

# **A U.S. Perspective on COVID-19 Claims Following Fortunes and Settlements**

Jeffrey W. Stempel  
Lee Professor of Law  
Boyd School of Law  
University of Nevada Las Vegas

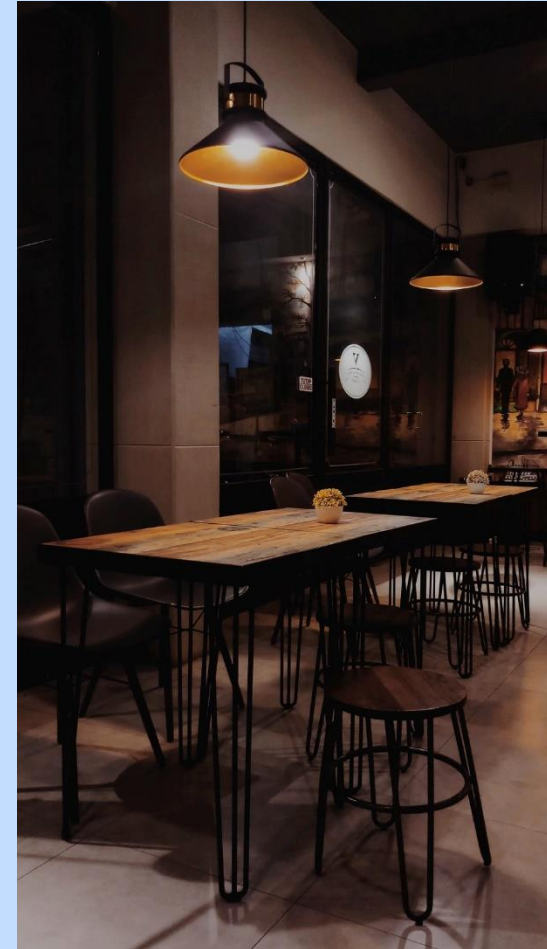
# AIDA International - Argentina Reinsurance Working Party Session

- May 12, 2021
- A Comparative Overview
- United Kingdom
- United States
- Principles of Reinsurance Contract Law (PRICL)
- Will there be common language or cacophony?



# COVID-19: USA Coverage Wars

- Almost exclusively Business Interruption/Business Income claims pursuant to Commercial Property Insurance
- Eventually there may be significant claims involving General Liability (*e.g.*, a business patron claims contracting COVID on premises) or Directors/Officers liability (company failure to respond adequately to COVID risks) or Employment Practices Liability (workers claim injury from unsatisfactory protections at work)



# But Liability Risk Reduced

- Because many US States have enacted immunity legislation for business that may face COVID-based tort claims
- A gift to liability insurers: most US business have significant general liability insurance and most of these policies (as contrasted with commercial property policies) do not contain a virus exclusion
- And the bodily injury trigger for liability insurance more easily met than the direct physical loss or damage trigger for property insurance

# Property/BI Insurance

- Property policies:
  - 1<sup>st</sup> party (PH-Insurer);
  - prototypically covers damage to property due to fire, windstorm, vandalism, water damage from burst pipes
  - with possible endorsements for flood, earth movement (normally excluded)
- Business Income (casually called Business Interruption) coverage a commonly purchased additional coverage
- Requires “direct physical loss or damage” to covered property that in turns causes loss of revenue
- Many courts (wrongly in my view) requiring tangible structural change for trigger – a big break for insurers

# Property/BI Insurance

- Policy may contain potentially applicable exclusions
- Virus (Insurance Services Office 2006 form)(estimated in some form in 80% of policies)
- Virus exclusion with anti-concurrent causation clause
- Pollution exclusion
- Contamination exclusion

# The COVID Coverage Questions

- Is the presence of the virus in the Air or on the Surfaces of the business sufficiently direct physical loss or damage?
- Do government-ordered closures count as either loss or damage or loss of revenue due to “Order of Civil Authority”?
- If so, is coverage nonetheless barred by an exclusion for injury due to Virus? Contaminant? Pollutant?



