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# Terrorism Insurance Market After September 11: The Case for Limited Federal Intervention, The

Lucien J. Dhooge

*University of the Pacific; McGeorge School of Law*

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# The Terrorism Insurance Market After September 11: The Case for Limited Federal Intervention

Lucien J. Dhooge\*

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\* Associate Professor of Business Law, University of the Pacific; Member, Colorado and District of Columbia Bars; L.L.M., 1995, International and Comparative Law, Georgetown University Law Center; J.D., 1983, University of Denver College of Law; B.A., 1980, University of Colorado. The author thanks his family, friends, and colleagues for their constant encouragement and inspiration. This article is excerpted from the author's comprehensive work entitled "A Previously Unimaginable Risk Potential: September 11 and the Insurance Industry" to be published in a forthcoming edition of the *American Business Law Journal*.

*If the government doesn't do something here . . . major cities [will] not [be] covered, and if these cities don't have insurance, what happens to America as we know it?*<sup>1</sup>

*[Federal intervention must not] allow insurance companies to rake in the premiums from customers worried about terrorism while the federal government is left with the bulk of the tab when losses occur.*<sup>2</sup>

## I. INTRODUCTION

The events of September 11 were a shattering experience for Americans. Long shielded from violence on their own shores, many Americans undoubtedly viewed acts of international terrorism as something that occurred somewhere else to other people. Be it bombings in Belfast or Bogota, shootings in Karachi or Kashmir, or the endless stream of attack and retribution in Israel and the Occupied Territories, terrorism was not perceived to be a threat to the American homeland. Nevertheless, the calling cards of terrorists were unmistakably present. The attack on the World Trade Center in 1993 and the destruction of the Murrah Building in Oklahoma City in 1995 demonstrated the vulnerability of Americans and their edifices to the evil designs of determined groups of fanatics. The tide of anti-American violence in the name of Islamic extremism was also on the rise in the late 1990s. The five years immediately preceding the final catastrophes in New York, Washington, and Pennsylvania saw the bombing of the U.S. military housing complex in Dhahran, Saudi Arabia; the destruction of the U.S. embassies in Nairobi, Kenya and Dar es Salaam, Tanzania; and the attack upon the U.S.S. Cole in Aden, Yemen. On September 11, what could not happen in America did, and the country has changed in ways yet to be fully determined.

September 11 also constituted a watershed event for the insurance industry. Prior to September 11, the most costly insurance event in world and national history was Hurricane Andrew, which resulted in losses totaling \$20.1 billion in August 1992.<sup>3</sup> This loss stands to be dwarfed by the financial impact of the

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1. Jackie Spinner, *Insurers Seek Help with Terror Coverage*, WASH. POST, Oct. 11, 2001, at E1 [hereinafter *Insurers Seek Help with Terror Coverage*] (quoting Ramani Ayer, chairman and chief executive of the Hartford Financial Services Group).

2. Editorial, *Next Bailout: Insurers?*, S.F. CHRON., Oct. 28, 2001, at C6 [hereinafter *Next Bailout*].

3. See *Disaster Statistics*, DISASTER INS. INFO. (Disaster Ins. Info. Office, New York, N.Y.), 2001, at 4, at <http://www.disasterinformation.org/stats.htm> (last visited Jan. 18, 2003) [hereinafter *Disaster Statistics*]. Other noteworthy world insurance losses include the Northridge, California earthquake in January 1994 (\$16.7 billion); Typhoon Mireille, Japan in September 1991 (\$7.3 billion); Winter Storm Daria, Europe in January 1990 (\$6.2 billion); Winter Storm Lothar, Europe in December 1999 (\$6.1 billion); Hurricane Hugo, United States in September 1989 (\$5.9 billion); European flooding in October 1987 (\$4.6 billion); Winter Storm Vivian, Europe in February 1990 (\$4.3 billion); Typhoon Bart, Japan in September 1999 (\$4.2 billion); and Hurricane Georges, United States and the Caribbean in September 1998 (\$3.1 billion). *Id.* at 4-5. In addition to Hurricanes Andrew, Hugo, and Georges and the Northridge earthquake, the ten most costly insurance losses in U.S. history include Hurricane Opal in October 1995 (\$2.4 billion); Hurricane Floyd in September 1999 (\$2

events of September 11, estimates of which have varied from thirty billion dollars to ninety billion dollars.<sup>4</sup> Assuming the most recent estimate of ninety billion dollars to be accurate, such a loss would exceed all of the combined insurance losses in the United States for the period of 1993 through 2000.<sup>5</sup> Even assuming the accuracy of a more modest estimate of sixty billion dollars, such a loss would exceed the entire property and casualty industry's combined net income for 1999 through 2001.<sup>6</sup> These estimates include one billion dollars in costs associated with demolition and debris removal at the former site of the World Trade Center in New York<sup>7</sup> as well as an estimated cost of rebuilding in excess of eight billion dollars.<sup>8</sup> These estimates are 120 to 180 times the \$500 million cost of the previous bombing of the World Trade Center in 1993.<sup>9</sup>

These enormous, and widely varying, loss estimates reflect the unprecedented scale of destruction associated with the attacks. In New York, the attack on the World Trade Center destroyed six buildings containing 13.3 million square feet of commercial space and damaged eleven buildings containing another 16.5 million

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billion); Winter storms in March 1993 (\$2.1 billion); Oakland, California fire in October 1991 (\$2.2 billion); Hurricane Iniki in September 1992 (\$1.9 billion); and Hurricane Fran in September 1996 (\$1.7 billion). *Id.* at 5-6. By contrast, prior to September 11, the three most expensive man-made disasters in the United States were the Los Angeles riots of 1992 (\$775 million), the 1993 bombing of the World Trade Center (\$510 million), and the Oklahoma City bombing in 1995 (\$125 million). Press Release, National Association of Independent Insurers, Insured Losses from Terrorist Attack Likely to Rank as One of Largest in U.S. History (Sept. 12, 2001) [hereinafter NAII Press Release] (on file with author). All monetary denominations are in U.S. dollars unless otherwise noted.

4. Estimates of losses fluctuated wildly in the months following the attacks. In the week following the attacks, estimated losses totaled thirty billion dollars. See John Christoffersen, *Insurance Losses from Attacks Expected to Exceed \$30 Billion*, ASSOCIATED PRESS, Sept. 19, 2001 (quoting Keith Buckley, managing director of Fitch Inc.); see also Steven Pearlstein, *Collateral Damage*, WASH. POST, Sept. 16, 2001, at H1. By mid-October, loss estimates doubled to sixty billion dollars. See TILLINGHAST-TOWERS PERRIN, WHY DO WE NEED FEDERAL REINSURANCE FOR TERRORISM? 1 (Oct. 8, 2001), available at [http://www.tillinghast.com/tillinghast/publications/reports/federal\\_reinsurance\\_terrorism/2002051610.pdf](http://www.tillinghast.com/tillinghast/publications/reports/federal_reinsurance_terrorism/2002051610.pdf) (last visited Jan. 17, 2003) [hereinafter TILLINGHAST REPORT]. Estimates increased to seventy billion dollars by the end of November 2001 and to ninety billion dollars by the end of 2001. See Arthur M. Louis, *Insurers' Sept. 11 Bill May Double*, S.F. CHRON., Nov. 28, 2001, at B3 (quoting John Scheid, chairman of PricewaterhouseCoopers's Americas Insurance Group); see also *Report: Disasters Spark \$115 Billion Loss*, ASSOCIATED PRESS, Dec. 20, 2001 (quoting an unidentified spokesperson for Swiss Reinsurance Co.).

5. Combined insured losses for catastrophes occurring in the United States between 1993 and 2000 totaled \$70.4 billion. *Disaster Statistics*, *supra* note 3, at 6.

6. *Terrorism Risk: Testimony Before the Senate Comm. on Commerce, Science, and Transp.*, 107th Cong. 1 (2001) (statement of Robert E. Vagley, President, Am. Ins. Ass'n) [hereinafter Vagley Senate Statement].

7. David R. Baker, *Bechtel in Talks to Help N.Y. Efforts*, S.F. CHRON., Nov. 9, 2001, at B1. There were four companies involved in demolition and debris removal at the World Trade Center site. Each company received up to \$250 million for its services. *Id.*

8. *WTC Attacks Will Cost Nearly \$40 Billion*, FOXNEWS.COM, Sept. 29, 2001, available at [http://www.foxnews.com/printer\\_friendly\\_story/0,3566,35388,00.html](http://www.foxnews.com/printer_friendly_story/0,3566,35388,00.html) (last visited Dec. 30, 2002) (copy on file with the McGeorge Law Review).

9. Gene Rappé, *The Role of Insurance in the Battle Against Terrorism*, 12 DEPAUL BUS. L.J. 351, 368 (2000). The World Trade Center bombing in February 1993 killed six people, injured one thousand others, created a crater approximately two hundred feet deep, and damaged the complex "five levels down and two levels up" from the location of the blast. Jeffrey S. Green & Ira Tripathi, *Coping with Chaos: The World Trade Center Bombing and Recovery Effort*, 27 URB. LAW. 41, 41 (1995).

square feet of commercial space.<sup>10</sup> In addition, hundreds of businesses were displaced, including 430 businesses that leased space in One and Two World Trade Center.<sup>11</sup> By comparison, the commercial office space destroyed in the attack on New York exceeded all such space available in Atlanta or Miami, and the combined amount of damaged and destroyed space exceeded the entire amount of such space available in San Francisco.<sup>12</sup> In Washington, the attack on the Pentagon damaged or destroyed two million square feet of office space.<sup>13</sup> The attack on the Pentagon also generated 57,000 tons of debris and removal and rebuilding estimates in excess of \$700 million.<sup>14</sup>

The September 11 attacks impacted numerous types of insurance. For example, commercial property insurance policies that cover direct losses to insured property, such as damage to buildings and their contents.<sup>15</sup> Such “policies may [contain an endorsement insuring] ‘indirect losses,’ such as the interruption of a business’s income stream following the loss of its premises.”<sup>16</sup> Equally impacted may be inland marine insurance policies that provide coverage for special types of personal property, such as computers and construction equipment.<sup>17</sup> Commercial property and inland marine “policies may apply on an ‘all-risk’ basis, [providing coverage for] any cause of loss not specifically excluded, or on a ‘named-peril’ basis, [only providing coverage for] causes of loss listed in the policy.”<sup>18</sup> Business income insurance provides coverage for income losses suffered as a result of destruction or damage to the insured’s place of business.<sup>19</sup> In a similar vein, business income civil authority coverage protects businesses that suffer

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10. Robert Burgess, *Insurers Dispute Trade Center Claim*, WASH. POST, Oct. 9, 2001, at E4; Dan Levy, *Scale of Destruction*, S.F. CHRON., Sept. 19, 2001, at D1. In addition to the combined 9.4 million square feet of commercial space located in One and Two World Trade Center, approximately four million additional square feet were lost in the destruction of World Trade Centers Four, Five, Six, and Seven. Burgess, *supra* note 10.

11. Michael S. Hiller, *Acts of War Exclusions Do Not Apply in Tragedy*, N.Y. L.J., Sept. 19, 2001, at 1; *Inside the Towers*, S.F. CHRON., Sept. 13, 2001, at D8; Peter Sinton & Victoria Colliver, *Bay Area Firms Join List of Those Taking Big Hit from New York Attack*, S.F. CHRON., Sept. 12, 2001, at B1. Margaret A. Woodbury, *Skyscraper Reopens at Ground Zero*, S.F. CHRON., Oct. 26, 2001, at A7. Several companies suffered significant losses with respect to their leased commercial space in the World Trade Center complex. For example, the ten largest tenants occupied 4.7 million square feet, which was more than half of the available space in One and Two World Trade Centers combined. See Sinton & Colliver, *supra* note 11.

12. Michael Grunwald, *Terror’s Damage: Calculating the Devastation*, WASH. POST, Oct. 28, 2001, at A12; Levy, *supra* note 10. For purposes of comparison, San Francisco’s northern Financial District has 25 million square feet of commercial office space presently available, which amount is 4.9 million square feet less than that which was destroyed or damaged in the attack upon the World Trade Center. Levy, *supra* note 10.

13. *Pentagon Picks Up Pieces of Lives, Limestone*, S.F. CHRON., Jan. 2, 2002, at A7.

14. *Id.*

15. See Jack P. Gibson, et al., *Attack on America: The Insurance Coverage Issues Part 2: General Coverage Provisions*, IRMI INSIGHTS, (Int’l Risk Mgmt. Inst., Inc., Wash., D.C.), at 1 (Sept. 2001), available at <http://www.irmi.com/insights/articles/gibson009.asp> (copy on file with the *McGeorge Law Review*).

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 1-2.

income losses as a result of the denial of access to their premises by civil authorities.<sup>20</sup> Income losses suffered by businesses as a result of their dependence on a business whose premises have been destroyed or damaged may be covered by contingent business income coverage.<sup>21</sup> Other impacted policies include those relating to general liability insurance, life insurance, workers' compensation, health and disability insurance, homeowners' and renters' insurance, and automobile insurance.<sup>22</sup> According to Insurance Services Office, Inc., the September 11 attacks have resulted in the filing of forty-nine thousand insurance claims in New York and two thousand claims in Virginia.<sup>23</sup>

This article examines federal intervention in the private terrorism insurance market. Part II of the article provides a general overview of the financial impact of the attacks upon the insurance industry. In Part III, the article focuses on recent federal initiatives to ensure the financial viability of the insurance industry in the event of future terrorist attacks, including the recently adopted Terrorism Risk Insurance Act. Part IV of the article provides a critique of the merits of the Terrorism Risk Insurance Act. The article concludes by advocating a limited role for the federal government in light of the continuing threat that terrorist attacks pose to the insurance industry's financial health.

## II. SEPTEMBER 11 AND THE INSURANCE INDUSTRY: THE FACTUAL BACKGROUND

### A. *The Financial Impact of September 11 on the Insurance Industry*

The September 11 attacks had a widely varying financial impact on insurance companies depending upon the type of coverage at issue. For example, commercial property losses as a result of the World Trade Center attack varied from a low of \$8.5 billion to a high of \$25 billion.<sup>24</sup> Business interruption claims have been valued as low as five billion dollars to as high as twenty-one billion dollars.<sup>25</sup> Aviation insurance policies were also impacted with anticipated losses of \$6

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20. *Id.* at 2.

