THE INSURANCE DISPUTES LAW REVIEW

Fifth Edition

Editors
Joanna Page and Russell Butland

THE LAWREVIEWS

THE INSURANCE DISPUTES LAW REVIEW

Fifth Edition

Reproduced with permission from Law Business Research Ltd
This article was first published in November 2022
For further information please contact Nick.Barette@thelawreviews.co.uk

Editors
Joanna Page and Russell Butland

THE LAWREVIEWS

PUBLISHER
Clare Bolton

HEAD OF BUSINESS DEVELOPMENT
Nick Barette

TEAM LEADER
Katie Hodgetts

SENIOR BUSINESS DEVELOPMENT MANAGER
Rebecca Mogridge

BUSINESS DEVELOPMENT MANAGER
Joey Kwok

BUSINESS DEVELOPMENT ASSOCIATE
Archie McEwan

RESEARCH LEAD
Kieran Hansen

EDITORIAL COORDINATOR
Leke Williams

PRODUCTION AND OPERATIONS DIRECTOR
Adam Myers

PRODUCTION EDITOR
Anne Borthwick and Robbie Kelly

SUBEDITOR
Janina Godowska

CHIEF EXECUTIVE OFFICER
Nick Brailey

Published in the United Kingdom
by Law Business Research Ltd
Holborn Gate, 330 High Holborn, London, WC1V 7QT, UK

www.TheLawReviews.co.uk

ISBN 978-1-80449-128-7

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following for their assistance throughout the preparation of this book:

AIYON ABOGADOS SLP

ALLEN & OVERY LLP

FGE EBRAHIM HOSAIN

HAVIARAS & PHILIPPOU LLC

HOFMANN-CREDNER RECHTSANWALTS GMBH

HOGAN LOVELLS STUDIO LEGALE

LYDIAN

MOMO-O, MATSUO & NAMBA

PRAGER DREIFUSS LTD

ROKAS

RPZ ADVOGADOS

SHALAKANY

SIMPSON THACHER & BARTLETT LLP

TULI & CO

WASELIUS & WIST

WISTRAND

CONTENTS

PREFACE

We are delighted that this is now the fifth edition of *The Insurance Disputes Law Review*. It is a privilege to be the editors of this excellent and succinct overview of recent developments in insurance disputes across 18 important insurance jurisdictions.

Insurance is a vital part of the world's economy and critical to risk management in both the commercial and the private spheres. The law that has developed to govern the rights and obligations of those using this essential product can often be complex and challenging, with the legal system of each jurisdiction seeking to strike the right balance between the interests of insurer and insured, and also the regulator who seeks to police the market. Perhaps more than any other area of law, insurance law can represent a fusion of traditional concepts (concepts almost unique to this area of law) together with constant entrepreneurial development, as insurers strive to create new products to adapt to our changing world. This makes for a fast-developing area, with many traps for the unwary. Further, as this indispensable book shows, even where the concepts are similar in most jurisdictions, they can be implemented and interpreted with very important differences in different jurisdictions.

To be as user-friendly as possible, each chapter follows the same format – first providing an overview of the key framework for dealing with disputes – and then giving an update of recent developments in disputes.

As editors, we have been impressed by the erudition of each author and the enthusiasm shown for this fascinating area. It has also been particularly interesting to note the trends that are developing in each jurisdiction.

An evolving theme in almost every jurisdiction is the increase in protections for policyholders. Much of the special nature of insurance law has developed from an imbalance in knowledge between the policyholder (who had historically been blessed with much greater knowledge of the risk to be insured) and the insurer (who knew less and, therefore, had to rely on the duties of disclosure of the policyholder). With the increasing use of artificial intelligence to assess data and more detailed scope for analysis across risk portfolios, the balance of knowledge has shifted; it will often now be the insurer who is better placed to assess the risk. This shift has manifested itself in tighter rules requiring insurers to be specific in the questions to be answered by policyholders when they place insurance, and in remedies more targeted at the insurer if full information is not provided. Coupled with these trends, however, is the increasing desire by some jurisdictions to set limits on the questions that can be asked so that, for example, in relation to healthcare insurance, policyholders are not denied insurance for historical matters. In light of the ongoing scourge of covid-19, and the complexity of its effects across the world's economies, this issue continues to be at the forefront of debate.

We can expect that this tussle between the commercial imperative for insurers to price risk realistically and the need to balance consumer protection, government policy and privacy will increasingly be at the heart of insurance disputes.

The past year has been tumultuous. The conflict under way in Ukraine, together with its impact on energy security and global supply chains, comes as a further shock on top of climate events and continued disruption from covid-19. This conflict is having a substantial effect on the aviation insurance market, particularly in relation to providing cover for war and contingency coverage. Business interruption issues, meanwhile, continue to be worked through across the affected legal systems; key areas of coverage have been addressed, but there are now more bespoke issues to deal with; for example, relating to application of policy limits.

