Shared Private and Public Specific Peril Terrorism Risk Programs

An Alternative to the Terrorism Risk Insurance Act of 2002

Ronald R. Robinson

Berkes Crane Robinson & Seal, LLP

515 South Figueroa Street
Los Angeles, CA 90071
(213) 955-1150
rrobinson@bcrslaw.com

Lindsay Peterson

Legal Intern
Berkes Crane Robinson & Seal, LLP

515 South Figueroa Street
Los Angeles, CA 90071
(213) 955-1150

Return to Course Book Table of Contents

RONALD R. ROBINSON is a partner in Berkes Crane Robinson & Seal LLP, in Los Angeles. He is a mediator, arbitrator, and trial and appellate coverage counsel for a number of insurers and reinsurers dealing with disputes over environmental, asbestos, intellectual property, and entertainment-related losses. Mr. Robinson is a past chair of the DRI Insurance Law Committee, a former member of DRI's Law Institute, and a member of the FDCC.

Shared Private and Public Specific Peril Terrorism Risk Programs

An Alternative to the Terrorism Risk Insurance Act of 2002

Table of Contents

I. A New Specific Peril Terrorism Coverage: Proposal Summary 317
II. September 11th Challenges the Resources of Insurance, Business, and Government Communities Worldwide 319
A. Private Direct Insurance Markets Face a New Catastrophic Risk 319
B. Private Re-Insurance Markets Want Terrorism's Risk to be Quantified and Limited 320
C. General Insurance Premiums are Increasing to Meet Terrorism's Risk 320
D. Specific Terrorism Limits and Exclusions are being Proposed for "All Risk" Policies 320
E. Private Insurance Cannot Assume All of the Business Community's Terrorism Risk 321
F. Governments are Reluctant to Share Terrorism's Risk with Private Insurers or Each Other 321
III. Specific Peril Terrorism Coverage: A Partnership Program 322
A. Catastrophic Losses, including Terrorist Attacks, Can Be "Covered" by Government Partnership Programs 322
B. Political Risk Property Coverage Provides Underwriting Principles Easily Adaptable to an SPTC Program 323
C. The Proposed Governmental Roles for the SPTC Program 323
D. The Proposed International Partnership of Nations 324
E. Program Limits, Layer Attachment Points, and Funding Mechanisms 324
IV. Underwriting Principles for Specific Peril Terrorism Coverage 325
A. A Philosophical Starting Point for an SPTC Coverage Grant 325
B. Drafting an SPTC Policy Separate Section or Endorsement 326
C. Protecting Carrier Solvency through Mandatory SPTC Risk Spreading 328
D. Dispute Resolution, Administrative Regulation, and Choice of Law Options for an SPTC Program 328
V. The 2002 Terrorism Risk Insurance Act 329
A. The Terrorism Risk Insurance Act 329
B. How the Act Came to be Law 329
C. Certain Proposed Amendments to the Act 330
D. Final Passage of the Act 331
E. Continuing Issues Not Addressed by the Act 331
F. Catastrophic Risks Not Covered under the Act 332
G. Re-Insurance Issues Not Addressed by the Act 332
VI. Conclusion 332
Appendix—The World Jurist Association's Madrid, Spain, 2002 Resolution on Terrorism Risk Insurance 334
Acknowledgments 335

Shared Private and Public Specific Peril Terrorism Risk Programs

An Alternative to the Terrorism Risk Insurance Act of 2002

I. A New Specific Peril Terrorism Coverage: Proposal Summary

The terrorist attacks of September 11th altered the lives of all people, dislocated their economic institutions, and rewrote a host of their government's policies throughout the world. More than one year later, the debate on how best to compensate the casualties and repair the damage of September 11th, as well as the critical need to protect against future attacks and defeat terrorism, continues to dominate every personal, business, and government agenda.

Each segment of society has something it can and ought contribute to the war against terrorism. Private insurance communities worldwide are playing a singularly valuable role in this effort. Terrorism's immediate goal is to destroy life and property, end any sense of security, and create fear. Insurance's historical goal is to protect life and property, provide a sense of security, and promote freedom from fear in the face of catastrophic damage and loss. Thus, the insurance companies in each developed nation have a direct and unique role to play in helping to defeat this old, but newly dangerous, enemy, simply by covering the risk posed by terrorists. Yet, the potential magnitude of new terrorist attacks presents a clear and present threat to the solvency of insurance communities in every nation. Consequently, insurance coverage for terrorism cannot continue, let alone expand, unless individual governments and the nations of the world act together with the private carriers so that each party can accept an appropriate portion of this newly expanded risk.

What is needed is a tripartite partnership between the insurance companies in each developed nation *and* their respective governments *and* the international community of nations, all acting together, to underwrite a new Specific Peril Terrorism Coverage Program ("SPTC Program"). Historically, "all risk" policy forms—as opposed to "specific peril" forms—in the three basic lines of private insurance include this risk generally, without specific reference to these kinds of attacks. However, an "all risk" policy simply does not provide the specificity that many analysts believe is now crucial to the continuation, let alone the expansion, of coverage for catastrophic terrorist attacks. Consequently, traditional specific peril based insurance principles ought to be adopted to underwrite and draft a separate coverage section or endorsement that can serve to establish the Program proposed in this article. Such an approach can safely continue and expand this coverage because specific peril based insurance will clearly define and limit the risk undertaken by each partner. Thus, future terrorist losses can be quantified and prudently insured.

