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PRINCIPLES OF REINSURANCE CONTRACT LAW (PRICL)

2019

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Foreword

This volume contains the "Principles of Reinsurance Contract Law (PRICL) 2019". The Principles were produced by the Project Group on Principles of Reinsurance Contract Law (PRICL) in cooperation with the International Institute for the Unification of Private Law (UNIDROIT). The PRICL provide reinsurance specific rules on contract law in areas where reinsurance practitioners felt that there was a need to improve legal certainty. At the same time, the PRICL incorporate uniform rules on general contract law by virtue of a reference to the UNIDROIT Principles of International Commercial Contracts (PICC 2016).

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Zurich, Vienna, Frankfurt am Main

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ABBREVIATIONS

2d Cir	*United States Court of Appeals for the Second Circuit*
AARP	*American Association of Retired Persons*
AC	*Appeal Cases*
ALI	*American Law Institute*
APRA	*Australian Prudential Regulation Authority*
ART	*Alternative Risk Transfer*
ATV	*All-Terrain Vehicle*
AVB	*Allgemeine Versicherungsbedingungen*
BGB	*Bürgerliches Gesetzbuch*
BGE	*Bundesgerichtsentscheid*
BGH	*Bundesgerichtshof*
Cal 4th	*California Supreme Court Opinions*
Cal Rptr	*California Reporter*
Cat XL	*Catastrophe Excess of Loss*
cf	*confer*
CISG	*United Nations Convention on Contracts for the International Sale of Goods*
Civ	*civil*
CLC	*Commercial Law Cases*
CNSP	*Conselho Nacional de Seguros Privados*
Co	*Company*
D Me	*District of Main*
D&O	*Directors and Officers*
DC	*United States Court of Appeals for the District of Columbia Circuit*
Del	*Delaware*
DFG	*Deutsche Forschungsgemeinschaft / German Research Foundation*
EC	*European Community*
eg	*for example*
EPL	*Employment Practices Liability*
et seq	*and the following*
et seqq	*and the following*
etc	*et cetera*
EWCA	*England and Wales Court of Appeal*
EWHC	*High Court of England and Wales*
F Supp	*Federal Supplement*
F3d	*Federal Reporter, Third Series*
fn	*footnote*
FWF	*Österreichischer Fonds zur Förderung der wissenschaftlichen Forschung / Austrian Science Fund*
GPS	*General Prudential Standard*
IBA	*International Bar Association*
ICC	*International Chamber of Commerce*
ie	*this is*
Inc	*Incorporation*

Indem	*Indemnity*
Ins	*Insurance*
lit.	*letter*
LJ	*Law Journal*
Lloyd's Rep	*Lloyd's Law Reports*
Lloyd's Rep IR	*Lloyd's Law Reports Insurance and Reinsurance*
Ltd	*Limited*
MA	*Massachusetts*
Mich Ct App	*Michigan Court of Appeals*
NDA	*Non-Disclosure Agreement*
NH	*New Hampshire*
NJ	*Supreme Court of New Jersey*
No	*Number*
NW2d	*North Western Reporter, Second Series*
NY2d	*New York Reporter, Second Series*
Ors	*Others*
P2d	*Pacific Reporter, Second Series*
PC	*Privy Council*
PDC	*Principles Drafting Committee*
PEICL	*Principles of European Insurance Contract Law*
PICC	*Unidroit Principles of International Commercial Contracts*
plc	*Public Limited Company*
PRICL	*Principles of Reinsurance Contract Law*
Pte Ltd	*Private Limited*
Reins Rep	*Reinsurance Report*
rev'd	*reversed*
SC	*South Carolina*
SCA	*Supreme Court of Appeal of South Africa*
SD Ohio	*Southern District of Ohio*
SDNY	*United States District Court for the Southern District of New York*
SE2d	*South Eastern Reporter, Second Series*
SNF	*Schweizerischer Nationalfonds zur Förderung der wissenschaftlichen Forschung*
SNSF	*Swiss National Science Foundation*
Tex	*Texas*
UK	*United Kingdom*
UKHL	*United Kingdom House of Lords*
UNIDROIT	*International Institute for the Unification of Private Law*
US	*United States of America*
US Fed R Civ P	*United States Federal Rules of Civil Procedure*
USC	*United States Code*
USD	*United States Dollar*
v	*versus*
VersR	*Versicherungsrecht*
VersVG	*Versicherungsvertragsgesetz*
VVG	*Versicherungsvertragsgesetz*
Wash	*Washington*
WD Mich	*Western District of Michigan*

WKV	*Warenkreditversicherung*
WL	*West Law*
WLR	*The Weekly Law Reports*
ZR	*Revisionsverfahren in Zivilsachen*

CHAPTER 5

LOSS AGGREGATION

ARTICLE 5.1
(Principle)

(1) With regard to deductibles and limits, the parties may agree in the contract of reinsurance to treat two or more separate losses allocated to the same reinsurance period as one single loss.

(2) In particular, they may agree to treat two or more separate losses as one single loss based on an aggregation per event or an aggregation per cause.

COMMENTS

1. General remarks

C1. This Chapter of the PRICL deals with the question of whether a reinsured may or must aggregate two or more separate losses for the purpose of presenting a claim to its reinsurers. Legal certainty in the matter of aggregating losses is of fundamental importance as the structure of the coverage forms a vital element in calculating the premium to be charged as well as the capacity needed.

C2. Aggregating two or more losses and treating them as a single loss may lead to the aggregated loss exceeding the deductible (retention; excess point; attachment point; priority), thereby triggering the reinsurer's duty to indemnify the reinsured. Depending on the sums involved, an aggregation of losses may also lead to a sum in excess of the reinsurance coverage limit, for which the primary insured will not be able to claim indemnification. Determining whom an aggregation of losses will benefit depends on the structure of the coverage (retention/coverage limit) as well as the structure of the separate losses in a specific case.

C3. An aggregation of losses may be undertaken on the basis of a particular period of time in the sense that all losses that can be attributed to this period (depending on whether the reinsurer's liability is triggered by the underlying "risk attaching", the underlying "losses occurring" or "claims made" by the primary insured) are to be added together for the purpose of determining whether the deductible is exceeded or the cover limit is pierced. The so-called aggregate policies do not require that the losses to be aggregated arise from a common unifying factor.

C4. By contrast, so-called event-based or cause-based policies require that there is some sort of causative link between the individual losses and the respective unifying factor. This Chapter exclusively deals with event-based and cause-based aggregation mechanisms. If the parties agree to aggregate two or more losses based on an aggregating factor other

than either an "event" or a "cause", the PRICL do not contain any direct rule but, may still provide some guidance.

C5. Generally, the parties are free to agree on whether they want to treat two or more separate losses as a single loss, and if so, under which conditions they wish to do so. If they agree to aggregate separate losses to one single loss, they will generally also agree on a unifying factor of some kind. If a contract does not provide for an aggregation mechanism, no loss aggregation is possible.

C6. In this Chapter, it will not be possible to dispel all of the uncertainties arising with regard to the aggregation of losses based on an "event" or a "cause". By making conscious decisions as to what constitutes an "event" or a "cause" under the PRICL, this uncertainty may, however, be reduced considerably. To this end, it is intended that the PRICL provide sensible definitions of the notions of "event" and "cause" in order to make them fit for their purpose in respect of aggregating losses in contracts of reinsurance. Hence, it may well be that the meanings the PRICL attach to these notions deviate from the meanings they have in ordinary speech. It should further be noted that the rules set forth in the PRICL do not necessarily coincide with the judicial or arbitral decisions under any particular applicable law. To the extent that the PRICL are inconsistent with a legal precedent, they control when they have been selected by the parties to the reinsurance contract.

2. Only individual losses allocated to the same reinsurance period can be aggregated

C7. Under the PRICL, individual losses will first be allocated to a reinsurance period (*see* Chapter 4). Only individual losses that are allocated to the same reinsurance period may be aggregated in application of Article 5.2 or 5.3. Conversely, if multiple individual losses are allocated to different reinsurance periods they are not to be aggregated even if they arise from the same event or the same cause.

Illustration

I1. Equipment is stored at a port and vandalized by a succession of individual acts of pilferage during a period of some 18 months. During this time, multiple individual losses occur. The individual losses all result from one originating cause (Article 5.3(2)), ie the port's failure to put in place an adequate system to protect the stored goods. Three consecutive contracts of reinsurance are in force during the 18 months period. Contract 1 is in force during the first 3 months, contract 2 during the 12 months following and contract 3 during the last 3 months.

Paragraph 1 provides that only individual losses that occur when either contract 1, 2 or 3 is in force can be aggregated. By contrast, individual losses that are allocated to different reinsurance periods cannot be aggregated even though they may all originate from the port's failure of putting in place an adequate system of protecting the stored goods.

C8. Consequently, the parties cannot extend the reinsurance period by means of an aggregation clause. Rather, if the parties wish to extend the reinsurance period to include losses that result from a cause or event that was initiated during the reinsurance period but occurred after the latter has elapsed, they may provide for an "extension of protection

clause". Where the contract provides for such a clause, individual losses occurring during the extension of the reinsurance period may be aggregated with losses occurring before the extension.

Illustration

I2. Reinsurance contract 1 is taken out against the peril of hurricane and is in force from 1 January 2018 to 31 December 2018. Contract 2 is taken out against the same peril and enters into force on 1 January 2019. Both contracts contain an "extension of protection clause" to the effect that if an event develops during the reinsurance period and causes individual losses but is still in progress when the reinsurance expires and thereafter causes further individual losses, the reinsurance period is extended to also cover those latter losses. Moreover, they both contain an event-based aggregation clause.

On 31 December 2018 a hurricane develops and causes multiple individual losses that day. The hurricane continues to sweep over town until the morning hours of 1 January 2019. Accordingly, some of the losses occur on 1 January 2019. Based upon contract 1's "extension of protection clause" hurricane losses that occur on 1 January 2019 are covered under contract 1. As all individual losses–no matter whether they occurred on 31 December 2018 or 1 January 2019–are allocated to contract 1, they are to be aggregated under Article 5.2(1).

3. Deductible, retention, priority, excess point, attachment point

C9. Both in facultative excess of loss reinsurance and treaty excess of loss reinsurance, a reinsured takes out reinsurance only on a sum in excess of a particular figure. Hence, the reinsured retains liability for the entire loss below that excess point but transfers liability for the part of the loss above that point. The amount of the loss for which liability is retained by the reinsured is termed a "deductible", "retention" or "priority". The upper limit of a deductible or retention is referred to as an "excess point" or "attachment point". Excess or attachment points are regularly defined in relation to any losses that arise from a unifying factor, such as an event or a cause. In other words, the reinsurer promises to indemnify the reinsured against the aggregate of all losses arising from a particular event or cause above the excess or attachment point.

