COVID Insurance Cases Highlight Federal-State Court Tension

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The coronavirus pandemic has spawned an unprecedented nationwide explosion of insurance coverage litigation. Nothing calls to mind an event triggering over 2,000 and counting similar lawsuits spread over most of the 50 states in the course of a year and a half.

To be sure, there have been and are other widespread insurance coverage battles, or litigation waves, in the courts. To name a few examples, there is the battle over pollution exclusions — both in their "sudden and accidental" and "absolute" or "total" iterations — the slew of issues arising from long-tail liabilities, coverage for construction defect cases, the 9/11 cases, Hurricanes Katrina and Sandy cases, and others.

But none of these involved such an acute explosion of geographically widespread litigation in such a short period of time. This new experience is putting a magnifying glass on our federal system, in which federal courts are being called upon to predict state law on a widespread scale before the states' high courts have the opportunity to weigh in.

Why does that matter? Because when it comes to interpreting the language of an insurance policy — which is typically subject to rigorous review and approval by state regulators — and applying it to a given set of facts, the state high courts have the final say. Insurance claims are governed solely by state law.

Although it's fairly common for a federal court to predict how a state high court would rule on a given state law issue, it's very uncommon for this to happen on such a widespread scale involving the same state law issues in such a short period of time, before any state high court has weighed in.

The litigation statistics are telling. According to Penn Law's COVID Coverage Litigation Tracker, approximately 2,062 COVID-19 coverage cases were filed nationwide over the last year and a half, with the majority being filed in federal court. Of the 2,062 cases filed, approximately 289 and counting are on appeal. Of those 289 cases on appeal, 224 are from various federal district courts spread over 30 states.

To date, the U.S. Courts of Appeals for the Sixth, Eighth, Ninth and Eleventh Circuits have issued decisions,[1] and the U.S. Courts of Appeals for the Third, Fourth, Fifth, Seventh and Tenth Circuits appear to be poised to issue decisions[2] on state law COVID-19 coverage issues that will bind the relevant federal district courts.

Those state law issues include:

- Whether a physical deprivation of property or loss of functionality of property for its intended purpose can constitute physical loss within an all-risks commercial property insurance policy;
- Whether the presence of the coronavirus can cause physical damage; and
- Whether various insurance policy exclusions preclude coverage for losses arising from the coronavirus.

In contrast, of the approximately 289 currently pending COVID-19 coverage appeals, 65 are in the state courts, spread over 20 states, compared to the 224 federal appeals. Perhaps the disparity is due to most cases being filed in, or removed to, federal court, and perhaps state courts have a slower response time.

Thus, at this juncture, the federal appellate courts have 159 more chances to opine on the state law coverage issues raised by the pandemic than state appellate courts. What is more, it's likely that appellate review of federal decisions will end with the circuit courts because, under our constitutional system, even the highest court in the land can still only offer a prediction regarding a question purely of state law.

For whatever reason, many federal courts nationwide seem to be quick to predict state law before state high courts have the chance to weigh in, leaving both policyholders and insurance companies uncertain as to whether subsequent, binding state high court decisions will be in accord. This situation created by the pandemic is unique and has the potential to bring undesirable results.

The most undesirable potential result is painfully obvious. If, for example, the federal district and appellate courts mostly rule against policyholders on the physical loss or physical damage issue, but even a few state high courts ultimately disagree, we will witness probably the most egregious and widespread case of conflicting outcomes in our nation's history.

Consider that the U.S. District Court for the Northern District of Ohio certified the physical loss and other COVID-19 coverage questions to the Ohio Supreme Court in Neuro-Communication Services Inc. v. Cincinnati Insurance Co. in January, but nevertheless the U.S. Court of Appeals for the Sixth Circuit decided these issues under Ohio law on Sept. 21 in favor of insurers in Santo's Italian Café LLC v. Acuity Insurance Co.[3]

If the Ohio Supreme Court decides the issues in favor of policyholders in Neuro-Communication Services, it appears the Sixth Circuit's decision will have been wrongly decided, along with all subsequent coverage decisions relying thereon, leaving policyholder litigants in a very unfair position.

Similarly, the U.S. District Court for the District of South Carolina certified these issues to its state's high court on Oct. 19 in the matter of Sullivan Management LLC v. Fireman's Fund Insurance Co.[4]

And, even though there are fewer pending appeals in the state courts than in the federal system, these state intermediate appellate courts are on the cusp of weighing in. For example, at least one appeal, Mac Property Group LLC v. Selective Fire Insurance Co., in the New Jersey Superior Court, Appellate Division has been fully briefed, and there are surely others in New Jersey and other states in a similar posture.[5]

In California, the Court of Appeal for the Fourth Appellate District issued a decision on Nov. 15 in Inns by the Sea v. California Mutual Insurance Co.,[6] but there are other appeals pending in California that may develop a split among its intermediate appellate courts.[7] And even then, intermediate appellate courts are still not the final arbiters of state law.

Another possible undesirable result is that the state courts may be unduly influenced by federal court predictions of the law that those state courts should be deciding in the first place.

Certainly, insurers and policyholders may see this point differently, but on a macro level, state courts should be allowed to develop the law in their jurisdictions independently and without fear of engendering the first undesirable result just discussed — conflicting outcomes — simply because federal courts serendipitously had the jump on predicting matters of state law.

The potential for these undesirable results is not new to our federal system, especially when it comes to insurance coverage. Consider the variety of state law positions on issues of whether the pollution exclusion applies only to traditional environmental contamination, or how to allocate long-tail losses among multiple successive policies, or whether late notice can bar coverage without prejudice to the insurer.

But what separates the pandemic coverage litigation from those other experiences is its intensity — that is, the volume of cases involving similar issues filed in a short period of time in almost every state in the union — and the fact that the majority of cases are in federal court.

In contrast, for example, the pollution exclusion issues have developed gradually — organically — over the years in both the state and federal courts such that state courts had the opportunity to weigh in and federal courts to receive guidance.

So, what can be done? In this author's view, the potential unfairness to litigants resulting from conflicting outcomes can be ameliorated if federal courts were more willing to certify questions of state law to state supreme courts.

It's difficult to understand why, for example, the Fourth Circuit refused to certify these issues to Maryland's highest court in Cordish Companies Inc. v. Affiliated Insurance Co.,[8] when eventually the Maryland Supreme Court is going to weigh in, and it may not agree with the Fourth Circuit's prediction of Maryland law.

Another approach is for federal courts to remand cases to state court where possible. The tension between federal and state courts that the pandemic is magnifying on a broad scale seems to be the archetypical reason to send state law insurance issues to state trial courts.

Yet another approach to mitigate the danger of conflicting outcomes is that the federal appellate courts could be more willing to stay appeals pending rulings from, ideally, state supreme courts. Yes, staying pending appeals will delay outcomes. But in this unique situation, does that really outweigh a potential onslaught of litigants whose cases may turn out to be wrongly decided by federal courts? On a macro level, there seems to be too much at stake not to give state courts their say on state law before we end up in a

potential quagmire of conflicting outcomes.

Imagine hundreds and even thousands of motions to vacate judgments — with no guaranty of success. Such a situation may even call for a legislative solution, which presents its own problems. It seems worth the time for federal courts to take a step back and consider how COVID-19 coverage litigation is unfolding.

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