Should Insurers Be Legislatively Compelled To Pay Uncovered COVID-19 Related Business Interruption Claims?

Business closures and other financial setbacks have been some of the many unfortunate economic consequences of the COVID-19 public health crisis. Many public-facing businesses such as restaurants, bars, gyms, theatres and retail stores have been ordered to limit or cease operations to prevent the spread of the coronavirus. Over the course of the past six months alone, a staggering number of businesses have been shuttered and/or filed for bankruptcy. Many others may not survive. Not surprisingly, lawmakers around the country have searched for statutory answers.

Some have suggested that the cost and impact of the virus should be borne by insurers. Thousands of business owners have sought coverage from their insurers for these losses, usually under the "business income" or "business interruption" coverage parts of their commercial property policies. Losses arising from pandemic-related business closures are, however, outside the coverage grants and other plain language of most of those policies. This is because the insurers issuing those policies simply did not agree to underwrite such risks.

Some business owners have argued that these insurers should be compelled to provide such coverage, irrespective of the terms of any insurance policy. Hearing the cry from their constituents, legislators have introduced bills in several states and at the federal level that would mandate business interruption coverage for certain businesses forced to close due to the coronavirus pandemic, regardless of policy provisions that would limit or preclude coverage for such claims. As Massachusetts State Senator James Eldridge—the proponent of one of these bills—has observed:

> If we don't find a way to provide financial support for these restaurants and businesses, whether it's the insurance industry or government, many of them will never reopen. And that won't be good for anyone, including the insurance industry. Restaurant owners and other business owners are closing and have closed, and they still have bills to pay. They need to pay rent, they're hoping to pay their employees and yet, in some cases, insurance companies are denying those claims because of the virus exclusion. I personally think this kind of pandemic should be covered by insurance companies.

While the need to help businesses deal with the economic harm caused by the pandemic is indisputable, retroactive legislative rewriting insurance contracts is not the answer. In addition to forcing insurers to pay potentially billions of dollars for claims they never agreed to cover, such legislation, if enacted, would also violate the "contracts clause" and the Fifth and, perhaps, the Fourteenth Amendments to the United States Constitution, as well as parallel provisions in state constitutions. It is, therefore, perhaps not surprising that—at least to date—none of these legislative proposals have been enacted.

The Pandemic and Government Response

A novel coronavirus—later designated as SARS-CoV-2—was first identified in late 2019. The disease caused by that virus is generally referred to as COVID-19. Beginning in March 2020, government officials in various states issued a series of orders, proclamations, and/or resolutions to address the

public health crisis caused by the spread of COVID-19. Many businesses were forced to limit or cease operations in response thereto. Others modified their businesses or ceased operations on their own either to avoid spreading the virus, or based upon the unavailability of employees or willing customers.

Business Income Insurance

"Business Income" insurance—often referred to as business interruption insurance—is intended to cover a commercial policyholder's loss of income when damage to its premises by a covered cause of loss forces it to reduce or suspend its business operations. The coverage is generally limited to losses incurred while the premises and/or business property are being repaired or replaced, although it can be extended. Business Income insurance is optional coverage that may be purchased as part of a property or "first-party" insurance policy.

The following is an example of a basic Business Income coverage grant:

> We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration." The "suspension" must be caused by direct physical loss of or damage to property at the described premises. The loss or damage must be caused by or result from a Covered Cause of Loss.

Losses arising from a commercial policyholder's inability to use property are generally not considered "direct physical loss of or damage to property" as that term is used in commercial property policies. Instead, physical loss or damage occurs when property undergoes a "distinct, demonstrable, physical alteration." *MRI Healthcare Ctr. of Glendale, Inc. v. State Farm Gen. Ins. Co.*, 187 Cal. App. 4th 766, 779 (2010) (citation and quotation marks omitted). "Detrimental economic impact" is not enough. *Id.* (citation and quotation marks omitted); *see also Doyle v. Fireman's Fund Ins. Co.*, 21 Cal. App. 5th 33, 39 (2018) ("[D]iminution in value is not a covered peril, it is a measure of loss" in property insurance).

Many policies containing Business Income coverage also include "Extra Expense" and "Civil Authority" coverage. Extra Expense coverage generally compensates the policyholder for necessary extra expenses to operate while business repairs are underway, as evidenced by the following policy definition:

> Extra Expense means reasonable and necessary expenses you incur during the "period of restoration" that you would not have incurred if there had been no direct physical loss of or damage to property caused by or resulting from a Covered Cause of Loss.