21. *Id.* at 2-3.

22. *Id.* at 3-7; Norman B. Arnoff & Sue C. Jacobs, *Terrorism's Effects and Insurance Coverage*, N.Y. L.J., Oct. 9, 2001, at 3.

23. *Property Losses to Top \$20 Billion*, ASSOCIATED PRESS, June 18, 2002. Insurance claims in New York consist of thirty thousand personal, fifteen thousand commercial, and four thousand automobile claims. *Id.* Insurance claims in Virginia consist of fifteen hundred personal, two hundred commercial, and three hundred automobile claims. *Id.*

24. See *The Impact of the September 11, 2001 Terrorist Attacks on America's Insurance System: Testimony Before the House Comm. on Fin. Servs.*, 107th Cong. 6-7 (2001) (statement of Kathleen Sebelius, Comm. of Ins., Kan.) (\$8.5 billion) [hereinafter Sebelius House Statement]; see also TILLINGHAST REPORT, *supra* note 4, at 1 (\$12 billion); Louis, *supra* note 4 (\$25 billion) (citing John Scheid, chairman of PricewaterhouseCoopers' Americas Insurance Group).

25. See Sebelius House Statement, *supra* note 24, at 7-8 (\$8.8 billion); see also TILLINGHAST REPORT, *supra* note 4, at 1 (\$7 billion); Grunwald, *supra* note 12 (\$21 billion).

billion for loss of life and \$434 million in hull coverage resulting from the destruction of the four hijacked aircraft.<sup>26</sup> In addition, it has been forecast that automobile insurance policies for vehicles damaged or destroyed in the attacks would be impacted by an anticipated ninety million dollars in claims.<sup>27</sup> Life insurance losses as a result of the attacks were estimated at between \$900 million and \$6 billion.<sup>28</sup> Finally, workers' compensation losses were estimated between \$2.4 billion and \$5 billion.<sup>29</sup>

The enormity of these losses becomes more apparent when particularized by an individual company. Among U.S. insurance companies, the greatest losses occurred in the reinsurance industry. Berkshire Hathaway suffered \$2.2 billion in losses, St. Paul lost \$659 million, while CNA Financial Corporation suffered losses totaling \$304 million.<sup>30</sup> Commercial property, casualty, and liability companies also posted large losses. For example, American International Group of New York suffered a pretax loss of \$820 million as a result of the attacks while Citigroup, Inc. incurred a \$502 million loss.<sup>31</sup> Other commercial property, casualty and liability companies incurring significant losses included Hartford Financial Services Group, Inc. (\$440 million), Chubb Corporation (\$240 million), and Allstate Corporation (\$32 million).<sup>32</sup> As an industry, U.S. property and casualty insurers paid \$24 billion in claims in 2001, the largest amount in history, primarily as a

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26. See Sebelius House Statement, *supra* note 24, at 10-11. Commissioner Sebelius's estimate of the financial impact of the loss of life as a result of the destruction of the four hijacked aircrafts was based upon insurance policies that American and United Airlines had in place at the time of the attacks containing limits of \$1.5 billion per occurrence. *Id.* at 10. However, other estimates of the financial impact of such losses reach as high as twenty billion dollars. TILLINGHAST REPORT, *supra* note 4, at 1. Commissioner Sebelius's estimate of the financial impact upon American and United Airlines' hull coverage for the destruction of the aircraft involved in the hijackings was based upon the replacement costs of Boeing 757-300 and 767-300ER aircraft at \$89.5 million and \$127.5 million, respectively. Sebelius House Statement, *supra* note 24, at 11.

27. Sebelius House Statement, *supra* note 24, at 9.

28. *Id.* (\$900 million); see also TILLINGHAST REPORT, *supra* note 4, at 1 (\$6 billion); Christoffersen, *supra* note 4 (\$3-5 billion); Kathleen Pender, *Good Time to Update Insurance*, S.F. CHRON., Oct. 21, 2001, at E1 (\$6 billion).

29. Sebelius House Statement, *supra* note 24, at 8 (\$2.4 billion); TILLINGHAST REPORT, *supra* note 4, at 1 (\$5 billion). However, it is important to note that Commissioner Sebelius's estimate did not include claims involving inhalation of airborne contaminants. See Sebelius House Statement, *supra* note 24, at 8.

30. See *Berkshire Estimates \$2.2B Loss*, ASSOCIATED PRESS, Sept. 20, 2001; see also *Insurer CNA Cuts 1,850 Jobs*, ASSOCIATED PRESS, Dec. 5, 2001 [hereinafter *Insurer CNA Cuts 1,850 Jobs*]; Phil Rooney, *Berkshire Posts Third-Quarter Loss*, ASSOCIATED PRESS, Nov. 9, 2001; Joe Ruff, *Businesses Hit by New Insurance Rates*, ASSOCIATED PRESS, Nov. 12, 2001; *St. Paul Cos. Reports \$659M Loss*, ASSOCIATED PRESS, Oct. 23, 2001. Berkshire Hathaway's losses resulted from its operation of General Re (\$1.7 billion) and Reinsurance Group (\$575 million). See Rooney, *supra* note 30.

31. See *Attacks Costly to Citigroup*, WASH. POST, Sept. 18, 2001, at E2; see also *Citigroup Profits Down 9 Percent After Attacks*, REUTERS, Oct. 17, 2001 [hereinafter *Citigroup Profits*]. The losses suffered by Citigroup, Inc., the leading financial services company in the United States, were a result of policies written by its Travelers Life & Annuity and Travelers Property Casualty Corporation units. See *Citigroup Profits*, *supra* note 31.

32. See Dave Carpenter, *Allstate Earnings Tumble 65 Percent*, ASSOCIATED PRESS, Oct. 18, 2001; see also *Insurer Says Loss Due to Terrorism*, ASSOCIATED PRESS, Oct. 29, 2001; Linda A. Johnson, *Insurer Chubb Posts \$240M Loss*, ASSOCIATED PRESS, Oct. 30, 2001.

result of the September 11 attacks.<sup>33</sup> U.S. life insurance companies were impacted by the September 11 attacks to a lesser degree. Nevertheless, major life insurance companies incurred significant losses, as exemplified by the \$210 million, \$100 million, and \$25 million losses suffered by MetLife, Inc., New York Life Insurance Company, and Cigna Corporation, respectively.<sup>34</sup>

Internationally-based insurance companies also suffered large individual losses. As in the United States, reinsurance companies suffered the largest losses. For example, Lloyd's of London incurred gross claims totaling \$5.36 billion and suffered a net loss of \$2.8 billion as a result of the attacks on the World Trade Center—the largest loss that the 314-year-old institution has ever suffered from a single occurrence.<sup>35</sup> Munich Re and Swiss Re, the world's two largest reinsurance companies, suffered net losses of \$1.95 billion and \$1.25 billion, respectively.<sup>36</sup> These estimates increased to \$2.6 billion and \$2 billion, respectively, by July 2002.<sup>37</sup> Other major insurers suffering large losses included German-based Allianz AG (\$1.3 billion) and Swiss-based Zurich Financial Services (\$900 million).<sup>38</sup> From a global standpoint, fifty-five insurance and reinsurance organizations had reported losses as a result of the attacks by the first week of October 2001.<sup>39</sup> Seventeen of these companies reported losses exceeding five percent of their consolidated capital for 2000, and six of these companies reported a financial impact exceeding ten percent of such capital.<sup>40</sup> Furthermore, in a decision announced in October 2001, the U.S. Financial Accounting Standards Board ruled that the attacks were not extraordinary from an accounting standpoint.<sup>41</sup> As a result, companies, including insurers, which suffered losses because of the attacks, could not list such losses separately on their financial statements.<sup>42</sup>

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33. *Insurers Faced Record Claims in 2001*, ASSOCIATED PRESS, Mar. 11, 2002.

34. *Cigna Sees Losses from Attack at \$25M*, ASSOCIATED PRESS, Oct. 1, 2001; *see also MetLife Cutting 1,900 Jobs*, ASSOCIATED PRESS, Oct. 22, 2001; *MetLife Earnings Fall 33 Percent*, ASSOCIATED PRESS, Nov. 6, 2001; Jackie Spinner, *Insurers May Drop Coverage of Terrorism*, WASH. POST, Sept. 27, 2001, at E1 [hereinafter *Insurers May Drop Coverage of Terrorism*].

35. *See Lloyd's Raises WTC Loss Estimates*, ASSOCIATED PRESS, Nov. 27, 2001; *see also Bruce Stanley, Lloyd's Wins Reprieve on WTC Funding*, ASSOCIATED PRESS, Oct. 26, 2001; *Lloyd's: WTC Attacks Cost \$2.87B*, ASSOCIATED PRESS, Apr. 10, 2002; *U.S. Gives Lloyd's Months to Pay Trade Center Insurance Claims*, S.F. CHRON., Oct. 27, 2001, at A7.

36. *See Attack Claims Put at \$3.2 Billion*, WASH. POST, Sept. 21, 2001, at E2; *see also Alexander G. Higgins, Reinsurers Double Loss Estimates*, ASSOCIATED PRESS, Sept. 20, 2001.

37. *See David McHugh, Munich Re Plans for Sept. 11 Claims*, ASSOCIATED PRESS, July 10, 2002.

38. *See Allianz Sees \$928M in Attacks Claims*, ASSOCIATED PRESS, Sept. 21, 2001; *see also Insurer Allianz Posts Q3 Loss*, ASSOCIATED PRESS, Nov. 14, 2001; *Terrorism Strains Swiss Insurer*, ASSOCIATED PRESS, Oct. 8, 2001.

39. TILLINGHAST REPORT, *supra* note 4, at 4.

40. *Id.*

41. Adam Geller, *In Accounting, Attacks Aren't "Extraordinary,"* S.F. CHRON., Oct. 6, 2001, at B2.

42. *Id.* This ruling has resulted in considerable controversy in the accounting and insurance industries. Dan Noll, director of accounting standards for the American Institute of Certified Public Accountants, noted that "[t]hese events certainly were extraordinary . . . [i]t's one of these things where . . . the devil is in the details." *Id.* Todd Thomson, chief financial officer for Citigroup, Inc., responded by stating that "[i]f claims payments caused by these events do not qualify as extraordinary, we fail to understand what other events possibly would." *Id.*



The losses associated with the events of September 11 struck the insurance industry just as it was beginning to show improvement in its financial performance. After a lackluster 1999 characterized by sharply higher underwriting losses, the industry began to show improvement in 2000 primarily as a result of growth in premiums and investment income.<sup>43</sup> The year 2001 was deemed “pivotal for property/casualty insurers . . . with significantly improved growth prospects and a slight improvement in underwriting performance.”<sup>44</sup> Unfortunately, this prediction proved inaccurate as the September 11 attacks and other man-made and natural disasters cost the world’s insurance industry \$34.4 billion for covered property and business losses in 2001.<sup>45</sup> Losses resulting from the attacks, when combined with a nineteen billion dollar decrease in industry surplus through the first six months of the year, led analysts to conclude that the industry was “extremely vulnerable to the impacts of catastrophe losses and the weak investment climate.”<sup>46</sup> Despite expressions of confidence by financial analysts, trade associations, and consumer groups<sup>47</sup> that the industry could cover all losses associated with the September 11 attacks, as many as seventeen insurance and reinsurance companies could ultimately be placed on watch lists by rating agencies as a result of their individual losses stemming from the attacks.<sup>48</sup>

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43. ROBERT P. HARTWIG, INS. INFO. INST., 2000—YEAR END RESULTS 1 (2000) [hereinafter YEAR END RESULTS 2000], available at <http://www.iii.org/media/industry/financials/2000yearend/content.print> (last visited Nov. 13, 2002) (copy on file with the *McGeorge Law Review*). The insurance industry suffered a \$32.6 billion losses in 2000 after subtracting \$329.4 billion in incurred losses and expenses and paid dividends from earned premiums totaling \$296.8 billion. *Id.* at 4. This loss was offset by \$58.3 billion in investment income and realized capital gains, resulting in pre-tax income of \$25.7 billion and net after-tax income of \$20.2 billion. *Id.* The industry surplus totaled \$319.4 billion at the end of 2000. *Id.* In 1999, the industry incurred an underwriting loss of \$23.4 billion after deducting incurred losses, expenses, and paid dividends of \$306.3 billion from earned premiums of \$282.9 billion. ROBERT P. HARTWIG, INS. INFO. INST., 1999—YEAR END RESULTS 3 (1999) [hereinafter YEAR END RESULTS 1999], available at <http://www.iii.org/media/industry/financials/1999endofyear/content.print> (last visited Nov. 13, 2002) (copy on file with the *McGeorge Law Review*). This loss was offset by investment income and realized capital gains of \$52.3 billion, which resulted in pre-tax income of \$27.6 billion and net after-tax income of \$22.2 billion. *Id.* The industry surplus was \$336.3 billion at the end of 1999. *Id.*

44. YEAR END RESULTS 2000, *supra* note 43, at 2.

45. *Swiss Company Reports on Disaster Costs*, ASSOCIATED PRESS, Mar. 13, 2002.

46. ROBERT P. HARTWIG, INS. INFO. INST., 2001—FIRST HALF RESULTS 1 (Sept. 18, 2001), available at <http://www.iii.org/media/industry/financials/2001firsthalf/content.print> (last visited Nov. 13, 2002) (copy on file with the *McGeorge Law Review*).

47. See Theresa Agovino, *Insurance Stocks Drop*, ASSOCIATED PRESS, Sept. 17, 2001 (citing the opinions of industry analysts); see also NAII Press Release, *supra* note 3, at 1; Press Release, National Association of Insurance Commissioners, NAIC Assesses Industry Impact of Terrorist Attacks (Sept. 14, 2001) (on file with the *McGeorge Law Review*); Jackie Spinner, *Aid Critics Cite Insurers' Wealth*, WASH. POST, Nov. 29, 2001, at A10 [hereinafter *Aid Critics Cite Insurers' Wealth*] (citing the opinions of consumer groups).

