LEGAL UPDATES

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Southern California Wildfires: Potential Reinsurance Issues

Service

Reinsurance

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The wildfires in Southern California have already scorched tens of thousands of acres and resulted in numerous fatalities; led to the destruction of thousands of homes, automobiles, and other property; caused massive business disruptions; and will result in billions of dollars in loss. Those losses will place substantial economic (and reputational) pressure on—and potentially spawn disputes between—insurers and reinsurers. While facts, circumstances, and contract wording will differ, if history is any guide, the nature of reinsurance disputes arising from the Southern California wildfire claims is likely to involve (at least) one or more of the following issues.

Number of limits

Over the course of a similar timeframe, Los Angeles has dealt with several wildfires in different parts of the city. Those fires appear to have caused substantially different damages, with the Palisades Fire and the Eaton Fire resulting in what appears to be the largest scale destruction. Under these circumstances, one of the most contentious issues in property reinsurance disputes (if any) will be what constitutes a "loss occurrence." Given the magnitude of the losses, insurers may bill reinsurers multiple loss occurrences (and thus multiple limits).

In reinsurance contracts without an "Hours Clause," the determination of the number of loss occurrences likely will be based on the definition of "loss occurrence." Again, contract language will vary, but a common definition of "loss occurrence" will be "an accident or occurrence or a series of accidents or occurrences arising from a single event." In those situations, determining the loss occurrence requires determination of the "event" and which losses "arise" from that event, which is essentially a causation analysis. As a general matter, the further away in time/proximity the "event" is to the actual loss, the more difficult it is to establish causation. Thus, one company might elect to define

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the "event" as a decision by Los Angeles to not properly clear debris (and argue that all losses across the city of Los Angeles are a single occurrence), while another company might define the "event" as the alleged arson in the Palisades (and argue that all losses arising from the Palisades fire are one occurrence). Obviously, these decisions can have enormous financial consequences.

The market has attempted to deal with the number of available limits through the "Hours Clause," which has become a standard provision in many recent reinsurance contracts. These clauses specify the maximum timeframe within which a covered event must occur in order for the loss to be treated as a single loss occurrence. In wildfires, where fires may spread unpredictably and impact large swathes of land over several days, the Hours Clause can become an issue when insurers seek to aggregate losses from arguably separate fires within the same time frame. For example, if a wildfire event lasts for a prolonged period and multiple properties are affected over several days, issues may arise over whether the damage occurred within the time parameters specified by the Hours Clause.

Finally, wildfires cause a mix of damages, such as fire, smoke, and water damage. Reinsurance contracts may treat these perils differently, and concurrent causation clauses can significantly affect claims outcomes. The determination of which peril caused the damage—and how much is attributable to each—can impact reinsurance recovery and lead to disagreements over loss allocation.

Follow the settlements/e*x gratia* payments

With wildfire claims, the follow-the-settlements doctrine can be tested where reinsurers argue payments to policyholders were *ex gratia*, i.e., outside the scope of the policy's requirements. In the aftermath of a wildfire, insurers might make payments to policyholders who may not fully satisfy the policy requirements for a claim in the face of pressure from regulators or because of reputational harm that might occur in the absence of such payments. Reinsurers may argue that such payments fall outside of their contractual obligations because they agreed to reinsure only those payments made by the insurer which are covered by the policy reinsured.

Exclusions

Reinsurance contracts may contain exclusions specific to wildfire risks, such as those related to fire following smoke damage. In other words, reinsurers may have arguments that losses covered under the policy are excluded from coverage under the reinsurance contract. Disputes can arise over the application of these exclusions.

Proof of loss

The magnitude of damage caused by wildfires can be difficult to estimate or ascertain immediately after the fires. Indeed, the extent of damage might vary widely depending on the location and/or severity of the fire and the type of properties affected. The issues might be compounded by the

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evolving nature of wildfire damage, where new claims may emerge in the weeks or months following the event. In some cases, insured parties may not fully realize the extent of their losses immediately, leading to revised and sometimes higher loss estimates. However, as noted above, there will certainly be pressure on insurers to resolve claims quickly. Disputes between insurers and reinsurers may arise concerning the level of documentation obtained by the cedent to support the policyholder's claims.

What this means to you

Reinsurance claims arising from the Southern California wildfires are likely to involve (at a minimum) complex contract construction issues concerning aggregation and the interpretation of exclusions, as well as the application of follow the settlements. Understanding, identifying, and addressing these issues as early as possible in the claim billing and evaluation process are key to insurers seeking to maximize coverage and to reinsurers seeking to ensure that they are paying only legitimate claims.

Contact us

If you have reinsurance questions pertaining to the wildfires in Southern California or seek more information, please contact Mike Robles, Brian O'Sullivan, Rachel Potter, or your Husch Blackwell attorney.

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