4. Cover, limit, cover limit

C10. Contracts regularly contain limits on liability. More specifically, reinsurers only reinsure their reinsureds up to a certain sum, the so-called "coverage limit", preventing the reinsureds from claiming indemnification for any loss amount above this "limit". The parties to a contract regularly define their coverage limit in relation to the aggregate of all losses that arise from a unifying factor, such as an event or cause. In other words, the reinsurer promises to indemnify the reinsured against any losses arising from a particular event or cause up to a fixed amount of money.

5. Loss

C11. In the context of loss aggregation, the word "loss" generally refers to the monetary damage suffered by the primary insured. By contrast, in the context of loss allocation, the word "loss" refers to the reinsured's obligation to reimburse the policyholder under the underlying contract (*see* Article 4.2 Comment 1).

C12. With regard to life insurance policies, the word "loss" refers to the primary insured's death and not to a monetary detriment caused by his death.

C13. Hence, the notion of "loss" does not refer to the event or "occurrence out of which a claim arises, for loss suffered by the original insured, such as storm damage, flood damage or the like, or in the case of professional [liability] losses, the negligent act or omission of the insured" (*see Caudle v Sharp* [1995] CLC 642, 648).

6. Unifying factor

C14. Individual losses may be aggregated if they all result from one common unifying factor. The terminology used to describe such unifying factors is manifold. In fact, the industry has used the notions of "event", "occurrence", "happening", "accident", "catastrophe", "disaster", "calamity", "cause" or "source", etc to define it.

C15. In Articles 5.2 and 5.3, there are rules for aggregation either on the basis of an "event" or a "cause". These two concepts are distinguished by different causation requirements between the individual losses on the one hand and the respective unifying factors on the other hand (*see* Article 5.1 Comments 18 et seqq).

7. Causation
a. General aspects

C16. Normally, the parties agree to aggregate losses that have a "common origin in some act or event or cause" (*see* EDELMAN AND BURNS 4.54). Hence, there must be a causal link between the unifying factor on the one hand and all the losses to be aggregated on the other.

C17. The degree of causality required in relation to loss aggregation is most controversial. As the workings of causation are infinite, the parties must decide how far back on the chain of causation a unifying factor may lie so that it is still justified to aggregate the losses that arise from it.

C18. Traditionally, contracting parties have used "event-based" and "cause-based" aggregation language. The parties agree on an event-based aggregation if they agree, eg, to aggregate "each and every loss […] arising out of one event" (*see Caudle v Sharp* [1995] CLC 642, 644) or similar wordings. They agree on a cause-based aggregation if they agree, eg, to aggregate losses "arising from one originating cause" (*see Cox v Bankside Members Agency Ltd* [1995] CLC 671, 679) or similar wordings.

C19. As to the difference between event- and cause-based aggregation, it has been held that an event is something which happened at a particular time, at a particular place, in a particular way. A cause is something less constricted and has a much wider connotation than the notion of event (*Axa Reinsurance (UK) Plc v Field* [1996] 1 WLR 1026, 1035).

C20. Consequently, cause-based aggregation allows the parties "to look further back" in the chain of causation and to "use a remoter common" unifying factor for determining the aggregate loss than event-based aggregation (LOUW AND TOMPKINSON 11). The question is, however, where exactly on the chain of causation each unifying factor comes to lie.

b. Causation: Unities test is inappropriate

C21. Applying English law, arbitral tribunals and courts determine the required degree of causation between the relevant event and the separate losses by means of the so-called "unities test", which was developed in the Dawson's Field Arbitration. The test assesses whether multiple losses "involve such a degree of unity as to justify their being described as, or as arising out of one" event. "In assessing the degree of unity regard may be had to such factors as cause, locality and time and the intentions of the human agents" (*Kuwait Airways Corporation v Kuwait Insurance Co SAK* [1996] 1 Lloyd's Rep 664).

C22. It is undisputed that there must be a causal link between the relevant event and the separate losses (unity of cause). This aspect does not, however, deal with the required strength of these causal links; it only establishes that there must be causal links. It is on the basis of the further aspects of "unity of locality", "unity of time" and "unity of intentions" that the unities test is meant to assess the strength of the causal links. However, the fact that separate losses occur in close spatial proximity (unity of location), in close temporal proximity (unity of time) and may be the product of related human intentions (unity of intentions) has no bearing on the required level of causation but rather on the level of correlation. Therefore, the unities test can be considered a mixed test of causation and correlation.

C23. It is certainly possible to test whether separate losses may be aggregated on the basis of a mixed test of causation and correlation. However, testing the unity of location and the unity of time is only sensible if the meaning of proximity in space and time is defined from the outset. The lack of a clear understanding of what spatial and temporal proximity means can be seen as the gravest deficiency of the unities test, as it allows for result-oriented judgments.

Illustration

I3. In *Aioi Nissay Dowa Insurance Company Ltd v Heraldglen Ltd* [2013] EWHC 154, paragraph 23, the court affirmed the arbitral tribunal's findings that the New York Twin Towers were located in close proximity to one another but that this proximity "did not give rise to a sufficient degree of unity for them to conclude that" the losses that occurred to them 16 minutes apart from one another can be said to have arisen out of one event. Similarly, the court affirmed that although "there were similarities in the timing of the events from the commencement of the flights to contact with the Towers […] these were not such as to lead to the conclusion" that the losses can be said to have arisen out of one event. Further,

the court confirmed the tribunals finding that, although the attacks on the Twin Towers could be said to be the "execution of a dastardly plot to turn each [aircraft] into a guided missile", there was no basis "for concluding that there was any factor amounting to an event of sufficient causative relevance to override the conclusion that two separate hijackings caused separate loss and damage (*Aioi Nissay Dowa Insurance Company Ltd v Heraldglen Ltd* [2013] EWHC 154, paragraph 21).

I4. In the Dawson's Field Arbitration, by contrast, three aircraft were hijacked and flown to a remote desert airstrip in Jordan. Thereafter, all three aircraft were blown up one after another "in close proximity more or less simultaneously, within the time span of a few minutes, and as a result of a single decision to do so without any one being able to approach the aircraft between the first explosion and their destruction." All the losses that resulted from the destruction of the three aircraft were held to have arisen out of one event (*Dawson's Field Arbitration*, quoted in: *Aioi Nissay Dowa Insurance Company Ltd v Heraldglen Ltd* [2013] EWHC 154, paragraph 9).

C24. The two Illustrations above demonstrate that the result of the unities test very much depends on how it is conducted. In fact, in the case of the attacks on the Twin Towers, the time span deemed relevant was "the whole period from check-in and passenger scrutiny (ie even before the hijacking of the aircraft) to the collapse of each Tower and not just from the time each flight took off" (*Aioi Nissay Dowa Insurance Company Ltd v Heraldglen Ltd* [2013] EWHC 154, paragraph 22) whereas in Dawson's Field Arbitration the relevant period was considered the time between the blowing up of the first and the blowing up of the third aircraft and not the whole period from the hijacking of the individual aircraft to their destruction.

C25. Based on the above, for the purposes of the PRICL, the unities test is considered inappropriate for determining whether a plurality of losses can be aggregated.

c. Causation: Unfortunate event test is inappropriate

C26. Applying New York law, courts use the so-called "unfortunate event test" to determine whether a multiplicity of losses arose out of one single or multiple events. The application of the unfortunate event test is, however, limited to third party liability insurance cases (*cf World Trade Center Properties, LLC v Hartford Fire Insurance Company,* 345 F 3d 154, 190 (2003)).

C27. The unfortunate event test determines whether multiple losses result from one event of an unfortunate character that takes place without one's foresight or expectation. The question at the core of the test is whether the liability arises out of one single or multiple "incidents". If liability arises out of multiple incidents, they may still be considered one event if they occur in temporal and spatial proximity and are part of the same causal continuum.

C28. There is no hard and fast rule determining a particular number of seconds or minutes that must elapse before two incidents are distinct events. Instead, it is relevant whether the relative timing of the various incidents played a role in causing any of the other incidents.

Equally, spatial proximity appears to be relative. Furthermore, to be part of the same event, the operative incidents must be part of the same causal chain. Once an incident occurs and that incident does not, in turn, cause one or more of the other incidents, the causal chain is broken.

C29. Unlike the unities test, the unfortunate event test not only requires that the different losses arise out of the same event but additionally that one liability triggering incident leads to the other liability triggering incident.

Illustrations

I5. Reinsured A provides primary automobile liability insurance to primary insured C. C collides with a car in one incident "but an instant" before striking another car in a second incident. The second incident was a consequence of the first incident.

Applying the unfortunate event test, the two collisions are to be considered one sole event as there was temporal and spatial proximity between the two incidents. Further, as one incident was consequential for the other one, the two incidents were part of the same causal continuum (facts based on *Hartford Accident & Indemnity company v Edward Wesolowski*, 33 NY2d 169, 907, 910 (1973)).

I6. Reinsured A provides construction insurance to building company C. C constructs two independent walls situated blocks away from each other at different job sites. During heavy rainfall, one protecting wall collapsed under the water pressure and destruction poured into a building. Almost an hour later, the other wall gave way and water flooded another building. The collapse of the first wall did not cause the failure of the second. Further, the rainfall in itself did not harm the walls. Rather, the walls collapsed primarily because they were wrongfully built (facts based on *Arthur A Johnson Corp v Indemnity Ins Co of N Am*, 7 NY2d, 227 et seqq).

Applying the unfortunate event test, the two collapses are to be considered two events as the collapse of the first wall did not cause the collapse of the second one and the collapses occurred at different locations and different times.

C30. The connection between the criteria of temporal and spatial proximity as well as the criterion of causal continuum has not been clearly established. Therefore, it is not easy to predict the impact of the different criteria in a specific case. It has been said that courts have reached inconsistent results even when applying the test to similar fact patterns (Murray, The law of describing accidents: a new proposal for determining the number of occurrences in insurance, 118 Yale LJ 1484, 1502).

C31. Based on the above, for the purposes of the PRICL, the unfortunate event test is considered inappropriate for determining whether a plurality of losses can be aggregated.

d. Causation: Proximate cause test is inappropriate

C32. Particularly under Californian law, courts determine the degree of causation between the unifying factor and the separate losses by means of the so-called "proximate cause test". This test should not be confused with cause-based aggregation under Article 5.3 or cause-based aggregation under English law.