48. Christoffersen, *supra* note 4; *Aid Critics Cite Insurers' Wealth*, *supra* note 47; Jackie Spinner, *Insurers See Terror Coverage Delays Unless U.S. Helps*, WASH. POST, Jan. 18, 2002, at E3 [hereinafter *Insurers See Terror Coverage Delays*].

## B. Industry Reaction to September 11

Insurance companies reacted to the losses associated with the September 11 attacks and potential losses associated with future attacks in a number of different ways. Some companies, such as CNA Financial Corporation and Dutch financial services group ING, acted to stem losses through large layoffs.<sup>49</sup> Other insurers immediately moved to raise premiums. Initial estimates of premium increases for commercial property insurance policies of ten to thirty-five percent were quickly dwarfed by what one member of the U.S. Congress characterized as exponential increases rendering insurance coverage unaffordable for many U.S. businesses.<sup>50</sup> In what has been described as “a feeding frenzy,” premiums on commercial property insurance and reinsurance policies increased by one hundred to four hundred percent.<sup>51</sup> Particularly hard hit by premium increases were the airline, shipping, and energy industries as well as commercial real estate owners, especially those who own or manage “iconic structures” perceived to be potential future terrorist targets.<sup>52</sup> In the months following the attacks, shippers and owners of large commercial properties saw premium increases ranging from fifty to one hundred percent.<sup>53</sup> As a result, some property owners elected not to insure their

49. See *ING to Cut 1,600 U.S. Jobs*, ASSOCIATED PRESS, Dec. 6, 2001; see also *Insurer CNA Cuts 1,850 Jobs*, *supra* note 30.

50. See Marcy Gordon, *House Nears Vote on Insurance Bill*, ASSOCIATED PRESS, Nov. 29, 2001 [hereinafter *House Nears Vote*] (citing the statement of U.S. Representative John LaFalce (N.Y.), the senior Democrat on the House Financial Services Committee); see also Marcy Gordon, *Insurers Accused of Rate Inflation*, ASSOCIATED PRESS, Dec. 5, 2001 [hereinafter *Insurers Accused of Rate Inflation*] (citing the opinion of J. Robert Hunter, the director of insurance for the Consumer Federation of America, stating that an appropriate increase in premiums for commercial property insurance would be between ten and fifteen percent); Jackie Spinner, *Builders Face Rising Insurance Rates*, WASH. POST, Oct. 22, 2001, at E4 [hereinafter *Builders Face Rising Insurance Rates*] (citing the opinion of unidentified insurance industry analysts asserting that an appropriate increase in commercial property insurance premiums would be between twenty-five and thirty-five percent).

51. *Insurers Accused of Rate Inflation*, *supra* note 50 (quoting J. Robert Hunter); see also Juliet Eilperin & Jackie Spinner, *House Votes to Assist Insurers*, WASH. POST, Nov. 30, 2001, at A1 (noting that premiums for commercial property insurance increased by as much as one hundred percent); Ruff, *supra* note 30 (citing the prediction of Mark Lane, an insurance research analyst at William Blair & Company, that commercial property owners should be prepared for a doubling of insurance premiums); *Insurers May Drop Coverage of Terrorism*, *supra* note 34 (citing predictions of unidentified insurance industry analysts that reinsurance premiums may increase by as much as four hundred percent as a result of the September 11 attacks).

52. Ruff, *supra* note 30; *Builders Face Rising Insurance Rates*, *supra* note 50.

53. Gerald D. Adams, *Sky-High Premiums*, S.F. CHRON., Feb. 27, 2002, at B1; Albert B. Crenshaw, *Businesses Face an Insurance Crunch*, WASH. POST, Oct. 11, 2001, at E16. For example, the annual cost of insuring Giants Stadium located in the Meadowlands Sports Complex in New Jersey increased from \$700,000 to \$3.5 million due, in part, to its proximity to Manhattan. *Insurers Accused of Rate Inflation*, *supra* note 50. Another example is Marriott International, Inc., which announced in April 2002 that it expected a three hundred percent increase in premiums when its insurance policies for its hotels renewed later in the year. Jackie Spinner, *Bush Urges Action on Insurance*, WASH. POST, Apr. 9, 2002, at E4. A third example is the Mall of America, located in Minneapolis, Minnesota and the largest shopping mall in the United States. Simon Property Group, the owner of the mall, initiated litigation against GMAC Commercial Mortgage Corporation, one of its lenders, on the basis that insurance coverage for terrorism requested by the lender cost three times that of all other insurance maintained on the property. Jackie Spinner, *Insuring Against Terror Costly*, WASH. POST, Feb. 26,

holdings against future terrorist attacks.<sup>54</sup> With respect to aviation, Goshawk Insurance Holdings, which insures aircraft throughout the world, reported that the rates in its particular field had increased ten-fold since the attacks.<sup>55</sup> Regardless of their size, premium increases were an unwelcome shock to U.S. businesses that had enjoyed drops in premiums in the 1990s as a result of aggressive price competition and were presently mired in economic doldrums, if not outright recession.<sup>56</sup>

In addition to premium increases, several insurers, especially those in the property and casualty industries, began to reevaluate the basis upon which they extended coverage. One month after the attacks, Munich Re stated that the attacks demonstrated the need for a “‘fundamental reassessment’ of the financial risks from terrorism faced by the insurance business.”<sup>57</sup> Executives at U.S.-based Kemper Insurance Companies and Germany’s General Cologne Re were even blunter in their conclusion that terrorism is an uninsurable risk that should be excluded from future policies upon initial underwriting or renewal.<sup>58</sup> According to insurers, the primary problem is their inability to predict and, thus, quantify the risks associated with terrorism, including the likelihood and location of future attacks and financial losses accruing as a result thereof.<sup>59</sup> As a result, insurance and reinsurance companies claimed they were unable to price appropriate coverage with any degree of certainty.<sup>60</sup>

As reinsurance companies began to eliminate coverage for terrorism in new and renewable commercial insurance policies, primary insurers undertook efforts

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2002, at E1. A final example is the insurance policy for the Golden Gate Bridge in San Francisco, California. The Golden Gate Bridge District, the operator of the Bridge, paid an annual insurance premium prior to September 11 of \$500,000 for coverage of \$125 million, which included coverage for terrorist attacks. David Lazarus, *Golden Gate’s Terrorist Toll*, S.F. CHRON., Apr. 3, 2002, at B1. The new insurance policy issued in April 2002 has an annual premium totaling \$1.1 million covering \$25 million in structural damage and \$25 million in lost revenue, but it is without additional coverage for terrorist attacks. *Id.*

54. See Jackie Spinner, *Lack of Terrorism Insurance Puts Utilities at Risk*, WASH. POST, Aug. 1, 2002, at E1 [hereinafter *Lack of Terrorism Insurance Puts Utilities at Risk*] (noting that some utility providers have elected not to insure their holdings against future terrorist attacks due to the cost of premiums, the minimal scope of coverage, and the existence of industry wide caps on insurer liability).

55. See *Cost of Plane Insurance Jumps*, ASSOCIATED PRESS, Sept. 28, 2001 (quoting Chris Fagan, the director of finance for Goshawk Insurance Holdings).

56. Crenshaw, *supra* note 53.

57. David McHugh, *Reinsurer: Attacks Will Mean New Coverage Ceiling*, ASSOCIATED PRESS, Oct. 18, 2001 (quoting an unnamed official at Munich Re).

58. See David McHugh, *Insurers: Government Must Help on Attacks*, ASSOCIATED PRESS, Oct. 22, 2001 (quoting Arno Junke of GeneralCologne Re that it had reached “the conclusion that terrorism, in itself, cannot be underwritten.”); see also Jackie Spinner, *Putting a Price on ‘What Ifs,’* WASH. POST, Oct. 24, 2001, at E1 (quoting David B. Mathis, chairman and chief executive officer of Kemper Insurance Companies as stating that “[t]he industry as a whole has come to the conclusion that the risk of terrorism is uninsurable”).

59. Jackie Spinner, *Insurance Industry Can Pay Claims*, WASH. POST, Sept. 26, 2001, at E1.

60. *Insurers May Drop Coverage of Terrorism*, *supra* note 34. Matthew C. Mosher, group vice president of A.M. Best Co., an insurance ratings firm, aptly noted that “[t]he terrorism issue isn’t an issue of capital. . . . It’s an issue of not being able to price it.” *Id.*

to exclude terrorism from the scope of their coverage.<sup>61</sup> Consequently, commencing in November 2001, insurance companies began filing petitions with state insurance commissions seeking to exclude terrorism from commercial, home, automobile, and life insurance policies effective January 1, 2002.<sup>62</sup> Many of these requests were based upon the National Association of Insurance Commissioners' proposal to exclude coverage in commercial insurance policies for losses incurred as a result of terrorist activities in excess of twenty-five million dollars.<sup>63</sup> Thirty-six states and territories had accepted this proposal at the time of the preparation of this article.<sup>64</sup> However, insurers were unable to obtain consent from commissioners in two of the largest insurance markets in the U.S., namely New York and California.<sup>65</sup> In any event, the market for terrorism insurance, especially for large and high profile buildings, has markedly shrunk.<sup>66</sup> As noted by one insurance executive, "[t]here is a clear and growing gap in commercial insurance coverage that the private marketplace cannot cover."<sup>67</sup>

Insurance companies also petitioned the judicial system for guidance in determining the existence and extent of their liability with respect to the September 11 attacks. For example, Lloyd's of London and Aon Corporation, an insurance broker that lost 176 employees in the collapse of the World Trade Center towers, are parties to litigation in the United Kingdom and the U.S. District Court for the Southern District of New York.<sup>68</sup> This litigation concerns Lloyd's denial of a one-hundred-million dollar claim on a reinsurance policy issued to Combined Insurance Company of America covering amounts payable by it to the families of Aon employees killed in the attacks pursuant to a primary accident insurance policy.<sup>69</sup> SR International Business Insurance Company, one

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61. Jackie Spinner, *Small Insurers Feel Sept. 11 Fallout*, WASH. POST, Jan. 17, 2002, at E8. David B. Mathis defended these efforts by stating that "[i]f the cumulative impact of a loss exposes your entire capital or surplus of your company and you have no reinsurance for it, you have no choice." *Id.* Maurice R. Greenberg, chief executive of American International Group, echoed these concerns, noting that "[y]ou have finite capital in the insurance industry, and you can't cover infinite risk with finite assets." Jackie Spinner, *Insurance Executive Warns of Upheaval Without U.S. Help*, WASH. POST, Jan. 9, 2002, at E3.

62. Jackie Spinner, *Insurers Ask to End Terrorism Coverage*, WASH. POST, Nov. 16, 2001, at E1; Jackie Spinner, *Terror-Insurance Market in Limbo*, WASH. POST, Nov. 21, 2001, at E1 [hereinafter *Terror-Insurance Market*].

63. Jackie Spinner, *States Move to Exclude Terrorism Coverage*, WASH. POST, Dec. 22, 2001, at E1. The recommendation of the National Association of Insurance Commissioners was only with respect to commercial insurance policies. The Association flatly rejected terrorism exclusions in homeowners and automobile policies and recommended that state insurance regulators deny requests for such exclusions. Jackie Spinner, *An Appeal on Terror Insurance*, WASH. POST, Jan. 30, 2002, at E3.

64. Michael Gormley, *New York Nixes Insurance Plan*, ASSOCIATED PRESS, Jan. 8, 2002.

65. *Id.*; *California Law to Cover Terrorism Insurance*, S.F. CHRON., Jan. 8, 2002, at A11.

66. Jackie Spinner, *In Search of Insurance*, WASH. POST, Jan. 16, 2002, at E1.

67. *Insurers See Terror Coverage Delays*, *supra* note 48.

68. Press Release, Aon Corporation, Aon Provides Update on Dispute with Reinsurers Regarding World Trade Center; Updates First Quarter Earnings Per Share Outlook (Apr. 29, 2002) (on file with the *McGeorge Law Review*); *Insurer May Take \$90M WTC Charge*, ASSOCIATED PRESS, Apr. 30, 2002 [hereinafter *Insurer May Take \$90M WTC Charge*].

69. *Insurer May Take \$90M WTC Charge*, *supra* note 68. Aon set aside ninety million dollars to cover

of the participating insurers in the World Trade Center, also initiated litigation in the U.S. District Court for the Southern District of New York seeking a determination of its proportionate share of liability.<sup>70</sup> The primary issue in this litigation is whether the attacks on the World Trade Center constituted one occurrence or multiple occurrences for purposes of calculating the total sum payable to the lessees for the loss of the properties and rental income accruing therefrom.<sup>71</sup> These claims remained pending at the time of the preparation of this article.

The issue of whether an insurance company can refuse to renew insurance coverage upon expiration of an underlying policy due to market uncertainty in the wake of the September 11 attacks and the probability of future attacks is also currently subject to litigation. In October 2001, Royal Insurance Company of America notified the state of Maryland that, due to its inability to procure reinsurance, it would not renew its insurance coverage for state-owned property after the expiration of the applicable policies in February 2002.<sup>72</sup> The notice of renewal affected five hundred million dollars in coverage for such state-owned properties as the statehouse in Annapolis, Baltimore-Washington International Airport, and the Camden Yards baseball facility.<sup>73</sup> Upon the complaint of the treasurer's office, the Maryland Insurance Administration barred Royal from discontinuing the policy in April 2002.<sup>74</sup> This decision is currently on appeal and, in a similar manner to the previously discussed disputes, will undoubtedly be subject to resolution in a court of law.

