# Terrorist Attack Coverage Should Not Be Barred by War Risk Exclusion in Standard Policies

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As America heroically strives to recover from the worst terrorist attack in history, the international insurance industry braces for an estimated $20-$70 billion in claims. The Insurance Information Institute, an industry group, has predicted that damage caused by the four hijacked planes would far surpass the $15.5 billion that insurers paid out in the wake of Hurricane Andrew, the most costly natural disaster in U. S. history.[1] Early indications are that many insurance carriers are not going to assert the standard "act of war" exclusion, found in most property-casualty policies issued in the United States, for the purpose of contesting coverage.[2] Most industry analysts seem to agree that an "act of war is typically defined as war between two sovereign nations."[3] Nonetheless, some insurance carriers are not yet committing to one position or the other with respect to the applicability of the "act of war" exclusion contained in most policies.[4]

The "act of war" exclusion, found in the 1984 version of the standard form policy issued by the Insurance Services Office, Inc., reads as follows:

> War, including undeclared war, civil war, insurrection, rebellion, revolution, warlike act by military force or military personnel, destruction or seizure or use for military purpose, and including any consequence of these. Discharge of a nuclear weapon will be deemed a warlike act even if accidental.

Various forms of the "act of war" exclusion can be found in current commercial property and comprehensive general liability policies, but they tend to be substantially similar to the above-quoted provision. It should be noted at the outset, however, that following the bombing of the World Trade Center in 1993, some policies may have been changed to add "acts of terrorism" to the listed exclusions. Therefore, the specific policy provisions applicable to any claim must be closely analyzed.

The case apparently most on point to the recent terrorist attacks is *Pan American World Airways v. Aetna Casualty & Surety Co.*, 505 F.2d 989 (2d Cir. 1974) (applying New York law). In that case, a U. S. airline brought an action to recover against the insurers of its aircraft which was destroyed by terrorists. The aircraft had been hijacked over London by members of a Palestinian terrorist group and was destroyed in Egypt. The United States District Court for the Southern District of New York found the insurers to be liable for the loss under the airline's all-risk policies. The insurers appealed, but the appellate court agreed that the war-risk exclusion did not apply.

In reaching its conclusion, the court held that war is a course of hostility engaged in by entities that have at least significant attributes of sovereignty. In that

1. David Houston, "Liability Could Hinge on What Is 'Act of War'", *Los Angeles Daily Journal*, September 14, 2001, p. 1.
2. "Act of war" Exclusion Doesn't Apply to Attacks, Insurers Say, *Los Angeles Times*, September 17, 2001, (latimes.com).
3. Nicole Maestri, "No 'Act of War' in Insurance Terms," *CBS.MarketWatch.com*, September 13, 2001.
4. Christopher Oster, "After World Trade Tragedy, Insurers Watch and Wait," *Los Angeles Daily Journal*, September 20, 2001, p. 4.

case, the terrorist group, which occupied land in Jordan at the sufferance of the Jordanian government, was not a de facto government. Therefore, the destruction of the aircraft was not done by "military" power within the meaning of the war exclusion of the all-risk policies. The court in *Pan American* noted that even if the terrorist group was engaged in a guerilla war against Israel, such a war would not appear to be the proximate cause of the hijacking of an aircraft owned by an American carrier, since that airline serviced no routes to Israel.

The *Pan American* case is discussed at length in *Holiday Inns, Inc. v. Aetna Insurance Co.*, 571 F.Supp. 1460 (S.D. N.Y. 1983). In *Holiday Inns*, the insured brought an action against the insurer to recover under an all-risk policy when the insured's hotel in Beirut, Lebanon was severely damaged during a period of civil unrest. The court found that the insurer failed to establish that the damage to the hotel fell within the excluded perils of insurrection or civil war. Although the damage to the hotel occurred during a period of civil unrest, coverage for "civil commotion" was specifically included in the policy by endorsement. Despite the fact that journalists and politicians had invariably referred to the events in Lebanon at the time as a "civil war," the court noted that its task was "to give the words at issue the insurance meaning; and to place the burden of proof in accordance with law." *Id.* at 1502. As in the *Pan American* case, the court in *Holiday Inns* applied the insurance doctrine of "contra proferentem." Under that doctrine, "experienced all-risk insurers must expect 'the exclusions drafted by them to be construed narrowly against them.'" *Id.* at 1463 (quoting *Pan American,s upra*, at 1003-1104).

