Atkinson
ATTORNEYS AT LAW
1 S.E. Third Avenue, Suite 2100, Miami, FL 33131

Coverage Issues Between Reinsurers and Insurers Relating to the COVID-19 Virus Claims[1]

April 23, 2020

By John Bond Atkinson, Tiffany A. Bustamante, and Maria-Gracia Diaz

We hope this Client Update finds you in good health and spirit. The recent spread of 2019 novel coronavirus ("the COVID-19 virus")[2] will likely bring diverse and challenging coverage issues, not only between insureds and insurers, but also between reinsureds and reinsurers. During these uncertain times, Atkinson, P.A. continues its decision to advise, address, and support your legal concerns relating to the diverse issues arising from this pandemic affecting individuals and businesses worldwide. As always, we hope to assist you in overcoming any complex case or coverage matter in any way we can.

Executive Summary

As reinsureds begin to pay claims stemming from business interruption losses due to the COVID-19 virus, they are anticipated to seek coverage under their reinsurance contracts[3] on the basis of Follow the Fortunes/Follow the Settlement Provisions and/or Excess of Loss Reinsurance agreements. This Update is intended to discuss and anticipate the potential issues that may arise between reinsurers and reinsureds relating to payment of claims stemming from the COVID-19 virus. Although this Update is necessarily speculative, it is informed based on Atkinson, P.A.'s extensive experience in the insurance industry, as well as its enthusiasm to research and address new law topics.

Follow the Fortunes and Follow the Settlements Clause

Many reinsurance certificates or contracts contain a provision that requires a reinsurer to follow the fortunes and/or settlements of the insurance company. Namely, reinsurers are generally bound by the reinsured's decision to pay the claim and must refrain from second guessing a good faith decision to do so. *Am. Bankers Ins. Co. v. Nw. Nat'l Ins. Co*., 198 F.3d 1332, 1335 (11th Cir. 1999). The contractual articulation of this general principle has been called the "Follow the Fortunes" or "Follow he Settlement" clause. This means that the reinsurer is bound by the claims-handling decisions of its reinsured, unless the reinsurer demonstrates that payment to the insured was the result of fraud and collusion or not reasonably within the scope of the original policy or reinsurance treaty.

Scenarios where the government pressures the insurance companies to pay, otherwise uncovered, claims – So far, the legislatures in New Jersey, Massachusetts, Ohio, Louisiana, New York, Pennsylvania, and South Carolina have proposed bills that would alter existing business

interruption insurance agreements to force coverage of business interruption claims stemming from the COVID-19 virus, even in the presence of applicable exclusions.

If passed into law, the proposed bills present potential dangers to both insureds and insurers. With respect to insureds, legislation mandating that insurers carry the financial burden of the financial crisis may result in unintended consequences as insurers might not be around to pay their claims in the future due to insolvency. Should the bills garner final approval, insurers are anticipated to file suit en masse, alleging the measures violate the U.S. Constitution's contracts clause, which curtails states' ability to interfere with private contracts.

Further, if an insurer succumbs to government pressure and pays uncovered claims, its reinsurer may turn around and argue that the reinsured's payment of explicitly excluded claims was not made in good faith and was in fact an *ex gratia* payment. This is because if a claim is not covered by the insurance policy, then it cannot be covered by insurance treaty or certificate.

Scenarios where the policy requires physical damage – Insurance policies usually require that the business interruption be directly caused by physical loss or damage to the insured premises. When a business remains fit for human habitation but has been closed, either as a mandatory or voluntary measurement, it arguably has probably not suffered a direct physical loss. Thus, if the reinsured pays a business interruption claim based on its determination that the COVID-19 virus did in fact cause physical damage on the insured premises, a variety of concerns arise. A reinsurer may claim that such finding of physical loss was not made in good faith. Undoubtedly, it will be difficult to determine what type of physical damage to premises may the COVID-19 virus cause. However, it may be argued that the insured premises became physically infected and uninhabitable due to the COVID-19 virus, thus there was a physical loss. It is unclear whether a reinsurer would agree with this theory of physical loss.

