IN RE AN ARBITRATION BETWEEN

COMMERCIAL LINES INSURANCE

AND

NATCAT GMBH

(Hon. Ozlem Gurses)

Reinsured's Statement of the Claim

Introduction

After a week of "constant" heavy rain which caused widespread flooding which in turn prompted an official UK Declaration of State of Emergency, Commercial Lines Insurance ("CLI") faced a torrent of claims for property damage and attendant business interruption that involved not only direct physical loss and damage but also losses flowing directly from the Declaration closing "all motorways" for one month, effectively precluding access to covered property.

Consistent with the coverage promised in its reinsurance treaty with NatCat GMbH ("NatCat"), CLI submitted a claim for payment of losses exceeding £20,000,000. The reinsurer denied the claim, asserting that "the losses did not arise from a single event" and that some payments had been made to policyholders that "had not suffered material damage." This latter contention is a de facto claim of ex gratia payments or overpayment by CLI. NatCat's defenses should be rejected by this tribunal.

I. Flooding and the Related Emergency Declaration and Business Interruption Losses Arise from a Single Event Within the Meaning of the CLI-NatCat Treaty

PRICL Art. 5.2(1), law chosen by the parties, states

Where the parties agree on an event-based aggregation in a contract reinsuring first-party insurance policies, all losses that occur as a direct

consequence of the same materialization of a peril reinsured against shall be considered as arising out of one event.

We first identify the relevant event for aggregation of losses. According to PRICL Art. 5.2 comments C4 and C5:

> C4. There must be a causal link between the relevant event on the one hand and any losses to be aggregated on the other hand. If the parties agree on an aggregation per event, any losses that can be considered a direct consequence of an event are aggregated. This involves a two-step analysis.
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> C5. First, the relevant event for the aggregation of losses is to be determined … Secondly, each loss must be tested to determine whether it can be considered a "direct consequence" of this event.

Rainfall from a single, massive low-pressure system is the same materialization of a single event that directly causes flooding-related losses ("Event 1"). Severe weather events can last for days, and encompass large geographic areas. Absent specific named storm or distinguishing weather system designation, excessive rainfall from the same low-pressure system constitutes materialization of the same event, directly causing flooding related losses for the entire affected region.

The Declaration closing highways was immediately and directly responsible for triggering denial of access coverage and accompanying business interruption coverage. The Declaration is therefore a second relevant event ("Event 2"). PRICL commentary C11, Article 5.2 provides:

> If a contract provides for all-risk coverage, the materialization of any unnamed peril that triggers the contract is to be considered a relevant event for the purpose of aggregating losses under paragraph (1). Similarly, in case a contract covers both named and unnamed perils, the materialization of any unnamed peril may constitute the relevant event within the meaning of paragraph (1). In such cases, any losses that directly result from the event furthest on the chain of causation may be aggregated under paragraph (1).
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> Illustration
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> Reinsured A takes out all-risk property reinsurance. An earthquake occurs and causes losses 1 and 2. At the same time, the earthquake triggers a tsunami which causes losses 3 and 4. As no peril is named in the contract, the materialization of any peril is to be considered an event under paragraph (1). Consequently, both the earthquake and the tsunami may constitute events. As the earthquake is the event furthest away from losses 3 and 4, it is the relevant event for the purpose of aggregation. Consequently, losses 1 and 2 are to be aggregated with losses 3 and 4.

Because the Declaration (Event 2) is directly caused by the widespread flooding from the excessive rainfall (Event 1), rainfall Event 1 is furthest in the chain of causation – with direct

causal link between rainfall, flooding, Declaration, and business interruption. The PRICL rules mandate aggregation of all losses from both rainfall and the government order under single loss event – in this case, Event 1.

II. Fire Contributing to Loss at a Refinery Does Not Preclude Aggregation Because a Direct Causal Link to Flood and Loss-of-Access Injury Also Exists

Although fire loss at a CLI-covered refinery is a separate event, flooding also caused substantial damaged to an insured refinery, which along with the closure Declaration caused business interruption loss notwithstanding the fire. Although the fire is a contributing cause to the magnitude of the loss, the rainfall and flooding nevertheless are causally directly linked with the business interruption loss at the refinery and therefore part of the relevant loss event.