There has in the past year been particular focus on directors' and officers' policies. These are under increasing pressure as directors are in the spotlight following strategic climate change litigation being conducted, particularly relating to greenwashing and transparency in the process of the transition to net zero. Similarly, cyber risks are ever increasing and again place directors and officers under scrutiny.

No matter how carefully formulated, no legal system functions without effective mechanisms to hear and resolve disputes. Each chapter, therefore, also usefully considers the mechanisms for dispute resolution in each jurisdiction. Courts appear to remain the principal mechanism, but arbitration and less formal mechanisms (such as the Financial Ombudsman in the United Kingdom) can be a significant force for efficiency and change when functioning properly. The increasing development of class action mechanisms, particularly among consumer bodies (e.g., in France and Germany) is likely to be an important factor.

We would like to express our gratitude to all the contributing practitioners represented in *The Insurance Disputes Law Review*. Their biographies are to be found in the first appendix and highlight the wealth of experience and learning that the contributors bring to this volume. On a personal note, we must also thank Lucia Craft-Marquez at our firm, who has done much of the hard work in this edition.

Finally, we would also like to thank the whole team at Law Business Research, who have excelled at bringing the project to fruition and in ensuring both a professional look and consistency in the contributions.

Joanna Page and Russell Butland
Allen & Overy LLP
London
October 2022

Chapter 18

UNITED STATES

Andy Frankel and Summer Craig[1]

I OVERVIEW

In the United States, insurance disputes are primarily governed by state law. Each state has its own statutory and common law applicable to insurance-related matters. Because the relevant law varies from state to state, practitioners must conduct a careful evaluation of potentially applicable law at the outset of an insurance dispute.

Most insurance disputes in the United States are litigated in the first instance in state or federal trial courts. Disputes may also be subject to arbitration if the insurance contract contains an arbitration clause. Where an insurance contract requires the parties to arbitrate but applicable state statutory law prohibits insurance-related arbitration, courts will address whether state law supersedes or pre-empts federal law or treaties favouring arbitration.

US courts have recently addressed a number of significant insurance-related issues, including the scope of a general liability insurer's duty to defend, the impact of a 'related claim' provision in a directors' and officers' (D&O) liability insurance policy, and the availability of coverage for ransomware payments. Going forward, courts undoubtedly will continue to address the parameters of cyber-related coverage, as well as coverage disputes arising out of the novel coronavirus disease (covid-19) and climate change events. Insurance-related issues will also continue to be litigated in bankruptcy cases commenced by policyholders as a means to resolve mass tort claims.

II THE LEGAL FRAMEWORK

i Sources of insurance law and regulation

The regulation of insurance in the United States is primarily performed by the states. In 1945, the US Congress passed the McCarran-Ferguson Act,[2] which provides that: 'No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance.'[3] Under the McCarran-Ferguson Act, federal law pre-empts state insurance law only if it specifically relates to the business of insurance.

---

1 Andy Frankel is a partner and Summer Craig is counsel at Simpson Thacher & Bartlett LLP. The authors would like to acknowledge Karen Cestari of Simpson Thacher & Bartlett LLP for her contribution to this chapter.

2 15 U.S.C. §§ 1011-15 (1945).

3 id. § 1012(b).

The law of insurance in the United States generally falls into one of two broad categories: the regulation of entities that participate in the business of insurance; and the regulation of the policyholder–insurer relationship. State law pertaining to the regulation of entities is generally comprised of statutes enacted by state legislatures and administrative regulations issued by state agencies, such as departments of insurance.

Each state also has statutory and common law applicable to the policyholder–insurer relationship. State statutes address a range of topics, including, among others, the disclosure obligations of the parties to an insurance contract, the nature of a policyholder's notice obligations and the circumstances in which a victim of tortious conduct may sue a tortfeasor's insurer directly. State common law is an important source of law for resolving disputes between policyholder and insurer. Practitioners must carefully assess potentially applicable law at the outset of a dispute, as insurance law (whether common law or statutory) varies by jurisdiction.

ii Insurable risk

In the United States, the validity of an insurance contract ordinarily is premised on the existence of an insurable interest in the subject of the contract. An insurable interest may be defined as any lawful and substantial economic interest in the safety or preservation of the subject of the insurance free from loss, destruction or pecuniary damage.[4] The insurable interest doctrine was first adopted by courts,[5] and has since been codified in state statutes.[6] The purpose of the insurable interest requirement, as articulated by courts and commentators, is to discourage wagering and the destruction of life and property and to avoid economic waste.

iii Fora and dispute resolution mechanics

Litigation of insurance disputes

The US judicial system is comprised of two separate court systems. The United States itself has a system comprised of federal courts and each of the 50 states has its own system comprised of state courts. Although there are important differences between federal and state courts, they share some key characteristics. Each judicial system has trial courts in which cases are originally filed and tried, a smaller number of intermediate appellate courts that hear appeals from the trial courts and a single appellate court of final review.