C33. The proximate cause test's principle rationale is that any losses resulting from one proximate, uninterrupted and continuing cause may be considered having arisen from one single event. In law, an act or omission is the proximate cause of a loss if, in a natural sequence, unbroken by any new efficient cause, it produces that loss absent of which the loss would not have happened. If, on the other hand, a cause is interrupted and replaced by another intervening cause, then the chain of causation is broken, resulting in two or more events depending on the number of intervening causes. An assessment of whether there is proximate cause is based on reasonability.

C34. The proximate cause test is similar but not identical to the approach taken under the PRICL. The similarity lies in the fact that, under both tests, the unifying factor must be a "direct" cause of the separate losses in order to aggregate them. The difference is that under Article 5.2 the unifying factor must be an "event" rather than any "cause". The concept of "event" is a narrower one than the concept of "cause" (*see* Article 5.3 Comments 2 et seqq).

C35. Based on the above, for the purposes of the PRICL, the proximate cause test is considered insufficient for determining whether a plurality of losses can be aggregated.

8. No presumption of back-to-back aggregation mechanisms

C36. There is no presumption that aggregation clauses in reinsurance contracts are to be interpreted in compliance with the primary insurance policies' aggregation clauses. In fact, aggregation clauses in non-proportional reinsurance contracts merit an autonomous interpretation under the PRICL.

Illustration

I7. The aggregation clause in the underlying errors and omissions insurance contract reads: "any one occurrence or series of occurrences arising from one originating cause". Hence, the primary insurance contract provides for a cause-based aggregation mechanism (facts based on *Cox and Ors v Bankside Members Agency Ltd and Ors* [1995] CLC 671, 679).

The primary insurer has taken out non-proportional reinsurance in the matter. The relevant contract provides for the following aggregation clause: "For the purpose of this reinsurance the term 'each and every loss' shall be understood to mean each and every loss […] arising out of one event". By contrast to the primary insurance contract, the reinsurance contract provides for an event-based aggregation mechanism (facts based on *Axa Reinsurance (UK) Plc v Field* [1996] 1 WLR 1026, 1031 et seq).

The two contracts' aggregation clauses cannot be said to be back-to-back and thus merit autonomous interpretation.

ARTICLE 5.2

(Event-based aggregation)

(1) Where the parties agree on an event-based aggregation in a contract reinsuring first-party insurance policies, all losses that occur as a direct consequence of the same materialization of a peril reinsured against shall be considered as arising out of one event.

(2) Where the parties agree on an event-based aggregation in a contract reinsuring third-party liability insurance policies, all losses that occur as a direct consequence of the same act, omission or fact giving rise or allegedly giving rise to the primary insured's liability shall be considered as arising out of one event.

COMMENTS

1. Event, occurrence, catastrophe, disaster, calamity, accident (paragraphs (1) and (2))

C1. In the PRICL, the notions of "occurrence", "catastrophe", "disaster", "calamity" and "accident" are equated with the notion of "event". For example, whenever a contract refers to the unifying factor of "catastrophe", which is often the case in Cat XL reinsurance, the parties agree on an aggregation pursuant to paragraph (1). Thus, a natural catastrophe, such as a hurricane, may be considered an event for the purpose of paragraph (1).

2. Individual losses

C2. Paragraph (1) applies where first-party insurance policies are reinsured. In the context of the aggregation of losses, the relevant individual losses to be aggregated are suffered by the primary insured and not by the reinsured for compensating the primary insured.

C3. Paragraph (2) applies where third-party insurance policies are reinsured. In the context of the aggregation of losses, the relevant individual losses to be aggregated are suffered by the primary insured each time his liability towards a third party is triggered under the applicable law and not by the reinsured for compensating the primary insured.

3. Causation

C4. There must be a causal link between the relevant event on the one hand and any losses to be aggregated on the other hand. If the parties agree on an aggregation per event, any losses that can be considered a direct consequence of an event are aggregated. This involves a two-step analysis.

C5. First, the relevant event for the aggregation of losses is to be determined. Depending on whether first-party (a) or third-party (b) insurance policies are reinsured, the process of

determining the relevant event differs. Secondly, each loss must be tested to determine whether it can be considered a "direct consequence" of this event (c).

c. Event – Determination of an instance of materialized peril (paragraph (1))

C6. In determining the relevant event in cases where first-party insurance policies are reinsured, regard must be had to the purpose and the scope of the reinsurance coverage and in particular the perils reinsured against. Under the PRICL, an event is considered to be an instance of materialized peril reinsured against.

C7. In the context of insurance and reinsurance, a peril or risk is the uncertainty arising from the possible occurrence of a given event that may cause injury, loss or destruction (*see Glossary of Insurance and Risk Management Terms, International Risk Management Institute Inc* under the search term "risk").

C8. Reinsurance policies regularly designate the perils reinsured against. Depending on the type of reinsurance involved, such perils may include illness, fire, windstorm, tempest, flood, earthquake, hail, terrorist attack, theft, etc.

C9. For natural perils, such as windstorm, tempest, flood, earthquake, hail or illness, it is expedient to resort to scientific data in order to determine the number of instances a peril has materialized.

C10. By contrast, in most cases, scientific data will not be available to determine the number of instances a man-made peril has materialized. Whether a man-made peril has materialized in one or multiple separate instances must be determined from the perspective of reasonable parties at the time the scope of coverage – ie the perils reinsured against – was negotiated.

Illustration

I1. Reinsured A takes out reinsurance for a first-party property insurance policy against the peril of windstorm. Two separate named windstorms cause damage to different buildings. Thus, the peril reinsured against materializes in two separate instances, which therefore constitute two separate events.

I2. Reinsured A takes out reinsurance for a first-party property insurance policy against the peril of snowstorm. Heavy snowfall occurs and causes a "substantial snow accumulation" on the house's roof. Due to the weight of the ice and snow, a part of the roof collapses on 1 March. On 17 March, another section of the same roof collapses. No new snowfall occurred between 1 and 17 March. The snowstorm can be considered the relevant event. Thus, the peril materializes in one sole instance (facts based on *Newmont Mines Ltd v Hanover Insurance Co*, 748 F2d 127 (2d Cir 1986)).

I3. Reinsured A takes out aircraft hull reinsurance for a fleet of 22 aircraft against the peril of war. Iraq invades Kuwait and hijacks 15 of the 22 aircraft and flies them to Iraq. In the course of the actions that follow the invasion, some of the

aircraft are destroyed. As Iraq's invasion of Kuwait can be considered an act of war, it marks the relevant event (facts based on CLYDE & CO 28.23).

I4. Reinsured A takes out reinsurance for an aviation hull insurance against the peril of hijacking an airplane. On 11 September 2001, two airplanes are hijacked at different airports and flown into the New York Twin Towers. Thus, the peril insured against (hijacking) materializes in two separate instances. Each hijacking marks a separate event.

I5. Reinsured A takes out reinsurance for property damage, including insurance against the peril of "an act for terrorist purposes". On 11 September 2001, two airplanes are hijacked at different airports and flown into the New York Twin Towers. The hijackers did so in execution of a dastardly plot to turn each aircraft into a guided missile each directed at one of the two signature Towers of a single property complex. It is certainly disputable whether the plot of hijacking two aircraft and turning them into guided missiles can be considered one single "act for terrorist purposes". In fact, the peril of "act for terrorist purposes" is quite openly formulated. If at the time the contract of reinsurance was negotiated, the parties would have considered the happenings in question as one act for terrorist purposes, the attacks would constitute one single event for the purposes of Article 5.2 (facts based on *Aioi Nissay Dowa Insurance Company Ltd v Heraldglen Ltd* [2013] EWHC 154, paragraph 21).

C11. If a contract provides for all-risk coverage, the materialization of any unnamed peril that triggers the contract is to be considered a relevant event for the purpose of aggregating losses under paragraph (1). Similarly, in case a contract covers both named and unnamed perils, the materialization of any unnamed peril may constitute the relevant event within the meaning of paragraph (1). In such cases, any losses that directly result from the event furthest on the chain of causation may be aggregated under paragraph (1).

Illustration

I6. Reinsured A takes out all-risk property reinsurance. An earthquake occurs and causes losses 1 and 2. At the same time, the earthquake triggers a tsunami which causes losses 3 and 4.

As no peril is named in the contract, the materialization of any peril is to be considered an event under paragraph (1). Consequently, both the earthquake and the tsunami may constitute events. As the earthquake is the event furthest away from losses 3 and 4, it is the relevant event for the purpose of aggregation. Consequently, losses 1 and 2 are to be aggregated with losses 3 and 4.

d. Event – Act, omission or fact triggering liability (paragraph (2))

C12. Where third-party liability insurance policies are reinsured, the act, omission or fact for which the primary insured is held liable under the applicable law is deemed the relevant event for the purpose of the aggregation of losses under the PRICL.

Illustrations

I7. Reinsured A provides professional liability insurance to a managing agent of a syndicate at Lloyd's. This managing agent underwrote 32 insurance contracts. After having discovered that the agent had negligently underwritten these contracts, members of the syndicate brought action in negligence against the managing agent. A had indemnified the managing agent for the losses he incurred due to his legal liability towards the members of the syndicate. Thereafter, A sought to recover claims it had met under the original professional liability insurance from its Reinsurer B.

Only the underwriting of each contract in negligence triggered the managing agent's liability. Thus, each instance of underwriting constitutes a separate event (facts based on *Caudle v Sharp* [1995] CLC 642, 642).

I8. Reinsured A provides liability insurance to a port. Equipment stored at the port was vandalized by a succession of individual acts of pilferage. The owner of the equipment brought action against the port for not putting in place an adequate system to protect the goods from pilferage and vandalism.

The port's failure to put in place an adequate system of protection from pilferage and vandalism did not itself trigger its liability. Rather, the port's liability was triggered with each act of vandalism it was unable to avert. Therefore, each failure to adequately avert an act of vandalism constitutes a separate event under the PRICL (facts based on *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] CLC 957, 966 et seqq).

I9. Reinsured A provides professional liability insurance to a wholesaler of birdseed. The latter bought birdseed from his manufacturer. One batch of birdseed was contaminated. The wholesaler sold portions of it to eight different customers, each of whom lost their birds.

The wholesaler did not contaminate the birdseed so the contamination cannot be said to have triggered his liability. Rather, the sale of the contaminated goods to his customers triggered his liability. Therefore, each of the eight sales can be considered a separate event under the PRICL (facts based on *Maurice Pincoff Co v St. Paul Fire and Marine Insurance Co*, 447 F2d 204 (1971)).

I10. Reinsured A provides professional liability insurance to a chemical manufacturer that has operated in locations throughout the US since the early 1900s. In the 1980s, federal, state and local governments as well as a number of private parties commenced environmental actions directed at more than 150 of the manufacturer's plant and disposal sites throughout the country.

