

**Project Group on Principles of Reinsurance Contract Law  
(PRICL Project Group)**

Zurich, Vienna, Frankfurt am Main

<https://www.ius.uzh.ch/de/research/projects/pricl.html>

in cooperation with the

**International Institute for the Unification of Private Law  
(UNIDROIT)**

Rome<sup>1</sup>

<https://www.unidroit.org/>

**NOTE  
ON  
THE PRINCIPLES OF REINSURANCE CONTRACT LAW  
(PRICL)  
AND  
THE COVID-19 HEALTH CRISIS**

authored by

KEVIN BORK, HELMUT HEISS, MARTA OSTROWSKA, JEFFREY W. STEMPEL,  
MANFRED WANDT, OLIVER D. WILLIAM IN COOPERATION WITH THE UNIDROIT  
SECRETARIAT

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<sup>1</sup> The present Note discusses the potential response to the COVID-19 health crisis exclusively by reinsurance contracts governed by the PRICL. It is not intended to express an official position of the PRICL Project Group or the UNIDROIT on the use or interpretation of the PRICL or the UNIDROIT Principles of International Commercial Contracts and exclusively reflects the authors' personal opinions. It merely constitutes a document for public discussion. The Authors wish to thank Professor Marcel Fontaine for his helpful comments on an earlier draft of the Note. For comments, please contact [pricl@rwi.uzh.ch](mailto:pricl@rwi.uzh.ch). Date of publication: 8 February 2023.

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## I. COVID-19 and (re)insurance

### 1. The COVID-19 outbreak

On 31 December 2019, the Chinese government reported its first pneumonia cases arising in the Chinese city of Wuhan. Shortly thereafter, it was determined that these cases were caused by an unknown type of virus named SARS-CoV-2 (also referred to as the coronavirus or the COVID-19 virus). The new, highly contagious virus began to spread to countries around the world, which resulted in the WHO declaring global pandemic. As of August 2022, there have been almost 600 million confirmed cases of COVID-19 in 223 countries, including more than 6 million deaths.<sup>2</sup> In an effort to reduce the spread of the virus, national governments were forced to put lockdown measures into effect, closing or limiting the operations of public and private businesses, thereby reducing individuals' exposure to the virus. This led the pandemic to cause not only a health crisis but also severe economic ramifications. In January 2022, the International Monetary Fund projected the cumulative output loss from the pandemic through 2024 to increase beyond USD 12.5 trillion.<sup>3</sup> The circumstances have also taken a toll on the insurance industry.

### 2. COVID-19 as an economic challenge: Its effects on insurance and reinsurance markets

According to the data submitted by insurers to the International Associations of Insurance Supervisors, the insurance sector has remained operationally and financially resilient overall throughout the crisis (see Figure 1)<sup>4</sup>. However, insurers' liabilities and underwriting activities have been affected by the pandemic and the government actions taken in response to it. The losses incurred simultaneously by individuals and businesses resulted in the submission of an overwhelming number of insurance claims in a short period of time. Clearly, the situation is the exact opposite to the one underlying the fundamental mechanism of risk pooling and redistribution. Highly correlated and aggregated risks have exposed insurers to unexpected payment obligations, and thereby to systemic risk. Although the pandemic is not yet over and

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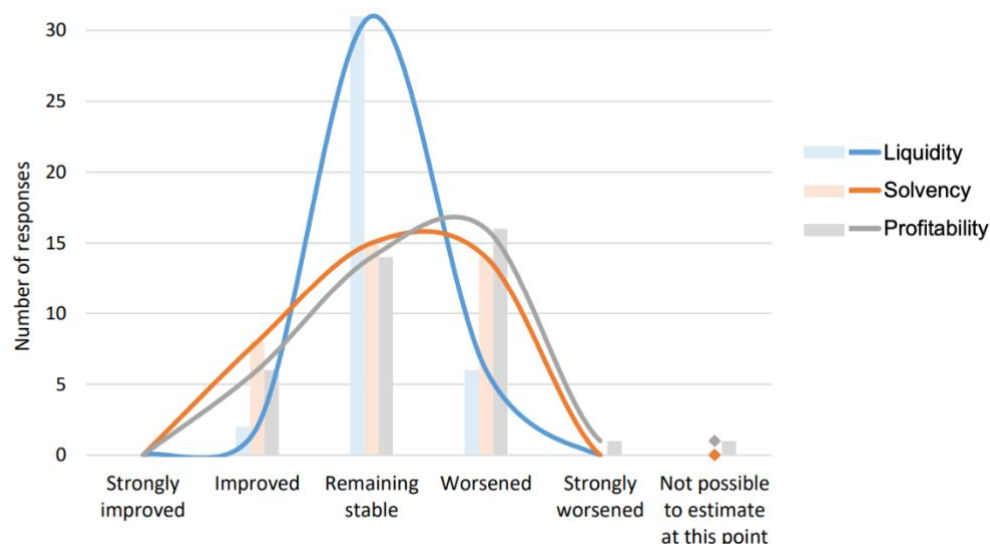
<sup>2</sup> WHO Coronavirus (COVID-19) Statistics available at: <https://covid19.who.int/>.

<sup>3</sup> Reuters, *IMF sees cost of COVID pandemic raising beyond USD 12.5trillion estimate*, 20 January 2022, available at: <https://www.reuters.com/business/imf-sees-cost-covid-pandemic-rising-beyond-125-trillion-estimate-2022-01-20/>.

<sup>4</sup> IAIS, *Global Insurance Market Report 2020. COVID-19 Edition*, 2020, 5.

the ultimate levels of claims that insurers and reinsurers will face as a result of the COVID-19 are still unknown, according to initial estimates, reported losses among large insurance and reinsurance companies have already reached USD 37.381 billion as of June 2021.<sup>5</sup> This number will continue to grow for some time, even after the pandemic has reached an end. The ultimate effect on claims will be shaped by different factors, such as late materialization of certain risks, rejection of claims falling out of the scope of coverage or resolution of coverage disputes and litigation. At the end of 2020, for instance, many courts in different jurisdictions were assessing whether the business interruption policy provided coverage against COVID-19-related losses.<sup>6</sup> Insurance Europe expects that the total global losses for the insurance sector will eventually amount to an estimated USD 50–100 billion,<sup>7</sup> whereas Willis Tower Watson estimates that, in the worst-case scenario, losses due to the pandemic may reach USD 140 billion.<sup>8</sup>

**Figure 1. Qualitative supervisory assessment of the impact of COVID-19**



Source: IAIS SWM 2020 Q2 data, IAIS Global Insurance Market Report 2020

<sup>5</sup> According to data collected by PeriStrat LLC and Reinsurance News, available at: <https://www.reinsurancene.ws/covid-19-insurer-reinsurer-loss-reports/>.

<sup>6</sup> OECD, *Global Insurance Market Trends 2021*, OECD, 2022, 5.

<sup>7</sup> Insurance Europe, *Position Paper. Response to IAIS consultation on the impact of COVID-19*, 1.

<sup>8</sup> Estimation for the US and UK market. See: Willis Towers Watson, *Scenario Analysis of the COVID-19 Pandemic. Analysis of key classes in the US and UK (including London Markets) P&C Insurance Industries*, 1 May 2020, 8.

Certain lines of business have been affected more significantly than others. For example, the greatest surge in claims has been reported for travel, event cancellation, business interruption and pandemic/excess mortality insurance (see Figure 2).<sup>9</sup> The main focus is on the losses associated with the widespread interruption of business activity. The Association of British Insurers estimates that of the claims paid by its members in the UK, three quarters will be related to business interruption losses.<sup>10</sup> Pandemic risk also has the potential to trigger different forms of liability insurance, including medical, professional and D&O liability,<sup>11</sup> if the insureds are found to have been negligent in their response to the pandemic. Furthermore, claims development in legal expenses insurance is anticipated due to legal disputes.<sup>12</sup> On the other hand, a temporary decrease in claims has been observed in relation to motor, marine, aviation and transport. Likewise, claims in health insurance decreased due to the postponement of providing healthcare services. However, when the healthcare services were carried out in 2021, the number of claims started to rise in most jurisdictions.<sup>13</sup> The increased number of deaths caused by COVID-19 has also affected life insurance business. Life insurance policies do not usually apply pandemic exclusions and therefore life insurers, as opposed to non-life business, will be obliged to pay most claims. The latest figures show that the life benefits paid were affected by the higher level of mortality claims but also a lower level of annuity pay-outs.<sup>14</sup>

According to the newest IAIS Global Insurance Market Report of 2021, almost 2 years after the COVID-19 outbreak, although the insurers' profitability is still under pressure, the market is slowly improving. Liquidity positions remained stable. Some lines of business, such as motor, property and casualty, have increased underwriting profits. However, event cancellation, travel, business interruption and credit insurance are still negatively affected.<sup>15</sup>

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<sup>9</sup> IAIS, *Global Insurance Market Report 2020. COVID-19 Edition*, 2020, 8.

