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## War and Terrorism Risk Insurance

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# **SYMPOSIUM: TERRORISM AND ITS IMPACT ON INSURANCE: LEGISLATIVE RESPONSES AND COVERAGE ISSUES**

## **WAR AND TERRORISM RISK INSURANCE**

**HELEN M. BENZIE\***

Just as biologists trace the origins of life to the sea, so too the origins of the Terrorism Risk Insurance Act<sup>1</sup> stem from the

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practices for insuring marine transit risks. Coverage for the risks of war and terrorism emanates from marine transit policies. The responses of London underwriters<sup>2</sup> and the government of the United Kingdom to insuring the risks of capture, seizure and confiscation at sea during the later half of the nineteenth century established the terms of coverage available for these risks.<sup>3</sup> During World War II the United States adopted the position of insurer and reinsurer of last resort in connection with these risks.<sup>4</sup>

The events of September 11, 2001 raised consciousness of the vulnerability of modern society to attacks from previously un- contemplated sources. International commerce is the lifeblood of a global economy now more than ever. Goods produced in Asia stock the shelves of stores all over the United States. Drugs produced in Europe are found in pharmacies in every state of the United States. As recent price fluctuations indicated, heating oil and gasoline prices are based upon the costs of imported oil. If war or the threat of war prevails, international commerce nevertheless continues, although at a somewhat reduced rate and shippers require some form of protection for their goods in transit.

Originally coverage against war risks was included as part of the coverage given by Lloyd's cargo policy.<sup>5</sup> In 1898, Lloyd's underwriters ceased issuing a combined policy. Rather, the

<sup>1</sup> Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 1(a), 116 Stat. 2322 (2002) (establishing a temporary federal program providing for insured losses resulting from terrorist acts).

<sup>2</sup> Why does the practice of London underwriters affect American Insurance? As the United States Supreme Court recognized in *Queen Insurance Co. v. Globe & Rutgers Fire Insurance Co.*, the insurance practices and reinsurance relationships between the two countries are inextricably intertwined. 263 U.S. 487, 493 (1923). Indeed, the second largest reinsurer of the World Trade Center losses was Lloyd's. See *Lloyd's Losses on World Trade Center Revealed*, INS. TIMES (London), Sept. 24, 2001, available at <http://www.alexanderforbes.com/afuknews/PressArchive/09242001LloydsLosses.htm>. At some \$2.87 billion, the Trade Center represented the largest loss ever sustained by the 314 year-old Lloyd's from a single event. Press Release, Lloyd's, Lloyd's Releases First Ever Annually Accounted Results for 2001 (Apr. 10, 2002) (on file with author).

<sup>3</sup> M.J. MUSTILL & J.C.B. GILMAN, ARNOULD'S LAW OF MARINE INSURANCE AND AVERAGE §880 (16th ed. 1981) (describing different types of insurance coverage available for capture, seizure, and confiscation at sea during war).

<sup>4</sup> 46 U.S.C. app. § 1281 (2003) (providing that the Secretary of the United States, with the President's approval may provide insurance and reinsurance against loss or damage by war risks).

<sup>5</sup> See MUSTILL AND GILMAN, *supra* note 3. "Lloyd's policies" are policies severally issued by members of insurance syndicates doing business at Lloyd's Insurance Exchange in London, England. Some members are individuals called "members" and some are corporations.

general marine cargo policy excluded war risks under a Free of Capture & Seizure Clause ("F.C. & S.").<sup>6</sup> A separate policy was issued covering those risks excluded from the standard form of marine policy by the F.C. & S clause with certain exceptions that evolved over time.<sup>7</sup>

Realizing the need to insure international waterborne commerce in the event of war, in 1913 the government of the United Kingdom established a committee to examine the health of the private insurance markets. Concluding that the private markets could not meet the needs if war broke out, the committee recommended that the government reinsure the business. The government of the United Kingdom agreed that if war risk insurance were not available from the commercial market at affordable pricing, at the outbreak of war, it would reinsure 80% of the war risks underwritten.<sup>8</sup> Between the end of World War I and 1938 as world events stabilized, it was commonplace to include war risk insurance at very nominal rates on the cargo policy. By the end of 1938 as war clouds again gathered, the British Government realized that the availability of war risk insurance would again be crucial for the continued conduct of international commerce. This led to the War Risk Act of 1939 under which the Ministry of War Transport made reinsurance agreements on standard terms with war risk underwriting associations.<sup>9</sup> The associations would give war risk coverage against "King's enemy risks" reinsured by the government of the United Kingdom.<sup>10</sup>