In a few more recent cases, carriers have been successful in seeking to rely on the war exclusion. Yet, a discussion of those cases should make it clear why they are likely to be limited to their facts. For instance, in *Younis Brothers & Co. v. Cigna Worldwide Insurance Co.*, 99 F.Supp. 1385 (E.D. Penn. 1995), aff'd., 91 F.3d 13 (3d Cir. Pa. 1996), the insured sued their carrier in connection with the loss of its property during an insurrection in Liberia. The District Court concluded, and the Court of Appeals agreed, that the excluded insurrection was the cause of the insured's fire and looting losses to their property and business. In that case, however, the evidence indicated that the leaders of the armed movements had stated an intention to overthrow the existing government. Indeed, the president had been captured and killed before a cease fire agreement was signed. Moreover, although it was not discussed, the policy at issue included a more expansive form of the "acts of war" exclusion, which specifically referenced "acts of terrorism." *Id.* at 1391.

Similarly, in *TRT/FTC Communications, Inc. v. Insurance Co. of the State of Pennsylvania, Inc.*, 847 F.Supp. 28 (D. Del. 1993), the court held that the theft loss suffered by a merchant was properly denied under the war exclusion in an all-risk policy. The loss in that case occurred in the context of a military conflict between the United States and the Republic of Panama. Regardless of whether the men who stole the insured's equipment were part of the Panamanian forces or a band of looters, the court held that there was ample evidence to support the conclusion that their actions against the merchant were enabled by the military hostilities occurring between Panama and the United States. Moreover, in that case, there was no question that a "war" had been declared and that the conflict involved sovereign nations.

Another case, arising out of the same conflict between the United States and Panama, is *Sherwin-Williams Company v. Insurance Co. of the State of Pennsylvania*, 863 F.Supp. 542 (N.D. Ohio 1994), aff'd. and rev. in part, 105 F.3d 258 (6th Cir. 1997). In that case, the court also found that the war exclusion applied, but that a special endorsement covering "civil commotion" permitted recovery by the insured. The court quoted from the war-risk exclusion, which contained an expansive provision relating to "acts of terrorism." That exclusion applied to:

> Acts of terrorism committed by a person or persons acting on behalf of or in connection with any organization. For the purpose of this condition, "terrorism" means the use of violence for political ends and includes any use of violence for the purpose of putting the public or any section of the public in fear. *Id.* at 544.

The court did not discuss that "acts of terrorism" exclusion since it had already determined that the looting and vandalism was covered by the special endorsement relating to civil commotions.

The cases discussed above generally contain a

review of the larger body of case law concerning the applicability of the standard form war exclusion. Those cases tend to focus on two main factors. The first is whether there was internal strife in the form of an insurrection, rebellion, revolution or civil war. In that event, there must have been an actual attempt to overthrow the government. Alternatively, the second factor concerns whether there was a conflict between either sovereign nations or de facto governments. Neither situation would appear to apply with respect to the recent terrorist attacks against the United States. Therefore, the subject attacks should be covered under standard form policies, which do not specifically exclude terrorist acts.

President Bush has announced that the prime suspect in the attacks is Osama bin Laden, the leader of the al-Qaeda terrorist organization. Osama bin Laden was formerly a citizen of Saudia Arabia, and his terrorist organization is believed to exist in some 60 countries. He has supported and is apparently now being protected by the Taliban. The Taliban is an insurgent Islamic fundamentalist faction currently in control of the government of Afghanistan. Although he and his organization are certainly hostile to the United States, bin Laden's attack appears to have been more generally aimed at our western culture and the values and ideals symbolized by our free society. The attack does not appear to have been an attempt to overthrow our government. The death toll from the attack on the World Trade Center includes people from over 60 countries. The attack had the obvious purpose and effect of striking at the heart of the free world, which is a reason why such a large coalition of nations is backing the United States in our efforts to bring bin Laden to justice.