Civil Authority coverage applies to loss of business income and the necessary Extra Expense incurred by a commercial policyholder that is caused by actions of civil authorities that prohibits access to described premises. The action of the civil authority must, however, be due to direct physical loss of or damage to property at other locations caused by or resulting from a Covered Cause of Loss.

The actions or orders of civil authorities must "completely prohibit[] access"—not "merely hinder[] access"—to implicate Civil Authority coverage. *Ski Shawnee, Inc. v. Commonwealth Ins. Co.*, No. 3:09-CV-02391, 2010 WL 2696782, at *4–5 (M.D. Pa. July 6, 2010) (no coverage when an order closed the main road to a ski resort, but another road was available to 30% of patrons); *see also Commstop, Inc. v. Travelers Indemn. Co. of Conn.*, No. cv-11-1257, 2012 WL 1883461 (W.D. La. May 17, 2012), at *9 (coverage only applies where access is "totally and completely prevented—i.e., made impossible" by the civil authority action).

As a result of the language contained in most commercial property policies, Business Income insurance is unavailable unless: (i) a civil authority action has "prohibited" access to the insured's premises, and (ii) that action was due to direct physical loss of or damage to property "caused by or resulting from a Covered Cause of Loss" (i.e., a cause that is not excluded from coverage).

Many commercial property policies also contain exclusions for losses caused by virus and disease, which are applicable to all coverage parts, including Business Income, Extra Expense and Civil Authority. For example, ISO form CP 01 40 07 06, titled "Exclusion for Loss Due To Virus Or Bacteria", provides, in part:

> We will not pay for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease.

Courts generally enforce such exclusions as written. *See, e.g.*, *Certain Underwriters at Lloyd's London v. Creagh*, Civ. A. No. 12-571, 2013 WL 3213345 (E.D. Pa. June 26, 2013) (exclusion for "any loss . . . arising out of or relating to . . . [a] microorganism of any type" precluded coverage for damage to bathroom caused by bacteria from dead body), *aff'd*, 563 F. App'x 209 (3d Cir. 2014); *Doe v. State Farm Fire & Cas. Co.*, No. 2015-0136, 2015 WL 11083311, at *2 (N.H. Sept. 21, 2015) ("We conclude that a reasonable person in the position of the insured, based upon more than a casual reading of the policy as a whole, would understand the policy to exclude all diseases and viruses that can be transmitted from one person to another."); *Lambi v. Am. Family Mut. Ins. Co.*, 498 F. App'x 655, 656 (8th Cir. 2013) ("the policy excluded bodily injury arising out of the actual or alleged transmission of a communicable disease, and infecting another with the HIV virus clearly falls within the plain and ordinary meaning of the transmission of a communicable disease.").

COVID Coverage Litigation

Claims for loss of income resulting from the suspension of businesses' operations due to COVID-19 orders and restrictions are outside the scope of business interruption coverage, as such suspensions are not caused by "direct physical loss of or damage to property" at the insured's business premises. A substantial number of the policies in force as of the onset of the pandemic also contain virus exclusions. Yet, in 2020, over 1,000 coverage actions—including numerous putative class actions—have been commenced by policyholders or their advocates against their insurers seeking coverage for business interruption losses caused by COVID-related shutdowns.

A number of these complaints have already been dismissed based on the lack of any alleged physical loss or damage and/or the effect of virus exclusions. *See, e.g. 10E, LLC v. Travelers*

Indemnity Co. of Connecticut, No. 2:20-cv-04418-SVWAS, 2020 WL 5359653 (C.D. Cal. Sept. 2, 2020) ("Under California law, losses from inability to use property do not amount to 'direct physical loss of or damage to property' within the ordinary and popular meaning of that phrase. Physical loss or damage occurs only when property undergoes a 'distinct, demonstrable, physical alteration.' … An insured cannot recover by attempting to artfully plead temporary impairment to economically valuable use of property as physical loss or damage."); *Franklin EWC Inc., et al. v. The Hartford Financial Services Group, Inc., et al.,* Case No. 20-cv-04434 JSC, WL 5642483 (N.D. Cal. September 22, 2020) ("The complaint repeatedly alleges that the virus caused and continues to cause the risk of direct physical loss required for a Covered Cause of Loss. Thus, as the loss was caused directly or indirectly by the virus, the Virus Exclusion applies under its plain and unambiguous language.") (citations omitted). [1]