The proposed SPTC Program consists of three specific peril policy based tiers of coverage: first, a private sector layer made up of primary, umbrella, and excess carriers, cons*tructed much like classic large risk programs; second, a government layer that attaches above the limits* of the private sector layer and "follows form" to the underlying SPTC policies; third, an international layer consisting of a fund created by participating nations that attaches above the limits of a given partner nation's layer and, likewise, follows form to the private sector layer SPTC policies. The fund could be chartered under the auspices of the United Nations and governed pursuant to whatever structure is acceptable to participating nations ("U.N. Fund"). Traditional marketplace forces, working in tandem with sovereign politics, would serve to create the Program's tri-tier coverage mechanism, as well as fix the different "limits" and attachment points for the private, governmental, and U.N. Fund "layers" of coverage.

The SPTC Program would encompass all of the traditional insurance lines that responded historically to terrorist losses, including: (1) life, workers' compensation, health, and accidental loss policies ("Personal Lines"); (2) first-party policies for fire, property destruction, and business interruption loss ("Property Lines"); and (3)

third-party policies for casualty claims and lawsuits ("Casualty Lines"). The Program would rely on these same policies, rewritten for this risk using separate coverage sections or endorsements based on specific peril underwriting principles, to replace the current "all risk" coverage, as well as to expand the new cover prudently. As for those undeveloped nations that do not have insurance communities, but seek the protection of an SPTC Program, carriers worldwide would have an opportunity to create a private sector layer for this Program in those sovereign states.

The SPTC Program would be financed by premiums at the private insurance layer only, with treasury revenues and surpluses being used to fund each nation's governmental layer. Each nation would also fund its *pro rata* share of a given loss that attached the U.N. Fund, on a case-by-case basis. Of the three partners, the insurance community has the most efficient mechanism to collect premium from and return it to all segments of society through investments, payment of claims and awards, and the creation of jobs. Thus, premiums are best left to funding only the private layer and ought not be the source of the monies that directly support the public national and international layers. Traditional private sector economic forces, bolstered by premium mechanisms, in turn can act to stimulate a given nation's economy, increase its treasury revenues, and fund the public "layers," nationally and internationally. Should governments directly receive premium dollars, political pressure would surely be brought to bear to reallocate these monies to "other important works," leaving the cupboard bare should an attack occur.

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

The SPTC Program would not require dramatic changes to the infrastructures of the participating insurance communities or nations or to the laws that govern them. Moreover, creation of an SPTC Program need not be delayed pending resolution of the myriad of civil justice and public policy issues that now dominate insurance, tort, and government reform agendas. As these far-reaching questions are answered, the resulting solutions can simply be applied to an SPTC Program.

The creation of the SPTC Program in each nation would best proceed in the context of a worldwide examination of this global risk. The United Nations is the entity best suited to convene a conference of insurance professionals, coverage lawyers, state insurance regulators, and government statesmen from all participating countries to discuss and coordinate creation of a Specific Peril Terrorism Cover Program in each nation. This same conference could also propose the ways and means to create and implement the U.N. Fund. When the SPTC Program concept was presented in four extensive white papers (including an expanded version of this paper) at the World Jurist Association's ("WJA") Conference on International Terrorism in Madrid, Spain, in April 2002, the WJA passed a resolution calling upon the U.N. to convene just such a conference (see the reprint at the end of this article). The U.N. has received this request but has yet to act on it.

The SPTC Program has been designed to be created by its partners from the "ground up," rather than im-

posed from "the top down." Each sovereign will provide stability and security while its private insurance market adjusts the Program's policy forms, illuminates underwriting choices, and fixes Program policy limits, attachment points, and private sector premiums. More importantly, as the SPTC Program matures, each nation's insurance community can replenish and protect its overall surplus and premium base.

The United Kingdom, Spain, South Africa, Israel, and the United States have in the past provided insurance for other forms of catastrophic loss. These programs prove the viability of solvent coverage for this new catastrophic risk. In addition to the protection and stability it would clearly be able to provide, if an SPTC Program is created in each nation, private market forces and geopolitical realities will soon disclose the true role being played by a given sovereign in the war on terrorism. It simply will not be feasible for any nation to long foster or support acts of terrorism while being required to pay for the losses it helps to create throughout the world. This is the overriding benefit of this proposal, which seeks to combat fear, build a sense of security, and protect society from the acts of terrorists.

II. September 11th Challenges the Resources of Insurance, Business, and Government Communities Worldwide

A. Private Direct Insurance Markets Face a New Catastrophic Risk

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

The total September 11th loss is estimated to be over $50 billion. About 80 percent of that loss will likely be covered as follows: (1) workers' compensation carriers will pay approximately $5 billion; (2) life carriers will pay approximately $6 billion; (3) Property Lines will pay about $12 billion; and (4) Casualty Lines will pay between $18 and $20 billion. The remaining $7 to $9 billion will not be paid by any line of insurance. Many of the carriers responding to September 11th losses are U.S. domestic companies. However, 60 percent of the actual covered losses will be paid by carriers with principal places of business outside of the United States.

Assuming the emerging consensus of a $50 billion loss on September 11th, Property and Casualty Lines will pay 60 percent ($30 billion). This $30 billion figure in turn represents 30 percent of the total current U.S. Property and Casualty Policy Surplus of $100 billion. To put the 30 percent figure in its full market context, there is about $125 billion of available Property and Casualty re-insurance surplus in the U.S. Consequently, the direct Property/Casualty and Re-insurance market's shared loss of $30 billion is only 13.5 percent of that combined market's surpluses ($225 billion). This graphically illustrates the impact on Property/Casualty insurers of any loss of re-insurance cover for this risk. Direct markets have more than a 200 percent increase in risk when acting alone, as opposed to much lower exposure when acting with re-insurance resources.

It is beyond debate that several more significant terrorist acts, or even one event with losses greater than those on September 11th, will result in a demand on the private insurance community worldwide in general, and on many United States carriers in particular, that will result in significant cash flow problems for all that will put some companies at risk for insolvency. Market pressures already in play have put a few companies on a negative

rating or credit watch as a direct result of the magnitude of their September 11th payments and/or future risk. While the primary, umbrella, and excess carriers in all lines responded admirably to September 11th losses, few carriers can stay solvent, let alone have sufficient cash, if called upon to respond fully but *alone* to future terrorist-caused losses. This is why both the government and U.N. Fund layers of coverage are needed for an SPTC Program.