<sup>10</sup> Association of British Insurers, *Covid-19: Payouts of over GBP 1.2 billion likely to be made to customers according to latest estimate from the ABI*, 25 April 2020, available at: <https://www.abi.org.uk/news/news-articles/2020/04/covid-19--payouts-of-over-1.2-billion-likely-to-be-made-to-customers-according-to-latest-estimate-from-the-abi/>.

<sup>11</sup> Insurance Europe, *Annual Report 2019-2020*, 12.

<sup>12</sup> OECD, *Global Insurance Market Trends 2020*, 2021, 27.

<sup>13</sup> Insurance Europe, *Insurance Europe: Preliminary Figures 2021*, Insurance Europe, July 2022, 13.

<sup>14</sup> Insurance Europe, *Insurance Europe: Preliminary Figures 2021*, Insurance Europe, July 2022, 10, 11.

<sup>15</sup> IAIS, *Global Insurance Market Report 2021*, 2021, 1, 8.

**Figure 2. Insurers' qualitative assessment of impact on insurance premiums and claims**



Source: IAIS IIM 2020 Q2 data, IAIS Global Insurance Market Report 2020

### 3. COVID-19 as a legal challenge: Reinsurance law in search of certainty

The extraordinary amount of loss caused by the COVID-19 crisis has caused tension in reinsurance relationships. The handshake mentality as traditionally observed in reinsurance relationships<sup>16</sup> will most likely not suffice by itself to resolve the tension. Legal disputes are to be expected and indeed demands for arbitration are currently being served by direct insurers upon many reinsurers, which may be followed by demands for arbitration served by reinsurers upon their retro-cessionaires. It is questionable to what degree the negotiations as well as proceedings between direct insurers and reinsurers will lead to solutions capable of satisfying the reasonable expectations of direct insurers without holding reinsurers liable for risks which they did not assume under the reinsurance agreement. Such solutions will be reached and recognized as fair by both parties more easily where the individual reinsurance agreement as well as the law applicable to the agreement provide the parties with legal certainty. Where

<sup>16</sup> See e.g. HEISS, From Contract Certainty to Legal Certainty in Reinsurance Transactions: The Principles of Reinsurance Contract Law (PRICL), in: Scandinavian Studies in Law, Volume 64 – Insurance Law, Stockholm 2018, 91.

reinsurance clauses are drafted in a vague manner and the law applicable is incapable of providing certainty, any settlement or arbitral award may leave disputants with a sense of not having been treated fairly or at least for having to accept a solution whose legal justification remains doubtful.

There are many sources of uncertainties in reinsurance relationships and they are mostly not COVID-19 specific. One of them is the many differences in national laws governing various transactions. Depending on the law chosen by the parties, crucial aspects of the contract, such as its conclusion, its validity, its interpretation or the existence of implied terms will be determined by the law chosen. More generally, the applicable legal rules determine the question of whether and, if so, which reinsurance customs should be taken into account in assessing the contractual relationship. Take the example of a reinsurance contract which does not contain a “follow-the-settlements clause”. While the reinsurer’s duty to follow the settlement of its reinsured will be accepted on the basis of a corresponding, purportedly international reinsurance custom when German law governs the contract and, similarly, will be considered an implied term by some US American courts, it will not be implied by all US American courts and rejected by English courts in the absence of a “follow-the-settlements clause” in the contract.<sup>17</sup>

Another source of uncertainty must be mentioned. Not only do the various laws differ in their substantive scope, many national laws also do not provide for a substantially coherent and comprehensive body of statutory or case law on reinsurance contracts. All they provide for is a set of rules on general contract law, including rules on contract interpretation. However, when it comes to reinsurance-specific issues, many national laws do not contain any provisions to govern them and, thus, do not provide for a default rule on the basis of which a particular wording in a reinsurance agreement could be interpreted.

These uncertainties are demonstrated in previous case law. Disputes arose e.g. concerning the term “event” (or equivalent terms), frequently used in aggregation clauses in reinsurance agreements.<sup>18</sup> In the absence of a background law giving guidance on the meaning of this term,

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<sup>17</sup> HEISS, From Contract Certainty to Legal Certainty in Reinsurance Transactions: The Principles of Reinsurance Contract Law (PRICL), in: Scandinavian Studies in Law, Volume 64 – Insurance Law, Stockholm 2018, 91.

<sup>18</sup> As to aggregation see below III.



English courts have established the so-called “unities test” yet failed to provide legal certainty.<sup>19</sup> Courts in the State of New York apply the “unfortunate event test”.<sup>20</sup> In many other jurisdictions, a default rule on what constitutes one event or one occurrence is simply missing. Disputes emerging from the COVID-19 pandemic have also raised uncertainties that the PRICL attempt to minimize by providing a set of principles that parties may incorporate into their contracts or refer to as widely accepted norms of the insurance/reinsurance industry.

#### 4. PRICL & PICC as a transnational background soft law

In view of the uncertainties in reinsurance contract law stated above, a Project Group was set up in 2016 to develop “Principles of Reinsurance Contract Law (PRICL)”. The Project Group is developing its Principles in cooperation with the International Institute for the Unification of Private Law (UNIDROIT) in Rome. The aim of the project is to provide reinsurance markets with uniform soft law rules on contract law issues. Contracting parties will be given the option of adopting the rules by way of a choice of law. Moreover, the PRICL pursue ideas similar to those of the Restatements of the American Law Institute (ALI) in the US. The ALI was founded “to promote the clarification and simplification of the law and its better adaptation to social needs, to secure the better administration of justice, and to encourage and carry on scholarly and scientific legal work.”<sup>21</sup> The Principles of Reinsurance Contract Law pursue the same aim, albeit at a transnational level.<sup>22</sup> In contrast, the PRICL must be distinguished from the Principles of European Insurance Contract Law (PEICL 2016). Not only do the PEICL exclude reinsurance contracts from their scope of application; they are also intended to be a model for a European regulation on insurance contract law in order to remove obstacles to the internal insurance market which are created by mandatory national rules on insurance contract law. They were not drafted to merely serve as a “soft” background law.

The first part of the PRICL was published in 2019. The PRICL provide for rules on reinsurance-specific issues. The second part of the PRICL is being drafted and the final version will be

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<sup>19</sup> WILLIAM, *Reinsurance and the Law of Agregation* (2021) 89 ff.

<sup>20</sup> STARING/HANSELL, *Law of Reinsurance* (2022) para 15:4.

<sup>21</sup> See the reference to the Charter at <https://www.ali.org/about-ali/creation/>, last accessed on 8 March 2018.

<sup>22</sup> See the Introduction to the 1994 edition of the UNIDROIT Principles of International Commercial Contracts, mentioning that the initiative of UNIDROIT goes into the direction of elaborating an international restatement of general principles of contract law.

published in 2024. Reinsurance-specific rules will only be able to provide legal certainty if they are based on a uniform and sound set of general contract rules. Such general contract law principles are set out in the PICC (Principles of International Commercial Contracts), which were elaborated and published by UNIDROIT. The PRICL and PICC together provide a quite comprehensive set of reinsurance contract law rules.

#### 5. The aim of this paper: PRICL and COVID-19

In this paper, an attempt shall be made to evaluate how a reinsurance contract governed by the PRICL would respond to the COVID-19 health crisis. For that purpose, it is assumed that parties had chosen the PRICL as the rules of law governing their reinsurance transaction.

According to Article 1.1.2 PRICL, issues not settled by the PRICL shall be settled in accordance with the UNIDROIT Principles of International Commercial Contracts 2016 (“PICC”). Thus, the parties’ choice in favor of the PRICL will, at the same time, constitute a choice in favor of the PICC. While the PRICL deal with reinsurance-specific issues of contract law, the PICC govern general issues of contract law, such as contract formation and interpretation.

The UNIDROIT Secretariat published a Note on “The UNIDROIT Principles of International Commercial Contracts and the COVID-19 Health Crisis” on 15 July 2020 (hereinafter “Note”). The Note’s focus was on the question of the extent to which parties to an international commercial contract may rely on defenses such as hardship (Articles 6.2.1 ff PICC) and force majeure (Article 7.17 PICC) due to the health crisis. Reinsurance is, of course, not dealt with specifically in that Note. Therefore, the present Note will, firstly, show the impact of the PICC’s rules on hardship and force majeure in the context of reinsurance, and, secondly, deal with reinsurance-specific issues of the health crisis from the point of view of the PRICL.

The reinsurance-specific issues dealt with in this paper are loss aggregation (infra Section III.) and follow-the-settlements/follow-the-fortunes (infra Section IV). Issues concerning loss aggregation prove to be of major concern whenever reinsurance claims concerning COVID-19 cases are settled and particularly when such claims are made subject to arbitration. Issues concerning follow-the-settlements/follow-the-fortunes are of obvious relevance too since

reinsureds try to recover for payments made based on settlements, court judgments or interventions by national governments and authorities.

