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How the UK and US are dealing with COVID-19-related insurance claims

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Like the rest of the world, the U.K. and the U.S. have each been ravaged by the COVID-19 pandemic — illnesses, deaths, business closures, lockdowns, economic downturns and spikes in unemployment.

The hallmark of property damage/business interruption insurance has historically been "direct physical loss or damage."

Not surprisingly, there has been a massive number of insurance claims by businesses impacted by forced closures, government orders and dramatic reductions in consumer confidence, consumption and economic activity.

In general, the insurance industry has responded to these claims with skepticism. The hallmark of property damage/business interruption insurance has historically been "direct physical loss or damage." But the responses of the insurance industry, government and the courts in the two countries have been dramatically different, even though the countries have a common language and historically related legal systems.

The UK

The U.K. has a long history with property insurance, dating back to the origins of Lloyd's and its insurance of marine cargos in the late 1600s. Lloyd's markets continue to be a major provider of property/business interruption coverage around the world. As such, the U.K. insurance industry is keenly familiar with property/business interruption coverage.

A key difference between the U.K. and the U.S. is that the U.K. has a single insurance regulator, the Financial Conduct Authority (FCA), and a fairly homogenous insurance market, whereas the U.S. has neither.

In recent years, Lloyd's and other London market insurers have developed broad policy wordings that have been commonly used for property covers, particularly for small businesses. These wordings were largely initiated by some of the large broking houses operating in London.

While the policies clearly cover certain business interruption losses resulting from the occurrence of a notifiable disease, such as COVID-19, at or within a specified distance of the business' premises and from public authority intervention limiting use of business premises, insurers argued that these forms were designed to cover businesses in the event of closure brought on by local disease outbreaks or government orders.

Their position is that the policies were priced on the basis that claims would arise only in relation to local outbreaks, not national or international pandemics. On this basis, insurers argued that policyholders would have to prove direct losses were caused solely by COVID-19 cases in the vicinity of their businesses and not by the national pandemic or government response — a potentially difficult task for policyholders.

Soon after the pandemic began, there was a deluge of claims under these policies. Insurers denied the claims on the grounds that this was clearly a national emergency, for which the policies were simply not designed. Billions of pounds and over 700,000 policyholders were affected by this issue.

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The FCA was concerned about this onslaught of claims and recognized the importance of getting payments to policyholders if they were entitled to them. Fortunately, it had a mechanism for dealing with this kind of situation.

Because the claims raised issues of general importance to financial markets that required immediate authoritative English law guidance, the English courts' Financial Markets Test Case

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Scheme allowed the FCA to apply to the High Court in London (the equivalent of a U.S. state court commercial calendar with an appellate court) for a declaration as to how the various forms of coverage that were in play should respond to COVID-19 claims.

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The FCA argued that the pandemic itself should be seen as integral to policy coverage and that insurers should not distinguish between losses caused by the pandemic, which the insurers argued were not insured, and losses caused by local infections, which, in the insurers' view, were covered.

The case went all the way to the U.K. Supreme Court, which found in favor of policyholders and the FCA in January 2021. Consequently, many insurers have rewritten these forms in order to restrict future coverage to purely localized disease outbreaks, reflecting the relatively modest premiums charged for these policies.

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The Supreme Court's judgment is not, however, the end of the story. Insurers are still disputing the size of claims, arguing that many of the losses claimed are not covered.

One very significant issue is whether the pandemic should be considered as one claim to which one policy limit applies or whether the many twists and turns in the history of the pandemic — government advice, laws and regulations, local lockdowns, multiple business locations, the distinction between physical and online sales, etc. — can trigger multiple claims and multiple policy limits.

There is also a growing number of claims against brokers made by policyholders who have found that their particular policies provide no pandemic coverage at all.

U.K. mediators and arbitrators are being kept busy with the resolution of these disputes, and it is certainly possible that more test cases will need to proceed through the courts to clarify outstanding points of law. The claims will eventually work their way into the reinsurance market, where further issues and disputes are likely to arise.

The US

The situation in the U.S. is starkly different. To begin with, the U.S. has an insurance regulatory system that is different from the system in the U.K. While the U.K. has a single insurance regulator, the U.S. has 50.

Enacted in 1945, the McCarran–Ferguson Act mandates that the regulation of insurance shall reside in each of the 50 states. As a result, while there have been some minor federal forays into the area, insurance regulation in the U.S. resides almost entirely in the hands of 50 state insurance commissioners (some elected and some appointed) and their departments.

In addition to being subject to state regulation, insurance disputes are largely the domain of state courts and state law. While federal courts can and often do consider insurance disputes under their diversity jurisdiction (typically disputes among citizens of different states), even then, the federal judges normally look to state law and to decisions of the relevant state courts.