B. Private Re-Insurance Markets Want Terrorism's Risk to be Quantified and Limited

One of the major obstacles to continued, let alone expanded, terrorism coverage is the prospective refusal of many re-insurers to "follow the fortunes" of their direct market policyholders for this specific risk. Re-insurers are threatening to add war or terrorism risk limit caps or outright exclusions to their treaties and facultative contracts in order to reduce or deny future terrorist claims. The direct market has not and, in many cases cannot, invoke similar bars to coverage. In fact, elected representatives in many jurisdictions have said they will not permit such limits or exclusions in Personal and Property Lines, let alone Casualty Lines of coverage. As terrorism amendments become part of the re-insurance renewal process, the "exclusion" debate will bring added instability to direct insurance markets worldwide.

Without continued re-insurance, the direct market must act to exclude this risk *or* obtain enough premium to remain solvent *or* "go bare;" *i.e.*, cover terrorism's losses without re-insurance. The parties are now at impasse, and there appears to be no viable solution in the immediate or foreseeable future except for governmental intervention. The SPTC Program proposes just such a lifeline.

C. General Insurance Premiums are Increasing to Meet Terrorism's Risk

The premium market had begun to "stiffen" about a year before September 11th, generally raising policy pricing for the first time in ten years. In the absence of a specific terrorist exclusion in most direct market policies, premiums increased again after September 11th from as little as 10 percent to 20 percent up to 200 percent, depending on the line of coverage and the perceived terrorism risk. However, the market has not and probably will not charge a separate terrorism cover premium. Such an approach is viewed by most analysts as not being successful in the general, as opposed to the specialty lines markets. The SPTC Program will, therefore, rely at the private sector layer on the general premium mechanisms now in place for "all risk" policies, with the amount thereof adjusted upwards to fund the new separate policy sections or endorsements required to add the Specific Peril Terrorism Coverage Program to these traditional contracts.

To the extent that special market terrorism insurance is being offered at all, it is available at much higher premiums. Only a few individuals or companies have the financial resources to buy the special policies, which are designed to cover large limit terrorism exposure. In summary, this coverage is available, but the carriers offering it are increasing deductibles and creating specific and generally lowers limits for this protection.

D. Specific Terrorism Limits and Exclusions are being Proposed for "All Risk" Policies

The Insurance Services Offices ("ISO") is the entity in the U.S. that presents and seeks to qualify premium rates and standard policy provisions on behalf of insurers in each of the 52 Regulatory Jurisdictions that separately govern insurance activities. ISO has now acted on behalf of direct Property and Casualty carriers to reduce cover for terrorist risks in each of the 52 Regulatory Jurisdictions. Currently, all jurisdictions but California, Florida, Georgia, New York, and Texas have accepted the proposed exclusion as an interim measure pending word from the re-insurance market on its coverage for this risk. However, the aforesaid five "hold-out" states account for 35 percent of the total U. S. insurance market, and their relevant regulatory agencies have either denied approval of the exclusion or suggested revisions in language, which are still being debated.

The ISO proposal seeks to both limit and exclude the terrorist coverage that each "all risk" property and

casualty policy must now, by law, provide. Under the ISO proposal, if a given terrorist attack (which has yet to be defined) results in an aggregate loss of $25 million or less, a Property or Casualty carrier will cover those damages. If a given loss exceeds $25 million, however, there will be no coverage, not even the for the first $25 million. The $25 million "cap" applies to one event. Splitting one event into two or more separate acts would permit multiple $25 million or less "payments." For example, there is a dispute today as to whether September 11th was a one, two, or multiple—event loss, *i.e.*, should separate policy limits apply to the losses from each of the buildings attacked and planes lost, or did all losses flow from one concerted act/event?

The ISO proposal also provides that if a terrorist event causes death or serious physical injury to 50 or fewer persons, those losses will be covered by "all risk" policies. However, if more than 50 persons are involved, there is no cover, not even for the first 50 claimants. This is true even if the total property damage is $25 million or less. The exact wording of the ISO exclusion's definition of a terrorist act and its proposal that coverage extend only to a $25 million/50 person or less loss is still the subject of much debate. As yet unaddressed is the question of this exclusion being added to Personal Lines.

If ISO's plan is put in place on a broad scale, the private market will be able to cover only a small portion of the terrorist risk, thus providing no real catastrophic protection outside of specialty policies unaffected by this proposal. One might ask why not spread the full catastrophic risk across three layers of private, public, and international insurance under the SPTC Program? The answer is simply one of political will. To date, governments have refused to partner with their private sector carriers to share this risk.

E. Private Insurance Cannot Assume All of the Business Community's Terrorism Risk

Commercial property owners, lessors, and businesses with significant terrorist exposures are already facing higher premiums, even though in many cases their general or specialty policies soon will either reduce or exclude their terrorism coverage. This has a direct and adverse impact on a nation's economy. For example, owners of large groups of buildings in major metropolitan centers can have a total risk of anywhere from $100 million to $1 billion. Prior to September 11th, a loss caused by a terrorist attack would be covered under the various lines of coverage held by these owners. Today, these parties, in large part, can only obtain the $25 million of coverage available under the ISO proposal, unless they have the funds to purchase a special policy with higher limits. Otherwise, these owners must simply "go bare." The uninsurability of this risk is preventing sales, transfers, and the leasing of these properties almost across the board. This is one of the major factors affecting the current economic situation and is one of the reasons it is not resolving itself favorably. We are all destined for a disastrous economic result if new terrorist attacks outpace the creation of the SPTC Program to cover this risk.

