

Terrorism, a Form of Modern Warfare

By Joseph J. Launie, Ph.D., CPCU, FACHE

The events at the World Trade Center on September 11, 2001, have permanently altered the insurance landscape. President Bush immediately reacted by declaring the terrorist attacks to be an act of war. From an insurance standpoint, such a declaration has essentially no effect on coverage. War risk exclusions in existing property insurance define *war* in a manner that fails to include most, if not all, terrorist events.

In 1965 severe and widespread rioting, looting and burning erupted in the Watts area of Los Angeles. A National Guard general, interviewed on television, stated, "This is an insurrection." While risk managers trembled, a Fireman's Fund Insurance Company executive quickly declared that it would be honoring its policies and not invoking the war risk exclusion. Clearly, insurrection and war cannot be created by pronouncement. More recently, following the September 11 attack, the Chubb Group of Insurance Companies stated that it would honor all property-related claims.

The perceptions of Fireman's Fund and Chubb executives that the war risk exclusion does not reach terrorist actions have been well established by the courts. On September 6, 1970, a group of hijackers associated with the Palestinians for the Liberation of Palestine (PFLP) seized a Pan American

plane near London. After flying it to Cairo and releasing the passengers, the hijackers destroyed the plane. Litigation regarding the applicability of the war risk exclusion ensued in *Pan American World Airways, Inc. v. Aetna Casualty & Surety Co.*, 505 F. 2nd 989 (2d Cir. 1974). The court stated in part that "war is a course of action engaged in by entities that have at least significant attributes of sovereignty." The court concluded that since the PFLP lacked these attributes of sovereignty, the hijacking was not an act of war and was not excluded.

The reasoning in the Pan Am case was also applied to the case of a hotel in Beirut severely damaged by factional battles. The court held that the faction causing the damage lacked the required sovereignty, and even if it met that test, it was not at war with another sovereign entity (*Holiday Inns Inc. v. Aetna Insurance Company, et al.*, 571 F. Supp. 1460 [USDC 1983]).

The result has been the development of a terrorism exclusion to deal with the risk of future property damage caused by terrorist acts. From the standpoint of insurance theory, war risk, in whatever form it may take, is uninsurable for the private insurers' basic book of property insurance. War risk coverage has always been selectively available for certain marine and aviation risks. For the vast bulk of

property policies, in both commercial and personal lines, a war exclusion has been present for a very long time. Until September 11, 2001, this caused most risk managers very little lost sleep with respect to property located in the United States because war damage was something that happened "over there," wherever that might be. The World Trade Center is over here.

The growth of terrorism as a tactic has altered the reality of war, whatever its definition. On one terrible September morning, the old insurance definitions of war became obsolete. Risk managers and underwriters alike are struggling to come to grips with the new reality.

Custom and usage and insurance theory both support the premise that war and its attendant risks are primarily the province of the government. The Constitution left the power to declare war to the Congress. It certainly follows that if government is going to wage war, it should accept the

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collateral costs including the damage to American property that results from enemy action.

The last time that substantial amounts of American property were perceived to be at risk was during World War II. From my office window I can see the beach at Ellswood, California. It may have slipped most people's minds, but Ellswood is the site of the oil field properties shelled by the deck gun of a Japanese submarine during World War II. The damage inflicted was quite minor, but it did depress beachfront real estate values for a while. The federal government stepped forward during the war to provide war risk insurance. The vast majority of all merchant marine war risk coverage was written by the War Shipping Administration. The federal government also provided nonmarine war risk coverage for domestic property following the form of the standard fire policy. Six days after war was declared on December 13, 1941, the Reconstruction Finance Corporation set up, under section 115 (d) of the R.F.C. Act, the War Damage Corporation. Policies issued by the corporation insured individuals "against direct physical loss or damage to property ... which may result from enemy attack including any actions taken by the military, naval or air forces of the United States resisting enemy attack." In 1942 alone, 6,000,000 policies were issued for approximately \$140 billion of coverage. As of December 31, 1943, written premiums exceeded expenses by \$218,000,000. Claims were approximately \$72,900. That was certainly an acceptable loss ratio. Looking back, we can see that the federal government responded quickly to a perceived problem.

Swift action has not been a characteristic of the present situation.

Part of the problem lies in the fact that terrorism itself is difficult to define. Conceptually, most risk managers would accept a broadening of the war risk exclusion to include terrorism. The next step would be for the federal government to boldly step into the breach and provide war risk coverage for domestic property; including damage caused by terrorism. While terrorists seldom are agents acting on behalf of a sovereign power, we can probably agree that they are our enemies. If we define the government's role as providing

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protection for its citizens and their property against enemy action, then government coverage for terrorism is a logical development. From the standpoint of insurance theory, the private insurance industry has no place in the insurance of its major books of commercial and personal lines property for the risk of war in any of its forms or manners. If government has any place in the world of commerce, it is here, when war is upon us.

The federal government could do a lot worse than to resurrect the old

War Damage Corporation, develop some sort of premium for the war risk associated with terrorism and start selling the policies. The old WDC paid a five percent commission, which would probably be enough for today's patriotic brokers and agents.