## **II. The background of the UNIDROIT Secretariat's Note on the UNIDROIT Principles of International Commercial Contracts and the COVID-19 Health Crisis**

In the context of the COVID-19 outbreak and the resulting public health and economic crises, which became evident in the first half of 2020 all around the world, the UNIDROIT Secretariat decided to reflect on how the PICC could help address the main contractual disruptions caused by the pandemic directly as well as by the measures adopted as a consequence thereof.

Hence, the Secretariat issued a Note in July 2020, which was published on the UNIDROIT website.<sup>23</sup>

It is important to underline that the aim behind issuing the Note was not to provide solutions to specific cases, but to help the reader identify the appropriate questions to ask and to consider the relevant facts and circumstances in each case. Naturally, solutions will vary according to the particular context of the pandemic in each jurisdiction and there is no one-size-fits-all approach. Considering the different ways the Principles have thus far been used in practice, the document is intended, in particular, to help parties use the UNIDROIT Principles when implementing and interpreting their existing contracts or when drafting new ones in the time of the pandemic and its aftermath; to assist courts and arbitral tribunals or other adjudicating bodies in deciding disputes arising out of such contracts; and to provide legislators with a tool to modernize their contract law regulations, wherever necessary, or possibly even to adopt special rules for the present emergency situation.

### **1. The UNIDROIT Principles and the regulation of supervening events**

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<sup>23</sup> Note of the UNIDROIT Secretariat on the UNIDROIT Principles of International Commercial Contracts and the COVID-19 Health Crisis, available at: <https://www.unidroit.org/english/news/2020/200721-principles-covid19-note/note-e.pdf>. The Note was drafted with the assistance of Prof. M.J. Bonell and benefited from substantial inputs provided by Prof. M. Fontaine, as well as from very helpful comments given by Prof. B. Fauvarque-Cosson, Mr. Ch. Seppala, Mr. F. Parise Kuhnle and Prof. D. Wallace.

The starting point of the Note was the consideration that although the pandemic has interfered with the ordinary execution of commercial contracts in many ways, the most obvious problems have concerned performance by at least one of the parties. It was also important to underscore the exceptional nature of the interference caused by the pandemic and its consequences, in light of its initial unforeseeability, global reach and intensity. Extraordinary situations require extraordinary solutions, and there is a global need to ensure that the economic value enshrined in commercial exchanges is preserved.

As it is well known, supervening circumstances, such as the ones resulting from the pandemic and its consequences, are normally discussed at domestic level using traditional concepts such as “frustration”, “act of God”, “impossibilité”, “Unmöglichkeit”, “imposibilidad en el cumplimiento”, “force majeure”, or of “imprévision”, “Störung der Geschäftsgrundlage”, “rebus sic stantibus”, “eccessiva onerosità sopravvenuta”, to mention but a few, and the solutions may vary considerably from country to country. Accordingly, it was necessary to analyze whether parties may invoke COVID-19 as an excuse for non-performance, and if so, based on which concepts and under what conditions; furthermore, the analysis also covered the situation, likely to be common in practice, where performance was still possible, but became substantially more difficult and/or onerous under the circumstances.

In relation to supervening circumstances, the UNIDROIT Principles undoubtedly offer parties and adjudicators a modern, flexible, and uniform approach, particularly in the provisions on “force majeure” (Article 7.1.7) and “hardship” (Articles 6.2.2–6.2.4). In their application, moreover, such provisions benefit from the general context of the contractual regulation provided by the PICC, concerning, among other things, the general principle of good faith (Article 1.7) and the duty of cooperation between the parties (Article 5.1.3), the rules on contract interpretation (Chapter 4), and the duty to mitigate harm (Article 7.4.8). A further element that ties the provisions of the UNIDROIT Principles with the specific factual circumstances of each case is the reliance on the notion of “reasonableness”: in applying the provisions on force majeure and hardship, the interpreter needs to consider what a person acting in good faith and in the same situation as the parties would consider to be reasonable, taking into account the nature and purpose of the contract, the circumstances of the case, and the usages and practices of the trades or professions involved.

Such an open and nuanced approach can help preserve valuable contracts for the parties. Especially (though not exclusively) in mid-to-long term contracts, and in view of the – apparently – temporary nature of the impediment, mechanisms that allow for an adequate renegotiation and proportionate allocation of losses could ultimately help preserve the contract and maximize value.

## 2. Force majeure in the UNIDROIT Principles and the COVID-19 pandemic

### a) The regulation of force majeure in Article 7.1.7

The provisions in the UNIDROIT Principles governing force majeure are found in the chapter on non-performance (Chapter 7), in the section on non-performance in general. The effect of the application of Article 7.1.7 is essentially to exonerate the obligor from paying damages for non-performance, and to suspend performance when the impediment is only temporary, while leaving other rights of the obligee unaffected. Despite its name, the concept of force majeure envisaged in Article 7.1.7 does not coincide with the traditional meaning given to that same expression in many civil law jurisdictions. Some of its elements also differ from equivalent constructs of civil and common law. Rather, it is intended to respond to the needs of commercial contractual practice.

Following the model of existing uniform law in the field of international sales (in particular the CISG), strict impossibility of performance is not required to invoke force majeure under the UNIDROIT Principles, which instead use the concept of “impediment” (which can also be temporary). However, a strict burden of proof is imposed on the non-performing party. First of all, there needs to exist a relevant obstacle and a causal link between the obstacle and the non-performance. In this case, the party invoking the force majeure will need to prove causation between the pandemic, or the measures adopted because of the pandemic, and the non-performance of the obligation due under the contract. The solution may vary depending on the type of contract or obligation involved. For example, the outbreak of COVID-19 may have impeded performance of certain contracts by directly affecting the health of a key performer (i.e., in those cases where the personal characteristics of the obligor constitute an essential part of the contractual consideration), or indirectly causing the temporary suspension or restriction of certain activities through containment measures imposed by public authorities (shutdown of factories; limitations on cross-border movements affecting employees or other workers, or

impacting on the opportunity to conduct an activity abroad; impediments affecting the activity of business parties in other countries, who, e.g., cannot import the goods from their suppliers because of an export ban; etc.). This, however, does not apply to all types of contract. Other types of contract could - and can still - be regularly executed during the time of COVID-19 because their performance is not affected, or only affected in a limited way, by the pandemic itself or by the containment measures. The non-performing party should, moreover, prove that: (a) the impediment was beyond its control; (b) it could not have reasonably foreseen the impediment at the time of conclusion of the contract; (c) it could not have been reasonably expected to have avoided or overcome the impediment or its consequences. The Note looks, in particular, at time and geographical location as key factual circumstances to be considered in order to ascertain whether such requirements are met (paras. 20-21). It also distinguishes between consequences of the pandemic as such and consequences of governmental measures, which were different depending on the time and jurisdiction concerned, adding a further element of complexity to the analysis (para. 22). Lastly, it offers a forward-looking insight into the situation of contracts in the aftermath of the pandemic (para. 23).

#### b) Force majeure clauses in the contract

The UNIDROIT Principles provisions on force majeure, mitigation of harm and the duty of cooperation between the parties are necessarily of a general character. Therefore, the parties may wish to stipulate in their existing (where subject to renegotiation) and future contracts a specific force majeure clause, including more detailed provisions or deviating from some requirements of the general rules of the Principles. Common features of force majeure clauses as they appear in practice are, for instance: the suspension of the contract indicated as the first remedy, whereas termination is only envisaged as a remedy if the obstacle appears to be permanent; furthermore, the inclusion of mechanisms triggering a renegotiation of the contract terms (which may contain provisions for the situation where renegotiation fails) in case the impediment lasts for longer than a certain period of time. Other common contractual provisions regard the attenuation of some of the above-mentioned requirements of force majeure and more specific indications of ways to provide evidence of the impeding event. Given the uncertainty surrounding the duration of the health crisis and the potential insurgence of new waves, the inclusion by the parties of a detailed clause might be advisable for future contracts, or for existing contracts which are subject to renegotiation. The Note provides further examples of

possible elements that parties may wish to expressly govern in a force majeure clause (para. 30).

### 3. Hardship in the UNIDROIT Principles

#### a) The provisions for hardship in Articles 6.2.1-6.2.3

The section on hardship starts by highlighting the binding character of the contract and its risk allocation as originally envisaged by the parties (Article 6.2.1): performance as initially agreed is, hence, conceived as binding notwithstanding a change of circumstances, in principle regardless of the burden it may impose on the obligor. This general rule is, however, subject to exceptions when supervening circumstances fundamentally alter the equilibrium of the contract, either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished. This alteration would constitute a situation of "hardship" under Articles 6.2.2 and 6.2.3, provided that additional requirements are met: the supervening circumstances could not reasonably have been taken into account by the disadvantaged party at the time the contract was concluded, these are beyond the control of the disadvantaged party, and the risk of the events was not assumed by the disadvantaged party. Thus, application to any particular case should be based on all the relevant circumstances of and surrounding the contract (nature of the contract, characteristics of the expected performance, conditions of the relevant market at the relevant time, etc.). The Note provides a number of specific examples of circumstances that may have increased the cost of a party's performance or diminished its value in the context of the COVID-19 pandemic (para. 37); it also analyses the potential relevance of chronological and geographical factors as well as the impact of the pandemic itself and of the different measures adopted by governments (para. 38).