F. Governments are Reluctant to Share Terrorism's Risk with Private Insurers or Each Other

State legislatures in the United States have introduced bills that would require full terrorism risk coverage across all insurance lines. While elected state officials are demanding this level of protection, their state's insurance regulatory agencies, recognizing the current threat to carrier solvency caused by the potential lack of re-insurance, have approved the ISO proposal—which offers a very low limit cover. At the same time, demands for federal government re-insurance and/or coverage for this risk from many quarters have fallen on seemingly deaf ears.

For the past ten months, the federal government has faced a wide range of arguments, based on both economic and moral grounds, asking it to share the risk of terrorist losses. This effort has paralleled the public demand for compensation and protection for the casualties of September 11th. The federal government has been presented with many solutions, and has even considered some of them, but it has done nothing to date except enact the Federal Air Transportation Safety and System Stabilization Act ("Act"). The Act provides a very limited

and specific response to the September 11th losses that serves only to cap the liabilities of the public agencies that responded to the attack, the airlines involved, and the owners of the buildings attacked and their tenants, as well as to limit recoveries by the families of the casualties of the attack on the World Trade Center, the Pentagon, and the passengers on the attacking aircraft. This government response, being solely remedial, is not relevant to the future threat.

Proposed and still pending solutions presented in the U.S. Congress to date include: a national regulatory system for terrorism coverage; tax deferred insurer catastrophe reserves; long-term federal loans to insurers to help manage terrorist losses; and various "re-insurance" programs to replace that market's role in this cover. All of these proposals have been debated, with different congressional constituencies finding fault with different parts of each. The result has been no federal government action at all.

The current U.S. Administration is itself hesitant to enter into the "insurance business" beyond the remedial September 11th Act. It does not want to place itself in competition with the private insurance sector. Moreover, any governmental insurance solution must, in the current U.S. Administration's view, include litigation reform, tort reform, prohibitions on punitive damages, limitations on recovery of non-economic losses, the elimination of joint and several liability, limitations on pain and suffering awards, and changes in the standards of proof that establish awards. The addition of these unresolved issues to the terrorism coverage debate has effectively stalled any government involvement to date.

III. Specific Peril Terrorism Coverage: A Partnership Program

A. Catastrophic Losses, including Terrorist Attacks, Can Be "Covered" by Government Partnership Programs

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

The United States government offers "insurance" to protect against floods, create security for mortgages, safeguard nuclear installations, and replace money lost while deposited in federal banks. Within the last 20 years, the U.S. government has created similar mechanisms to stabilize and protect Chrysler Corporation, the U.S. savings and loan market, and, most recently, under the Act, the airline industry and certain New York City building owners, lessors, tenants, and the responding governmental agencies.

The lessons learned from these international and U.S. federal programs can be adapted to create the layer of governmental coverage for terrorist-caused losses in the Program. These precedents prove the viability of the SPTC Program.

B. Political Risk Property Coverage Provides Underwriting Principles Easily Adaptable to an SPTC Program

Private insurers and governments, separately or as partners, currently provide Property Line Political Risk Insurance. A $50 million political risk specific peril property policy can cost anywhere from $500,000 to $2 million per year, as compared to $50,000 to $200,000 for a traditional all risk Property Line policy. The underwriting principles for political cover are based upon what is called a "country risk" analysis. Analysts study the potential for corruption, political unrest, revolutionary upheaval, civil wars, and other untoward political events that may shift the balance of power in a given nation. This analysis is then applied to an evaluation of the economic significance of the role in a given nation played by the business seeking such protection. The question asked by underwriters is whether or to what extent is the potential insured a target for terrorist acts in this particular geopolitical context. This risk is then quantified, a premium is set, and coverage is put in place.

Companies offering this coverage include Chubb, AIG, and Lloyds of London. Several European governments, as well as the World Bank, offer similar protections. The underwriting principles that permit these covers to be viable can serve as blueprints for the underwriting principles of the SPTC Program.

C. The Proposed Governmental Roles for the SPTC Program

Sovereign states have three unique roles in the SPTC Program. First, they have the ability to act directly to prevent terrorist attacks. Interestingly enough, this is a classic insurance role as well. The *sine qua non* of Property and Casualty carriers has always been "loss control." Simply put, carriers supply loss control experts who "walk the plant" of a given insured to find first-party and/or third-party coverage hazards which, if eliminated, serve to lower an insured's risk of loss *and* its premium rates. Moreover, "loss control" programs serve to actually prevent needless destruction of life and property. In addition to providing financial resources to the SPTC Program, participating governments alone can play the critical "loss control" role for this cover—prevention of or reduction in terrorists losses. Only sovereigns can "walk the global plant," if you will, to try to prevent or limit acts of terrorism. Neither insurers nor insureds are equipped to perform this role, though they, and indeed all sectors of society, must do their part.

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

Some argue that governments ought to assume this entire expanding risk alone. Yet most sovereigns are ill prepared or equipped to handle claims or manage their defense. The insurance community is the more capable partner for that task. Its claims handling mechanisms are in place and fully funded. Government claims handling would have to be created from whole cloth in order to respond to this kind of loss. This is neither efficient nor practical. Nevertheless, a government "guaranty fund," whose sole function is to "back-stop" any private insurer in the SPTC Program whose demise can be traced to terrorist-caused losses, would be a third and most appropriate role for a sovereign to play.

There are, however, pitfalls and problems to be avoided when creating the governmental layer of coverage in an SPTC Program. These include at least the following:

- Care must be taken to ensure that the governmental "layer" does not degenerate into an anti-market "bailout."
- The current debate over tort and litigation reforms should not delay the implementation of this

cover. If not resolvable now, these questions should be tabled as to this Program and, when answered generally, any resulting solutions to these problems can be adapted for this cover.

