



## 2019 HURRICANE SEASON

**Hurricane Dorian, which recently devastated the northwestern Bahamas and caused significant damage to the southwestern United States and Atlantic Canada, was the first major hurricane of the 2019 Atlantic hurricane season. Most current projections estimate that something in the region of 2 – 4 further major hurricanes can be expected during the 2019 season, suggesting above average activity.**

This briefing examines the consequences of extreme weather events such as Hurricane Dorian and its aftermath from the perspective of insurers, reinsurers, policy-holders and their brokers.

# “Without language in the policy instructing us to do so, we decline to interpret the business interruption provision in such a way that the loss caused by Hurricane Katrina can be distinguished from the occurrence of Hurricane Katrina itself.”

## Key questions

Below we consider issues which are likely to arise across particular classes of business. However, certain broader issues are likely to arise in the current circumstances across the spectrum of policy types. These include:

- How are deductibles and co-insurance warranties in original policies to be applied?
- Under what law are the relevant policy obligations to be construed and in which forum are disputes to be decided? There may be significant differences in coverage positions depending upon the answers to these questions. Such questions may arise even within jurisdictions, For example, in the US primary cover under the National Flood Insurance Program (NFIP) is always subject to federal law and jurisdiction, but any additional excess cover is subject to state law. Unlike under Federal law, state laws are claimant-friendly and provide for “bad faith” sanctions on insurers such as treble damages, penalty interest, attorneys’ fees.
- To what extent will there be waiver of claims documentation to support claims? This may be encouraged by broker and/or political pressure to get

losses compensated as soon as possible, but may cause issues in the context of recoveries from reinsurers. Similarly, to what extent will any ex gratia settlements be recoverable from reinsurers?

- Does local law provide for a time limit on adjustment of claims? For example, for a weather catastrophe, Texas has a 30-business day plus 15-day time limit for the completion of investigations, but in the case of previous extreme weather events many properties were underwater and could not be accessed. Where such time limits apply, non-compliance can lead to penalties.
- In light of AIRMIC guidelines, are reservations of rights off limits or a necessary protection whilst information is scarce - even if only as an interim protection? Will potential differences in practice between jurisdictions regarding the use of reservation of rights language cause friction?
- Will Lloyd’s step in and “urge” the London market to deal with claims in a particular Lloyd’s way?
- Will there be co-operation between Lloyd’s and London companies markets and other international markets, such as Bermuda, Japan and the Far East,

so that cedants get a consistent message or will each market work on its own thereby risking mixed responses by an international group which has participations on several platforms?

- What lessons can be learnt from previous incidents, such as the Queensland floods, Japan and New Zealand earthquakes, Thai floods and Japanese wind/ weather events?

## Property Damage Issues

The following issues are likely to arise in the context of property damage:

- Has the hurricane event triggered cover? There may be issues over, for example, whether property damage has been caused by flooding, which is often excluded under the terms of property damage cover, or by wind-driven water, which is usually covered. Those US policy-holders with flood exclusions may be covered for such damage under the National Flood Insurance Programme operated through FEMA (Federal Emergency Management Agency), although the number of at risk properties so protected is likely to represent a small proportion of those suffering damage.



- Are there multiple events or occurrences and if so how will the loss be allocated between them? As weather systems move inland and northwards they may develop so that, for example, a hurricane is swiftly followed by winter storms and freezing rain. The burden of proof is on the Insureds and it is difficult to distinguish damage between losses. Determination of the number of events, and their respective impact, can have consequences for both policyholders and underwriters. The issue can be exacerbated where there are complex multilayer programmes with diverging interests across the layers. Notwithstanding the presence of “hours clauses” (see below), there are well known difficulties in breaking down periods of sustained heavy weather (and the inter-relationship between different sequential weather patterns) into different “events” or “occurrences” to allocate and aggregate losses and to apply deductibles and policy limits. Synoptic analysis may be employed as a part of this exercise. Such issues arose, for example, in the Caribbean in the case of Hurricanes Irma and Maria. Irma devastated the Islands but before loss adjusters

could get in to assess the damage, Maria came through, hitting them again and causing even more damage. Some insureds / cedants argued that the damage was one event, despite them clearly being separate events per the English law principles, as it was impossible to say what damage was caused by which hurricane.

