Superstorm

Most of the damage from Sandy has been repaired. But the US East Coast needs to be better prepared for future storms. PAGE 6

Natural hazards
Extreme weather puts strain on infrastructure

Fine art
New York art galleries flooded

Space flight
Costliest rocket crash of all time
Dear Reader,

It is a year now since Sandy swept over the US East Coast. And like every major storm, Sandy also left its own very distinct footprint. What lives most in the memory are the images of the terrible damage along the New Jersey coast and the flooding in downtown New York.

Anyone who has stood on the waterfront of Battery Park and looked across to the Statue of Liberty knows just how perilously close to sea level this city is. Downtown Manhattan lies like a huge barge between the Hudson and East River. Hit by the storm surge, the basement levels of the enormous One World Trade Center construction site filled like a bathtub not long after they had been completed.

It is less well known that there were also major losses in the fine arts sector. In spite of warnings, many galleries still had artworks stored in basements and on ground floors, which were seriously damaged by the flood waters.

And after each catastrophe we always hear calls for better prevention and storm-proof buildings. The experts all agree what needs to be done. But as time passes and memories fade, such ideas are pushed more and more into the background. This issue of Topics Schadenspiegel looks at the special features of this superstorm and analyses the losses and their significance for the insurance industry.

I wish you an interesting read.

Nicholas Roenneberg
Head of Claims Management & Consulting at Munich Re

NOT IF, BUT HOW
Sandy - One year on

Superstorm Sandy showed just how vulnerable Greater New York is to major natural catastrophes. Plans to improve the infrastructure there, such as making important traffic routes like the Carey Tunnel above more flood-resistant, have yet to be completed. The 20 billion dollar programme PlaNYC will help to reduce losses but not avoid them entirely.
Desalinated seawater is becoming increasingly important as a source of drinking water. However, if the intake pipes are not properly anchored to the seabed, significant losses are likely to result.

The crash of Intelsat 27 is the costliest loss in the history of space flight insurance. In the event of a loss, satellites of this size cost space insurers nearly half the global market premium for a whole year.

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Nowhere in the world are weather risks changing faster than in Eastern Asia. Our new publication “Severe weather in Eastern Asia” addresses weather hazards in that region from the viewpoint of a leading reinsurer.

The publication sheds light on the basic concepts and physical principles behind weather hazard phenomena, explains their occurrence and impact, and analyses resulting loss aspects. The underlying factors, including climate variability and climate change, are described and supported by a wealth of statistical evidence. Severe weather in Eastern Asia also gives advice on risk reduction and on how to prepare for and deal with extreme events. Implications are drawn for the Eastern Asian insurance markets based on the findings presented.

The recent accumulation of major natural catastrophes in various parts of the world has underscored the key role of the insurance industry in enabling societies to cope with and rebound from major losses.

Our new publication “Claims management following natural catastrophes” looks at major natural disasters of the recent past and seeks to draw conclusions that can help the insurance community in further enhancing its preparedness and claims management capabilities. Events examined include Hurricane Katrina, the Tohoku, Christchurch and Chilean earthquakes, the floods in Thailand, thunderstorms in the US and Superstorm Sandy. The publication also highlights the importance of highly professional contingency planning and provides practical guidelines to help companies develop and refine their own individual plans.

Insured values can be allocated spatially to specific natural hazard zones and CRESTA zones. The automatically generated Portfolio Risk Assessment Report offers data on loss amounts and sums insured. And finally, to round off the picture, the risks can also be visualised by geographic location.

Our Beijing branch celebrates its 10th anniversary this year. With the opening of this branch, Munich Re became the first international reinsurer to be granted a licence to offer multiline reinsurance throughout the country. Today, we operate in all lines of reinsurance business.

Munich Re has appointed Bernhard Kaufmann (44) Group Chief Risk Officer with effect from 1 January 2014. Kaufmann will take over the position from Joachim Oechslin, who is joining the Executive Board of the Credit Suisse Group.

Our tried and tested NATHAN Risk Suite now offers even greater benefits. Its new tools make natural hazard risks even more transparent and offer a customised portfolio analysis function. An additional function enables users to include individually definable data such as sums insured or claims payments in the analysis and to have them evaluated for a portfolio.

The new client seminar programme “Knowledge in dialogue 2014” is now available. We are again offering our international clients a wide range of seminars and workshops. These include courses covering not only all the important classes of insurance business but also specialist topic areas such as financial lines insurance or enterprise risk management. Contact your Client Manager for further details.
Ten years of connect.munichre

Are you connected?

Munich Re’s exclusive client portal celebrates its tenth birthday.

With connect, Munich Re offers its clients a secure online platform with professional expertise, electronic data exchange and document management. A survey of users yielded the following results: almost 90% of clients are satisfied or very satisfied with the platform.

connect.munichre gives our clients and business partners round-the-clock access to expert knowledge and the latest information from the world of insurance. This customisable online platform brings clients together with Munich Re’s in-house experts and their years of industry experience. The portal offers a safe environment – accessed via secure log-in and password – to exchange and process even the most confidential information on product development, underwriting, risk management and claims handling. The homepage welcomes users with up-to-the-minute news, and guides them through a wealth of informative content with user-friendly navigation tabs.

Providing better business solutions

Over 7,000 users of the project rooms benefit from real-time electronic data exchange and document management as a safer, quicker alternative to e-mail for sharing information and organising their work. A selection of specialist online tools facilitates the underwriting process, for example, by helping clients to identify and assess risks. The latest insurance news and easy-read PDF downloads of popular publications, such as Topics and Topics Schadenspiegel, ensure users are always well-informed of what is happening in the global insurance market. Finally, the learning centre keeps skills fresh with a wide range of seminars and workshops hosted by Munich Re around the globe, as well as fast and effective e-learning solutions and webinars.

Almost 60% of users have been using connect.munichre for more than two years. In 2010, connect.munichre surpassed the 1 million user sessions mark. Today, that figure is 1.6 million and almost three-quarters of Munich Re clients have access to the tool.

>> Further information is available from your Client Manager or at: connect.munichre.com

2013: connect.munichre is a market leader with thousands of regular users.
When Sandy hit the northeast US on 29 October 2012, it was no longer classed as a tropical cyclone but as a post-tropical cyclone. Though this change in classification is frequently assumed to indicate a drop in intensity, this is not necessarily the case – as in this instance. In fact, this classification merely indicates that the storm has completed its transition from a tropical storm system to one with all the characteristics of an extratropical cyclone. Storms tend to grow in area during the course of what is known as “extratropical transition”, a process which sometimes takes several days. Sandy was no exception and is now classed as the largest tropical storm system ever observed in the Atlantic, with tropical storm force winds (i.e. with a one-minute mean wind speed of at least 64 km/h) covering an area of 1,500 km at its greatest extent.
The vast area of Sandy’s wind field was not the only factor influencing loss development. The track taken by the storm was another key aspect. A high-pressure system over the Maritime provinces of Canada blocked Sandy’s path to the northeast while low pressure over the American continent created an eddy, drawing the storm westward – a rare occurrence for such a storm – where it made landfall at nearly a right angle to the coast. To exacerbate matters further, the southern tip of Manhattan and the Atlantic coast of New Jersey experienced a spring tide, one of the highest tides of the year, at the same time the storm surge was at its peak.

These factors combined to create a very large storm surge, extending along the entire coast of New Jersey northward to Cape Cod. Some tide gauge stations, like the Battery on the southern tip of Manhattan, measured the highest surge in New York Harbor since records first began in 1880. The extensive wind field extended even further, leaving a trail of damage that extended all the way to Canada.
Despite accurate forecasting and days of preparation, Sandy still waged untold devastation. The death toll reached 127 in the US alone, and more than 650,000 buildings and 330,000 vehicles were damaged or destroyed. The total insured loss (including the National Flood Insurance Program) came to almost US$ 30bn and economic losses are estimated to be more than double this amount. Power outages were reported in 17 different states, affecting some 8.5 million people. Damage to infrastructure, such as railway tracks, roads and tunnels, brought traffic to a standstill in many areas, and repairs are likely to cost several billion US dollars in total. The states of New York and New Jersey were hardest hit. According to figures published by the Property Claims Service (PCS), these two states accounted for around 85% of the overall claims bill. Of the insurance classes, marine business played a significant role, with claims payments totalling some US$ 3bn – a record figure from one single event.

A chain of unlikely events was ultimately responsible for causing Sandy – a storm with moderate wind speeds – to unleash such a severe storm surge across a vast area. But Greater New York had long been known to be susceptible to severe storms with a similar impact, and the probability of such events will continue to rise as climate change progresses and sea levels rise.

This was one of the reasons behind New York’s introduction of PlaNYC in 2007. This is a programme designed to prepare the city for its future challenges such as a growing population and enhancing the quality of life of its inhabitants, against the backdrop of climate change. Unfortunately, the authorities had not even begun to tackle most of the planned infrastructural improvement measures when Sandy struck. In areas where measures had already been concluded, the restoration of coastal wetlands and new regulations specifying that buildings be constructed at higher elevations did indeed prove to be effective. But the storm also highlighted the need to undertake more than has hitherto been planned. After Sandy, the list of measures to be taken were expanded and funding of the programme was increased to US$ 20bn.