In response to these problems and the perception of a growing crisis, the insurance industry sought financial assistance from the U.S. Congress. Based upon the "Pool Re" program in place in the United Kingdom, insurance industry executives and trade associations proposed the creation of an insurance company that would pool premiums collected from the private sector to be paid in the event of damage to commercial property as the result of a future terrorist attack.<sup>75</sup> Pursuant to the industry's plan, insurance companies would charge additional

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payments to families of the victims in the event it was unsuccessful in its litigation with Lloyd's. *Id.* Aon further characterized the amount it is seeking from Lloyd's as "potentially uncollectable." *Id.*

70. See generally Complaint for Declaratory Relief, SR Int'l Bus. Ins. Co. v. World Trade Ctr. Props. LLC, No. 01-CV-0233 (S.D.N.Y. 2001); see also *Trade Center Insurer Sues*, WASH. POST, Oct. 23, 2001, at E2. The entities named as defendants in the complaint include the lessees of the former World Trade Center complex, their parent companies, and the lending institutions that extended credit to these entities to finance the acquisition of their leasehold estates. Compl. for Declaratory Relief, *supra* note 70, ¶¶ 7-21.

71. Compl. for Declaratory Relief, *supra* note 70, ¶¶ 49-58; Vicki Lankarge, *Swiss Re Says Collapse of the World Trade Center is One Insured Loss, Not Two*, Oct. 24, 2001, available at <http://www.insure.com/business/swissre1001.html>.

72. Jackie Spinner, *Maryland, Insurer Battle Over Terrorism Coverage*, WASH. POST, June 21, 2002, at E1.

73. *Id.*

74. *Id.*

75. Jackie Spinner & Steven Pearlstein, *U.S. Prepares Alternate Insurance Plan*, WASH. POST, Oct. 13, 2001, at A7; Jackie Spinner, *Insurers Push British-Style Plan*, WASH. POST, Sept. 25, 2001, at E3 [hereinafter *British-Style Plan*].

premiums, five percent of which would be retained by companies voluntarily opting to participate in the program.<sup>76</sup> Participating insurance companies would retain five percent of the risk for damage to commercial property resulting from a future terrorist attack.<sup>77</sup> The remaining ninety-five percent of premiums would be utilized to create a common reinsurance pool of five to ten billion dollars, known as “Freedom Re” or the Homeland Security Mutual Reinsurance Company, to fund claims beyond the initial five percent contributed by participating insurers.<sup>78</sup> The U.S. government would pay claims in excess of the pool’s resources.<sup>79</sup> Premiums would be established based upon perceived risk with purchasers in major population centers paying higher premiums to obtain terrorism coverage than those located in rural areas.<sup>80</sup> Terrorism would be included as standard coverage in homeowner and small business insurance policies.<sup>81</sup> By contrast, larger commercial purchasers would have the ability to opt out of such coverage.<sup>82</sup> According to industry representatives, a reinsurance pool would limit “[t]he potential maximum loss for individual companies and the industry . . . in a way that allows [them] to service the coverage needs of . . . policyholders while remaining financially strong.”<sup>83</sup>

### III. THE FEDERAL RESPONSE TO THE PERCEIVED CRISIS IN THE TERRORISM INSURANCE MARKET: THE THREE LEADING PROPOSALS AND THE ULTIMATE RESULT

#### A. *The Bush Administration Plan*

In contrast to the plan advocated by the insurance industry, the Bush Administration presented its assistance plan in October 2001. The plan provided significant federal assistance to insurers in the event of a terrorist attack for a period of three years. Specifically, in 2002, the federal government would be responsible for eighty percent of the first twenty billion dollars in claims resulting from a terrorist attack and ninety percent of claims in excess of twenty billion dollars.<sup>84</sup> In 2003, insurance companies would be responsible for the first

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76. Steven Pearlstein, *Congress to Face Question of Who Will Share in Risk*, WASH. POST, Oct. 11, 2001, at E1 [hereinafter *Congress to Face Question*].

77. *Id.*

78. *Congress to Face Question*, *supra* note 76; *British-Style Plan*, *supra* note 75.

79. *Congress to Face Question*, *supra* note 76.

80. *Id.*

81. *Id.*

82. *Id.*

83. Jackie Spinner, *Insurers Say White House Plan Doesn't Spread Risk*, WASH. POST, Oct. 23, 2001, at A6 (quoting David B. Mathis, chairman and chief executive of Kemper Insurance Cos.).

84. Marcy Gordon, *Administration Lays Out Insurance Plan*, ASSOCIATED PRESS, Oct. 15, 2001; Jackie Spinner, *White House Offers Insurance Plan*, WASH. POST, Oct. 16, 2001, at A5 [hereinafter *White House Offers Insurance Plan*].

ten billion dollars in claims.<sup>85</sup> Claims in excess of ten billion dollars but less than twenty billion dollars would be divided equally between the insurance industry and the federal government.<sup>86</sup> The federal government would be responsible for ninety percent of claims in excess of twenty billion dollars.<sup>87</sup> Finally, in 2004, the last year of the program, private insurers would pay the first twenty billion dollars in claims.<sup>88</sup> Claims between twenty billion dollars and forty billion dollars would be divided equally between private insurers and the federal government with the government responsible for ninety percent of claims in excess of forty billion dollars.<sup>89</sup> Under the Bush Administration's proposal, the insurance industry's maximum liability would be twelve billion dollars in 2002, twenty-three billion dollars in 2003 and thirty-six billion dollars in 2004.<sup>90</sup> The federal government's liability for terrorism claims was capped at one hundred billion dollars.<sup>91</sup> The Secretary of the Treasury could request consultations with the U.S. Congress in the event of an attack causing in excess of one hundred billion dollars in damage.<sup>92</sup>

The Bush Administration plan received a mixed reaction. Although the administration plan received support from the insurance industry and state insurance regulators, the proposal was subject to bipartisan criticism in the U.S. Congress.<sup>93</sup> The proposal was criticized as fiscally unsound and as amounting to a federal guarantee of the industry's future profits.<sup>94</sup> These profits would continue to accrue to the industry without a countervailing continuation of risk.<sup>95</sup> Other critics noted that federal taxpayers could overpay if the plan was adopted and insurance companies charged policyholders inflated premiums for terrorism coverage.<sup>96</sup> The proposal was also criticized as leaving open the possibility of the creation of a permanent governmental program.<sup>97</sup>

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85. Gordon, *supra* note 84; *White House Offers Insurance Plan*, *supra* note 84.

86. Gordon, *supra* note 84; *White House Offers Insurance Plan*, *supra* note 84.

87. Gordon, *supra* note 84; *White House Offers Insurance Plan*, *supra* note 84.

88. Gordon, *supra* note 84; *White House Offers Insurance Plan*, *supra* note 84.

89. Gordon, *supra* note 84; *White House Offers Insurance Plan*, *supra* note 84.

90. Gordon, *supra* note 84.

91. *Id.*

92. *Id.*

93. Jackie Spinner, *States Support U.S. Terrorism Insurance Proposal*, WASH. POST, Oct. 18, 2001, at A9. However, it should be noted that industry support for the Bush Administration plan was not unanimous. For example, David B. Mathis, chairman and chief executive officer of the Kemper Insurance Companies, characterized the plan as failing to provide sufficient security for the industry by forcing it to retain excessive risk with respect to future terrorist attacks. *Id.*

94. See Marcy Gordon, *Insurance Proposal Draws Some GOP Criticism*, ASSOCIATED PRESS, Oct. 24, 2001 [hereinafter *Insurance Proposal Draws Some GOP Criticism*] (noting criticism by Senator Jim Bunning (Republican, Kentucky) that the Bush Administration proposal guaranteed the industry's profits at the expense of federal taxpayers); see also Jackie Spinner & Glenn Kessler, *Bush Advisers Concerned About Insurance Package*, WASH. POST, Oct. 31, 2001, at A20 (noting the criticism of Senator Barbara Boxer (Democrat, California) that the administration proposal was "fiscally irresponsible").

95. *Next Bailout*, *supra* note 2.

96. See *Insurance Proposal Draws Some GOP Criticism*, *supra* note 94 (noting the comments of

B. *The House of Representatives' Plan*

Despite a vigorous defense by the administration, the U.S. Congress failed to adopt the Bush proposal.<sup>98</sup> Rather, the U.S. House of Representatives adopted the "Terrorism Risk Protection Act" on November 29, 2001.<sup>99</sup> Federal assistance to private insurers negatively impacted by a terrorist attack was triggered either by industry-wide or individual insurer losses. The industry-wide trigger called for federal assistance in the event losses exceeded one billion dollars.<sup>100</sup> The individual insurer trigger was tripped in the event industry-wide losses exceeded one hundred million with losses accruing to any single commercial insurer in excess of ten percent of its capital surplus and net premium in force and effect at the time of the loss.<sup>101</sup> Section 19 defined an act of terrorism that triggered federal intervention as an unlawful act that "cause[d] harm to a person, property, or entity, in the United States, or in the case of a domestic United States air carrier or a United States flag vessel . . . in or outside the United States."<sup>102</sup> In addition, this unlawful act must be "committed by a person or group of persons or associations who are recognized, either before or after [the] act, by the [U.S.] Department of State or Secretary [of the Treasury] as an international terrorist group."<sup>103</sup> The act must constitute an attempt "to overthrow or destabilize the government of any country, or to influence the policy or affect the conduct of the government of the United States or any segment of the economy of United States, by coercion" but must not constitute "an act of war."<sup>104</sup> Activities constituting an act of war were not defined in the bill. In any event, absolute discretion to determine the occurrence of an act of terrorism was delegated to the Secretary of the Treasury.<sup>105</sup> The exercise of this discretion was not subject to judicial review.<sup>106</sup>

The Terrorism Risk Protection Act provided for federal cost sharing for commercial property and casualty insurers in the event of a terrorist attack within the parameters of the industry-wide or individual insurer triggers. In the event of an industry-wide triggering occurrence, the Act provided for assistance to each affected insurer in an amount equal to the difference between ninety percent of

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Senator Paul Sarbanes (Democrat, Maryland)).

97. *Next Bailout*, *supra* note 2.

98. See Spinner & Kessler, *supra* note 94 (noting Secretary of the Treasury Paul H. O'Neill's defense of the Bush Administration plan: "Not one damn dime . . . would go to an insurance company because of what [the Bush Administration has] proposed . . . . The idea that this is a bailout for an insurance company is preposterous, and it only exists in the mind of the stupid. It's just outrageous.").

99. Terrorism Risk Protection Act, H.R. 3210, 107th Cong. (2001); Eilperin & Spinner, *supra* note 51.

100. Terrorism Risk Protection Act § 5(a)(1).

101. *Id.* § 5(a)(2)(A-B). In order for this trigger to be tripped, the insurer suffering the loss must have provided commercial property and casualty insurance coverage prior to September 11, 2001. *Id.* § 5(a)(2).

102. *Id.* § 19(1)(B)(i-ii).

103. *Id.* § 19(1)(B)(iii).

104. *Id.* § 19(1)(B)(iv-v).

105. *Id.* § 5(b)(1-2).

106. *Id.* § 15(a)(2)(A).



its insured losses as a result of the event and five million dollars.<sup>107</sup> In the event of an individual insurer triggering occurrence, the Act provided assistance to each affected insurer in an amount equal to ninety percent of the amount of its losses and ten percent of its net premium in force at the time of the loss.<sup>108</sup> The aggregate amount of financial assistance available from the government was one hundred billion dollars with the possibility of additional assistance from the U.S. Congress to address “severe losses” in excess of this limitation.<sup>109</sup> The assistance program was to commence on the date of enactment of the legislation and end on January 1, 2003, subject to the Secretary of the Treasury’s decision to extend the program for an additional period not to exceed two years.<sup>110</sup>

Federal assistance received by commercial insurers as a result of acts of terrorism was not without cost to the industry, private insurers, and, ultimately, policyholders. Proceeds advanced by the government to the industry or to an individual insurer were repayable through assessments and surcharges.<sup>111</sup> In the event of a terrorist attack triggering the Act’s financial assistance provisions, the Secretary of the Treasury was authorized to determine an aggregate assessment to be imposed upon all commercial property and casualty insurers equal to the lesser of twenty billion dollars or the amount of financial assistance actually paid to the industry or individual members thereof.<sup>112</sup> In order to collect this amount, the Secretary was authorized to impose an industry obligation assessment in an amount equal to the lesser of “the difference between [five billion] and the aggregate amount of any assessments made by the Secretary . . . during the portion of such covered period preceding the triggering determination; and the amount of financial assistance made available under section 6 . . .”<sup>113</sup> In the event that the aggregate assessment exceeded the industry obligation assessment, the difference was to be collected through an additional financing assessment.<sup>114</sup> Payment of assessments was due no later than sixty days from an individual insurer’s receipt of notice from the Secretary of the Treasury.<sup>115</sup>

In addition to assessments, the Secretary of the Treasury was authorized to impose surcharges upon commercial property and casualty insurers in the event that financial assistance extended pursuant to section 6 exceeded twenty billion dollars.<sup>116</sup> The amount of the surcharge was to be established in the absolute discretion of the Secretary of the Treasury upon consideration of “the ultimate costs to taxpayers if a surcharge . . . [was] not established; the economic

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107. *Id.* § 6(b)(1)(A-B).

108. *Id.* § 6(b)(2)(A-B).

109. *Id.* § 6(c)(1-2).

110. *Id.* § 20(a-b).

111. *Id.* § 6(e).

112. *Id.* § 7(b).

113. *Id.* § 7(c)(2)(A)(i-ii).

114. *Id.* § 7(d)(1-3).

115. *Id.* § 7(f)(2).