In case of hardship, the UNIDROIT Principles seek to allow the parties to reinstate the equilibrium that has been altered by a set of circumstances, thereby placing one of the parties in a fundamentally disadvantaged position. This is a particularly relevant and useful tool for long-term contracts, where it might often be in the interest of both parties to ensure that temporary, exceptional circumstances (such as those generated by the COVID-19 and the accompanying measures) do not thwart a relationship otherwise considered to be balanced and beneficial for all. In light of this aim, the disadvantaged party is entitled to request renegotiation of the original agreement with a view to adapting it to the changed circumstances. The request

to open renegotiations does not in itself entitle the disadvantaged party to withhold its performance (Article 6.2.3(2)), unless there are exceptional circumstances which objectively warrant it, i.e. circumstances that could be linked with the impossibility of eliminating – even partially – the consequences of performance before renegotiation takes place.<sup>24</sup>

Both the request for renegotiations by the disadvantaged party and the conduct of both parties during the renegotiation process are subject to the general principle of good faith and fair dealing (see Article 1.7) and to the duty of co-operation (see Article 5.1.3). Similarly, once the request is made, both parties must conduct the renegotiations in a constructive manner, in particular by refraining from any form of obstruction and by providing all the necessary information (see Comment 5 to Article 6.2.3). The renegotiations must be conducted to restore the lost, initially agreed equilibrium. They are thus not conceived as a fresh start to renegotiate the terms of a contract *ex novo*, but rather as an opportunity to replicate, under the new circumstances, the allocation of rights based on the proportionality envisaged in the original agreement. It should be noted that the provisions of the Principles on the conclusion of the contract (Chapter 2) and its validity (Chapter 3) would be applicable to the conclusion of the new agreement resulting from the renegotiations. These provisions would offer a remedy, for example, in case a party, availing itself of the exceptional circumstances created by the pandemic, would unjustifiably seek to take unfair advantage of the other party's dependence, economic distress or urgent need deriving from the COVID-19 situation (see Article 3.2.7).

If the parties fail to reach an agreement within a reasonable time, either of them may resort to a court or arbitral tribunal which, if it finds hardship, may terminate the contract at a date and on terms to be fixed, or adapt the contract with a view to restoring its equilibrium (but only if this is reasonable (Article 6.2.3(3) and (4)), direct the parties to resume negotiations, or simply confirm the terms of the contract as they stand (cf. Comment 7 to Article 6.2.3(4)). At least for contracts concluded before the end of 2019, or in the first stages of development of the health

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<sup>24</sup> The following example, modelled on Comment 4 to Article 6.2.3, may help clarify the type of exceptional circumstances envisaged: A enters into a contract with B for the construction of a plant, which is to be built in country X. This country adopts new safety regulations in the light of the risks posed by the COVID-19 pandemic, requiring the use of additional machinery, and a different type of materials, more costly but safer for builders due to its higher isolation power. This situation makes A's performance substantially more onerous. Depending on all other requirements of art. 6.2.3 being met, A might be entitled to temporarily withhold - at least partial - performance in view of the time it needs to implement the new regulations.



crisis, the outbreak of a global pandemic and the extreme measures adopted in many jurisdictions would seem to be a likely case for some sort of apportionment of the damage that arose under such extraordinary circumstances. But again, this assertion might have to be qualified depending on the specific circumstances of the case.

b) Hardship clauses in the contract

As is the case with force majeure, parties may wish to stipulate in their contract a specific hardship clause with more detailed provisions or deviating from some requirements or other elements of the general rules of the Principles, which would prevail over the default rules. With specific reference to cases of pandemic such as COVID-19, a hardship clause may for example take into account the different ways in which a fundamental alteration of the equilibrium of the contract may arise, as a consequence of the pandemic as such and/or of the containment measures adopted by public authorities. Parties could restrict the right to invoke hardship by making it dependent on the territorial extension (e.g. local or nationwide) and/or the duration (e.g. a minimum of X days) of the pandemic and/or the containment measures adopted by the public authorities. Parties may, on the other hand, prefer a different or more specific criterion than the “fundamental alteration of the equilibrium” provided for in the Principles to determine a situation of hardship. A grace period could be stipulated before the occurrence of hardship can be invoked. Finally, in relation to long-term contracts which require a significant level of investment by both parties, parties may further wish to allow for renegotiation even when not all the requisites of Article 6.2.1 – and particularly that of foreseeability – are met, with a view to redistribute the risk of a future adverse event similar to the present pandemic.

Moreover, parties may draw inspiration from the remedies provided in Article 6.2.3 of the UNIDROIT Principles, if appropriate adapting them to their needs. In respect of the right to request renegotiations, for example, parties may wish to introduce further elements concerning the organization of the renegotiations (e.g. location, duration, aims), and/or specify its effects on any performance otherwise due (continuation, or temporary suspension).

Even more importantly, parties may wish to regulate what happens if renegotiations fail. A party (or both) could have an option to terminate the contract, or on the contrary, performance of the contract would be resumed on unchanged terms. These are radical solutions, the main purpose of which is to give a strong incentive to parties to try to negotiate in the most constructive way. Particularly in the case of long-term contracts parties may, however, opt for other solutions, such as that the disputed matters be discussed in the framework of a mediation

board facilitating the reaching of a consensus, or be referred to a neutral dispute resolution board or other adjudicating body. In this respect, considering the special circumstances created by the pandemic, parties may wish to resort to online dispute resolution bodies. Parties may also wish to agree on several dispute resolution methods to be used on a sequential basis in order to avoid and solve conflicts.

#### 4. Application to reinsurance agreements

As demonstrated in the introductory remarks on COVID-19 as an economic challenge to the insurance and reinsurance industry, the health crisis has, so far, placed a probably unprecedented burden on the insurance and reinsurance industry and will continue to burden it. Reinsurance as a global business industry faces a global disaster, leading to enormous liabilities for reinsurers. Therefore, reinsurers might consider to rely on the PICC rules on hardship and/or force majeure applicable to reinsurance contract which are subject to the PRICL. However, reinsurers will, as a general rule, not be able to rely on defenses such as hardship and force majeure in situations as the pandemic.

A core aspect of the typical reinsurance contract is the shifting of some of the insurer's risk to the reinsurer, just as the reinsured accepts risk shifted to it from the underlying policyholders. Consequently, in the absence of coverage limitations specifically addressing epidemics and pandemics, use of a hardship or force majeure defense to defeat cover improperly defeats the purpose of insurance and reinsurance. Relying on defenses, such as hardship or force majeure, would defeat the very purpose of pandemic cover in the reinsurance agreement. In the same vein, once pandemic risks are insured under a reinsurance agreement, they will obviously not have gone unnoticed by the parties, but will, in fact, have been a focus of the transaction. Thus, there is nothing unforeseeable in a pandemic, even if the virus causing it had been unknown before its outbreak. Though nothing excludes that parties may draw inspiration from some aspects of the hardship provisions of the PICC in order to contractually address issues of epidemics and pandemics, those issues will be more commonly addressed through the means of specific coverage limitations and other specific clauses in line with the purpose of such contracts.

This does not, of course, exclude the applicability of the respective rules in the PICC in other contexts, that are not COVID-19 related. Exceptional situations can be imagined, such as a fire or a flood destroying the offices and the files of the (re)insurer, preventing timely settlement of

losses (force majeure), or a monetary crisis leading to a dramatic inflation which would deeply increase the amounts of losses to indemnify (hardship). The authors of the Note, however, are unaware of any concrete examples so far in reinsurance practice.

### III. Loss aggregation

#### 1. Introduction

In excess of loss reinsurance, reinsurers only cover the amount of a loss exceeding the reinsureds' retention (deductible, excess point, attachment point) but not piercing the agreed upon cover limit. Handling losses, therefore, presupposes an educated understanding of what *one* loss is. As is the case in primary insurance contracts, the parties to a reinsurance contract often agree on a so-called aggregation clause (loss occurrence clause) pursuant to which one loss may be constituted by a multiplicity of individual losses that stem from one event or cause.

Loss aggregation has proven to be particularly critical in the context of treaties reinsuring an entire portfolio of underlying contracts that each provide cover for COVID-19 losses. On the level of the reinsurance treaty, the question is raised as to whether COVID-19 losses covered by different individual underlying contracts in the portfolio may constitute one loss under the treaty if they arise from a common event or cause. In other words, the question becomes whether the individual losses covered under different underlying contracts are to be aggregated under the reinsurance treaty.

