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Reinsurers Must Prepare For Coronavirus-Related Claims

By **Scott Seaman and Edward Lenci** (April 9, 2020, 3:53 PM EDT)

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The enormous economic losses resulting from COVID-19 — coupled with the unprecedented governmental orders imposing restrictions on travel, movement and assembly and requiring businesses to close or limit operations — likely will result in a tremendous volume of insurance claims and coverage lawsuits. In fact, some lawsuits already have been filed.

These claims and lawsuits will inevitably result in reinsurance cessions and, as night follows day, disputes between cedents and reinsurers.

The insurance industry survived the asbestos tsunami, which has not yet completely subsided. The sheer number of asbestos-related claims and the enormous defense and indemnity dollars paid, mostly as a result of judicial decisions stretching to find coverage for these claims, resulted in many insurer insolvencies, receiverships and liquidations, particularly in the late 1970s and the 1980s.

The subsequent hard work of the industry and regulators enhanced the financial stability and solvency of the insurance industry in the face of large claims and natural disasters that have followed.

Some recent initiatives demonstrate efforts on the part of some governmental entities to pressure insurers to pay noncovered COVID-19 claims.

For example, on March 18, 16 members of Congress, including members of both major political parties, wrote a letter to insurance industry and broker associations urging commercial property insurers to provide business interruption coverage for losses related to COVID-19 — whether covered or not. Such entreaties are emblematic of governmental forces pressuring insurers to pay claims that are not covered by their policies.[1]

More troubling are bills pending in various jurisdictions, including New York, New Jersey, Ohio and Massachusetts, that would mandate that insurers cover business interruptions claims that are not covered by property insurance policies. This represents unsound and inefficient public policy in response to a pandemic, abrogates rights under contracts previously executed and priced, undermine the integrity of the insurance regulatory process under which some of the impacted policy provisions previously were approved by regulators, and could even threaten insurer solvency.

Of course, any governmental efforts to rewrite policies along such lines will face legal and constitutional challenges. They also may factor into the examination by reinsurers of COVID-19 cessions.

As noted, COVID-19 coverage cases have already been filed. For example, French Laundry, a Napa Valley restaurant owned by chef Thomas Keller, filed suit against Hartford Fire Insurance Co., seeking a declaration of coverage for interruption of business due to the pandemic.[2] The complaint alleges that the "all risks" policy issued by Hartford provides coverage for lost business income and extra expenses due to prohibitions on access to restaurants imposed by local and state civil authorities.

The complaint further alleges coverage due to physical loss or damage under the Civil Authority coverage part of the policy based upon a March 19 government order. It alleges the policy does not include an exclusion for viral pandemic and the "policy's Property Choice Deluxe Form specifically extends coverage to direct physical loss or damage caused by virus."

Tellingly, in response to a statement that "unless policies specifically outline non-physical damage coverage, businesses 'are unlikely to find relief within the four corners of their policies,'" the restaurant's attorney said, "They're wrongfully denying us, which is going to cripple millions of people and their livelihoods."[3]

The foregoing, as well as the early and extensive COVID-19-related coverage advocacy of some policyholder firms, leaves little doubt that policyholders will be extremely aggressive in seeking coverage. They will seek to abrogate policy exclusions and attempt to enlist courts to construe away express policy requirements such as "direct physical injury" and make virus exclusions disappear.

Policyholders may attempt to exploit the sympathies associated with the pandemic and use all available resources, including the unabashedly pro-policyholder Restatement of the Law of Liability Insurance, to advocate that courts rewrite contracts and turn time-honored maxims of contractual construction on their heads even if the state legislation discussed above is not enacted.

COVID-19 claims will present challenges to insurers and reinsurers that will take many years to resolve. Broadly speaking, reinsurers should promptly review their assumed portfolios thoroughly to determine their potential exposures, as multiple lines of coverage are implicated. Moreover, many of the insurance coverage issues will be imported into resulting reinsurance cessions.

Any determination of whether a particular COVID-19 cession is covered by a reinsurance treaty or facultative certificate begins with an analysis of whether the underlying claims were covered by the cedent's insurance policy or policies. The next level of evaluation of a cession involves application of the terms, conditions and exclusions of the particular reinsurance treaty or facultative certificate in question. Each cession will be considered on its own merits. Here are some of the considerations that may be involved in COVID-19-related cessions:

Whether Claims Paid Are Covered Under the Insurance Policy

Where ceding insurers pay COVID-19-related claims based upon pressure from governmental entities or policyholders, reinsurers may examine whether such claims are covered by the insurance policy or constitute ex gratia payments.

Application of Follow-the-Fortunes or Follow-the-Settlements Provisions

Where ceding companies must pay otherwise uncovered business interruption claims due to legislation or a judicial ruling, they generally can be expected to argue that their reinsurers are required, in turn, to pay resulting cessions based upon follow-the-fortunes or follow-the-settlements provisions in the reinsurance contracts.[4]

Application of Follow-the-Fortunes or Follow-the-Settlements Principles

Ceding companies face a greater challenge where there is no follow-the-fortunes or follow-the-settlements provision in the reinsurance contract. In such instances, ceding companies may argue that, as a matter of custom and practice or course of dealings, principles of follow-the-fortunes or follow-the-settlements exist and apply to require the reinsurer to pay. Where they are unsuccessful with this argument, ceding companies generally will be required to establish that the claim was actually covered by their insurance policies.

Proper Credits

Reinsurers may inquire as to whether proper credits were given for other policyholder recoveries and governmental relief or subsidies, and also whether subrogation rights were pursued.

Whether the Cession Is Covered By the Terms of the Reinsurance Contract

Follow-the-fortunes and follow-the-settlements provisions do not override the terms, conditions and exclusions of the reinsurance contracts. Accordingly, determination of whether a cession is reinsured requires consideration and application of the terms, conditions and exclusions of the reinsurance contract itself.

Aggregation and Loss Occurrence Issues

Issues may be presented concerning aggregation of COVID-19 claims payments as well as loss occurrence issues.

Limits and Retention Issues

COVID-19 cessions may present issues regarding reinsurance limits as well as whether retentions have been satisfied. Treatment of defense costs associated with COVID-19 claims under the terms of reinsurance contracts may also become issues, including, for example, whether the language of a facultative certificate included expenses within assumed limits of the certificate.[5]

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[1] In a joint response, the American Property Casualty Insurance Association, the Council of Insurance

Agents and Brokers, the Independent Insurance Agents & Brokers of America, and the National Association of Mutual Insurance Companies stated:

> Standard commercial insurance policies offer coverage and protection against a wide range of risks and threats and are vetted and approved by state regulators. Business interruption policies do not, and were not designed to, provide coverage against communicable diseases such as COVID-19. The U.S. insurance industry remains committed to our consumers and will ensure that prompt payments are made in instances where coverage exists.

[2] https://www.cnn.com/2020/03/27/business/thomas-keller-lawsuit-coronavirus-losses/index.html

[3] Id.

[4] See generally A Primer on Reinsurance Law & Principles (Hinshaw & Culbertson 2016); S.M. Seaman, and J.R. Schulze, Allocation of Losses In Complex Insurance Claims (8th ed. West Thomson Reuters 2019-20).

[5] See generally E.K. Lenci and S.M. Seaman, "The Bellefonte Cap Returns," Best's Review, August 2016; Global Reinsurance Corp. of America v. Century Indemnity Co., No. 13 Civ. 6577 (LGS) (S.D.N.Y. Mar. 2, 2020).