The 400-page report entitled “A Stronger, More Resilient New York” sets out, among other things, how coastal protection and building codes can be improved. It also contains suggestions for insurance, infrastructure, power supply and telecommunications, healthcare, and the transportation systems. At the same time, however, the report also clearly stated that, in view of climate change and the resultant rise in sea levels, the measures could only hope to reduce damage in the medium to long term, not avoid it entirely.

A plan with a comparable level of detail has not been prepared for New Jersey’s coastal areas. Here, efforts have so far been confined to reinforcing the coast with sand dunes and reconstructing buildings destroyed by Sandy at a higher elevation to bring them in line with the new regulatory requirements of the Federal Emergency Management Agency (FEMA). However, what is needed, and is still sadly lacking, is an overall plan that would take account of future climate developments and their consequences. A great deal of this responsibility has been transferred to individual communities, whose primary concern at this time is to rebuild as quickly as possible. If exposure to large-scale storm events is to be minimised, however, a regional strategy is also called for – one that takes account of both local circumstances and locally available expertise. Viewed in this light, the direction New York has taken seems to indicate that the authorities have learned some key lessons from Sandy. But this does not mean that losses can be avoided entirely. The main goal is to counter the continually rising exposure by means of appropriate strategies. If the measures contained in the report are systematically implemented, New York could at least achieve its aim of minimising potential losses in the medium term.


OUR EXPERT
Peter Miesen specialises in the creation and validation of natural hazard models and in assessing risks relating to meteorological hazards. pmiesen@munichre.com
Homeowners’ policies in the US often cover storm damage but exclude losses caused by flooding. Sandy caused heavy losses on both counts. Are insurers still able to apply this exclusion?

Leon Taylor and Aidan M. McCormack

It is now more than a year since Sandy wreaked havoc along the US Atlantic coastline, causing devastation in numerous states including New York, where serious flooding affected Manhattan and led to hundreds of thousands of homeowner and commercial insurance claims across a diverse range of different lines of business.

In New York State alone, around 350,000 homes were damaged or destroyed. In addition, there were around 250,000 automobile claims and a similar number of businesses were impacted. Flooding of the New York Subway and World Trade Center site resulted in losses claimed at several billion dollars.

The total loss attributable to Sandy is now reckoned to be in the order of US$ 70bn. That makes Sandy the second most expensive storm in US history after Hurricane Katrina.

As well as being one of the most significant weather-related events of recent years, Sandy has also been characterised by the swift response of the insurance industry to approximately 500,000 homeowner claims, encouraged by the uncompromising attitude of a number of state authorities and politicians.

### Development of a superstorm

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>22.10.2012</td>
<td>Cluster became organised 500 km south of Kingston, Jamaica</td>
</tr>
<tr>
<td>24.10.2012</td>
<td>Jamaica Landfall east of Kingston as Cat 1</td>
</tr>
<tr>
<td>25.10.2012</td>
<td>Santiago de Cuba, Bahamas Landfall as Cat 3 in eastern Cuba, entering the Bahamas</td>
</tr>
<tr>
<td>26.10.2012</td>
<td>Centre well off Florida coast Wind speed decreased but size of the storm increased dramatically</td>
</tr>
<tr>
<td>27.10.2012</td>
<td>Centre far off Carolinas, starts to track northeastward Increased convection near centre</td>
</tr>
<tr>
<td>29.10.2012</td>
<td>5 p.m. EDT Mid-Atlantic and northeast coastline After strengthening due to collision with cold air masses, Sandy is declared to be an extratropical storm by the National Hurricane Center</td>
</tr>
</tbody>
</table>
SANDY

Deductibles and sublimits

Most US homeowners’ insurance policies in coastal states contain significant deductibles for hurricane events, typically 2–5% of the insured property value. Each state has different rules for when hurricane deductibles can apply. For example, in New York hurricane deductibles apply if a storm is designated a Category 1 or higher hurricane by the National Weather Service and makes landfall in New York State. In New Jersey, the storm must be designated a hurricane by the National Weather Service and sustain wind speeds of 74 miles per hour (approx. 120 km/h) somewhere in the state. Separate sublimits may also apply to losses resulting from certain events, such as a named storm or flood.

In the immediate aftermath of Sandy, various state governors and insurance regulators publicly proclaimed that hurricane deductibles should not be applied by insurance carriers, on the basis that the storm did not fit the criteria for the language used to specify hurricane deductibles. This was the first indication of what was to become a remarkably robust and proactive response by regulators towards insurers and their handling of homeowners’ claims following Sandy.

Deductibles and sublimits can cause problems when calculating the indemnity, for instance where multiple locations of the same policyholder may have been affected, or where a storm makes landfall across a wide geographic area and over an extended period of time. Hurricane Katrina was generally treated as one “occurrence” or “event” for aggregation purposes. Sandy potentially raised other questions because of its characteristics as an event, which were unique in that there were two weather fronts (a westerly weather front of snow, wind and rain met up with Sandy just off the coast and changed it to a “post-tropical cyclone” according to a National Hurricane Center classification) before it made landfall. In addition, Sandy was followed by a “Nor’easter” storm, which hit the Tri-State area on 7 November 2012. The question could therefore be asked: was Sandy one or two events? The answer to this question depends heavily on the particular aggregation wording in the policy, and the precise factual circumstances to which the wording is being applied.

Wind vs. flood in storm surge cases

One of the most significant issues dealt with following Hurricane Katrina, and which may yet arise in the context of coverage disputes in the wake of Sandy, concerns whether flood losses caused by storm surge can be excluded. According to the definition of the US National Hurricane Center, a storm surge is caused by water which is “forced towards the coast by winds circling the storm in cyclonic fashion”. The majority of homeowners’ policies in the US exclude “flood” losses and industrial policies usually specify sublimits for such losses. However, “storm” is normally an insured peril. For this reason, policyholders commonly argue that their loss following a storm surge was caused by “storm” and not “flood”.

29.10.2012
Evening EDT

Lower Manhatten
Storm surge through the Battery and the East River flooding tunnels, subways

29.10.2012
Evening EDT

Near Brigantine, New Jersey
Landfall US; strongest winds occurred on western side of cyclone; maximised water level heights along NE coastline north of circulation centre

29.10.2012
Evening EDT

Jersey shore to Long Island and Southern Rhode Island
Sandy’s most severe coastal flood damage

31.10.2012
Eastern Canada
After steadily weakening over land, the remnants of Sandy merge with an area of low pressure over eastern Canada

30.10.2012
Appalachians
Blizzard conditions in large parts of the mountain range
Concurrent or proximate causation?

What happens if more than one cause – one covered and one excluded – contributes to the loss, for instance if a court decides that both flood and wind are operative causes in a storm surge case? Can insurers rely on the exclusion?

If the damage is divisible between the two causes – for example, flood damage to the basement of a house and wind damage to the roof – then there will usually be no difficulty in adjusting the claim, as the loss can be apportioned between the two causes.

However, if there is no anti-concurrent causation wording and the two causes of loss operated simultaneously or if either on its own could have caused all the damage, the answer is determined by the applicable test of causality. Different states operate different legal tests. In most jurisdictions, including New Jersey for example, it is necessary to decide which of the competing causes is the “efficient or proximate cause”, i.e. the cause which sets the other causes in motion. Insurers can refuse to indemnify losses altogether if the “efficient or proximate cause” is excluded. Some courts, including those in New York, apply a similar approach called the “concurrent cause” test.

Anti-concurrent causation and ensuing loss clauses

Causation issues such as these may implicate anti-concurrent causation (ACC) clauses and ensuing loss clauses in the insurance policy. Ensuing loss clauses operate as exceptions to exclusions if a certain, definable, insured risk is realised as a result of an excluded risk. This may be the case, for example, if flooding of a building results in an electrical short causing a fire.

ACC clauses, on the other hand, permit insurers to rely on exclusions even if a concurrent covered cause is also in play. A typical ACC clause might be worded as follows:

“We do not cover loss to any property resulting directly or indirectly from any of the following ... Such a loss is excluded even if another peril or event contributed concurrently or in any sequence to the loss.”

Such clauses cannot be legally enforced in some US states (e.g. Washington and West Virginia), although following Katrina most courts upheld them when relied on by insurers.

Following Sandy, ACC clauses have attracted significant criticism, at least in respect of homeowners. In New York, legislation prohibiting the use of ACC clauses is currently being considered by the state legislature as part of a draft of legislation designed to increase protection for homeowner policyholders.

Reinsurance issues

Reinsurance coverage issues relating to Sandy were slow to emerge. However, issues could arise in conjunction with the “follow the settlements”/“follow the fortunes” doctrine and the aggregation of claims. There is no doubt that the introduction of new regulations put increased pressure on ceding companies to resolve Sandy claims quickly. In addition to declaring that hurricane deductibles should not apply, several state insurance departments introduced new rules for handling Sandy claims, designed to expedite and simplify the process for homeowners.
In New York, for example, the Department of Financial Services (DFS) required insurers to inspect damage no more than 15 days after the filing of a claim and to decide on claims within 15 business days (and in some counties within six business days) after completion of their investigation. The DFS also required insurers to accept photographic and video documentation of losses. Such actions undoubtedly contributed to the early resolution of many Sandy claims. However, this could lead to doubts over whether such a settlement of claims is in keeping with entrepreneurial principles and the principles of good faith, and ultimately whether reinsurers are bound by such settlements.