116. *Id.* § 8(a)(1).

conditions in the commercial marketplace; the affordability of commercial insurance for small- and medium-sized businesses; and such other factors as the Secretary consider[ed] appropriate.”<sup>117</sup> The amount ultimately set by the Secretary was to be assessed and collected by commercial insurers as a policyholder premium surcharge on commercial property and casualty insurance written after the Secretary’s determination.<sup>118</sup> The sole limitation on the surcharge was that it could not exceed three percent of the premium charged for such coverage on an annual basis.<sup>119</sup>

In determining the method and manner of imposing assessments and surcharges, the Secretary of the Treasury was required to take into consideration “the economic impact of any such assessments and surcharges on commercial centers of urban areas, . . . the risk factors related to rural areas and smaller commercial centers, . . . and the various exposures to terrorism risk for different lines of commercial property and casualty insurance.”<sup>120</sup> Failure to pay assessments or charge, collect, or remit surcharges was punishable by a civil fine in an amount equal to the greater of one million dollars or the amount of assessments or surcharges due and owing.<sup>121</sup>

Finally, the Act contained additional provisions concerning its relationship to state insurance regulations and limitations upon private litigation arising from future terrorist attacks. With respect to the relationship between the Act and state insurance regulations, section 12 provided for the preemption of any state law requiring or regulating terrorism coverage that was inconsistent with the Act.<sup>122</sup> In addition, any state law or regulation that prevented an insurer from increasing premiums in order to recover assessments levied pursuant to section 7 was also preempted.<sup>123</sup> Section 13 of the Act expressed Congress’s sense that “the [National Association of Insurance Commissioners], in consultation with the Secretary [of the Treasury], should develop appropriate definitions for acts of terrorism that are consistent with [the] Act.”<sup>124</sup> The Act recommended that each state adopt these definitions.<sup>125</sup> Section 13 also expressed Congress’s sense that each state, in conjunction with the National Association of Insurance Commissioners, develop guidelines for the maintenance of reserves against the risks of future acts of terrorism and require disclosure of the price of terrorism coverage, including the cost of related surcharges and assessments.<sup>126</sup>

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117. *Id.* § 8(a)(2)(A-D).

118. *Id.* § 8(a)(3).

119. *Id.* § 8(c).

120. *Id.* § 9(a)(2)(A-C).

121. *Id.* § 9(d)(2).

122. *Id.* § 12(a).

123. *Id.* § 12(b).

124. *Id.* § 13(a)(1).

125. *Id.* § 13(a)(2).

126. *Id.* § 13(b)(1)(A-B), (c)(1).

The Act also limited the right to initiate and prosecute litigation with respect to injuries resulting from a terrorist attack. In the event the Secretary of the Treasury determined the occurrence of a terrorist attack, injured parties were granted a federal cause of action, which was to serve as “the exclusive remedy for claims arising out of, relating to, or resulting from such acts of terrorism.”<sup>127</sup> The Judicial Panel on Multidistrict Litigation was responsible for designating one or more federal district courts with exclusive jurisdiction over all actions brought with respect to a specific act of terrorism.<sup>128</sup> These courts were required to apply the substantive law of the state in which the act of terrorism occurred to all such claims.<sup>129</sup> However, awards of punitive damages and prejudgment interest were expressly prohibited.<sup>130</sup> Furthermore, the liability of each defendant was limited to an amount of noneconomic damages in proportion to its individual percentage of responsibility.<sup>131</sup> Awards for noneconomic losses without accompanying physical injury were prohibited.<sup>132</sup> Finally, attorneys’ fees for representing claimants in such litigation were capped at twenty percent of the damages awarded by a court or any court-approved settlement.<sup>133</sup>

However, the U.S. Senate failed to take up the Act prior to the end of 2001 and the concurrent expiration of approximately seventy percent of commercial reinsurance policies for U.S. properties.<sup>134</sup> Although Karl Rove, President Bush’s chief political advisor, sardonically noted that “[t]he world was supposed to collapse on December 31 and we’re still around,” the failure of the administration and Congress to act was roundly criticized.<sup>135</sup> State insurance regulators announced that they would permit insurance companies that were still obligated to provide terrorism coverage to deny claims from any attack that caused in excess of twenty-five million dollars in insured losses.<sup>136</sup> Executives from a wide range of industries warned of the consequences of the U.S. government’s failure to adopt a plan to assist insurance and reinsurance companies in the event of a future

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127. *Id.* § 15(a)(1). Section 15 exempted any limitation upon “the liability of any person who attempts to commit, knowingly participates in, aids and abets, or commits any act of terrorism . . . or any criminal act related to or resulting from such act of terrorism; or participates in a conspiracy to commit any such act of terrorism or any such criminal act.” *Id.* § 15(b)(1-2). “[F]rozen assets of [terrorist organizations are also] available for satisfaction of [any] judgment” that may be entered against the terrorist organization, subject to presidential waiver for reasons of national security. *Id.* § 15(e)(1-2).

128. *Id.* § 15(a)(4).

129. *Id.* § 15(a)(3).

130. *Id.* § 15(a)(5)(A).

131. *Id.* § 15(a)(5)(B)(i).

132. *Id.* “Noneconomic damages” were defined as “damages for losses for physical and emotional pain, suffering, inconvenience, physical impairment, mental anguish, disfigurement, loss of enjoyment of life, loss of society and companionship, loss of consortium, hedonic damages, injury to reputation, and any other nonpecuniary losses.” *Id.* § 15(a)(5)(B)(ii).

133. *Id.* § 15(a)(7). Any attorney demanding, receiving or collecting compensation in excess of the cap was subject to the imposition of a two-thousand-dollar fine or imprisonment for not more than one year, or both. *Id.*

134. Jackie Spinner, *Congress Unable to Pass Terror Insurance Bill*, WASH. POST, Dec. 21, 2001, at E1.

135. Jackie Spinner, *Bush Aides Seek Evidence of Insurance Woes*, WASH. POST, Jan. 8, 2002, at A8.

136. Marcy Gordon, *Failure to Enact Aid Bill Criticized*, ASSOCIATED PRESS, Dec. 21, 2001.

terrorist attack. Standard & Poor's noted that "insurers offering terrorism provisions would unduly expose their capital bases and invite ratings downgrades . . . unless policies were written with some form of government protection, such as a federally backed reinsurance pool."<sup>137</sup> Lending institutions warned that they would be required to review their practices in major U.S. cities with respect to large properties or those deemed to be high risk.<sup>138</sup> The reaction of lending institutions rippled throughout the commercial real estate industry, which expressed concern with respect to the ability of developers to obtain financing and maintain liquidity.<sup>139</sup> The pressure on real estate investors was increased in March 2002 when Moody's Investor Service announced that it would evaluate commercial mortgage-backed securities on the basis of whether the underlying property was insured against terrorist attacks.<sup>140</sup> Bonds secured by buildings without terrorism insurance could be subject to downgrading, thereby resulting in increased borrowing costs and difficulty in obtaining capital for new ventures.<sup>141</sup> Private industry also warned of "severe economic dislocation in the coming months if insurance-related issues tied to terrorism are not addressed by the federal government immediately."<sup>142</sup>

Numerous federal officials echoed these concerns. In October 2001, the Secretary of the Treasury, Paul H. O'Neill, noted that "[l]eaving this problem unresolved threatens [U.S.] economic stability."<sup>143</sup> In his first statement on the topic before the House Financial Services Committee, Federal Reserve Chairman

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137. STANDARD & POOR'S, MAINTENANCE OF INSURANCE RATINGS DEPENDS ON MITIGATING TERRORISM RISKS 1 (2001) [hereinafter STANDARD & POOR'S].

138. *Terror-Insurance Market*, *supra* note 62.

139. *Insurance Industry Wants Taxpayer Aid to Escape Future Losses, Liability*, KNIGHT-RIDDER TRIBUNE, Oct. 29, 2001. In this regard, Steven A. Wechsler, president and chief executive of the National Association of Real Estate Investment Trusts, stated that lending institutions that extend loans to commercial real estate developers "assume adequate insurance coverage for risk' . . . 'If the system doesn't provide it, it has the potential to create significant disruption.'" *Builders Face Rising Insurance Rates*, *supra* note 50.

140. Jackie Spinner, *Moody's to Weigh Terror Risk*, WASH. POST, Mar. 2, 2002, at E1.

141. *Id.* An example of such downgrading is the decision by Moody's Investors Service and Fitch Ratings to downgrade forty-three separate debt issues backed by properties that are not adequately insured against terrorism, including a loan pool for a portfolio of eight hotels owned by Host Marriott Corporation. *Terror Fears Imperil Debt Ratings*, WASH. POST, June 5, 2002, at E3.

142. *Builders Face Rising Insurance Rates*, *supra* note 50 (quoting a letter sent to President Bush by several industry organizations); *Insurers Seek Help with Terror Coverage*, *supra* note 1. The macroeconomic impact of the failure of the U.S. government to adequately address the issue of insurance coverage for terrorism was perhaps best summarized in correspondence forwarded to President George W. Bush by sixty trade associations. In this correspondence, the associations stated:

Our market-driven economy is predicated on risk. Insurers provide much-needed security. Without insurance, financiers cannot lend, and companies are reluctant to invest. Without insurance, new construction would cease. All types of cargo would be stuck in place. Some businesses may choose to cease operations after determining that the risks of continuing to operate in the current environment without the ability to share potential losses is too great. In addition, the potential benefits of the Administration's economic stimulus package could be greatly muted.

Letter from Airports Council International-North America, et al. to George W. Bush, President of the United States of America 1 (Oct. 25, 2001) (on file with the *McGeorge Law Review*).

143. Jackie Spinner, *Insurance Uncertainty a Threat, O'Neill Says*, WASH. POST, Oct. 25, 2001, at A6.

Alan Greenspan stated that “[i]t may be necessary . . . for the Congress to stipulate that in the event of a terrorist attack . . . the federal government, with some deductible, would cover the cost. . . .”<sup>144</sup> In the most comprehensive governmental study of the impact of the attacks upon the market for commercial insurance to date, the General Accounting Office concluded that the potential negative consequences of the growing cost and unavailability of terrorism insurance are cause for serious concern.<sup>145</sup> Specifically, the General Accounting Office found that insurers were shifting the risk of losses associated with terrorism to property owners through the withdrawal of reinsurers from the terrorism insurance market.<sup>146</sup> Primary insurers were also abandoning the market as a result of their inability to obtain coverage from reinsurers.<sup>147</sup> Not surprisingly, the report found that the assumption of increasing amounts of uninsured risk posed potentially grave consequences for private industry.<sup>148</sup> These consequences would have the most significant impact on the relationship between commercial property owners and developers and lending institutions.<sup>149</sup> The lack of available and affordable terrorism coverage would serve to shift unacceptable amounts of risk to owners and financiers as well as discourage new commercial development and lending activities.<sup>150</sup> The current state of the terrorism insurance market could also cause conflict with respect to the maintenance of required insurance coverage on existing mortgaged properties.<sup>151</sup> In presenting the report to the House Financial Services subcommittee, Richard J. Hillman, the General Accounting Office’s director of financial markets and community investments, emphasized that the extent of the problem posed by terrorism to the economy in general and the insurance industry in particular remains unknown.<sup>152</sup> As such, the necessity of federal aid for the insurance industry remained an issue for legitimate debate.<sup>153</sup> However, he also warned of the “potentially significant” impact of the problem upon the recovering economy and the “real and . . . potentially large” consequences of continuing congressional inaction in addressing the issue.<sup>154</sup>

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144. Jackie Spinner, *Greenspan Backs Federal Backup for Terrorism Insurance*, WASH. POST, Feb. 28, 2002, at E4 [hereinafter *Greenspan Backs Federal Backup*]. However, Chairman Greenspan also acknowledged that “there is considerable dispute” over the necessity of federal intervention given the unknown nature of the continuing terrorist threat. *Id.*

145. U.S. GEN. ACCOUNTING OFFICE, TERRORISM INSURANCE: RISING UNINSURED EXPOSURE TO ATTACKS HEIGHTENS POTENTIAL ECONOMIC VULNERABILITIES, Rep. GAO-02-472T 15 (2002) [hereinafter 2002 GAO REPORT].

146. *Id.* at 3-4.

147. *Id.* at 4-7.

148. *Id.* at 7.

149. *Id.* at 10-14.

150. *Id.* The Mortgage Bankers Association estimated that the lack of insurance coverage for terrorism prevented the closing of \$3.7 billion worth of real estate transactions in 2002 and delayed or changed transactions valued at an additional \$4.5 billion. *Lack of Terrorism Insurance Puts Utilities at Risk*, *supra* note 54.

151. 2002 GAO REPORT, *supra* note 145, at 12.

152. *Greenspan Backs Federal Backup*, *supra* note 144.

153. *Id.*

154. *Id.*

C. *The Senate Plan*

In response to these concerns, the U.S. Senate adopted the “Terrorism Risk Insurance Act of 2002” on June 18, 2002.<sup>155</sup> The Terrorism Risk Insurance Act was significantly different from its counterpart passed by the U.S. House of Representatives. The initial difference between the two acts was the definition of terrorism. In contrast to the House version of the Act, the Terrorism Risk Insurance Act defined an “act of terrorism” as an act certified by the Secretaries of the Treasury and State as well as the Attorney General that is “violent” or “dangerous to human life; property; or infrastructure; [and] to have resulted in damage within the United States, or outside the United States in the case of an air carrier or vessel.”<sup>156</sup> Furthermore, the act must “have been committed [on behalf of a foreign person or interest], as part of an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion.”<sup>157</sup> Acts committed in the course of a congressionally declared war or that result in losses less than five million dollars were specifically excluded from the definition.<sup>158</sup> The determination of the occurrence or non-occurrence of an act of terrorism was final and not subject to judicial review.<sup>159</sup> Participation in the program established by the Terrorism Risk Insurance Act was mandatory for any insurance company “licensed or admitted to engage in the business of providing primary insurance in [the United States]” or “if it [was] an eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers.”<sup>160</sup>

The second major difference between the Senate and House versions of terrorism risk insurance was the calculation of payments to the industry in the event of a certified attack. Initially, no participating insurance company could collect payment from the Secretary of the Treasury for a certified act of terrorism unless it received claims from those suffering an insured loss, disclosed the premium charged for insured losses covered by the program and the federal share of compensation for insured losses, processed claims utilizing standard business practices, and submitted a written claim.<sup>161</sup> In the event that a participating insurance company complied with these requirements, the federal share of compensation was “equal to [eighty] percent of [the] aggregate insured losses that—exceed[ed] the participating insurance company deductibles required to be

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155. Terrorism Risk Insurance Act, S. 2600, 107th Cong. (2002); Mark Felsenthal, *Senate Passes Federal Insurance Backstop*, REUTERS, June 18, 2002; Jackie Spinner, *Terrorism Insurance Bill Passed by Senate*, WASH. POST, June 19, 2002, at E1.