Unlike state courts, which include courts of general jurisdiction that can address most kinds of cases, federal courts principally have jurisdiction over two types of civil cases. First, federal courts may hear cases arising out of the US Constitution, federal laws or treaties.[7] Second, federal courts may address cases that fall under the federal 'diversity' statute, which generally authorises courts to hear controversies between citizens of different US states and controversies between citizens of the United States and citizens of a foreign state.[8] For diversity jurisdiction to exist, there must be 'complete' diversity between litigants (i.e., no plaintiff shares a state of citizenship with any defendant) and the amount in controversy must exceed US$75,000.

4 *See generally* Steven Pitt *et al.*, Couch on Insurance § 41:1 (3rd ed. 2019).

5 *See, e.g.*, *Kramer v. Phoenix Life Ins Co*, 940 N.E.2d 535 (N.Y. 2010) (discussing common law origins and codification of New York insurable interest requirement).

6 *See, e.g.*, Cal Ins Code §§ 280, 281 (2019).

7 28 U.S.C. § 1331 (1980).

8 28 U.S.C. § 1332(a) (2011).

Most insurance disputes are litigated in the first instance in federal or state trial courts. Federal courts commonly exercise jurisdiction over insurance disputes under the diversity statute. In this context, an insurance company, like any other corporation, is deemed to be a citizen of both the state in which it is incorporated and the state in which it has its principal place of business.

An insurance action that is originally filed in state court may be 'removed' to federal court based on diversity of citizenship of the litigants. In the absence of diversity of citizenship or some other basis of federal court jurisdiction, insurance disputes are litigated in state courts. In some cases, plaintiffs may seek to prevent removal by including a non-diverse party as a defendant. Such tactics may be challenged, for example, if it can be shown that the non-diverse party has no potential liability or if the party was fraudulently joined in order to prevent removal to federal court. The venue is typically determined by the place of injury or residence of the parties, or may be dictated by a forum selection clause in the governing insurance contract. The law applied to the dispute may likewise be dictated by a choice-of-law clause in the insurance contract or, in the absence of such a clause, determined by a court based on relevant choice-of-law principles, which may vary by state and are frequently decided on an issue-by-issue basis.

Arbitration of insurance disputes

Some insurance contracts contain arbitration clauses, which are usually strictly enforced. The Federal Arbitration Act (FAA)[9] and similar state statutes empower courts to enforce arbitration agreements by compelling the parties to arbitrate. If an insurance contract contains a broadly worded arbitration clause, virtually every dispute related to or arising out of the contract typically may be resolved by arbitrators rather than a court of law. One issue that has been a point of contention in matters involving an arbitration clause is whether a non-signatory to the agreement may be compelled to arbitrate a dispute with parties to the agreement. Resolution of this issue frequently turns on whether the non-signatory is deemed to be a third-party beneficiary to the agreement or is equitably estopped from arguing that its status as a non-signatory precludes enforcement of arbitration because it seeks to benefit from other provisions of the agreement.[10]

While all US states recognise the validity and enforceability of arbitration agreements in general, some states have made a statutory exception for arbitration clauses in insurance contracts. Complex legal issues may arise when an insurance contract obligates parties to arbitrate but applicable state statutory law prohibits the arbitration of insurance-related disputes. Although state laws that prohibit arbitration are generally pre-empted by the FAA, by virtue of the Supremacy Clause in the Constitution, state anti-insurance arbitration statutes may be saved from pre-emption by the McCarran-Ferguson Act. As noted, the McCarran-Ferguson Act provides that state laws enacted for the purpose of regulating the business of insurance do not yield to conflicting federal statutes unless a federal statute specifically relates to the business of insurance. Because the FAA does not specifically relate to insurance, courts have held that the FAA may be 'reverse pre-empted' by a state anti-insurance arbitration statute if the state statute has the purpose of regulating the business

9 9 U.S.C. §§ 1-16 (1947).

10 *See, e.g., Philadelphia Indem Ins Co v. SMG Holdings, Inc,* 44 Cal. App. 5th 834 (Cal. Ct. App. 2019); *Wilson v. Willis*, 426 S.C. 326 (S.C. 2019).

of insurance.[11] As discussed in Section IV, courts are split regarding whether the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), an international treaty that mandates the enforcement of arbitration agreements, may be reverse pre-empted pursuant to the McCarran-Ferguson Act.

Where an insurance dispute is resolved through arbitration, the resulting award is generally considered to be binding, although there are grounds to vacate or modify an award under the FAA, similar state statutes and the New York Convention. The FAA describes four limited circumstances in which an arbitration award may be vacated by a court:

a where the award was procured by corruption, fraud or undue means;

b where there was evident partiality or corruption in the arbitrators;

c where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or if by any other misbehaviour the rights of any party have been prejudiced; or

d where the arbitrators exceeded their powers or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made.[12]

One area of legal uncertainty is whether a court may vacate an award based on an arbitrator's 'manifest disregard' of the law. Although the manifest disregard standard is not listed in the FAA, some courts have ruled that an award may be vacated on this basis.