Several courts have nonetheless found that allegations in certain complaints were sufficient to support claims of direct physical loss or damage and challenges to virus exclusions.[2]

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[1] *See also Wilson v. Hartford Casualty Co*., No. 20-3384, 2020 WL 5820800 (E.D. Pa. September 30, 2020) (granting insurer's motion to dismiss based on "conspicuously displayed, clear, and unambiguous" virus exclusion); *Oral Surgeons, P.C. v Cincinnati Insurance Co*., No. 4-20-CV-222-CRW-SBJ, 2020 WL 5820552 (S.D. Iowa September 29, 2020) ("OSPC does not allege any such "physical" or "accidental" loss, but instead contends its loss was caused by the COVID-19 coronavirus and the government actions to suspend temporarily non-emergency dental procedures. Recent cases cited by Cincinnati have held that virus-related closures of business do not amount to direct loss to property covered by the Cincinnati policy of insurance. The few contrary cases cited by OSPC are distinguishable on their facts and not as well analyzed as the many authorities cited by Cincinnati."); *Infinity Exhibits, Inc. v. Certain Underwriters At Lloyd's London Known As Syndicate PEM 4000, et al*., Case No: 8:20-cv-1605-T-30AEP, 2020 WL 5791583 (M.D. Fla. September 28, 2020) ("Plaintiff argues that economic damage is synonymous with 'physical loss' and is therefore covered under the Policies. Plaintiff's argument is unpersuasive because Florida law and the plain language of the Policies reflect that actual, concrete damage is necessary. Although the Court is sympathetic to Plaintiff and all insureds that experienced economic losses associated with COVID-19, there is simply no coverage under the policies if they require 'direct physical loss of or damage' to property."); *Sandy Point Dental, P.C. v. The Cincinnati Insurance Company***,** Case No. 20 CV 2160 (N.D. Ill. September 21, 2020) ("The critical policy language here—'direct physical loss'—unambiguously requires some form of actual, physical damage to the insured premises to trigger coverage. The words 'direct' and 'physical,' which modify the word 'loss,' ordinarily connote actual, demonstrable harm of some form to the premises itself, rather than forced closure of the premises for reasons extraneous to the premises themselves, or adverse business consequences that flow from such closure."); *Vandelay Hosp. Group LP v. Cincinnati Ins. Co.*, 3:20-CV-1348-D, 2020 WL 5946863, at *1 (N.D. Tex. Oct. 7, 2020) (granting motion to dismiss but giving leave to replead on basis that policyholder failed to plausibly allege direct physical loss or damage); *Mark's Engine Co. No. 28 Rest., LLC v. Traveler's Index. Co. of Conn.*, 2:20-CV-04423-AB-SK, 2020 WL 5938691, at *1 (C.D. Cal. Oct. 2, 2020) (finding policy holder failed to plausibly allege "direct physical loss or damage" and regardless the policy's virus exclusion applied to preclude coverage); *Mudpie, Inc. v Travelers Cas. Ins. Co. of Am*., Case No. 2-cv-03213-JST, 2020 WL 5525171 (N.D. Cal., Sept. 14, 2020) ("[T]here is nothing to fix, replace, or even disinfect for Mudpie to regain occupancy of its property, which Mudpie admits in its opposition brief: 'Mudpie's loss is caused by state closure orders and thus will last for however long those restrictions remain.'").

[2] *See, e.g., Studio 417, Inc. v. Cincinnati Ins. Co.*, 20-CV-03127-SRB, 2020 WL 4692385 (W.D. Mo. Aug. 12, 2020) (rejecting Cincinnati Insurance's arguments that plaintiffs had not adequately stated a claim for "direct physical loss" or for "civil authority," "ingress/egress," "dependent property," and "sue and labor" coverage under their "all risk" policies." The court concluded that the complaint "plausibly alleges a 'direct physical loss' based on 'the plain and ordinary meaning of the phrase.'" denying insurer's motion to dismiss on the basis that that plaintiffs adequately alleged direct "physical loss" by specially alleging that the virus was a physical substance present at the insured premises; the policy at issue did not contain a virus exclusion. The court acknowledged that "physical loss" and "physical damage"—both undefined in the policy—are distinct and not synonymous, and that "loss" includes "the