- The question of a national regulation scheme for this new cover, standing separate and apart from the current 52 Regulatory Jurisdictions, ought be addressed later, so as to not delay the implementation of the Program.
- Government dollars ought to be paid to claimants *indirectly* through the participating carriers. In order to avoid the typically exorbitant government fees that often attend catastrophic loss claims handling indemnity payments, the private sector should control actual claimant payments at the public layers.

D. The Proposed International Partnership of Nations

The U.N. Fund ought to be created in a manner that is instantly compatible with the existing infrastructures of participating governments and carriers. Any attempt by the U.N. (or any sovereign, for that matter) to make major and immediate private or public layer infrastructure changes or to implement an SPTC Program from "the top down" will surely delay, if not derail the proposal. The governance and operation mechanisms put in place for the various national programs and the U.N. Fund ought not require any disruption to commercial, public, or civil justice systems already in place. In other words, the Fund ought to be created and administered in harmony with the existing geopolitical and economic realities of the participating partners. The goal should be to create the U.N. Fund from the "ground up" and not from the "top down." Thus, the process ought to be based on cooperation and responsible participation by each partner, using their existing but independent infrastructures and economics.

E. Program Limits, Layer Attachment Points, and Funding Mechanisms

The Program would require by law that each individual primary, umbrella, or excess insurance company participating in the private sector "layer" of coverage offer coordinated and fair specific per event and/or aggregate limits. For example, both of these limits could safely be fixed at ten percent of a given carrier's annual insurance surplus or premium collections. All companies could remain economically viable at this percentage level because the risk of insolvency would be quite low. Moreover, the use of a set percentage for all "limits" will make it impossible for one company to manipulate a market advantage by "scamming" the SPTC Program through an anti-competitive laying off of extra risk to higher level carriers in the private layer or to the government layer above it.

A given sovereign's per event and/or aggregate limit for its governmental "layer" could likewise be based on a coordinated, fair, and objective figure, such as total policy surplus or total annual premiums of all carrier participants in the SPTC Program for that country. In the United States, this would mean a governmental layer of approximately $300 billion, if based on total policy surplus, or $300 to 400 billion, if based on total annual premiums. In the alternative, a set percentage of each nation's Gross Domestic Product could serve as the limit for each sovereign's layer.

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

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

Funding for the Program's private sector layer of primary, umbrella, and excess cover would come from general "all risk" premiums and would not be separately rated or paid. The Program's "premiums" would simply be included as part of the price of the existing all risk policies to which this cover would be added either by a specific section or an endorsement. A sovereign's treasury and surplus, not premium collected from Program insureds, would fund a government's Program obligations. Likewise, there would be no premium paid to the U.N. Fund. This third layer of cover would be financed as needed, by participating sovereigns using the above noted share system to respond to a given loss.

The elimination of private premium payments to a given sovereign or to the U.N. Fund serves to keep these dollars in the private marketplace. If separate SPTC Program premiums are paid to a government or to the U.N. Fund by insureds, political pressures to use these funds for other than terrorist losses could prove irresistible. In any case, demands therefore would be unrelenting. Government/U.N.-collected premiums soon would be argued by many to be government/U.N. surplus revenue. Then the monies designed to protect against catastrophic loss might well be diverted to pay for budget deficits, programs, entitlements, grants, and the like. There might also be attempts to divert premiums to rebuild public infrastructures, rather than to protect the businesses and the people who paid them and who are directly impacted by a terrorist attack. The lack of premium accumulation at either the government or the U.N. layers will eliminate any potential for this result and keep private dollars in the private sector, where they can act to stimulate the economy and, in turn, fund the public layers of the Program.

IV. Underwriting Principles for Specific Peril Terrorism Coverage

A. A Philosophical Starting Point for an SPTC Coverage Grant

The drafting and imposition of uniform policy provisions for the SPTC Porgram's separate sections or endorsements is neither practical nor necessary. Endless time consuming debates over the superiority of one provision over another must be avoided. There need only be agreement by all partners in all nations on the scope of the grant of coverage, *i.e.*, the specific perils insured. Otherwise, nations could vary the losses covered and "lay off" risk on the U.N. Fund. Financial stability for this cover does require at the very least a uniform starting point—the scope of the perils covered—but not more.

The SPTC Program envisions that the relevant existing "all risk" policies in all lines will add a standalone section or an endorsement to provide the proposed insurance. The grant of coverage provision that serves as the core of the Program ought to define a terrorist loss by reference to both the purposes and the consequences of the act that produces it. Following is a philosophical starting point for the drafting of a specific peril coverage grant. We discuss in Part IV. B. the problems to be avoided in drafting the numerous policy provisions necessary to provide the separate specific coverage encompassed in the grant.

> Protection is hereby afforded for [the insured's direct losses]—[or]—[damages imposed by law] arising solely from a "Terrorist Act." A Terrorist Act means: bodily injury, death and/or tangible or intangible property damage that results in the interruption, disablement or destruction of personal, business or governmental affairs and/or infrastructures and/or other personal losses that are caused by an individual, a group of individuals or a sovereign state in order to influence, disrupt or eliminate a nation's economic stability, its business or govern-

mental operations or infrastructures and/or its political and policy positions and doctrines, whether such a result directly attends or simply arises from such an act.

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

B. Drafting an SPTC Policy Separate Section or Endorsement

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

SPTC Program policy section or endorsement provisions will have to be approved in each of the 52 Regulatory Jurisdictions that govern policyholder and carrier rights and obligations. Each company will, of necessity, initially develop its own provisions and separate section or endorsement format. However, there is no reason why there cannot be cooperation and coordination in the drafting of the new provisions needed for this cover across all three lines. Traditional drafting entities such as ISO, regulatory agencies such as the National Association of Insurance Commission ("NAIC"), and other insurance professionals and coverage counsel should work together to draft the provisions that support the agreed upon specific perils that define this cover. Thus, the sections or endorsements in private sector primary, umbrella, and excess policies in the Program's "first layer" would not start out as uniform products. Yet, over time, market pressures, loss experience, and cooperation will lead to a standard provision approach nationally and, eventually, internationally. This is an important goal for the SPTC Program, as consistent application of policies to claimed losses in every sovereign nation is essential.