Political commentators have posited that bin Laden seeks to diminish U. S. influence in Saudi Arabia and the rest of the Middle East, particularly with respect to the Israeli-Palestinian conflict. Although bin Laden and his followers do not appear particularly adverse to engaging the West in a "Jihad," or Islamic "holy war," there is no evidence that their goal was to actually take over the United States government. Furthermore, at this time, it does not appear that the facts would justify the conclusion that bin Laden was acting at the behest of any government wishing to engage the United States in war. In fact, even the Taliban and Iraq's Sadam Hussein have expressly denied any involvement in the attack. Reports are that, "U. S. officials and terrorism experts say there is little evidence Sadam Hussein's regime played a role in the hijacking attacks."[5]

In his address to a joint session of the U. S. Congress on September 20, 2001, President Bush stated that:

> The evidence we have gathered all points to a collection of loosely affiliated terrorist organizations known as al-Qaeda . . . al-Qaeda is to terror what the Mafia is to crime. But its goal is not making money. Its goal is remaking the world and imposing its radical beliefs on people everywhere.

Such a diabolical terrorist network would not constitute a state, or de facto government, so as to trigger the application of the standard war-risk exclusion contained in most policies.

Other coverage issues will undoubtedly arise as a result of claims following the recent terrorist attacks. An extensive review of those issues is beyond the scope of this article. One issue that deserves some discussion concerns the relationship between insurance companies and their reinsurers. "The reinsurance relationship consists of a reinsured or ceding insurer, which transfers all or a portion of the risk it underwrites, and a reinsurer, which assumes the risk transferred by the ceding insurer. A retrocessionaire is a reinsurer for the reinsurer."[6]

For the present purposes, it is important to note that a reinsurer must generally "follow the fortunes" of the reinsured, which means that the reinsured's settlement decisions are binding on the reinsurer. This applies even when there is a dispute about the amount, timing or location of the underlying claim.[7] If it were not for the "follow the fortunes" doctrine, a

5. Warren P. Strobel, "Iraqi Link to Attacks is Unlikely, Experts Say", *The San Diego Union-Tribune,* September 22, 2001, p. A5.

6. John K. DiMugno, *California Insurance Law Handbook,* 2001, Section 68.01.

7. *Id.* at Section 68.05(1).

ceding insurer seeking reimbursement from its reinsurer, would risk having to relitigate in hindsight close coverage questions it previously resolved in good faith. *See, Insurance Co. of North America v. United States Fire Ins. Co.*, 322 N.Y.S. 2d 520, 523 (Sup. Ct. 1971), aff'd., 42 A.D. 2d 1056 (1973). A NewYork case found that the weight of authority supports the conclusion that the "follow the fortunes" doctrine is implicitly contained in every reinsurance agreement. *See, Aetna Cas. & Sur. Co. v. Home Ins. Co.*, 882 F.Supp. 1328 (S.D.N.Y. 1995); *see also, Christiania General Ins. Corp. of New York v. Great American Ins. Co.*, 979 F.2d 268, 280 (2d Cir. 1992) (applying New York law). The foregoing should establish that the fate of reinsurance carriers will generally rise and fall with that of the ceding insurers, with respect to the application of the war-risk exclusion.

Now that the United States has officially declared war against global terrorism, the author expects that there may well be an increase in form policy provisions in this country specifically excluding that risk. There will undoubtedly also be an increase in special endorsements that specifically cover risks associated with terrorism.[8] In conclusion, absent an unambiguous exclusion for terrorist acts in policies held by victims of the recent attacks, the courts are likely to determine that their claims are not barred by the standard war risk exclusion.

8. For an example of such a provision, see *New Market Investment Corp. v. Fireman's Fund Ins. Co.*, 774 F.Supp. 909, 912 (E.D. PA 1991).