Perspective from a Corporate Policyholder's Counsel

Why New Insurance Claims—Such as COVID-19 Claims—Lead to Problems for Policyholders, Defense Counsel, and Insurance Companies

By William G. Passannante

The recent spread of the novel coronavirus (SARS-CoV-2), which causes coronavirus disease known as COVID-19, has and will cause disruption to businesses and communities and take a significant human toll.

The problems highlighted by the spread of SARS-CoV-2 provide a model to illustrate difficulties in the defense of liability claims and insurance issues in the context of new types of losses. Policyholders who have claims made against them and submit mundane insurance claims often end up meeting frustration in a process foreign to them. By contrast, trusted experienced defense counsel address complex claims every day, as do insurance companies, and their experience shows. Policyholders seldom make significant insurance claims, and thus have less experience related to new claims and liabilities.

As a lawyer for corporate policyholders, I can attest that the average purchaser of business insurance understands that the primary purpose of insurance is *to insure against losses*. Appleman, *Insurance Law and Practice* §7001 (1981); *Newmont Mines Ltd. v. Hanover Ins. Co.*, 784 F.2d 127, 135–36 (2d Cir. 1986) ("[T]he meaning of particular language found in insurance policies should be examined in light of the business purposes sought to be achieved…"). Indeed, most policyholders would say that purpose—to insure—meets their *"reasonable expectations."* Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 Harv. L. Rev. 961, 967 (1970).

A new type of liability and new insurance claim accentuates the disparity in experience among defense counsel, claims professionals, and insurance policyholders. Misunderstandings and disputes in the context of an unusual insurance claim such as one related to COVID-19 will increase risk and costs associated with such losses. Experienced and trusted defense counsel, insurance claims personnel, and coverage professionals have more to offer their clients and customers on account of the heightened uncertainty involved in the unusual circumstances related to possible COVID-19 losses. The uniqueness of the liability, the losses, and the damages introduce exceptional uncertainty into the claims process. That uncertainty leads to problems for policyholders, defense counsel, and insurance companies.

Below, this article describes such problems in the context of possible COVID-19 losses related to: (1) D&O and securities claims; (2) business interruption and business income losses; and (3) the impact on claims handling. The article concludes with some suggestions related to unusual claims.

New Liability for Mistakes Made by Directors and Officers and Securities Claims

Suppose that management or the board of directors is alleged to have made a misstep in preparing for, disclosing the impact of, or responding to the COVID-19 event?

Classic D&O liability claims can be asserted by: securities holders, competitors, customers, vendors, and business partners. Securities claims have the highest average severity. Such claims ordinarily are covered by D&O liability insurance, usually with independent defense counsel paid for by the insurance company providing payment for a defense to the company and possibly to individual officer and director insureds.

The U.S. Securities and Exchange Commission ("SEC") has permitted an extension of time to meet reporting obligations relating to COVID-19, subject to conditions, which could give rise to future claims.

The SEC issued an Order permitting issuers subject to reporting requirements under the Securities Exchange Act of 1934 additional time in meeting certain of their obligations under federal securities laws. The Order provided extra time to meet reporting obligations by extending the time period from March 1, 2020 to April 30, 2020. SEC Release No. 34-88318 (March 4, 2020) (available at https://www.sec.gov/rules/other/2020/34-88318.pdf). The SEC Order contains several conditions including a direction to include "if appropriate, a risk factor explaining, if material, the impact of COVID-19 on its business." The SEC Order also notes that, the "Commission believes such statements, as furnished, to the extent they contain 'forward-looking

statements,' would be subject to the safe harbor under Exchange Act, Section 21E. *See* Private Securities Litigation Reform Act of 1995, 15 U.S.C. §77z-1 (1998)."