The manufacturer's deficient corporate environmental policy did not itself trigger his liability. Rather, each act of pollution at each different site triggered the manufacturer's liability. Therefore, each act of pollution constitutes a separate event under the PRICL (facts based on *Travelers Casualty and Surety v Certain Underwriters at Lloyd's of London*, 96 NY2d 583 (2001)).

I11. Reinsured A provides professional liability insurance to primary insured C – an insurance company. Several of C's underwriters mis-sold pensions for which they were held liable. They have been found to have done so due to their lack of proper training.

The insurance company and their underwriters did not incur liability until they mis-sold pensions to their customers. Hence, each act of mis-selling is to be considered a separate event. By contrast, the underwriters' lack of training did not itself trigger their or their employer's liability and can, thus, not be an event for the purposes of paragraph (2) (facts based on *Countrywide Assured Group Plc v Marshall* [2002] WL 31173646, 6).

I12. Reinsured A issued a policy of insurance covering the liabilities of 14 directors, officers and employees of an American financial institution. The institution collapsed and a claim was made against all 14 of the directors and officers, each of whom was alleged to be personally liable for having been negligent or otherwise at fault in the handling of the institution's affairs.

The relevant events were the acts or omissions of the directors, officers and auditors, not the subsequent collapse of the institution. Therefore, it is not possible to aggregate all of the individual losses resulting from the collapse of the institution (facts based on *American Centennial Insurance Company v INSCO Limited* [1996] WL 1093224).

C13. A primary insured's omission may only be considered an event if the omission itself directly triggered the primary insured's liability (pure omission). By contrast, dormant omissions do not themselves trigger the insured's liability but require some further positive act or event. So long as the negligent individual remains passive, no actionable harm ensues in such cases (LOUW AND TOMPKINSON 11).

Illustrations

I13. A solicitor was required to issue a writ which he failed to do before the deadline. The omission to file the writ itself without any requirement of positive action caused the harm. Hence, the solicitor's failure can be considered a pure omission and is consequently an event according to paragraph (2) (facts based on *Forney v Dominion Insurance Co Ltd* [1969] 1 WLR 928).

I14. An underwriter underwrote multiple contracts without researching a particular risk. He does not incur any liability for not having researched the risk. Rather, his state of ignorance becomes relevant only if he undertakes the further positive acts of underwriting the insurance contracts. Thus, the omission to research the said risk must be considered a dormant omission which does not amount to an aggregating event (facts based on *Caudle v Sharp* [1995] CLC 642, 649). By contrast, each positive act of underwriting a contract is to be considered an event. However, because the need to determine the existence and scope of an event arises only when there is a covered claim, this even may never become the subject of dispute if there are no losses pursuant to the negligently underwritten contract.

C14. Equally, a fact giving rise to the primary insured's liability can be considered an event. Any happening that directly triggers the primary insured's liability in the absence of any fault may be considered such a fact.

Illustration

I15. Without any fault on the part of the driver, one of a car's tires blew out and resulted in a multi-person accident on a highway. The operational risk of a driving car has materialized and triggered the car owner's strict liability. Hence, even in the absence of any negligent act or omission on the part of the driver, the car owner becomes liable to indemnify third parties involved in the accident. For the purposes of aggregating losses, the fact that the accident happened is to be considered the relevant event.

C15. In paragraph (2), it is stated that any act, omission or fact "for which the primary insured is or allegedly is liable" may constitute an event for the purpose of aggregating losses. This specification ensures that aggregation is possible even if the primary insured's liability cannot be evidenced by court verdict or arbitral award. In fact, whenever a reinsured becomes liable towards a primary insured, an aggregation of losses is possible, provided that all the losses are covered under the contract.

e. Direct consequence

C16. It is not appropriate to aggregate every loss that arises from the same event. Rather, losses are to be aggregated only if they are the direct consequence of the relevant event, ie an instance of materialized peril reinsured against or a liability triggering act, omission or fact.

C17. Therefore, the test under the PRICL is whether the causal links between the event and the individual losses are strong enough so as to consider the losses an event's direct consequences. The notion of "direct consequence" under the PRICL is not to be confounded with the notion of proximate or efficient cause under English or US law.

C18. A loss may be considered an event's direct consequence if it can be considered an inevitable result of the relevant aggregating event. A loss may not be considered the direct consequence of the relevant event if an independent, intervening factor has decisively contributed to the occurrence of the loss and thereby broken the chain of causation.

C19. This does, however, not mean that the relevant event, ie an instance of materialized peril or a liability triggering act, omission or fact, is necessarily the last happening immediately preceding the occurrence of the loss. Rather, an event may lead to a further happening which then results in losses. If an event inevitably results in a further happening – which may but does not have to be the materialization of another peril reinsured against – then any individual losses which result directly therefrom shall be deemed to have directly arisen from the aggregating event. The reason for this is that the chain of causation between the event and the losses remains unbroken.

Illustration

I16. Reinsured A takes out reinsurance for a first-party property insurance policy against the perils of earthquake and tsunami. An earthquake occurs and causes losses 1 and 2. At the same time, a tsunami is triggered by the earthquake. Losses 3 and 4 arise from the tsunami.

Each loss must be tested individually. In particular, it is to be determined whether losses 1-4 can be considered direct consequences of the relevant event, ie the earthquake. Losses 1 and 2 occurred due to the earthquake, whereas losses 3 and 4 resulted from the tsunami which, in turn, was triggered by the earthquake.

As the tsunami was an inevitable consequence of the earthquake, losses 3 and 4 may be considered direct consequences of the earthquake. Hence, losses 1-4 are to be aggregated, even though the earthquake did not immediately precede losses 3 and 4.

C20. The chain of causation between the relevant event and a loss can be considered broken if an intervening factor decisively interferes. This factor must be independent from the relevant event, ie the materialization of the peril reinsured against (paragraph (1)) or the liability triggering act, omission or fact (paragraph (2)). It may be constituted in a person omitting to prevent the event from happening if this person was under a duty of care to avert the corresponding losses. In such a case, the test is whether the corresponding losses would not have arisen, had the person acted in compliance with his duties (*conditio cum qua non*). Such an omission may occur before or after the relevant event.

Illustrations

I17. Reinsured A takes out reinsurance for a first-party property insurance policy against the perils of earthquake and fire. An earthquake occurs and causes losses 1 and 2. At the same time, a tsunami is triggered by the earthquake and results in a short circuit because electric cables have not been insulated according to the required standards. The short circuit causes a fire from which losses 3 and 4 arise.

The lack of proper insulation of the electric cables can be considered an intervening factor sufficient to break the chain of causation. Losses 3 and 4 cannot be considered direct consequences of the earthquake. Thus, losses 3 and 4 are not to be aggregated with losses 1 and 2.

I18. Reinsured A takes out reinsurance for a first-party property insurance policy against the perils of earthquake and fire. An earthquake occurs and causes losses 1 and 2. At the same time, a tsunami is triggered by the earthquake and results in a short circuit. All of the electric cables were insulated in accordance with the required standard but broke as a result of the earthquake. The short circuit results in a fire which causes losses 3 and 4.

As the short circuit and the resulting fire can be considered inevitable consequences of the earthquake and the tsunami, neither can be considered a decisively intervening factor. Losses 3 and 4 are to be aggregated with losses 1 and 2.

I19. Primary insured C negligently injures a company's director D who must subsequently be hospitalized. Treatment costs result in loss 1. Due to the absence of D, deputy director E is in charge. The latter makes some unfortunate decisions which result in losses 2 and 3.

The company is under a duty to organize its affairs appropriately. It is under a specific duty to ensure that the company is able to operate in case of D's absence. Thus, the company's failure to hire a capable deputy director can be considered an intervening factor sufficient to break the chain of causation. Losses 2 and 3 cannot be considered the direct consequence of the primary insured's negligent act. Thus, losses 2 and 3 are not to be aggregated with loss 1.

I20. Reinsured A takes out reinsurance for a landowner's third-party liability insurance policy. An airplane flies into a building and thereby injures some of the landowner's employees (losses 1-10; workers' compensation claims) for which the primary insured became liable. In the time after the accident, there is a massive clean-up operation by the landowner. Evidence shows that the clean-up workers have been negligently exposed to asbestos during the clean-up operations. The workers' exposure resulted in losses 11-50 for which the primary insured is equally liable (respiratory claims). Consequently, the landowner is liable for losses 1-50.

The respiratory losses did not arise from the same event as the workers' compensation claims, ie the airplane accident. This is so because the landowner is under a duty of care to protect the clean-up workers from injuries by providing them with adequate protective equipment. The landowner's failure to provide such protection can be considered an intervening factor sufficient to break the chain of causation between the airplane accident and respiratory claims. Therefore, the workers' compensation claims are not to be aggregated with the respiratory claims (facts based on *Mic Simmonds v AJ Gammell* [2016] EWHC 2515).

C21. Similarly, an intervening factor sufficient to break the chain of causation may be constituted in a happening which occurs independently of the event reinsured against and which inevitably results in the corresponding losses (*conditio sine qua non*). Such a happening may occur before or after the relevant event.

Illustrations

I21. Reinsured A takes out all risk reinsurance for a first-party property insurance policy. A bushfire spreads and causes losses 1 and 2. At the same time, it destroys vegetation on a slope so that the ground is unable to absorb larger amounts of water. Eight months later, during extraordinarily heavy rainfalls, a landslide occurs and losses 3 and 4 result.

The materialization of the peril of fire constitutes the event within the meaning of paragraph (1). Losses 3 and 4 occurred due to a combination of the destroyed vegetation and the heavy rain. The bushfire alone would not have caused losses 3 and 4, which means that the instance of heavy rain may be considered a decisively intervening factor independent of the relevant event. Therefore, losses 3 and 4 are not to be aggregated with losses 1 and 2.

I22. Reinsured A takes out all risk reinsurance for a first-party property insurance policy. A vessel spills a significant amount of oil into the sea near the coast. Some days later, a windstorm occurs and blows some of the spilled oil into a river. Due to the strength of the windstorm, it eventually causes a flood. Losses 1 and 2 arise from the destructive force of the flood. Furthermore, in the course of the flood, some of the oil pollutes nearby agricultural land which results in losses 3 and 4.

The flood constitutes the event within the meaning of paragraph (1). Losses 3 and 4 occurred due to a combination of the oil spillage and the flood. Hence, losses 3 and 4 would not have occurred had there not been an independent oil spillage. Therefore, losses 3 and 4 are not to be aggregated with losses 1 and 2.

I23. Reinsured A takes out reinsurance for a professional liability insurance policy. A vessel owner negligently spills a significant amount of oil into the sea near the coast which results in the pollution of two coastal villages located some distance apart and thereby triggers his liability (losses 1 and 2). The spilled oil is washed towards the two different locations due to the common wind conditions in the area.