The PRICL deal with loss aggregation in Chapter 5. Despite its name, the concept of aggregation envisaged in Chapter 5 does not coincide with the traditional concepts in English law<sup>25</sup> and many US jurisdictions. It is a novel concept aimed at dispelling some legal uncertainty that is inherent in the classical concepts. Hence, we are not suggesting that terms such as “event” or “cause” should be interpreted in the same way under English or any US law as we do in applying the PRICL. Depending on the scenario in question, it may well be that in the English or a US understanding, a “cause” may be what we consider an “event” under the

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<sup>25</sup> Cf. *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others* [2022] EWHC 2548 (Comm) for an account of the English law dealing with aggregation issues in the context of COVID-19. See also *Greggs Plc v Zurich Insurance Plc* [2022] EWHC 2545 (Comm); *Various Eateries Trading Ltd v Allianz Insurance Plc* [2022] EWHC 2549 (Comm).

PRICL and *vice versa*. For this reason, the rules and ideas envisaged in Chapter 5 of the PRICL should not be indiscriminately applied where the reinsurance treaties are not governed by the PRICL.

It is, further, important to highlight that even if a contract of reinsurance is governed by the PRICL, the parties may, in accordance with Article 1.1.3 PRICL, adapt the aggregation mechanisms provided for in Chapter 5 to their needs or deviate from them altogether.

In Article 5.1 PRICL, which itself has no normative bearing, the concept of aggregation and the normative provisions of Articles 5.2 and 5.3 are introduced. Article 5.2 is meant to provide guidance as to what is a relevant event in the context of loss aggregation and thus which individual losses are to be aggregated under a so-called event-based aggregation clause. Article 5.3 serves to assist in determining what is a cause in the context of loss aggregation and accordingly in understanding which individual losses are to be aggregated under a so-called cause-based aggregation clause.

Both in Article 5.2 and Article 5.3 PRICL, the peril against which the reinsurance has been purchased is of particular importance. Sometimes, reinsurance contracts specifically define or describe the perils for which they provide coverage. Regularly, however, they do not explicitly spell out the reinsured perils, but instead refer to the risks covered by the primary insurance policies contained in the portfolio. Such a reference clause may read as follows:

This Contract shall indemnify the Reinsured in respect of all business wheresoever written by the Reinsured in its Property, Construction and Engineering [...].

In such cases, the parties define the perils reinsured by reference to the insuring clauses in the underlying contracts. Thus, the materialization of a peril reinsured against becomes the materialization of the insured peril under a primary insurance contract. The examples contained in this Note are based on the idea that the reinsurance treaty does not itself define the perils reinsured against but refers to the risks covered under the underlying contracts.

This section focuses on losses resulting from COVID-19, such as business interruption losses. A variety of different clauses insuring business interruption losses are used in the market. For present purposes, we will examine a “prevention of access clause” and a “disease clause”

regularly contained in an extension to basic business interruption covers of primary insurance contracts. Such clauses generally appear in first-party insurance policies. Accordingly, only aggregation mechanisms of reinsurance treaties reinsuring first-party insurance policies will be discussed.

## 2. Event-based aggregation and COVID-19 coverage

### a) Text

#### Article 5.2

#### (Event-based aggregation)

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

### b) The contours of the concept of Article 5.2(1)

The application of the provision is restricted to situations where the parties include an event-based aggregation clause in their contract of reinsurance. Article 5.2(1) PRICL provides for an aggregation mechanism where first-party insurance policies are reinsured. The provision requires the following three step analysis:

1. Determination of the materialization of a reinsured peril, i.e. an event;
2. Determination of the number of instances the peril has materialized;
3. Each and every individual loss must be tested to determine whether it can be considered a “direct consequence” of the relevant event.

As previously mentioned, the workings of Article 5.2(1) PRICL will be tested against a prevention of access clause as well as a disease clause.

### c) Prevention of access clause

*1. Determining the relevant event.* By reference, the insured peril under the underlying contract may become a peril reinsured against under the reinsurance treaty. Pursuant to Article 5.2(1) PRICL, any materialization of the peril is an event for the purposes of loss aggregation.

Primary insurance is regularly being taken out against losses resulting from the prevention of accessing business premises. A variety of different wordings for such a cover exist in the market. An underlying contract may e.g. provide cover for “loss ... resulting from ... Prevention of access to the Premises due to the actions or advice of a government or local authority due to an emergency which is likely to endanger life or property” (Arch wording; *The Financial Conduct Authority v Arch Insurance (UK) Ltd and others* [2021] UKSC 1 [96], [245 ff.]).

In *The Financial Conduct Authority v Arch Insurance (UK) Ltd and others*, the UK Supreme Court concluded that the peril would have materialized only if the business interruption loss arose from the prevention of access to the premises resulting from the actions or advice of a government or local authority, which in turn was caused by an emergency that was likely to endanger life [245]. It found that the COVID-19 pandemic was an emergency endangering life [246] that led the government to forbid [116, 120] certain policyholders from accessing their business premises [155] which ultimately led to business interruption losses.

In accordance with the wording of Article 5.2(1) PRICL, the peril reinsured against materialized with governmental actions or advice which prevented policyholders from accessing their business premises where such actions or advice were based on the emergency situation created by COVID-19.

2. *Determination of the number of instances of the materialized peril.* Only individual losses that occur as the consequence of the *same* materialization of the reinsured peril are to be aggregated. Thus, each materialization of a peril reinsured against constitutes a separate event. In order to determine whether an event has materialized once or multiple times, it is necessary to establish the meaning of the wording used by the parties in their description of the perils covered. The interpretation of the reinsurance treaty is governed by Chapter 4 of the PICC (see Article 1.1.2 PRICL). If the parties’ intention cannot be established with certainty, Article 4.1(2) PICC requires a contract to be interpreted according to the meaning a reasonable person in the same circumstances as the parties would give to it.

In *The Financial Conduct Authority v Arch Insurance (UK) Ltd and others*, the UK Supreme Court interpreted the mentioned prevention of access clause under English law and not under the PICC. In the judgment, it noted that the interpretation of an insurance policy must be

conducted “objectively by asking what a reasonable person, with all the background knowledge which would reasonably have been available to the parties when they entered into the contract, would have understood the language of the contract to mean” [47]. The interpretation principles used by the UK Supreme Court appear to be similar to those promoted by Article 4.1(2) PICC. For reasons of simplicity, we, therefore, apply the interpretation of the insured peril by the UK Supreme Court, but emphasize that in reality under the PRICL, the interpretation of a reinsurance contract is governed by the PICC and not the English law of contract interpretation.

In order to assess the number of instances the peril has materialized, the wording of the clause must be interpreted.

Closely following the wording of the clause, it is not any single action that a government takes or piece of advice that a government gives that constitutes the materialization of the peril, but the entirety of “actions” taken and advice given due to “an emergency which is likely to endanger life”. Accordingly, all of the measures taken by a government, no matter whether they are announced in one or multiple statements or enacted in one or multiple statutory instruments, constitute one single event if they are aimed at preventing COVID-19 from spreading.<sup>26</sup>

*3. The requirement of direct consequence.* Article 5.2(1) PRICL allows for an aggregation only if the individual losses can be said to be the event’s direct consequences. If an individual loss can be considered “an inevitable result of the relevant aggregating event”, the former may be considered the latter’s direct consequence (Comment C18 to Article 5.2). By contrast, if an intervening factor has, independently of the event, decisively contributed to the occurrence of the individual loss, the latter cannot be considered the event’s direct consequence (Comment C18 to Article 5.2). This does not mean, however, that the relevant event must be a happening immediately preceding the occurrence of the individual losses (Comment C19 to Article 5.2).

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<sup>26</sup> By contrast, see *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others* [2022] EWHC 2548 (Comm), 186, where it was argued that a number of different government measures constituted a number of occurrences. This difference between the PRICL and the law of England and Wales lies in the fact that under English law an “event” or “occurrence” is not derived from the insured peril but constitutes some other happening.

In the context of the COVID-19 pandemic, this raises the question of whether an individual business interruption loss sustained by a policyholder can be considered an inevitable result of the government's order not to access his business, or whether an intervening factor (other than the government order) has independently and decisively contributed to the occurrence of that individual loss. The UK Supreme Court found that the actions taken by the English Government inevitably caused the individual business interruption loss [247]. Therefore, any individual business interruption loss sustained by a policyholder may be considered a direct consequence of the relevant event within the meaning of Article 5.2(1) PRICL.<sup>27</sup>

*4. Conclusion.* The wording used in the prevention of access clause is quite broad. Cover is provided for government actions and advice that are not individually directed to any one policyholder. Yet, a critical number of policyholders are directly affected by the government orders. This broad description of the peril against which the underlying policies provide cover has a direct impact on the breadth of the aggregation mechanism. The set of measures taken by the government constitutes one single event and any individual losses resulting therefrom can be considered their direct consequence, so that they are all to be aggregated under Article 5.2(1) PRICL.