156. Terrorism Risk Insurance Act § 3(1)(A)(i-ii).

157. *Id.* § 3(1)(A)(iii).

158. *Id.* § 3(1)(B)(i-ii).

159. *Id.* § 3(1)(C).

160. *Id.* §§ 3(6)(A)(i)-(ii), 4(c)(1).

161. *Id.* § 4(b)(1-4).

paid for those insured losses; and [did] not exceed [ten billion dollars].”<sup>162</sup> The percentage was increased to ninety percent with respect to aggregate insured losses that exceeded ten billion dollars.<sup>163</sup> In any event, if the aggregate insured losses during any one year period exceeded one hundred billion dollars, the Secretary of the Treasury and insurance companies were prohibited from paying amounts in excess thereof.<sup>164</sup> Rather, Congress was authorized to determine the procedures and source of any such excess payments.<sup>165</sup>

The term “participating insurance company deductible” was defined in the first year of the program as “a participating insurance company’s market share, multiplied by [ten billion dollars] with respect to insured losses resulting from an act of terrorism occurring during the [one]-year period beginning on the date of enactment of [the] Act.”<sup>166</sup> Market shares of participating insurance companies were calculated utilizing the “total amount of direct written property and casualty insurance premiums for the . . . company during the [two]-year period preceding the year in which the subject act of terrorism occurred . . . as a percentage of the aggregate of all such property and casualty insurance premiums industry-wide during that period.”<sup>167</sup> This determination of market share was subject to unilateral adjustment by the Secretary of the Treasury.<sup>168</sup> Unlike the Terrorism Risk Protection Act, the Terrorism Risk Insurance Act did not require insurance companies to repay amounts they received from the federal government as the result of the occurrence of a certified terrorist attack.

The federal terrorism risk insurance program approved by the U.S. Senate was subject to extension under limited circumstances. The Terrorism Insured Loss Shared Compensation Program was scheduled to expire of its own accord one year from the date of its enactment.<sup>169</sup> However, the Secretary of the Treasury was authorized to extend the program for one additional year based upon two separate findings of which he was required to inform the U.S. Congress.<sup>170</sup> Specifically, the Secretary was required to find that “widespread market uncertainties continue[d] to disrupt the ability of insurance companies to price insurance coverage for losses resulting from acts of terrorism, thereby resulting in the continuing unavailability of affordable insurance for

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162. *Id.* § 4(e)(1)(A)(i)(I-II).

163. *Id.* § 4(e)(1)(A)(ii)(I-II).

164. *Id.* § 4(e)(2)(A-B).

165. *Id.* § 4(e)(3).

166. *Id.* § 3(7)(A). The “participating insurance company deductible” in the year in which the program may be extended is calculated by multiplying the company’s market share by fifteen billion dollars with respect to insured losses resulting from a certified act of terrorism during the period in which the program is extended. *Id.* § 3(7)(B).

167. *Id.* § 3(4)(A).

168. *Id.* § 3(4)(B).

169. *Id.* § 6(a)(1).

170. *Id.* § 6(a)(1)(A).

consumers.”<sup>171</sup> The Secretary was also required to certify that such an extension would “likely encourage economic stabilization and facilitate a transition to a viable market for private terrorism risk insurance.”<sup>172</sup> In any event, the Secretary was not authorized to extend the program beyond a single additional year.<sup>173</sup>

The final difference was the absence of tort reform or limitation of punitive damages in the Terrorism Risk Insurance Act. In a similar fashion to the Terrorism Risk Protection Act, the Senate created “a [f]ederal cause of action for property damage, personal injury, or death arising out of or resulting from an act of terrorism.”<sup>174</sup> This federal cause of action was the exclusive remedy for claims arising from such injury, damage, or death, other than claims against the terrorists themselves.<sup>175</sup> All state causes of action arising from such injury, damage or death were expressly preempted.<sup>176</sup> The sole provision relating to tort reform in the Terrorism Risk Insurance Act provided that “[a]ny amounts awarded in a [federal] civil action . . . that are attributable to punitive damages shall not count as insured losses for purposes of this Act.”<sup>177</sup> The absence of such reform proved to be controversial. A Republican-sponsored amendment to eliminate punitive damage awards against companies whose buildings suffer a terrorist attack failed by a party-line vote of fifty to forty-six.<sup>178</sup> This difference has threatened to impede resolution of the conflicting acts.<sup>179</sup> In addition to continued opposition in the House of Representatives for legislation that did not effect some protections for companies victimized by future terrorist attacks and their insurers, the Bush Administration signaled its willingness to scuttle the entire program without tort reform. In a statement issued at the time of the Senate’s adoption of the Terrorism Risk Insurance Act, President Bush noted that he could not “support enactment of any terrorism insurance bill that leaves the nation’s economy and victims of terrorist acts subject to predatory lawsuits and punitive damages.”<sup>180</sup>

#### D. *The Terrorism Risk Insurance Act of 2002*

In response to these concerns and after prolonged debate, the U.S. Congress passed and President Bush signed the “Terrorism Risk Insurance Act” on November 26, 2002.<sup>181</sup> Federal assistance to private insurers is triggered by the

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171. *Id.* § 6(c)(1).

172. *Id.* § 6(c)(2).

173. *Id.* § 6(a)(3).

174. *Id.* § 10(a)(1).

175. *Id.* § 10(a), (d).

176. *Id.* § 10(a)(2).

177. *Id.* § 10(c).

178. Jesse J. Holland, *Senate Fights Over Terror Insurance*, ASSOCIATED PRESS, June 13, 2002.

179. Jesse J. Holland, *Dispute May Hold Up Insurance Bill*, ASSOCIATED PRESS, June 19, 2002.

180. Jackie Spinner, *Terrorism-Insurance Battle Looms*, WASH. POST, June 14, 2002, at E2.

181. Terrorism Risk Insurance Act of 2002, Pub. L. 107-297, 116 Stat. 2322 (2002); *see also* Mike Allen, *Bush Signs Bill to Boost Terrorism Insurance Policies*, Wash. Post, Nov. 27, 2002, at A3; Edward



occurrence of an act of terrorism that meets a four-part definition. In order to constitute terrorism, the act must be “a violent act or an act that is dangerous to human life, property or infrastructure.”<sup>182</sup> Second, the act must result in damage within the United States or outside the United States in the case of air carriers, vessels and U.S. missions.<sup>183</sup> Third, the act in question must be committed by an individual or individuals acting on behalf of foreign interests in “an effort to coerce the civilian population of the United States or to influence the policy or affect the conduct of the United States Government by coercion.”<sup>184</sup> Finally, in order to qualify as an act of terrorism triggering the Act’s provisions, the act in question must be certified as such by the Secretary of the Treasury in concurrence with the Secretary of State and the Attorney General.<sup>185</sup> All certification decisions of the Secretary of the Treasury are final and not subject to judicial review.<sup>186</sup> Acts committed in the course of a war, as declared by the U.S. Congress, and aggregate losses resulting from an act in an amount less than five million dollars are specifically excluded from the definition of terrorism.<sup>187</sup>

All commercial insurers writing policies in the United States are required to participate in the program established by the Act and write policies covering terrorism as defined above.<sup>188</sup> The effect of these requirements is to nullify exclusions for occurrences meeting the Act’s definition of terrorism in place on the effective date of the Act, specifically, November 26, 2002.<sup>189</sup> In order to be eligible for reimbursement in the event of a certified terrorism loss, insurers must provide a “clear and conspicuous disclosure” to their policyholders of premiums being charged for such coverage and the extent to which any losses are reimbursed by the federal government.<sup>190</sup> This notice was required to be provided to existing policyholders no later than ninety days from the effective date, specifically, February 24, 2003.<sup>191</sup> Notice with respect to policies purchased within ninety days of the effective date of the Act must be provided at the time of the policy’s purchase or renewal.<sup>192</sup> Policies purchased more than ninety days after adoption of the Act must provide the notice as a separate line item in the policy.<sup>193</sup> Exclusions for acts of terrorism may be reinstated in the event the insured provides a written authorization for such reinstatement or fails to pay the

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Walsh, *Two More Senate Victories for Bush*, Wash. Post, Nov. 20, 2002, at A5.

182. Terrorism Risk Insurance Act § 102(1)(A)(ii)(I-III).

183. *Id.* § 102(1)(A)(iii)(I-II).

184. *Id.* § 102(1)(A)(iv).

185. *Id.* § 102(1)(A).

186. *Id.* § 102(1)(C).

187. *Id.* § 102(1)(B)(i-ii).

188. *Id.* § 103(a)(3).

189. *Id.* § 105(a).

190. *Id.* § 103(b)(2).

191. *Id.* § 103(b)(2)(A).

192. *Id.* § 103(b)(2)(B).

193. *Id.* § 103(b)(2)(C).

premium for such coverage within thirty days after receipt of the required notice from the insurer.<sup>194</sup>

In the event of a certified act of terrorism, the reimbursement provisions of the Act depend upon when the act occurred. For losses occurring during the transition period of November 26 through December 31, 2002, insurers are liable for the initial amount of covered losses up to one percent of the insurer's direct earned premiums for the preceding calendar year.<sup>195</sup> For losses occurring during 2003, this deductible increases to seven percent of the previous calendar year's direct earned premiums.<sup>196</sup> In 2004, the deductible increases to ten percent, and, in 2005, the final year of the program, the deductible increases to fifteen percent of the previous year's direct earned premiums.<sup>197</sup>

The Terrorism Risk Insurance Act provides for federal cost sharing for commercial property and casualty insurers in the event of a certified terrorist attack. The federal government is responsible for ninety percent of losses beyond the above-referenced insurer deductibles until aggregate losses for any program year (or the transition period and 2003 combined) reach one hundred billion dollars.<sup>198</sup> Insurers are responsible for the remaining ten percent of such aggregate losses beyond their deductibles.<sup>199</sup> Compensation from the federal government must be reduced by any compensation provided by the federal government to any person under any other federal program.<sup>200</sup> Federal assistance to insurers is capped at one hundred billion dollars.<sup>201</sup> The U.S. Congress is responsible for determining procedures for and the source of any payments to be made to insurers in excess of one hundred billion dollars.<sup>202</sup> In any event, pro rata allocation of federal compensation to individual insurers is within the sole discretion of the Secretary of the Treasury, whose determination is final and not subject to judicial review.<sup>203</sup>

Federal assistance received by commercial insurers as a result of acts of terrorism is not without cost to the industry, private insurers and, ultimately, policyholders. There are two separate methods by which the federal government may recoup payments to insurers occurring as the result of a certified act of terrorism. Mandatory recoupment of payments is based upon the difference between the sum paid for losses resulting from a certified act of terrorism by insurers, specifically the earned premium deductibles and ten percent participation payment, and specified dollar amounts. These dollar amounts are

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194. *Id.* § 105(c)(1-2).

195. *Id.* § 101(7)(A).

196. *Id.* § 101(7)(B).

197. *Id.* § 101(7)(C-D).

198. *Id.* § 103(e)(1)(A).

199. *Id.*

200. *Id.* § 103(e)(1)(B).

201. *Id.* § 103(e)(2)(A)(i-ii).

202. *Id.* § 103(e)(3).

203. *Id.* § 103(e)(4-5).

referred to as “insurance marketplace aggregate retention amounts.”<sup>204</sup> If the sum of earned premium deductibles and insurer participation payments do not equal the aggregate retention amount for a given year of the program, insurers are required to remit the difference to the federal government.<sup>205</sup> The aggregate retention amount for the transition period and 2003 is ten billion dollars.<sup>206</sup> This amount increases to \$12.5 billion in 2004 and \$15 billion in 2005.<sup>207</sup> There is no mandatory recoupment in the event the sum of the insurer deductibles and participation payments equals or exceeds the aggregate retention amount for a specified year.<sup>208</sup> The Secretary of the Treasury may also assess discretionary recoupment to the extent that federal assistance exceeds any mandatory recoupment amount.<sup>209</sup> The amount of such discretionary recoupment is based upon the cost to taxpayers if no additional recoupment is assessed, economic conditions in the marketplace, the affordability of insurance to small and medium-sized businesses, and other factors the Secretary deems relevant.<sup>210</sup>

Recoupment is to be achieved through policy surcharges on property and casualty insurance policies in force and effect after the date of establishment of the recoupment amount. This surcharge is to be established by the Secretary based upon a percentage of the premiums charged to such policyholders.<sup>211</sup> However, such surcharges may not exceed three percent of the premium charged to policyholders on an annual basis.<sup>212</sup> In determining the method and manner of imposing surcharges, the Secretary of the Treasury is required to take into consideration “the economic impact of any such assessments and surcharges on commercial centers of urban areas . . . the risk factors related to rural areas and smaller commercial centers . . . and the various exposures to terrorism risk for different lines of insurance.”<sup>213</sup> Insurers are legally obligated to collect such surcharges and remit them to the Secretary.<sup>214</sup> Failure to collect or remit surcharges is punishable by a civil fine in an amount equal to the greater of one million dollars or the amount of surcharges due and owing.<sup>215</sup>

Finally, the Act contains additional provisions concerning its relationship to state insurance regulations and limitations upon private litigation arising from future terrorist attacks. With respect to the relationship between the Act and state insurance regulations, section 105 provides for the preemption of any state law

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204. *Id.* § 103(e)(6).

205. *Id.* § 103(e)(7)(A)(i-ii).

206. *Id.* § 103(e)(6)(A)(i-ii).

207. *Id.* § 103(e)(6)(B-C).

208. *Id.* § 103(e)(7)(B).

209. *Id.* § 103(e)(7)(D).

210. *Id.* § 103(e)(7)(D)(i-iv).

211. *Id.* § 103(e)(8)(A)(i-iii).

212. *Id.* § 103(e)(8)(C).

213. *Id.* § 103(e)(8)(D)(i)(I-III).

214. *Id.* § 103(e)(8)(B).