That Order was modified and superseded by an SEC Order dated March 25, 2020 (Available at https://www.sec.gov/rules/exorders/2020/34-88465.pdf), which extended the period of relief to July 1, 2020. In the SEC's March 25, 2020 press release (Available at https://www.sec.gov/corpfin/coronavirus-covid-19), the Commission states a number of questions regarding the effects of COVID-19 for companies to consider. The release questions the: (1) impact on financial condition and operations; (2) impact on capital and financial resources; (3) effect on assets on the balance sheet; (4) material impairment or changes in accounting judgment regarding certain assets; (5) impact on demand for the issuer's product or services, among others. The release states, that in sum, "each company will need to carefully assess COVID-19's impact and related material disclosure obligations."

The Commission's release also includes a fundamental reminder to avoid trading prior to the dissemination of material non-public information, referencing Fair Disclosure regulations. Regulation FD 17 CFR 243.100, *et seq.* The release states, "where a company has become aware of a risk related to COVID-19 that would be material to investors, the company, its directors and officers, and other corporate insiders who are aware of these matters should refrain from trading in the company's securities until such information is disclosed to the public."

Accurately disclosing the "impact of COVID-19 on its business" is a significant undertaking for an issuer, and one that might be second-guessed after-the-fact by the plaintiffs' securities bar. As the outbreak has developed rapidly, assessing the likely impact on current and future operations is difficult. The current increased pricing volatility in the financial markets means that disclosures may well have a more significant impact on share price. Such volatility in relation to disclosures is the recipe for allegations in a classic securities "stock drop" case. Given the backdrop of increased D&O liability exposure from the opinion in *Cyan, Inc. v. Beaver County Employees Retirement Fund* (138 S. Ct. 1061 (2018)), which upheld plaintiffs' right to bring certain securities class actions in state courts, it is not outrageous to forecast increased liability exposure on account of the impact of COVID-19. Some commentators have described how and when COVID-19 may require disclosures by an issuer. Adele Hogan, *When Coronavirus May Trigger SEC Disclosure Requirements,* Law360 (Feb. 25, 2020, 4:48 PM EST) (available at https://www.law360.com/articles/1245738/when-coronavirus-may-trigger-sec-disclosure-requirements).

"Custom and Usage" Is Less Customary in New Claims

If they happen, such unusual securities claims will lead to similarly new types of insurance claims seeking defense and payment for settlements and judgments. As part of that defense process, experienced defense counsel will assess the matter, determine reasonable defense strategies, and evaluate timing of litigation or a settlement. In the context of an unusual claim those actions are more difficult. The first D&O liability insurance claim related to COVID-19 will be un precedented, and thus more fraught. For example, new claims do not have the same body of "custom and usage" in the industry, and such custom and usage may be admissible to give meaning to terms. *National Union Fire Ins. Co. v. Continental Illinois Corp.,* 658 F. Supp. 781 (N.D. Ill. 1987); *Carey-Canada, Inc. v. California Union Ins. Co.,* 118 F.R.D. 242, 244 (D.D.C. 1986) (drafting history documents and interpretive materials relevant). Without such a broad body of prior usage with regard to the specifics of a novel claim, additional areas of disagreement are more likely to emerge.

Indeed, central issues regarding insurance coverage potentially impacting COVID-19 already are the subject of debate, such as, Randy Maniloff, *Coronavirus and CGL Coverage: Is it an "Occurrence"?.* Available at https://www.coverageopinions.info/Vol9Issue2/CGLCoverage.html. The Maniloff article contrasts the treatment of "occurrence" and "accident" in *Liberty Mut. Ins. Co. v. Estate of Bobzien* (377 F. Supp. 3d 723 (W.D. Ky. 2019) (intentional exposure to second-hand smoke not an "accident")) *with Campanella v. Northern Properties Group, LLC* (No. 19-cv-171, 2020 U.S. Dist. LEXIS 34454 (D. Minn. Feb. 28, 2020) (disease caused by exposure to chicken feces was an accident)).

Commentators will spill more ink on these coverage topics.

