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## What History Can Tell Us About the Future of Insurance and Litigation After COVID-19

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# WHAT HISTORY CAN TELL US ABOUT THE FUTURE OF INSURANCE AND LITIGATION AFTER COVID-19

*Kenneth S. Abraham<sup>1\*</sup> & Tom Baker<sup>2\*\*</sup>*

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*This Article chronicles a series of developments in American history that profoundly influenced the course of insurance and insurance law in order to predict the post-Covid-19 future of these fields. In each instance, there was a direct and decided cause-and-effect relationship between these developments and subsequent change in the world of insurance and insurance law. As important as the influence of Covid-19 is at present and probably will be in the future, in our view, the Covid-19 pandemic will not be as significant an influence on insurance and insurance law as the historical developments we identify, and that is part of our message. Nonetheless, the Covid-19 pandemic will cause change, and change does not take place from a standing start. The world of insurance and insurance law have a history that places them already in motion when such new developments as a pandemic occur. Understanding how major historical developments influenced and continue to influence insurance can help us to predict the post-Covid-19 future of insurance.*

*The developments this Article identifies exercised three different forms of influence. First, certain events in the twentieth century – most notably the rise of modern tort liability and the introduction of automobiles and computers – stimulated the insurance marketplace, by generating entirely new forms of insurance to protect against the risks posed by or brought into being by these events. Second, other developments – including mass tort and pollution liability, climate change, and natural catastrophes – influenced the evolution of insurance law doctrine in important ways, bringing modern insurance law into existence. Third, modern finance has affected insurance, and in turn insurance coverage, through the “financialization” of insurance. Having chronicled these events and developments and assessed their influence, this Article concludes by identifying some lessons that can be learned from our analysis and applies them to support our predictions about the post-Covid-19 world of insurance and insurance litigation.*

INTRODUCTION

Studying history and predicting the future both involve causal attribution. History often identifies causes after the fact,<sup>3</sup> and prediction

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3. We recognize that the issue of causation is controversial in historiography. For discussions, see generally MICHAEL STANFORD, AN INTRODUCTION TO THE PHILOSOPHY OF HISTORY (1998); Mendel F. Cohen, *Causation in History*, 62 PHIL. 341, 344 (1987); John Henry Schlegel, *Philo-*

does so before events occur. This Symposium asks contributors to envision the future, by predicting what civil litigation will look like after the Covid-19 pandemic. We propose to do this by exploring the history of insurance and insurance law, to help us predict their future in the world that will exist after the pandemic ends. Despite the difficulties that are sometimes involved in causal attribution, there are certain watershed events and developments in the history of insurance whose predominant influences clearly can be identified. These past patterns of influence can give us some guidance – though only some – about what the future holds.

To accomplish this, we will chronicle a series of developments in American history and show how they profoundly influenced the course of insurance and insurance law. In each case, we will argue that there was a direct and decided cause-and-effect relationship between these events and subsequent developments in the world of insurance and insurance law. However, as important as the influence of Covid-19 is at present and probably will be in the future, in our view, the Covid-19 pandemic will not be as significant an influence on insurance and insurance law as the historical developments we will identify, and that is part of our prognostication. Nonetheless, change does not take place from a standing start. The world of insurance and insurance law has a history that places them already in motion when such new developments as a pandemic occur. Understanding how certain major historical developments influenced, and continue to influence, insurance can help us to predict what the post-Covid-19 future of insurance will look like, with an eye toward its impact on civil litigation involving insurance.

The events and developments that shaped insurance law exerted three different forms of influence. First, Part I addresses how certain events in the twentieth century influenced the insurance *marketplace*, by generating entirely new forms of insurance to protect against the risks posed by or brought into being by such events. Part II is concerned with a different form of impact, that arose from other events and their influence on the evolution of insurance law *doctrine*. Part II surveys both the expansion and the restriction of existing coverage in response to major events in the twentieth and twenty-first centuries. Part III examines the ways in which modern finance has affected insurance, and in turn insurance coverage, through what we term the “*financialization*” of insurance. Finally, Part IV identifies some lessons

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*sophical Inquiry and Historical Practice*, 101 VA. L. REV. 1197, 1198 (2015); Charles Barzun, *Causation, Legal History, and Legal Doctrine*, 64 BUFF. L. REV. 81 (2016). But we consider it indisputable that at least some history involves some causal attribution.

that can be learned from our analysis and applies them to support our predictions about the post-Covid-19 world of insurance and civil litigation.

## I. HISTORICAL INFLUENCES ON THE DEVELOPMENT OF NEW FORMS OF INSURANCE

All forms of insurance came into existence because of events in the world. We could go far back in history to make that point. Fire insurance, for example, developed only after, and as a consequence of, the Great Fire of London in 1666.<sup>4</sup> We will focus on four major types of insurance that developed in response to significant events in U.S. history over the past one hundred and fifty years. These events are: the emergence of modern tort liability; the invention of the automobile; the rise of modern corporate finance and of corporate liability for financial misconduct; and the invention of the computer.

### A. *Modern Tort Liability and Business Liability Insurance*

To say that there would be no liability insurance without civil liability is a truism, if not an outright tautology. The way in which the most important form of business liability insurance – what is now called Commercial General Liability (CGL) insurance<sup>5</sup> – came into being and evolved, however, is instructive.

Tort law emerged as a separate field only in the second half of the nineteenth century, after abolition of the writ system and the forms of action.<sup>6</sup> Nearly simultaneously, industrialization and the mechanization of transportation caused substantial increases in the incidence of accidental bodily injury.<sup>7</sup> There was then a consequent increase in suits seeking recovery of damages for bodily injury caused by negligence. The law of liability for injury caused by negligence was tort law's means of addressing these developments.

But it was not the law of negligence as we know it today. Not only were the settings in which there was a duty to exercise reasonable care limited, but in addition, the business defendants that were most commonly the causes of injury had a series of strong defenses. These de-

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4. STEPHEN PORTER, *THE GREAT FIRE OF LONDON* 34, 70–72 (1996); F.C. Oviatt, *Historical Study of Fire Insurance in the United States*, 26 *ANNALS AM. ACAD. POL. & SOC. SCI.* 335–36 (1905).

5. KENNETH S. ABRAHAM & DANIEL SCHWARCZ, *INSURANCE LAW & REGULATION* 463 (7th ed. 2020); TOM BAKER ET AL., *INSURANCE LAW AND POLICY* 404 (5th ed. 2021).

6. KENNETH S. ABRAHAM, *THE FORMS AND FUNCTIONS OF TORT LAW* 64–67 (5th ed. 2017).

7. See KENNETH S. ABRAHAM, *THE LIABILITY CENTURY: INSURANCE AND TORT LAW FROM THE PROGRESSIVE ERA TO 9/11*, at 33–35 (2008) [hereinafter ABRAHAM, *THE LIABILITY CENTURY*].

fenses were strongest when an employee sought recovery from an employer, although contributory negligence and assumption of risk operated strongly in suits by third parties as well.<sup>8</sup> Then, statutes known as the Employers Liability Acts began to loosen employers' protection against liability for injuries suffered by their employees.<sup>9</sup>

At this point there was no such thing as liability insurance, partly because there previously was so little tort liability that there had been little or no demand for it, and partly because the validity of insuring against tort liability was uncertain as a matter of public policy.<sup>10</sup> The premodern notion that insuring against liability even for merely negligent behavior might discourage care – what we would now call “moral hazard” – figured in this uncertainty.<sup>11</sup>

Following what had been done in England a few years earlier, in 1886 some New England mill owners formed a mutual company to provide them with insurance against the anticipated expansion of their exposure to tort liability.<sup>12</sup> They called it “Employers Liability” insurance.<sup>13</sup> In fairly short order the courts confirmed the validity of this form of insurance, and it began to spread.<sup>14</sup> A key feature of this coverage, to which we will recur, was that it not only indemnified the insured against liability, but also provided a defense outside the monetary limits of the policy – that is, the costs the insurer incurred in defending the insured did not reduce the amount of insurance provided.<sup>15</sup>

Soon it was recognized that employers faced potential liability not only to their employees, but also to third parties injured by the business's activities. An additional component of coverage, known as “public liability” insurance, was therefore incorporated into the policies.<sup>16</sup> By early in the new century, Employers Liability insurance was becoming common.<sup>17</sup> In 1909, for example, there were twenty-seven companies selling this insurance; they collected \$21 million in premiums.<sup>18</sup>

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8. Robert L. Rabin, *The Historical Development of the Fault Principle: A Reinterpretation*, 15 GA. L. REV. 925, 939–40 (1981).

9. See ABRAHAM, *THE LIABILITY CENTURY*, *supra* note 7, at 28.

10. *Id.* at 24–27.

11. *Id.* at 26.

12. *Id.* at 28–35.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.* at 32–33.

Then, beginning around 1910, the widespread adoption of workers' compensation, with its abolition of the tort liability of employers to their employees, rendered the core coverage provided by Employers Liability insurance unnecessary.<sup>19</sup> But, there was still a form of tort liability that businesses faced: liability to third parties, who were not employees. Coverage against this form of tort liability was preserved, and the policy was renamed. It became "Public Liability" insurance.<sup>20</sup> The policy bore that name for the next twenty-five years, with different forms of public liability insurance sold separately – elevator liability, landlord's liability, manufacturer's liability, etc.<sup>21</sup>

The fragmentation that this policy disaggregation produced was increasingly unsatisfactory, however, and in 1941 the different rating bureaus that prepared policy forms and pooled claim and loss data consolidated these different forms of public liability insurance into a single instrument.<sup>22</sup> This marked the birth of the CGL insurance policy, covering liability for bodily injury and property damage in general, and eventually a few ancillary forms of coverage as well.<sup>23</sup> The CGL policy has remained, though in 1986 the name, but not the abbreviation, was changed to "Commercial General Liability" insurance.<sup>24</sup> This is the policy now purchased by most businesses, small and large. It is the policy to which businesses turn when they are sued for causing bodily injury or property damage, whether arising out of an individual slip-and-fall case or mass products liability. It is this policy which provides them a defense and, if necessary, indemnity in the event a tort case is settled, or a judgment is entered against the insured.

We have no doubt that the development, evolution, and contemporary importance of today's CGL policy can be heavily attributed to the rise of modern tort liability. Undoubtedly, there were other prerequisites as well. Underwriters' ability to assess the risks posed by different kinds of businesses under a single, standard-form policy was important, as was the lawfulness – from an antitrust standpoint – of the rating bureaus' collection and pooling of claim data from individual insurers and the bureaus' preparation of industry-wide standard-

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19. *Id.*

20. *Id.*

21. Kenneth S. Abraham, *The Rise and Fall of Commercial Liability Insurance*, 87 VA. L. REV. 85, 88 (2001).

22. *Id.* at 88–89.

23. *Id.* at 89.

24. See ABRAHAM & SCHWARCZ, *supra* note 5, at 463–64.

form policies.<sup>25</sup> Without these prerequisites being satisfied, the picture would have been very different.

If the causal story we have just told seems plainly obvious, that may be because the influence of tort liability on the development of the CGL policy seems in retrospect to have been inevitable rather than contingent, to use the language of contemporary historians.<sup>26</sup> But inevitable in what way? It does seem inevitable that once liability insurance was ruled to be valid as a matter of public policy, the very existence of tort liability would generate demand for such insurance, and that capital would be accumulated to provide this insurance.