The aggregation of claims could also become an issue at the reinsurance level. Many reinsurance contracts contain “hours clauses”, under which losses caused within a certain period of time (normally 72 hours) are aggregated to form a single loss event. Because the damage caused by Sandy occurred over a longer period of time, it may not be possible to aggregate claims under these clauses. For example, more than 72 hours separated damage occurring in the Caribbean and that in the northeastern United States, particularly when the secondary Nor’easter storm is taken into account. If the ceding company insured businesses in both locations, there could be more than one “occurrence” under the reinsurance contract.

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Lessons insurers can learn from Sandy

In the United States, property damage lawsuits based on the mass tort litigation model are a common phenomenon following natural catastrophes and are frequently backed by well-financed law firms. Those who are familiar with their methods can take action to avert unjustified claims.

Roger D. Higgins and J. Richard Harmon

Whether Katrina, Rita, Ike or Dolly, the procedure has always been the same following tropical cyclones along the US Gulf Coast: as soon as the hurricane has moved on, contractors, roofers and public adjusters swarm out hoping to do business with the victims. Law firms likewise attempt to cash in on the situation. With the help of advertising campaigns and free seminars on “policyholder rights”, they hope to add as many victims as possible to their client portfolios. Their objective is to increase the price and scope of damages with the aid of their own experts and with little basis in fact.

Where possible, they seek to avoid any litigation of their clients’ actual covered damages. Instead, they concentrate specifically on weaknesses in claims handling procedures and in the terms of insurance, in order to make these the focus of their litigation. Superstorm Sandy once again showed that this is a very real risk. Just what insurers can expect is indicated by a number of similar cases following hurricanes in Louisiana, Mississippi and Texas. Not uncommonly, attention focuses on disputes over clauses excluding concurrent causes (anti-concurrent causation or ACC clauses). Such clauses exclude coverage for losses and damage which were simultaneously caused by an insured peril (e.g. storm) and an uninsured peril (e.g. flood), regardless of which occurrence directly or predominantly caused the damage. The lawyers argue that insurers either misapply the ACC clauses or that there was a mistake in adjustment procedures with respect to concurrent causation.

Although each insured’s property damage is particular to that insured, policyholder lawyers often strive to combine several cases in class action lawsuits, thus increasing the scope of any one court’s ruling. Insurers have not always been able to defeat attempts to certify class actions. Several courts have indeed certified class actions or approved class settlements.

Winds and storm surge tore away jetties and boats moored in the Great Kills marina on the east coast of Staten Island, catapulting them into the nearby resort.
Another strategy employed are blast filings, in which multiple lawsuits are filed against one or more insurers at once, in order to tax the resources of insurers and create an opportunity to resolve contested issues in favour of insureds.

This is also the objective underlying attempts to file lawsuits in plaintiff-friendly venues. The lawyers hope to use the rulings made at these venues on discovery disputes as binding precedents with much broader impact. To combat these efforts, a number of insurers have sought to transfer cases to multi-district litigation (cf. 28 U.S.C. § 1407 providing for the transfer of cases with common questions to a particular court). Multi-district litigation offers the possibility of uniform discovery with less duplication of depositions and more predictability in pre-trial rulings.

**Stop plaintiffs with more effective claims handling**

One lesson learned from the Gulf Coast hurricanes concerns the importance of effective claims handling. In hundreds of lawsuits, plaintiff lawyers attempted to prove that certain acts or omissions performed by insurers in handling a claim were actually being performed on a company-wide or “institutional” basis. The underlying idea is to highlight weaknesses in the insurers’ terms of insurance and claims handling procedures in order to divert attention from deficiencies in the insured’s ability to prove covered damages.

The best strategy to combat this cookie-cutter approach is through proactive, timely claims adjustment. A properly adjusted claim and detailed file allow the insurer to demonstrate that each claim is different from both a coverage and damage perspective. The following suggestions for improving claims handling are based on prior litigation of catastrophe claims. While it is certainly not an exhaustive analysis, these tips may prove useful.

**Document all communication with the insured**

Following the Gulf Coast hurricanes, many insureds frequently claimed in court that they had not filed any bills for repairs or photographed the damage because they were never asked to keep receipts. In this way, they attempt to shift the burden of proof of demonstrating covered damage. A jury is likely to sympathise with the insured, unless the insurer can prove otherwise.
Take photographs of the damage

Many policyholders in Texas informed their insurers of disputes more than a year after initial adjustment of the claim, often in the form of a demand letter or lawsuit. They contended that the actual damage was well beyond that found during the initial claim adjustment. Such allegations are easily countered with the aid of photographs. Photographs of the damage are just as important as photographs of undamaged property (household effects, walls, ceilings, etc.). They can also be used to diffuse the argument that the adjusters never inspected that part of the building. In the age of digital photography, failing to extensively document a loss is virtually inexcusable.

Timely and accurate documentation of the claim file

The insurer’s claim file or diary may be discoverable if coverage litigation ensues. Timely and accurate documentation of the file is therefore imperative, and it should include all communications with the insured, the adjusters involved and all other persons assisting in adjustment of the loss.

As with Hurricane Katrina, many of the claims stemming from Sandy involve whether property damage resulted from wind or flood. The real question is how coverage is determined when damage results from both a covered peril and an excluded peril. A court’s interpretation regarding application of the ACC clause in such a case could have enormous repercussions for the insurer. After all, just 4% of New York homeowners have flood insurance. Claims involving sewage back-up can also impact the ACC clause.

Most property policies include water damage exclusions with anti-concurrent causation language similar to the following provision:

“[The insurer] will not pay for loss or damage caused directly or indirectly by [sources identified in the water damage exclusion]. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.”

After the storm surge, sediment and overturned cars hampered rescue and recovery operations in New Jersey.
This language eliminates application of the “efficient proximate cause rule”, which determines coverage by the relative contribution of the covered and excluded perils to the property damage. The Fifth Circuit, interpreting Louisiana, Mississippi and Texas law, has repeatedly upheld the application of ACC clauses. The Mississippi Supreme Court, however, has significantly narrowed the Fifth Circuit’s interpretation. In the case Corban v. United States Automobile Insurance, the court held that: “Only when facts in a given case establish a truly ‘concurrent’ cause, i.e. wind and flood simultaneously converging and operating in conjunction to damage the property, would we find, under Mississippi law, that there is an ‘indivisible’ loss which would trigger application of the ACC clause.” Based on this reading of the provision, the court concluded that all “direct physical losses” caused by wind were covered, while all “direct physical losses” caused by flood, or flood to which wind contributed concurrently, were excluded.

Relatively few courts have addressed the application of ACC provisions under New York, New Jersey and Pennsylvania law. An ACC clause was upheld by a New York intermediate appellate court in a case involving an exclusion for subsurface water pressure exerted on a swimming pool, even though the previous drainage of the pool and rainfall contributed to the damage. In New Jersey, an unpublished intermediate appellate opinion similarly upheld the application of an ACC clause. A Pennsylvania intermediate court, on the other hand, held in 2009 that the clause was ambiguous and should be construed in favour of the insured and against the insurer.
Changing weather risks are having a major impact on the insurance industry. Insurers today need to find ways to manage major losses and expedite recovery. Two new publications from our Knowledge Series can help you find the answers to these questions.

In “Claims management following natural catastrophes” we examine the major weather-related natural catastrophes of recent years and present conclusions that help insurers to optimise their contingency planning and claims management.

“Severe weather in Eastern Asia” presents an in-depth analysis of the changed exposure situation in East and Southeast Asia.

These two publications are available in English as a download from our client portal connect.munichre.com or from your Client Manager.

For further information, please contact your Client Manager.

NOT IF, BUT HOW
Sandy caused enormous damage to US infrastructure, and the storm threat to the East Coast is increasing all the time. Tony Kuczinski talks about ways of making the region more resistant to the threat of severe weather.

Schadenspiegel: Mr. Kuczinski, how did you experience Sandy at first hand?

Tony Kuczinski: When Sandy hit the East Coast, I was in Munich with several colleagues from the US, so our return to the States was slightly delayed. In the immediate aftermath of the storm, I had some difficulties communicating with the Princeton office and with my family in Pennsylvania, because of downed power and phone lines.

What was your initial assessment when you heard about the storm?

I met with a number of colleagues in Munich, and our initial assessment was that the storm would be similar to Irene in terms of losses. However, we started seeing more pictures coming through in Germany and the extent of the damage became clearer. We realised that it would be an event for which the insurance loss would be hard to estimate because of the flood and storm surge components.

How costly was Sandy in the final analysis?

Sandy cost Munich Re around €800m before tax. Total insured losses were about US$ 30bn and economic losses were approximately US$ 70bn.

US infrastructure is generally considered vulnerable and somewhat outdated in many respects. Did the damage to infrastructure surprise you nevertheless?