These issues become even more complicated if the reinsurance contract does not contain an express "Follow the Fortunes" or "Follow the Settlements" clause, as the reinsurer may use the absence of this provision to avoid reimbursement of COVID-19 pandemic-related business interruption losses. A reinsured may argue that this well-known doctrine should be implied into the reinsurance contract based on common practice and costume. Nonetheless, courts have previously held that this doctrine need not be implied into all reinsurance contracts as the parties could have added said provision within the reinsurance treaty should that clause be particularly important or desirable to them. *Emplr. Reinsurance Corp. v. Laurier Indem. Co.*, 2006 U.S. Dist. LEXIS 40451 (M.D. Fla., June 19, 2006).

Excess of Loss Reinsurance – Aggregation of Losses

Excess of loss reinsurance is a type of reinsurance in which the reinsurer indemnifies the reinsured for losses that exceed a specified limit. *See Seaton Ins. Co. v. Yosemite Ins. Co.*, 748 F. Supp. 2d 139, 155 n.10 (D.R.I. 2010). Excess of loss reinsurance comes in three forms: per risk (or per policy), per occurrence (property catastrophe or casualty clash), and annual aggregate. These three methods differ in the manner in which risks "attach" to the reinsurance agreement. *Munich Reinsurance Am., Inc. v. Am. Nat'l Ins. Co.*, 893 F. Supp. 2d 686, 690 (D.N.J. 2012).

Multiple "loss occurrences" may be combined; this allows the reinsured to satisfy only one retention limit provided that those loss occurrences can be correlated to a common event or cause. The issue arises as COVID-19 business interruption claims may not fit "event-based" provisions in reinsurance contracts.

Some reinsurance treaties require that all individual losses be directly occasioned by a disaster or loss arising out of one event which occurs within contiguous areas of the states of the United States or provinces of Canada, and be limited to a period of certain consecutive hours arising out of and directly occasioned by the same event. Thus, since the "event," e.g. the spread of the COVID-19 virus appears to have originated in Wuhan, China[4] and brought to the United States and other countries within a period of several months, the reinsurer may prevent the reinsured to combine the COVID-19 virus losses because they fall outside the geographic and time-related requirements.

Since policyholders are arguing that the "stay-at-home" orders are the basis for their business interruption claims[5], reinsureds may use the same argument in an attempt to aggregate their losses. For example, Prime Time Sports Grill, Inc. recently filed a lawsuit against Certain Underwriters at Lloyd's of London in the U.S. District Court for the Middle District of Florida.[5] The complaint alleges that the commercial property insurance policy's "all risks" coverage includes coverage for loss of business income resulting from the COVID-19 virus. Specifically, the insured alleges that it lost business when ordered to close by the March 17, 2020 directive of the Governor of Florida.[6] Likewise, a Florida scuba shop in the Florida Keys is suing its insurer, arguing, among other things, that its insurance policy contains a civil authority clause, which should trigger coverage as the business was ordered to close by local and state officials and the Florida Keys has been closed to travel.

However, even if a court upholds such arguments, a reinsured may not be able to combine "stay-at-home" orders from different states to the extent that said orders became effective on different dates and were not mandated in states contiguous to each other. Should the reinsurer allow combination of losses related from the "stay-at-home" orders, theoretically, a reinsured may be able to combine losses related from "stay-at-home" orders within a particular state and/or "stay-at-home" orders that were issued on the same date among neighbor states, if covered by the insurance policy and claim was paid in good faith.

On the other hand, some reinsurance contracts have "cause-based" provisions, pursuant to which the reinsured may aggregate losses arising out of an originating or common "cause." Here, the spread of the COVID-19 virus could potentially be considered an originating or common "cause." Thus, hypothetically speaking, reinsurance treaties containing the "cause-based" language could likely allow reinsureds to aggregate more claims, unlike the "event-based" provisions.

Pending Bills and Interpretation of Policy Provisions By Courts

To date, there are bills pending in various jurisdictions that would mandate the reinsureds to pay business interruption claims that are not covered under the insurance policies.[6] These bills have been met with pushback as federal and state governments seemingly attempt to alter or impair

the contractual relations and obligations between parties by essentially retroactively rewriting the insurance contracts forcing insurers to undertake risks they did not assume, and even potentially contributing to insurance insolvency. Even if the proposed bills do not pass, insureds themselves are anticipated to push for coverage, and courts, as a result of this pandemic, may sympathize with them and interpret policy provisions in favor of coverage. In either scenario, reinsureds and reinsurers' future payment of the COVID-19 virus claims is uncertain and concerning.

Summary.