Unusual Insurance Losses Caused by Business Income Disruption

Most property insurance policies, often based upon the ISO Standard Property Insurance policy, contain business interruption or business income insurance. The purpose of such insurance is to pay the policyholder loss arising from the inability to continue its normal operations, and to place the policyholder – from an earnings standpoint – into the position it would have occupied but for the loss-causing event. *Pennbarr Corp. v. Insurance Co. of North America,*

976 F.2d 145 (3d Cir. 1992); *Keetch v. Mutual of Enumclaw Ins. Co.*, 831 P.2d 784 (Wash. Ct. App.1992).

One common type of coverage contained in property insurance policy forms is Civil Authority coverage. In *Sloan v Phoenix of Hartford Insurance Co.* (207 N.W.2d 434, 435–36 (Mich. Ct. App. 1973)), the policy contained the following clauses:

> This policy covers against loss resulting directly from necessary interruption of business caused by damage to or destruction of real or personal property by peril(s) insured against during the term of this policy, on premises occupied by the insured and situated as herein described....
>
> *Interruption by Civil Authority.* This policy is extended to include the actual loss as covered hereunder, during the period of time, not exceeding 2 consecutive weeks, when as a direct result of the peril(s) insured against, access to the premises described is prohibited by order of civil authority.

The court affirmed a determination of civil authority coverage relating to a government curfew. If access to your premises is prevented by an order of civil authority on account of COVID-19, business income coverage may be implicated.

Similarly, many current property programs include Civil Authority coverage and do not exclude loss caused by bacteria, viruses ,or communicable diseases. Indeed, some policies explicitly define such events as a peril insured under the policy. Thus, in the context of the COVID-19 event a closure under an "order of civil authority" should trigger the business income coverage under many property programs.

Insurance companies might argue the "physical loss or damage" under a property policy does not include the COVID-19 event. *Phoenix Ins. Co. v. Infogroup, Inc.*, 147 F. Supp. 3d 815, 826 (S.D. Iowa 2015) (holding that material questions of fact existed regarding cross-motions related to damage to premises). The court looked to dictionary definitions of "physical loss" since the insurance policy left the term undefined:

> The dictionary defines "physical" as "having material existence: perceptible especially through the senses and subject to the laws of nature." MERRIAM–WEBSTER, available at http://www.merriam-webster.com/dictionary/physical. The common usage of physical in the context of a loss therefore means the loss of something material or perceptible on some level.

Phoenix Ins., 147 F. Supp. 3d at 823.

Another case, *Murray v. State Farm Fire and Cas. Co.* (509 S.E.2d 1 (W. Va.1998)), supports the proposition that loss of use of premises constitutes physical loss or damage. In *Murray*, government employees required owners to leave their homes due to the possibility of falling rock, and found that loss of use sufficient to trigger coverage. *Id. See also, Customized Distribution Servs. v. Zurich Ins. Co.*, 862 A.2d 560 (N.J. Super. Ct. App. Div. 2004) (customers' change in perception of a product constituted physical loss or damage); *Manpower Inc. v. Ins. Co. of Penn.,* No. 08C0085, 2009 U.S. Dist. LEXIS 108626 (E.D. Wis. Nov. 3, 2009) (inaccessibility of personal property constituted a physical loss). *Western Fire Ins. Co. v. First Presbyterian Church*, 437 P.2d 52 (Colo. 1968); *Advance Cable Co. v. Cincinnati Ins. Co.*, No. 13-cv-229-wmc, 2014 U.S. Dist. LEXIS 32949 (W.D. Wis. Mar. 12, 2014), *aff'd*, 788 F.3d 743 (7th Cir. 2015) (cosmetic hail damage to roof covered); *Pepsico, Inc. v. Winterthur Int'l Am. Ins. Co.,* 24 A.D.3d 743 (2d Dep't 2005) (unmerchantable "off-tasting" beverage covered).

The argument that the coverage is triggered is even more straightforward under policies that explicitly include bacteria, viruses, and communicable disease as a covered peril. Or, under policies which exclude bacteria and fungus, but not viruses—as SARS-CoV-2 is a virus.