Yet, a narrow description of the peril insured against in the underlying contract leads to a narrow aggregation mechanism. An example of this is the RSA3 disease clause to be discussed below.

d) Disease clause

*1. Determining the relevant event.* Primary insurance is regularly taken out against losses resulting from business interruption due to the occurrence of a notifiable disease in a certain vicinity. A variety of different wordings for such type of cover exist on the market. An underlying contract may, e.g., provide cover for an interruption of business “following any occurrence of a Notifiable Disease within a radius of 25 miles of the [insured] Premises” (wording in RSA3, (a)(iii)). Regularly, the underlying contracts containing such a clause define

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<sup>27</sup> Cf. *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others* [2022] EWHC 2548 (Comm), 191, where it was held that the instructions given to all pubs, bars and restaurants to close on 20 March and not to reopen the next day was a single occurrence and that the requirements of causation between this occurrence and the individual losses were met.



the notion of notifiable disease as “illness sustained by any person resulting from [...] any human infectious or human contagious disease [...] an outbreak of which the competent local authority has stipulated shall be notified to them”.

By reference, the insured peril under such an underlying contract becomes a peril reinsured against under the reinsurance treaty. Pursuant to Article 5.2(1) PRICL, any materialization of the peril “occurrence of a Notifiable Disease within a radius of 25 miles of the [insured] Premises” is an event for the purposes of loss aggregation.

*2. Determination of the number of instances of the materialized peril.* As mentioned previously, only individual losses that occur as the consequence of the *same* materialization are to be aggregated, so that each materialization of a peril reinsured against constitutes a separate event.

In *The Financial Conduct Authority v Arch Insurance (UK) Ltd and others*, the UK Supreme Court concluded that “each case of illness sustained by an individual” constitutes a separate occurrence of a notifiable disease [69]. The cover is provided for business interruption losses that are caused by an individual becoming ill “within a radius of 25 miles of the premises from which the business is carried on”.

In line with this interpretation, each individual contracting COVID-19 and thereby causing a business interruption constitutes one separate event under Article 5.2(1) PRICL. It may be that an individual contracting COVID-19 lives within 25 miles of multiple business owners that each suffered business interruption losses. Accordingly, one single event, i.e. the contraction of COVID-19 by an individual within 25 miles of the premises may have caused multiple individual losses. This does not necessarily mean, however, that such individual losses are to be aggregated.

*3. The requirement of direct consequence.* The reason for this is that Article 5.2(1) PRICL allows for an aggregation only if the individual losses can be said to be the event’s direct consequences, i.e. if an individual loss can be considered “an inevitable result of the relevant aggregating event” (Comment C18 to Article 5.2). By contrast, if an intervening factor has, independently of the event, decisively contributed to the occurrence of the individual loss, the latter cannot be considered the event’s direct consequence (Comment C18 to Article 5.2).

In the context of the COVID-19 pandemic, this raises the question of whether an individual business interruption loss sustained by a policyholder can be considered an inevitable result of an individual contracting COVID-19 within 25 miles of the premises, or whether an independent factor decisively contributed to the occurrence of the individual loss.

In *The Financial Conduct Authority v Arch Insurance (UK) Ltd and others*, the UK Supreme Court held that “it obviously could not be said that any individual case of illness resulting from COVID-19, on its own, caused the UK Government to introduce restrictions which led directly to business interruption”, rather “the Government measures were taken in response to information about all the cases of COVID-19 in the country as a whole” [176].

While a single case of COVID-19 within 25 miles of the premises can – as a non-dominant concurrent cause – be enough to trigger a notifiable disease cover of the kind under discussion here [176], it cannot be said that this single COVID-19 contraction has inevitably led to a business interruption loss. Rather, the sum of all COVID-19 contractions in an entire country led governments to take measures in order to contain the virus, which in turn resulted in each individual business interruption loss. Therefore, a business interruption loss cannot be considered the direct consequence of a case of illness sustained by an individual within 25 miles of the premises.<sup>28</sup>

*4. Conclusion.* Each case of illness sustained by an individual constitutes a separate event. Hence, the description of the peril in the underlying policy links a business interruption loss to the very specific event of an individual falling ill. The contraction of the virus by one individual may, at most, be considered a non-dominant concurrent cause of a business interruption. Many more infections with the virus are necessary in order for the government to close down businesses. Hence, by referring to a single individual falling ill rather than to the entirety of the people contracting the virus, the parties deemed the occurrence of each individual loss to be a separate event, so that no aggregation takes place.

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<sup>28</sup> Cf. *Greggs Plc v Zurich Insurance Plc* [2022] EWHC 2545 (Comm), 94.

If the parties wish for individual losses to be aggregated, they should either ensure that the description of the peril in the underlying contract refers to the actual happening that results in the individual losses and not merely to one of many non-dominant concurrent causes, or that they amend Article 5.2(1) PRICL by declaring the requirement of “direct consequence” inapplicable.

### 3. Cause-based aggregation and COVID-19 coverage

#### a) Text

##### Article 5.3

##### (Cause-based aggregation)

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

#### b) The contours of the concept of Article 5.3

The application of Article 5.3(1) PRICL is restricted to situations where the parties include a cause-based aggregation clause in their contract of reinsurance. The provision determines the relevant cause where first-party insurance policies are reinsured.

It provides that only individual losses resulting from any one cause may be aggregated. An aggregation is possible if there are causal links between the relevant cause and each individual loss. Yet, cause-based aggregation is conceptually broader than event-based aggregation. In event-based aggregation, only losses that resulted from the same event may be aggregated, whereas in a cause-based mechanism an aggregation is possible where multiple separate events originated in one cause.

Under Article 5.3(1) PRICL, issues of aggregation require the following three step analysis:

1. Conducting steps 1–3 as discussed under Article 5.2(1) PRICL above;
2. Search for the event’s cause further back in the chain of causation;

3. Determination of whether it was reasonably foreseeable that such a cause would provoke one or multiple events of this kind.

- a. Prevention of access clause

*1. Determining the relevant event.* Any loss that is covered under the contract of reinsurance necessarily resulted from the materialization of a peril against which reinsurance has been taken out. The first step in determining an individual cause of loss within the meaning of Article 5.3(1) PRICL is to identify the materialization of the peril for each individual loss. This is what Article 5.2(1) PRICL terms an event. As is the case under Article 5.2(1) PRICL, a relevant event is one from which the loss results as a direct consequence (Comment C10 to Article 5.3).

It has previously been established that the entire set of measures taken by a government to contain the COVID-19 pandemic constitutes one single event and that any individual losses resulting therefrom can be considered their direct consequences. Accordingly, any individual business interruption losses resulting from the same set of governmental measures are aggregated under an event-based aggregation clause under Article 5.2(1) PRICL.

As cause-based aggregation mechanisms within the meaning of Article 5.3(1) PRICL are broader than event-based aggregation mechanisms pursuant to Article 5.2(1) PRICL, it must be examined whether individual losses resulting from measures taken by different governments are to be aggregated.

*2. Search for a unifying cause by regressing on the chain of causation.* The entirety of actions taken and advice given by governments to contain COVID-19 have been identified as the relevant events within the meaning of Article 5.2(1) PRICL. In order to determine whether individual losses resulting from different events are to be aggregated, one must trace back along the chains of causation leading up to the events in search of a common cause, i.e. a cause that provoked all the relevant events.

In the context of the COVID-19 pandemic, this means asking what caused different governments to close businesses. Hence, it is necessary to trace back along the chains of causation leading up to different governments taking measures to contain the virus in search of

a common cause. Obviously, the spreading of COVID-19, endangering the lives of their citizens, has led governments to close down businesses. Therefore, the spreading of COVID-19 can be considered a common cause for taking said measures.

*3. The requirement of reasonable foreseeability.* However, not just any common cause justifies an aggregation of individual business interruption losses that have occurred due to the orders of different governments. In fact, the third step of the analysis introduces the requirement of reasonable foreseeability to separate relevant from irrelevant causes.

This requirement abstractly defines the causal requirements of a cause-based aggregation. It controls how far back along the chains of causation one must trace in search of the relevant cause. The test is whether the parties, at the time the contract of reinsurance was concluded, could reasonably have foreseen that a cause of the kind in question could give rise to such events that in turn gave rise to the individual losses. It is only if – in the ordinary course of things – a cause of the kind in question may result in each of the relevant events that the individual losses resulting therefrom are to be aggregated.

Hence, the question becomes whether the parties to the reinsurance contract could reasonably have foreseen that different governments would close down businesses in order to contain a virus endangering the lives of their citizens. In fact, the risk management systems in many countries provide for detailed plans to follow when facing dangerous epidemics or pandemics. It appears obvious that public health crises, such as an epidemic or a pandemic, can only be contained by governmental actions. Therefore, the spreading of COVID-19 can be considered a reasonably foreseeable cause for multiple governments to close down businesses.

*4. Conclusion.* The spreading of COVID-19 is a reasonably foreseeable cause for governments around the world to close down businesses. Thus, under a cause-based aggregation mechanism within the meaning of Article 5.3(1) PRICL, any individual business interruption loss sustained due to the prevention of access by public orders are to be aggregated no matter which government issued the order or in which country the loss occurred.

c) Disease clause

*1. Determining the relevant cause.* The first step in determining an individual cause of loss within the meaning of Article 5.3(1) PRICL is to identify the materialization of the peril for each individual loss. This is what is described as an event in Article 5.2(1) PRICL. As is the case under Article 5.2(1) PRICL, a relevant event is one from which the loss results as a direct consequence (Comment C10 to Article 5.3).