What was less inevitable, however, was the way in which the availability of liability insurance contributed to the expansion of tort liability. The threat of this expanded tort liability generated increased demand for liability insurance, and the availability of liability insurance then made the further expansion of liability possible. It is far from inevitable – and in any event far from being plainly obvious – that this cycle would repeat itself, with both tort liability and liability insurance becoming mutually reinforcing.<sup>27</sup> That cycle of development's occurrence was dependent on an underlying change in the wider culture that involved a gradual evolution away from reliance on individual responsibility, and toward greater socialization of risk in many different domains, including the expanded tort liability of parties who could spread risk into broad channels of distribution, through both insurance and the price system.<sup>28</sup>

What also was less inevitable was that large corporations, which could easily self-insure against all but tens or even hundreds of millions dollars-worth of tort liability, would nonetheless find it in their interest to purchase CGL insurance,<sup>29</sup> thereby fueling the growth of the insurance companies that sold this form of coverage. What was also less inevitable was that, as a consequence, corporate policyholders and their CGL insurers would then find themselves in the last quarter of the twentieth century in high-stakes litigation over claims

25. See *id.* at 166–67.

26. John Fabian Witt, *Contingency, Immanence, and Inevitability in the Law of Accidents*, 1 J. TORT L. 1, 4 (2007).

27. Kenneth S. Abraham & G. Edward White, *Rethinking the Development of Modern Tort Liability*, 101 B.U. L. REV. 1289, 1314–36 (2021).

28. See ABRAHAM, THE LIABILITY CENTURY, *supra* note 7, at 2.

29. Both of us have elsewhere offered explanations for this counter-intuitive phenomenon. See *id.* at 233–35; Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L. J. 1795, 1832–33 (2007) (offering an explanation for the purchase of D&O insurance that would also apply to CGL insurance).

for coverage of toxic tort and environmental cleanup liability under their CGL policies.<sup>30</sup>

Whether all of this was inevitable or more nearly contingent, our point is that the path that led to the introduction and subsequent development of CGL insurance was anything but plainly obvious or predictable in its details. Tort liability and liability insurance have had a symbiotic relationship in which each was both a cause-and-an-effect of the other's development.<sup>31</sup> No account of one would be complete without a corresponding account of the other.

### *B. The Ubiquitous Influence of the Automobile on Insurance Coverage*

It would be almost impossible to exaggerate the influence of the automobile on American life. Its influence on insurance is no exception.<sup>32</sup> That influence has been both direct and indirect. Soon after the invention of the automobile, insurers began to offer coverage for liability arising out of operation or maintenance.<sup>33</sup> By the 1920s, there was carnage on the roads. There were twenty times more deaths per mile driven in 1930 than there are today.<sup>34</sup> Auto-related injury and death were becoming significant enough to be problems of public health. A variety of measures began to address the problem, including better road design, traffic control, and safer vehicles.<sup>35</sup>

Unlike businesses, few individuals held liable in tort for auto accidents were solvent enough to pay judgments. Liability insurance therefore not only protected drivers, but also victims as well. The victim-protection purpose and effect of auto liability insurance were prominent in discussions of the proper approach to take to compensation for auto injury.<sup>36</sup> In 1927, Massachusetts enacted the first mandatory insurance law.<sup>37</sup> But insurers opposed such laws, largely out of concern that they would be compelled by regulation to insure all applicants at premium rates that were insufficient to cover their

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30. See ABRAHAM, *THE LIABILITY CENTURY*, *supra* note 7, at 155–70.

31. See generally Tom Baker, *Liability Insurance as Tort Regulation: Six Ways that Liability Insurance Shapes Tort Law in Action*, 12 *CONN. INS. L. J.* 1 (2005).

32. Jonathan Simon, *Driving Governmentality: Automobile Accidents, Insurance, and the Challenge to the Social Order in the Inter-War Years, 1919-41*, 4 *CONN. INS. L. J.* 521, 526–27 (1998).

33. ABRAHAM, *THE LIABILITY CENTURY*, *supra* note 7, at 77.

34. See *id.* at 71.

35. Alan R. Raucher, *Paul G. Hoffman, Studebaker, and the Car Culture*, 79 *IND. MAG. HIST.* 209, 211 (1983).

36. ABRAHAM, *THE LIABILITY CENTURY*, *supra* note 7, at 77–78.

37. See *id.* at 73.

expected costs.<sup>38</sup> This opposition was successful; it was not until the 1960s that other states managed to enact mandatory auto insurance laws.<sup>39</sup> All states now have them.<sup>40</sup>

In the meantime, however, both as a result of market forces and regulation, omnibus and drive-other-cars (DOC) coverage was added to liability insurance policies.<sup>41</sup> These clauses ensured, respectively, that everyone driving an insured vehicle with permission to do so would have insurance, and everyone driving an uninsured vehicle (with permission) who had their own insurance would be insured.<sup>42</sup> We now spend over \$186 billion on auto liability insurance (and an additional \$112 billion on other forms of auto insurance).<sup>43</sup> This is three times what we spend on workers' compensation, well over four times what we spend on CGL insurance, and about twenty times what we spend on medical malpractice insurance.<sup>44</sup>

Perhaps even more than was the case with CGL insurance, the availability of auto liability insurance fueled the growth of tort liability. And that growth was enormous. Auto liability insurance paid losses of \$29 million in 1921, \$122.9 million in 1931, \$2.4 billion in 1961, \$66.3 billion in 2001, and \$117.2 billion in 2017.<sup>45</sup> This was an increase of nearly 8000 percent, adjusted for inflation,<sup>46</sup> in a little less than one hundred years. As Nora Freeman Engstrom has shown, the litigation that helped to generate these payouts was responsible for a good deal of twentieth-century tort law doctrine and settlement practices as well.<sup>47</sup>

38. *Id.*

39. *Id.*

40. ABRAHAM & SCHWARCZ, *supra* note 5, at 713.

41. ABRAHAM, *THE LIABILITY CENTURY*, *supra* note 7, at 78.

42. . *See id.*

43. AM BEST CO., *BEST'S AGGREGATES & AVERAGES – PROPERTY CASUALTY EDITION 5–6* (2020), [https://www3.ambest.com/aggavg/pc/20/data/2020BAAPC\\_001-008\\_CumulativeUnderwritingDirect.pdf](https://www3.ambest.com/aggavg/pc/20/data/2020BAAPC_001-008_CumulativeUnderwritingDirect.pdf) (showing premiums through 2019).

44. *Id.* at 4 (providing data on workers' compensation and "other liability," which is CGL insurance, among other things) and 3 (medical liability). Note that much of CGL and medical liability is no longer insured in the traditional sense as large organizations increasingly retain very substantial amounts of risk through self-insured retentions, fronting, and captive insurance, and through non-admitted mutual insurance arrangements such as risk retention groups and group captives.

45. Abraham & White, *supra* note 27, at 1308.

46. *Id.*

47. *See generally* Nora Freeman Engstrom, *When Cars Crash: The Automobile's Tort Law Legacy*, 53 *WAKE FOREST L. REV.* 293 (2018); Nora Freeman Engstrom, *Sunlight and Settlement Mills*, 86 *N.Y.U. L. REV.* 805 (2011).

Auto liability insurance also had indirect effects. A plaintiffs' bar specializing in personal injury cases developed,<sup>48</sup> because ordinary drivers with liability insurance were not judgment-proof. The fact that they had liability insurance meant that it was not pointless to sue them. Further, because liability insurance policies provided the insured with a defense outside the limits of liability of the policy, every potentially covered auto suit also had lawyers defending the case. Consequently, a defense bar therefore developed.<sup>49</sup> By the 1960s, when higher-stakes non-automobile litigation emerged, there was a plaintiffs' bar already experienced in personal injury litigation available to bring suits and, through established networking,<sup>50</sup> to acquire the additional expertise that was necessary to handle new forms of products liability and toxic tort suits that comprised the higher-stakes cases.<sup>51</sup>

At the same time, in some quarters there was dissatisfaction with auto accident litigation, because of delays and under-compensation, especially of victims of serious injury. An important period for auto liability was the 1970s, when no-fault systems, designed (among other things) to address this concern, were enacted in sixteen states.<sup>52</sup> For a time, it appeared that this approach would continue to be adopted, perhaps displacing auto liability for all but the most serious injuries. For a variety of reasons, however, the movement halted, and in a few states has since been repealed.<sup>53</sup> The tandem of tort liability and auto liability insurance, with almost all cases settled without trial, continues to dominate in most states.

### C. *Corporate Liability and Directors & Officers Liability Insurance*

The directors and officers of corporations are subject to liability for wrongful conduct in office.<sup>54</sup> Suits alleging such liability, however, were rare until the later years of the twentieth century. Beginning in the 1980s, there was an increase in the frequency of derivative suits alleging that the directors and officers of publicly-traded corporations

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48. JOHN FABIAN WITT, PATRIOTS AND COSMOPOLITANS: HIDDEN HISTORIES OF AMERICAN LAW 211–17 (2007) (discussing the career of plaintiffs' lawyer Melvin Belli).

49. ABRAHAM, THE LIABILITY CENTURY, *supra* note 7, at 83.

50. *Id.* at 85.

51. See Paul D. Rheingold, *The MER/29 Story—An Instance of Successful Mass Disaster Litigation*, 56 CAL. L. REV. 116, 121–30 (1968) (describing cooperation among plaintiffs' attorneys in one of the early mass tort cases).

52. ABRAHAM, THE LIABILITY CENTURY, *supra* note 7, at 94.

53. For discussion of the history of auto no-fault, see *id.* at 92–100.

54. TOM BAKER & SEAN GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION 43, 45 (2010).

had violated a duty to the corporation, and securities suits alleging that these individuals, or the corporation itself, had misrepresented the financial condition of the corporation to investors and the public.<sup>55</sup> These liabilities are potentially enormous because they affect the share values of publicly-traded corporations. Even a decline in share value of a few dollars as a result of allegedly wrongful conduct could involve billions of dollars of personal liability that would force individual defendants into bankruptcy.

The first line of liability protection for directors and officers is supposed to be the solvency of their corporation, which is permitted to provide indemnification against liability for securities law violations.<sup>56</sup> But a corporation that is insolvent – perhaps because of securities liability in its own right – cannot keep its promise to indemnify. Further, conventional corporate law precludes indemnification against liability in derivative suits, which are nominally suits by the corporation against individual directors or officers.<sup>57</sup> Consequently, directors and officers need other protection. In recent decades, no individual contemplating service on the board of a major corporation would consider doing so without being covered by tens or hundreds of millions of dollars of liability insurance – known as Directors & Officers (D&O) insurance – that insures them against liability that their corporation did not or could not indemnify them for.

While the genesis of D&O insurance may have been protecting these individuals when their corporations could not, the product very quickly expanded, first to indemnify the corporation for the corporation's obligation to indemnify the directors and officers, and then to indemnify the corporation for its own liabilities in securities litigation.<sup>58</sup> Perhaps the most salient feature underlying litigation is that major suits almost never go to trial, largely because neither side can risk going to trial. Plaintiffs risk recovering nothing, and the individual defendants risk a judgment that could easily exceed the amount of D&O insurance covering them.<sup>59</sup> But the structure of D&O insurance reinforces that dynamic – while fraud exclusions in policies typically

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55. See generally Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991).

56. BAKER & GRIFFITH, *supra* note 54, at 43 (stating that indemnification is widely permissible under state law except for derivative actions).

57. *Id.*

58. *Id.* at 44.

59. Tom Baker & Sean Griffith, *How the Merits Matter: Directors' and Officers' Insurance and Securities Settlements*, 157 U. PENN. L. REV. 755, 768 (2009) (“Trials are exceedingly rare in securities class actions, and adjudicated outcomes after the motion to dismiss are almost unheard of.”).

exclude payments resulting from fraud, such exclusions do not preclude coverage of *settlements* of securities suits alleging fraud, which virtually all of them do.<sup>60</sup> Suits tend to be settled for a small fraction of the alleged decline in the market value of securities whose value was allegedly misrepresented, which is often in the billions.<sup>61</sup> That is why D&O policies cover the undoubted moral hazard associated with settlements of suits for fraud. Directors and officers are common targets of suits alleging fraud, and they would not serve if their own assets were exposed to liability for settling such suits. Indeed, it might be said that the whole point of D&O insurance is to ensure that there is coverage for such settlements.<sup>62</sup> Thus, while it might once have been true that, in contrast to *physical* hazards, insurers would exclude rather than price moral hazard,<sup>63</sup> that is no longer the case, at least in the context of a product like D&O insurance sold to large corporations.