<sup>6</sup> See Marine Insurance Services, *C42 Principles and Practice of Marine Insurance*, at <http://www.webgate.net/~downer/c42.html> (last visited Oct. 14, 2003) (explaining how this exclusion clause was added to Lloyd's policy in 1898 to "delete" war perils).

<sup>7</sup> See *Britain Steamship Co. v. The King* [1919] 2 K.B. 670, 692 (C.A.) *aff'd*, [1921] 1 A.C. 99 (1920) (depicting that although the practice of excluding war risks from a marine policy and issuing a separate war policy insuring only part of the excluded war risks is convoluted, it continues today with marine cargo transit policies).

<sup>8</sup> See MUSTILL AND GILMAN, *supra* note 3, §881.

<sup>9</sup> See War Risks Insurance Act, 1939, 4 & 5 Geo. 6, c. 57, Repeal (Eng. 1981) (displaying a step taken by the British government to make war risk insurance more available); see also War Damage Act, 1941, 4 & 5 Geo. 6, c. 12, Repeal (Eng. 1981) (demonstrating another step by the British government to reform war risk insurance).

<sup>10</sup> Permanent legislation designating the government of the United Kingdom as the insurer of last resort was enacted by the Marine and Aviation Insurance (War Risks) Act, 1952, 15 & 16 Geo., 6 & 1 Eliz. 2 c. 57 (Eng). With various reorganizations, the responsibility for acting under this statute has shifted among various ministries. The Act permits (a) reinsurance against war risks of ships, aircraft and cargoes at any time, (b) direct insurance of ships, aircraft and cargoes against war risks in peacetime if the private market is not adequate, and (c) in time of war, direct insurance against ordinary marine risks if the responsible Minister is satisfied such insurance is needed. *Id.*

Beset by domestic terrorist bombings in London and Manchester in the early 1990's, the London insurance community ceased writing cover for terrorist risks in the United Kingdom. In response, Pool Reinsurance Company Limited ("Pool Re") was established in 1993 to write terrorist risks on commercial property insurance.<sup>11</sup> All property insurers on the British mainland may participate in the pool. Special legislation permitted the Secretary of State of the United Kingdom to make the reinsurance contract enabling the government to reinsure Pool Re. Under this statute, the government of the United Kingdom has sponsored and funded reinsurance for terrorist risks and supports provision of primary terrorist cover by the private markets.<sup>12</sup>

In the United States during World War I, no organization provided meaningful reinsurance for American underwriters. Practically all reinsurance came from London. Frustrations caused by compounded delays, errors and omissions inherent with cables going back and forth to London riddled this business. Scant domestic American reinsurance was provided on a limited basis requiring brokers to solicit companies to severally participate in insuring high-valued cargoes.

As the situation in Europe worsened during 1938, London reinsurers raised reinsurance rates to levels Americans considered economically unfeasible. This prompted a meeting<sup>13</sup> in New York of the leading American marine underwriters to discuss the merit of various reinsurance proposals to protect the anticipated volume of individual shipments. Additionally, they wanted to retain the reinsurance premiums generated in the United States.

The American underwriters decided that the most efficient form of reinsurance would be a reciprocal exchange to which all the companies in the American market would subscribe.<sup>14</sup> Each

<sup>11</sup> See Tillinghast – Towers Perrin Update, *Pool Re and Terrorism Insurance in Great Britain*, available at [http://www.tillinghast.com/tillinghast/publications/publications/till\\_update\\_uk/Uk\\_Pool\\_Re\\_and\\_Terrorism/2002052111.pdf](http://www.tillinghast.com/tillinghast/publications/publications/till_update_uk/Uk_Pool_Re_and_Terrorism/2002052111.pdf) (Oct. 2001) (presenting a summary of the development of Pool Re in Great Britain).