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

Many U.S. court decisions in the 1980s and 1990s distorted Casualty Line policy language and/or simply re-wrote the underwriting intent of this coverage. These opinions served to create insurance for asbestos, toxic tort, and environmental losses where none in fact had ever existed or was intended. This, in turn, led to the bankruptcy of many insurance companies. The insurance community can neither be unprepared for the massive losses attendant to terrorist attacks nor be put in a position of paying for losses that it never agreed to cover. To protect the financial security of the tripartite partnership, in general, and the solvency of the private sector layer of coverage, in particular, care must be taken to provide that:

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

SPTC Program exclusions should address at least the following issues:

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

Punitive, bad faith, treble, exemplary, or other like extraordinary damage awards ("punitive awards") present a difficult exclusion question. U. S. courts have been incredibly unsuccessful in bringing rhyme or reason to the imposition of punitive awards. The losses covered under this Program will be extensive enough to not burden it with the potential for unrestricted punitive awards. To the extent that punitive awards are requested by claimants as against an alleged insured tortfeasor, public policy ought to and generally does bar coverage of such damages by insurance. These awards ought to flow only from a wanton and/or willful, if not intentional, disregard for life and property. Why protect and thus encourage such conduct by providing insurance for it? Punitive awards against insureds should not be part of the SPTC Program.

Policyholders may also demand that punitive awards be available as against an SPTC Program carrier, participating government, or the U.N. Fund for "failure to honor a claim" or "for claims handling or coverage litigation misconduct" and the like. However, the SPTC Program should permit a punitive award only for actual fraud or intentional deceit by a Program partner. No punitive awards should be available for or arise from the conduct of coverage litigation or claims handling errors or problems. The threat of punitive awards for this and other perceived "wrongs" serves mainly to cripple traditional defense advocacy, to hamper and/or outright inhibit a carrier's assertion of its positions on legal issues or factual questions, and to create an unfair litigation advantage in favor of the policyholder's advocate, rather than to protect an aggrieved policyholder or to prevent "like abuse" in the future. The losses expected in a terrorist event are on such a scale that there simply is not enough money to cover punitive awards or permit windfalls for error, mistake, neglect, or a difference of opinion on law, fact, or proper advocacy. Existing lesser sanctions available to courts are sufficient to discourage such conduct.

Neither courts nor regulatory agencies ought to be permitted to add to the policy specific acts that permit a punitive damage award under the Program's "policies."

C. Protecting Carrier Solvency through Mandatory SPTC Risk Spreading

The SPTC Program should be mandatory in the Personal, Property, and Casualty line "all risk" policies that traditionally have covered terrorist losses. These policies will have to be adapted to add Specific Peril Terrorism Coverage sections or endorsements. As noted above, general "all risk" policy premiums, although different depending on the risk and desired policy limits, will continue to increase, but there ought not be a "separate price" for the SPTC Program. If all policyholders pay a market-set premium to the private insurance community for all policy covers, in all lines, the "rule of large numbers" ought to protect each carrier for the terrorist risk assumed. In this way, no one economic sector of society will be asked to unfairly subsidize another for coverage of this risk. The specialty market terrorism coverage that is available can continue as separate cover sold in parallel with the Program, but is not addressed here. Obviously, the general and specialty markets should coordinate their products or with the Program.

Those who chose not to purchase SPTC Program policies in a given line of insurance or who do not receive some of the benefit of the new cover through their employment will not have this protection. Assuming an individual or business has a choice to use its resources to enter the Program, this is not an inequitable result. However, careful thought must be given to the critical question of how to protect persons or businesses that have no ability to purchase Program policies in the relevant lines because of limited financial resources. Mandatory Program coverage and the differing resources of individuals and businesses will likely focus us anew on an old societal debate: How do we ensure an adequate and complete safety net of insurance for all citizens? Once the SPTC Program is in place, each sovereign must respond to the question of equal access to the protections of the Program. There is nothing about this particular problem that is unique to the new terrorism cover. This question must be answered for all insurance coverages in most nations. Thus, whatever the solution is for this problem in the general insurance market, it can serve as the solution for SPTC Program policies in particular. Implementation of the Program cannot await resolution of this important issue. It is equally true, however, that resolution of this issue ought not be delayed too long, simply because, for the moment, we do not have time to do it before the SPTC Program must be put into place.

D. Dispute Resolution, Administrative Regulation, and Choice of Law Options for an SPTC Program

No national or uniform coverage or claim dispute mechanisms need be created for the SPTC Program. State civil justice systems can handle these issues during the startup of the Program. Likewise, existing interna-

tional law forums can be utilized to handle disputes at the U.N. Fund "layer," all as is determined by the participating nations. However, dispute resolution might someday be transferred to federal/national civil justice systems in order to end the problems of conflicting policy interpretations. Such a uniform approach would also avoid forum shopping and the dislocations flowing from contrary results in otherwise competing "forums." This need not be an initial goal of the SPTC Program. It is, however, a valid second generation question. If a federal system approach were to be implemented, a federal administrative mechanism could replace the 52 Regulatory Jurisdictions now in charge of these objections.

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

It would be essential, however, to include the traditional basic protections of the civil justice system in any ADR mechanism. These safeguards include the following aspects of the rule of law: (1) evidentiary and procedural standards and rules; (2) formal discovery; (3) formal briefing; (4) written findings by the arbitrator based on the applicable law; and (5) the same rights and mechanisms of appeal as are available to litigants in the public civil system. All ADR forums ought to be open to the public.