# A Possible Added Issue

- State legislation (US law, particularly insurance, generally more decentralized than law in other countries) may require payment
- Proposed but not enacted
- Most think such laws violates U.S. Constitution's "Contract Clause" forbidding laws that "impair" contract obligations (but an arguable public "emergency" justification)
- State regulators may attempt this through regulation or simply "lean" on insurers to pay claims, cut deals – but this seems not to happen



# PRICL Articles 2.4.3

**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.**

- Consistent with case law. *See, e.g.*, GRAYDON S. STARING & DEAN HANSELL, LAW OF REINSURANCE Ch. 18 (2013)

# Follow-the-Fortunes

- Straight-Forward; the Easier of the Two Concepts for purposes of COVID-19 questions
- The Reinsurer is bound by litigation outcomes that bind the Reinsured unless there are serious deficiencies in the Reinsured's conduct of the litigation
- Reinsurer normally not permitted to question ("second-guess" judicial outcome)
- Usually requires recklessness or intentional failure by the Reinsured

# Follow-the-Fortunes

- Examples of Reinsured misconduct that may negate Reinsurance
  - failure to raise obvious defenses to coverage
  - fraud
  - expiration of policy,
  - virus exclusion
  - absence of triggering injury
  - no direct physical loss or damage

# The USA Scorecard So Far



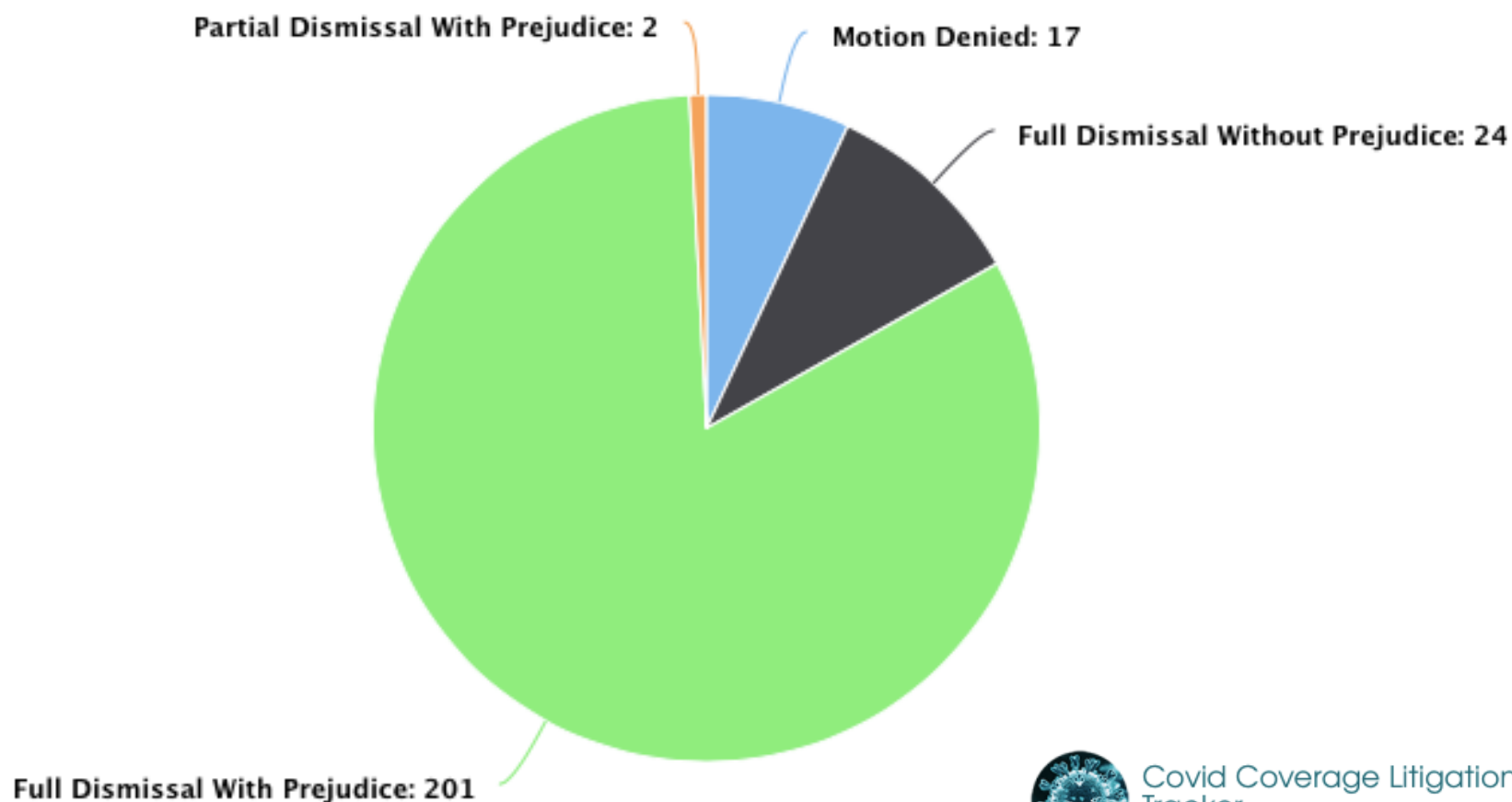
- Insurers winning big in federal (national government) courts – roughly 90 percent of the time
- Usual vehicle is a Motion to Dismiss for Failure to State a Claim. Seeks a ruling that -- as a matter of law – neither COVID presence nor government orders constitute physical loss or damage
- Many courts require permanent, structural change to count as damage – and treat “loss” and “damage” as synonyms