- To what extent will steps taken to sue and labour in prevention of damage (whether pre-emptive or reactionary) be covered? The answer to this will of course depend in each individual case upon the terms of the contract, and the applicable governing law.

### Business Interruption (BI) Issues

The damage to property, disruption of transport links and prolonged utility outages experienced as a result of extreme weather events are certain to lead to claims for consequent business interruption - often the largest, most complex and most contentious claims. Many factors may impact upon the calculation of the loss. Considerations for policyholders, insurers and also brokers who may be required to assist in the preparation of claims include:

- Establishing causation. BI cover is sometimes said to operate on a “double trigger”. First, it

requires property damage to be sustained by operation of an insured peril. Secondly, it requires the interruption to the assured’s business to result from that property damage rather than from some other cause. When there has also been serious disruption to both transport links and utilities, causation issues may arise. Where there are gaps in cover, these may be filled by appropriate extensions.

- The nature and length of the indemnity period as defined by the policy. BI policies typically provide for a period of cover by reference to which the Insured’s loss is calculated. Where it may take a long time before trading conditions return to normal, it will be important to understand not only the triggers that cause the period to commence, but also the length of the period and any categories of loss that can be claimed outside the period, as is usually the case for ICW (increased costs of working).
- The presence and application of sub-limits. Policies often provide for sub-limits to apply to loss from particular perils or loss of a particular nature, such as loss resulting from denial of access. The application of sub-

limits, in particular whether they are cumulative (ie whether they “stack”) or are exclusive, can have an important impact on the indemnity provided by the policy. Hurricanes can affect wide geographic areas, spanning multiple jurisdictions, with damage being caused, arguably, by a variety of different perils. Issues could arise as to the different sub-limits applying to elements of a claim and the interaction between them.

- The operation and effect of Adjustments Clauses and/or special circumstances clauses for wide-scale area effects. In the aftermath of Hurricane Katrina, a hotel chain sought to rely upon an Adjustments Clause, which required the insurer to provide for trends, variations and special circumstances to “represent, as nearly as may be reasonably practicable, the [hotel’s trading] results which but for the Damage would have been obtained [during the Indemnity Period]” (Orient-Express Hotels Ltd v Assicurazioni General S.p.a) . The hotel argued this clause required the insurer to adjust its loss as if the hotel had been undamaged, without taking into account the effects of Hurricane Katrina on the wider New Orleans area. The hotel’s argument failed. The English court upheld the arbitration tribunal decision that OEH could only recover loss which would not have arisen “but for” the damage to the hotel. It was held that “special circumstances” in the Adjustments Clause could include the same event (insured peril) that gave rise to the Damage and, since the loss would have been suffered by OEH as a result of the damage to the surrounding area, even if the hotel itself had not been damaged, there could be no indemnity under the BI section of the policy. Recovery was available pursuant to the loss of attraction and prevention of access extensions, but a lower limit applied.

There is also a substantial body of US case law on this issue. For example, in the most recent of these listed

cases, *Catlin Syndicate Ltd v Imperial Palace of Mississippi, Inc*<sup>1</sup>, the court upheld an insurer’s calculation of business interruption loss based only on the insured’s pre-catastrophe sale figures, without taking into account the insured’s significantly higher, post-interruption sales figures. In this case, the insured’s property was damaged by Hurricane Katrina and, as a result, was forced to suspend its casino business. Upon re-opening, its revenues were substantially greater than before the hurricane, due in large part to the closing of several competitor casinos that were also damaged by the hurricane. The insured contended that its loss of earnings should be measured by assuming a hypothetical scenario in which Hurricane Katrina struck, causing damage to other casinos, but causing no loss to the insured. The insurer argued that the appropriate hypothetical was one in which/ hurricane Katrina never struck in the first place. The court agreed with the insurer, stating (at page 7) that:

“Without language in the policy instructing us to do so, we decline to interpret the business interruption provision in such a way that the loss caused by Hurricane Katrina can be distinguished from the occurrence of Hurricane Katrina itself”.

