

No (Social) Distance for Reinsurers? If Lawmakers Force Insurers to Pay COVID-19 Claims, Will Reinsurers Follow?

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As legislators in New Jersey debate a new law that would force insurers to pay COVID-19-related claims that are excluded under the plain language of their new law, insurers are left to contemplate a number of critical questions regarding their ability to recover from reinsurers for these claims. Chief among these questions is whether their reinsurer will follow their fortunes and share in these unexpected losses. While there are a number of specific reinsurance issues that might arise from the COVID-19 crisis (e.g., aggregation and number of occurrences), whether and to what extent reinsurers are bound to follow their ceding companies' fortunes may be the overarching issue.

The follow the fortunes doctrine requires reinsurers to follow the underwriting fortunes (or more accurately misfortunes) of their ceding companies and binds the reinsurers to the ceding companies' good faith claims handling decisions. When applied in the context of settlements, the doctrine is referred to as follow the settlements and it effectively precludes reinsurers from second-guessing good faith settlement decisions. The doctrine, however, has its limitations. It does not, for example, compel a reinsurer to pay a claim that is clearly outside the scope of coverage of the reinsured policy.

So what happens when a claim is clearly outside the scope of coverage of the policy, but the ceding company is forced to pay anyway – because the government mandates it by law (including retroactive change in law) or by exerting extreme pressure on carriers? In order to answer that question, the ceding company first needs to look at its reinsurance contracts to confirm that they contain follow the fortunes/follow the settlements language. While such language is found in the vast majority of reinsurance contracts, there are exceptions. Some facultative contracts, for example, do not contain an express follow the fortunes/follow the settlements provision. And where the reinsurance is memorialized only by a binder, slip or cover note – without reference to a more complete wording – all substantive terms and conditions are not always expressly referenced. While many in the industry believe that follow the fortunes is implied in every reinsurance contract, that view has been rejected in several recent court cases. In the absence of a follow the fortunes/follow the settlements provision, ceding companies may face substantial hurdles in proving coverage under their policy. The height of those hurdles may depend in large part on whether disputes with reinsurers will be decided in litigation (where strict rules of law apply) or arbitration (where industry custom and practice typically controls).

Assuming that the reinsurance contracts contain some form of follow the fortunes/follow the settlements provision, does the doctrine apply and require a reinsurer to pay a claim that might not be covered under the reinsured policy? Where a government actually mandates payment by law, as would appear to be the case if the New Jersey statute concerning business interruption is enacted, it seems fairly clear that such circumstances fall within the scope of the follow the fortunes doctrine and the reinsurer would be required to pay. Indeed, such governmental intervention is the kind of misfortune outside the control of the insurer that the doctrine is intended to address. It may be a closer call where the

government does not require payment by law but instead puts pressure on insurers to waive defenses or relax claim handling requirements. While it is arguable that such pressure is likewise a misfortune that reinsurers should be required to follow, reinsurers may see that differently.

The COVID-19 crisis has created a tremendous strain on the global economy, and lawmakers appear ready to compel the insurance industry to shoulder a significant share of the burden – even if that means legislatively re-writing policies to provide coverage. Insurers forced to pay these claims should be proactive to ensure that their reinsurance partners are on board. The best way to do so is for ceding companies to engage with their reinsurers in real time (as practically possible, of course) to keep them apprised of developments. Reinsurers who are on notice and engaged from the start are much more likely to follow their ceding companies' fortunes. Coordination with reinsurers is probably even more important where the reinsurance contracts do not contain express follow the fortunes/follow the settlements language.

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As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates [here](#).

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