Further, note that other coverage under a property insurance program may be available, possibly not subject to the insurance company argument regarding "direct physical loss or damage." Check for coverage clauses for: (1) communicable disease coverage; (2) contingent business income coverage; (3) contingent extra expense coverage; and (4) ingress and egress coverage. These and similar provisions may provide coverage for events that interfere with suppliers or customers, or prevent or hinder access to premises.

Impact on Claims Handling and Settlement of Novel Claims

Uncertainty in unusual claims possibly leads to uncertainty in defense, claims handling and settlement posture by all involved. The "unknowns" surrounding COVID-19 will cause greater uncertainty in defense and claim evaluation. Maintaining a stance consistent with the insurance companies' duty of good faith and fair dealing becomes more difficult with increased uncertainty. Most states' laws support that a duty of good faith and fair dealing is implied in an insurance policy. *E.g., Rowe v. Nationwide Ins. Co.*, 6 F. Supp. 3d 621 (W.D. Pa. 2014). Similarly defense counsel, who ordinarily assess an overall defense to provide protection to the policyholder – and by extension to the insurance company

– are left in a more difficult position with the unusual claim. Without the reliable body of historical data, history and experience associated with the more mundane types of claim, the task of developing a strategy to resolve liability and losses related to COVID-19 will be more complex.

Experienced defense counsel will develop those strategies, but the uncertainty associated with them will be significant. Should we fight the COVID-19 liability claim or not? Should we adopt an administrative claims processing approach? Should we fight liability at perhaps significant cost and risk? Unusual claims render all these questions fraught with additional uncertainty.

At the policyholder and insurance company level the impact of that uncertainty increases. Should the policyholder aggressively contest all claims against it? Is it in their interest to do so? Should claims be resolved? Defense counsel guides the policyholder on difficult defense questions, and then the claims professionals must fit that defense appraisal and tactical decision-making into its claims program. The uncertainty at various levels in unusual claims sometimes leads to sub-optimal decision-making. Policyholders may argue that the claims decision-making was so incorrect that it amounts to bad faith because of malicious or dishonest conduct to avoid an obligation to the policyholder. *Employers Equitable Life Ins. Co. v. Williams*, 665 S.W.2d 873 (Ark. 1984).

One regularly recurring problem is the need to resolve claims quickly – perhaps driven by plaintiffs' or trial court deadlines—leaving little time for dispassionate consideration. Yet, courts have held that the good faith duty reasonably and fairly to settle includes a duty to act promptly. *See Hayes Bros., Inc. v. Economy Fire & Cas. Co.,* 634 F.2d 1119, 1122–24 (8th Cir. 1980). Further, disagreements about agreeing to a settlement or not can lead to disputes regarding the duty to settle claims. "By refusing to settle within the policy limits, an insurer risks being charged with bad faith on the premise that it has 'advanced its own interests by compromising those of its insured.'" *Pavia v. State Farm Mut. Auto. Ins. Co.*, 82 N.Y.2d 445, 452 (1993); *see also, New England Ins. Co. v. Healthcare Underwriters Mut. Ins. Co.*, 295 F.3d 232 (2d Cir. 2002), *vacated by, remanded by and in part*, 352 F.3d 599 (2d Cir. 2003).

The assertion of these arguments in a context of mundane claims is difficult. In the context of possible and unusual COVID-19 claims, the arguments take on additional substantial variation and bite.

Suggestions Regarding New Claims

Suggestions regarding unusual losses or claims may serve as the beginning of an insurance checklist in the event of a COVID-19 loss. Things to consider include: giving notice, consulting trusted defense counsel, keeping track of limitations periods, keeping written records, possibly enlisting help, and considering the availability of other insurance.

Give Notice

If you have a claim or loss, give notice and comply with time limits. Usually, your insurance broker should give notice under the potentially implicated policies. The broker should send you a copy of the notice letter.