- The ability or otherwise to make up production at the affected or other locations. Although the damage and disruption may be widespread, some areas may be relatively unscathed, with businesses able to operate as usual. Any ability to switch production/operations to unaffected areas and thereby continue to trade will have to be taken into account in calculating the level of any indemnity.
- The task of collecting and tracking information for the purpose of preparing or scrutinising a claim. BI claims usually require significant amounts of documentary evidence to demonstrate the impact of the insured damage upon the business’s profitability. This task is made even more onerous in circumstances in which records may have been destroyed by the

property damage giving rise to the interruption.

- The calculation and ascertainment of ICW and additional ICW claims. BI policies will usually cover the assured for the increased costs of working incurred as a consequence of the peril. In the absence of contrary provision, these costs may be recovered in full, even though they extend beyond the indemnity period. It may also be necessary to take account of savings, such as reduced overheads, that may follow an interruption of business. This is to prevent an insured being over indemnified.

Contingent Business Interruption (CBI) has developed in recent years as businesses’ loss exposure from interruption to their supply chain or customer chain has become more clearly appreciated. CBI issues that may arise include:

- Is cover extended by expanding the concept of “damage” to include loss from denial of access and/or loss of attraction? For example, disruption to public transport and other key infrastructure may severely hinder accessibility to certain areas and is likely to have a severe effect upon business in areas to which people are unable to travel.
- The nature and effect of identifying (whether generically or individually) suppliers and/ or customers in the CBI extensions to cover. Even if an assured does not suffer damage to their property, resulting in business interruption, they may nonetheless experience an impact upon their ability to trade as a consequence of damage suffered to a key supplier or customer. Just as it will be important for an insured and their advisors to be able to record and document the interruption suffered to the business, it will also be crucial to understand the effect and scope of any extensions to cover in respect of such interruption, which will itself involve a thorough understanding of the assured’s chain of key suppliers and customers.



### Liability Insurance Issues

After catastrophes such as major hurricanes, it is not uncommon for there to be enquiry into the loss, the extent to which and how it could have been avoided, and how such loss may be mitigated in future. Whether or not they become the subject of public scrutiny, businesses and public authorities may be exposed to liability depending upon the adequacy and professionalism of their risk management, preparation prior to the storm, and their disaster management during and following it. Exposures may arise, for example, from:

- Liabilities for contaminants or pollutants which escape from premises on to third parties' property as a result of flooding.
- Liability for damage attributable to inadequate insulation or safety precautions.
- Failure to make contingency plans in respect of interrupted utility supply.
- Design liabilities may arise where questions are raised about the adequacy of building and flood retention design, particularly in the case where key services such as electrical and communications are located in basement areas prone to flooding.

Issues may also arise as to whether a particular act constitutes an intervening event giving rise to liability. For example, where sluice gates are opened to alleviate the filling of reservoirs, causing damage to property which has not been damaged by the original storm (as occurred in Texas in the aftermath of Hurricane Harvey), is this to be considered an intervening event or part of the original storm?

### Reinsurance and Retrocession Issues

The overall losses suffered in the event of a hurricane are often at a value which will impact property catastrophe programmes and so it is likely that there will be significant reinsurance losses arising out of such events. Where issues arise as to whether or not larger hurricane deductibles on household policies are triggered, reinsurers may have coverage arguments regarding whether such deductibles should in law be applied. Where liability losses are involved as well as property losses expect issues around whether liabilities are non-elemental rather than elemental losses, where reinsurance towers are split.

In the case of industry loss warranties, issues frequently arise as to whether captives are included, or whether

uninsured losses which are picked up by insurers due to state decree are included. Aggregate ILW covers are now common, for example responding to the industry loss across the entire hurricane season.