<sup>12</sup> See Reinsurance (Acts of Terrorism) Act, 1993, c. 18, §§ 1-2 (Eng.) (setting forth the financing of reinsurance obligations of the Secretary of the State and to which such arrangements the Act applies).

<sup>13</sup> This meeting was possible by the Merchant Shipping Act § 29, 46 U.S.C. app. § 885 (1920), which exempts marine insurers from the anti-trust constraints of the Sherman-Clay Anti-Trust Acts.

<sup>14</sup> See American Cargo War Reinsurance Exchange, *Exchange Operations*, available at

subscriber would cede 100% of its war risk liability to the Exchange and in turn would participate in a fixed percentage of all combined premium and liabilities of all subscribers on a several, not joint basis. This led to the formation of the American Cargo War Risk Reinsurance Exchange,<sup>15</sup> which began business on April 17, 1939 writing reinsurance up to \$2,500,000 per vessel.<sup>16</sup> The Exchange obtained excess reinsurance above that amount if required. At its formation, approximately 140 insurance companies subscribed to the Exchange.<sup>17</sup> Although fewer than during World War II, ACWRRE members today reinsure marine transit for the risks of war, strikes, riots, civil commotions and terrorist acts within the United States and internationally.

During World War II, the United States enacted a government sponsored war risk insurance program similar to that adopted by the United Kingdom in 1939.<sup>18</sup> This program established a structure through which the United States would act as insurer or reinsurer of last resort to facilitate and protect waterborne commerce should private markets not be able to do so on reasonable terms. Initially adopted on a five-year renewable basis, this program has been extended at the end of every five-year term. Amendments broadening the scope of terrorist actions that could be insured were enacted in December 2001 to respond to the post September 11, 2001 situation.<sup>19</sup> Until the passage of the Terrorism Risk Insurance Act<sup>20</sup> last November, the maritime war risk program was the only way that the United States Government was authorized to respond to the insurance

<http://www.amich.org/acwrrepub/exchangeops.htm> (2000) (describing how a reciprocal exchange by companies in pooling the war risks would enable the marine insurance market to provide an important coverage for American international traders).

<sup>15</sup> Commonly referred to as the "ACWRRE" or "the Exchange". See Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 103(g), 116 Stat. 2322 (2002) (maintaining that insurers have rights to reinsure deductible exposures under the act using direct and pooled reinsurance structures).

<sup>16</sup> In 1941, \$2,500,000 was considered a substantial limit of liability. See Donald H. Chadwick, *The American Cargo War Risk Reinsurance Exchange*, Contingencies, at [http://www.contingencies.org/mayjun01/War\\_Risk.doc](http://www.contingencies.org/mayjun01/War_Risk.doc) (May/June 2001) (indicating that on June 10, 1939, the final agreement went into effect).

<sup>17</sup> See generally *id.* (explaining that the intent was to provide a reciprocal exchange for the entire American market).

<sup>18</sup> See 46 U.S.C. app. §§ 1281-1283 (2003) (establishing a government-sponsored insurance program to cover sea vessels involved in commerce).

<sup>19</sup> See Terrorism Risk Insurance Act of 2002, Pub. L. No. 107-297, § 103(g), 116 Stat. 2322 (2002) (expanding the response capabilities of the government).

<sup>20</sup> *Id.*

problems posed by terrorism.<sup>21</sup>

The United States war risk insurance program encompasses war and terrorist risks involving the waterborne commerce of the United States. This federal legislation establishes a structure for federal insurance or reinsurance if the private markets cannot provide the cover on a reasonable basis. Cover for war risks is limited to marine transit while the goods are waterborne with limited additional cover for goods being transshipped. Cover for terrorist risks extends to internationally caused acts of terrorism anywhere in the world, internationally caused acts of terrorism in the United States and domestic acts of terrorism in the United States.<sup>22</sup>

The statute grants the Secretary of Transportation discretionary authority to:

- a. insure and reinsure war risks defined as including losses excluded from marine coverage by the Free of Capture or Seizure Clause or analogous clauses and other losses from hostile acts, including confiscation, expropriation, nationalization, or deprivation,<sup>23</sup>
- b. insure associated cargo, hull and liability risks<sup>24</sup> and
- c. reinsure cargo, hull and liability risks.<sup>25</sup>

An executive action by the President is a prerequisite for action by the Secretary of Transportation.<sup>26</sup> President Bush activated this program in 2001.<sup>27</sup> Although activated, since September 11,

<sup>21</sup> See 46 U.S.C. app. § 1284 (2003) (allowing secretary to provide insurance for risks that fall outside of war risks under the Merchant Marine Act).