III RECENT CASES

US courts recently have addressed a number of significant insurance-related issues, including the scope of a general liability insurer's duty to defend, the impact of a related claim provision in a D&O policy and the availability of coverage for ransomware payments.

i Duty to defend

State high courts have recently issued significant decisions concerning the scope of a general liability insurer's duty to defend.

Under well-established case law, a general liability insurer's duty to defend a suit against a policyholder is determined solely by comparing the four corners of the complaint against the four corners of the policy, subject to very few narrow exceptions in certain jurisdictions. The Texas Supreme Court recently clarified the scope of one exception to this long-standing principle, sometimes referred to as the 'eight-corners rule'. In *Monroe Guaranty Insurance Company v. BITCO General Insurance Corporation*,[13] Texas's highest court ruled that Texas courts may look to certain information outside the allegations in the complaint and the insurance policy in evaluating whether an insurer has a duty to defend. The Texas Supreme Court ruled that courts may consider extrinsic evidence when the evidence '(1) goes solely to an issue of coverage and does not overlap with the merits of liability, (2) does not contradict

11 *See, e.g.*, *Standard Life Ins v. West*, 267 F.3d 821 (8th Cir. 2001) (Missouri statute's insurance arbitration bar reverse pre-empts FAA pursuant to McCarran-Ferguson Act).

12 9 U.S.C. § 10(a) (2002).

13 640 S.W.3d 195 (Tex. 2022).

facts alleged in the pleading, and (3) conclusively establishes the coverage fact to be proved'. Notwithstanding this exception, the Court emphasised that the eight-corners rule remains the 'initial inquiry' to determine an insurer's defence obligations.

In *Ace American Insurance Company v. Rite Aid Corporation*,[14] the Delaware Supreme Court ruled that insurers were not obligated to defend Rite Aid in underlying opioid-related lawsuits because the suits sought economic damages, not personal injury damages. Government entities sued Rite Aid alleging that it failed to maintain effective controls related to the distribution of opioid prescriptions. Ride Aid sought coverage under a policy that indemnified damages 'for' or 'because of' personal injury. Reversing the trial court, the Delaware Supreme Court found no connection between the government plaintiffs' claimed damages and any personal injuries. The Court noted that although the government plaintiffs' economic losses were 'arguably linked to care for . . . residents affected by the opioid epidemic', they were, nonetheless, outside the scope of coverage because the policy only covered damages on behalf of the injured persons, or by persons or organisations that treated injured persons.

The Ohio Supreme Court recently decided a similar matter centring on whether damages sought by government plaintiffs in underlying lawsuits for the increased cost of responding to the opioid epidemic are 'because of' alleged bodily injuries. In *Acuity v. Masters Pharmaceutical Inc*,[15] the Ohio Supreme Court found that general liability insurers were not obligated to defend a pharmaceutical wholesale distributor in the underlying opioid lawsuits, explaining that the governments' alleged economic losses, including medical expenses and treatment costs, are not damages because of bodily injury because they are not specifically tethered to any particular injury sustained by a person. The Court was not persuaded by the policyholder's argument that the phrase because of bodily injury should be interpreted broadly in favour of triggering the duty to defend.

ii Related claim provision

In *First Solar, Inc v. National Union First Insurance Company*,[16] the Delaware Supreme Court affirmed a lower court decision holding that a securities class action and a later follow-on action were substantially related such that the later action was excluded from insurance coverage under an exclusion for related claims. The Supreme Court clarified that the standard for a related claim is individually determined by the language of the specific policy at issue, rather than a blanket 'fundamentally identical' standard that Delaware courts had previously used to assess relatedness-based coverage issues. The Supreme Court held that the two actions in this case were related under the broad policy language at issue, which defined a related claim as a 'Claim alleging, arising out of, based upon or attributable to any facts or Wrongful Acts that are the same as or related to those that were . . . alleged in a Claim made against an Insured'. The Court found that this standard was met because the second action was based on the same types of misrepresentations made during the same time frame, involved the same overall legal theory and shared common facts with the first action. The Supreme Court's

14 270 A.3d 239 (Del. 2022).

15 2022-Ohio-3092 (Ohio 2022).

16 274 A.3d 1006 (Del. 2022).

rejection in *First Solar* of the rigid fundamentally identical standard, which had permitted Delaware courts to analyse relatedness without reliance on the particular policy's definition of related claims, is a reprieve for insurers.

iii Coverage of ransomware payments

Ransomware, a form of malware designed to extort ransom payments from companies or individuals by encrypting data and demanding payment for decryption instructions, has become increasingly common and sophisticated. Several courts have recently addressed the scope of coverage for ransomware payments under computer fraud provisions of commercial crime policies.