Other issues likely to arise in a reinsurance context include:

- Issues surrounding triggers, aggregation, excess/attachment points, and reinstatements.
- As to aggregation, property catastrophe excess of loss contracts usually contain an "hours" clause containing a definition of a "loss occurrence", as meaning all losses arising out of and directly occasioned by one catastrophe. However, the duration of any "loss occurrence" is usually limited where the losses are caused by a named peril (e.g. hurricane where a 72 hours limit applies) or where they are caused by a non-named peril (where a 168 hours limit may apply). There are various different wordings of such clauses, but they generally provide that losses caused by a hurricane or a typhoon or windstorm, and occurring within the specified number of hours (say, 72 hours), can be aggregated. Furthermore, depending on the wording of the hours clause, losses caused by

# “Design liabilities may arise where questions are raised about the adequacy of building and flood retention design.”

flood may be aggregated for 72 hours or 168 hours. Some clauses also provide for aggregation of such storm losses, with losses arising from flooding. It is generally for the reinsured to choose the time and date when the applicable hours period commences, and it is usually not before their first reported losses. Subject to reinstatement of the reinsurance cover, it may be possible for a reinsured to recover in respect of two or more loss occurrences within the same hurricane catastrophe, although they usually cannot overlap. Issues may also arise as to how cedants' aggregations are to be verified, and whether they fall within the aggregation language of the corresponding reinsurance contracts. Fact patterns, definitions, and full contract wordings need to be reviewed carefully.

- Follow the settlements/follow the fortunes obligations will need to be considered. Compromises of casualty claims where there is a duty to defend but no right to indemnity may be subject to valid challenges under reinsurance on JELC terms but this is more difficult with full follow clauses.

- Claims control clauses, which may allow reinsurers to deny claims following insurers' loss settlements which they (reinsurers) have not controlled. This may even be the case where compliance with the clause is not strictly described as a condition precedent and where the reinsured can show that they were actually liable to pay the claim in question. Reinsureds must proceed with caution where such clauses are present. Where there is a captive or fronting arrangement, similar issues may arise as to the extent of the captive/front's role in claim investigation and negotiation.
- Cover not being “back to back”, and involving the law of different jurisdictions, so that important terms may be defined differently in the direct or master insurance policy, as against the reinsurance policy (e.g. aggregation terms, definition of “flood”, “storm” etc). Other such issues might include, for example, the reinsurance excluding flood when the original policy does not do so, or the period of cover differing. Issues may therefore arise as to how many “losses” or “loss occurrences” can be aggregated

and significantly how many insurance and reinsurance deductibles may apply.

- Reinsurers may be under significant pressure to meet early cash calls, typically requests of up to 25% or 33% of the cedant's UNL estimate. The information provided to reinsurers is often lacking in detail, but there is commercial and competitive pressure to provide cash urgently to where it is needed. Reinsurers should take protective measures to ensure e.g. that funds paid are clearly earmarked for covered losses only and put into designated or trust accounts. Cash call requests were made in respect of Hurricane Maria where damage caused to the same property by Hurricane Irma had not yet been repaired (or even adjusted). Agreeing such cash calls without verification risks depriving reinsurers of Reinstatement Premium and complicates aggregation and retention issues.
- “Cat surge” or price gouging and loss inflation can be expected to increase claims on reinsurers, with reports in previous instances of increases as high as 20%. This is sometimes contributed to by contactors buying up homeowner insurance claims, undertaking work involving a significant element of betterment, and then submitting large insurance claims. This can be a major factor in loss deterioration for reinsurers and retrocessionaires and has previously been the subject of a scandal in Florida.
- The exclusion by some leading property reinsurers of CBI, because it is difficult to underwrite on an informed basis and the risk is too difficult to price.
- Reinsurers may wish to consider judicious use of inspection of records clauses, in view of potential issues concerning the limited amount of claims information/documentation available, particularly in the early stages of the adjustment process.

## HFW

Our team includes specialists who have managed large and complex insurance and reinsurance PD, BI, Marine, Logistics and Aviation claims arising out of all of the recent major natural catastrophes globally, including for example Hurricanes Ivan, Katrina, Rita, Ike, Wilma, Matthew, Harvey, Irma, Maria & Juliette, Thailand flooding, Queensland Flooding and Christchurch earthquakes.

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