# Insurers do less well in State Court

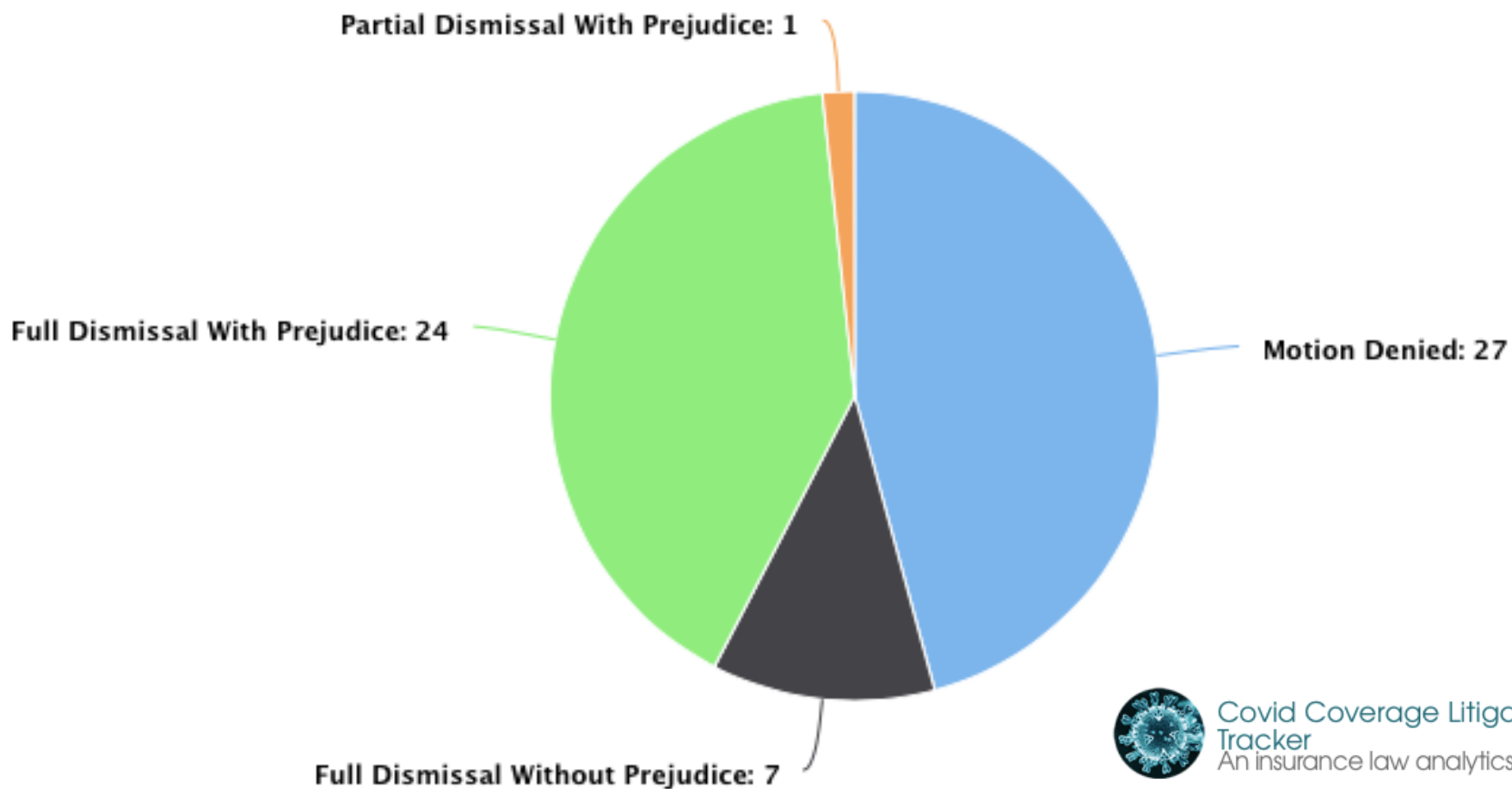
- Only 20 percent of cases in state court
- But insurer win rate there is 50 percent rather than 95 percent
- “Loss” (denial) of a Motion to Dismiss not fatal. The insurer might still prevail on Summary Judgment or other pretrial motion or after a full bench (judge) or jury trial