In *G&G Oil Company of Indiana, Inc v. Continental Western Insurance Company*,[17] the Indiana Supreme Court ruled that ransomware losses may be subject to coverage under a computer fraud policy provision. The computer fraud policy provision covered loss 'resulting directly from the use of any computer to fraudulently cause a transfer of that property'. The trial court, affirmed by the court of appeals, ruled that the insurer owed no coverage for the ransomware attack losses because the policyholder's payments to hackers to regain access to its computer systems following a ransomware attack were not caused by the fraudulent use of a computer, but rather were the result of theft. The Indiana Supreme Court reversed this decision. The Court first noted that G&G Oil's declination of computer hacking and computer virus coverage under another part of the policy was not dispositive of its claim. With respect to the policy language, the Court held that the term 'fraudulently cause a transfer' is unambiguous and means 'to obtain by trick', but remanded the case for further fact-finding on whether the hackers accessed the company's computer system using 'some sort of deception', noting that '[w]e do not think every ransomware attack is necessarily fraudulent'. The Court further held that the term 'resulting directly' required loss that resulted either 'immediately or proximately without significant deviation from the use of a computer', and that the trial court erred in ruling as a matter of law that G&G Oil's voluntary payment of ransom was an intervening cause that severed the causal chain of events. The Court noted that the payment was 'voluntary' only in the sense G&G Oil 'consciously made the payment', but that it 'more closely resembled one made under duress', and as a result the payment was 'not so remote that it broke the causal chain'.

In *EMOI Services, LLC v. Owners Insurance Company*,[18] an appellate court in Ohio reversed a lower court declaration that a ransomware attack on a policyholder's computer system did not trigger coverage under a business owner's policy. When EMOI was the victim of a ransomware attack, it paid the hacker and then sought coverage from its insurer. The insurer denied coverage, noting that a data compromise endorsement explicitly precluded coverage for ransomware payments and that an electronic equipment endorsement did not apply because it required 'direct physical loss or damage'. The trial court agreed and dismissed the suit, reasoning that there was no physical loss because, even assuming that EMOI's software was damaged while it was encrypted by the hackers, it became fully functional after payment was made. The appellate court reversed, noting, among other things, that EMOI had raised an issue of fact for trial as to whether its software incurred direct physical damage

17 165 N.E.3d 82 (Ind. 2021).

18 180 N.E.3d 683 (Ohio Ct. App. 2021).

because the record established that portions of the software remained unusable even after decryption. The Ohio Supreme Court agreed to review the appellate court decision and, as of the date of publication, has heard oral arguments in this matter.

IV THE INTERNATIONAL ARENA

Complex jurisdictional issues may arise when an international insurance contract mandates arbitration of disputes but applicable state law prohibits such arbitration. In these circumstances, courts must address the interplay between governing state law and the New York Convention, which obligates the enforcement of foreign arbitration agreements. More specifically, such disputes require a determination of whether the New York Convention pre-empts state law such that arbitration is required or, conversely, whether state law reverse pre-empts the New York Convention pursuant to the McCarran-Ferguson Act such that disputes may be litigated in a court of law.

Federal courts of appeals are divided on this critical issue of international insurance law. The Court of Appeals for the Ninth Circuit recently ruled in *CLMS Management Services Ltd Partnership v. Amwins Brokerage of Georgia LLC*[19] that state law prohibiting the arbitration of insurance disputes does not reverse pre-empt the New York Convention. The Ninth Circuit reasoned that the relevant provision of the Convention is 'self-executing', and, therefore, not an 'Act of Congress' subject to reverse pre-emption under the McCarran-Ferguson Act.

The other federal appellate courts that have addressed whether reverse pre-emption pursuant to the McCarran-Ferguson Act extends to international disputes involving the New York Convention have reached conflicting conclusions. The Fourth and Fifth Circuits have held that reverse pre-emption under the McCarran-Ferguson Act is limited to federal legislation (such as the Federal Arbitration Act) and does not encompass an international treaty such as the New York Convention. See *ESAB Grp Inc v. Zurich Ins PLC,*[20] *McDonnel Grp, LLC v. Great Lakes Ins SE, UK Branch,*[21] *Safety Nat'l Cas Corp v. Certain Underwriters at Lloyd's, London.*[22] However, the Second Circuit reached the opposite conclusion in *Stephens v. American International Insurance Company.*[23]

V TRENDS AND OUTLOOK

i Covid-19

The global spread of the novel coronavirus disease (covid-19) has had major impacts on businesses, financial markets and international commerce, which in turn has led to a flood of suits against insurers for coverage of losses. According to the University of Pennsylvania Carey School of Law Covid Coverage Litigation Tracker, as of the end of June 2022, there were approximately 2,305 covid-19 coverage cases filed in state and federal courts across the US. A central issue in these cases is whether there has been physical damage to insured property. The physical damage requirement is inherent in most business interruption provisions, which insure against a loss of business income caused by covered physical damage

19 8 F.4th 1007 (9th Cir. 2021).
20 685 F.3d 376 (4th Cir. 2012).
21 923 F.3d 427 (5th Cir. 2019).
22 587 F.3d 714 (5th Cir. 2009).
23 66 F.3d 41 (2d Cir. 1995).

to the policyholder's own property. A physical loss requirement is also included in most civil authority provisions, which cover loss of income resulting from restrictions on access to insured premises by a government or civil authority.