The vessel owner’s negligent act alone has caused losses 1 and 2. The common wind condition in the area cannot be considered a decisively intervening factor independent of the relevant event (negligent spillage of oil). Therefore, losses 1 and 2 are to be aggregated.

I24. Reinsured A takes out reinsurance for a professional liability insurance policy. A vessel owner negligently spills a significant amount of oil into the sea near the coast which results in the pollution of the coastal area and thereby triggers his liability (losses 1 and 2). Some days later, an unusually heavy windstorm occurs and blows some of the spilled oil into a river and eventually causes a flood. In the course of the flood, some of the oil pollutes nearby agricultural land resulting in losses 3 and 4.

Losses 3 and 4 occurred due to a combination of the oil spillage and the flood. Hence, the vessel owner’s negligent act alone would not have caused losses 3 and 4, which means that the flood may be considered a decisively intervening factor independent of the relevant event (negligent spillage of oil). Therefore, losses 3 and 4 are not to be aggregated with losses 1 and 2.

C22. If an intervening factor contributes to the occurrence of a loss but cannot be said to be decisive for the occurrence of the loss, such intervening factor cannot prevent the aggre-

gation of this loss with other losses resulting from the relevant event. For instance, common circumstances in place at the time the peril reinsured against materializes (eg common wind which spreads the fire to adjacent properties) or the primary insured's liability is triggered are generally not considered decisively intervening factors although they may support the occurrence of losses.

Illustrations

I25. Reinsured A takes out reinsurance for a first-party property insurance policy against the perils of tsunami and fire. A tsunami occurs and causes losses 1 and 2. At the same time, the tsunami causes a short circuit which results in a fire that easily spreads because of the common wind conditions. Losses 3 and 4 occur.

As the short circuit can be considered the inevitable consequence of the tsunami, losses 1 - 4 are to be aggregated. The fact that losses 3 and 4 only occur due to the common wind conditions does not make such conditions an independent and decisively intervening factor.

I26. Reinsured A takes out reinsurance for a portfolio of personal liability insurance policies. Primary insured C negligently sets fire to a building which results in loss 1. Due to the common wind conditions in the area the fire spreads and causes losses 2 and 3.

Losses 2 and 3 can be considered the direct consequence of the primary insured's negligent act. The commonly windy weather cannot be considered a decisively intervening factor that breaks the chain of causation. Therefore, losses 1- 3 are to be aggregated.

I27. Reinsured A takes out reinsurance for a portfolio of personal liability insurance policies. Primary insured C negligently sets fire to a building which results in loss 1. Shortly thereafter, an unusual heavy windstorm occurs and causes the fire to spread. Losses 2 and 3 occur.

Losses 2 and 3 occurred due to a combination of the fire and the seldom windstorm. Hence, E's negligent act alone would not have caused losses 2 and 3, which means that the windstorm may be considered a decisively intervening factor independent of the relevant event (negligently setting fire). Therefore, losses 2 and 3 are not to be aggregated with loss 1.

4. Sublimits

C23. Reinsurance contracts typically not only contain coverage limits but also sublimits. Sublimits define a limit of liability with respect to a particular peril when the contract provides coverage against a multitude of perils or with respect to a specific reinsured asset when reinsurance is taken out for a multitude of different assets or with respect to a specific location when the reinsured assets are located at a multitude of places.

C24. Under the PRICL, aggregation is dealt with on each level of limits, ie total coverage limits and sublimits. Thus, event-based aggregation of losses is subject to any coverage limits specified in the contract.

Illustrations

I28. There is reinsurance coverage per occurrence with a total coverage limit of USD 40 million. The contract states a USD 20 million sublimit per occurrence for the peril of tsunami.

An earthquake occurs and causes losses amounting to USD 30 million. The earthquake further directly results in a tsunami which causes tsunami losses amounting to USD 30 million. The event caused damage totaling USD 60 million. Both earthquake and tsunami losses can be considered direct consequences of the earthquake, so that generally all of the losses can be aggregated.

In order to respect the different sublimits, however, it is necessary to test whether the aggregate tsunami loss is within the tsunami cover limit. This is not the case. USD 20 million of the tsunami losses are covered by the sublimit specified for tsunami losses, while the remaining USD 10 million of the tsunami losses are not.

Another necessary test is whether the aggregate loss that results from the event is within the total coverage limit. Losses caused by the tsunami can be considered losses caused by the earthquake. Therefore, all the covered tsunami losses are aggregated with the earthquake losses. They amount to USD 50 million (USD 20 million tsunami losses and USD 30 million earthquake losses). The total coverage limit is USD 40 million, meaning that losses amounting to another USD 10 million are not covered.

I29. Reinsured A takes out aviation reinsurance for a public liability insurance policy. The reinsurance coverage is per occurrence with a total coverage limit of USD 40 million. The contract states a USD 20 million sublimit per occurrence for damage caused by the release of substances hazardous to soil or water.

Due to a wrong manipulation by the pilot, the primary insured's aircraft negligently releases liquid fuels which results in the pollution of agricultural land. The damage amounts to USD 30 million. The leakage of the fuels further results in a crash that causes property damage in the amount of USD 30 million. The event causes damage totaling USD 60 million.

Both the pollution and the property damage losses can be considered direct consequences of the pilot's wrong manipulation. In order to respect the different sublimits, however, it is necessary to test whether the aggregate pollution loss is within the pollution sublimit. This is not the case. USD 20 million of the pollution losses are covered by the sublimit specified for pollution losses, while the remaining USD 10 million of the pollution losses are not.

Another necessary test is whether the aggregate loss that results from the event (wrong manipulation) is within the total coverage limit. Both pollution and property damage losses can be considered losses caused by the pilot's wrong manipulation. Therefore, all the covered pollution losses are aggregated with the property damage losses. They amount to USD 50 million (USD 20 million pollution losses and USD 30 million property damage losses). The total coverage limit is USD 40 million, meaning that losses amounting to further USD 10 million are not covered under the contract.

5. Treaty reinsurance

C25. In the case of treaty reinsurance, a reinsured takes out reinsurance against a multitude of risks covered by multiple (re)insurance policies under a single contract.

C26. If multiple first-party primary insurance policies are triggered as a result of the same materialization of a peril reinsured against, multiple losses occur under the contract. Under paragraph (1), these losses are treated as one single loss with regard to reinsurance retention (deductible) and coverage limit.

Illustration

I30. Reinsured A takes out reinsurance for a reinsurance portfolio of car property damage policies. The peril insured against is destruction by accident. Several car accidents occur under different primary insurance policies in the reinsurance portfolio. As the accidents occur independently of one another, the peril insured against materializes in multiple instances so that the individual losses incurred by the different car owners cannot be aggregated for the purpose of aggregating losses under the reinsurance treaty.

By contrast, if a multiple collision accident occurs so that the first car crash was causative for any of the other crashes involved, the first car crash can be considered the materialization of the peril insured against. Any losses that directly originate from this first car accident are to be aggregated under the PRICL (facts based on *Hartford Accident & Indemnity Co v Wesolowski*, 33 NY2d 169, 910). The fact that the accident triggered a multitude of primary insurance policies does not conflict with the aggregation of losses under paragraph (1).

C27. It should be noted that it is generally not possible for one event to trigger multiple third-party primary insurance policies as third-party liability risks are normally covered in only one primary insurance policy. Thus, if this primary insurance policy is triggered, the other primary insurance policies under the reinsurance treaty remain unaffected.

6. Hours clauses

C28. Catastrophe excess of loss contracts in particular often contain hours clauses defining a time frame within which losses arising from an event are to be aggregated. Regularly, such clauses refer to a “catastrophe” as the unifying factor for the aggregation of losses. Under the PRICL, a “catastrophe” equates to any other event (*see* Article 5.2 Comment

1), therefore paragraph (1) applies. However, hours clauses tend to narrow down the scope of the aggregation mechanism provided for in paragraph (1).

C29. Where the parties include an hours clause, paragraph (1) will to some extent be altered. In such a case, the relevant event is still determined pursuant to paragraph (1) and it still applies that only losses directly occasioned by this event may be aggregated. The parties then, however, amend the mechanism provided for in the PRICL in that they specify that only losses that occur within the time frame agreed upon in the hours clause aggregate.

7. Life insurance policies

C30. Under paragraph (1), life insurance policies are equated with first-party insurance policies where appropriate. In life insurance, a primary insurer pays a stipulated sum of money to the designated beneficiaries upon death of the insured.

C31. A policyholder's death is to be considered the loss suffered. As an insured can only lose his life once, there can only be one loss per individual life insurance policy. Therefore, loss aggregation is irrelevant in primary life insurance.

C32. By contrast, if a portfolio of primary life insurance policies is reinsured, the reinsurance treaty may provide for a retention, coverage limit and coverage sublimit for the whole portfolio rather than for each primary life insurance policy. In this case, the question of aggregating losses arises.

C33. Generally, life insurance is all-risk insurance subject to the exclusion of a number of risks. Unless a certain cause of death has been excluded from the policy's scope of coverage, the insurance payment becomes due once the primary insured has died. The primary insured's cause of death is to be considered the aggregating event, whereas his death is the loss. Therefore, an event, under the PRICL, is the materialization of any risk (cause of death) not specifically excluded from the life insurance policy's scope of coverage.

C34. If multiple losses originate in the same materialization of a risk, they may be aggregated for the purpose of loss aggregation (Article 5.2(1)). As life insurance policies generally cover all-risks, any event (cause of death) responsible for the death of multiple people may be considered the relevant event for the purpose of aggregating losses.

Illustrations

I31. Multiple people die from an earthquake. Each insured's death may be considered a loss. As all of the losses directly originated in the earthquake, they are to be aggregated.

I32. Multiple people die of lung cancer. Each insured's death may be considered a loss. However, the development of the illness is a separate instance of materialized peril for each insured. Hence, the individual losses are not to be aggregated.

I33. Multiple people die of the exact same virus strain. The outbreak of the respective virus and the subsequent infection of people can be considered one instance of materialized peril and the individual deaths can be considered a direct consequence of the materialization. Hence, the individual losses are to be aggregated.

8. Bundled insurance products

C35. If a primary insurance policy contains aspects of first- and third-party insurance, it may be that an instance of materialized peril (first-party) coincides with the liability triggering act, omission or fact (third-party). In such cases, losses under the first-party insurance are to be aggregated with losses under the third-party insurance.

Illustration

I34. Primary insured C takes out property car insurance as well as liability car insurance. He commits a car accident in negligence, whereby his and another driver's cars are both damaged. Under the first-party property car insurance, the peril of damage by accident materialized when the accident occurred. Thus, the accident can be said to be the event for the purposes of paragraph (1). Simultaneously, by negligently causing the accident, the driver triggered his liability under the third-party insurance. Thus, the accident can also be considered the event for the purposes of paragraph (2). As the events under these two provisions are identical, the respective losses are to be aggregated.