#### D. *Computers, the Internet, and Cyber Insurance*

Our last example of the impact of watershed events on insurance is the way that the world has been revolutionized by the advent of computers and connected digital devices. Billions of people and millions of businesses are potentially connected to each other, and connected to data about each other, via the internet. With such connectivity has come cyber-risk. Contemporary businesses face the risk of computer malfunction, cyberattack, unlawful publicity, loss of data, invasion of sexual privacy, business interruption, and liability to third parties for release of confidential data.<sup>64</sup> While greater historical distance is needed before insurance scholarship can expect the cyber-equivalent of Jonathan Simon's *Driving Governmentality*,<sup>65</sup> digital technologies surely will be seen to have had as great a social impact as the automobile, with corresponding – though as yet still uncertain – impact on insurance.

Compared to the aforementioned types of insurance (CGL, auto, and D&O liability insurance), both first-party and third-party cyber

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60. *Id.* at 802.

61. *Id.* at 805–06. See generally Blakely B. McShane et al., *Predicting Securities Fraud Settlements and Amounts: A Hierarchical Bayesian Model of Federal Securities Class Action Lawsuits*, 9 J. EMP. LEG. STUD. 482 (2012).

62. BAKER & GRIFFITH, *supra* note 54, at 10 (“D&O insurance funds shareholder litigation.”).

63. Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 240–41 (1996).

64. Kenneth S. Abraham & Daniel Schwarcz, *Courting Disaster: The Underappreciated Risk of a Cyber Insurance Catastrophe*, 27 CONN. INS. L. J. 408, 408–09 (2021) [hereinafter Abraham & Schwarcz, *Courting Disaster*].

65. See Simon, *supra* note 32.

insurance are in their infancy, both in terms of development and the extent to which parties at risk are covered exclusively under specialized cyber insurance policies or under both general property and liability insurance policies. There are both substantive and monetary limitations on coverage that reflect the uncertainty insurers face in the new world of cyber risk.

We are struck by the similarities between the way the now-mature forms of liability insurance have developed, and the way cyber insurance appears to be developing. In each instance, when the policies were first marketed, they were subject to low limits on the amount of coverage they provided, and contained narrow grants of coverage, restrictive exclusions from coverage, or both. As time went on, insurers acquired experience and data that reduced their uncertainty and enabled more confident underwriting, and policyholders came to appreciate the value of insurance, demanding both broader coverage and higher limits of liability.

We expect that cyber insurance will follow a similar pattern. Currently, insurers have limited information about the probability of cyber loss and limited ability to assess variations in vulnerability to cyber attack among their policyholders. Both limitations will become less severe over time. As this occurs, cyber insurance will provide increased protection, both in terms of risks covered and the amount of insurance that cyber insurers are willing to provide.

Along with this increase in the breadth and amount of coverage will come new efforts by cyber insurers to address three major threats to the insurance function: adverse selection, moral hazard, and correlated risk. To combat the first two threats, insurers are likely to engage in more sophisticated underwriting and risk reduction support for their policyholders that is the natural result of acquiring more information about the nature of cyber risk and ways of reducing or mitigating such risk. Correlated cyber risk poses a more difficult challenge for individual insurers to combat on their own. As we suggest in Part IV, here as in other forms of insurance in the post-Covid-19 world, both private and public forms of reinsurance are going to be necessary to spread and cushion the impact of correlated loss.<sup>66</sup>

There are, of course, differences between the development of cyber insurance and the others forms of insurance we have mentioned. Perhaps the most significant difference lies in the greater difficulty of separating cyber risks from those insured under already existing forms of

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66. Each of us has written elsewhere about aspects of the challenges that cyber insurers face in this respect. See Abraham & Schwarcz, *Courting Disaster*, *supra* note 64; see generally Tom Baker, *Back to the Future of Cyber Insurance*, 2019 *PLUS J.* 1 (2019).

insurance. D&O insurance protects against what tort law would consider pure economic loss and, thus, D&O insurance filled a gap in, and remains easily separated from, the bodily injury and property damage liability coverage at the core of general liability insurance. The physical nature of the automobile facilitates the separation of bodily injury and property damage liability risks insured by general and auto liability policies, though the cases involving the use of guns while driving that provide so much entertainment in teaching insurance law show that drawing that line is not always easy.<sup>67</sup>

By contrast, as so much of work, school, social life, and even health-care have become infused with digital technology, separating cyber risks from other risks seems considerably more difficult. Some insurers currently are attempting to eliminate what they call “silent” or “shadow” cyber risks from their traditional property and liability insurance policies – risks that fall within the insuring agreements of those policies but that insurers would prefer to cover under specialized cyber policies.<sup>68</sup> Others attempt to manage those uncertainties through sub-limits in those traditional policies.<sup>69</sup> Whatever the strategy, these efforts reveal some of the difficulties of separating cyber risks from traditional property and liability risks. When the history of cyber insurance is written, it seems just as likely to report the absorption of cyber risks by the existing forms of insurance as it is to report the survival of cyber insurance as a separate insurance line.

## II. DOCTRINAL EXPANSION, RESTRICTION, AND ELABORATION

There is a longstanding debate among legal historians about the extent to which law – by which they mean the common law – is autonomous.<sup>70</sup> The “internalists” hold that the law is largely autonomous, with an internal logic of its own that mainly determines its course.<sup>71</sup> The “externalists” believe that law is not autonomous but a mirror of society, and that its doctrinal development reflects the larger culture

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67. See BAKER ET AL., *supra* note 5, at 490–91.

68. See Abraham & Swarcz, *Courting Disaster*, *supra* note 64, at 410. Note that in the liability insurance context, the most likely candidate for absorbing cyber risks is not general liability insurance, however, but rather the (poorly named) “professional liability insurance,” which has gradually become the general-purpose “pure economic loss” insurance for commercial activities of all kinds.

69. See, e.g., Factory Mutual TE Advantage Select 2016 Form at 5 (providing sublimit for cyber events and data restoration), Exhibit B to the complaint filed in Madison Square Garden Sports Corp. v. Factory Mut. Ins. Co., Civil Action No 651521/2021 at 18–20 (Sup. Ct. N.Y. Cty., Mar. 5, 2021).

70. See KENNETH S. ABRAHAM & G. EDWARD WHITE, *TORT LAW AND THE CONSTRUCTION OF CHANGE: STUDIES IN THE INEVITABILITY OF HISTORY* 14–15 (2022).

71. *Id.*

and economy of which it is a part.<sup>72</sup> These different conceptions are pure types, with the characteristics of views at the extreme that few scholars actually hold. The predominant view, we think, is that law is semi-autonomous. Legal development reflects and is constrained by the inner logic and dynamics of the common law. But law is certainly not immune to influence by the external political and economic factors that always affect public policy.

The tension between internal and external influence has clearly been reflected in the development of insurance law doctrine over roughly the last half-century. The locus of this tension has been the courts' approach to the interpretation of insurance policies, whose provisions furnish the raw material for construction of the default rules that comprise much of the common law of insurance. Much of this doctrinal development since the mid-1970s has involved judicial decisions regarding the scope of coverage of liability for long-latency bodily injury or property damage, and regarding the scope of coverage for damage caused by catastrophic fires and floods, that in recent years have most often been associated with climate change.

#### *A. Coverage of Liability for Long-Latency Injury or Damage*

There has been a vast array of litigation over the meaning of liability insurance policy language in long-tail coverage cases. For ease of exposition, we first address issues associated with the “trigger and allocation” of coverage, and then consider several major issues involving other doctrines.

#### *1. Trigger of Coverage, Stacking, and Allocation under Liability Insurance Policies*

A “trigger” of coverage is the event that activates potential coverage under an insurance policy.<sup>73</sup> Under CGL and malpractice policies, the triggering event was traditionally specified as the occurrence of bodily injury (or property damage) “during the policy period.”<sup>74</sup> For this reason, policies with this trigger of coverage have been referred to

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72. Perhaps the most influential historiographical treatment of internalist views is that of Robert W. Gordon, *Critical Legal Histories*, 36 *STAN. L. REV.* 57, 101 (1984). For expression of the externalist point of view, see LAWRENCE M. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 10 (3d ed. 2005) (arguing that “American law” is “not as a kingdom unto itself, not . . . a set of rules and concepts, not . . . the province of lawyers alone, but . . . a mirror of society” and that there is “nothing . . . autonomous” about legal decisions,” which are “molded by economy and society”).

73. *RESTATEMENT OF LIAB. INS.* § 33 cmt. a (AM. LAW INST. 2019) [hereinafter *RLLI*]; ABRAHAM & SCHWARCZ, *supra* note 5, at 499.

74. See ABRAHAM, *THE LIABILITY CENTURY*, *supra* note 7, at 155.

as “occurrence” policies.<sup>75</sup> These policies potentially cover liability arising out of latent injury or damage that occurred long before a suit alleging liability for such injury or damage is brought. For this reason, this form of liability, and insurance against it, are often described as having a “long tail.”<sup>76</sup>

Between 1975 and 1985, two developments related to long-tail coverage placed pressure on insurers’ confidence in their capacity to offer coverage for this trigger. First, courts began to apply the trigger language quoted above in straightforward fashion, holding that if injury or damage occurred during the policy period, then the policy in force at that point was responsible for coverage, even if the injury or damage remained latent and undiscovered for decades.<sup>77</sup> This meant that, going forward, insurers encountered difficulty setting accurate premiums for occurrence coverage, because of the increased incidence of long-tail liability coverage claims. Because the length of time between the time a premium was set for coverage and the time a policy was called upon for coverage could be decades, pricing became increasingly difficult as the expected incidence of long-tail claims increased. This concern was recognized by malpractice insurers in the 1970s,<sup>78</sup> and by CGL insurers in the 1980s,<sup>79</sup> especially after the enactment of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) in 1980, which imposed retroactive, strict, and joint and several liability for the costs of environmental cleanup at sites where damage had begun occurring, out of sight, sometimes decades earlier.<sup>80</sup>

Second, initially in claims for coverage of asbestos liability, and then in pollution claims, the courts held that multiple years’ policies could be triggered to cover claims for coverage of these liabilities, and that (in ways that varied by state) the coverage provided during multiple triggered years could be stacked together.<sup>81</sup> Hundreds of millions of

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75. ABRAHAM & SCHWARCZ, *supra* note 5, at 170.

76. RLLI, *supra* note 73, at § 33 cmt. f; Kenneth S. Abraham, *The Long-Tail Liability Revolution: Creating the New World of Tort and Insurance Law*, 6 U. PA. J. L. & PUB. AFF. 346, 376 (2021).

77. *See, e.g.*, *Amer. Home Products v. Liberty Mut. Ins. Co.*, 748 F.2d 760, 764 (2d Cir. 1984); *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034, 1040 (D.C. Cir. 1981).

78. *See* Kenneth S. Abraham, *Medical Malpractice Reform: A Preliminary Analysis*, 36 MD. L. REV. 489, 492–93 (1977).

79. Some insurers were so concerned about this difficulty that they attempted to have the industry’s standard form policy changed to avoid the problem. *See* *Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 773–74 (1993).

80. Codified mainly at 42 U.S.C. §§ 9601–74 (1980).

81. *See, e.g.*, *In re Silicone Implant Ins. Coverage Lit.*, 667 N.W.2d 405 (Minn. 2003); *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502, 507 (Pa. 1993).

dollars of coverage under policies issued over a period of decades could therefore be available to policyholders.