Although a unique storm, Munich Re foretold a Sandy-like scenario in a discussion about Hurricane Irene in its publication “Severe Weather in North America”, which was published just weeks before Sandy hit: “A stronger hurricane, like the 1938 Great New England Hurricane, would easily cause more extensive wind damage throughout the region and generate a storm surge that could devastate coastal communities, and the financial hub of the United States, causing losses several times higher than Irene’s.”

This publication includes a map with the hurricane-related flood zones in New York City, and the flooded areas in NYC matched up very closely with the expected levels we had shown in our report.

So why wasn’t New York better protected?

Every four years, the American Society of Civil Engineers produces a report card on the nation’s infrastructure, and in 2013 our infrastructure was given a D+. Four years earlier it was graded D. Knowing that our infrastructure was in this condition, and that the East Coast is vulnerable to Atlantic hurricanes, the result could have been expected.

Unfortunately, it often takes a devastating event before public officials and service providers respond. It was known that the levee system, flood walls and pumps in New Orleans needed technical improvements. It is understandable, and human nature, to put things off until it becomes critical, especially when there is limited funding. But it makes me wonder how much money or lives would have been saved over the years if we hadn’t delayed.

1 See “American Society of Civil Engineers Infrastructure Report Card” http://www.asce.org/
What measures could reduce the loss potential of future events in this region?

We must consider the changing weather patterns, factoring in climate change as we invest in infrastructure and other measures.

Take New Jersey, where Munich Re America is based, as an example. During Sandy, the state experienced enormous losses from storm surge and flooding. Based on current climate models, we can expect that New Jersey will face even greater risk in the future from heavy precipitation, hurricanes, flood and storm surge.

Water events are therefore the biggest worry for New Jersey as far as future perils are concerned, especially since a map from the American Geosciences Institute shows that between 10% and 20% of the state is in a flood plain. So the focus on how to spend limited dollars on infrastructure improvements should be to protect against flooding. We also need to look at where we rebuild, and not keep rebuilding in areas with recurrent flooding. And when we do rebuild, we should build to higher standards.

So land-use planning and effective building codes can play an important role in preventing future losses. Improvements to water and wastewater systems, as well as power and energy structure, will also minimise the impact from these events, making us a more resilient, weather-ready nation.

What does Sandy mean for the insurance industry in the USA?

Sandy was to the general public what Hurricane Andrew was to the insurance industry in 1998: a wake-up call.

It brought certain discussions to the forefront, such as the implications of severe weather on our deteriorating infrastructure. The storm made more people aware of their homeowners’ coverage and what is included or not; what flood coverage does and doesn’t cover. People are looking more closely at their policies, recognising the importance of having adequate coverage and in taking risk mitigation measures.
It has prompted a dialogue about who should bear the cost of risk; whether coverage for people living along the coast should be subsidised by those in less exposed areas.

These are all topics the insurance industry has been talking about for years but now, after Sandy, people are paying attention. Once there is an acceptance that there are problems, it is more likely that the industry, the public and policymakers will work together toward solutions.

Further hurricanes are inevitable. What conclusions do you draw from Sandy for Munich Re with a view to similar events in the future?

We need to analyse the changes, quantify them, and if they are driven by changing hazards and/or vulnerabilities, consider these changes in our risk models. This is how we deal with any type of risk of change.

In addition, as a leader in the insurance and reinsurance industry, we need to take a leadership role in educating our elected officials and our communities on the potential for more severe weather. We also need to be part of the solutions that will make us more resilient in the future – by helping to address an ageing and inadequate infrastructure, advocating better land use, and encouraging the building of fortified homes.

How did Munich Re America support its clients in the aftermath of this catastrophe?

Our goal was to support our insurance company clients as much as we could so they could help their customers. This included making claims payments as quickly as possible. In some cases involving smaller regional clients, where we knew we would be paying claims, we accelerated payment to alleviate cash flow concerns. We wanted to get the money flowing to where it was needed.

The Munich Re companies American Modern and Hartford Steam Boiler (HSB) also wrote business in the impacted areas. Both companies moved claims adjusters in as soon as it was safe to do so, with HSB creating a dedicated CAT team focused exclusively on Sandy claimants. Our first goal was to give our customers comfort and communicate that we were there to help provide solutions.
How can research at the Insurance Institute for Business & Home safety, which Munich Re supports, help to minimise future losses?

The IBHS is an independent, non-profit, scientific research and communications organisation supported by the property insurance industry. IBHS’ mission is to conduct objective, scientific research to identify and promote effective actions that strengthen homes, businesses, and communities against natural disasters and other causes of loss. IBHS does this by conducting research and advocating improved property design, construction, strengthening, maintenance, repair, and preparedness practices. Several states have adopted some of the IBHS building standards into legislation or regulations designed to strengthen homes, particularly in coastal areas.

The need for sound building science research that leads to stronger, safer homes, businesses and communities has never been more apparent. Nowhere in the world is the rising number of natural catastrophes more evident than in North America, where the number of weather-related loss events have almost quintupled over the past three decades.

How do our clients benefit from this?

IBHS research also helps member companies better understand structural vulnerability and the role that mitigation plays in reducing it, as well as what mitigation features to look for when inspecting a residential or commercial building. This, in turn, can strengthen risk-based underwriting and pricing as practised by individual insurers.

Munich Re and other member companies expect that these efforts will lead to a reduction in the cost of weather-related claims, ensuring a strong, robust property insurance market.
Art galleries under water

Floods, power outages, destroyed works of art: in October 2012, Superstorm Sandy seriously damaged many New York art galleries. The high accumulation risk proved costly for insurers.

Many art galleries in the Chelsea district of New York had to undergo extensive salvage operations.
New York is one of the most important art centres in the world. Over the years, a large number of galleries have been set up, particularly in the Chelsea district, which lies by the Hudson River on Manhattan's West Side. Outside of the city's major museums, nowhere has such a large concentration of artworks as the hundreds of smaller and larger exhibition rooms between West 14th Street and West 26th Street. When Superstorm Sandy swept across New York on 29 October 2012, the Hudson River burst its banks. The floods inundated parts of Chelsea, causing serious damage to the galleries.

The flood waters destroyed or damaged thousands of works of art. Especially badly affected were the street-level galleries between 10th Avenue and 11th Avenue, where the water was up to six metres deep. Storage facilities and galleries that were below street level were flooded almost without exception. With losses estimated at 400 to 500 million dollars, insurers specialising in fine arts insurance had to pay out roughly as much for losses in New York as the total premium they receive in a year.

Pop artist Peter Max alone initially claimed US$ 300m for damage to works that were in a flooded warehouse in New Jersey. The claim has since been significantly reduced. All the same, this is still being spoken of as one of the biggest individual losses in the history of fine arts insurance.

Early warning only partially successful

Once it became apparent that Superstorm Sandy would make landfall in the New York area, insurers tried to contact their policyholders in order to agree adequate loss prevention measures beforehand. Large parts of the Chelsea art district were located in the evacuation zone, which meant that measures taken in good time were able to prevent damage. Even if not all clients were reached, the early warnings were successful: many gallery owners managed to place their stock in fine-art storage facilities outside Manhattan before bridges and tunnels were closed.

However, owing to time pressure, it was impossible to save every work of art. The large size and fragility of some works would have required elaborate preparations for their transport. To make matters worse, it subsequently transpired that ostensibly safe storage facilities outside Manhattan – in New Jersey, for example – were also flooded.

Another problem was that, following their experience with earlier hurricanes which had passed through without serious consequences, many gallery owners underestimated the possible scale of the flooding. The flood waters ended up being considerably higher than expected, with the result that many protective measures proved ineffective.

Complex loss adjustment

Once the evacuation zones had been given the all-clear, insurers immediately set about assessing the damage. A crisis management team made up of loss adjusters, experts and restorers carried out an initial review of the situation. It turned out to be almost exclusively contemporary modern art and photographs that were affected. As is usual in the case of large disaster relief operations, claims management was carried out on the basis of triage. Damaged artworks were first classified into “total losses”, which either could not be saved or would be uneconomic to save, and “partial losses”, for which salvage or restoration was possible and economically viable. Although this process is very time-consuming, the first claims payments were already being made just one week after the event.

Where it was decided that a work could be restored, measures had to be taken on the spot to avoid further damage. Wherever possible, works of art were taken to dry storage facilities in order to prevent mould. In moist air, mould can also form on objects that have not even been in contact with water. Salt from the seawater and the cold – there was no electricity or heating for days – increased the risk of further belated claims and made salvage operations more difficult. It was also necessary to move works of art to places of safety to prevent looting – a fate which befell many artworks in New Orleans following Hurricane Katrina.

Gallery owners and restorers received support from numerous institutions like the American Institute for Conservation – Collections Emergency Response Team (AIC-CERT) and the Museum of Modern Art (MoMA). These provided advice on what emergency measures to take and how best to avoid consequential losses.
Problem of missing inventories

Gallery owners generally take out all-risks covers, which also include loss or damage caused by natural hazards. Depending on the type of risk, inclusion of these hazards usually requires the payment of an additional premium or is even declined outright. Because the city government of New York had already issued a warning almost four days prior to the flooding that Superstorm Sandy was expected to make landfall in the area, insurers had to clarify whether the gallery owners had responded adequately and in good time. One problem was the loss or destruction of the inventories that gallery owners are required to maintain. These inventories provide evidence of what works of art were on sale, and were therefore covered by the insurance, and the asking price. Without these inventories, claims settlement proves difficult.

