IN-DEPTH

Insurance Disputes

EDITION 6

Contributing editor
Russell Butland
Allen & Overy LLP

LEXOLOGY

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Preface

Russell Butland

I am delighted that this is now the sixth edition of *The Insurance Disputes Law Review*. It is a privilege to be the editor of this excellent and succinct overview of recent developments in insurance disputes across 17 important insurance jurisdictions. I am particularly pleased in this edition to welcome chapters from China and Mexico.

Insurance is a vital part of the world's economy and critical to risk management in both the commercial and the private worlds. 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 (that are 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 the editor, I have been impressed by the erudition of all authors 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 proliferation of data, the increasing use of artificial intelligence to assess that data and provide 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.

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 being fought in Ukraine, and its effect on energy security and global supply chains, comes as a further shock on top of climate events and the legacy of the disruption from covid-19. The effect of the Ukraine conflict is having a substantial effect on the aviation insurance market, with previously lightly litigated policy forms now at the front and centre of major litigation in the US, the UK and Ireland. Business

interruption issues from the covid-19 pandemic meanwhile continue to be worked through across the legal systems; key areas of coverage have been addressed but now there are more bespoke issues, for example relating to the 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 as a result of strategic climate change litigation (particularly relating to greenwashing and transparency of transition to net zero). Similarly, cyber risks are ever increasing, as the scope of cover and capacity provided by the insurance market retreats.

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.

I would like to express my 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 I must also thank Rebecca Daramola at my firm, who has done much of the hard work in this edition. I would also like to thank the whole team at Law Business Research, who have excelled at bringing the project to fruition and in adding a professional look and more coherent finish to the contributions.

Last, but not least, I would to like thank Joanna Page, who co-edited the first five editions of this book. Joanna's leadership and intellect were instrumental in bringing the original concept for this book to fruition, and ensuring that it has gone from strength to strength with each edition. In following Joanna as editor I have big shoes to fill.

Russell Butland
Allen & Overy LLP
London
October 2023

Chapter 17

United States

Andy Frankel and Summer Craig[1]

Summary

I INTRODUCTION

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 availability of business interruption coverage for losses arising out of the novel coronavirus disease (covid-19), the scope of a 'securities claim' in a directors' and officers' (D&O) liability insurance policy, the availability of coverage for ransomware payments, and the application of a war exclusion to losses arising out of a malware attack. Going forward, courts undoubtedly will continue to address the parameters of cyber-related coverage, as well as coverage disputes arising out of covid-19, PFA 'forever chemicals' 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 YEAR IN REVIEW

i General liability

Duty to defend

Several courts have addressed duty to defend in the context of lawsuits commenced against policyholders by local governments and other entities to recover alleged losses incurred by plaintiffs in addressing the opioid crisis.

In *Acuity v. Masters Pharmaceutical Inc*,[2] the Ohio Supreme Court ruled that a liability insurer had no duty to defend a pharmaceutical wholesale distributor in underlying opioid-related lawsuits brought by West Virginia cities and counties alleging economic losses caused by the opioid epidemic. The underlying suits alleged that the policyholder failed to monitor and report suspicious opioid pharmaceutical orders which contributed to an epidemic that caused financial harm to the government entities. The Ohio Supreme Court explained that the governments' alleged economic losses, including medical expenses and treatment costs, are not damages 'because of' bodily injury, as required by the policies, because they are not specifically tethered to any particular injury sustained by a person. The Court was not persuaded by the policyholders' argument that the phrase 'because of bodily injury' should be interpreted broadly in favour of triggering the duty to defend.

The Delaware 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 were 'for' or 'because of' personal injury. In *Ace American Insurance Company v. Rite Aid Corporation*,[3] 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.

Most recently, in *Westfield National Insurance Company v. Quest Pharmaceuticals Inc*,[4] the United States Court of Appeals for the Sixth Circuit affirmed a Kentucky district court holding that insurers had no duty to defend or indemnify a pharmaceutical company in underlying opioid litigation brought by cities and other government agencies alleging misconduct that contributed to a nationwide epidemic of opioid abuse because the claims failed to allege damages 'because of' bodily injury. Addressing this matter of first impression under Kentucky law, the Sixth Circuit concluded that claims seeking compensation for losses incurred by government agencies in addressing the opioid crisis were not damages 'because of' bodily injury. The Court reasoned that 'because of' requires a connection between the damages sought in the underlying suits and particular individual bodily injury, which was not present here. The Court noted that the Supreme Courts of Delaware and Ohio have employed similar reasoning in finding that insurers were not obligated to defend underlying opioid suits.