It is not easy to place the courts' holdings about the trigger and allocation of coverage on the internalist-externalist axis. The policy language itself dictated an injury-in-fact trigger of coverage. But the courts were aware that insurers' collective position – generally, that only the policy that was in force when injury or damage was manifested – would lead to less coverage. Judicial holdings regarding the allocation of responsibility among all the policies “stacked” together are even more difficult to classify. On the one hand, the allocation holdings neither ignored precedent nor the policy language. Rather, there was no relevant precedent, and the policy language did not really speak to the problem.<sup>82</sup> The courts had to create legal doctrines to deal with the issue. In a sense there was even some judicial restraint involved, since the courts actually could have been more aggressive and invoked the doctrine that ambiguities in policy language should be interpreted in favor of coverage – *contra proferentem* – in addressing the allocation issue in particular.<sup>83</sup>

On the other hand, it seems pretty evident that the courts were not oblivious to the public policy favoring risk-spreading that had underwritten the expansion of tort liability and the adoption of other pro-coverage insurance law doctrines during the period between 1960 and

82. RLLI, *supra* note 73, at § 41 cmt. d. notes: “The split of authority regarding the allocation rule reflects the fact that the liability risks presented by the rise of mass toxic-tort suits and environmental-cleanup and property damage causes of action were not adequately anticipated and addressed in” CGL policies. There was some evidence in the drafting history of the standard form from the 1960s that the drafters considered the issue but decided not to address it with policy language. See Eugene R. Anderson et al., *Liability Insurance Coverage for Pollution Claims*, 59 Miss. L.J. 699, 731 (1989) (quoting Richard Schmalz, The New Comprehensive General Liability and Automobile Program, Presentation at Mutual Insurance Technical Conference 6 (Nov. 15–18, 1965)) (“According to one of the drafters of the CGL policy, ‘there is no proration formula in the policy, as it seemed impossible to [develop] a formula which would handle every possible situation with complete equity.’”); see also *Owens-Illinois, Inc. v. United Ins. Co.*, 650 A.2d 974, 990 (N.J. 1994) (quoting the same); Marcy Louise Kahn, *Looking for “Bodily Injury”: What Triggers Coverage Under a Standard Comprehensive General Liability Insurance Policy?*, 19 THE FORUM 532, 536 n.20 (1984).

83. RLLI, *supra* note 73, at § 41 cmt. d explains that the courts' preference for the more insurer-friendly pro rata allocation rule cannot be explained through ordinary interpretive principles:

Not all these courts provide the same reasons for their choice but their results are all consistent with the following reasoning: (a) pro rata by years is the default allocation rule for long-tail claims under occurrence policies with harm-based triggers, (b) ambiguous or uncertain terms that can be read in two ways—as consistent with the default rule or to the contrary—are insufficient to alter that default rule, and (c) the “all-sums” working in the pre-1986 policies is, at best for policyholders, ambiguous or uncertain in that regard and, thus, insufficient to displace the default rule.

*Id.*

1985.<sup>84</sup> The multi-year trigger and stacking doctrines were an extension of this policy, with a vengeance. Collectively, U.S. policyholders were facing responsibility for hundreds of billions of dollars of liability in asbestos, other mass toxic tort, and CERCLA liabilities. The doctrines were a means by which the courts ensured that the insurance industry would pay a meaningful portion of this sum. Looking at the matter in this manner provides support for the externalist explanation.

The combined effect of the difficulty of pricing occurrence policies in the face of potential long-tail liability, and the advent of the multi-year trigger accompanied by stacking, led to two changes. One change involved a shift from occurrence to claims-made coverage for most professional liability insurance (a broad category within the insurance market that includes “errors and omissions” insurance for most service businesses as well as the traditional professions).<sup>85</sup> Under claims-made coverage, the trigger is a claim made against the policyholder (and typically, also reported to the insurer) during the policy period.<sup>86</sup> This removes long-tail coverage from the policy and makes setting a price for it much easier. Most professional liability insurance, and even some CGL insurance, is now sold on a claims-made rather than occurrence basis.<sup>87</sup>

The second change involved removing a principal form of long-tail coverage from all CGL policies, but especially from those that continued to be sold on an occurrence basis. This was the addition of an “absolute” pollution exclusion to those policies, beginning in 1986.<sup>88</sup> Even today, there is some uncertainty about the scope of the exclusion given its unrealistically broad definition of “pollutants,” but one thing is clear – it does not cover the cost of mandated environmental cleanup involving hazardous waste.<sup>89</sup>

Over time, however, insurance coverage for pollution liabilities returned, notwithstanding the absolute pollution exclusion in the CGL, through the addition of buyback endorsements to CGL policies and special pollution coverage, both of which require much more targeted

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84. For example, some courts held during this period that the policyholder’s reasonable expectations of coverage should be honored under some circumstances, notwithstanding policy language to the contrary. *See, e.g., Atwater Creamery Co. v. West. Nat’l Ins. Co.*, 360 N.W.2d 271, 278–79 (Minn. 1985). Other courts ruled that policyholders could recover extracontractual damages for the insurer’s bad-faith breach of insurance policy. *See, e.g., Silberg v. Cal. Life Ins. Co.*, 521 P.2d 1103 (Cal. 1974).

85. *See* BAKER ET AL., *supra* note 5, at 490, 497–98.

86. ABRAHAM & SCHWARCZ, *supra* note 5, at 170.

87. *See* BAKER ET AL., *supra* note 5, at 527.

88. *See* ABRAHAM & SCHWARCZ, *supra* note 5, at 554.

89. *See id.* at 469–70 (setting out the “absolute” pollution exclusion).

underwriting than CGL policies and involve strict discovery and notice requirements that function much like claims-made coverage.<sup>90</sup> There can be no doubt, however, that the rise of long-tail liability substantially affected the development of liability insurance during the last several decades of the twentieth century.

## 2. *Other Doctrinal Developments*

A series of other issues, not directly related to trigger of coverage, stacking, or allocation, also arose in the asbestos, toxic tort, and environmental cleanup coverage litigation in the last two decades of the twentieth century. These included: whether cleanup costs incurred in response to an injunction or administrative order constitute covered “damages,” how to determine the number of occurrences for purposes of calculating per occurrence limits of liability and per occurrence deductibles, a group of questions about the meaning and application of the “expected or intended” harm limitation on coverage, the meaning of the exception to the pollution exclusion for “sudden and accidental” discharges, and how to apply the exclusion of coverage for damage to property owned by the insured when cleanup of owned property is necessary to prevent additional harm to non-owned property, to name some of these issues.<sup>91</sup>

For our purposes, there are two related points to be made about the doctrines that emerged from the courts’ resolution of these issues. First, although we expect that insurers would have said at the time, and would perhaps say even now, that the decisions had a pro-coverage bias, in fact the body of doctrine, taken as a whole, was a mixed bag. The decisions went both ways, not only from doctrine to doctrine, but also state to state with respect to particular doctrines. In our judgment, overall, insurers were winners about as often as they were losers on legal issues.

Second, even the doctrines and decisions that were pro-coverage mainly did not rely on *contra proferentem*, the most pro-coverage doctrine of all. Rather, courts chose to create legal doctrines, mostly without reference to arguable ambiguities in the relevant policy language. This largely reflected the courts’ implicit assumption, we think, that many of the issues that had arisen could not reasonably have been anticipated or could not effectively have been addressed with concise policy language. Understood in this way, the courts were not interpreting policy language, but construing incomplete contracts. And be-

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90. *Id.* at 560–61.

91. On the development of these and other related doctrines, see *id.* at 483–559.

cause these were standard-form contracts, these constructions had broad precedential effect and the status, not merely of interpretations, but of legal rules, unless and until the policy language in question was amended.<sup>92</sup>

For insurance and insurance law, these doctrines constituted a new world that previously had barely existed. Insurance law was no longer a backwater subject that involved low-stakes, sporadic cases mainly in the fields of life, auto, and homeowners' insurance. Rather, insurance law disputes frequently involved tens or even hundreds of millions of dollars and posed issues under CGL policies that had been purchased by virtually all businesses in the United States. Insurance law was now a focus of big-law practice.<sup>93</sup>

### *B. Climate Change, Natural Catastrophes, and Adherence to Policy Language*

In recent years there has been an increase in the incidence of both wildfires and hurricanes, at least in part because of climate change.<sup>94</sup> Wildfires have increased because of greater summertime drought, more snowmelt, and additional lightning strikes.<sup>95</sup> Severe hurricanes are on the rise because of the rise in ocean temperatures, which fuel these storms.<sup>96</sup> Large-scale wildfires and hurricanes constitute substantial threats to insurance, because they pose the risk of correlated, and therefore catastrophic, loss.

The original, and still the primary risk covered by first-party property insurance, whether covering individuals (homeowners' insurance) or businesses (commercial property insurance) is fire. In addition, an important feature of coverage is for damage by wind, and high wind is the defining feature of a hurricane. Property insurance that did not cover these risks would not receive regulatory approval, and if it did,

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92. For discussion of this phenomenon, see Kenneth S. Abraham, "Incomplete" Insurance Coverage, 26 CONN. INS. L. J. 115, 141–43 (2020).

93. See, e.g., *Best Law Firms for Insurance Law*, U.S. NEWS & WORLD REP., [https://bestlawfirms.usnews.com/search.aspx?practice\\_area\\_id=12&page=1](https://bestlawfirms.usnews.com/search.aspx?practice_area_id=12&page=1) (last visited Mar. 2, 2022) (including top firms such as Covington & Burling LLP, Jones Day, and Sidley Austin LLP); *USA Guide Rankings*, CHAMBERS & PARTNERS, <https://chambers.com/guide/usa?publicationTypeGroupId=5&practiceAreaId=1563&subsectionTypeId=1&locationId=12788> (last visited Mar. 2, 2022) (listing firms like Simpson Thacher & Bartlett LLP with top insurance dispute resolution practice groups).

94. See BO MACINNIS & JON A. KROSNICK, CLIMATE INSIGHTS 2020: SURVEYING AMERICAN PUBLIC OPINION ON CLIMATE CHANGE AND THE ENVIRONMENT 1 (2020), [https://media.rff.org/documents/Climate\\_Insights\\_2020\\_Natural\\_Disasters.pdf](https://media.rff.org/documents/Climate_Insights_2020_Natural_Disasters.pdf).

95. *Id.*

96. *Id.*

would probably be rejected by both the policyholder and mortgage lender sectors.

On the other hand, homeowners' insurers long ago ceased insuring against damage caused by floods, principally because the risk of coastal flooding from hurricanes was so substantial and correlated.<sup>97</sup> We are not at all sure that the elimination of flood coverage from property insurance policies would be permitted or understood as necessary today in light of the growth in the natural catastrophe reinsurance market, but the situation was path dependent. The federal flood insurance program was established in 1968, and now bears this risk for those who purchase separate flood coverage, up to certain limits (\$500,000 for commercial buildings and \$250,000 for residential buildings).<sup>98</sup>

The meaning of the flood exclusion in homeowners' policies has consequently been repeatedly tested in suits against homeowners' insurers, especially after Hurricane Katrina devastated much of the Gulf Coast in 2006.<sup>99</sup> There were some cases in which there were pro-coverage rulings, especially those in which there was likely both wind and flood damage to properties that were totally destroyed in the absence of any witnesses who could testify about what happened when.<sup>100</sup> For the most part, however, the flood exclusion was strictly applied.<sup>101</sup> Almost certainly part of the reason the flood exclusion was applied was that the homeowners seeking coverage under their policies had often foregone the opportunity to purchase federal flood insurance. Most policyholders should not have been surprised that they were not covered, though their insurance agents might have been to blame.

In contrast, despite the fact that forest and brush fires can cause massive losses for insurers, we are not aware of any significant litigation about the application of homeowners insurance to wildfire damage in the vast majority of situations. Because these are often all-risk policies with no potentially applicable exclusions in most cases, this is not anything remarkable. But it is worth emphasizing that nothing remarkable occurred. Insurers' remedy, when they have one, is not to insure properties in fire-prone areas. Regulators have weapons too,

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97. See generally Jennifer Wriggins, *Flood Money: The Challenge of U.S. Flood Insurance Reform in a Warming World*, 119 PA. ST. L. REV. 361 (2014).