Agreed value as the upper limit

In the UK and the USA, it is usual to arrange fine arts policies on the basis of “agreed values”, under which the insurer and the policyholder agree a specific value for each individual work of art. In the case of art galleries, special valuation clauses are used to determine the agreed value for each picture. These clauses can vary significantly. One recommended approach is to determine the value on the basis of the purchase or sales price plus or minus a certain percentage. As well as loss or damage, the policy usually also covers the cost of ascertaining the damage, restoration, and any loss in value.

In the case of a total loss, the agreed value is the binding maximum limit of indemnity. The same applies in cases where the cost of restoration and the estimated loss in value exceed the agreed value. If, upon occurrence of the loss, the actual value of the work of art exceeds the agreed value, this will result in the application of average. In order to counter this risk, the values in the gallery owners’ inventories should be checked regularly and adjusted to take account of the latest developments.

The application of average is often removed against payment of an additional premium by means of a relevant Waiver of Average Clause. Should the value of the insured works of art then greatly exceed the agreed sum insured, no deduction is made when calculating the amount of loss.
Difficulty in determining the value

There is no preset pattern for determining claims for indemnity in the art sector. Each case is as unique as the work of art itself. Here, all those involved (gallery owner, insurer, expert, restorer, artist) have different viewpoints and therefore arrive at different valuations.

Whereas a gallery owner may base the assessment of a total loss on whether a work of art is still salable, artists will assess the value of their pictures subjectively and with much greater emotional attachment. In their eyes, even a slight change in an artwork may constitute a total loss. For the restorer, on the other hand, it is primarily a question of whether it is technically possible to restore the item to its original condition at a reasonable cost. Without objective guidelines and rules on the criteria to be used to assess damage or loss in value, expert reports are often based on purely subjective assessments.

In the case of contemporary works where the artist is still alive, copyright issues have to be taken into consideration. There are numerous precedents for this in German case law. Restoration without the consent of an artist who is still alive would be disastrous and would have considerable consequences for an art expert’s subsequent valuation.

In order to arrive at a mutually acceptable solution in such circumstances, all the parties must have a special appreciation of other points of view and approach the matter with appropriate delicacy. Only if all parties are involved in the outstanding settlement issues at an early stage and agree on how to proceed can lengthy legal disputes be avoided.

Reduction in value often contentious

In the case of partial losses, discussions concerning the amount of reduction in value often lead to disputes. Whether, given the technical and practical possibilities of restorers, there is any reduction in value at all will depend on the success of the restoration work carried out. An expert should definitely be brought in to assess this issue.

From the expert’s perspective, the more extensive the alterations to the original are, the more problematic the restoration of artworks becomes. Generally speaking, any loss in value can only be assessed once the restoration has been completed. The expert also has to decide whether damage may be earlier in date and had already occurred prior to the inception of the insurance. It is very rare for there to be a condition report before a risk is assumed. Databases like Artpiece, Artnet or Artfacts, which list auction results but also the condition of art works, can be an important aid here.

Fine arts insurance after Sandy

Insurers have now become more aware of risks from natural hazards in the art sector. They will have to pay closer attention to these exposure situations in future and adapt their underwriting policy to the latest claims experience.

They will also need to investigate other hurricane flood scenarios and take them into account as possible exposures. The focus will increasingly fall on the individual locations of galleries and art rooms (basement, ground floor, first floor), something which could lead to more policy exclusions being agreed in future.

However, an event like Sandy will also make gallery owners and collectors more aware of the importance of adequate insurance. With increasing demand, the downward trend in the price of policies ought to come to a halt. Given that, in view of higher risk awareness, some fine arts insurers will reduce their capacities, rising premiums cannot be ruled out either.

OUR EXPERT

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The insured’s obligations in fine arts insurance

Eva-Maria Goergen

As there was considerable advance warning that Superstorm Sandy was likely to hit New York, and therefore also the city’s art scene in Chelsea, we need to ask the following: what measures could gallery owners have reasonably been expected to take to protect the insured risk? And how is a failure to act sanctioned under the coverage relationship?

Policies issued under US law specify certain duties in the event of a loss. Attention should first be paid to the actual wording because the US insurance industry continues to be heavily influenced by differences in the various states and the relevance of case law is only marginally behind codified law. Property insurance policies usually incorporate key loss mitigation arrangements that include a “Duties in The Event of Loss Or Damage” clause:

“You must see that the following are done in the Event of Loss or Damage to Covered Property: take all reasonable steps to protect the Covered Property from further damage and keep a record of Your expenses necessary to protect the Covered Property for consideration in the settlement of the claim. This will not increase the Limit of Insurance. However, We will not pay for any subsequent Loss or Damage resulting from a cause of loss that is not a Covered Cause of loss. Also, if feasible, set the Damaged Property aside and in the best possible order for examination.”

Proportionality and reasonableness

According to the strict wording of the clause (“in the event of loss” and “protect ... from further damage”), the policyholder is required to act as soon as a loss occurs. However, the loss occurrence defined in policies is rarely brought forward so far as to have hurricane warnings trigger the insured event. The loss occurrence is usually deemed to have started only once there is a detrimental change to the substance of the tangible property. Legal leverage to ask for the removal of insured items from a possible danger zone even before a hurricane has made landfall is a difficult issue. Once a hurricane has reached the insured location, the contractual arrangements would of course take effect. However, it would then be necessary to carefully check whether it was proportionate and reasonable for the policyholder to take loss prevention and mitigation measures while the storm was raging.

In the case of Sandy, an acute risk to life and limb in the evacuation zones could not be denied. Furthermore, formal government evacuation orders were in place. Once the hurricane had made landfall in Manhattan, sensible rescue operations for works of art were almost impossible. Weighing up the benefits, effort and risks would at best have allowed measures to be taken within a safe building – for example, moving objects to higher floors. However, this would have required a policyholder to ignore the evacuation order.

Protective measures after the event

Once the hurricane had moved away from Manhattan, the top priority was to avoid consequential losses. As is often the case in disaster areas, there was an immediate risk of looting. As soon as the evacuation zones could be entered again, it was reasonable for policyholders to take appropriate safeguarding measures. As part of the loss mitigation measures, policyholders were required to remove from the danger zone any works of art that were exposed to damp or fire and smoke as a result of interrupted and damaged electricity and gas supplies.

Regarding the question of whether a work of art should be restored, a balanced decision is needed, taking into account the post-sales rights of the artist (who is sometimes also the policyholder). An unreasonable decision not to restore might have effects on the insurer’s liability. In insurance, too, whether artworks become a write-off because they are abandoned cannot ultimately depend on the subjective and possibly irrational decisions of individuals.

Additional risk exclusions

Furthermore, in US contracts it is usual to round off the duties in the event of a loss contractually by means of a risk exclusion to motivate the policyholder to act. Such an exclusion could typically be worded as follows:

“We will not pay for Loss or Damage caused directly or indirectly by any of the following: Such Loss or Damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the Loss. Neglect of an insured to use all reasonable means to save and preserve property from further damage at and after the time of loss.”

A policyholder should not carelessly gear his actions to the fact that he has insurance cover.
Where a policyholder has not responded to the gale warnings, it must therefore be asked what measures he could have been expected to take in order to avert the loss. In the case of forces of nature though, it is relatively difficult to define the precise area of responsibility. There is always the possibility that a hurricane will leave its predicted path rather suddenly. In the case of Sandy, however, it may be assumed that the forecasts and the orders by the authorities made the population sufficiently aware of the approaching disaster. Where a policyholder has not taken any measures to protect the insured property, there is therefore at least a starting point for holding settlement discussions about a reduction in the claims payment.

**Costs and extension of the risk**

Loss prevention and mitigation measures can give rise to costs. In US policies, these costs are generally covered by mitigation expense clauses. It is the other side of the coin that loss minimisation measures which initially appear justified but subsequently prove unsuccessful give rise to reimbursable costs within the policy limits. This applies all the more so where the insurer not only draws attention to existing severe weather warnings but also issues an instruction to remove a specific object from a danger zone.

Unfortunately, Sandy also showed how unpredictable forces of nature remain, despite all the forecasting efforts. Areas considered to be safe were thus also affected, which in turn triggered claims for weather-related damage and consequential loss in respect of the works of art transferred there. The risk of a loss occurring somewhere other than the original insured location cannot be borne solely by the policyholder. Even in the absence of express off-premises insurance, in such a case it should be checked whether property damage occurring in New Jersey, for example, is still covered despite the fact that the insured location agreed in the policy was confined to a gallery in Chelsea.

**Proof of the amount of loss**

One of the policyholder’s duties is also to enable an assessment of the damage to be carried out. Here it is often claimed that the documents needed to prove the amount of the property damage have been lost during the loss occurrence through no fault of the policyholder.