Covid-19-related coverage litigation has centred on whether the loss of use of property that has become uninhabitable or unusable because of actual or potential covid-19 contamination constitutes a physical loss for purposes of business interruption coverage. The vast majority of courts, including 11 federal appeals courts and the high courts of four states (Iowa, Massachusetts, Wisconsin and South Carolina), have concluded that claims seeking coverage for covid-19 pandemic-related business losses are outside the scope of insurance coverage. These courts have ruled that policyholders' inability to use their property for their intended purpose (because of government restrictions on access, capacity, hours or type of service) does not constitute physical loss or damage to property, as required by most property policies. Courts have also ruled that the actual presence of the covid-19 virus on surfaces does not constitute physical loss or damage because the virus does not physically alter the policyholders' premises. Most courts have similarly rejected policyholders' efforts to obtain coverage under civil authority coverage provisions on the basis that there has been no physical loss or damage to property in close proximity to the insured property. A significant number of courts have also ruled that virus or communicable disease exclusions operate to bar coverage for covid-19-related claims, rejecting policyholder assertions that virus exclusions are ambiguous or inapplicable.

A minority of courts have allowed covid-19-related claims to proceed based on the specific factual allegations and policy language. Some courts have concluded that allegations of the presence of the virus on surfaces adequately plead physical loss or damage under the policy, while others have declined to dismiss litigation on the basis that physical loss can include property that is temporarily uninhabitable. A few courts have allowed covid-19 coverage claims to proceed based on the policyholder's reasonable expectations or ambiguity in policy language.

While insurers have prevailed on the merits in the vast majority of trial and appellate decisions, leading some policyholders to voluntarily dismiss claims, given the high stakes, policyholders will be likely to continue to pursue coverage for their covid-19 losses, including via appeals to state high courts.

ii Cyber breaches, data loss and computer fraud

Data breach incidents, cyberattacks and hacking activities designed to obtain financial gain or access to sensitive personal information continue to proliferate at an unprecedented rate. As such, courts undoubtedly will be called upon to address the parameters of both first-party property and third-party liability insurance coverage for myriad cyber-related claims. A growing body of case law is defining the scope of coverage for losses arising out of fraudulently induced wire transfers under computer fraud provisions. In the coming months and years, courts will continue to apply governing state law to decide whether various coverage or exclusionary provisions in general liability and crime policies encompass specific factual scenarios. Additionally, as highlighted and discussed in Section III, courts will continue to address novel questions of law, such as:

a whether cyber-related losses, including damage to software or other computer system components, constitute covered 'property damage' under general liability or first-party policies;

b whether and under what circumstances hackers' intentional taking of sensitive data constitutes a publication of private information sufficient to trigger personal and advertising injury coverage;
c the timing and number of losses or occurrences under applicable policy language; and
d the scope of coverage under D&O policies for cyber-related claims against a company by its shareholders or by regulatory agencies.

Furthermore, the applicability of certain exclusions, including those related to acts of war or terrorism, professional services or disputes based on contract, are likely to take centre stage in emerging cyber-coverage disputes.

Another recent development in this context is the issuance of formal advisories by US federal agencies relating to risks of ransomware payments. Specifically, the US Department of the Treasury's Office of Foreign Assets Control (OFAC) and its Financial Crimes Enforcement Network (FinCEN) concurrently issued formal advisories warning cyber insurance firms and others of the regulatory risks associated with ransomware payments to global bad actors, including certain designated persons and entities on OFAC's specially designated nationals and blocked persons (SDN) list pursuant to cyber-related sanctions implemented by the government. OFAC's advisory reiterates informal guidance, cautioning that, in the absence of a licence, it is a violation of law for a US person or entity to pay or facilitate a ransomware payment to a party on the SDN list, even if it did not know or have reason to know that it was engaging in a transaction of this kind. Relatedly, FinCEN's advisory explains about the regulatory risks for entities that process ransomware payments. These and other advisories serve as a message of caution to insurance companies offering cyber insurance products that reimburse policyholders for ransomware payments to take care in ensuring that those payments do not run afoul of recently enacted regulations.

iii Climate change

Climate change is an emerging concern for insurers, based on the increasing frequency of wildfires, storms, floods and other natural disasters. As such, future litigation is likely to implicate the scope of coverage under both first-party property and third-party liability policies for the catastrophic losses – both physical and economic – associated with such natural disaster events.