Policyholder efforts to centralize or consolidate COVID-19 business interruption coverage litigation have largely been unsuccessful. The Judicial Panel on Multidistrict Litigation concluded that "industry-wide centralization requested by movants will not serve the convenience of the parties and witnesses or further the just and efficient conduct of this litigation." *In Re: COVID-19 Bus. Interruption Prot. Ins. Litig*., MDL 2942, 2020 WL 4670700 (U.S. Jud. Pan. Mult. Lit. August 12, 2020).[3]

The Proposed Legislation[4]

Legislatures in several states—to date California, Louisiana, Massachusetts, Michigan, New Jersey, New York, Pennsylvania, Oklahoma, Ohio, Rhode Island and South Carolina—are considering or have considered bills that would require insurers to provide business interruption coverage for certain insured businesses forced to close because of COVID-19, irrespective of policy provisions to the contrary. All of the proposed state legislation would invalidate any policy

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act of losing possession" and "deprivation," as well as property being in a condition that is "unusable for its intended purpose); *Urogynecology Specialist of Florida LLC v. Sentinel Insurance Co.*, No. 6:20-cv-1174 (M.D. Fla. Sept. 24, 2020) ("[S]everal arguably ambiguous aspects of the Policy make determination of coverage inappropriate at this stage. … it is not clear that the plain language of the policy unambiguously and necessarily excludes Plaintiff's losses. The virus exclusion states that Sentinel will not pay for loss or damage caused directly or indirectly by the presence, growth, proliferation, spread, or any activity of "fungi, wet rot, dry rot, bacteria or virus." (*Id*.). Denying coverage for losses stemming from COVID-19, however, does not logically align with the grouping of the virus exclusion with other pollutants such that the Policy necessarily anticipated and intended to deny coverage for these kinds of business losses. … Sentinel cites a number of cases which uphold similar virus exclusions … Importantly, none of the cases dealt with the unique circumstances of the effect COVID-19 has had on our society—a distinction this Court considers significant."); *Optical Services USA/JC1 v. Franklin Mutual Ins. Co.*, No. BER-L-3681-20 (N.J. Super. Ct. Bergen Cty. Aug. 13, 2020) (Oral Transcript) ("[T]his Court reaches the inevitable conclusion solely for purposes of disposition of this Motion that the plaintiff should be afforded the opportunity to develop their case and prove before this Court that the event of the COVID-19 closure may be a covered event under the Coverage C, Loss of Income, when occupancy of the described premises is prohibited by civil authorities. There is an interesting argument made before this Court that physical damage occurs where a policy holder loses functionality of their property and by operation of civil authority such as the entry of an executive order results in a change to the property.")

[3] Proposals for regional and state-based MDLs have also been rejected. *Id.* The Panel more recently determined that insurer-specific MDLs with respect to the claims against Certain Underwriters at Lloyd's, London, The Cincinnati Insurance Company (and its affiliates), The Hartford Financial Services Group, Inc. and The Travelers Companies, Inc. would not be efficient. *In Re: Certain Underwriters at Lloyd's, London COVID-19 Business Interruption Protection Insurance Litigation*, MDL No. 2961, 2020 WL 5887416 (U.S. Jud. Pan. Mult. Lit., October 2, 2020); *In Re: Cincinnati Insurance Company COVID-19 Business Interruption Protection Insurance Litigation*, MDL No. 2962, 2020 WL 5884791 (U.S. Jud. Pan. Mult. Lit., October 2, 2020); *In Re: Hartford COVID-19 Business Interruption Protection Insurance Litigation*, MDL No. 2963, 2020 WL 5884782 (U.S. Jud. Pan. Mult. Lit. October 2, 2020); *In Re: Travelers COVID-19 Business Interruption Protection Insurance Litigation*, MDL No. 2965, 2020 WL 588478 (U.S. Jud. Pan. Mult. Lit. October 2, 2020). The Panel did, however, determine that the actions against Society Insurance Company "presents a manageable controversy that can best be streamlined by proceeding before a single judge." *In Re: Society Insurance Company COVID-19 Business Interruption Protection Insurance Litigation*, MDL No. 2964 (U.S. Jud. Pan. Mult. Lit. October 2, 2020).