<sup>22</sup> See 46 U.S.C. app §§ 1283, 1284 (2003) (authorizing coverage to extend over cargoes anywhere in the world and to include such risks deemed worthy by the secretary).

<sup>23</sup> 46 U.S.C. app. §§ 1281(c), 1282, 1283 (2003).

<sup>24</sup> 46 U.S.C. app. §§ 1284, 1286 (2003).

<sup>25</sup> 46 U.S.C. app. § 1287 (2003).

<sup>26</sup> See 3 U.S.C. § 301 (2003) (requiring an executive action prior to any action is to be taken by the Secretary of Transportation).

<sup>27</sup> See 46 U.S.C. app. § 1282 (2003); see also President's Memorandum for the Secretary of State, Secretary of Transportation, at <http://www.whitehouse.gov/news/releases/2001/12/20011214-9.html> (Dec. 12, 2001). The memorandum provides, in relevant part:

December 12, 2001

MEMORANDUM FOR THE SECRETARY OF STATE  
THE SECRETARY OF TRANSPORTATION

SUBJECT: Provision of Marine War Risk Insurance Coverage

By virtue of the authority vested in me by the Constitution and laws of the United States, including 3 U.S.C. 301 and section 1202 of the Merchant Marine Act, 1936, as amended (the "Act"), 46 U.S.C. App. 1282, I hereby:

Approve the provision by the Secretary of Transportation of insurance or reinsurance of vessels (including cargoes and crew) entering the Middle East region against loss

2001, this program has only provided insurance for hull risks involving vessels carrying strategic cargoes to and from the Middle East. As the private markets provided cargo insurance at reasonable rates, the program has not been funded for cargo insurance.

The statute established an administrative structure for issuance of policies, regulations, valuation of hulls, retention of experts, prescription of regulations, forms, rates, fees and utilization of services of other government agencies and underwriting agents and actions on policies. The war risk insurance legislation requires annual reports by the Secretary to Congress, with permission of the Secretary permits excess insurance with other entities,<sup>28</sup> and requires renewal of the authority every five years.<sup>29</sup> Key in the existing administration

or damage by war risks in the manner and to the extent approved in title XII of the Act, 46 U.S.C. App. 1281, et seq., for purposes of responding to the recent terrorist attacks, whenever, after consultation with the Department of State, it appears to the Secretary of Transportation that such insurance adequate for the needs of the waterborne commerce of the United States cannot be obtained on reasonable terms and conditions from companies authorized to do an insurance business in a State of the United States. This approval is effective for 6 months. I hereby delegate to the Secretary of Transportation, in consultation with the Secretary of State, the authority vested in me by section 1202 of the Act, to approve the provision of insurance or reinsurance for these purposes after the expiration of 6 months.

The Secretary of Transportation is directed to bring this approval to the immediate attention of all operators and to arrange for its publication in the Federal Register.

(GEORGE W. BUSH).

*Id.*; see also Press Release, Department of Transportation, Maritime Administration (Feb. 11, 2003) (Press Book, B03-013), which provides in relevant detail:

**Marine War Risk Insurance Extended**

Secretary of Transportation Norman Y. Mineta has approved an extension of the authority to provide war risk insurance under Section 1202 of the 1936 Merchant Marine Act (Act). Unlike Section 1205 insurance, which is provided to the Department of Defense (DOD) on vessels chartered to them at no premium and with a full DOD indemnity, Section 1202 insurance is underwritten by DOT in return for a premium from shipowners. This insurance or reinsurance of vessels is available for vessels (including cargoes and crew) entering the Middle East region, whenever commercial insurance cannot be obtained on reasonable terms and conditions.