With respect to first-party policies, disputes may involve interpretation of policy provisions relating to causation, particularly where losses are caused by a complex interaction of perils, such as wind, rain and storm surge. Given that property policies often provide coverage for certain perils while excluding others, future litigation arising from weather-related events are likely to complicate this issue. Indeed, complex issues of interrelated causation frequently took centre stage in prior coverage disputes arising out of Hurricane Katrina and other major storms to impact the United States.

Coverage under third-party policies for damage caused by severe weather events are likely to be a source of litigation in coming years. In this context, a central issue for courts may be whether climate change or greenhouse gas emission claims give rise to a covered occurrence for purposes of liability coverage. The sole US court to address this issue thus far ruled that an insurer had no duty to defend or indemnify a policyholder for underlying nuisance claims relating to carbon dioxide and greenhouse gas emissions. In *AES Corp v.*

Steadfast Insurance Co,[24] the court reasoned that the underlying claims did not allege an occurrence because the damage was not accidental, but rather the natural and foreseeable consequence of the policyholder's intentional emissions. Other courts may confront similar coverage claims arising out of policyholders' detrimental contributions to climate change. Outcomes are likely to depend on not only the particular factual scenario presented, but also policy language and applicable law. More specifically, future decisions are likely to turn, in part, on governing law relating to whether conduct may deemed an accidental occurrence if the resulting harm is expected or foreseeable, even if not intended.

Similar coverage disputes may arise in connection with pending cases against oil and gas industry giants, which face civil and regulatory litigation over their alleged role in global warming. Litigation has also been filed against the federal government and various state governments based on the alleged failure to safeguard the environment. To the extent that these defendants seek insurance coverage, complicated issues pertaining to justiciability, fortuity, actual property damage and trigger and allocation of coverage are likely to follow.

iv Mass tort bankruptcy

As a consequence of the rapid expansion of mass tort litigation in the US over the past few decades, there has been a substantial increase in the number of companies seeking refuge from such claims under federal bankruptcy laws. Bankruptcy provides a means for a debtor to aggregate all claims against it and emerge as a reorganised entity after resolving its liability. Resolution of mass tort claims within the bankruptcy process has its roots in asbestos litigation. More recently, overwhelming liability caused by other types of mass torts has spawned diverse cases such as the Purdue Pharma opioids bankruptcy, talc bankruptcies (Imerys Talc America, Cyprus Mines, Johnson & Johnson subsidiary LTL Management) and sexual abuse bankruptcies (Boy Scouts of America (BSA), Catholic Church, and USA Gymnastics).

When a debtor is the target of significant number of tort claims, the debtor and its tort creditors – normally adverse to one another outside bankruptcy – may seek to jointly propose a bankruptcy plan that aims to facilitate the tort creditors' access to proceeds of the debtor's insurance policies. This issue has arisen in asbestos-driven and other mass tort bankruptcy cases, causing insurers to raise objections to plans of reorganisation or liquidation that insurers regard as threatening to violate their contractual rights.[25] Generally, the rights and obligations of the debtor and its insurers under insurance policies are not altered because of the debtor's Chapter 11 filing,[26] as the filing of a bankruptcy petition does not alter the scope or terms of a debtor's insurance policy;[27] nor does it permit a policyholder to 'obtain greater rights to the proceeds of [an insurance] policy'.[28] The property interests of debtors in bankruptcy and their contractual counterparties are generally created and defined by state law.[29]

Nonetheless, given the efforts of debtors and tort claimants in some cases to accelerate and expand insurers' potential coverage obligations through bankruptcy plans, which give

24 725 S.E.2d 532 (Va. 2012).

25 See, e.g., In re BSA, No. 1:20-bk-10343 (LSS), 2022 Bankr. LEXIS 2095 (Bankr. D. Del. Jul. 29, 2022) (discussing insurer's objections to Boy Scouts of America's proposed plan of reorganisation because, among other things, the proposed plan impermissibly sought to modify its insurance contracts).

26 See In re Amatex Corp, 107 B.R. 856, 865-866 (E.D. Pa. 1989), aff'd, 908 F.2d 961 (3d Cir. 1990).

27 In re MF Glob Holdings Ltd, 469 B.R. 177, 193 (Bankr. S.D.N.Y. 2012).

28 In re Denario, 267 B.R. 496, 499 (Bankr. N.D.N.Y. 2001).

29 See Butner v. United States, 440 U.S. 48, 55 (1979).

rise to a host of bankruptcy issues and potential coverage defences, careful insurers often scrutinise plans that may appear to override the applicable terms of insurance policies and potentially create rights against insurers that may not otherwise exist. Several bankruptcy plans contain 'insurance neutrality' language purporting to protect state law coverage rights and defences; however, such provisions have not always prevented debtors, bankruptcy trusts or claimants from attempting to seek coverage and override insurers' contractual and common law defences as a result of bankruptcy court rulings.[30]