ARTICLE 5.3

(Cause-based aggregation)

(1) Where the parties agree on a cause-based aggregation in a contract reinsuring first-party insurance policies, all losses that occur as the direct consequence of one or multiple events within the meaning of Article 5.2 paragraph (1) shall be considered as arising out of one common cause if it was reasonably foreseeable that a cause of this kind could give rise to such an event.

(2) Where the parties agree on a cause-based aggregation in a contract reinsuring third-party liability insurance policies, all losses that occur as the direct consequence of one or multiple events within the meaning of Article 5.2 paragraph (2) shall be considered as arising out of one common cause if it was reasonably foreseeable that a cause of this kind could give rise to such an event.

COMMENTS

1. Individual losses

C1. For the notion of individual losses, *see* Article 5.2 Comment 2.

2. Originating or original cause (paragraphs (1) and (2))

C2. Under the PRICL, the unifying factor of "cause" allows for a wider aggregation than the unifying factor of "event". Furthermore, in the PRICL, the notions of "cause" and "source" are equated. Thus, whenever a contract refers to the unifying factor of "source" the parties agree on an aggregation pursuant to Article 5.3.

C3. An aggregating cause may provoke multiple instances of materialized perils or liability triggering acts, omissions or facts each of which may result in a plurality of losses. Under cause-based aggregation, any losses that arise from such a cause are aggregated no matter the number of instances a peril materialized or the number of liability triggering acts, omissions or facts.

C4. Similarly, the reinsured may take out reinsurance against multiple perils in one contract. If a cause within the meaning of Article 5.3 leads to the materialization of multiple different perils reinsured against or multiple different liability triggering acts, omissions or facts, such cause is the unifying factor not only for any losses resulting from multiple instances of the materialization of the same peril or multiple identical liability triggering acts, omissions or facts, but also for losses resulting from the materialization of different perils or different liability triggering acts, omissions or facts.

Illustration

I1. Reinsured A takes out reinsurance against the perils of tsunami and fire. An earthquake occurs and provokes a tsunami and a fire independently of one another. Multiple losses result from the tsunami and multiple losses result from the fire.

The peril of tsunami materialized in one instance, as did the peril of fire. Within the meaning of Article 5.2(1), the materialization of the peril of tsunami is considered an event distinct from the materialization of the peril of fire. In the ordinary course of things, it appears quite likely that an earthquake will result in the materialization of a tsunami and the materialization of a fire. Under paragraph (1), the earthquake is, therefore, to be considered the unifying cause. Any losses that can be considered the direct consequence of either the fire or the tsunami are aggregated under paragraph (1).

C5. As illustrated, the concept of "cause" is much wider than the concept of "event". In fact, a cause may be the reason why an event occurred. More specifically, a state of affairs (*cf Axa Reinsurance (UK) Plc v Field* [1996] 1 WLR 1026, 1035), a state of ignorance (*cf Axa Reinsurance (UK) Plc v Field* [1996] 1 WLR 1026, 1030), the lack of proper training (*cf Countrywide Assured Group Plc v Marshall* [2002] WL 31173646, 6), a misunderstanding as to the results of discussions (*cf American Centennial Insurance Company v INSCO Limited* [1996] WL 1093224, 8) and a failure of putting in place an adequate system to protect goods (*cf Municipal Mutual Insurance Ltd v Sea Insurance Ltd* [1998] CLC 957, 967) may be considered causes for the purpose of aggregating losses.

3. Causation
a. Causation in general

C6. There must be a causative link between the relevant cause on the one hand and any losses to be aggregated on the other hand. This involves a three-step analysis:

C7. First, any loss covered under the contract results from an instance of materialized peril reinsured against or a liability triggering act, omission or fact, ie an event within the meaning of Article 5.2. The relevant event or events as defined in Article 5.2 is/are to be

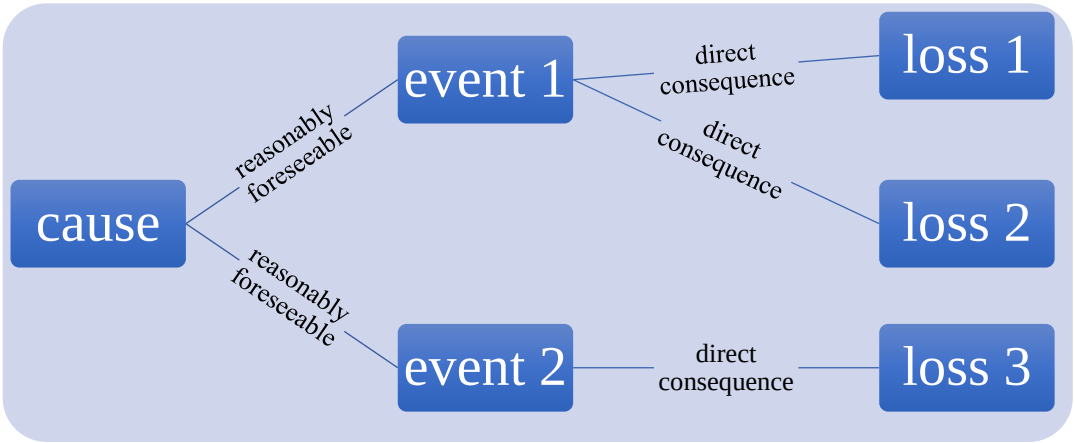
determined and pinpointed on the chain of causation. For more details as to this test, *see* Article 5.2 Comments 6 et seqq.

C8. Second, to find the aggregating cause as defined in Article 5.3, it is necessary to move further back in the chain of causation as compared to Article 5.2. It is to be determined whether there is a cause that triggered one or multiple events within the meaning of Article 5.2. If there is no such cause, the materialization of a peril reinsured against or the liability triggering act, omission or fact is to be considered the aggregating cause. In this case, an event within the meaning of Article 5.2 equates to a cause within the meaning of Article 5.3.

C9. By contrast, if there is a cause from which one or multiple events (Article 5.2) originated, it is necessary to test whether it was reasonably foreseeable that such a cause would provoke one or multiple such events. If so, this cause is to be considered the aggregating cause within the meaning of Article 5.3. It is distinct from one or multiple events within the meaning of Article 5.2. It is important not to give a court or arbitral tribunal the leeway to consider the materialization of a peril reinsured against or the liability triggering act, omission or fact the relevant cause within the meaning of Article 5.3. Otherwise, the parties' choice for a broader aggregation mechanism would be disregarded.

C10. Third, not every loss arising from an event which in turn originates in such an aggregating cause may be aggregated. Rather, the only losses that are aggregated are those that can be said to arise as a direct consequence of the materialization of the peril reinsured against or the liability triggering act, omission or fact.

C11. Consequently, the standard of "reasonable foreseeability" operates between the aggregating cause within the meaning of Article 5.3 and the materialization of a peril reinsured against or a liability triggering act, omission or fact, ie an event within the meaning of Article 5.2. By contrast, the standard of "direct consequence" operates between an event within the meaning of Article 5.2 and the individual losses. This is illustrated below.



b. Reasonable foreseeability

C12. A cause may be somewhere further back in the chain of causation than an event. The concept of reasonable foreseeability is meant to restrict how much further back in the chain of causation a court or arbitral tribunal may look in the search for an aggregating cause. In fact, not every cause that provokes an instance of materialized peril can be considered an aggregating cause within the meaning of Article 5.3. If a cause is too loosely connected to the event to justify an aggregation of losses, it cannot be considered an aggregating cause within the meaning of Article 5.3.

C13. Under Article 5.3, a cause may be considered the unifying factor for the purpose of aggregating losses if it was reasonably foreseeable to the parties that – in the ordinary course of things – a cause of this kind may lead to an event of the kind under consideration, ie an instance of materialized peril (Article 5.2(1)) or an act, omission or fact that triggers the primary insured's liability (Article 5.2(2)).

C14. Consequently, it is not necessary that it is reasonably foreseeable that a cause would provoke multiple events or that the events which flowed from the cause would eventually result in a plurality of losses. Similarly, the number of separate losses that may arise from an event originating from the cause in question or the extent of such losses does not have to be reasonably foreseeable. Rather, it is sufficient that it is reasonably foreseeable that a cause of the kind in question may lead to an event of the kind in question.

C15. The requirement of reasonable foreseeability is an objective one. Whether a certain cause was reasonably foreseeable must be determined by reference to a reasonable person in the circumstances of the parties. Furthermore, reasonable parties judge the standard of foreseeability in light of the ordinary course of things.

C16. It is at the time of entering into the contract that reasonable parties must have been able to reasonably foresee that a cause of the kind in question might result in one or more reinsured events.

C17. In any case, it is important to note that the concept of foreseeability in Article 5.3 does not correspond with the concept of foreseeability in tort law or the concept of foreseeability in general contract law or insurance law (*cf* SWISHER (2002) 361 et seq for the distinction between the different concepts).

C18. In fact, in tort law, the concept of foreseeability is used to determine "whether [someone's] act, or omission to act, was too remote or did in fact constitute the proximate cause" of the injured's damage and therefore triggered the wrongdoer's liability (SWISHER (2007) 9). In general contract law, the concept of foreseeability is used to limit a party's liability for breach of contract (§ 351(1) Restatement (Second) of Contracts). In insurance law, the concept of foreseeability is used to determine whether a certain loss is covered by the insurance policy (*cf* SWISHER (2002) 361 et seqq). In all of these cases, the concept of foreseeability is used to limit liability.

C19. The PRICL do not use the concept of reasonable foreseeability to limit the reinsurers' liability, ie to determine whether a certain loss is covered under the contract. Rather, the question of whether these separate losses are to be aggregated only arises once it has been

established that a plurality of losses are generally covered by the contract. In fact, limiting the extent of aggregation can – depending on both the structure of the reinsurance policy and the structure of the individual losses – lead to an increase or decrease in a reinsurer's liability.

Illustrations

I2. Under the primary insurance policy, Reinsured A provides professional liability insurance to primary insured C. C is an insurance underwriter who underwrites a plurality of insurance contracts without appreciating the risk of asbestosis. Reinsurer B provides reinsurance coverage to A for the third-party liability insurance policy between A and C.

It must be determined whether, at the time of contract formation, it was reasonably foreseeable that – in the ordinary course of things – an underwriter's liability would be triggered if the latter underwrote insurance contracts without having appreciated all of the known risks.