98. FEMA & NAT'L FLOOD INS. PROGRAM, FLOOD INSURANCE MANUAL 3-3 (2021), [https://www.fema.gov/sites/default/files/documents/fema\\_nfip-all-flood-insurance-manual-apr-2021.pdf](https://www.fema.gov/sites/default/files/documents/fema_nfip-all-flood-insurance-manual-apr-2021.pdf).

99. ABRAHAM & SCHWARCZ, *supra* note 5, at 272–73.

100. See, e.g., *Corban v. United Serv. Auto. Ass'n*, 20 So. 3d 601, 619 (Miss. 2009) (holding that the anti-concurrent causation clause could not preclude coverage under the circumstances).

101. See, e.g., *In re Katrina Canal Breaches Litig.*, 495 F.3d 191, 196 (5th Cir. 2005) (holding that the “flood” exclusion was unambiguous).

however, so a protracted tug-of-war over premium increases, threats to withdraw from the market, and the possible establishment of state-funded backup or reinsurance plans to help address these issues have been a likely outcome when insurers have taken a hit from these events.<sup>102</sup>

### III. THE CHANGING FINANCIAL CONTEXT

The U.S. economy during the period from the end of World War II until the early 1970s was a rising tide that raised all ships. There was economic expansion, inflation, and interest rates were low, and there was an increasing demand for insurance. Expansions in the incidence and scope of tort liability were predictable and steady, mainly involving auto accidents, with the result that liability insurance premiums grew during this period at roughly the same rate as the GDP, with short term deviations that are easily explained by the insurance underwriting cycle.<sup>103</sup> The investment side of the insurance business was conventional. Premium income from invested premiums was an ingredient of insurers' overall performance, but the claims side was dominant.

This financial stability began to change in the 1970s. With the oil crisis beginning in the early '70s, widespread inflation, and the escalation of long-tail liability we described above, the investment side of the business, and more complicated financial arrangements that accompanied it, took on greater importance. At the turn of the century, after the 9/11 attacks, terrorism exclusions began to appear in insurance policies.<sup>104</sup> To encourage coverage, a government funded reinsurance program was instituted.<sup>105</sup> Finally, the securitization of risk began to be employed as a new means of bringing capital into insurance. In different ways, each of these developments has cast insurance in a somewhat new, more "financialized" light.

#### A. *More Complex Financial Arrangements*

Of the various new financial arrangements that have come to play a role in insurance generally, those related to the "runoff" of business

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102. For discussion of the difficulties faced in Florida, for example, see Ed Leefeldt, *Why Is Homeowners Insurance in Florida Such a Disaster?*, FORBES (Oct. 21, 2020), <https://www.forbes.com/advisor/homeowners-insurance/why-is-homeowners-insurance-in-florida-such-a-disaster/>.

103. Tom Baker, *The Shifting Terrain of Risk and Uncertainty on the Liability Insurance Field*, J. FIN. PERSP., Nov. 2013, at 29, 32 (2013).

104. ABRAHAM & SCHWARCZ, *supra* note 5, at 181.

105. *Id.*

that an insurance company no longer wishes to keep may best illustrate how this financialization operates in the liability insurance business.

With the rise of long-tail liability described in Part II, liability insurers in the late 1980s began facing an overhang of potential liability under policies sold decades earlier, which required increasing their reserves and thus consequent limitations on use of capital.<sup>106</sup> Some of these insurers developed innovative ways to deal with the overhang of long-tail claims by isolating these liabilities in entities that no longer wrote active business and, instead, simply processed and paid the claims that made up the overhang.<sup>107</sup> These insurers found four main ways to isolate the legacy liabilities—three of which create total legal separation between the overhang and the insurer’s ongoing business.<sup>108</sup>

First, the insurer can create a new entity with the sole purpose of removing the legal responsibility for the liability overhang from the books of the transferor. The new entity assumes full responsibility for processing and paying the claims that made up the overhang. This first method is permitted only in a few U.S. states and in the United Kingdom, under what is said to be “strict” regulatory supervision that focuses on the capitalization of the new entity.<sup>109</sup>

Second, the insurer can shut down the active business of a separately incorporated subsidiary and transfer that subsidiary to an insurance group that specializes in these legacy liabilities.<sup>110</sup> This method relies on the existing legal separation between the subsidiary and the rest of the insurance group, and it only works if the insurer no longer needs that subsidiary to continue writing new business and if either (a) the insurer had not included that subsidiary in its internal reinsurance pool, or (b) the insurer’s domiciliary regulator permits the insurer to remove the subsidiary from that pool.<sup>111</sup> Of note, as evidence of the “financialization” inherent in the runoff market, the insurance groups that acquire insurers’ runoff value their acquisitions purely in terms of

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106. For an explanation of the relationship between reserves and capital, see Tom Baker, *Medical Malpractice and the Insurance Underwriting Cycle*, 54 DEPAUL L. REV. 393, 396–402 (2005).

107. See generally Tom Baker, *Uncertainty > Risk: Lessons for Legal Thought from the Insurance Runoff Market*, 62 B.C. L. REV. 60 (2021).

108. *Id.* at 80–84.

109. *Id.* at 80–81.

110. *Id.* at 81.

111. *Id.* at 81.

cash flows and operate more like private equity funds than ordinary insurance groups.<sup>112</sup>

Third, the insurer can create a new entity within the holding company structure to operate the active business and use dividends and internal reinsurance transactions to transfer the assets supporting the active business out of the existing entity, leaving the existing entity to run off the overhang.<sup>113</sup> This was the method that the municipal bond insurer, MBIA, used, controversially, in an attempt to save its municipal bond insurance business after the financial crisis of 2008 destroyed the viability of its commercial securities insurance business.<sup>114</sup> Like the first method (and sometimes the second), this third method involves, or at least should involve, substantial regulatory scrutiny.

The three preceding methods create a legal separation between the insurer's active, ongoing business and the liability overhang. The enormous advantage of the legal separation to the transferring insurer is that the uncertain exposure that has been acting as a reserve drag on the insurer's financial condition comes *entirely* off the insurer's books. Another advantage (to the transferring insurer) is that the natural tendency to risk undercapitalizing the runoff entity can be camouflaged by the substantial uncertainty associated with quantification of the legacy liabilities being transferred. Moreover, because the runoff entity does not sell any new insurance, it has no need to maintain a favorable credit rating, in effect allowing the transferring insurer to retain more of its capital than it would otherwise.<sup>115</sup> In addition, because a runoff entity has no ongoing book of business with which it wishes to maintain good relations and continual policy renewals, its interest in holding onto its assets while they earn income is not counterbalanced by the incentives favoring the prompt payment of valid claims. Greater intransigence regarding settlement is widely alleged to be the likely result, lowering the cost to the transferring insurer of removing the overhang from its books.<sup>116</sup>

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112. *Id.* at 95.

113. *ABN Amro Bank N.V. v. Dinallo*, 962 N.Y.S. 2d 854, 861–62 (Sup. Ct. 2013).

114. *Id.*

115. Published sources refer only to the “capital relief” benefits from sale to a runoff specialist. *See, e.g.*, PRICE WATERHOUSE COOPERS, GLOBAL INSURANCE RUN-OFF SURVEY (Feb. 2021), <https://www.pwc.com/gx/en/financial-services/assets/Global-Insurance-Run-off-Survey-2021/global-insurance-run-off-survey.pdf>. Baker's discussions with runoff market participants confirm that one important reason for the capital relief is that because runoff acquirers “don't need to consider capital from a 1m AM Best or other criteria[,] it makes life easier on the capital side.” Email from runoff insurance market specialist to Tom Baker, Author (July 6, 2021) (on file with author).

116. *See* PRICE WATERHOUSE COOPERS, *supra* note 115, at 101.

The fourth way to isolate legacy liability does not create a legal separation between the active business and legacy business. Rather, depending on the terms of the deal, this method can create economic separation. This approach most often involves a retrospective reinsurance and claims administration contract known as a “loss portfolio transfer,” or LPT. The LPT transfers the economic responsibility for the overhang to an insurance group that specializes in handling these kinds of legacy liabilities, subject to a stated cap on the total amount that the reinsurer is obligated to pay.<sup>117</sup> This cap means that the transferring insurer retains residual financial responsibility as well as the formal legal responsibility for the legacy liabilities.<sup>118</sup> The degree to which this residual financial and legal responsibility ameliorates the incentives just described is a matter of debate.

In theory, an operating insurer cannot simply abdicate its liabilities by reinsuring them after the fact. But in practice, a LPT can have that effect. For example, in the 1990s, Lloyds restructured itself by creating a new company, “Equitas,” that entered into a LPT with Lloyds.<sup>119</sup> Equitas had a substantial, but not unlimited, amount of capital. In our experience, U.S. policyholders (and presumably others as well) seeking to settle their long-tail coverage claims found that, in the course of negotiations, Equitas argued that it had only a limited amount reserved for that policyholder’s claims, and that settlement in excess of that (usually undisclosed) reserve would require a heroic exception to the established relation between Equitas and Lloyds.<sup>120</sup>

An exception could be made in theory, because ultimately Equitas was not the policyholder’s sole source of recovery, but in practice, getting around Equitas would be difficult and usually impractical. A policyholder could decline to settle, seek recovery from Equitas, secure a U.S. judgment, and, if necessary, attempt to collect on an individual basis in the United Kingdom and elsewhere from each of the individual “Names” that comprised the Lloyds syndicate or syndicates that had issued the policies in question.<sup>121</sup> But that was extremely unlikely and, to the best of our knowledge, never occurred. In effect, as a run-off company, Equitas was made exclusively for Lloyds’ prior amassed liability.<sup>122</sup> Eventually, this *de facto* separation became *de jure* through

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117. *Id.* at 82–83.

118. Baker, *supra* note 107, at 82–83.

119. Abraham, *supra* note 76, at 402–03.

120. For discussion of the entire episode, see generally Steven E. Sigalow & Richard E. Stewart, *How Lloyds Saved Itself*, JONES DAY (Feb. 2010), <https://www.jonesday.com/en/insights/2010/04/how-lloyds-saved-itself-ijones-day-in-printi>.

121. See generally Baker, *supra* note 107.

122. *Id.* at 74.

a legal process created by legislation subsequent to the creation of Equitas.<sup>123</sup> Shortly thereafter, Equitas entered into its own LPT contract with Berkshire-Hathaway's National Indemnity Company (NICO), pursuant to which Equitas transferred all its assets to NICO in return for NICO's agreement to manage the claims, subject to a \$5.7 billion limit that, because Equitas did not have any other assets, functioned as a cap on the total amount that policyholders could collect on Lloyds' legacy liabilities.<sup>124</sup>

For present purposes, the rise of all four types of insurance runoffs has three potential consequences. First, having learned how to deal with the unforeseen and radically uncertain asbestos and pollution liabilities, insurers may be more willing, or at least able, to deal with uncertain liabilities in the future. Second, there are signs that the financialization of legacy asbestos and pollution liabilities may be extending further into the liability insurance business, allowing insurers to exit more easily from geographic markets or lines of insurance that are no longer priorities. While the liability insurance business is a long way from the residential home mortgage market, in which the issuing and servicing of home mortgages have become almost entirely separate businesses, the rise of runoffs holds the potential to further separate the sales and claims side of the insurance business, especially when the originating insurer no longer has the same appetite for sales of that same kind of insurance. Third, if the runoff example is representative of the consequences of financialization, the result may be to reduce the extent to which liability insurance actually shifts risk.

This shift of long tail risk to policyholders would be similar, perhaps, to what has transpired in the life insurance business, in which policyholders bear more of the investment risk in long-term life insurance products than they did in the past.<sup>125</sup> In liability insurance, that would mean that policyholders would bear more of the risk that liabilities will grow in an unforeseen direction than was arguably the case in the asbestos and environmental liability context, not only because liability insurance contracts are increasingly written to avoid shifting long-tail risk, but also because insurers have learned how to use financial engineering to shift some of that risk back to their policyholders after the fact.