[4] A chart listing the legislative proposals and their current status is annexed hereto.

provisions requiring that business interruption be caused by "physical damage" and/or deem COVID-19 losses to have been caused by "physical damage" or otherwise covered. The effect of the proposed legislation is typically limited within the bills to the duration of the emergency declared by the state.

Certain bills would also specifically invalidate any otherwise applicable exclusion(s), including the "virus exclusion", with respect to COVID-19 first-party property claims.[5] While other proposals do not address exclusions by name, most, and perhaps all, courts construing the legislation in question would likely conclude that the legislature intended to require insurers to provide coverage, irrespective of any applicable exclusions. Some of the pending bills are limited in scope to small and mid-size businesses and some provide a mechanism for insurer reimbursement funded with a surcharge against the insurers based on net written premiums.

Four bills related to business income insurance have been introduced in the United States House of Representatives, all of which have been referred to the House Committee on Financial Services. Like many of the bills introduced in state legislatures, H.R. 6494, the "Business Interruption Insurance Coverage Act of 2020," would require insurers to provide coverage—under policies in force as of the date the legislation goes into effect—for "any viral pandemic," "any forced closure of businesses", and "any power shut-off conducted for public safety purposes." Any exclusions to the contrary are to be deemed void under the bill, although they can be reinstated with the consent of the insured or if the insured fails to pay any increased premium, subject to certain conditions.

The "Never Again Small Business Protection Act of 2020," H.R. 6497, would require insurers to offer optional additional business interruption insurance for losses resulting from governmental orders requiring cessation of operations during a national emergency. The bill also calls for a study to determine the feasibility of creating a Federal reinsurance backstop for insurers providing this additional coverage. H.R. 7011 (the "Pandemic Risk Insurance Act of 2020") and HR 7412 (the "Business Interruption Relief Act of 2020") would establish voluntary programs through which insurers would pay COVID-related business interruption claims, which would be reinsured through a Federal backstop.[6]

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[5] The proposed California legislation would not override the virus exclusion, but provides that COVID-19 cannot be considered a "pollutant" or "contaminant" for purposes of any exclusion.

[6] The insurance departments of several states issued post-pandemic guidance regarding business interruption insurance. For example, the West Virginia Insurance Commissioner's Bulletin 20-08 (March 27, 2020) states: "Business interruption coverage is typically triggered under a commercial insurance policy when a ***covered risk*** causes ***direct physical loss or damage*** to the insured's or policyholder's premises resulting in the need to shut down business operations. … Perils that are not listed or described in the policy, or that are specifically excluded in the policy, are generally not covered. These excluded perils are typically risks that are too great to be underwritten at an affordable price. For example, insurance policies generally contain exclusions for loss or damage caused by war, nuclear accident and radiation. The potential loss costs from such perils are so great that providing coverage would jeopardize the financial solvency of insurers and many businesses could not afford the premium costs to cover such catastrophic events even if they were covered perils. Global pandemics like COVID-19 usually fall into this category of risks or perils that are not covered. Business interruption policies were generally not designed or priced to provide coverage against communicable diseases, such as COVID-19, and therefore usually include exclusions for that risk." (emphasis in original).

Insurer Response

The American Property and Casualty Insurance Association ("APCIA"), the National Association of Mutual Insurance Companies ("NAMIC"), and other industry groups have objected to proposed legislation that would force insurers to cover COVID-19 business interruption losses, irrespective of any policy provisions to the contrary. For example, a March 30, 2020 letter to Massachusetts Governor Charlie Baker from APCIA, NAMIC, and the Massachusetts Insurance Federation provides, in part, as follows:

> As devastating as the business losses caused by the pandemic are, they are not covered under business interruption insurance. The claims do not meet the initial requirement of being related to physical damage of the insured premises and, perhaps more important, the virus exclusion would apply, meaning there is no coverage under the insurance contract for any loss or damage caused by the COVID-19 virus.
>
> SD 2888 would essentially rewrite existing insurance contracts by retroactively mandating coverage for exposures that had not been contemplated by insurers, properly priced nor paid for by the policyholders. This is unprecedented. We have not seen legislation or regulation to change insured perils after the fact before; not after Hurricane Andrew, 9/11, Hurricane Katrina, Deepwater Horizon, N1H1, the Boston Marathon attack, California Wildfires or Superstorm Sandy. Such a change would profoundly upset the insurance marketplace in the Commonwealth and elsewhere.
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> ***Catastrophic Financial Impact***. Whether mandated business interruption coverage is retroactive or prospectively applied, it will cause catastrophic financial harm for the property casualty insurance industry. Many Massachusetts domestic insurers that write commercial property coverages would likely become insolvent, perhaps in a matter of months, if forced to pay business interruption claims arising out of the COVID-19 pandemic. An analysis prepared by APCIA estimates that the total cost of business interruption claims for property casualty insurers in Massachusetts would range from ***$3 - $7billion per month!***