It has previously been established that each case of illness sustained by an individual constitutes a separate materialization of the peril reinsured against and hence a separate event. It has also been established that any individual business interruption loss suffered by a policyholder cannot be said to be the event's direct consequence, because the government order closing down the businesses has not been issued due to the contraction of COVID-19 by one individual. Therefore, an aggregation of multiple different individual business interruption losses is impossible.

As no event can be identified that directly caused a multiplicity of losses, there is no point in tracing back along the chain of causation in search of a cause. An aggregation is simply not possible.

Generally, if a contract of reinsurance includes a cause-based aggregation clause, the parties will expect multiple individual losses to be aggregated. Under Article 5.3(1) PRICL, this result can only be achieved if the peril described in the underlying contract refers to the entire happening that causes multiple individual losses. If they merely refer to a non-dominant concurrent cause, Article 5.3(1) PRICL will not allow for an aggregation. Alternatively, the parties may amend Article 5.3(1) PRICL by declaring inapplicable the requirement of "direct consequence", which would apply by virtue of the reference to Article 5.2(1) PRICL.

#### 4. Some final observations

Chapter 5 PRICL provides an alternative to the English and US concepts of aggregating losses in the context of reinsurance. The PRICL formulate rules that are aimed at helping to interpret aggregation clauses. These rules differ from the English and any US concepts in that they define the unifying factor – be it an "event" or a "cause" – in relation to the reinsured peril (insuring

clause). Any materialization of a peril constitutes an event whereas any happening that cannot be considered a materialization of a peril does not qualify as an event.

By doing so, the PRICL can avoid the regularly controversial question of whether something can properly be described an event. The PRICL thereby simplify the issue of aggregation. This may be well illustrated by *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others*<sup>29</sup> which was recently decided under the law of England and Wales. In that case, the parties representatives advanced 19 different arguments as to what constitutes an event or an occurrence. It was, for instance, argued that

- the “outbreak of Covid-19 in Wuhan”,
- “the earliest SARS-Co V-2 viral genome in a single host animal”,
- “the UK Government’s decision that people should not visit pubs, bars, restaurants etc.”,
- its “decision to order the closing of pubs”,
- “the implementation of [that] decision,
- “the reaching of a level that an epidemic was likely”,
- “the reaching of a level that an epidemic was inevitable”,
- “the reaching of a level that an epidemic has occurred” etc. constitute the relevant event or occurrence for the purposes of aggregation respectively.<sup>30</sup>

The fact that under English law, legal representatives advance such a huge variety of different arguments as to what constitutes an event or occurrence shows that the concept of event or occurrence under English law is severely uncertain. In the Commercial Court, Butcher J has patiently tested these arguments and stated his well argued positions to each of them. Yet in several instances, the court deviated from statements in previous case law<sup>31</sup> and was not entirely sure whether its opinion would prevail so that it felt the urge to advanced its own alternative reasonings.<sup>32</sup>

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<sup>29</sup> *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others* [2022] EWHC 2548 (Comm).

<sup>30</sup> For a short overview of these 19 different arguments, see *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others* [2022] EWHC 2548 (Comm), 117-118.

<sup>31</sup> *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others* [2022] EWHC 2548 (Comm), 176-178.

<sup>32</sup> For instance, see *Stonegate Pub Co Ltd v MS Amlin Corporate Members Ltd and others* [2022] EWHC 2548 (Comm), 181.

The concepts envisaged by the PRICL do not allow room for such an abundant variety of arguments. Solely the materialization of a peril can be an event or occurrence. Yet, the PRICL do not constrict the parties' freedom to tailor the aggregation mechanism that fits their needs. On the contrary, testing the PRICL rules on aggregation in COVID-19 business interruption insurance has shown results which vary extremely depending on the parties' formulation of their insuring clause, i.e. depending on their choice as to the reinsured perils.

This goes to show that the PRICL do not impose any particular mechanism on the parties' agreement. They may easily modify and adapt their aggregation mechanism by consciously choosing the reinsured perils. Should the parties to a reinsurance contract in a particular case feel a need to define the unifying event without reference to the reinsured peril, they can do so by excluding the application of the PRICL rules on aggregation.

In case, however, the parties choose the PRICL as the law governing the reinsurance agreement, it will be very important for them to analyze the potential effects of the PRICL rules on aggregation and make an informed choice.



#### **IV. Follow-the-settlements/Follow-the-fortunes**

##### 1. Introduction

Article 2.4.3 adopts the concepts of follow-the-settlements and follow-the-fortunes as default rules for contracts of reinsurance. As with other default rules of contract, the parties to the reinsurance agreement may agree to avoid the concepts or adopt a different approach specific to their situation. Most reinsurance contracts, however, contain express follow-the-settlements and follow-the-fortunes clauses. Individual clauses would prevail over Article 2.4.3. In case of doubt or where the reinsurance contract only provides for a vague rule, the PRICL's default rule mirrors the concepts in reinsurance industry, understanding, custom and practice. It reads:

- To the extent a loss is covered by the contract of reinsurance, the reinsurer shall
- (a) follow the settlements of the reinsured if the losses are arguably within the cover of the primary insurance contract;
  - (b) follow the fortunes of the reinsured.

##### 2. The concepts

The follow-the-settlements concept provides that the reinsurer is obliged to accept the settlements made by the reinsured. The follow-the-fortunes concept provides that the reinsurer shall be bound by developments beyond the control of the reinsured. Some degree of confusion attends this area of reinsurance in that courts and even industry insiders display different understandings of the terms and concepts. Courts, particularly in the United States, are often criticized as incorrectly collapsing the concepts into one and adopting a view of the concept that gives insufficient consideration to the interests of reinsurers. The PRICL adopt the view that follow-the-fortunes and follow-the-settlements principles are similar but distinct.

The reinsurer's duty to follow the reinsured's settlements is subject to two requirements: first, the claim as settled by the reinsured is arguably covered by the underlying contract and, second, the claim as recognized in the settlement of the original claim is within the coverage of the contract of reinsurance as a matter of law. As is the case with the follow-the-settlement rule, the follow-the-fortunes rule will also not expand coverage under the contract of reinsurance.

Yet, insofar as a claim is covered under the contract of reinsurance, the reinsurer is required to follow the reinsured's fortunes.

The follow-the-fortunes principle covers developments beyond the reinsured's control and this includes coverage judgments against the reinsured. Even though the reinsured may have some influence on the judgment by exercising its rights as a party to the proceedings, ultimately the decision by the court or the arbitral panel is beyond its control. This will apply irrespective of whether the reinsurer approves the reinsured's defense strategy.

### 3. Regulatory demands with respect to COVID-19 coverage

The scope of the COVID-19 pandemic has been sufficiently severe to prompt governments to consider various actions to ameliorate the adverse economic impact of the pandemic. As an example, legislation has been introduced in some US jurisdictions that would require the reinsured to pay COVID-19 business interruption claims in commercial property policies regardless of the language of the policies and the existence of any virus exclusions in the policies.

If such legislation is adopted, a reinsured's obligation to pay or decision to settle in light of such a new law should be evaluated in the same manner as is the reinsured's conduct under an operative legal regime that has been in force for some time. Comment C8 to Article 2.4.3 speaks to this issue and states: "A further example for an application of the follow-the-fortunes rule is a change in national law which has an impact on the cover under the underlying contract of insurance."

Legislation of this type is thought by many observers to violate the provision of the US Constitution that bars legislation altering or impairing existing contracts. However, the follow-the-fortunes rule under PRICL remains untouched by these objections. The reinsurer will still be obliged to follow the fortunes of the reinsured in that effective law must be applied. Yet, the reinsured may be required to interpose a reasonable challenge to the law's legality in order to satisfy its duties under Chapter 2, in particular the duty of utmost good faith. The breach of which results in remedies as provided by Chapter 3, in particular a claim for damages pursuant to Article 3.1(1)(b).

#### 4. COVID-19 business closures: The requirement “arguably covered”

With COVID-19, the overarching question of whether a settlement was arguably covered under the insurance applies to many insurance products. The reason is that insurance contracts typically do not address the exact scenario of a pandemic. Quite naturally, the more general wording of the respective insurance contract leaves room for different interpretations of the same clause. In addition, case law does (at least at the time of a settlement) not guide the decision-making of the insurer. Consequently, reinsureds often face the problem of difficult and uncertain circumstances.

A prominent example of these difficulties became apparent over the last year regarding business closure/interruption coverage claims due to government-ordered business closure. For example, in Germany, business closure policies often covered losses from a business closing due to official measures ordered pursuant to the German Infection Protection Act. The different wordings of insurance products distributed in Germany led to a variety of judgments either granting or denying coverage in total. After the topic had occupied the courts for several months, the Supreme Court offered guidance at least for the standard clause in early 2022. Yet, prior to that decision, insurers were confronted with a highly ambiguous legal environment – and, nevertheless, had to decide on whether and to which amount they could settle respective claims. Needless to say, insurers had to bear in mind that their reinsurers might argue that the insurance contract would not cover the claims and, hence, that there would be no reinsurance coverage.