ii Covid-19 business interruption

Reversal of appellate decision in favour of policyholder

In ***Cajun Conti LLC v. Certain Underwriters at Lloyd's, London***,[5] the Louisiana Supreme Court reversed a rare state appellate court decision in favour of a restaurant owner seeking covid-19 coverage. The Supreme Court reinstated a trial court's judgment in favour of insurers, finding that covid-19 did not cause 'direct physical loss of or damage to' insured property. The court noted that the alleged losses were not 'physical in nature,' as it 'never repaired, rebuilt or replaced any property.' The restaurant owner's case had been the first covid-19 coverage suit to reach trial in February 2021. As discussed in Section V, the Louisiana Supreme Court's ruling joined recent pro-insurer decisions by the high courts of Ohio, Maryland, Connecticut, New Hampshire and Oklahoma. Insurers have prevailed on the merits in the vast majority of trial and appellate decisions.

iii Cyber

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. Courts recently have addressed the scope of coverage for ransomware payments under computer fraud provisions of commercial crime policies.

In *EMOI Services, LLC v. Owners Insurance Company*,[6] the Ohio Supreme Court ruled that a business owner's policy that requires 'direct physical loss of or damage to' property does not cover losses stemming from a ransomware attack. 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 of or damage to' property. The trial court agreed and dismissed the suit, reasoning that there was no physical loss, and additionally, even assuming that EMOI's software was damaged while it was encrypted by the hackers, most system files became fully functional once the ransom payment was made.

An intermediate appellate court reversed, ruling that issues of fact existed as to whether the attack resulted in direct physical loss. The appellate court noted that the electronic equipment endorsement covered 'direct physical loss of or damage to media' and that 'media' was defined as 'materials on which information is recorded such as film, magnetic tape, paper tape, disks, drums, and cards.' The policy further stated that 'media' included 'computer software and reproduction of data contained on covered media.' Viewing the evidence in a light most favourable to EMOI, the appellate court ruled that the company's computer servers may be considered 'media' because they 'constituted materials on which EMOI's information was recorded.' Additionally, the court ruled that EMOI had raised an issue of fact as to whether its software incurred 'direct physical damage' because the record established that portions of the software remained unusable even after decryption.

The Ohio Supreme Court reversed and reinstated the trial court's grant of summary judgment in the insurer's favour. The court held that under the 'clear and unambiguous' language of the electronic equipment endorsement, there must be direct physical loss of or damage to property, which does not include damage to software. Although the term 'computer software' was included within the definition of 'media,' the court explained that it is included only insofar as the software is 'contained on covered media', which means media that has a physical existence. As the court emphasised, all examples of media in the definition of that term are of a physical nature ('film, magnetic tape paper tape, disks, drums, and cards'). The court stated: '[T]he policy requires that there must be direct physical loss or physical damage of the covered media containing the computer software for the software to be covered under the policy.' Because EMOI did not incur damage to its physical media, any loss or damage

to software was not covered. Rejecting the notion that software itself could sustain direct physical loss or damage, the court explained that software is 'essentially nothing more than a set of instructions' and lacks a 'physical existence.'

The war exclusion

In ***Merck & Company, Inc v. Ace American Insurance Company***,[7] an intermediate New Jersey appellate court affirmed a trial court ruling that a war exclusion does not bar coverage for property damage claims arising out of a malware attack known as NotPetya that had infected Merck's global computer network systems. When Merck submitted a notice of loss to its 'all risk' property insurers, they issued reservations of rights, raising a hostile/warlike action exclusion. The insurers noted that a cyber-consultant had concluded that the cyber-attack was 'very likely orchestrated by actors working for or on behalf of the Russian Federation.' The exclusion applied to 'loss or damage caused by hostile or warlike action in time of peace or war, including action in hindering, combating, or defending against an actual, impending, or expected attack: (a) by any government or sovereign power (*de jure* or ***de facto***) or by any authority maintaining or using military, naval or air forces; (b) or by military, naval, or air forces; (c) or by an agent of such government, power, authority or forces[.]' While the insurers conceded that the term 'warlike' might not apply, they contended that 'hostile' encompassed antagonistic actions that reflect ill will or a desire to harm, such as a malware attack by a government actor. The appellate court rejected this contention, reasoning that the plain language of the exclusion 'requires the involvement of military action.'

iv Directors and officers

Securities claim

In ***Verizon Communications v. National Union Fire Insurance Company of Pittsburgh, Pennsylvania***,[8] the Delaware Superior Court held that a bankruptcy trustee's fraudulent transfer suit against Verizon counted as a covered securities claim under the company's D&O policy, requiring Verizon's insurers to cover the company's settlement of claims with the bankruptcy trustee that accused Verizon of luring then-insolvent FairPoint Communications into a 'disastrous' acquisition of Verizon's outdated telephone equipment and infrastructure. The court found that the trustee's suit was 'brought derivatively' on behalf of an entity that was created by Verizon for delivering the outdated assets to FairPoint in a merger, and which qualified as a covered organization under the D&O policy at issue. The court also found the trustee to be a security holder for the Verizon-created entity, which meant that the lawsuit brought by the acquiring company FairPoint was a covered securities claim.