An April 6, 2020 APCIA statement "estimates that closure losses just for the small businesses with 100 or fewer employees has increased to $255 billion to $431 billion per month. These numbers dwarf the annual premiums for all commercial property risks in the key insurance lines of $71 billion per year, or about $6 billion a month." APCIA has also observed that the total surplus for all of U.S. insurers is $800 billion. As a result, the proposed legislation could create a solvency issue for the entire insurance industry. [7]

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[7] A March 25, 2020 statement from the National Association of Insurance Commissioners observed: "[W]e would caution against and oppose proposals that would require insurers to retroactively pay unfunded COVID-19 business interruption claims that insurance policies do not currently cover….Business interruption policies were generally not designed or priced to provide coverage against communicable diseases, such as COVID-19 and therefore include exclusions for that risk.… While the U.S. insurance sector remains strong, if insurance companies are required

In fact, insurers have offered more than objections to the proposed legislation. APCIA, NAMIC and the Independent Insurance Agents & Brokers of America have proposed creation of a Business Continuity Protection Program ("BCPP"). The BCPP would be run by the Federal Emergency Management Agency ("FEMA"), with limited administrative assistance from private contractors. The BCPP would provide business revenue replacement assistance—purchased through state-regulated insurance entities that participate on a voluntary basis—that would reimburse up to 80 percent of payroll, benefits, and expenses for three months. Businesses would certify that all funds received are used to retain employees and pay necessary operating expenses and that they will follow applicable federal pandemic guidance.[8] Relief would be automatically triggered following a federally declared public health emergency.

The Proposed Legislation Would Violate the Contracts Clause

Article 1, Section 10 of the United States Constitution (commonly referred to as the "Contracts Clause") provides that "No State shall … pass any ex post facto Law, or Law impairing the Obligation of Contracts …" Much of the proposed legislation seeking to compel business interruption coverage—if enacted—would indisputably "impair" and alter existing contracts of insurance between insurers and their policyholders. That alone will not, however, establish a violation of the Contracts Clause. The Supreme Court has articulated a two-part test to determine whether a violation exists:

> The threshold issue is whether the state law has "operated as a substantial impairment of a contractual relationship." In answering that question, the Court has considered the extent to which the law undermines the contractual bargain, interferes with a party's reasonable expectations, and prevents the party from safeguarding or reinstating his rights. If such factors show a substantial impairment, the inquiry turns to the means and ends of the legislation. In particular, the Court has asked whether the state law is drawn in an "appropriate" and "reasonable" way to advance "a significant and legitimate public purpose."

Sveen v. Melin, 138 S. Ct. 1815, 1821-22 (2018) (citations omitted). The severity of the impairment informs the second step of the analysis:

> The severity of the impairment measures the height of the hurdle the state legislation must clear. Minimal alteration of contractual obligations may end the inquiry at its first stage. Severe impairment, on the other hand, will push the inquiry to a careful examination of the nature and purpose of the state legislation."

Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 245 (1978).

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to cover such claims, such an action would create substantial solvency risks for the sector, significantly undermine the ability of insurers to pay other types of claims, and potentially exacerbate the negative financial and economic impacts the country is currently experiencing."

[8] A similar approach is evident in the Paycheck Protection Program administered by the Small Business Administration.