The risk of asbestosis was public knowledge at the time C underwrote the insurance contracts. It may be said that it was reasonably foreseeable that an underwriter's ignorance about this risk would lead to an act of negligent underwriting. Consequently, the underwriter's ignorance is to be considered a cause within the meaning of Article 5.3. This is so because – in the ordinary course of things – it appears reasonable that the lack of appreciation of such a significant risk as asbestosis may trigger C's liability. Therefore, under paragraph (2), any losses that originated in B's ignorance are to be aggregated.

I3. Reinsured A takes out property reinsurance for banks against the peril of damage or theft. In the course of five months, multiple instances of robbery occur independently of one another. Sociological experts have opined that these instances of theft could be considered a sign of the increasing materialism in society.

The peril "theft" materialized in several instances. Each instance of materialization is to be considered a distinct event for the purpose of Article 5.2(1). From the perspective of reasonable parties to a contract reinsuring property risks, it does not appear reasonably foreseeable that – in the ordinary course of things – separate instances of theft would occur because of such a thing as increasing materialism in society. For lack of reasonable foreseeability, increasing materialism in society cannot be considered a unifying cause under paragraph (1).

C20. Like the concept of proximity (*cf* Article 5.1 Comments 21 et seqq), the concept of reasonable foreseeability is generally open to result-oriented judgments and can, hence, be considered unclear to some degree. In full awareness of this fact, the concept of reasonable foreseeability is used in Article 5.3, in which a standard is thereby adopted which may – under certain circumstances – not be clear-cut, but that is nevertheless able to reduce legal uncertainty to some degree.

c. Direct consequence

C21. It is not appropriate to aggregate every loss that arises from the same event which in turn originates in a cause within the meaning of Article 5.3. Rather, the only losses that are to be aggregated are those that are a direct consequence of the relevant event, ie an instance of materialized peril reinsured against or a liability triggering act, omission or fact.

C22. Therefore, the necessary test is whether an individual loss can be considered a direct consequence of the relevant event within the meaning of Article 5.2. In order to ensure this, just as under Article 5.2, only the strength of the causal links between the instances of materialized perils or liability triggering acts, omissions or facts on the one hand and the corresponding losses on the other hand are to be tested. For the test of whether a loss can be said to be a direct consequence of an instance of materialized peril, *see* Article 5.2 Comment 16 et seqq.

C23. By contrast, the "direct consequence" test does not involve determining the degree of causation between the aggregating cause within the meaning of Article 5.3 and the individual losses.

Illustrations

I4. Reinsured A takes out property reinsurance for a large number of buildings against the peril of tsunami with the peril of earthquake excluded. An earthquake occurs and leads to multiple separate tsunamis each of which damages some buildings.

The peril of tsunami materializes in several instances. Each instance of materialization is to be considered a distinct event for the purposes of Article 5.2(1). After having determined the plurality of tsunamis as multiple events, it is necessary to move further back on the chain of causation in the search for an aggregating cause that provoked each of the tsunamis. In the ordinary course of things, it appears reasonable that an earthquake may result in a tsunami. Under Article 5.3 paragraph (1), the earthquake is, therefore, to be considered the unifying cause. The fact that the peril of earthquake is excluded from the coverage under the contract does not bar the earthquake from figuring as the aggregating cause under Article 5.3 paragraph (1).

The final step is to determine whether each loss can be considered to be a direct consequence of the respective tsunami. Any losses that can be considered a direct consequence of any of the tsunamis are aggregated under Article 5.3 paragraph (1).

I5. Reinsured A takes out property reinsurance for a large number of supermarket stores against the peril of damage or destruction by vandalism. After the country's president resigns, 22 stores are damaged by rioters in a number of instances of vandalism over a period of some two days. The rioters are said to be centrally orchestrated by the government. Having determined that the plurality of acts of vandalism are multiple events, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of the acts. In

the ordinary course of things, it appears reasonable that a centralized orchestration by political rioters may lead to one or more instances of vandalism. Under paragraph (1), the rioters' centralized orchestration is, therefore, to be considered the aggregating cause.

The final step is to determine whether each loss can be considered to be a direct consequence of the respective act of vandalism. Any losses that can be considered a direct consequence of any of the acts of vandalism are aggregated under paragraph (1) (facts based on *Mann & Anor v Lexington Insurance Co* [2000] CLC 1409 which, by contrast, dealt with event-based aggregation).

I6. Reinsured A takes out property reinsurance for a large number of supermarket stores against the peril of damage or destruction by vandalism. After the market price of cigarettes increases substantially, 22 stores are damaged independently of one another by rioters in a number of instances of vandalism over a period of some two days. A majority of rioters declare to have vandalized due to a substantial increase in the market price of cigarettes. Having determined the plurality of acts of vandalism as multiple events, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of the acts.

In the ordinary course of things, it does not appear reasonably foreseeable that that a rise in the market price of cigarettes would lead to one or more instances of vandalism. For lack of reasonable foreseeability, the increase in the cigarettes' market price cannot be considered a unifying cause under paragraph (1).

I7. Reinsured A provides professional indemnity insurance to a managing agent of a syndicate at Lloyd's. Due to the latter's culpable misappreciation, he successively fails to pay sufficient regard to proper principles of underwriting. After having incurred gross losses, the members of the syndicate bring action in negligence against the managing agent.

With each act of underwriting in disregard of the "proper principles of underwriting", the managing agent triggered his liability. Hence, each act of underwriting constitutes a separate event for the purposes of Article 5.2(2). Having determined that each act of underwriting constitutes a separate event, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of these underwritings. It appears reasonable that an underwriter who is unaware of the proper underwriting principles may negligently underwrite contracts and thereby incur liability. Consequently, the agent's culpable misappreciation can be said to constitute the single originating cause responsible for all the negligent acts and can, hence, be considered a common cause for the purposes of Article 5.3 paragraph (2).

The final step is to determine whether each loss can be considered to be a direct consequence of the respective act of underwriting. Any losses that can be considered a direct consequence of any of the acts of underwriting are aggregated under Article 5.3 paragraph (2) (facts based on *Cox v Bankside Members Agency Ltd* [1995] CLC 180).

I8. Reinsured A issues a policy of insurance covering the liabilities of 14 directors, officers and employees of an American financial institution. The institution collapsed and a claim was made against all 14 of the directors and officers, each of whom was alleged to be personally liable for having been negligent or otherwise at fault in the handling of the institution's affairs. Any faults committed by the directors and officers can be said to be the consequence of a common culpable misunderstanding as the result of a discussion between them on which they all subsequently acted.

Each negligent act or fault triggers the respective directors' and officers' liability. Thus, each negligent act or fault can be considered a separate event for the purposes of Article 5.2(2). Having determined that each act constitutes a separate event, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of these acts. It appears reasonable that directors and officers may reach a common understanding that may translate into multiple wrongful acts and omissions. Hence, their discussion that resulted in the misunderstandings can be regarded as the common cause for the purposes of Article 5.3 paragraph (2).

The final step is to determine whether each loss can be considered to be a direct consequence of the respective act. Any losses that can be considered a direct consequence of any of the acts are aggregated under Article 5.3 paragraph (2) (facts based on *American Centennial Insurance Company v INSCO Limited* [1996] WL 1093224).

I9. Reinsured A provides liability insurance to a port. Equipment stored at the port is vandalized by a succession of individual acts of pilferage. The owner of the equipment brings action against the port for not putting in place an adequate system to protect the goods from pilferage and vandalism.

The port's liability is triggered by each act of vandalism it is unable to avert. Thus, each instance of vandalism the port was unable to avert can be considered a separate event for the purposes of Article 5.2(2). Having determined that each act constitutes a separate event, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of these omissions to avert acts of vandalism. The port's inability to avert these instances of vandalism originated in its failure to put in place an adequate system of protection from pilferage and vandalism. It appears reasonable that stored goods may be vandalized if no system of protection was put in place. Consequently, the port's failure can be regarded as a common cause for the purposes of Article 5.3 paragraph (2).

The final step is to determine whether each loss can be considered to be a direct consequence of the respective omission to avert acts of vandalism. Any losses that can be considered a direct consequence of any of these omissions are aggregated under Article 5.3 paragraph (2) (facts based on *Municipal Mutual Insurance Ltd v Sea Insurance Co Ltd* [1998] CLC 957, 966 et seqq).

I10. Reinsured A provides professional indemnity insurance to primary insured C – an insurance company. Several of C's underwriters mis-sell pensions for which they are held liable. They are found to have done so due to their lack of proper training.

C's liability is triggered by each instance of mis-selling a pension. Therefore, each instance of mis-selling can be considered a separate event for the purposes of Article 5.2(2). Having determined that each act of mis-selling constitutes a separate event, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of these instances of mis-selling. It appears reasonable that not providing the sales personnel with adequate training may lead to the mis-selling of pensions. Therefore, the lack of proper training can be considered a common cause for the purposes of Article 5.3 paragraph (2).

The final step is to determine whether each loss can be considered to be a direct consequence of the respective instance of mis-selling. Any losses that can be considered a direct consequence of any of these instances of mis-selling are to be aggregated under Article 5.3 paragraph (2) (facts based on *Countrywide Assured Group Plc v Marshall* [2002] WL 31173646, 6).

I11. Reinsured A provides professional indemnity insurance to C, a chemical manufacturer that has operated in locations throughout the US since the early 1900s. In the 1980s, federal, state and local governments as well as a number of private parties commenced environmental actions directed at more than 150 of the manufacturer's plant and disposal sites throughout the country. Experts have found that the pollution originated in the manufacturer's deficient corporate environmental policy.

Primary insured C's liability is triggered by each act of pollution. Therefore, each instance of pollution can be considered a separate event for the purposes of Article 5.2(2). Having determined that each instance of pollution constitutes a separate event, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of these instances of pollution. It appears reasonable that not having in place an adequate corporate environmental policy may lead to the pollution of environmental sites. Therefore, the lack of a proper environmental policy can be considered a common cause for the purposes of Article 5.3 paragraph (2).

The final step is to determine whether each loss can be considered to be a direct consequence of the respective instance of pollution. Any losses that can be considered a direct consequence of any of these instances of pollution are to be aggregated under Article 5.3 paragraph (2) (facts based on *Travelers Casualty and Surety v Certain Underwriters at Lloyd's of London*, 96 NY2d 583 (2001)).

4. Sublimits

C24. Reinsurance contracts regularly contain not only coverage limits but also sublimits. Sublimits define a limit of liability with respect to a particular peril when the contract provides for coverage against a multitude of perils or with respect to a specific reinsured asset when reinsurance is taken out for a multitude of different assets or with respect to a specific location when the reinsured assets are located at a multitude of places.

C25. Under the PRICL, aggregation is dealt with on each level of limits, ie total coverage limits and sublimits. The aggregation mechanism does not have to be identical on each level of limits.