Consult Trusted Defense Counsel

In the event of significant loss or potential claims related to COVID-19, consult experienced trusted defense counsel. Preparation in the face of possible significant losses is always worthwhile. Let your insurance company know the identity of selected trusted defense counsel.

Beware of Time Limitations

Property and business interruption losses often take time to resolve. Extend by written agreement limits on time to provide "proof of loss" or to make repairs.

Keep a Diary

The lawyers' adage that, "If it's not in writing, it did not happen," is a guide. Document loss-related items and emergency expenses related to the COVID-19 event. Keeping complete and accurate records is helpful to ensure proper payment. Consider video and photographs to document losses.

If You Have a Claim, Consider Help

Accounting firms, adjusters, and brokers often have groups that specialize in property and business income insurance accounting. The insurance company might hire its own adjuster, and one or more accounting firms or law firms. Getting your proper insurance recovery requires preparation. Be prepared – more than the other side.

Consider Other Insurance

COVID-19 may cause far-reaching effects and implicate various relationships and lines of insurance. Consider providing notice of an "occurrence" or of "circumstances"

under certain liability insurance policies. Vendor agreements may contain applicable indemnity provisions. Also, determine the availability of "additional insured" status under the insurance policies of others.

Consult with your insurance broker or risk manager regarding the implications on insurance renewals of the COVID-19 events.

Conclusion

The impact of COVID-19 and the disruption it causes will continue its human toll.

The spread of COVID-19 also illustrates potential difficulties in defense of liability claims and insurance issues in the context of new types of losses. Above we described such problems in the context of possible COVID-19 losses related to: D&O and securities claims; business interruption and business income losses; impact on claims handling; and suggestions related to unusual claims.

Defense counsel together with their policyholder clients and insurance professionals on all sides of the COVID-19 issue can be a force to help solve serious liability issues.

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Gables: Do the AIA's Standard Construction Contract Forms Really Waive

By Alex J. Brown

In March of 2014, a catastrophic fire destroyed a four-story apartment complex that was under construction and just weeks away from completion. The fire insurer covering the construction project paid the property owner more than $17 million in fire insurance proceeds. That should have been the end of the story, but it is just the beginning.

The fire insurer stepped into the owner's shoes and filed a subrogation action against one of the service providers at the construction site, a security company that was providing "fire watch." The security company settled the owner/fire insurer's subrogation claim for $14 million, and then successfully sued the general contractor for contribution of half that amount ($7 million) under Maryland's version of the Uniform Contribution Among Tortfeasors Act ("UCATA"). On appeal, Maryland's intermediate appellate court affirmed (but reduced the award on grounds not pertinent here). *Gables Construction, Inc., v. Red Coats, Inc.*, 241 Md. App. 1 (2019), *cert. granted*, 464 Md. 25 (2019). The general contractor appealed again, presenting an issue of first impression that will soon be decided by Maryland's highest court, and which is likely to have an impact around the country. *Id.*

In *Gables*, the Maryland high court will decide whether the waiver of subrogation claim provisions ("WOS Provisions") contained in the general contractor's construction contract with the property owner ("Prime Contract"), and which are based on the widely used American Institute of Architects ("AIA") construction contract forms, operate to waive the security company's statutory contribution claim against the general contractor under Maryland's Uniform Contribution Among Tortfeasors Act ("UCATA"), a uniform statute that has been adopted in many States. Although the security company was not a party to the Prime Contract, the general contractor argues that the security company is asserting its UCATA claim while "standing in the shoes" of the property owner who agreed to the WOS Provisions, such that the security company is bound by the property owner's waivers of claims in the Prime Contract.

The issue does not simply turn on a comparison of the contractual language of the AIA forms to the statutory language of UCATA. Subrogation claims are, at least in Maryland, purely equitable claims. The waiver at issue in the *Gables* case, and in similar cases, is thus a purported *contractual* waiver of a *statutory* contribution claim that