Any assertions of this kind by the policyholder should initially be looked at critically. Inventories and valuations are generally produced not only for insurance purposes. The documents are also needed to draw up balance sheets, arrange sales and, not least, to provide evidence of tax items. In the age of electronic correspondence, copies of such supporting documentation are often to be found on an external server, or are at least filed with an auditor or tax adviser.

Where such documents have been destroyed and the insurance policy did not contain any requirement for them to be stored separately, it is in most cases more a problem of proof than a question of insurance cover. In the absence of an agreed value, the burden of proof for the value of an insured object generally lies with the policyholders, so any doubts about the amount of loss will be to their detriment. For the insurer who has to check the claim, however, such a case will involve considerably more effort and expense.

**Legal consequences**

The legal consequences of a breach of obligations have to be viewed differently in American law. First and foremost it is about what has been agreed in the primary insurance contract. In the absence of relevant agreements, courts will generally interpret the contract to categorise the obligation. Basically, there are three different kinds: exclusions, conditions precedent to recovery and duties bearing on the amount of recovery.
Exclusions and conditions precedent to recovery are most likely to result in the indemnity being reduced to zero. Although a claim for coverage could arise in a case where a condition was not met, failure of the condition to be met generally results in the cover being completely null and void. When it comes to the legal consequences of breaches of the third point – duties bearing on the amount of recovery – the situation is different. If the policyholder fails to comply with these duties, his claim for coverage remains. The insurer’s indemnity is reduced, however. Particularly in legal systems that allow juries, this reduction constitutes a considerable risk for the policyholder.

**Conclusion**

In fine arts insurance, even a small percentage reduction of the insurer’s liability can come to a considerable amount. It is therefore worth checking in every case whether a policyholder could have influenced the occurrence and the amount of the loss he has reported and whether he has met his contractual obligations adequately. The first step involves filtering out losses which the policyholder could have prevented. Second, it must be examined whether he took sufficient care to protect against consequential losses. Yet, it should be remembered that loss mitigation costs may be covered under the policy. Although they do generally reduce claims expenditure, they can lead to claims even in cases where no property damage has arisen.

**OUR EXPERT**

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Alberta floods

The floods in Calgary and the surrounding areas in the summer of 2013 were the costliest natural catastrophe in Canada's history. They also raise the issue of concurrent causation.

Jordan Solway

Southern Alberta is not a part of Canada which typically receives a high amount of rainfall. However, in the days leading up to 19 June earlier this year, a low-pressure system in northern Alberta triggered over 200 mm of rain in just 36 hours, especially west and southwest of the city of Calgary. The substantial rainfall contributed to an already saturated ground from a delayed spring thaw which, taken with the steep watershed and heavy snow loads in the front mountain ranges of the Rocky Mountains, resulted in a substantial increase in the size and flow of several rivers.

Current estimates put the total damage caused by the flooding in excess of Can$ 6bn, while insurable losses are estimated to be approximately Can$ 1.7bn. According to the Insurance Bureau of Canada, the 2013 Calgary floods will go down in record as the most expensive natural disaster in Canadian history.

Question of insurability

The long-term consequences of this tragic event raise a number of questions, including the availability of flood insurance for homeowners who continue to live in flood-prone areas of southern Alberta. Flood insurance is not available for residential properties in Canada, although it can be purchased for commercial properties but is typically sublimited or subject to higher deductibles according to the risk. Given this fact, the Alberta government recently announced that it would be offering to relocate those presently living in a "floodway" area.

Homeowner insurers in Canada will typically offer sanitary sewer back-up coverage for an additional premium and even then, this is sometimes subject to a sublimit. The issue for the primary insurance companies was how to adjust the loss and interpret their policies in light of what, in some circumstances, were multiple causes of the loss or damage. For example, where water on flooded streets or high groundwater drains into the sanitary sewer system, this can overload the sewer pipes and force sewage back through the sewer line and into the basement of a residential property. The same result can occur where the stormwater system experiences flow-back due to rising water levels, causing water to drain into the sanitary sewer system. In such circumstances, the cause-in-fact of the damage to the homeowner's basement may have been sewer back-up but the proximate cause, or the legally culpable cause of the harm, was clearly overland flooding. However, such a tort law causation analysis is seemingly different when one considers the terms of an insurance policy in order to determine whether the loss or damage is considered to be "covered".

Concurrent causation

This gives rise to the issue of concurrent causation in insurance, which occurs when a loss is brought about through a combination of two or more potential causes, some of which are covered under a policy and some of which are excluded. Under the approach established by the Supreme Court of Canada in a 2001 decision Derksen v. 539938 Ontario Ltd. 2001 SCC 72, where the loss or damage was the result of two concurrent causes, one covered and one excluded, the insurance policy must respond to the loss for the non-excluded loss or damage absent specific language to the contrary. Derksen was a significant change in the law which, up until that point, treated the loss as being uncovered because the excluded peril was essential to the chain of causation leading to the loss. In other words, without the overland flooding there would not be any sanitary sewer back-up. This approach was rejected as an invariable rule by the court in the Derksen case, which found that whether a particular exclusion clause actually ousts coverage in a given case was a matter of interpretation.

The problem, therefore, remains in the context of concurrently caused losses from flooding and sewer back-up to apportion the indemnity in a fair and reasonable manner, particularly in circumstances where the informational costs of being able to now make that determination are likely to be too high to sensibly isolate the involvement of the alleged causes on the final loss claimed. As the Alberta flood claims continue to be adjusted and submitted to reinsurers for consideration, this will now be the focus of deliberations between cedants and their reinsurers.
Settlement is better than uncertainty

Tort law expert Prof. John Goldberg explains why US companies frequently prefer to settle with plaintiffs rather than go to trial and reveals how tort law has changed over the years.

Schadenspiegel: Prof. Goldberg, the settlement rate in the US in tort cases is extremely high. Why?

Prof. John Goldberg: The vast majority of tort suits that are not voluntarily withdrawn are resolved by a settlement agreement rather than a trial. For suits seeking modest compensatory damages, the reasons are straightforward. Pursuing litigation through to trial takes time and money. Because most trials are jury trials, their outcomes are unpredictable.

For “mega-tort” cases involving allegations of widespread injury and enormous damages, costs and delay can still be an issue – for example, a defendant might face years or even decades of litigation, as has Exxon over the Valdez oil spill in Prince William Sound in Alaska.

What other factors are significant besides costs and time?

In some so-called “bet-the-company” cases, defendants feel that the stakes are too high to gamble on a trial. In others, the parties may face uncertainty about how governing law will be applied to their dispute. Applicable law may be unclear or, even when it is clear, the parties might reasonably worry that courts will exercise their common law authority to modify the law precisely because it is a special case with especially high stakes.

Does public opinion influence the defendants’ willingness to settle?

Other considerations can come into play in mega-tort cases. Most obviously, there are reputational considerations: suits involving allegations of widespread, serious injuries attract media attention, and defendants are anxious not to be saddled with claims that they are irresponsible or unconcerned for the well-being of their customers or the public. In addition, large-scale events attract the attention of government officials, and can lead to criminal prosecutions and civil penalties apart from tort liability. Defendants may find that it is in their interest to settle tort claims as part of an overall strategy for reducing the likelihood of adverse actions by government officials. Finally, there is real value to achieving prompt and full “closure”. Stakeholders and markets seem to prefer the certainty of a settlement – even a large settlement – to uncertainty.

Could you give us some examples of this?

The pharmaceutical company Merck was sued by thousands of consumers alleging that its painkiller Vioxx caused them to suffer heart attacks and strokes. The plaintiffs had in their favour evidence that Merck knew of the risk and downplayed it to regulators and the public. However, many plaintiffs also faced a serious hurdle in proving that it really was Vioxx, as opposed to other factors, such as age, smoking, or obesity, that caused their injuries. In the US system, this question of individualised causation is a question for the jury.

The lawyers for the plaintiffs and Merck agreed to hold a series of “bellwether” jury trials to help figure out whether juries were likely to find that Vioxx caused particular plaintiffs to suffer heart attacks and strokes. And, although Merck won most of these sample trials outright, and although almost all of the jury verdicts won by plaintiffs were reversed on appeal, Merck nonetheless settled the case for nearly US$ 5bn. Probably they did so for some of the reasons mentioned above. In particular, they avoided years or decades of litigation, and they got the benefit of closure. Notably, Merck’s stock saw
an increase in value on the day on which the US$ 5bn settlement was announced.

Another example, still unfolding, concerns BP’s liability arising out of the disastrous Deepwater Horizon spill. Both through the Gulf Coast Claims Facility (GCCF) that BP set up to settle claims against it, as well as through a recent settlement of thousands of claims pending in federal court in Louisiana, BP has paid and will pay millions of dollars as compensation for losses in profits and wages suffered by Gulf Coast businesses. Yet it is not clear, as a matter of common law or the federal statute known as the Oil Pollution Act, that BP is obligated to pay all of this compensation, particularly with respect to losses that resulted not from property being damaged or rendered unusable by pollution, but instead from the general economic downturn that occurred as tourists decided to stay away from the Gulf Coast area.

Here there is genuine legal uncertainty: the Oil Pollution Act is a relatively new piece of legislation and the courts have never definitively interpreted the scope of liability that it imposes. BP no doubt is also concerned for its reputation. But perhaps most importantly, BP has been faced with the threat of prosecution and the denial by the US Department of Interior of permits required to engage in offshore drilling. Adopting a relatively generous approach to victim compensation is one way in which BP is “negotiating” with US government officials.

