



**IN RE AN ARBITRATION BETWEEN**

**COMMERCIAL LINES INSURANCE**
**AND**
**NATCAT GMBH**

**(Hon Ozlem Gurses)**

## Reinsurer's Reply to Statement of the Claim

### A. Aggregation issues

1. It is common ground that the parties have agreed an event-based aggregation, with the result that under PRICL Art 5.2(1) "all losses that occur as a direct consequence of the same materialisation of a peril reinsured against shall be considered as arising out of one event." CLI asserts that these words make it is necessary to identify the "event" and then to determine whether the losses are a "direct consequence" of that event. NatCat questions this interpretation. The wording makes it necessary: (i) to identify the peril reinsured against; (ii) to ascertain if the losses form the same materialisation of that peril; and (iii) to ask if those losses were the direct consequence of that materialisation. The word "event" in the treaty is to be construed in accordance with these tests, rather than by reference to its traditional use of something happening at a particular time, at a particular place and in a particular way.

2. Turning first to the water "peril", this must mirror the policy, and a typical policy will not refer to rain, but rather to flood. In our submission rainfall does *not*[1] constitute a "peril" and the relevant peril is flood. The question is then whether all of the losses are the consequence of the "same materialisation" of flood. Necessarily there were separate local floods, and therefore the number of floods must be identified and the losses from each of them can then be aggregated. However, CLI has aggregated on a national rather than local basis, and there is accordingly no evidence before the Tribunal as to the correct number of events.

3. If the Tribunal does not accept our primary submission and holds that rainfall is the relevant peril, it does not follow that there is only one peril. Rainfall operates differently in different places, and so there can be no single "materialisation" of rainfall but rather a series of local manifestations. Our alternative submission is that continuous rain cannot simply be treated as a single peril. This gives rise to the same outcome as in para 2 above.

[1] *not* added, correcting and inadvertent error contained on the original version

4. If the Tribunal is still against us, we argue in the alternative that rainfall is the result of the coincidence of a number of meteorological features, such as air pressure, wind, cloud formation. Over a period of days those features will coincide at different times and in different ways, and each combination is a separate peril. CLI has asserted that "rainfall from a single, massive low-pressure system is … a single event". There is no scientific basis for that argument and no evidence as to the number of events.

5. As to the Declaration of the State of Emergency on 20 April 2020, the peril reinsured against is not simply the Declaration but the risk of having to provide indemnity for "denial of access" consequent on the Declaration by reason of an event in the vicinity of an insured building. Translated into the words of Art 5.2(1) of PRICL, it is possible to aggregate only those losses occurring as a direct consequence of the same materialisation of the Declaration in the vicinity of any one insured building.

**B. The Refinery**

6. The loss of the refinery to fire occurred after the refinery had been flooded. NatCat concedes that CLI is entitled to treat any loss up to the date of the fire as part of the aggregation for flooding, but contests that loss after the fire can be so treated. A loss may be treated as caused by a peril if, but for the occurrence of that peril, there would have been no loss. Had there been no flood, there would still have been loss by reason of the fire, so it cannot be said that the flood was the relevant proximate cause. That was held by the English High Court in *Orient-Express Hotels Ltd v Assicurazioni General SpA* [2010] EWHC 1186 (Comm), applying the "but for" test.

7. CLI has argued that flood caused substantial damage to the refinery. However, that is irrelevant; the question is whether the damage to the refinery caused a loss of revenue. But for the flood there would still have been a loss of revenue.

8. CLI has further suggested that it is impossible to separate out the business interruption losses caused by fire and losses caused by flood. Again, that is not the relevant point: CLI must show that the loss was caused by the flood but cannot do so. NatCat does not dispute that there may be a claim against CLI for business interruption losses consequent on the fire, but disputes that such loss can be included as a part of the "event" for which aggregation is sought. The fire is a separate event and is irrecoverable from NatCat because it falls below the per event deductible of £20,000,000.

**C. The Settlement**

9. NatCat accepts that following a catastrophe there will be multiple insurance claims of a similar type. NatCat nevertheless disputes that CLI is entitled to rely upon article 2.4.3 of PRICL to recover "for payment of loss covered by the reinsurance contract and arguably covered by the primary insurance contract." That is so for two reasons.

10. First, PRICL cannot override the express terms of the reinsurance. The Treaty specifically provides that NatCat will provide indemnity for losses falling <u>within the terms of the underlying policies</u> and within the terms of the treaty (our emphasis). This is standard wording for an excess of loss treaty issued in London. Whatever the effect of PRICL in the absence of such wording, clause 2.4.3 has in this case been disapplied.

11. Secondly, even if PRICL 2.4.3 had been applicable, commentary C5 notes that the follow the fortunes/settlements principle has no application where there has been on the part of the reinsured "failure to act with the utmost good faith toward the reinsurer." Article 2.1.2 of PRICL states that:

> The parties owe one another the duty of utmost good faith. "Utmost Good Faith" means honesty and transparency as well as fairly taking into account the interests of the other party.

12. It is NatCat's submission that a mass resolution of claims for 80% inevitably means that some policyholders (including those without valid claims) will have been overcompensated and some will have been undercompensated, but almost certainly none of them would have received a settlement figure based on actual loss. NatCat fails to see how this can be good faith conduct. NatCat does not question CLI's honesty or genuine desire to keep its own investigation and settlement costs to a minimum, but such costs are not a part of the reinsured risk. Accordingly, it cannot be said that CLI's conduct was either transparent or carried out with the interests of NatCat in mind.

Professor Rob Merkin QC
Dr Eberhard Witthoff

3 August 2020