III 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,[9] 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.'[10] Under the McCarran-Ferguson Act, federal law pre-empts state insurance law only if it specifically relates to the business of insurance.

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 generally comprises 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.[11] The insurable interest doctrine was first adopted by courts,[12] and has since been codified in state statutes.[13] 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 comprises two separate court systems. The United States itself has a system comprising federal courts and each of the 50 states has its own system comprising 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.[14] 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.[15] 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.

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)[16] 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.[17]

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 of insurance.[18] 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:

- where the award was procured by corruption, fraud or undue means;
- where there was evident partiality or corruption in the arbitrators;
- 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
- 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.[19]

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.

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.

The Court of Appeals for the First Circuit recently ruled in *Green Enterprises LLC v. Hiscox Syndicates Ltd.*[20] that a Puerto Rico statute prohibiting mandatory arbitration of insurance disputes does not reverse pre-empt the New York Convention, and thus an arbitration clause in the insurance policy at issue must be enforced. The First Circuit reasoned that the relevant provision of the Convention is 'self-executing', that is, directly enforceable as a domestic law, without the aid of any legislative provision, and, therefore, not an 'Act of Congress' subject to reverse pre-emption under the McCarran-Ferguson Act.

The First Circuit's decision signals a growing consensus among federal circuit courts on this issue. While the Second Circuit has ruled that the Convention is not 'self-executing' and therefore that state law prohibiting arbitration of insurance disputes reverse-preempts the Convention, the Fourth, Fifth and Ninth Circuits have reached contrary conclusions. *Compare Stephens v. Am Int'l Ins Co*[21] with *ESAB Grp Inc v. Zurich Ins PLC*,[22] *McDonnel Grp, LLC v. Great Lakes Ins Se*,[23] *Safety Nat'l Cas Corp v. Certain Underwriters at Lloyd's, London*,[24] and *CLMS Mgmt Servs Ltd P'ship v. Amwins Brokerage of Georgia, LLC*.[25] Notably, the Ninth and First Circuits expressly ruled on the 'self-executing' issue, whereas the Fourth and Fifth Circuits did not reach that issue and instead held that, regardless of whether the Convention is self-executing, the McCarran-Ferguson Act does not apply to international treaties and instead limits reverse pre-emption to the domestic Federal Arbitration Act.

V OUTLOOK AND CONCLUSIONS

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 August 2023, there were approximately 2,389 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 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 11 states (Connecticut, Iowa, Louisiana, Maryland, Massachusetts, New Hampshire, Ohio, Oklahoma, South Carolina, Washington and Wisconsin), have concluded that claims seeking coverage for covid-19 pandemic-related business losses are outside the scope of insurance coverage. The Vermont Supreme Court is the only state high court to have sided with a policyholder seeking covid-19 coverage.

Those courts to have rejected policyholders' covid-19 claims 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.

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. Among the courts poised to weigh in are the high courts of New York, Louisiana, Nevada, Alaska and California.

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 I, courts will continue to address novel questions of law, such as:

- whether cyber-related losses, including damage to software or other computer system components, constitute covered 'property damage' under general liability or first-party policies;
- 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;
- the timing and number of losses or occurrences under applicable policy language; and
- 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 Forever chemicals

Courts have long dealt with the limits of general liability coverage for property damage and bodily injury claims arising out of exposure to various harmful substances, such as asbestos, lead paint particles, carbon monoxide and toxic fumes. In many cases, policyholders have argued that such claims are not excluded from coverage by a pollution exclusion because they do not arise from traditional environmental contamination. An emerging area of litigation is whether claims arising out of exposure to PFA 'forever chemicals' are excluded from coverage by virtue of pollution exclusions.