Whether reinsureds may be able to obtain coverage from their reinsurers with respect to payment of COVID-19 virus claims is likely going to depend on the language of the policies and reinsurance treaties combined with the theories upon which the claims are presented to the reinsurers. We would recommend analyzing every matter on a case-by-case basis.

Moreover, to the extent that the state and federal government push the reinsureds and reinsurers to cover business interruption claims stemming from the COVID-19 virus, different reinsureds and their respective reinsurers may need to join forces to fight such government pressure/ legislation under state and U.S. constitutions. This will likely have a stronger impact than if all companies engage in independent battles.

Atkinson, P.A. is committed to providing you with sound guidance and representation in response to the complex coverage issues presented by the coronavirus outbreak. We continue to monitor CDC guidelines, court developments, regulatory activity, and public sector announcements; and will continue to circulate articles with respect to the latest news and analysis of potential insurance claims and disputes stemming from the COVID-19 virus in the upcoming weeks.

While our office continues to remain open in limited capacity, all of our attorneys remain fully available to assist you through remote access. As needs arise, continue to contact us via telephone or e-mail. Should you need immediate assistant, please feel free to contact our partners directly.

John Bond Atkinson	**Tiffany A. Bustamante**	**John B. Atkinson**
561-212-4089	305-431-7497	561-289-2331

[1] This information is intended to inform firm clients and friends about potential coverage issues that may arise between reinsurers and insures pertaining to The COVID-19 virus claims. Nothing in this Client Update should be construed as legal advice or a legal opinion, and readers should not act upon the information contained in this Client Update without seeking the advice of legal counsel. Prior results do not guarantee a similar outcome.

[2] The official name for the virus (previously referred to as "2019 novel coronavirus") is severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2) and the disease it causes is coronavirus disease (the COVID-19 virus). For the purpose of this discussion, we will refer to the 2019 novel coronavirus as "the COVID-19 virus."

[3] A reinsurance contract provides that one insurer (the "ceding insurer" or "reinsured") "cedes" all or part of the risk it underwrites, pursuant to a policy or group of policies, to another insurer. The reinsurer agrees to indemnify the ceding insurer on the transferred risk. The purpose of the reinsurance contract is to diversify the risk of loss and to reduce required capital reserves. *See* 13A John A. Appleman & Jean Appleman, Insurance Law and Practice §§ 7681, at 480 (1976); 19 George J. Couch, Cyclopedia of Insurance Law §§ 80:1, at 624 et seq. (2d ed.1983).

[4] The COVID-19 virus first emerged in Wuhan, China in December 2019. https://wwwnc.cdc.gov/eid/article/26/5/20-0146_article#r1

[5] These lawsuits are happening all over the country. In Chicago, multiple restaurant owners have brought suit in federal court against Society Insurance. The complaint alleges that the presence of the coronavirus on or around the plaintiffs' properties rendered the premises unsafe and unfit for their intended use and therefore caused physical property damage or loss under the Policies. It also alleges that the state's stay-at-home order was "issued in direct response to these dangerous physical conditions." In Texas, a group of restaurants brought suit against the Farmers Group, alleging that several insured restaurants suffered covered losses when they were forced to close following government-issued orders, including the March 15, 2020 order issued by Los Angeles Mayor Eric Garcetti.

[6] Florida has yet to propose such a bill. However, Florida's Office of Insurance Regulation (OIR) issued an Informational Memorandum OIR-20-03M: (1) directing insurers to review and update their business continuity and/or continuity of operations plans; (2) requiring that any insurer that activates its business continuity and/or continuity of operations plan in response to the COVID-19 virus must immediately notify the OIR; and (3) if a regulated entity's business operations are compromised to the extent that it jeopardizes the company's ability to provide essential insurance services to policyholders, it must immediately notify OIR, and provide details of which operations are compromised.

[5] Prime Time Sports Grill Inc. v. Certain Underwriters at Lloyd's London, case number 8:20-cv-00771, in the U.S. District Court for the Middle District of Florida.

[6] *See also* Café International Holding Company LLC v. Chubb Limited et. al., case number 1:20-cv-21641, in the U.S. District Court for the Southern District of Florida. The South Florida restaurant claims its business income losses are covered by the business interruption clause and, additionally, its insurer should pay under its civil authority coverage for the losses of business income caused by the government prohibiting access to the restaurant.