Coverage disputes may be litigated or resolved consensually during the course of a policyholder's bankruptcy case. When a policyholder files for bankruptcy, its insurers may confront issues regarding the scope of a bankruptcy court's jurisdiction over coverage disputes. The critical determination is whether the dispute is a 'core' proceeding or a 'non-core' proceeding under the federal bankruptcy code. Courts have reached conflicting conclusions on this issue. In addition, where a prior coverage action has been commenced, which raises state law issues that can be timely adjudicated in state court, bankruptcy courts are required to abstain so that the issues can be resolved in the state court forum.[31]

Settlements in the bankruptcy context can take the form of policy 'buybacks', coverage-in-place agreements or other similar structures. In a coverage-in-place settlement, the insurer and the policyholder typically agree on a lump settlement payment for past amounts owed, and establish a formula for payment indemnification or defence costs, or both, moving forward. In a buyback agreement, the insurer pays a lump sum to the policyholder to resolve a coverage dispute – i.e., the insurer effectively buys back the policy from the policyholder and the policy is then cancelled. In one closely watched case, the bankruptcy court overseeing the BSA bankruptcy recently issued a 274-page ruling confirming aspects of a plan of reorganisation proposed by the BSA to deal with more than 80,000 claims of childhood sexual abuse. See *In re BSA*.[32] The bankruptcy court's ruling touched on a number of insurance-related issues. Among other things, the court approved the creation of a US$2.7 billion settlement trust to be funded by contributions from the BSA, its local councils and charter organisations, and the insurers that settled with the BSA. The plan calls for the settling insurers to make cash contributions to the trust and for the insurers to buy back the insurance policies. The insurers will be released from future liability related to the sex abuse claims in exchange for their contributions to the trust. A group of non-settling insurers opposed confirmation of the plan, saying that it would impermissibly affect their contractual rights under the policies they issued to the BSA and related entities. Following the bankruptcy court's final order confirming the plan, certain non-settling insurers filed a notice of appeal, which will be heard in the federal district court in the first instance.

30 For a comprehensive illustration of the competing arguments and issues that can arise in such situations, see Fuller-Austin Insulation Co v. Highlands Ins. Co, 38 Cal. Rptr. 3d 716 (Cal. App. 2006).

31 See 28 U.S.C. § 1334(c)(2).

32 2022 Bankr. LEXIS 2095 (Bankr. D. Del. Jul. 29, 2022).

Appendix 1

ABOUT THE AUTHORS

ANDY FRANKEL

Simpson Thacher & Bartlett LLP

Andy Frankel is co-head of Simpson Thacher's insurance and reinsurance practice and a partner in the firm's litigation department. He has more than 30 years of experience successfully representing clients in a wide variety of complex disputes, including insurance, securities, product liability and other commercial litigation and investigations.

Andy has successfully litigated cases in state and federal trial and appellate courts throughout the United States and in domestic and international arbitrations.

He has been recognised by Law360 as an 'Insurance MVP' for his work representing insurers in several high-profile disputes, including asbestos-related direct actions and coverage disputes involving other mass tort litigations. He has also been named a 'Litigation Star' by Euromoney's *Benchmark Litigation*, which has highlighted the enthusiastic praise he consistently receives from his peers, in addition to numerous other accolades.

Andy received his JD from Brooklyn Law School, where he was a member of the *Brooklyn Law Review.* He clerked for Judge Morton I Greenberg of the US Court of Appeals for the Third Circuit, and Judge Mitchell H Cohen of the US District Court for the District of New Jersey.

SUMMER CRAIG

Simpson Thacher & Bartlett LLP

Summer Craig is counsel in Simpson Thacher & Bartlett's litigation department. Summer represents clients in a variety of complex commercial litigation matters at both trial and appellate level, with particular emphasis in the areas of insurance and reinsurance.

Summer has authored numerous appellate briefs in high-profile insurance and reinsurance matters. Her appellate work has resulted in the affirmance of trial court decisions worth hundreds of millions of dollars and precedent-setting decisions by the New York Court of Appeals and the US Court of Appeals for the Second Circuit concerning allocation and non-cumulation clauses.

Summer has also served in a variety of capacities in trial-level cases, including discovery, dispositive motions, trial and helping to ensure appellate issues are properly preserved.

Summer received her JD in 2002 from Cornell Law School. She received her BA, *cum laude*, from Dartmouth College in 1997, where she graduated with high honours in history.

SIMPSON THACHER & BARTLETT LLP

425 Lexington Ave
New York, NY 10017
United States
Tel: +1 212 455 2000
Fax: +1 212 455 2502
afrankel@stblaw.com
scraig@stblaw.com
www.stblaw.com

ISBN 978-1-80449-128-7