Thus far, a handful of courts have addressed insurers' coverage obligations for PFA claims against policyholders in the face of pollution exclusions. In two cases, the court granted

insurers' motions to dismiss, concluding that pollution exclusions barred coverage for alleged bodily injuries and property damage arising out of PFA claims as a matter of law. See *Tonoga, Inc v. New Hampshire Ins Co*;[26] *Grange Ins Co v. Cycle-Tex Ins Co*.[27] However, other courts have ruled that insurers are required to defend suits alleging bodily injury and property damage arising out of exposure to PFA chemicals. See *Wolverine World Wide, Inc v. Am Ins Co*;[28] *Colony Ins Co v. Buckeye Fire Equip Co*.[29]

An Ohio federal district court recently declined to exercise jurisdiction over a declaratory judgment action relating to an insurer's duty to defend and indemnify underlying PFA claims. In *Admiral Insurance Company v. Fire-Dex, LLC*,[30] the court explained that resolution of the coverage issues, including application of total pollution exclusions, involved 'novel and unsettled matters of state law' which were best left for a state court forum.

Aside from pollution exclusion clauses, future coverage litigation in this context is likely to implicate other complex questions of fact and law, including issues relating to the date of allegedly covered bodily injury or property damage (see *Crum & Forster Specialty Ins Co v. Chemicals Inc*[31]), questions of causation between PFA exposure and any potential bodily injury, applicability of a 'discharge' requirement in many pollution exclusions for claims that arise out of PFA-containing products as opposed to environmental contamination, and the applicability of intended act exclusions, among other things.

iv 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*,[32] 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.

v 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 and 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.[33] 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,[34] as the filing of a bankruptcy petition does not alter the scope or terms of a debtor's insurance policy;[35] nor does it permit a policyholder to 'obtain greater rights to the proceeds of [an insurance] policy'.[36] The property interests of debtors in bankruptcy and their contractual counterparties are generally created and defined by state law.[37]

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 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.[38]

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.[39]

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 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*.[40] 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, as did a relatively small number of abuse claimants who opposed the plan. The bankruptcy court's decision was thereafter affirmed on appeal by the federal district court in a 155-page opinion.[41] The appeal is currently pending in the United States Court of Appeals for the Third Circuit.

In a development that could significantly impact mass tort bankruptcies, the US Supreme Court recently agreed to hear a challenge to the bankruptcy plan in the Purdue Pharma bankruptcy. Faced with criminal charges and thousands of claims alleging that Purdue fuelled the opioid crisis by its sale and marketing of painkiller OxyContin, Purdue filed for bankruptcy protection in 2019. Following extensive mediation, the vast majority of claimants, the debtor, and various third parties agreed to a comprehensive plan that would compensate individual and governmental claimants (such as states and cities that had sued Purdue and related parties) billions of dollars through a trust funded by Purdue and other related parties. Notably, the plan requires the Sackler family, former Purdue shareholders who were also the targets of opioid litigation, to make payment into the trust of approximately US$5.5 billion. Under the Plan, non-debtor parties such as the Sacklers will receive broad releases and injunctive protections in exchange for their contributions to the trust.

Despite overwhelming support for the plan, a small number of objecting parties appealed the confirmation order. Disagreeing with numerous decisions upholding third-party releases of non-debtor parties, the federal district court reversed, finding that such releases are not authorised under the Bankruptcy Code.[42] On 30 May 2023, that decision was reversed by the United States Court of Appeals for the Second Circuit, which held that in appropriate circumstances, bankruptcy courts may approve releases to non-debtor parties facing liabilities arising from the debtor's conduct in exchange for substantial contributions to the debtor's plan.[43] Thereafter, the Solicitor General, on behalf of the United States Trustee, filed an emergency application for a stay in the US Supreme Court, arguing that the Bankruptcy Code does not authorise the releases contained in the plan and that if the plan becomes effective, the doctrine of 'equitable mootness' could eliminate the government's ability to appeal the Second Circuit's decision. The Supreme Court granted the stay and, at the government's suggestion, treated the application as a petition for writ of certiorari, which it also granted. The Supreme Court agreed to hear the case on an expedited basis, and directed the parties to brief and argue '[w]hether the Bankruptcy Code authorizes a court to approve, as part of a plan of reorganization under Chapter 11 of the Bankruptcy Code, a release that extinguishes claims held by nondebtors against nondebtor third parties, without the claimants' consent.'