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123. . *Id.* at 72–73.

124. *Id.* at 76–77 (citing this figure as the amount of reinsurance that NICO provided, above Equitas's own assets).

125. TOM BAKER & JONATHAN SIMON, *EMBRACING RISK: THE CHANGING CULTURE OF INSURANCE AND RESPONSIBILITY* 4 (2002).

*B. Government and Reinsurance*

Government has long facilitated the provision of insurance when markets would not provide it without assistance. Pursuant to state legislation, assigned-risk plans and joint underwriting associations make auto insurance available to drivers who cannot obtain coverage in the regular market, but spread the actual cost of insuring these drivers among all auto insurers, usually in proportion to their market share.<sup>126</sup> There is also authority in some states to establish medical malpractice joint underwriting associations when malpractice insurance becomes tight or unavailable.<sup>127</sup> Some hurricane or earthquake-prone jurisdictions have similar mechanisms in place for earthquake losses.<sup>128</sup> Notably, the FAIR program is a famous example of government-provided reinsurance that so invigorated the private market – in this case, urban centers that had been subject to redlining – that, eventually, the government was able to phase out the program.<sup>129</sup>

Reinsurance is a traditional form of the financialization of insurance. Economically, it is a vehicle through which capital can be invested in insurance, without the same heavy involvement in underwriting and claims administration that insurers selling to the public must incur. There are some risks, however, that have not been fully amendable to reinsurance. After the attacks on 9/11, insurers in many quarters incorporated terrorism exclusions into their policies.<sup>130</sup> In order to encourage insurers to offer coverage of loss or liability arising out of terrorism, the U.S. Congress enacted the Terrorism Risk Insurance Act (TRIA) in 2002.<sup>131</sup> Under TRIA, after an act certified by the Secretary of State is found to constitute terrorism, only the first losses of \$200 million in total are borne solely by insurers and their policyholders (through deductibles and coinsurance).<sup>132</sup> After that, eligible insurers may recoup reinsurance for 80 percent of their payments beyond their deductible, which is calculated as 20 percent of the

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126. ABRAHAM & SCHWARCZ, *supra* note 5, at 157–60; BAKER ET AL., *supra* note 5, at 244–46.

127. *See, e.g.*, VA. CODE ANN. §§ 38.2-2800–2814 (West 2022).

128. *See generally* RICHARD V. ERICSON & AARON DOYLE, *THE UNCERTAIN BUSINESS: RISK, INSURANCE, AND THE LIMITS OF KNOWLEDGE* (2004).

129. Jennifer B. Wriggins, *In Deep: Dilemmas of Federal Flood Insurance Reform*, 5 U.C. IRVINE L. REV. 1443, 1457 (2015). FAIR is an acronym for the federal Fair Access to Insurance Requirements program.

130. ABRAHAM & SCHWARCZ, *supra* note 5, at 181.

131. Terrorism Risk Insurance Act (“TRIA”), 15 U.S.C. § 6701 (1999); 28 U.S.C. § 1610 (2012); 12 U.S.C. § 248 (2019); *see generally* Howard Kunreuther, Professor, Univ. Penn., Testimony before the United States Senate Committee on Banking, Housing, and Urban Affairs (June 18, 2019), <https://www.banking.senate.gov/imo/media/doc/Kunreuther%20Testimony%206-18-19.pdf>.

132. Kunreuther, *supra* note 131, at 3.

insurer's previous year's direct earned premiums in TRIA-eligible lines.<sup>133</sup> Aggregate government and private insurer payouts for insured losses are capped at \$100 billion annually.<sup>134</sup> The availability of TRIA has in fact achieved its aim. A terrorism exclusion can be removed from most policies for an additional premium, or such an exclusion is added if the policyholder chooses not to pay an additional premium.<sup>135</sup>

Aside from these examples, the government-funded reinsurance model has not been adopted for other categories of insured losses, but has been proposed in a number of settings as a means of dealing with insurers' reluctance to cover potentially catastrophic risks.<sup>136</sup> The dilemma posed by these proposals is that there is a long list of risks that insurance companies could be encouraged to cover if there were government-backed reinsurance available – a decline in housing values, obsolescence of products, and so on<sup>137</sup> – but there is no evident political will to adopt such programs. The politically acceptable solution, instead, seems to be to deal with such risks *ex ante*, through means other than insurance (including, mostly, what amounts to individual risk-bearing), and *ex post* through government initiatives like the 9/11 Victims Compensation Fund<sup>138</sup> and Covid-19 relief under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) of 2020.<sup>139</sup>

### C. Securitization of Risk

A final development in the world of insurance finance is securitization. Although there are any number of possible means of securitizing risk, the principal existing means are *ex ante*, through the issuance of catastrophe bonds, and *ex post*, through litigation financing.

#### 1. Catastrophe Bonds

*Ex ante*, insurers covering a particular risk – for example, hurricane-related wind damage – can sell bonds that pay investors an attractive rate of return unless loss exceeding an index or other proxy for a specified level of insured loss occurs. This is “parametric” as distinguished

133. *Id.* at 3–4.

134. 15 U.S.C. § 6701(103)(e)(B)(2)(A); Kunreuther, *supra* note 131, at 3.

135. See Kunreuther, *supra* note 131, at 3–4.

136. See, e.g., KAI-UWE SCHANZ ET AL., PUBLIC-PRIVATE SOLUTIONS TO PANDEMIC RISK, THE GENEVA ASS'N 20 (2021) (discussing government-provided reinsurance for pandemic risk).

137. See generally ROBERT J. SHILLER, THE NEW FINANCIAL ORDER (2003).

138. 49 U.S.C. § 40101 (2000).

139. Pub. L. No. 116-136 (2020).

from “indemnity” insurance.<sup>140</sup> If there are enough such bonds sold covering different, uncorrelated losses, then investors should be able to diversify their “coverage” of these uncorrelated risks. In this way, insurers can raise capital more effectively, and otherwise difficult-to-insure risk can be spread through the global financial markets.

Interestingly, *ex ante* securitization has not yet played a major role in insurance finance. Only about \$11 billion in catastrophe bonds were sold worldwide in 2019.<sup>141</sup> To get a sense of the relative importance of catastrophe bonds in the insurance market, the proper comparison is insurance policy limits. The face value of a catastrophe bond functions like a policy limit – i.e., the maximum amount available to pay a claim – because a catastrophe bond is a loan that the insurer has to repay, with interest, if the catastrophe does not occur.<sup>142</sup> To our knowledge, there are no public reports of the total property insurance limits in force, but that amount must be in the trillions of dollars given that it is not at all unusual for a university that owns a hospital, a major league sports team, or any large corporation with a significant property footprint or business interruption exposure to have a property insurance program with a billion dollar limit or more.<sup>143</sup> Thus, it stands to reason that the total property insurance limits in place in the world in any given year must be in the tens of trillions of dollars, if not more.

Next to that kind of number \$11 billion is a rounding error. It may be that part of the explanation for this thin of a market is that potential investors in catastrophe bonds are likely to want to be able to diversify their risk by holding a variety of bonds covering unrelated risks. But in the absence of a robust supply of such bonds, diversification is difficult. In a sense, then, the explanation for the absence of a

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140. See NAT'L ASS'N INS. COMM'RS, *Parametric Disaster Insurance* (June 29, 2020), [https://content.naic.org/cipr\\_topics/topic\\_parametric\\_disaster\\_insurance.htm](https://content.naic.org/cipr_topics/topic_parametric_disaster_insurance.htm).

141. See ARTEMIS, *Catastrophe Bonds & ILS Issued and Outstanding by Year*, <https://www.artemis.bm/dashboard/catastrophe-bonds-ils-issued-and-outstanding-by-year/> (last visited Jan. 6, 2021).

142. J. David Cummins & Mary A. Weiss, *Convergence of Insurance and Financial Markets: Hybrid and Securitized Risk-Transfer Solutions*, 76 J. RISK & INS. 493, 523 (2009).

143. Because insurance policies are regularly included as attachments to complaints and other publicly filed documents, it has recently become quite easy to obtain them using, for example, Lex Machina. Cf. Daniel Schwarcz, *Reevaluating Standardized Insurance Policies*, 78 U. CHI. L. REV. 1263 (2011) (reporting great difficulty in obtaining copies of homeowners insurance policies). New York University's commercial property insurance policy filed with the complaint in a Superstorm Sandy case shows that NYU's property insurance limit was \$1.2 billion. See N.Y. Univ. v. Factory Mutual Ins. Co., 374 F. Supp. 3d 315, 318 (S.D.N.Y. 2015). The policies filed in the Covid-19 litigation include Major League Baseball's \$1.2 billion program. See generally *Oakland Athletics Baseball Co. v. AIG Specialty Ins. Co.*, No. RG20079003 (Cal. Sup. Ct. Oct. 16, 2020).

rich market in catastrophe bonds is the absence of a rich market in catastrophe bonds.

In any event, in the same way that we are puzzled by the failure of the world reinsurance markets to facilitate the coverage of certain risks that the insurance market is reluctant to insure, we are puzzled by the failure of securitization to develop on a more widespread basis and thrive. There is certainly enough global capital to fund this kind of undertaking more generously than has been the case to this point. Part of the explanation must be that the perennial “compared to what” question is not answered favorably by potential investors. Insurers are not willing to pay premiums for the reinsurance in question, or interest on catastrophe bonds associated with the risks in question, sufficient to interest reinsurers or securities investors. And insurers’ unwillingness to pay must in turn be related to the greater net expected rate of return they can earn in other insurance efforts, or investments.

This may be the product of excess uncertainty and risk-aversion on the part of the potential parties and counterparties. Alternatively, it may be yet another demonstration of the difference between the frictionless finance that is so easy for scholars to imagine, and the friction-filled, path-dependent financial institutions populated by real people that exist in the world. For now, the limited higher earning, riskier opportunities available through non-traditional ways to invest in insurance risk seem to be enough to satisfy the demand of investors willing to consider such risks. As broader investment funds become more familiar with all the forms of securitization that are available, and the parametric pricing and return structure on which they depend, the pool of investors willing to engage in these non-traditional investments may well expand.

## 2. *Litigation Investment Funds*

Ex post, parties whose risks have matured into losses for which they have a less than certain legal right to be indemnified – such as plaintiffs in tort cases – can sell all or part of that uncertain right to investment funds.<sup>144</sup> For individuals or companies with that right, the outcome of the lawsuit to enforce the right is, to a significant extent, binary – a win or a loss. To an investment fund with a portfolio of

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144. See, e.g., Anthony J. Sebok, *Should the Law Preserve Party Control? Litigation Investment, Insurance Law, and Double Standards*, 56 WM. & MARY L. REV. 833 (2015) (arguing, though, that parties should not be encouraged to sell their control over litigation which would vindicate their legal rights); Jonathan T. Molot, *A Market in Litigation Risk*, 76 U. CHI. L. REV. 367, 432 (2009).

appropriately selected and priced claims, however, those largely binary outcomes become a book of claims with an expected value – similar in some respects to the set of liabilities that are the subject of the runoff transactions described earlier (with the key difference being that runoff liabilities include the risks of claims that have not yet been made). As a result, the investment fund can pay, or fund the legal expenses, of the individual with the uncertain legal right based on the expected value of that right.

This is in some ways conceptually similar to the “after the event” insurance that, in practice, brought contingent fee litigation into the United Kingdom,<sup>145</sup> and, of course, contingent fee lawyers have long acquired shares in claims in the United States through sweat equity and the advancement of expenses. More recently, that contingent fee practice has expanded to include joint ventures in which some lawyers finance the litigation and others supply the labor, all in support of building a portfolio of claims with sufficiently predictable outcomes in the aggregate to justify the investment needed to prevail against well-funded adversaries. There are some differences, of course, between these precedents and the new litigation investment funds. For one, the litigation investment funds are neither insurance companies nor law firms. Furthermore, litigation investment funds are prepared to buy nearly the whole of the liability claim, not just the slice of that claim represented by an agreement to advance the payment of legal expenses against the promise to be repaid out of the proceeds of that claim. These two differences greatly expand the pool of capital available to support the enforcement of legal claims, to an extent that seems likely to have an impact on civil litigation and, thus, the liability insurance companies that ultimately pay most of those claims.

