

Lawyer Insights

To Offset or Not to Offset: The Interaction between CARES Act Payments/PPP Loans and Insurance Recoveries Due to COVID-19

By Syed Ahmad and Cary D. Steklof
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The unprecedented impact of COVID-19 on the American economy has forced many businesses of all sizes and in all industries to seek some form of financial relief. Perhaps the most prominent source is the Coronavirus Aid, Relief, and Economic Security Act (commonly known as the CARES Act), which provides over \$2 trillion in assistance through the largest economic stimulus package in U.S. history. A common example of funding under the CARES Act is through the Paycheck Protection Program (PPP) in the form of loans to certain businesses. The CARES Act allocates funds

through numerous provisions, the two largest of which are dedicated to corporate and small business loans. Many businesses that receive federal funds will also seek recovery from a second, hotly debated source: insurance. Whether companies are pursuing payment for business interruption, event cancellation, or some other loss, the coming years will bring litigation over coverage and a critical question: Are insurance companies entitled to an offset for any relief that a business receives from the CARES Act (or are losses reduced by any of the ancillary payments for other reasons)? As is often the answer in the legal world, it depends.

While insurers may insist that any CARES Act payment must reduce what is owed under a policy, the analysis begins (and may sometimes end) with the policy itself. The right to an offset is just that—a right that must be grounded in the insurance contract. Many insurance policies contain clauses that specifically address how recoveries from other sources will impact the insurance payout. This frequently takes the form of a “Salvage and Recoveries” provision, “Collection from Others” provision, or some type of subrogation clause. If a policy is devoid of any such language, this should end the inquiry. While different states may have common law doctrines that could affect the outcome, an insurer has no contractual basis to complain. It could have addressed this risk in its policy and failed to do so. As is the case in many jurisdictions, the coverage must be construed broadly and the benefit of the doubt goes to the party that suffered the loss—not the insurance company.

Even when an insurer does address other-source recoveries in its policy, an offset is not necessarily required. Just as before, the policy language and law are key. Generally speaking, one kind of policy provision addressing offset is intended to reduce the carrier’s obligation to pay for *the same* losses that a policyholder has already recovered from another source. As courts have explained, this requires consideration of the intent behind the “other” funds received by the policyholder. If the statute’s intent is to compensate the company for something other than its losses, courts have held that such a recovery does not entitle the insurer to an offset. That is because the insurance company is obligated to pay for one thing, and the collateral payment may be used to compensate for something different.

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This issue was considered in *Northrop Gruman Corp. v. Factory Mut. Ins. Co.*,¹ where Northrop made an insurance claim for lost earnings from property damage caused by Hurricane Katrina. The federal court in California rejected the insurer's argument that it was entitled to an offset for federal income tax relief that Northrop received under the Katrina Emergency Tax Relief Act of 2005. Because the Tax Relief Act "was conceived as an incentive to retain employees rather than compensation for a loss," the court found that the credit received by Northrop was "not a 'recovery' or 'collection for such loss from others' under the policy language."

Subrogation clauses are another type of provision on which insurers may rely to claim entitlement to an offset. Such a clause typically provides that "if any person or organization to or for whom we make a payment under this Coverage Part has rights to recover damages from another, those rights are transferred to us to the extent of our payment." Addressing an offset claim under this language, a Louisiana federal court held that the insurer, RSUI, needed to establish that the policyholder had a "right to recover damages" from the other source.

In *Cameron Parish Sch. Bd. v. RSUI Indem. Co.*,² CPSB was entitled to recovery under its flood insurance policy and received assistance from the Federal Emergency Management Agency policy ("FEMA") in the wake of Hurricane Rita. RSUI argued that it was entitled to an offset because CPSB was attempting to "re-characterize and 'double recover' alleged losses . . . that [were] already [] allotted or promised from FEMA." The court rejected this argument, holding that "RSUI has not demonstrated that CPSB has a 'right to recover damages' from FEMA, and as such, RSUI is not entitled to receive an offset for FEMA funds." The insurer failed to present evidence of FEMA payments or cite any authority where an insurer was entitled to receive an offset from FEMA payments.

Determining whether CARES Act payments create offset rights for insurers can be impacted by the section under which payment is made and how the recipient ultimately spends the money. For example, one of the most popular sections of the Act is the Small Business Paycheck Protection Program, which is generally open to small businesses with 500 or fewer employees. Funds are provided in the form of loans that will be fully forgiven when used for payroll costs, interest on mortgages, rent, and utilities. At least 75% of the forgiven amount, however, must have been used for payroll. None of these elements are expressly intended to compensate businesses for lost income due to the COVID-19 pandemic. But this is where the policy language becomes key. Business interruption policies may address some of these elements, potentially creating room for debate as to whether an offset is appropriate. Other policies, however, provide coverage entirely unrelated to the compensation that a business might receive under the CARES Act. The greater the distinction between the coverage and the statutory payment, the less likely it is that an offset is due.

Regardless of the type of policy provision at issue, the burden of proving entitlement to an offset will almost uniformly fall to the insurance company. And, as is the case in most jurisdictions, any uncertainty will be interpreted in favor of the policyholder and broader coverage. This was precisely the case in *Yorktowne Shopping Ctr., LLC v. Nat'l Sur. Corp.*,³ where the court ruled in the insured's favor after the insurer failed to demonstrate which portions of a separate recovery entitled the carrier to an offset. Policyholders are placed at an advantage from the outset, as the evidentiary burden and the benefit of the doubt are both in the insured's favor.

Though insurance companies may seek to deduct any CARES Act recoveries from their insurance payouts, the inquiry is more nuanced than simple arithmetic. Carriers will be quick to point the accusatory

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“double recovery” finger at policyholders to ensure that they pay out as little as possible. But the “double recovery” accusation assumes the answer. Policyholders, in turn, must be prepared to show that a setoff is not warranted. Ultimately, courts will have to carefully consider whether there is overlap between the statutory payment and the insurance coverage at issue and if there is a basis in the insurance policy to allow the insurer to an offset or to otherwise reduce the loss it is obligated to pay. As with many other aspects of COVID-19 and its ramifications, it is too early to tell how all of the different insurance angles will play out.

Notes

1. *Northrop Grumman Corp. v. Factory Mut. Ins. Co.*, No. CV 05-08444 DDP PLAX, 2013 WL 3946103 (C.D. Cal. Jul. 31, 2013).

2. *Cameron Parish Sch. Bd. v. RSUI Indem. Co.*, No. 2:06 CV 1970, 2008 WL 4622328 (W.D. La. Oct. 16, 2008).

3. *Yorktowne Shopping Ctr., LLC v. Nat'l Sur. Corp.*, No. 1:10-CV-1333, 2011 WL 4829933 (E.D. Va. Oct. 11, 2011) (noting that the party who asserts an offset must prove its claim, and that the insurer failed to offer sufficient evidence to show which portions of a separate judgment and security deposit required an offset under its policy).

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