215. *Id.* § 104(e)(1)(A) & (2).

requiring or regulating terrorism coverage that is inconsistent with the Act.<sup>216</sup> In addition, all state causes of action of any kind seeking compensation for property damage, personal injury, or death are preempted.<sup>217</sup> In the event of a determination by the Secretary of the Treasury of the occurrence of a terrorist attack, injured parties are granted a federal cause of action, which shall serve as the exclusive remedy for claims seeking compensation for property damage, personal injury, and death.<sup>218</sup> The Judicial Panel on Multidistrict Litigation is responsible for the designation of one or more U.S. district courts as having exclusive jurisdiction over all actions brought with respect to a specific act of terrorism.<sup>219</sup> These courts are required to apply the substantive law of the state in which the act of terrorism occurred to all such claims.<sup>220</sup>

#### IV. CRAFTING AN APPROPRIATE FEDERAL INTERVENTION PLAN

##### A. Existing Precedents for Federal Intervention

There is precedent for federal intervention in the U.S. private insurance market. For example, pursuant to the Atomic Energy Damages Act of 1957, operators of nuclear reactors are required to obtain insurance in the private market to the maximum amount available and capitalize a secondary insurance fund.<sup>221</sup> There is implicit government financial backing for accidents in which the damages exceed the combined limits of private insurance and the secondary fund.<sup>222</sup> In addition, for the past thirty-one years, the federal government has provided political risk insurance to facilitate private investment by U.S. businesses in developing countries through the Overseas Private Investment Corporation.<sup>223</sup> The federal government also provided federal reinsurance for damages caused to property located in urban areas as a result of riots and civil disorder. Established by the Housing and Urban Development Act of 1968, the National Insurance Development Program encouraged state regulators and private insurers to make property and casualty insurance available for such properties.<sup>224</sup>

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216. *Id.* § 105(b).

217. *Id.* § 107(2).

218. *Id.* § 107(a)(1). Section 107 exempts any limitation upon the liability of “any government, an organization, or person who knowingly participates in, conspires to commit, aids and abets, or commits any act of terrorism.” *Id.* § 107(b). Frozen assets of terrorist organizations are also available for satisfaction of any judgment that may enter against the terrorist organization subject to presidential waiver for reasons of national security. *Id.* § 201(a).

219. *Id.* § 107(a)(4).

220. *Id.* § 107(a)(3).

221. Atomic Energy Damages Act, Pub. L. No. 85-256, 71 Stat. 576 (1957) (codified as amended in scattered sections of 42 U.S.C.).

222. *Id.*

223. 22 U.S.C. §§ 2191-2200a (2000).

224. Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 476 (codified as amended in scattered sections of 5, 12, 15, 18, 31, 38, 40, 42 & 49 U.S.C.).

Until its discontinuance in 1984, private insurers writing policies upon such properties could elect to purchase federal reinsurance and thereby transfer the vast majority of the risk associated with urban disturbances to the federal government.<sup>225</sup> Finally, through authority granted by the National Flood Insurance Act, the federal government funds the National Flood Insurance Program.<sup>226</sup> This program offers federally-backed flood insurance to property owners residing in communities that join the program.<sup>227</sup> This program has proven to be the most controversial of federally-backed insurance plans due to its failure to generate sufficient income from premiums to accumulate adequate reserves to meet the cost of future flood-related losses.<sup>228</sup> This failure has resulted in occasional additional appropriations by the U.S. Congress as well as periodic borrowing from the U.S. Treasury.<sup>229</sup>

Nevertheless, if federal intervention in the private insurance market with respect to terrorism is warranted, the issue remains what form the intervention should take. There are numerous international examples from which to choose. For example, the United Kingdom's Pool Reinsurance (Pool Re) program insures owners of industrial, commercial and residential property located on the British mainland against losses caused by terrorist attacks.<sup>230</sup> Established in 1993, Pool Re permits policyholders to purchase additional coverage from their primary property insurer to protect against terrorism.<sup>231</sup> Insurers are responsible for the first £100,000 with losses in excess of this amount paid from premiums accumulated within a pool consisting of insurance companies and Lloyd's of London syndicates.<sup>232</sup> Claims exceeding the pool's resources are funded through an additional ten percent call on premiums collected by participating insurers, investment income, and, ultimately, the British government.<sup>233</sup> It has not been necessary for the British government to provide assistance to the pool to date.<sup>234</sup>

Another international example of government intervention in the terrorist insurance market is Israel's Property Tax and Compensation Fund.<sup>235</sup> Administered by the Israeli Income and Property Tax Commission, this law levies a national

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225. *Id.*

226. National Flood Insurance Act of 1968, Pub. L. No. 90-448, 82 Stat. 572 (codified as amended in scattered sections of 42 U.S.C.).

227. *Id.*

228. U.S. GEN. ACCOUNTING OFFICE, TERRORISM INSURANCE: ALTERNATIVE PROGRAMS FOR PROTECTING INSURANCE CONSUMERS, Rep. GAO-02-199T 6 (2001) [hereinafter 2001 GAO REPORT].

229. *Id.*

230. *Id.* at 8. For an in-depth discussion of the British Pool Re program, see William B. Bice, Comment, *British Government Reinsurance and Acts of Terrorism: The Problems of Pool Re*, 15 U. PA. J. INT'L BUS. L. 441 (1994).

231. 2001 GAO REPORT, *supra* note 228, at 8.

232. *Id.*

233. *Id.*

234. *Id.*

235. *Id.*

property tax on Israeli businesses.<sup>236</sup> The tax proceeds fund claims for property damage directly resulting from terrorist attacks.<sup>237</sup> Claims for property damage are based upon the market value of the property immediately prior to the attack.<sup>238</sup> Property owners may purchase additional gap coverage insurance for differences between the market value of their property and its replacement cost from private insurers or the government.<sup>239</sup> The Commission is not responsible for payment of indirect losses, such as those associated with business interruption.<sup>240</sup> Rather, it is the responsibility of property owners to procure private insurance for such losses.<sup>241</sup>

## B. Critique of the Primary Provisions of the Terrorism Risk Insurance Act of 2002

### 1. The Necessity of Defining Terrorism for Insurance Purposes

Despite their merits, the previously discussed forms of governmental intervention were rejected by the U.S. Congress in favor of the Terrorism Risk Insurance Act.<sup>242</sup> The Act has much to commend itself to the insurance industry and, ultimately, to policyholders. The initial strength of the Act is its recognition of the need to define terrorism for insurance purposes. There is universal agreement among state insurance commissioners, trade associations and consumer advocates of the need for a uniform definition in any federal insurance program.<sup>243</sup> A uniform definition is not only essential to determining those acts that trigger coverage (or exclusions as the case may be) but also to the industry's future ability to measure risk and price premiums accordingly. Any definition of terrorism should be free from ambiguity and establish standards that the industry may use to support theoretical and empirical risk analysis, the results of which would be utilized to set

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236. *Id.*

237. *Id.*

238. *Id.*

239. *Id.*

240. *Id.*

241. *Id.* Israel also provides coverage to its citizens and visitors for medical care, lost wages and personal injuries suffered as a result of terrorist attacks pursuant to the Law for the Compensation of Victims of Enemy Action administered by the National Insurance Institute. *Id.* at 8-9.

242. Terrorism Risk Insurance Act of 2002, Pub. L. 107-297, 116 Stat. 2322 (2002).

243. 2001 GAO Report, *supra* note 228, at 15; *The Role of the Federal Government in Assuring that Insurance for Terrorist Acts Remains Available to American Consumers: Testimony Before the Senate Comm. on Commerce, Science and Transp.*, 107th Cong. 13 (2001) (statement of Diane Koken, Comm. of Ins., Pa.) [hereinafter Koken Senate Statement]; *Federal Assistance in Assuring that Insurance for Terrorist Acts Remains Available to American Consumers: Testimony Before the Senate Comm. on Banking, Hous. and Urban Affairs*, 107th Cong. 13 (2001) (statement of Kathleen Sebelius, Comm. of Ins., Kan.) [hereinafter Sebelius Senate Statement]; Press Release, National Association of Insurance Commissioners, NAIC Adopts "Guiding Principles" for Federal Insurance Pool Proposals (Oct. 17, 2001) [hereinafter NAIC Press Release]; Press Release, Consumer Federation of America, CFA Supports Federal Treasury Back-Up for Terrorism Insurance (Oct. 12, 2001) [hereinafter CFA Press Release].

appropriate premiums. Furthermore, by including all terrorist attacks regardless of their location within the scope of the definition, the Act eliminates the ability of insurers to self-select those risks they choose to retain and those they are willing to pass on to the government. Known as “cherrypicking,” this practice occurs when insurance companies choose to retain coverage for low risk structures while only purchasing federal reinsurance coverage for buildings and other structures deemed to be of high risk.<sup>244</sup> By including high risk and low risk insureds and their structures within its provisions, the Act serves to distribute the risk associated with future acts of terrorism while simultaneously shielding the federal government from assuming a disproportionate degree of exposure associated with high profile structures.<sup>245</sup>

There are, however, three potential problems with the definition selected for inclusion in the Terrorism Risk Insurance Act. Initially, the Act’s definition differs from that contained in other federal statutes, specifically those statutes defining the crime of terrorism. The Act is much broader than its criminal counterpart in that an act of terrorism may occur as a result of activities harmful to property and entities.<sup>246</sup> By contrast, the federal crime of terrorism includes only acts dangerous to human life.<sup>247</sup> However, the Act is narrower than the federal crime of terrorism as it requires that the activity in question be undertaken by persons or entities designated as terrorists by the U.S. Department of State or the Secretary of the Treasury.<sup>248</sup> This additional requirement is completely absent from the definition of the federal crime of terrorism, which conceivably applies to all persons and entities regardless of their designation.

The Act and its criminal counterpart are also inconsistent with respect to the intent required of those perpetrating acts of terrorism. Federal criminal law requires the purpose of the alleged terrorist activities to be the intimidation, coercion or exercise of influence upon any civilian population or government.<sup>249</sup> Thus, a person committing such an act in the United States with the intent of intimidating, coercing or influencing a foreign government or population has conceivably committed the federal crime of terrorism. In contrast, the Terrorism Risk Insurance Act requires that the intent of the activity in question be to coerce, affect or influence the civilian population of the United States or the U.S. government.<sup>250</sup> This is a much narrower definition than provided by federal criminal law to the extent that the required intent is limited to the United States. The Act’s reach is also narrower than federal criminal law based upon the

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244. *Insuring Terrorism Risks After September 11: Testimony Before Senate Comm. on Banking, Hous. and Urban Affairs*, 107th Cong. 4 (2001) (statement of J. Robert Hunter, President of the Consumer Federation of America) [hereinafter Hunter Senate Statement].

245. *Id.* at 9.

246. Terrorism Risk Insurance Act § 102(1)(A)(iii)(I-III).

247. 18 U.S.C. § 2331(1)(A) (2000).

248. Terrorism Risk Insurance Act § 102(1)(A).

249. 18 U.S.C. § 2331(1)(B)(i-iii) (2000).

250. Terrorism Risk Insurance Act § 102(1)(A)(iv).

exclusion of acts resulting in less than five million dollars in damage from the definition of terrorism, which limit is not part of federal criminal statutes.<sup>251</sup> Given the differences in these definitions, it is conceivable that a future attack may violate federal criminal law but not constitute an act of terrorism for insurance purposes. This possibility is exacerbated by the different governmental departments authorized to make such determinations, specifically, the U.S. Departments of Justice, State and the Treasury, and the different standards of proof necessary to support such determinations.

## 2. *The Financial Provisions of the Terrorism Risk Insurance Act*

The second feature of the Terrorism Risk Insurance Act meriting discussion is its financial provisions. Analysis of these features leads to mixed conclusions. The insurance marketplace aggregate retention amounts representing the maximum amount that all insurers participating in the program will be liable to pay out for certified terrorism losses in a given year may be too low. Given the wide variety of potential instruments of destruction that may be utilized in future terrorist attacks, the industry may be entitled to federal assistance for attacks that do not resemble the extraordinary events of September 11. Furthermore, there has been no indication of the source of these aggregate retention amounts. Most certainly it is not related to the industry's ability to weather losses of this magnitude as the industry has done so on a routine basis with other types of insurable (and equally unpredictable) events.<sup>252</sup> As such, it is reasonable to conclude that federal assistance may flow to insurers for a "non-extraordinary" terrorist attack (if such an event truly exists).

The generous assistance provisions may also discourage insurers from implementing necessary reforms of their risk assessment, pricing and coverage policies with respect to terrorism. This lack of incentive for the industry to undertake reform, including risk mitigation, will impact policyholders who may not receive needed encouragement to minimize their risk of incurring losses as a result of future terrorist attacks. Although section 103 places a one-billion-dollar cap upon the aggregate amount of financial assistance that may be provided to the industry, the Act also permits Congress to address additional losses.<sup>253</sup> This authority presumably includes the ability to appropriate additional sums. There would undoubtedly be considerable pressure placed on Congress to appropriate such funds in the event of industry losses in excess of one billion dollars. This pressure and the absence of guidelines for Congress to take into account in appropriating additional funds may render the effect of any cap on financial assistance nugatory.

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251. *Id.* § 102(1)(B)(ii).

252. *Supra* note 2 and accompanying text.

253. *Id.* § 103(e)(3).



There are benefits accruing from the financial provisions of the Act as drafted. Initially, the terms will permit the insurers to accumulate reserves that will be necessary to underwrite the risk of terrorism after the expiration of the Act. Second, the financial provisions should serve to maintain the solvency of individual insurers that may be severely impacted by future terrorist attacks. Furthermore, the Act's repayment plan imposes substantial requirements that must be met by insurers as well as substantial penalties for noncompliance.<sup>254</sup> However, the effect of this repayment obligation is somewhat muted by the wide latitude provided to the Secretary of the Treasury with respect to recoupment. The Act grants authority to the Secretary to waive mandatory recoupment under specific circumstances.<sup>255</sup> Nevertheless, the repayment provisions do serve to deflect some of the criticism with respect to the financial provisions of the Act. These provisions also prevent the program from deteriorating into an open-ended loan program to the industry.