Because it is impossible separate business interruption loss caused by the fire and loss caused by rainfall and road closure, the £5,000,000 settlement (for loss of an entire refinery) represents a commercially attractive, relatively low-cost resolution irrespective of the role of the fire. Consequently, the entire amount should be allocated to the same rainfall/flooding/business interruption loss.

III. The Coverage and Valuation Settlement Decisions of CLI Were a Reasonable, Prudent and Businesslike Response to Potentially Massive Claims Liability That Protected NatCat From Larger Liability

As previously noted, NatCat argues that not all settlement payments were for "material" damage and that, if true, this relieves NatCat of its obligations pursuant to the treaty.

First, it should be noted that policy conditions included denial of access endorsement which would have triggered even had the insured itself not suffered material damage. NatCat's argument clearly has no merit in respect of policyholders whose policies were triggered by the denial of access endorsement.

Second, for the policyholders whose claims have been settled at 80% value, in effect, NatCat is implicitly contending that CLI needlessly paid or overpaid such claims. These cases represent a commercial settlement on the part of CLI, which NatCat is obligated to follow subject to PRICL Art 2.4.3 criteria:

> **The reinsurer shall follow the fortunes of the reinsured and follow the settlements of the reinsured by reimbursing the reinsured for payment of loss covered by the reinsurance contract and arguably covered by the primary insurance contract.**

As noted in PRICL Art. 2.4.3 commentary (C5), the follow-the-settlements principle

> refers to the reinsurer being bound by the negotiated resolution of claims by the reinsured so long as these settlements [are] not: collusive; fraudulent; clearly outside of coverage; or beyond the amount of limits set forth in the agreement; unreasonable in amount and terms due to gross negligence, recklessness, or failure to act with the utmost good faith toward the reinsurer.

Where mass-claims are settled as a group, the appropriateness of the settlement procedure should be assessed based on the entirety of the arrangement, rather than pin-pointing individual cases in which there might have been payment that could have been higher than strictly justified. CLI sought to adopt a mass settlement procedure and achieve a superior financial outcome that benefited both CLI and NatCat due to substantial savings on both litigation costs and risks. CLI obviously did not collude with thousands of claimants and made an apt, businesslike response to resolve claims swiftly and informally.

A reinsurer may not second-guess its reinsured but needs to demonstrate at least one of the failings outlined in the PRICL commentary if it is to avoid promised payment. Otherwise, a reinsured's resolution of claims stands, notwithstanding the reinsurer's post hoc view that it might have done better. CLI's conduct fits well within the parameters of the follow-the-settlements principle, which in turn precludes NatCat from questioning the specific extent of loss of any particular CLI policyholder claimant.

CLI's comprehensive claims handling procedure/strategy does not violate PRICL 2.4.2 criteria for reasonable and prudent claims handling, as further detailed under comment C3 – CLI's claims behavior was not fraudulent, deceptive, grossly negligent, reckless, self-serving or intended to unfairly impose liability upon the reinsurer.

The PRICL standard for "reasonable and prudent" claims handling (Article 2.4.2, Comment 2) includes a recognition that the reinsured should resolve matters economically when compromise is justified by the merits of the claim. CLI, being an insurer in direct contact with policyholders and in full possession of much more detailed facts related to each and every claim, was in a superior position to make claims resolution judgments justified by the magnitude of the losses and the coverage merits of the claims.

Conclusion

The PRICL mandates that a seamless catastrophic loss of this magnitude be treated as a single event and that CLI's non-collusive, reasonable, prudent, swift, and economical resolution of the resulting claims bind its reinsurer. Second-guessing and quibbling by NatCat undermines the effective operation of reinsurance. If NatCat were to avoid its contractual responsibilities in the face of unprecedented losses by the reinsured, fundamental principles of reinsurance would be dangerously eroded. NatCat's extreme theory of disaggregating the consequences of a single natural disaster would effectively make event-based excess-of-loss reinsurance a nullity.

Respectfully submitted,

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