Illustrations

I12. Reinsured A takes out property reinsurance for a large number of buildings on an island against the perils of fire and tsunami. The contract provides for a total liability limit of USD 30 million for any losses originating in one cause. It further provides for sublimits of USD 20 million for losses arising from the peril of tsunami and USD 20 million for losses resulting from the peril of fire. An earthquake provokes a tsunami which hits the island's coast and causes losses in the amount of USD 20 million. At the same time, it provokes a short-circuit resulting in a fire which causes a loss totaling USD 30 million.

Two separate perils (tsunami and fire) materialize. Each materialization is to be considered a distinct event within the meaning of Article 5.2(1). The sublimits clause refers to the materialization of a peril reinsured against. Thus, for the purpose of aggregation under the sublimits, an event-based aggregation according to Article 5.2(1) applies. The tsunami losses of USD 20 million remain within the sublimit for tsunami losses. The fire losses of USD 30 million, however, exceed the sublimit for fire losses by USD 10 million. Hence, USD 10 million of the fire losses are not covered under the contract.

All the losses covered under the sublimits may then be aggregated under the total liability clause providing for a cause-based aggregation. Both fire losses and tsunami losses are caused by the earthquake. Therefore, the earthquake can be considered the unifying cause under Article 5.3 paragraph (1). Consequently, USD 20 million of tsunami losses are aggregated with USD 20 million (not USD 30 million) of fire losses. The aggregate of these losses amounts to USD 40 million, which exceeds the total liability limit by USD 10 million. Under this contract, USD 30 million of losses resulting from the unifying cause of earthquake are covered.

I13. The contract provides that Reinsured A has taken out reinsurance for losses originating from one common cause in the amount of USD 11 million. It further provides for a sublimit of USD 10 million per occurrence for fire losses. For sexual assault losses, A is covered for up to USD 1 million per occurrence. At a Christmas party, director D sexually assaults an employee and thereby causes a loss in the amount of USD 5 million. Later in the evening, D negligently sets fire to his offices resulting in damage to the building worth USD 6 million. Hence,

the total loss amounts to USD 11 million. K was intoxicated during the entire evening.

D triggers his liability in two separate instances, ie upon negligently setting the fire and upon sexually assaulting an employee. Each liability triggering act is to be considered a distinct event within the meaning of Article 5.2(2). The sublimits clauses refer to the liability triggering acts of setting fire and committing sexual assault. Thus, for the purpose of aggregation under the sublimits, an event-based aggregation according to Article 5.2(2) applies. The fire losses of USD 6 million remain within the respective sublimit. The sexual assault losses of USD 5 million, however, exceed the respective sublimit by USD 4 million. Hence, USD 4 million of the sexual assault losses are not covered under the contract.

All the losses covered under the sublimits may then be aggregated under the total liability clause providing for a cause-based aggregation. Both fire losses and sexual assault losses are caused by D's inebriation. Therefore, D's inebriation can be considered the aggregating cause under Article 5.3 paragraph (2). Consequently, USD 6 million of fire losses are aggregated with USD 1 million (not USD 5 million) of sexual assault losses. The aggregate of these losses amounts to USD 7 million, which remains within the total limit liability of USD 11 million. Under this contract, USD 7 million of losses resulting from the unifying cause of inebriation are covered.

C26. If the sublimits clause provides for a sublimit with regard to the losses that occurred to a specified reinsured asset and originated from one cause, then the parties agreed on cause-based aggregation for losses occurring to this asset and paragraph (1) applies. Any losses covered with regard to this asset are then aggregated with other losses under the total limit of liability clause if they originated in the same cause.

Illustration

I14. Reinsured A takes out property reinsurance for a large number of buildings on an island against the perils of tsunami and fire. The contract provides for a total liability limit of USD 60 million for any losses originating in one cause. It further provides for a sublimit of USD 20 million for damage that occurs to building X at the sea bank. An earthquake provokes a tsunami which hits the island's coast and causes losses amounting to USD 30 million. Furthermore, it causes tsunami losses in the amount of USD 15 million as well as a fire loss of USD 10 million to building X.

Two separate perils (fire and tsunami) materialize independently of one another. Each instance of materialization is to be considered a distinct event within the meaning of Article 5.2(1). The sublimits clause refers to damage occurring to building X and originating in one cause. Thus, for the purpose of aggregation under the sublimits, a cause-based aggregation according to Article 5.3 paragraph (1) applies. Both the tsunami loss and the fire loss in building X originated in the earthquake and therefore aggregate. This aggregate amounts to USD 25 million and exceeds the sublimit with regard to building X by USD 5 million. Hence, USD 5 million of losses to building X are not covered under the contract.

All the losses covered under the sublimit may then be aggregated with other losses under the total liability clause providing for a cause-based aggregation. Both losses to building X and other losses are caused by the earthquake. Therefore, the earthquake can be considered the unifying cause under Article 5.3 paragraph (1) with regard to the total limit of liability. Consequently, USD 30 million for further losses are aggregated with USD 20 million (not USD 25 million) for losses occurring to building X. The aggregate of these losses amounts to USD 50 million and is within the total liability limit of USD 60 million. Under this contract, USD 50 million of losses resulting from the unifying cause of earthquake are covered.

5. Treaty reinsurance

C27. In the case of treaty reinsurance, a reinsured takes out reinsurance for a multitude of risks covered by multiple primary insurance policies (the portfolio) under a single contract.

C28. A common cause may lead to one or more instances of materialized peril (Article 5.2(1)) or multiple liability triggering acts, omissions or facts (Article 5.2(2)), which in turn trigger a multitude of primary insurance policies within the portfolio. Under Article 5.3, these losses are treated as one single loss with regard to reinsurance retention (deductible) and coverage limit.

Illustrations

I15. Reinsured A takes out reinsurance for a reinsurance portfolio of property insurance policies. The peril insured against is fire. An earthquake occurs and leads to 15 separate fires at different places. These different fires damage properties which were insured in a multitude of primary insurance policies, all figuring in the treaty reinsurance portfolio. The peril of fire materializes in 15 separate instances.

Each instance of materialization is to be considered a distinct event within the meaning of Article 5.2(1). In the ordinary course of things, it appears reasonable that an earthquake may result in a fire. Therefore, under Article 5.3 paragraph (1), the earthquake is to be considered the aggregating cause. Consequently, any losses occurring as a direct consequence of any fires that originated from the earthquake are to be aggregated. The fact that the separate fire losses occurred under separate primary insurance policies does not conflict with the aggregation of losses under Article 5.3 paragraph (1).

I16. Reinsured A takes out reinsurance for a portfolio of property car insurance policies. The peril insured against is damage or destruction. Due to an instance of heavy rainfalls in Germany, multiple accidents occur independently of one another.

The peril of damage or destruction materializes in multiple instances. Each instance of materialization is to be considered a distinct event for the purposes of Article 5.2(1). In the ordinary course of things, it appears reasonable that heavy

rainfalls lead to the occurrence of a car accident and result in damage to or destruction of a car. Therefore, under Article 5.3 paragraph (1), the rainfalls are to be considered the unifying cause. Consequently, any losses that occurred as a direct consequence of any accident originating in the heavy rainfalls are to be aggregated. The fact that the separate losses occurred under separate primary insurance policies does not conflict with the aggregation of losses under Article 5.3 paragraph (1).

I17. Reinsured A takes out reinsurance for a portfolio of property car insurance policies. The peril insured against is damage or destruction. Due to multiple instances of heavy rainfalls in Germany and Argentina, multiple accidents occur independently of one another.

The peril of damage or destruction materializes in multiple instances. Each instance of materialization is to be considered a distinct event for the purposes of Article 5.2(1). In the ordinary course of things, it appears likely that heavy rainfalls may lead to the occurrence of a car accident and result in damage to or destruction of a car.

Under Article 5.3 paragraph (1), the rainfalls in Germany and the rainfalls in Argentina are each to be considered a separate unifying cause. Consequently, any of the individual losses resulting from the rainfalls in Germany are aggregated and any losses arising from the rainfalls in Argentina are aggregated.

By contrast, as the rainfalls in Germany and those in Argentina are to be considered separate unifying causes under Article 5.3 paragraph (1), the losses arising from the rainfalls in Germany are not to be aggregated with the losses resulting from the rainfalls in Argentina

I18. Three primary insureds, D, E and F, all work for the same employer, C, who has taken out three separate professional indemnity insurance policies for his employees. Reinsured A takes out reinsurance for all three primary insurance policies under one contract. For lack of proper training, the D, E and F independently of one another, trigger their liability by mis-selling pensions.

Each instance of mis-selling is to be considered a distinct event within the meaning of Article 5.2(2). Having determined that each act of mis-selling constitutes a separate event, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of these underwritings. In the ordinary course of things, it appears reasonable that improper sales training may lead to the mis-selling of pensions. Therefore, under Article 5.3 paragraph (2), the employees' lack of training is to be considered the unifying common cause.

Any losses that occurred as a direct consequence of any of the acts of mis-selling are to be aggregated. The fact that the errors and omissions of each employee were insured under separate primary insurance policies does not conflict with the aggregation of all the losses under Article 5.3 paragraph (2) (facts based on *Countrywide Assured Group Plc v Marshall* [2002] WL 31173646, 6).

6. Life insurance policies

C29. For the relevance of aggregating losses in life insurance, *see* Article 5.2 Comments 30 et seqq.

7. Bundled insurance products

C30. If a primary insurance policy contains aspects of first- and third-party insurance, it may be that an instance of materialized peril (first-party) and a liability triggering act, omission or fact (third-party) originated in the same cause. In such cases, losses under the first-party insurance are to be aggregated with losses under the third-party insurance.

Illustration

I19. A sole household insurance policy protects primary insured C against first- and third-party losses. After a house party, C – in an intoxicated condition – damages an expensive work of art which belongs to an artist and was displayed at the party. By negligently damaging the painting, C triggers his liability under the third-party aspect of the household insurance. This accident can be considered the event for the purposes of Article 5.2(2). A few minutes later, C stumbles over his TV and damages it. Under the first-party aspect of the household insurance, the peril of damage by accident materialized when C stumbled over his TV. This accident can be said to be the event for the purposes of Article 5.2(1). Having determined that damaging the work of art and damaging the TV are to be considered two separate events, it is necessary to move further back on the chain of causation in search of an aggregating cause that provoked each of the events.

In the ordinary course of things, it appears reasonable that an inebriated person may damage goods belonging to himself or others. Therefore, under Article 5.3, C's condition of intoxication is to be regarded as the aggregating cause. Therefore, the loss associated with the art work and the loss associated with the TV are aggregated.