# Judicial Rulings on the Merits in Business Interruption Cases

## Merits Rulings on Motions to Dismiss in Federal Court



## Merits Rulings on Motions to Dismiss in State Court



	Virus exclusion in policy		No virus exclusion in policy	
	State Count	Federal Count	State Count	Federal Count
<b>MTD granted</b>	182		75	
	23	159	7	68
<b>MTD denied</b>	17		27	
	11	6	16	11
<b>Insurer MSJ granted</b>	6		5	
	2	4	3	2
<b>Policyholder MSJ granted</b>	3		4	
	2	1	4	0
<b>Insurer MSJ denied</b>	0		1	
	0	0	1	0





# More on the USA Scorecard

- Although most COVID coverage cases are in federal (national) courts, substantive insurance law is provided by the State with the closest connection to the dispute, usually the state of loss
- Eventual decisions by State Supreme Courts may provide more pro-Policyholder decisions
- Insurers pick their battles. In many cases, an Answer filed to the complaint without a Motion to Dismiss. Carriers seeking favorable rulings in favorable situations (helpful state law)

# But Even Winners Are Usually Not Undefeated



- The 50% of state court Motion defeats and the 5-10% of federal court Motion defeats adds up in dollars
- Even after subsequent motions and fighting at trial, insurers will lose some coverage cases – particularly where the insurance policy does not contain a sufficiently specific virus exclusion
- A potential problem for Cincinnati, Erie, and Society Insurance Cos. Their policies typically lack virus exclusions
- Estimated 20% of all policies lack virus exclusion

# When Insurers Lose in Litigation

- Follow the Fortunes will apply
- Even if most COVID cases do not result in coverage
- Reinsurers will almost certainly have to pay in this subset of cases (absent reinsured misconduct)
- But the consequences of settlement are less clear

# Follow-the-Settlements

- More difficult to apply because of the absence of definitive, controlling judicial decisions – but these will come in time
- Settlements involve the lurking question of whether the Reinsured has been too quick to settle a weak claim
- PRICL Standard – which accords with that of most USA courts, is whether the (1) settled claim is arguably covered by the underlying policy of the reinsured and (2) within the coverage provided by the contract of reinsurance

# Contested Concerns

- Did the Reinsured “blink” in the face of a weak claim?
- Is the settlement gratuitous rather than reflecting the actual legal exposure of the reinsured?
- Was there fraud, collusion, deception, recklessness, or gross negligence?
- Is the claim clearly outside the reinsured’s coverage?
- Or clearly for an amount exceeding the underlying insurance?



# In Practice in the USA . . .

- A judgment against the Reinsured almost always requires the Reinsurer to pay pursuant to treaty or facultative certificate so that it is following the fortunes of the Reinsured. Comparatively easy cases.
- A settlement by the Reinsured will be given substantial deference. As a practical matter, the Reinsurer seeking to avoid payment must prove a rather substantial irregularity.
- Reinsured will prevail if it has a colorable claim that it owed coverage and was not making an ex gratia payment for business or political reasons

# But . . .

- COVID claims may have better odds for the Reinsurer refusing to be bound by settlement
- Because of the high Insurer win rate in litigation
- A settlement that does not provide a significant discount to the Insurer/Reinsured may be seen by Reinsurers (and Courts) as unduly generous



# Nonetheless

- Even the type of claim that loses most of the time presents an arguable risk of coverage
- Reinsured should prevail if it behaves as a reasonably prudent insurer that has no reinsurance – likely in that Reinsureds are now emboldened to resist easy settlement
- A case-specific inquiry that could generate arbitration/litigation if Reinsurer and Reinsured to not agree
- Claims Control Clause important
- Relations of Reinsurer and Reinsured important



# The Likely Scenario

- Virus exclusions will be effective
- Pollution exclusions will not
- Contamination exclusions probably effective
- Arguments that loss “caused” by Govt Order rather than virus unlikely to win but possible
- And where policy lacks exclusion, there will be both PH wins and sufficient risk to give Reinsureds a reasonably wide zone for settling and receiving coverage per the follow-the-settlements principle.

# Where Does This Leave Reinsurers?

- Likely to eventually pay significant but not enormous amounts
- *COVID is not asbestos – it is Y2k*
- (Re)insurers pay far less than the overall amount of Pandemic-related losses
- And payment will come at a later time giving time for investment income
- Within the boundaries of good faith, Reinsurers also will have room to negotiate for lower payments (but will have business relation considerations with reinsureds)

# Questions



# Special Thanks

- Carlos Estebenet, Ozlem Gurses, Jorge Angell
- AIDA
- David McClure, Boyd School of Law-UNLV
- Tom Baker, University of Pennsylvania and the COVID Litigation Coverage Tracker
- PRICL Project Group