Although Congress explicitly authorised non-debtor releases and protections in the context of asbestos pursuant to 11 USC Section 524(g), as noted above, bankruptcy filings modelled on Section 524(g) have become common (albeit with varying degrees of success) in other contexts, including not only opioids, but to resolve litigation relating to talc, sex abuse, earplugs, breast implants and other mass torts. These cases typically require funding from non-debtor third parties to be successful, which in turn is usually conditioned on the ability of bankruptcy courts to provide finality to the third parties through releases and injunctive or other forms of bankruptcy court protections. Broadly speaking, proponents argue that bankruptcy courts offer the best and only vehicle to achieve finality by fairly and equitably resolving both present and future claims, and that non-debtor releases and other protections are limited to certain parties that share an identity of interest with the debtor, such as insurers, officers and directors, and past and present corporate affiliates of the debtor, and require significant contributions by such third parties. Critics generally argue that Congress has only authorised such protections in the context of asbestos, and that bankruptcy protections should only be available to parties that file for bankruptcy and are thereby subject to the strictures of the Bankruptcy Code.

The Supreme Court intends to hear argument during the December 2023 argument session, with a ruling likely by summer 2024.

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Endnotes

1 Andy Frankel is a partner and Summer Craig is counsel at Simpson Thacher & Bartlett LLP.
2 205 N.E.3d 460, 474 (Ohio 2022).
3 270 A.3d 239, 253–54 (Del. 2022).
4 57 F4th 558, 567 (6th Cir. 2023).
5 359 So. 3d 922, 939 (La. 2023).
6 208 N.E.3d 818, 823 (Ohio 2022).
7 293 A.3d 535, 538 (N.J. Super. Ct. App. Div. 2023).
8 No. N18C-08-086 EMD CCLD, 2022 WL 14437414, at *11 (Del. Super. Ct. Oct. 18, 2022).
9 15 U.S.C. §§ 1011-1015.
10 15 U.S.C. § 1012(b).
11 See generally Steven Pitt et al., Couch on Insurance § 41:1 (3rd ed. 2019).
12 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).
13 See, e.g., Cal. Ins. Code §§ 280, 281 (West).
14 28 U.S.C. § 1331.
15 28 U.S.C. § 1332(a).
16 9 U.S.C. §§ 1-16.
17 See, e.g., Phila Indem Ins Co v. SMG Holdings, Inc, 257 Cal. Rptr. 3d 775 (Cal. Ct. App. 2019); Wilson v. Willis, 827 S.E.2d 167 (S.C. 2019).
18 See, e.g., Standard Life Ins Co. v. West, 267 F.3d 821, 619–21 (8th Cir. 2001) (Missouri statute's insurance arbitration bar reverse pre-empts FAA pursuant to McCarran-Ferguson Act).
19 9 U.S.C. § 10(a).
20 68 F.4th 662, 676–77 (1st Cir. 2023).
21 66 F.3d 41 (2d Cir. 1995).
22 685 F.3d 376 (4th Cir. 2012).
23 923 F.3d 427 (5th Cir. 2019).
24 587 F.3d 714 (5th Cir. 2009).
25 8 F.4th 1007 (9th Cir. 2021).
26 159 N.Y.S.3d 252 (N.Y. App. Div. 3d Dept. 2022).
27 No. 4:21-CV-147, 2022 WL 18781187 (N.D. Ga. Dec. 5, 2022).
28 No. 1:19-cv-00010, 2021 U.S. Dist. LEXIS 200978 (W.D. Mich. June 15, 2021).
29 No. 3:19-cv-00534, 2020 U.S. Dist. LEXIS 194709 (W.D.N.C. Oct. 19, 2020).
30 No. 1:22-CV-1087, 2022 U.S. Dist. LEXIS 198034 (N.D. Ohio Oct. 31, 2022).
31 No. H-20-3493, 2021 U.S. Dist. LEXIS 146702 (S.D. Tex. Aug. 5, 2021).
32 725 S.E.2d 532, 619–21 (Va. 2012).
33 See, e.g., In re BSA, 642 B.R. 504, 551, 645–58 (Bankr. D. Del. 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).
34 See In re Amatex Corp, 107 B.R. 856, 865-866 (E.D. Pa. 1989), aff'd, 908 F.2d 961 (3d Cir. 1990).
35 In re MF Glob Holdings Ltd, 469 B.R. 177, 193 (Bankr. S.D.N.Y. 2012).
36 In re Denario, 267 B.R. 496, 499 (Bankr. N.D.N.Y. 2001).
37 Butner v. United States, 440 U.S. 48, 51–54 (1979).
38 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).
39 See 28 U.S.C. § 1334(c)(2).
40 642 B.R. 504 (Bankr. D. Del. 2022).
41 Nat'l Union Fire Ins v. BSA (In re BSA), 650 B.R. 87 (D. Del. 2023).
42 In re Purdue Pharma, LP, 635 B.R. 26, 29 (S.D.N.Y. 2021).
43 Purdue Pharma, L.P. v. City of Grande Prairie (In re Pharma LP), 69 F.4th 45, 57 (2d Cir. 2023).