Business closure insurance is only one example of many insurance products where COVID-19 will pose the question of coverage or at least the extent of coverage. The uncertainty and conflict found regarding insurance claims will have a corresponding impact on reinsurance coverage decisions.

In this respect, the PRICL do not offer an ultimate answer to the question of whether the reinsurer must follow a specific settlement of its reinsured under a specific business closure policy. Although each coverage situation is fact-specific, it is possible to establish rough boundaries of reasonable coverage analysis that must be exhibited by a reinsured responding to

COVID-19 claims. On one end of the spectrum are cases where the reinsured has nearly ironclad defenses to coverage but nonetheless pays all or nearly all of a claim. In such situations, the reinsurer should not be bound to follow this type of settlement. In light of the fact that the wording of the business closure policies mostly gives room for a rejection, it seems fair to prospect that an insurer settling at 100 per cent of the sum insured under a typical business closure policy will most likely face denial of coverage by its reinsurer.

It may also be that the policy provides for a clear exclusion of the original claim (clearly outside of coverage, see Comment C4 to Article 2.4.3) which would not meet the requirement under Article 2.4.3. For example, if the insurance policy of a restaurant contains an exclusion for “any and all claims arising out of or linked to the spread of a virus regardless of any other causes arguably involved”, there could not be a finding of coverage from a COVID-19 business closure. Another example would be a policy which grants coverage only for business closure caused by named diseases and clarifies that coverage for unnamed diseases requires a supplemental agreement.

A reinsured that paid full policy benefits to the policyholder in these situations without initially denying the claim and mounting substantial legal resistance should not obtain reinsurance benefits pursuant to the follow-the-settlements principle and Article 2.4.3 PRICL. However, if the reinsured disputed the claim at length but court(s) deciding the case nonetheless erred and ordered coverage in spite of this strong limiting language, the reinsured will obtain the benefits of the follow-the-fortunes principles under Article 2.4.3 as the court judgment must be considered outside of the reinsured's control (see Comment C6 to Article 2.4.3).

On the other end of the spectrum, if the insurance policy in question broadly stated that it provided coverage for “any reduction of business caused by a public health problem”, there would be coverage for the types of government-ordered retail business closures spurred by the COVID-19 pandemic. Reinsureds with this sort of policy language that settle claims by policyholders on generous terms should obtain reinsurance pursuant to the follow-the-settlements principle. The reinsurer should not succeed in denying reinsurance by strained arguments such as asserting that the COVID-19 pandemic was not a public health problem.

In practice, of course, most insurance policies do not have language that clearly mandates or bars coverage for the types of COVID-19 claims currently at issue. In addition to sometimes lacking any virus exclusion or using debatable exclusionary language, many policies tend to use terms such as direct physical “loss” or “damage” without greater specification, leading to uncertainty and division of litigation outcomes. Where the reinsured concludes an out-of-court settlement with its policyholder under unclear policy terms, coverage under the reinsurance contract will depend on the individual case as it does under national law. The PRICL also give guidance in this respect:

Although the follow-the-settlements mechanism under PRICL in principle follows settled UK case law on the outset, the solutions under each regime may vary. The PRICL do not only offer a mere summary of UK case law but rather a regime that does not uphold known inconsistencies. With respect to the individual case, the PRICL do not only refer to reasonable claims handling but provide guidance when a claim as settled by the reinsured is arguably covered. First of all, and in line with UK case law, the reinsured must have acted honestly and have taken all proper and businesslike steps in settling the claim. Of course, this description alone will be interpretable either way.

On top of that, the PRICL takes the stand that a settlement is generally to be followed by exclusively describing the scenarios in which the claim will not be arguably covered. According to Comment C4 to Article 2.4.3, “arguably covered” requires that the settlement of claims made by the reinsured is not collusive, fraudulent, deceptive, grossly negligent or reckless, clearly outside of coverage, or beyond the limits set forth in the agreement. Among these scenarios, only grossly negligent settlement and claims clearly outside of coverage seem to be realistic defenses for a reinsurer.

With respect to business closure claims and the aforementioned unsettled case law, both defenses will mostly fail. Consequently, the PRICL state that the settlement should generally be considered sufficiently reasonable in amount and terms if it cannot be said with positive assurance that after consideration of these factors, no reasonable person would support the amounts paid in settlement. In comparison with, e.g., UK case law, the PRICL solution provides clarity, in particular in the absence of case law in scenarios unpredicted by the respective wording of the original policy.

After nearly a year of insurance coverage litigation concerning COVID-19 business closure claims, reinsureds had prevailed in the bulk of decisions, frequently obtaining court orders dismissing policyholder claims. Still, a significant number of these claims have survived dismissal motions or have been the subject of pending appeals. Now that the sky clears up with high court decisions coming in, it becomes much easier for insurers to evaluate the merits of the claims. However, with respect to the reinsurance coverage, one must bear in mind that the legal situation at the point in time in which the insurer had to handle the claim and reach a settlement is decisive. Consequently, an individual reinsured's decision to settle a COVID-19 coverage claim does not need to reflect lack of sufficient vetting and defense of a claim or unreasonable behavior by the reinsured. Each claim must be assessed on its own factual merits in light of the insurance policies and reinsurance contracts at issue.

#### 5. Types of settlements, in particular block settlements

The PRICL rules regarding the reinsurer's obligation to follow the settlements of the reinsured apply to all settlements. However, some types of settlements may be more problematic in terms of assessing the applicability of the rules.

For example, where a settlement is unusual in design or implementation, the reinsurer may have greater concern to follow the settlements of the reinsured. Such scenarios can be a reinsured settling claims clearly outside of coverage just as a reaction to public pressure or overly generously settling because the reinsured is in a position to pass most of the financial consequences on to the reinsurer.

A reinsured may, for example, enter into a large "block" settlement of cases or concede coverage and agree to determination of damages by a special master or arbitrator or according to a schedule allotting a set payment for specific types of claims. Such situations may also raise concern that individual claims are not subjected to sufficient scrutiny, defense and negotiation. However, a group settlement or settlement employing alternative dispute resolution features is permissible and does not abrogate the application of the follow-the-settlements rule. Yet, the particular terms of a group settlement or atypical-cum-innovative settlement may present more challenge in determining arguable coverage of the settlement. Each case must be resolved on

its own facts. The reinsurer is entitled to make reasonable investigation and inquiry regarding group, hybrid, or creative settlements just as it has that right for more typical individual settlements. The reinsured must satisfy its burden of showing arguable coverage but must not prove that the settled claim was sure to succeed at trial nor is it required to demonstrate the amount of any resulting judgment.

Regardless of the type of settlement, it remains the reinsured's obligation to show that the claim falls within the scope of the relevant reinsurance agreement. Where the reinsured satisfies the two prongs of the follow-the-settlements doctrine, the reinsurer may not second-guess the reinsured's settlement decisions and must cover the settlement subject to any additional terms of the reinsurance contract or agreement of the parties.

#### 6. Handling of COVID-19 business closure claims

Besides follow-the-settlements and follow-the-fortunes principles, the PRICL entail additional duties for both reinsured and reinsurer:

- a duty of utmost good faith (Article 2.1.2);
- a duty of confidentiality regarding information exchanged by parties to the reinsurance contract (Article 2.1.3);
- a duty to make reasonable and diligent efforts to resolve disputes pursuant to the contract as expeditiously and efficiently as possible (Article 2.1.4);
- a duty of the reinsured to provide the reinsurer with all information of which it is or reasonably out to be aware and which is material to the risks to be assumed by the reinsurer (Article 2.2.1);
- a duty of the reinsured to pay premiums promptly as demanded according to the terms of the contract (Article 2.3.1);
- a duty to cooperate regarding documentation of agreements (Article 2.3.2);
- a duty of the reinsured to give adequate and timely notice of claims (Article 2.4.1) and
- additional duties of general contract law derived from the PICC.

Perhaps most importantly, the reinsured is subject to a duty to “act reasonably and prudently” in its claims handling (Article 2.4.2). To satisfy this duty, the reinsured must respond to the claim as if it had no reinsurance. This standard incentivizes the reinsured to instigate, evaluate,

and defend or settle claims as appropriate in light of the strength of the claim and likelihood of coverage. The reinsured is also required to “make reasonable efforts to obtain indemnity, contribution, salvage or recovery from third parties who have contributed to creating the reinsured’s liability” (Comment C5 to Article 2.4.2). In addition, the reinsured must comply with the particulars of any express claims handling provisions contained in the contract of reinsurance.

It is important to note that any breach of these duties by the reinsured does not abrogate the reinsurer’s duty to follow the settlements or the fortunes of the reinsured. Acts or omissions of the reinsured may only provoke the remedies as provided by Chapter 3 of the PRICL, in particular a claim for damages, see Article 3.1(1)(b).