V. The 2002 Terrorism Risk Insurance Act

A. The Terrorism Risk Insurance Act

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

B. How the Act Came to be Law

The Terrorism Risk Insurance Act of 2002 originated in the House of Representatives and was sponsored by Representative Michael G. Oxley. It was introduced to the House on November 1, 2001 and named H.R. 3210. After its introduction it was immediately referred to the House Committee on Financial Services, the House Committee on Ways and Means, and the House Committee on the Budget. On November 19, the Committee on Financial Services and the Committee on Ways and Means filed reports (House Report 107-300, Part 1-2) on the bill, and it was referred to the Committee on the Budget for a period extending no later than November 26, 2001. The House considered the bill, adopted the text of H.R. 3357 as an amendment, and passed the bill as amended by 227 yeas to 193 nays.

The bill was received in the Senate on November 30, 2001, and placed on the Legislative Calendar. On June 7, 2002, it was introduced and assigned the number S. 2600. On July 25, 2002, the Senate considered the bill, struck the majority of the text, and inserted the new text of S. 2600 by unanimous consent. The Senate then passed

the bill as amended, by unanimous consent. The same day, the Senate requested a conference with the House. The chair was authorized to appoint the following conferees on the part of the Senate: Senators Durbin, Johnson, Reed, Byrd, Bennett, Stevens, and Cochran. On July 26, the House rejected the Senate amendments and agreed to a conference. Representatives Oxley (chair), Baker (chair), Ney, Kelley, Shays, Fossella, Ferguson, LaFalce, Kanjorski, Bentsen, Maloney, Hooley, Sensenbrenner, Cobles, and Conyers were appointed as conferees for the House.

On September 10, 2002, Representative Fossella made a motion to instruct the conferees to ensure the continued financial capacity of insurers to provide coverage for risks from terrorism and to agree to the provisions contained in Section 11 of the Senate amendment, relating the satisfaction of judgments from frozen assets of terrorists, terrorist organizations, and state sponsors of terrorism, and it was passed by a unanimous vote. Throughout September remarks were heard from Representatives Kennedy, Owens, Mascara, Clement, Kleczka, Ehrlich, Pryce, and Barrett. The text of the Conference Report was printed and filed by the House Committee of Conference on November 13, 2002. The House considered and agreed to the conference report on November 14, and the Senate considered and agreed to the conference report on November 19, 2002. The bill was signed by the President on November 26, 2002, and became Public Law (P.L. 107-297).

The sponsor of the Act in the House was Representative Michael Oxley [OH], who was joined by the following 35 co-sponsors: Representatives Spencer Bachus [AL], Bob Barr [GA], Doug Bereuter [NE], Eric Cantor [VA], Mark Foley [FL], Paul Gillmor [OH], Felix Crucci [NY], Darrell Issa [CA], Sue Kelly [NY], James Leach [CT], Robert Ney [OH], Earl Pomeroy [ND], Bob Riley [AL], Marge Roukema [NJ], Jim Ryun [KS], Christopher Shays [CT], Dave Weldon [FL], Richard Baker [LA], Ken Bentsen [TX], Judy Biggert [IL], Mike Ferguson [NJ], Vito Fossella [NY], Mark Green [WI], Melissa Hart [PA], Walter Jones [NC], Steve LaTourette [OH], Frank Lucas [OK], Gary Miller [CA], Frank Lucas [OK], Gary Miller [CA], Doug Ose [CA], Deborah Pryce [OH], Mike Rogers [MI], Edward Royce [CA], John Shadegg [AZ], and Patrick Tiberi [OH]. In the Senate, the Act was sponsored by Senator Christopher Dodd [CN], and co-sponsored by Senators Hilary Clinton [NY], Barbara Mikulski [MD], Paul Sarbanes [MD], Jon Corzine [NJ], Harry Reid [NV], and Charles Schumer [NY].

C. Certain Proposed Amendments to the Act

Throughout the development of the Terrorism Risk Insurance Act, amendments were proposed to alter the nature of the bill. Although there were only four amendments proposed to H.R. 3210, which eventually evolved into the Terrorism Risk Insurance Act, there were 54 proposed to S. 2600. The only relevant amendments to H.R. 3210 were House amendment numbers 411 and 412. Amendment 411 to the bill was the text of H.R. 3357, the Terrorism Risk Protection Act of 2001, which was agreed to without objection. The second proposed amendment, number 412, sought to include an insurance industry deductible of $5 billion, require terrorism coverage as part of commercial property and casualty insurance, and specify no limits on tort actions or recoveries. This amendment was proposed by Representative LaFlace, and failed in the yea/nay vote by 197–222.

It appears that the reason for the extensive number of amendments to S. 2600 is the need for several technical points of revision, such as adding certain punctuation and changing a number of words. But there were also a number of amendments concerned with changing the content of the Act. Senate amendment 3834, proposed by Senator Nelson, required restrictions on the insurance rate increases for terrorism risks. The motion to table this amendment was agreed to in a Senate vote. Senator McConnell proposed amendment number 3836, providing for procedures for civil actions, although it did not state any limitations for the amount of damages sought. The motion to table this amendment was passed as well. Senate amendment 3838, by Senator Harkin, was proposed and agreed to, and it provided for the satisfaction of judgments from frozen assets of terrorists, terrorist organizations, and state sponsors of terrorism.

Senator Hatch proposed the amendment 3839, but it was withdrawn on June 13, 2002. The purpose of this amendment was to implement the International Convention for the Suppression of Terrorist Bombings to strengthen criminal laws relating to attack on places of public use, to implement the International Convention on the suppression of the Financing of Terrorism, and to combat terrorism and defend the nation against terrorist acts. It seems that this amendment coincided in part with the fundamental principles of the Multi-Nation Specific Peril Terrorism Coverage Program, but it was never put to a vote in the Senate. Senator Hatch also proposed another noteworthy amendment that put a ban on punitive damages, number 3871. Specifically, the amendment said that punitive damages are not permitted in any action under the Act. This amendment was ordered to lie on the table.