Do you see any new developments in this area in the US?

Since about 1980, a majority of the American public and most courts have grown more sceptical of tort law. This is the era of “tort reform” – efforts by legislatures and courts to cut back on perceived excesses of the tort system. These developments should, on average, reduce the pressure on defendants to settle claims.

However, there are also some countervailing trends, although these are more diffuse and harder to describe. Around the country, many trial judges have adopted a “managerial” approach to the resolution of mega-torts. They see their job as bringing into court all victims who can credibly allege to have been injured and all persons whose actions might be connected to those injuries, then overseeing a fair allocation of the cost of those injuries among all the parties before the court. While there is something to be said for this “loss-spreading” approach, it departs from traditional tort law principles, under which liability is imposed only on parties who can be deemed to have injured the victims by breaching a duty owed to the victim.

How does this division of costs work in practice?

For example, as a result of the 9/11 terrorist attacks that destroyed the World Trade Center towers, owners and lessees of properties that were damaged or destroyed in the attacks sued American and United Airlines (among others) for failing to prevent the damage by more adequately securing their planes against the risk of hijacking. Under New York law, there is a strong argument that the airlines owed no duty to take protective measures for the benefit of these owners of property, and hence cannot be held liable even if they carelessly contributed to the attacks. Yet the federal court presiding over the litigation has seemed reluctant to apply this no-duty rule, perhaps out of a belief that the airlines bear causal and perhaps some moral responsibility for the harm, and thus are appropriate bearers of at least some of the cost of the damage.
Fracture in the intake pipe of a seawater desalination plant

Desalinated seawater is becoming increasingly important as a source of drinking water. However, if the intake pipes of desalination plants are not properly anchored to the seabed, lengthy repairs and serious business interruption losses are likely to result.
The seawater desalination plant on the coast of Algeria had an underwater intake pipe to draw water from the sea into a pumping station and a water treatment plant. On 10 February 2010, the pressure in the seawater intake pipe suddenly fell. On that day waves were averaging three to five metres high at the plant with maximum wave heights of seven to nine metres. An underwater inspection of the pipeline six days later showed that it was broken. Underwater photos indicated that both broken ends along with a total of 30 metres of pipe had sunk into the seabed. Sand from the seabed had been sucked into the intake pipe and had formed a crater with a diameter of approximately 60 metres at the site of the fracture.

Only a part of the pipeline runs under the seabed. The pipeline is composed of six-metre long pipes arranged in three sections (section T0 140 metres long, section T1 460 metres and section T2 571 metres). The break occurred in section T2, about 350 metres from the pipe inlet and 821 metres from the shore. Sections T0 and T1 were buried in the seabed, whereas section T2 was laid on the seabed attached with ring-shaped weights (Fig. 1).

After the fracture, the output of the seawater desalination plant fell to about 40% of capacity. However, by installing a temporary replacement intake pipe parallel to the damaged pipeline, it was soon possible to gradually increase the plant’s output to 80%. After successful repairs, normal operations were resumed in December of the same year.

The cause of the fracture was a design fault

The intake pipe was laid on the seabed. The pipeline was secured to the sandy seabed by annular and U-shaped weights. The seabed in this region is sandy with average grain size distribution and is very dynamic.

The storm and the associated swell at the time of the fracture were clearly less than the maximum conditions for which the intake pipe had been designed (i.e. average wave height of 6.2 metres and maximum wave height of 11.2 metres). In relation to the design conditions, the storm was therefore not classed as an exceptional event.

The policyholder, the insurer and the leading reinsurer dispensed with the idea of recovering the damaged part of the pipeline. This enabled costs to be saved but also prevented the cause of the fracture from being clearly established. Possible causes of the fracture such as defective workmanship (for example faulty work during construction on land, during welding, transporting the pipe to the sea, sinking the line on the seabed) or defective material could not be ruled out. The inadequate anchoring of the intake pipe to the dynamic seabed in the T2 section was presumably the cause of the damage. It is advisable to cover an intake pipe on the seabed with material over its entire length or to secure it with micro-piles.

As further delays would have involved significant business interruption costs, the fastest possible repair to the plant was of prime importance.

For financial and practical reasons, the repair consisted of removing a portion of the seawater intake pipe that was approximately 100 metres long. The broken pieces remained on the seabed. The crater around the fracture site was then filled in and the missing 100 metres of pipe replaced with the three pipe sections. The broken pipeline ends were left on the seabed.
Population growth, rising standards of living and dwindling natural water sources are the reasons why more and more seawater desalination plants are being constructed.

The traditional process used in these operations is vacuum distillation – essentially the boiling of water at less than atmospheric pressure and thus a much lower temperature than normal. This is because the boiling of a liquid occurs when the air pressure equals the ambient pressure and vapour pressure increases with temperature. Thus, because of the required lower operating temperature, low-temperature “waste” heat from electrical power generation or industrial processes can be used.

Another process involved in desalination is based on the principle of reverse osmosis, where semi-permeable membranes and pressure are used to separate salts from water. Reverse osmosis plant membrane systems typically use less energy than thermal distillation, which has led to a reduction in overall desalination costs over the past decade.

However, desalination remains energy-intensive and costly. The product quality and the output of the plant can be impaired by contaminated seawater, large sediment particles in the water after a storm or the entrainment of algae and seaweed.

Seawater desalination plants need a reliable power supply and intensive maintenance. In some countries with a shortage of water, desalination plants constitute a critical part of the infrastructure and can be the target of politically motivated attacks.

The absence of weather data can both prejudice the design and, in the case of a loss, the loss adjustment. Storms, the dynamics of the seabed, currents and ships’ anchors can also damage the intake pipe.
Material losses, business interruption losses and loss adjustment aspects

Immediately after the pressure loss in the pump house, the seawater desalination plant lay idle for a week after the fracture in the seawater intake pipe in February 2010.

During this time, a temporary replacement pipeline was installed parallel to the existing damaged pipeline as a preliminary measure to reduce the loss. A step-by-step increase to 80% was achieved. In the treatment plant, the water is forced through cartridge filters and is then fed into the reverse osmosis modules. The next stage is the addition of salts and chlorination. The five reverse osmosis units each provide 20% of the total output of the plant. The second measure to reduce the loss was to employ more people to clean the entire plant. As the temporary intake pipe was closer to the shore and in shallower water, larger volumes of sand and small particles of solids (such as algae) were entrained and therefore had to be removed from the intake pumps, primary filters and filter stages in order to avoid increased wear; labour costs therefore increased. Wearing parts and filters were renewed. As the design of the plant had already incorporated a spare intake pump, it was possible to alternate the repair and cleaning work on the pumps without disturbing ongoing operations.

However, sand which had collected in the intake system as a result of the fracture in the pipeline reduced plant output and, at the same time, increased wear. After lengthy and complicated “flushing” of the plant during operations, it was then possible to eliminate any reductions in output. Even after the repair was completed in December 2010, the reduction in output caused by the sand in the plant continued until July 2011, and therefore five months beyond the period of indemnity.
Production limitations which were not attributable to the fracture, such as regular maintenance or transformer downtime, were excluded from the loss calculation. The calculation of the gross loss of profit after the fracture took account of important variable costs such as power consumption and chemical usage. Additional costs (ICoW) for the maintenance of production, such as the installation of a makeshift seawater intake pipeline, the more intensive cleaning of plant components (removal of significant sand contamination from pumps and filters) and the replacement of wearing parts such as pump seals and microfilters (after allowing for the expected useful life), were also taken into account when calculating the loss. Property damage came to about €1.3m, but this was overshadowed by the business interruption loss of €4.8m.

Cover was via a property all-risks policy (including machinery breakdown and loss of production) in which neither defective design nor “normal action of the sea” was excluded; the policyholder was therefore covered. In this case, the idea of recovering the damaged part of the pipeline was discarded for reasons of time and cost. Repairs to damaged plant can be difficult if only a narrow time window is available due to weather and tides: here some two to two-and-a-half months a year. If there are ongoing business interruption losses, this can be a major loss driver unless it is possible to complete the repairs within this time window.

**OUR EXPERT**

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NOT IF, BUT HOW
Expensive launch failure in the Pacific

A rocket crash on 31 January 2013 produced the largest loss in the history of space flight insurance.

The Zenit-3SL is a Ukrainian-Russian launch vehicle transporting commercial telecommunication satellites weighing more than six tonnes into orbit from a converted oil drilling platform in the Pacific. With the optimal launching position on the Equator, not far from the island state of Kiribati, the maximum speed of the earth’s rotation and the benefit of being able to launch directly into the geosynchronous orbital plane with no inclination offer ideal conditions for launching rockets. This enables two more tonnes of payload to be transported into geostationary orbit than with similar rockets launched from the Kazakh-Russian Baikonur Cosmodrome.

On-board computer assumes control of launch process

Once at the launch location, the rocket and satellite were fuelled, and after the last manual launch preparations were complete, the platform was evacuated. It was still possible at this point to abort the launch process from the convoying ship at any time. However, once the on-board computer had assumed sole command (for the Zenit, a few seconds before ignition of the first stage), the start process could only be stopped in certain programmed situations.