There remains only one small fly in the ointment of this solution. One must define terrorism so as to create a bright line between the province of private insurance and the domain of the WDC. Defining terrorism may prove to be more difficult than defining pornography. One justice remarked that while "I may not be able to define pornography, I know it when I see it." But one may well see terrorism and not know it. On the other hand, Al Capone was overheard to remark, "Once is an accident, twice is a coincidence, three times is enemy action." Obviously, if terrorists strike repeatedly, they can be identified. But what about the single occurrence? On July 4, 2002, a man armed with two guns and a knife broke out of line at the El Al Airline counter in Los Angeles and started shooting. Before he was killed by El Al guards, he killed an airline worker and a bystander. Was this an act of terrorism, or was this another traveler snapping under the strain of one more delay? El Al immediately stated that it was terrorism, but the official American position was much more equivocal.

In the present environment, with the federal government not yet stepping up to the plate to provide war risk coverage for terrorism, the definition of *terrorism* in any applicable exclusions becomes even more critical to the risk manager. It is one thing to have a dispute as to which of two policies provides coverage for a particular incident. It is another thing entirely

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FROM NEAR AND FAR



Texas – Flooding throughout South and Central Texas at the end of June and the beginning of July claimed at least 19 lives. Thirty-seven counties have been declared eligible for disaster relief.



Western U.S. – Fires in many Western states have not yet resulted in huge insured losses. According to *Business Insurance*, the majority of fires have burned on federal land, minimizing the effect on private insurers. However, as published in *Business Insurance*, according to the Insurance Services Office's Property Claim Service unit, the insured losses from the Rodeo-Chediski fire in Arizona alone are estimated to reach \$120 million.



Washington, DC – President Bush signed legislation that says the government will subsidize 65% of COBRA premiums for those who lose their jobs because of foreign competition.

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when the policy language is going to determine whether a risk is covered or suddenly self-assumed.

The terrorism exclusions which have surfaced to date seem to define *terrorism* quite broadly. Too broad a definition of *terrorism* will have the effect of reducing coverage for domestic vandalism and other types of property damage which have nothing to do with enemy action. The insurance industry provided coverage for the damage caused by the Watts riots and their various sequels. Would this same coverage survive the modern terrorism exclusion? Let us examine some current exclusionary language.

A Lloyd's War and Terrorism Exclusion Endorsement excludes in part:

“Any act of terrorism.

For the purpose of this endorsement an act of terrorism means an act, including but not limited to the use


of force or violence and/or the threat thereof, of any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organizations or government(s), committed for political, religious, ideological or similar purposes including the intention to influence any government and/or to put the public, or any section of the public, in fear.”

Clearly the underwriter who wrote this endorsement read the Pan Am case and recognized that terrorism is different from conventional warfare between sovereign nations. While the net crafted by this underwriter will clearly capture the intended enemy, it ensnares many previously covered actions as well. In 1992 the Los Angeles area was disrupted by riots which broke out following a jury verdict which found certain police officers not guilty in the Rodney King episode. One could certainly argue that this outbreak of violence was committed for the political purpose of protesting an unpopular jury verdict. While one may question the

efficacy of such a means of political expression, it would be hard for anyone who witnessed it to deny that it put at least a section of the public in fear. Is it really in the public interest for the insurance industry to back away from a previously covered riot peril in the name of a response to terrorism?

To further make the day of the risk manager, this endorsement recognizes that honest people might differ in their interpretation of the scope of this endorsement. Therefore it states:

“If the Underwriters allege that by reason of this exclusion, any loss, damage, cost or expense is not covered by this insurance the burden of proving the contrary shall be upon the Assured.”

To summarize the current state of affairs with respect to insurance coverage for terrorism, the federal government is hiding behind a tree while the insurance industry has panicked and disappeared over the hill. Franklin Delano Roosevelt once said, “The only thing we have to fear is fear itself.” There seems to be a lot of that around, as any risk manager can attest. 

References

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INTRODUCING ...

We have recently added several new associates to our cadre of experts. Following is a brief bio on each of them.

George J. Biehl

Mr. Biehl has more than 40 years of reinsurance and insurance industry experience. His expertise covers a broad spectrum, from underwriting major casualty programs to spending almost 30 years as a reinsurance broker. His early insurance career provided him with exposure to and involvement with some of the first umbrella forms as well as many other special coverages and manuscript policy forms.

Paul T. Keyser, M.S., JD

Mr. Keyser is an attorney with a broad working knowledge of the insurance industry. He has held senior positions with a number of the largest and best-known insurance companies. His experience includes, but is not limited to; large loss subrogation, environmental claim handling, coverage investigations, liability analysis and construction claims (including professional liability for architects). Mr. Keyser also has an M.S. in business from the University of Wisconsin at Madison. He is now in private practice and became associated with Robert Hughes Associates, Inc., in the summer of 2002.


Timothy J. Adams, FSA

Mr. Adams is an independent actuarial consultant who specializes in life, health and benefits consulting. He also provides financial analysis of life insurance companies. His expertise includes claims projections, financial forecasts, financial statements and reserving as well as life, health and pension projections.

Charles Nunemaker, FLMI, CLU, Ch.F.C.

Mr. Nunemaker has nearly 30 years of life insurance industry experience. His background encompasses a wide range of expertise within the administration areas of insurance companies. His experience includes, but is not limited to, managing claims departments, managing underwriting departments, policy issue, customer service, premium accounting, commission accounting, home office operations, managing TPA operations and policy administration.

Clem H. Winter

Mr. Winter's experience spans more than 25 years as both a hands-on regional bond claim manager in several offices and an assistant vice president with North American Re, now Swiss Re America. This experience covers a broad range of the surety/reinsurance industry, including, but not limited to, surety bonds, fidelity bonds, defaults, bank losses, workouts, reinsurance negotiations and recovery arrangements. 

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