It should be noted that Section 1202 authority was used very judiciously and sparingly during Operations Desert Shield/Desert Storm and it is contemplated that this new authority will be used in the same manner.

President George W. Bush approved the provision of war risk insurance by memorandum in December 2001; the Secretary of Transportation has approved the extension for an additional one-year period until December 12, 2003).

*Id.*

<sup>28</sup> 46 U.S.C. app. §§1289, 1292 (2003) (providing a workable framework for insurance coverage).

<sup>28</sup> See 46 U.S.C. app. § 1293 (2003) (asserting that a person with an insurable interest in a vessel may "with the approval of the Secretary, insure with other underwriters in an amount in excess of the amount insured with the Secretary of Transportation. . .").

<sup>29</sup> See 46 U.S.C. app. § 1294 (2003). Since 1970, Congress has extended the authority under this act for an additional five years in the year prior to its potential expiration. See

scheme is the adoption of the “commercial practice in the marine insurance business.”<sup>30</sup> Classic marine insurance terms, such as cargo, hull, vessel and personal effects to describe property and masters, officers, members of the crew, other persons or employees transported upon the vessels to describe personnel, are used to describe the subjects of the insurance and reinsurance.<sup>31</sup>

Reported cases under the maritime war risk insurance program deal with claims for losses and the question of whether the war risk insurer must respond.<sup>32</sup> The majority of these emanate from losses during World War II. Under the federal maritime war risk insurance and reinsurance statutes, the Secretary may also cover peacetime risks. The Free of Capture and Seizure clauses in marine policies also exclude losses due to events other than formally declared wars between nation states such as customs seizure, detentions and pollution mitigation. As amended, the statute gives the Secretary authority to insure such risks if the commercial markets do not do so on a reasonable basis.<sup>33</sup> This authority has no geographic limitation and may be invoked to provide federally sponsored insurance or reinsurance on a worldwide basis.

In addition to the maritime war risk insurance statutes, the United States has several other programs<sup>34</sup> where it stands as

*id.* (original version at ch. 858, Title XII, § 1214 (1936)).

<sup>30</sup> 46 U.S.C. app. § 1289(c) (2003). Under this scheme, the Secretary “may exercise his powers, perform his duties and functions, and make his expenditures, in accordance with commercial practice in the marine insurance business.” *Id.*

<sup>31</sup> See 46 U.S.C. app. § 1283(a)-(e) (2003) (noting examples which are insurable under the statute).

<sup>32</sup> See generally *Calmar Steamship Corp. v. Scott*, 345 U.S. 427, 428–30 (1953) (discussing a claim under the government war risk insurance policy for damage to a ship inflicted by enemy aircraft); *Standard Oil Co. v. United States*, 340 U.S. 54, 58–61 (1950) (holding that the relevant government war risk insurance policy does not, as a matter of law, cover the collision between the insured vessel and a Navy mine sweeper when both vessels were at fault); *Libby, McNeil & Libby v. United States*, 340 U.S. 71, 71–72 (1950) (finding that the stranding of an insured ship due to a steering mistake made by an inexperienced helmsmen was not covered under the government war risk insurance policy); *Reinhold v. United States*, 167 F.2d 556, 559 (2d Cir. 1948) (finding that the loss here was not caused by any “warlike operations”); *Crist v. United States War Shipping Admin.*, 63 F.2d 145, 152 (3d Cir. 1947) (stating that under the government war risk insurance policy “Remote consequences of hostilities cannot become a recoverable loss. . .”).

<sup>33</sup> See generally Graydon S. Staring & George L. Waddell, *Marine Insurance*, 73 TUL. L. REV. 1619, 1675 n.313 (1999) (discussing what the Free of Seizure and Capture Clause included as opposed to what the war risk insurance policies cover).