The ignition of a rocket motor is always a particularly critical moment. In 2007, the Zenit-3SL had experienced a launch failure when the rocket exploded on the platform due to a foreign metallic object in the liquid oxygen pump.

Immediately before ignition of the motor, the thrust direction of the engine must be tested and the nozzle aligned. Smaller rocket drives rotate the thruster with electric actuators. For large engines such as the RD-171M on the Zenit, stronger hydraulic cylinders are used. Prior to ignition of the motor, the oil pressure required comes from a hydraulic pump with a cold
When assembled, however, the tolerance between the two components was borderline but the error could no longer be measured directly. Only a functional test under realistic flight conditions would have revealed the problem in time.

Quality problems were known

The Zenit-3SL has embarked on a total of 35 space flights since 1999. The first launch failure occurred back in 2000, when the flight had to be aborted early due to an engine malfunction in the second stage. Incidentally, the Russian Proton has also had quality problems – it has experienced a launch failure almost every year recently.

Because launch failures of proven rockets are frequently attributable to quality deficiencies and not design defects, additional checks in the manufacturing processes should enable remedial action to be taken. The measures have turned out to be less than successful in recent years, however. Far-reaching modifications would be necessary in order to guarantee fundamental changes, such as rigorous adherence to qualified processes.

Over and above the technical problems, the originally international company structure of Sea Launch also proved to be non-sustainable following the launch failure of 2007. The company went into bankruptcy in 2009 and could only be bailed out with help from the Russian space flight company Energia. The new failure at the end of January 2013 is likely to once again put the company in a precarious position.

Insurance for operators absolutely essential

During the launch, space flight policies typically cover the intrinsic value of the rocket and satellite. Cover starts at the same time as initiation of the ignition process or upon lift-off of the rocket, depending on the launch vehicle system used, and automatically ends one year later. In most policies, the satellite operator is also the policyholder because this party assumes the commercial risk of a launch failure. Because no rocket operator is able to offer a guarantee of success, transferring the risk of loss to the insurance market is of key importance. Virtually all commercial satellite operators therefore insure the unch of their satellites and then renew the cover annually until the end of service life after up to 15 years.
The “Odyssey” launch platform and the “Commander” convoying ship in the port of Long Beach in California. The original plan was to load up to three rockets from the convoying ship onto the launch platform at sea. However, as technical problems made this impossible from the beginning of the Sea Launch project, Zenit-3SL had to be transferred to the platform in the port.

Thanks to the ideal launch site on the Equator, the Zenit-3SL is able to take its payload directly into a geosynchronous orbital plane. This makes it possible to transport much larger satellites into geostationary orbit than from the Baikonur Cosmodrome.
Intelsat 27 on board the fated rocket belonged to the world’s largest commercial satellite operator Intelsat. It was supposed to extend the range of voice and broadband applications in America, the Atlantic regions and Europe. Built by Boeing Satellite Systems, Intelsat 27 was fitted with 20 C-band, 20 Ku-band and 20 UHF-band transponders and, weighing over 6.2 tonnes, was one of the biggest commercial satellites ever. The sum insured was correspondingly high at US$ 406m, meaning that Intelsat 27 is the most expensive loss in the history of space flight insurance. The insurers paid for the loss within a few weeks because the loss of the satellite and the loss amount were undisputed.

In the event of a loss, satellites of this size cost space flight insurers nearly half the global market premium for a whole year. The majority of this is earned with only a few risks of 25 to 30 insured launches per year, so that just one additional loss can have a major bearing on the annual result.

>> Further information on Munich Re’s space flight insurance can be found at: https://www.munichre.com/touch/space/de/homepage/default.aspx


OUR EXPERT

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Flooding on building sites

In May 2009, one of Europe’s largest construction sites was hit by a severe storm bringing torrential rain. The damage was immense, particularly in the shopping mall’s new electrical equipment rooms. Effective loss management helped to significantly reduce the expected loss of several tens of millions of euros.

Alfons Maier

Water flooded the site after temporary roofing materials and glass elements were torn away in the storm. Rainwater also poured into the building via sloping parking areas, through open external walls and window cavities. Water streamed down stairs, through ceilings into the underground garage and flooded the new electrical substations in the basement.

Those walls and ceilings which had already been painted also sustained water damage in this 80,000 m² shopping mall. Walls and ceilings as well as girder and column claddings made from plasterboard were saturated with water, buckled and fell down or became mouldy.

The loss was initially divided into the two categories of structural damage (primarily damage to plasterboards and paintwork) and damage to electrical installations (flooding of electrical equipment rooms) and estimated at a relatively low amount of several hundred thousand euros.

One great cause for concern, however, was the damage caused by rain and surface water in the three large electrical equipment rooms in the basement. Initial signs of corrosion due to the high humidity quickly appeared on the transformers, power distribution systems and elevated flooring, under which cables had been laid for the high- and low-voltage systems.

Rain entered the construction site from the roof of the shopping mall.
The companies in charge of the construction work planned to restart the electrical systems as quickly as possible after pumping off the muddy water. The loss adjusters and insurers recommended professional rehabilitation measures after the repairs – after all, a loss of up to €20m was looming for the electrical systems alone.

**Speedy and professional loss minimisation measures**

Since the sum insured for the electrical installations already amounted to tens of millions of euros, the parties involved could not risk a total loss due to defective rehabilitation, delays in opening the shopping mall to accommodate complex repair work, or lengthy delivery times for electrical equipment.

The loss adjuster contracted by the primary insurer arranged for a professional rehabilitation company to dry and dehumidify the electrical areas and carry out special anti-corrosion measures once the muddy water had been pumped off. Since the building’s concrete structures were also saturated with water, they likewise had to be dried to ensure safe operation of the electrical equipment. Thanks to swift and professional restoration of the electrical installations, the original manufacturer’s guarantee even remained valid.

**Joint loss inspection by insurer and reinsurer proves its worth**

Due to the expected extent of the loss, the primary insurer and reinsurer inspected the site together and decided on further immediate measures. Many of the drainage pits and pipelines in the basement were blocked with caked mud and had to be cleaned. Since not all of the floor openings to the electrical rooms had yet been sealed, insurers recommended during their loss inspection that covers be kept available as a preventive measure to protect the transformers and switchgear from rain. Shortcomings in fire protection and waste management were rectified without delay.

**Loss prevention was especially important**

As is usual in lengthy and complex construction projects, the future site was examined before the work started to identify potential risks and their repercussions, and the measures adopted were monitored to ensure strict compliance.

Flooding occurred several times during construction of the shopping mall. Some years previously, the area had been flooded to a depth of up to one metre. In the winter months, rapidly rising groundwater levels during excavation work also created a risk of flooding in the excavation pit.
Conclusion

The sooner loss minimisation measures are introduced following flood damage, the more effective they are – but only if the policyholder recognises and implements the measures in time.

Engaging a professional rehabilitation company can in many cases also help to considerably reduce the extent of loss. In the case of this shopping mall, professional drying and rehabilitation of the electrical installations reduced the potential flood loss from several tens of millions of euros to under ten million.

Close risk monitoring by the insurer during the construction phase has proved extremely worthwhile in large-scale projects. Joint professional loss minimisation procedures and the various repair options must be closely coordinated by the insurer (together with the contracted loss adjuster) and the policyholder.

Strict adherence to the loss prevention recommendations helps to prevent flood losses from the outset. Munich Re claims and loss prevention experts will be glad to advise you on this.

OUR EXPERT

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The amount of compensation is not always based solely on the scope of legal liability. Certain factors can exert such strong pressure on liable parties and their insurers that they pay out higher amounts than would seem appropriate on the basis of liability law alone.

The desire to avoid litigation risks and to create clarity regarding the amount of indemnity owed at an early stage, through a compromise settlement, is well known. This is especially so in markets where the outcome of litigation proceedings appears particularly unpredictable due to the involvement of juries or due to the threat of punitive damages. Furthermore, the way a company’s quoted value responds to even high settlements is mostly more favourable than its response to legal uncertainty. Therefore, “global peace” often appears to be the better option, even when it comes at a high price (see the John Goldberg interview on page 32). Often closely linked to such settlements is the attempt to avoid forum shopping in jurisdictions that are particularly plaintiff-friendly (for more on this, see “Column” in Topics Schadenspiegel 1/2013).

Another potential reason for overcompensation could be efforts to avoid stricter regulation and thus more extensive liability in the future. In certain liability scenarios, overcompensation may also appear advisable in order to avoid or limit sanctions under public law (fines, withdrawal of licences) or even criminal law. An example is where a dispute over liability could contribute to the undesirable clarification of the severity of the liable party’s fault (gross negligence vs. “normal” negligence). The pressure to accept high settlements can increase even further if confidential company data or product information has to be protected from disclosure.

However, clarity in regard to liability by accepting overcompensation often leads to uncertainty on the coverage side and with respect to the limits of the reinsurer’s duty to follow. This once again illustrates the importance of a clear wording that is based on a holistic assessment of the insured risk and not only on the scope of legal liability.

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