policies. It is important to consider the terms of all policies that may respond to a loss to see how potentially concurrent covers dovetail with one another.

Where there is double insurance, as is quite possible in the context of the inter-dependant energy industry, the English law approach, in the absence of any policy wording to the contrary, is to seek an equitable pro-rating of the loss based on policy exposure and limits.

V

VERIFICATION OF LOSS

The huge disruption caused by Nat Cats often leads to the Insured being unable to properly support a claim, or lead to long delays in being able to do so. In circumstances where a distinction has to be made between insured and uninsured losses and extra expense within a Business Interruption claim, a slow-start to the verification process can drastically undermine the efficiency of the claim review process. This can be to the detriment of both the insured, who may not be able to support what is a valid claim, and insurers who may be left having to pay the insured's subsequent significant claim preparation costs. An early understanding of what support and documentation is required will likely benefit all parties involved.

JOINT VENTURE

Many covers relate to joint venture projects and may be placed in the existing facilities of one of the joint venture parties. Clarity as to the cover provided to all parties is essential, especially if full cover is not provided to one or more party.

W

WINDSTORM

Property damage policies are often triggered by 'windstorm'. Under English law there is no specific definition of this term. It is generally accepted, however, that for coverage to be provided under the windstorm peril, the wind must be: (1) unusual in that it is greater than normally expected in the area at that time of year; (2) sufficiently strong to have caused damage to other property in the area; and (3) identifiable as a specific incident of some kind.

For the purpose of US property claims, the definition of a hurricane is generally accepted to be a storm named by the US National Hurricane Centre. As a result, distinctions between high winds, windstorms and hurricanes are not generally queried in hurricane-related insurance disputes. The issue may arise, however, in losses caused by unnamed storms.

As an example, in 2007 the Californian Court addressed a flood/wind exclusion in *Northrop Grumman Corp v Factory Mutual Ins*. A primary policy excluded flood damage "whether driven by wind or not", and the excess policyexcluded flood but did not contain that extra wording. The excess policy was said to be ambiguous and did not clearly exclude hurricane storm surge damage.

X

EXCESS

The insured values at risk on the programme of even a medium-size insured often results in fractured insurance placements; with split and multi-layer placements common. It is important, therefore, to properly understand the placement structure and in particular the application of any Excess limits, self-insured retentions or drop-down provisions. Uncertainties concerning the impact of eroded aggregate retentions on the surrounding placement and the impact on related or contingent covers are becoming increasingly common.

From a practical point of view, the appropriate market response to large claims in particular needs to be guided by an accurate understanding of each insurer's exposure.

We also consider that it is important for insurers to adopt a consistent approach to losses so as to avoid any concerns as to criticisms or being seen to 'cherry-pick' a position.

Y

YEAR OF ACCOUNT

The hurricane season in the Gulf region does not pose problems for accounts written on a calendar year basis. However, increasingly accounts are renewed at different dates within the year and at times with bespoke trigger points and dates. For risks with a predominant hurricane exposure it is clearly sensible to avoid any possibility of overlapping years of account. See the separate entries for Aggregation and Seventy-Two Hours Clauses.

For liability exposures written on a claims made basis, the usual caution will need to be taken in respect of marrying inwards and outwards claims.

Z

ZIP CODES

Legitimate claims for Nat Cat-related damage are often accompanied by fraudulent claims for unrelated damage to properties outside of the affected area. Given the volume of claims it is often difficult to spot the frauds, but some assistance is given by the list of affected zip codes published by the state authorities. Many claims passed on to reinsurers in the wake of Katrina and Rita were found to be from zip codes not on the affected lists, and as such their legitimacy could be examined more closely than the others. Whilst such difficulties will arise on smaller claims, it may be a relevant issue for those on Treaty accounts or responsible for reviewing delegated authorities.

FURTHER INFORMATION

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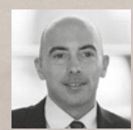

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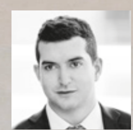

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