<sup>34</sup> See generally *Terrorism Insurance: Alternative Proposals for Protecting Insurance Consumers* (Oct. 24, 2001) (statement of Thomas J. McCool, Managing Director Financial Markets and Community Investment before the Senate Committee on Banking, Housing

insurer or reinsurer of last resort. Most notable are the Price-Anderson Act of 1957<sup>35</sup> limiting liability and providing indemnification for nuclear accidents, insurance against overseas political risks through the Over Seas Private Investment Corporation to facilitate private investment in developing countries,<sup>36</sup> insurance against urban riots and disorders,<sup>37</sup> flood insurance,<sup>38</sup> federal deposit insurance,<sup>39</sup> aviation war risk insurance,<sup>40</sup> federal crop insurance,<sup>41</sup> Pension Benefit Guaranty Corporation Insurance,<sup>42</sup> savings association insurance fund,<sup>43</sup> service-disabled veterans insurance<sup>44</sup> and the National Vaccine Injury Compensation Program.<sup>45</sup> States too insure risks in the public interest. Each state has a guaranty fund similar to New York<sup>46</sup> covering the obligations to the public under certain types

and Urban Affairs) available at <http://www.gao.gov/new.items/d02199t.pdf>. In addition to the United Kingdom, Israel, among other nations, has government sponsored terrorist reinsurance programs. *See id.*

<sup>35</sup> 42 U.S.C. §§ 2011 - 2210 (2003) (applying to liability and indemnification for nuclear accidents).

<sup>36</sup> *See* 22 U.S.C. § 2194 (2003) (“recognizing that major private investments in less developed friendly countries or areas are often made by enterprises in which there is multinational participation...the Corporation may make arrangements with foreign governments (including agencies, instrumentalities, or political subdivisions thereof) or with multilateral organizations and institutions for sharing liabilities assumed under investment insurance for such investments. . .”).

<sup>37</sup> *See generally* National Insurance Development Program, 12 U.S.C. § 1749bbb (2003). This program was profitable and was discontinued in 1984 because the private markets ceased seeking federal support. The power of the director terminated Nov. 30, 1983. *Id.*

<sup>38</sup> *See* 42 U.S.C. §§ 2414, 4001-4128 (2003) (creating a flood insurance program).

<sup>39</sup> *See* 12 U.S.C. § 1811 (2003) (establishing a Federal Deposit Insurance Cooperation).

<sup>40</sup> *See* 44 U.S.C. § 44301 (2003) (creating a program dedicated to aviation risk during war).

<sup>41</sup> *See* 7 U.S.C. § 1501 (2003) (initiating a program for federal crop insurance).

<sup>42</sup> *See* 29 U.S.C. §§ 1003, 1301 (2003) (covering all employee benefit plans if “established or maintained by any employer engaged in commerce or in any industry or activity affecting commerce; or by any employee organization or organizations representing employees engaged in commerce or in any industry or activity affecting commerce; or by both.”).

<sup>43</sup> *See* 12 U.S.C. § 1441 (2003) (establishing a federal Financing Corporation to issue nonvoting capital stock to the Federal Home Loan Banks, and to invest in any security issued by the Federal Savings and Loan Insurance Corporation).

<sup>44</sup> *See* 38 U.S.C. § 1922 (2003) (offering life insurance to disabled veterans honorably discharged on or after April 25, 1951).

<sup>45</sup> 42 U.S.C. § 300aa-10 (2003) (promulgating a National Vaccine Program “to achieve optimal prevention of human infectious diseases through immunization and to achieve optimal prevention against adverse reactions to vaccines.”).

<sup>46</sup> *See* N.Y. Ins. Law §§ 7501-7506, 7603 (2003) (explicating the life insurance guaranty fund as “a fund arising from assessments upon domestic life insurance companies to be used for the promotion of the stability of such companies and the performance of their contractual obligations.” And the property/casualty insurance security fund as the vehicle for paying allowed claims remaining unpaid “by reason of the inability due to insolvency of an authorized insurer to meet its insurance obligations under policies...”).

of coverage issued by insurers, which afterwards need rehabilitation or become insolvent.

The interface between the maritime war risk insurance program and the Terrorism Risk Insurance Act is an area that will be covered as the regulations under TRIA are developed. Combined, both statutory schemes provide a safety net for the waterborne commerce of the United States and permit government reinsurance of terrorist risks on international shipments from point of origin to destination.