The Act is also subject to criticism for fostering geographic discrimination. Specifically, section 103 of the Act grants the Secretary of the Treasury discretion in calculating and imposing loss risk-spreading premiums based upon geographic distinctions. These distinctions include decreased risk factors and the magnitude of loss associated with rural areas and smaller commercial centers.<sup>256</sup> As insurers are permitted to pass a portion of these assessments on to policyholders in the form of a premium surcharge, consumers in certain areas of the nation, particularly those operating in major urban and commercial areas, could be assessed higher premiums. To the extent that such considerations reflect the fundamental principle of pricing premiums to meet risk, section 103 makes perfect economic sense. However, the war against terrorism is not a regional conflict but rather a national enterprise, the weight of which should be bore equally by all sections of the country. To the extent that combating terrorism is deemed a national problem, any disproportionate shift of financial responsibility to specific regions of the country pursuant to section 103 constitutes an unfortunate example of geographic discrimination.

### 3. *Preemption and Litigation Management: The Role of State Law*

There are two additional criticisms of the Terrorism Risk Insurance Act that merit discussion. Initially, the Act runs roughshod over the traditional role of the states with respect to the regulation of insurance. Specifically, the Act expressly preempts any state law requiring or regulating terrorism coverage that is inconsistent with the Act.<sup>257</sup> The effect of such provision is that any commercial insurer complying with its requirements is considered to be in compliance with

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254. *Id.* §§ 106-07.

255. *Id.* § 103(e)(7)(B).

256. *Id.* § 103(e)(8)(D)(I)(i-iii).

257. *Id.* § 105(b).

any state law requiring or regulating coverage for acts of terrorism. Presumably, this means that any state rate law that restricts an insurer from increasing its premiums in an amount necessary to recoup assessments is preempted.

The federalization of this portion of the insurance market is understandable given that terrorism is a national issue worthy of national solutions. However, in its eagerness to address the issue, Congress should not overstep its bounds and lose sight of the expertise of the states in numerous areas of insurance regulation. State regulations with respect to insurer licensing, solvency surveillance, rate oversight, form requirements, and market research should not go by the wayside in any attempt to administer a federal terrorism insurance program.<sup>258</sup> Most importantly, insurance providers should not be allowed to utilize any federal program as a means of avoiding state consumer protection measures.<sup>259</sup> In this regard, states should remain free to assist policyholders during the claim settlement process.<sup>260</sup> Furthermore, jurisdiction over claim settlement practices should remain with the states.<sup>261</sup> As a general rule, the vibrant role of the states in insurance regulation should be retained to the greatest degree possible and, where so retained, subject to the least amount of federal interference.

A final criticism of the Terrorism Risk Insurance Act lies in its attempt to restrain civil litigation and attorneys with respect to causes of action arising from terrorist attacks through the guise of "Litigation Management." Of particular note is the federalization of all claims arising from acts of terrorism as determined by the Secretary of the Treasury.<sup>262</sup> The creation of an exclusive federal cause of action with respect to acts of terrorism is a further intrusion upon the role of the states with respect to insurance regulation. There is no evidence of flooding of state courts with cases relating to terrorism, the inability or incompetence of such courts to resolve these cases or abuse of such venues by claimants or their attorneys. The ability of the Secretary of the Treasury to unilaterally determine the existence of an act of terrorism without judicial review is also of considerable concern.<sup>263</sup> This provision imprudently places the discretion to increase federal jurisdiction while concurrently limiting state jurisdiction within the exclusive authority of a member of the executive branch. This provision raises the specter of industry lobbying of the executive branch for a determination of exclusive federal jurisdiction and potential manipulation of applicable standards.

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258. Koken Senate Statement, *supra* note 243, at 15; Sebelius Senate Statement, *supra* note 243, at 15.

259. Koken Senate Statement, *supra* note 243, at 15; Sebelius Senate Statement, *supra* note 243, at 15.

260. Koken Senate Statement, *supra* note 243, at 15; Sebelius Senate Statement, *supra* note 243, at 15.

261. Koken Senate Statement, *supra* note 243, at 15; Sebelius Senate Statement, *supra* note 243, at 15; CFA Press Release, *supra* note 243.

262. Terrorism Risk Insurance Act § 107(2).

263. *Id.* § 102(1)(C).

#### 4. The Strengths of the Terrorism Risk Insurance Act

Despite these shortcomings, the Terrorism Risk Insurance Act does contain two important and appropriate provisions that should characterize any federal assistance program. Initially, the assistance program terminates after three years.<sup>264</sup> A set date for termination is consistent with the views expressed by government commentators, state insurance commissioners, and consumer advocates.<sup>265</sup> The limits upon the duration of the assistance program give the insurance industry time to determine how and if to cover future terrorist attacks and how to price such policies.<sup>266</sup> In fact, it may be the case that the assistance program contemplated by the Terrorism Risk Insurance Act does not continue for a sufficient period of time for the industry to make these determinations.<sup>267</sup> The Act provides for this contingency by requiring the Secretary of the Treasury to submit a report to the U.S. Congress no later than June 30, 2005 assessing the Act's effectiveness, the ability of the industry to offer insurance for terrorism after the termination of the assistance program, and the availability and affordability of such insurance for policyholders.<sup>268</sup> Despite this limitation, the Act fails to establish standards for any future congressional determination to extend the Act's benefits. This lack of standards constitutes a design flaw that raises the possibility of self-perpetuation without careful monitoring.<sup>269</sup> In any event, the result that must be avoided is the creation of a permanent entitlement program that unjustly enriches insurance companies through the collection of enhanced premiums without an accompanying degree of risk and provides no incentive to the industry to take appropriate action to price future terrorism coverage. Only time will tell if the assistance program contemplated by the Act will actually be of limited duration or prove to take on a life of its own.

The second important and appropriate provision contained in the Act is the implicit recognition of the ultimate need for a market solution to the issue of terrorism insurance. Ultimately, any federal assistance program should supplement, but not replace, private insurance.<sup>270</sup> As noted by the General Accounting Office, private insurance providers should retain market incentives in any government assistance program.<sup>271</sup> Retention of these market incentives recognizes the industry's "long and proud record of finding ways to overcome new obstacles while advancing its business goals and serving the interests of the insurance-buying

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264. *Id.* § 108(a).

265. 2001 GAO REPORT, *supra* note 228, at 16; Koken Senate Statement, *supra* note 243, at 13; Sebelius Senate Statement, *supra* note 243, at 13; NAIC Press Release, *supra* note 243; CFA Press Release, *supra* note 243.

266. Koken Senate Statement, *supra* note 243, at 8; Sebelius Senate Statement, *supra* note 243, at 8.

267. See STANDARD & POOR'S, *supra* note 137, at 2 (contending that any "envisaged withdrawal by [the] federal government after 2004 raises questions about the future strength of commercial-lines carriers.").

268. Terrorism Risk Insurance Act, § 108(d)(1-2).

269. 2001 GAO REPORT, *supra* note 228, at 17.

270. Hunter Senate Statement, *supra* note 244, at 13.

271. 2001 GAO REPORT, *supra* note 228, at 16.

public.”<sup>272</sup> For example, the industry has discovered methods by which “to assess and insure extremely large and difficult risks that were initially considered uninsurable . . . [and] weathered enormous financial losses” associated with claims relating to asbestos, environmental contamination, and medical malpractice.<sup>273</sup> By requiring the industry to retain some degree of risk and repay a portion of any federal assistance, private firms will have the proper incentive to maximize efficiency with respect to setting premiums, establishing underwriting policies, and handling and adjusting claims.<sup>274</sup> Although the Act may allocate a disproportionate share of risk to the federal government and, ultimately, U.S. taxpayers, its recognition of the primacy of the private market in addressing the issues raised by the events of September 11 is a step in the proper direction.

## V. CONCLUSION

September 11 was a watershed event for the insurance industry. Prior to the attacks, coverage for acts of terrorism was extended on a routine basis on most commercial property and casualty policies. The industry’s most serious concerns were related to natural catastrophes, the 10 most costly of which in the past 30 years cost the industry \$77.1 billion on a global basis and \$57.3 billion in the United States.<sup>275</sup> By comparison, the three most expensive man-made disasters in the United States, the Los Angeles riots of 1992, the 1993 World Trade Center bombing, and the 1995 Oklahoma City bombing, resulted in losses totaling \$1.4 billion—an amount insufficient to make the top ten most costly catastrophes in the United States or the world.<sup>276</sup>

By comparison, the losses suffered by the industry on September 11 are forty-three to sixty-four times the combined amount of these three man-made disasters and will most likely exceed the combined losses attributable to the ten most costly natural disasters in the United States in the past thirty years.<sup>277</sup> In fact, it is conceivable that industry losses will exceed the combined losses for the ten most costly natural catastrophes in the world in the past thirty years.<sup>278</sup> The industry’s new focus has now become man-made risks. One might conclude that the insurance industry has met its greatest risk, and it is not Mother Nature, but rather humankind itself.

One of the many lessons of September 11 for the insurance industry has been adaptation to a newly perceived risk. It is not that the risk of terrorism was previously unknown. Rather, it was that the magnitude of the destruction and

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272. Koken Senate Statement, *supra* note 243, at 5; Sebelius Senate Statement, *supra* note 243, at 5.

273. Koken Senate Statement, *supra* note 243, at 4; Sebelius Senate Statement, *supra* note 243, at 4.

274. 2001 GAO REPORT, *supra* note 228, at 16.

275. *Supra* note 3 and accompanying text.

276. *Id.*

277. *Id.*

278. *Id.*

instantaneous financial impact were previously unimaginable.<sup>279</sup> Even assuming the accuracy of the more modest estimate of sixty billion dollars, the commercial property and casualty industry still stands to lose more than its combined net income for 1999 through 2001.<sup>280</sup> Such a loss is 120 times the \$500 million cost of the previous bombing of the World Trade Center in 1993.<sup>281</sup>

In assessing the enormity of the risk posed by terrorism, the insurance industry would be well-served to note that ultimate responsibility for adapting to this risk lies with the industry itself. Nevertheless, a strong case now appears for limited federal intervention in the commercial property and casualty insurance industries.<sup>282</sup> The U.S. government must now realize that which has been long known to other governments, most notably the British and Israeli governments, that the health of a significant portion of the economy is reliant upon the ability of private industry to procure and maintain affordable insurance. Any inability to obtain and retain such insurance in the wake of September 11 will seriously hinder the ability of the economy to rebound from its current doldrums and hamstring future growth. The reluctance of companies to reveal their lack of terrorism coverage and subsequent anecdotal nature of the inability to obtain such coverage is of no consequence. Despite considerable delay, the federal government has acted through the Terrorism Risk Insurance Act, the effectiveness of which remains to be determined.

Nonetheless, the government must resist two temptations. Initially, it must avoid trying to do too much in a hasty manner. The natural inclination of government under such circumstances is to overreact in an impulsive fashion. This has already occurred with respect to the overreaching nature and intrusiveness of the USA PATRIOT Act.<sup>283</sup> Traces of this same inclination are

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279. See Alexander G. Higgins, *Reinsurers Double Loss Estimates*, ASSOCIATED PRESS, Sept. 20, 2001 (quoting an unidentified spokesperson for Munich Reinsurance as stating that “[t]he attacks have revealed a previously unimaginable risk potential”).

280. See *supra* note 43 and accompanying text.

281. *Id.*

282. See Jackie Spinner, *Bush to Renew Insurance Drive*, WASH. POST, Apr. 4, 2002, at E6 (citing the opinion of Deborah B. Beck, the executive vice president of the Real Estate Board of New York, that “[terrorism insurance is] clearly a problem that is beyond the individual property owner and insurance industry’s capacity to solve on their own.”).

283. USA PATRIOT Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001). The official title of the USA PATRIOT Act is the “Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001.” Drafted and adopted by the U.S. Congress largely without the benefit of submission to the committee process within seven weeks of September 11, the USA PATRIOT Act was signed by President George W. Bush on October 26, 2001. *Bush Signs Anti-Terror Package*, S.F. CHRON., Oct. 27, 2001, at A6; see also Jonathan Krim & Robert O’Harrow, Jr., *Bush Signs into Law New Enforcement Era*, WASH. POST, Oct. 27, 2001, at A6. Despite the lack of substantive debate, the USA PATRIOT Act has proven controversial in the intervening months due to its provisions with respect to enhanced surveillance, money laundering and currency crimes, detention of suspected terrorists, the removal of obstacles to investigating terrorism, and the strengthening criminal laws against terrorism. See generally USA PATRIOT Act, §§ 201-25, 312-77, 413-18, 501-08, 801-17; see also Steve Fainaru, *Suspect Held 8 Months Without Seeing Judge*, WASH. POST, June 12, 2002, at A1; Steve Fainaru, *Justice Department to Examine Treatment of Detainees at 2 Jails*, WASH. POST, Apr. 3, 2002, at A7; George Lardner, Jr., *U.S. Will Monitor Calls to*

evident in aspects of the Terrorism Risk Insurance Act. Such overreaction must not be permitted to occur at the undue expense of taxpayers with respect to any future plan to assist the insurance industry.

Congress must also resist the temptation to politicize the issue of financial assistance to the industry. This is not a Republican or Democratic issue but rather one of the continuing financial well-being of the country. Industry trade associations must resist the temptation to overreach, and consumer protection advocates must quell their tendency to demonize the industry at every turn. Future cooperative efforts in the national interest cannot be permitted to degenerate into political bloodbaths.<sup>284</sup> Ultimately, with an even-handed approach by the federal government, cooperation between competing trade and consumer interests, and adaptation to the changed circumstances by the industry itself, insurance companies can emerge from the nightmare of the September 11 attacks risk savvy and financially stronger. All parties will be severely tested, but their success is absolutely essential. The stakes could not be higher, and ultimate success is absolutely essential.

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*Lawyers*, WASH. POST, Nov. 9, 2001, at A1; Jim McGee, *An Intelligence Giant in the Making*, WASH. POST, Nov. 4, 2001, at A4.

284. See Tamara Loomis, *Terrorist Attack Raises Complex Issues*, N.Y. L.J., Oct. 11, 2001, at 5 (citing the statement of Marvin Milton, President of Anderson Kill Loss Advisors, an insurance consulting company based in Wellesley, Massachusetts, that “[t]he odds are [insurance issues are] going to start out touchy-feely and end up a bloodbath”).

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