#### IV. THE FUTURE

If attributing causal responsibility for past developments in insurance law and insurance markets is difficult, predicting future developments is doubly so. Yet, that happens in insurance all the time. What is any set of insurance policies sold at a fixed price other than a prediction of the future?<sup>146</sup> Or, for that matter, the price of any security sold

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145. See, e.g., Richard Lewis, *Litigation Costs and Before-the-Event Insurance: the Key to Access to Justice?*, 74 *MODERN L. REV.* 272, 274 (2011) (explaining the role of after the event insurance in the development of conditional fees in England).

146. See Tom Baker, *Insuring Liability Risks*, 29 *GENEVA PAPERS ON RISK & INS.* 128, 130 (2004); Alberto Cevoloni, *Time Construction in Insurance Society*, 29 *J. HIST. SOCIOLOGY* 160, 161 (2016) (“[T]he thesis proposed is that the insurance premium is the price of the observation of the future.”).

in the market?<sup>147</sup> Recent work in the sociology of risk asserts that a defining feature of contemporary life is the extent to which we live in the future – an imagined future, to be sure, but the future nonetheless.<sup>148</sup> Thus, with the modesty that comes from living through the unexpected recent past, what follows are some observations about how that past may intersect with the trends that we have just described.

We can divide our predictions into four categories. The first two developments that we predict are a product of Covid-19 itself: future litigation that will arise out of insurance claims associated with pandemic losses; and the capacity of the insurance market to cover new or newly discovered risks, including pandemic risk. The second two developments are not directly related to the pandemic, but they will occur in a future that is colored by the pandemic experience: litigation that will be the byproduct of the increasing financialization of insurance that we described in Part III; and the posture that the courts will take toward insurance claims in the post-Covid-19 era.

#### A. Covid-19-Related Insurance Litigation

It does not take a very astute historian to observe from our earlier discussion that when there have been big losses there often are first-party insurance claims, lawsuits seeking to impose liability on third parties, and subsequent liability insurance claims. Covid-19 produced big losses, has already produced lawsuits and insurance coverage claims, and is likely to produce more of the same in the future.

By far, the most active current form of Covid-19-related insurance coverage litigation involves claims for coverage of lost revenue under Business Interruption (BI) and Contingent Business Interruption (CBI) policies. These suits—roughly 2,100 by March 2022—have been filed by a variety of businesses, with restaurants and bars predominating.<sup>149</sup> Nearly 900 have been resolved on the merits, most unsuccessfully, with the appeals process well underway as of March 2022.<sup>150</sup> The basic challenge policyholders face is that the core coverage provide by

147. See generally Elena Esposito, *Using the Future in the Present: Risk and Surprise in Financial Markets*, 12 MAX PLANK INST. STUDY SOCS. 13 (2011).

148. See, e.g., Alberto Cevoloni, *Insurance as a Business of Imagination*, 22 SOCIOLOGIA E POLITICHE SOCIALI 105 (2019).

149. The most comprehensive database on these suits, the Covid Coverage Litigation Tracker (CCLT), is maintained under the supervision of one of the authors (Baker) at UNIV. PENN. LAW SCH., CCLT, <https://cclt.law.upenn.edu/> (last visited Mar. 14, 2022) [hereinafter UNIV. PENN. LAW SCH., CCLT].

150. See UNIV. PENN. LAW SCH., CCLT: *Trial Court Rulings on the Merits in Business Interruption Cases*, <https://cclt.law.upenn.edu/judicial-rulings/> (last visited Mar. 14, 2022) [hereinafter UNIV. PENN. LAW SCH., CCLT: *Trial Court Rulings*]; UNIV. PENN. LAW SCH., CCLT: *Appeals*, <https://cclt.law.upenn.edu/appeals/> (last visited Mar. 14, 2022).

BI and CBI policies is for losses resulting from property damage, and Covid-19-related business closures and revenue reductions are not the result of “property damage” as that term has been conventionally understood by many people in the insurance industry.<sup>151</sup> Policyholders have good counter-arguments based on detailed analysis of the language of the policies and reasoning-by-analogy from the prior caselaw, but insurers have taken unified stand on this issue.<sup>152</sup> Some policies also contain virus exclusions, and others contain contamination exclusions, so prevailing on the threshold “physical loss or damage to property” will not be enough for the policyholders to prevail in many cases. We expect that this litigation, and probably an additional increment of suits that have not yet been filed, will wind its way through the courts for some time to come.

There have also been tort suits alleging liability on the part of businesses for causing or contributing to the plaintiffs contracting Covid-19. Thus far, the number of such suits has been limited,<sup>153</sup> but we expect that they will increase. Such suits are likely to be followed by liability insurance coverage claims, regardless of the outcome of the underlying suit. This is because CGL insurance policies covering most businesses embody a duty to defend, even apart from their duty to indemnify in the event of a judgment or settlement. Insurance brokerage errors and omissions insurers are still waiting for the predicted wave of claims from small businesses that have BI policies with virus exclusions, as only a small percentage of the recent wave of BI lawsuits include insurance brokers as defendants.<sup>154</sup>

In addition, we expect eventually to see derivative suits brought by the shareholders of corporate entities, alleging that the entities have lost money as a result of mismanagement, during or after the pandemic. The directors and officers against whom such suits will be brought are almost always covered by D&O insurance, and litigation over coverage, on various grounds, is a near certainty. D&O insurance observers report varying counts of pandemic-related securities claims.<sup>155</sup> Thus far, the overall numbers are unimpressive, and the

151. See generally Scott G. Anderson, *What Constitutes Physical Loss or Damage in a Property Insurance Policy*, 54 *TORT TRIAL & INS. PRAC. L.J.* 95 (2019).

152. See generally Richard P. Lewis et al., *Couch’s “Physical Alteration” Fallacy: Its Origins and Consequences*, 56 *TORT TRIAL & INS. PRAC. L.J.* 621 (2021).

153. LAW.COM, *Lawsuits Filed in 2020 Over Covid Were Diverse, but Limited* (Dec. 29, 2020), <https://www.law.com/2020/12/29/lawsuits-filed-in-2020-over-covid-19-were-diverse-but-limited/>.

154. See UNIV. PENN. LAW SCH., *CCLT*, *supra* note 149.

155. See, e.g., Kevin LaCroix, *The Top Ten D&O Stories of 2021*, *THE D&O DIARY* (Jan. 3, 2022), <https://www.dandodiary.com/2022/01/articles/director-and-officer-liability/the-top-ten-dostories-of-2021/>.

pandemic-related securities class actions primarily demonstrate the continuing truth of Matt Levine’s initially provocative claim that “everything is securities fraud.”<sup>156</sup>

There may be other forms of insurance coverage litigation as well, involving coverage of liability for employment discrimination and under workers’ compensation policies, for example. Some of the issues raised in BI coverage litigation have been unique to Covid-19, and some have been more conventional. The same is, or will be, the case for CGL and D&O insurance litigation.

Except in the unlikely case that courts in large numbers hold that claims for coverage under BI and CBI policies are covered in large part or in full even in the face of virus exclusions, we do not expect that any of this litigation will be catastrophic for the insurance industry. Rather, it will be an ongoing vulnerability for some time, as payouts may be large but sustainable, or small and routine, and precedents set in litigation may be significant, but they will not be revolutionary.<sup>157</sup> Half-a-dozen years from now, Covid-19-related insurance coverage litigation will be a thing of the past, the way that a heavy hurricane season hits property insurers hard but is eventually seen in their rearview mirror.

### *B. The Availability of New Forms of Pandemic Coverage*

Our most general observation from the foregoing survey of twentieth-century developments in the insurance marketplace is the banal, but important, “where there’s a will, there is a way.” But we would also paraphrase in reverse: “where there’s a way, there’s a will.” Taking both adages together, both the supply and demand sides of the insurance market will combine to make available coverage that it is feasible to offer to potential policyholders who are willing to pay for it.

We know from the past that insurance markets usually adapt to address new risks—not automatically; not in a seamless, straight-line manner; not without controversy, litigation, or occasional failure—but

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156. See Emily Strauss, *Is Everything Securities Fraud?*, 3, 8–9 (UC Irvine Law R., Working Paper No. 2021-04, 2020), <https://ssrn.com/abstract=3664132>. Matt Levine began with the concept that “every crime is also securities fraud.” *Id.* at 1. Levine then generalized that insight into “[e]verything is securities fraud.” Matt Levine, *It Doesn’t Pay to be Too Ethical*, BLOOMBERG OP. (May 1, 2020), <https://www.bloomberg.com/opinion/articles/2020-05-01/it-doesn-t-pay-to-be-too-ethical>.

157. See Baker, *supra* note 107, at 108 (“Insurance already involves so much uncertainty, and insurers have so many ways to manage it, that the most likely result will always be that they will continue to muddle through.”).

they adapt. Flood risks have been insured.<sup>158</sup> Riot risks have been insured.<sup>159</sup> Environmental risks have been insured.<sup>160</sup> Terrorism risks have been insured.<sup>161</sup> Cyber risks are being insured.<sup>162</sup>

Similarly, pandemic risks will be insured, perhaps initially with reluctance and limits of various sorts, but eventually with broader and more substantial coverage.<sup>163</sup> BI coverage presents the hardest, most important case for covering pandemic risk, because of the potentially enormous losses involved. Perhaps policies will require express opt-ins with additional premiums, as with pollution buybacks under CGL policies now.<sup>164</sup> There may well be some form of public backstop, preferably preemptive in the form of governmental reinsurance or something similar, if only because the recent pandemic experience demonstrates the enormous pressure to provide relief when private insurance is lacking.<sup>165</sup>

If the recent experience is a guide to the future, liability insurance and other forms of coverage, such as life, health, and disability, are less likely to experience financial disruptions in a pandemic. Auto and health insurers have done well in the pandemic because people drove and went to the doctor less. Life insurers may have paid more claims, but the preponderance of deaths among the very old means that the pandemic did not as significantly vary from actuarial projections that could otherwise have been the case.<sup>166</sup> Moreover, the demand for life insurance increased during the pandemic, so the overall financial re-

158. See HOWARD C. KUNREUTHER & ERWANN O. MICHEL-KERJAN, *AT WAR WITH THE WEATHER: MANAGING LARGE-SCALE RISKS IN A NEW ERA OF CATASTROPHES* 4–10 (2011).

159. See generally Wriggins, *supra* note 97.

160. See ABRAHAM & SCHWARCZ, *supra* note 5, at 560–61.

161. See Tom Baker and Anja Shortland, *Government and Insurance: Lessons for Ransomware*, at 13–15 (Jan. 2022) (working paper on file with authors).

162. See generally Abraham & Schwarcz, *Courting Disaster*, *supra* note 64; Baker, *supra* note 66.

163. See Carolyn Cohn, *Underwriters Puzzle Over How to Make Pandemics Insurable Again*, REUTERS (May 10, 2021, 12:22 AM), <https://www.reuters.com/business/finance/underwriters-puzzle-over-how-make-pandemics-insurable-again-2021-05-10/>.

164. See ABRAHAM & SCHWARCZ, *supra* note 5, at 560–61.

165. George L. Priest, *Government Insurance Versus Market Insurance*, 28 GENEVA PAPERS ON RISK & INS. 71, 78 (2003). See generally George L. Priest, *The Government, the Market, and Catastrophic Loss*, 12 J. RISK & UNCERTAINTY 219 (1996).