Senator Dodd also played a major role in proposing amendments to S. 2600. Senate amendment 3876 aimed to include workers' compensation insurance under the Act, and it was passed in the Senate by unanimous consent. Amendment 3887 prohibited any duplicative federal compensation for the same act of terrorism that is covered under any other federal insurance or re-insurance program. This amendment was also agreed to in the Senate by unanimous consent. Finally, another amendment that is relevant to this discussion of the limitations of the Terrorism Risk Insurance Act is number 3880, also proposed by Senator Dodd. This amendment called for the investigation and reporting on the issues relating to permitting insurance companies that provide property and casualty insurance, life insurance, and other lines to establish deductible reserves against terrorism or other catastrophic events. This amendment was submitted and ordered to lie on the table on June 17, 2002.

D. Final Passage of the Act

On November 14, 2002, the House agreed to the Conference Report by a voice vote, and the bill was sent to the Senate. Roll call vote number 252 was taken in the Senate on the Conference Report, and the bill passed by a vote of 86 yeas to 11 nays, with three members abstaining. The President signed the Terrorism Risk Insurance Act on November 26, 2002. On December 16, 2002, the new legislation became Public Law (P.L. 107-297).

E. Continuing Issues Not Addressed by the Act

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

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

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

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

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

F. Catastrophic Risks Not Covered under the Act

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

G. Re-Insurance Issues Not Addressed by the Act

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

VI. Conclusion

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

The continued viability of this critical infrastructure requires that carriers in the various nations of the world not be called upon to bear an unrealistic or destructive share of terrorism losses. The governments in each nation should bear their fair share of this risk—that which is above and cannot be covered by the private sector. Governments are also equipped to share this risk on an international basis when necessary. Sovereigns can mandate a terrorism insurance program in harmony with their existing financial, governmental, and civil justice sys-

tems. They can and ought also provide protections to the private re-insurance community's terrorist loss market, so it too can be stabilized and have a playing field level with its direct carrier insureds.

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

Appendix
The World Jurist Association's Madrid, Spain, 2002 Resolution on Terrorism Risk Insurance

WHEREAS the availability of insurance is essential, from both a historic and pragmatic perspective, to provide for the security and compensation of human and economic losses which result from various causes;

WHEREAS insurance is a means to instill confidence and stability in individuals, nations and economic transactions worldwide;

WHEREAS acts of terrorism are capable of causing catastrophic human and economic loss, the disruption of economic stability and the destabilization of governments;

WHEREAS the potential magnitude of human and economic losses which result from acts of terrorism can exceed the capacity of the private insurance sector alone;

WHEREAS individual governments have the capacity, in varying degrees, to enter into insurance coverage partnerships with the private insurance sector, or if they lack the capacity to enter into such partnerships, to consider enabling legislation to allow for such partnerships, to more fully efficiently and quickly respond to international terrorism losses than either party could without the other;

WHEREAS both the private insurance sector and individual governments may need the aid and assistance of other nations in the international community to respond to such losses;

WHEREAS the United Nations could provide a unique forum for insurance professionals, business leaders and statesmen from all nations to meet, consider and analyze how insurance establishments and government partnerships worldwide can best prepare for and respond to the economic and human consequences of acts of terrorism before such acts cause further catastrophic economic and social harm;

WHEREAS one of four objectives stated in the preamble of the Charter of the United Nations is to employ international machinery for the promotion of the economic and social advancement of all peoples;

IT IS HEREBY RESOLVED that this conference recommends that the Executive Board of the World Jurist Association urge the United Nations to address, by the most appropriate means, how best the private insurance sector, individual governments and the United Nations can work together to provide an international terrorism risk insurance program designed to preserve, protect and defend each nation, its people and the world community from the economic consequences of international terrorism, and thereby promote economic stability and social advancement. It also calls upon the Executive Board to subsequently pursue this issue through interaction with the United Nations Secretary General.

The World Jurists Association's Executive Board acted in July 2002 to send the above-resolution to the United Nations.

Acknowledgments

The analysis, opinions, and proposals in this article are the sole responsibility of the author. This article is based on a much more detailed paper presented at the World Jurist Association's ("WJA") Conference on International Terrorism in Madrid, Spain, April 14-17, 2002. Members of a WTA Madrid 2002 Panel—"Is There and Will There be Insurance Coverage for the Risk of International Terrorism?"—contributed to, commented upon, or critiqued that paper. They included: Ronald M. Greenberg, Of Counsel to Berkes Crane Robinson & Seal; Renny W. Hodgskin, Senior Vice President of Cambridge Integrated Services Group, Inc.; David R. Robb, Executive Vice President of The Hartford; and James L. Seal, partner at Berkes Crane Robinson & Seal, LLP. Beverly Eckert, co-chairperson of the Voices of September 11, a family advocacy group, also provided comments on this article in its original form.

The article also relies in large part on the report of the proceedings of the Subcommittee on Oversight and Investigation, Committee on Financial Services, House of Representatives, United States Congress and, in particular, from the statement to the subcommittee by Richard J. Hillman, Director of Financial Markets and Community Investments, General Accounting Office of the United States. In addition, the article relies on the observations and analysis of Ellen Seidman, Senior Counsel, Democratic Staff, to the Committee on Financial Services, in her remarks to the 2002 World Insurance Forum in Bermuda, as well as a recent Swiss Re Focus Report—"*Terrorism—Dealing With The New Spector.*" All contributions and resources were insightful, helpful, and very much appreciated.

Return to Course Book Table of Contents