As a result, it is uncommon for the U.S. Supreme Court to decide insurance issues, much less to do so in a way that will bind state courts to a particular outcome. In addition, statutory and common law regarding insurance often varies considerably from state to state, sometimes causing litigants to race to the courthouse in an effort to establish jurisdiction in a state whose laws they believe will be favorable.

This state-driven regulatory regime has important practical implications for the insurance industry. Initially, many insurance policy forms, particularly those in use by consumers and small businesses, are common forms that have been approved by all 50 states, so they are subject to only minor variations.

As a result, many "standard" forms for property/business interruption coverage are tied to the traditional concept of "direct physical loss or damage."

On the other hand, less common, niche forms like contamination or product recall policies, or forms for property/business interruption coverage purchased by large companies, are often subject to regulatory exemptions that may allow them to vary significantly, even though they are largely subject to state law interpretation.

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This landscape has largely controlled the response of U.S. courts and litigation to pandemic- related business interruption claims. The fact patterns and issues are largely the same as in the U.K., but the responses of the regulators and the courts have been entirely different.

Initially, and perhaps most critically, there was no centralized judicial forum to decide pandemic-driven property damage and business interruption claims.

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before federal multi-district panels so that large numbers of cases could be decided together.

The effort had some economic logic. Neither small businesses nor their attorneys could economically pursue some of these cases individually, so they sought to bring them together in an effort to create economic leverage.

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Nonetheless, with a few limited exceptions, the insurers were largely successful in resisting those efforts, with the U.S. Judicial Panel on Multidistrict Litigation finding that the existence of multiple defendants would diminish any chance of common discovery and that the policy forms at issue and the facts of how the pandemic impacted a particular industry or business in a particular place could vary widely.

More recently, a Pennsylvania appeals court overturned a lower court order that had sought to consolidate all cases concerning pandemic related property coverage against a single insurer.

The result has been a mass of litigation. According to the Covid Coverage Litigation Tracker created by Professor Tom Baker at the University of Pennsylvania Law School (https://cclt.law.upenn.edu/), as shown on August 13, 2021, 1,981 COVID-19-related coverage cases have been filed in state and federal courts in the U.S.

There have been 526 decisions on motions to dismiss or for summary judgment, including 120 in state courts, where decisions have been relatively equally divided between policyholders and insurers at least where no virus exclusion is involved , and 406 in federal courts, which have tended to favor the carriers.

While the tracker lists 230 appeals as pending in state and federal courts, it shows oral arguments scheduled in only 6, and while there was one federal appeals decision that has garnered significant publicity, the parties are already arguing about the extent to which it should be distinguished on its facts or policy language.

There has been at least one effort to get a case before the U.S. Supreme Court, but that request was rejected without opinion. On the other hand, at least one state supreme court has granted a federal court's request to answer a certified question relating to COVID-19 property coverage, and other requests for certification to state supreme courts are pending.

The primary argument by the insurers in opposition to coverage is that there has been no "direct physical loss or damage" to property of the insured and that closures due to state or local orders cannot trigger coverage because they too were not the result of "direct physical loss or damage."

Policyholders have countered with a variety of contrary arguments, including that the policies cover "loss," which they contend is not the same as "damage," and that the virus caused physical loss or damage to property, including in cases in which there was no evidence of a tangible change in the physical characteristics of the property.

There are also factual arguments based on whether there is any evidence of COVID-19 at a particular property and whether an individual with COVID-19 at a particular property constitutes property damage to that property. Numerous other arguments have been made on both sides, in most cases based on particular language of particular policies.

As a result, there have been relatively few payments of pandemic-related property damage business interruption claims in the U.S., except under contamination or product recall policies, which sometimes include specific provisions supporting recovery.

There remains significant uncertainty about the outcome of claims. While insurers have generally been more successful in U.S. coverage disputes to date, new cases continue to be filed by leading policyholder counsel on behalf of major companies with manuscripted policies that do not necessarily follow standardized forms, and state supreme court decisions may undermine previous decisions by federal courts.

Numerous insureds are waiting to see how the litigation plays out before determining whether to devote the resources necessary to pursue a claim (though there may be contractual limitations provisions in some policies that flush out litigation sooner as opposed to later).

Many of these large company programs also contain clauses requiring arbitration in the U.S. or abroad, which make them difficult to track in any meaningful way.

This playing field has also made it difficult to resolve claims through the kinds of negotiations or mediations that are commonly used to resolve property/business interruption losses. The insurance industry has been largely unwilling to negotiate in light of their successful trends in the courts.

In the event that there are more policyholder victories, there may be more negotiations and mediations, but even then, there may be trials on factual issues that have yet to be considered by the courts.

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