166. *COVID-19 Mortality Overview: Provisional Death Counts for Coronavirus Diseases 2019 (COVID-19)*, CDC, <https://www.cdc.gov/nchs/covid19/mortality-overview.htm> (last visited Jan. 19, 2022) (74.4% of deaths occurred in the 65 and older age group); *Risk for COVID-19 Infection, Hospitalization, and Death By Age Group*, CDC (Nov. 22, 2021), <https://www.cdc.gov/coronavirus/2019-ncov/covid-data/investigations-discovery/hospitalization-death-by-age.html> (indicating that the rate of infection in adults 85+ has been the same as those in adults 18-29, but the incidence of death from Covid-19 in the 85+ age group is 370 times as great as that in the 18-29 age group) (data for both CDC reports as of June 24, 2021).

sult may well have been positive.<sup>167</sup> Workers' compensation insurance is the most impacted of the casualty lines of insurance, but the most direct cause is the newly adopted legal presumption that employees contracted Covid-19 at work, rather than elsewhere.<sup>168</sup> Because that was a regulatory change, insurers are likely to be permitted to recover those costs through premium increases.<sup>169</sup>

Consequently, multi-line insurers who sell many different lines of insurance can expect pandemic losses to be offset to some degree by pandemic gains. We predict the slow addition of express pandemic coverage in these lines of insurance – not because pandemic losses are not already covered, but so that insurers can specify some accompanying limitations on it.

As we indicated in Part III A, it is too soon to assess the impact of the pandemic on business liability insurance claims. Some law firms have reported that “[t]he COVID-19 pandemic spawned more than 1000 workplace-related lawsuits last year,”<sup>170</sup> but, as with auto and health insurance, there are likely to be offsetting declines in claims as a result of reduced activity levels. For example, we expect that there will be fewer claims against restaurants, bars, and health clubs that were shut down entirely and fewer claims against healthcare related businesses that experienced a decline in patient visits. We, therefore, do not expect to see pandemic-related liability to be excluded altogether from liability insurance policies, at least in the long run.

167. Leslie Scism, *Covid-19 Pandemic Motivates Younger People to Buy Life Insurance*, WALL ST. J. (Feb. 1, 2021, 8:00 AM), <https://www.wsj.com/articles/covid-19-pandemic-motivates-younger-people-to-buy-life-insurance-11612184402> (reporting the MIB Group Inc. findings that applications for life-insurance policies jumped 4% in 2020 in the United States and that Northwestern Mutual Life Insurance Co. experienced a nearly 8% increase over 2019).

168. Josh Cunningham, *COVID-19: Workers' Compensation*, NAT'L CONF. STATE LEGISLATURES (Dec. 9, 2020), <https://www.ncsl.org/research/labor-and-employment/covid-19-workers-compensation.aspx>.

169. Fatima Hussein, *Workers' Comp Premiums Could Skyrocket with Covid-19 Claims*, BLOOMBERG LAW (Mar. 30, 2020, 2:26 PM), <https://news.bloomberglaw.com/safety/workers-comp-premiums-could-skyrocket-with-covid-19-claims>; Aaron N. Colby, *The Workplace and COVID-19: Workers' Compensation to the Rescue?*, FORBES (May 13, 2020, 4:22 PM), <https://www.forbes.com/sites/aaroncolby/2020/05/13/the-workplace-and-covid-19-workers-compensation-to-the-rescue/?sh=7c9d3fa26295>. *But see* N.J. STAT. ANN. §§ 34:15-31.11–31.14 (2020); Michael Sullivan, *COVID-19 Workers' Comp Considerations for Calif. Employers*, LAW360 (Dec. 11, 2020, 4:51 PM), <https://www.law360.com/articles/1336418/covid-19-workers-comp-considerations-for-calif-employers-> (noting that “[t]he Insurance Commission in California has indicated that it will not count COVID-19 cases when calculating the employer’s experience modification rate, and so premiums should not be affected”).

170. Paul Davidson, *COVID-19 Sparks More than 1000 Workplace-Related Lawsuits in 2020 as Employees Complain About Safety, Wages*, USA TODAY (Jan. 5, 2021, 10:01 AM), <https://www.usatoday.com/story/money/2021/01/05/covid-19-lawsuits-pandemic-spawned-over-1-000-workplace-lawsuits/4135280001/>.

With this new or newly expressed coverage, litigation over the meaning, scope, and application of pandemic-related coverage provisions will inevitably follow. If pandemic losses are huge, then the coverage litigation these losses generate will be huge as well. That is the lesson of Parts I and II: Big losses in an area that is touched by insurance produce substantial insurance litigation.<sup>171</sup>

### C. *Litigation over Financialization*

A more speculative prediction is that there will be increased future litigation associated with the various forms of financialization in insurance. We say that this prediction is more speculative because we do not have any direct precedent for it in the history we have canvassed. On the other hand, we do know that the more prevalent a form of risk-spreading is – and the financializations we have discussed are forms of risk-spreading – the more likely it is to generate litigation. And financialization is becoming more prevalent.

First, the various types of runoffs have thus far been accomplished with little litigation challenging their validity, in part because several types of runoffs have been the subject of regulation, and in part because runoffs thus far appear to have been adequately capitalized. Consequently, there is little caselaw addressing the validity of runoffs. It is only a matter of time, however, before a runoff entity turns out to be inadequately capitalized, whether by design or chance. At that point, we can expect significant litigation that begins to establish the scope of policyholder rights and the liabilities of insurers that establish runoff entities, when runoff capital is inadequate to pay claims under policies sold by the establishing entity.

Second, parametric insurance offers one of the most promising avenues for innovative insurance coverage, whether in the area of securitized insurance, micro-insurance, or conventional coverage. Typically, and in each instance, insurance becomes payable if an indexed, damage-causing event occurs. Such a parametric trigger of coverage may be a specified amount of overall damage such as \$500 million in hurricane-related damage, an earthquake of 7.0 or more on the Richter scale, or a crop failure of a particular magnitude, often within a defined geographic area.<sup>172</sup>

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171. See Abraham, *supra* note 21, at 94–95.

172. See NAT'L ASS'N INS. COMM'RS, *Parametric Disaster Insurance* (June 29, 2020), [https://content.naic.org/cipr\\_topics/topic\\_parametric\\_disaster\\_insurance.htm](https://content.naic.org/cipr_topics/topic_parametric_disaster_insurance.htm); Daniel Brettler & Timothy Gosnear, *Parametric Insurance Fills Gaps Where Traditional Insurance Falls Short*, INS. L. J. (Jan. 9, 2020), <https://www.insurancejournal.com/news/international/2020/01/09/553850.htm>.

Because a parametric trigger that has been satisfied gives large numbers of policyholders a right to payment virtually by definition, whether coverage is triggered is a high-stakes decision, often delegated to or made in deference to a neutral third party. The more objective and unambiguous a parametric trigger is, the less controversy there will be over whether it has been satisfied. As parametric insurance spreads and develops, it will naturally experiment with more sophisticated triggers in order to classify and distinguish between complex risks that are and are not to be covered. Complexity in triggers of coverage will lead naturally to putative ambiguity and to coverage litigation.

Finally, we predict litigation over litigation financing. Litigation financing is not, technically, insurance. It is not, or at least has not yet been ruled to be subject to, state-based insurance regulation. But as we showed in Part III, litigation finance is a form of risk-transfer and risk-diversification that employs some of the same tools as insurance. Like insurance, litigation finance is accomplished through contracts which are often standard-form. And like much insurance, one of the parties to litigation finance contracts is almost always a commercially unsophisticated individual, and the other party is a sophisticated commercial entity.

We predict that, as with runoffs and parametric insurance, it is only a matter of time before disputes over the meaning and application of litigation finance contracts break into the open and end up in litigation themselves. Moreover, in that litigation, the principles and policies that inform the interpretation and application of insurance policies will be recognized as providing a close analogy for the resolution of these disputes. Similarly, it may well be that influence eventually operates in the other direction as well, with principles and policies developed in disputes over litigation financing informing insurance coverage litigation. The resulting cross-fertilization may enrich both fields.

#### *D. The Judicial Ethos in Insurance Litigation in the Post-Covid-19 Era*

Some other features of the past may not characterize the future, because they have already begun to be transformed. In particular, the pro-coverage ethos that characterized the trigger-of-coverage/long-tail liability saga of the 1980s and 1990s era appears to be less dominant today than it was then. For example, courts have been less likely in the more recent sex abuse insurance coverage cases to make decisions

that are aggressively pro-coverage.<sup>173</sup> It may be that the courts learned that their decisions about past policies could have significant impacts on the scope of future coverage. For example, the courts are more likely than they may have been in the past, in our view, to respect the market segmentation that allocates coverage responsibility for certain kinds of losses to one kind of policy rather than to two kinds. Similarly, as comparatively new forms of coverage develop – such as cyber insurance – the courts may be reluctant to engage in aggressive interpretation that inhibits insurers from offering such coverage. And it may be that the insurers have upped their litigation game. Although there will always be categories of coverage claims that could go one way or the other, policyholders should not expect nationwide, one-directional pro-coverage decisions from the courts, even in situations of catastrophic loss, as suggested by the outcomes in the early rounds of Covid-19-related BI litigation, in which the insurers overwhelmingly are prevailing.<sup>174</sup>

#### CONCLUSION

The history of insurance and insurance law provide both a guide and some perspective on how the Covid-19 pandemic will influence the future of these fields. We have shown how the most important events in the history of insurance and insurance law – the rise of modern tort and corporate liability and the introduction of the automobile and the computer – generated new forms of coverage that are now fundamental fixtures in the insurance world. And we have shown that, once such coverage was sold, claims litigation produced the body of legal doctrine that now comprises much of contemporary insurance law.

The pandemic has disrupted the world in far-reaching ways. But the effect of that disruption on insurance and insurance litigation is unlikely to compare to the influence of the events and developments in the history of insurance that we have recounted. Our analysis shows that, where there is a need for a new form of insurance, it is likely to develop. That will probably be the case for pandemic insurance. Liti-

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173. See, e.g., *Doe v. Hudson Specialty Ins. Co.*, 719 Fed. Appx. 951 (11th Cir. 2018); *Erie Ins. Prop. & Cas. Co. v. Dolly*, 507 F. Supp. 3d 702 (N.D. W. Va. 2020); *Allstate Vehicle & Prop. Ins. Co. v. Hunter*, No. 2019 WL 251500, U.S. Dist. LEXIS 8217 (D. S.C. Jan. 17, 2019); *J.G. v. Wangard*, 753 N.W.2d 475 (Wis. 2008); *Sanzi v. Shetty*, 864 A.2d 614 (R.I. 2005); *Gearing v. Nationwide Ins. Co.*, 665 N.E.2d 115 (Ohio 1996); *High Point Ins. Co. v. J.M.*, 942 A.2d 804 (N.J. Super. Ct. App. Div. 2008); *Westfield Nat'l Ins. Co. v. Cont'l Cmty. Bank & Trust Co.*, 804 N.E.2d 601 (Ill. App. Ct. 2003); *State Farm Fire & Cas. Co. v. Tippet*, 864 So. 2d 31 (Fla. Dist. Ct. App. 2003); *Am. Econ. Ins. v. Estate of Wilker*, 977 P.2d 677 (Wash. Ct. App. 1999).

174. See UNIV. PENN. LAW SCH., *CCLT: Trial Court Rulings*, *supra* note 150.

gation over the contours of the new coverage, and the consequent emergence of new legal doctrines will follow, just as it has in the past when new forms of insurance were introduced. Similarly, where existing forms of financial organization have been ill-suited to the needs of the insurance market, new forms of financing have developed. That is likely to be the pattern not only for pandemic insurance, but also for the insurance market as a whole. We can expect litigation over the rights and liabilities of those affected by the new forms of financing to establish and regulate those rights and liabilities.

In short, we predict that the Covid-19 pandemic will impact the future of insurance and insurance litigation in significant but not radically disruptive ways. There may be considerable innovation and important doctrinal development in its wake. But there will be continuity with the past, and not a sharp break with it, even as change occurs.