The Supreme Court has also held that a state's ability to enact legislation affecting contracts may be greater with respect to industries that are already subject to extensive state regulation. *Veix v. Sixth Ward Bldg. & Loan Ass'n of Newark,* 310 U.S. 32, 38 (1940) ("When he purchased into an enterprise already regulated in the particular to which he now objects, he purchased subject to further legislation upon the same topic"); *see also Hudson County Water Co. v. McCarter,* 209 U.S. 349, 357 (1908) ("One whose rights, such as they are, are subject to state restriction, cannot remove them from the power of the State by making a contract about them."). Regulation and impairment are not, however, mutually exclusive. *Toledo Area AFL-CIO Council v. Pizza*, 154 F.3d 307, 324 (6th Cir. 1998) ("The substantiality of an impairment is not discounted simply because the affected contract provision is in some way connected to a previously regulated area. Rather, prior regulation of a field mitigates the substantiality of an impairment only to the extent that it opens a contracting party's eyes to the prospect of changes in the existing regulations or to new regulations that may affect the value of negotiated terms in the contract").

a. The Proposed Legislation Would Substantially Impair Insurers' Contractual Rights

Much of the proposed legislation would clearly impair insurers' contractual rights by rewriting thousands of insurance policies, which would force insurers to provide coverage that was neither bargained for nor paid for. Policyholders might nonetheless argue that the legislation would not result in a "substantial impairment" since: a) insurance is already subject to extensive state regulation that affects policy language, coverage and pricing; b) the additional risk is within the general scope of coverage and c) affected insurers will be able to recoup their losses.

The Supreme Court's most recent decision on "substantial impairment" arose in the life insurance context. At issue in *Sveen, supra*, was a Minnesota statute which automatically revoked the designation of a spouse as a life insurance beneficiary upon divorce. *Sveen*, 138 S. Ct. at 1821-22. The plaintiff was designated as the beneficiary of a life insurance policy purchased by the decedent prior to their divorce and prior to the enactment of the statute. The decedent's children were deemed beneficiaries upon the decedent's passing due to the revocation statute. The plaintiff argued that the statute was unconstitutional, as it retroactively and substantially impaired her rights under the life insurance contract. The Supreme Court disagreed:

> First, the law is designed to reflect a policyholder's intent—and so to support, rather than impair, the contractual scheme. It applies a prevalent legislative presumption that a divorcee would not want his former partner to benefit from his life insurance policy and other will substitutes. Thus, the law often honors, not undermines, the intent of the only contracting party to care about the beneficiary term. Second, the law is unlikely to disturb any policyholder's expectations at the time of contracting, because an insured cannot reasonably rely on a beneficiary designation staying in place after a divorce. Divorce courts have wide discretion to divide property upon dissolution of a marriage, including by revoking spousal beneficiary designations in life insurance policies or by mandating that such designations remain. Because a life insurance purchaser cannot know what will happen to that policy in the event of a divorce, his reliance interests are next to nil. And that fact cuts against providing protection under the Contracts Clause. Last, the law supplies a mere default rule, which the policyholder can undo in a moment. If the law's presumption

> about what an insured wants after divorcing is wrong, the insured may overthrow it simply by sending a change-of-beneficiary form to his insurer.

Id. at 1821-22.

As evident in *Sveen* and the cases described below, whether the impairment of rights under or connected to an insurance policy is "substantial" is a case-specific inquiry. *Compare Leg. Asset Funding, LLC v. Travelers Cas. & Sur. Co.*, 155 F. Supp. 2d 90 (D.N.J. 2001) (law regulating transfer of structured settlement payment rights did not substantially impair parties' contractual rights); *Liberty Mut. Ins. Co. v. Texas Dept. of Ins.*, 187 S.W.3d 808 (Tex. App. 2006) (Texas Department of Insurance rule requiring insurers to pay surpluses to policyholders did not deprive insurers of contractual rights; "the Liberty companies did not have a vested right to retain the surpluses. Without a vested right, there could be no impermissible impairment of the Liberty companies' contractual rights under the federal or the Texas Constitutions.") *with Anderson Bros., Inc. v. St. Paul Fire & Marine Ins. Co.*, 729 F.3d 923, 936 (9th Cir. 2013) (definition of the term "suit" in Oregon Environmental Cleanup Assistance Act did not violate Contracts Clause; "[a]bsent OECAA, we would simply construe the [term] against St. Paul as required by Oregon common law"); *Vesta Fire Ins. Corp. v. State of Fla.*, 141 F.3d 1427 (11th Cir. 1998) ("Plaintiffs make a sufficient showing that the Florida legislation substantially impaired the contracts between the insurance companies and their insureds….Plaintiffs are forced to continue contractual relationships that otherwise, pursuant to the terms of the contracts, could be rightfully terminated); *Universal Ins. Co. v. Dept. of J.*, 866 F. Supp. 2d 49 (D.P.R. 2012), *on reconsideration in part* (June 22, 2012) (statute that prevented insurers from exercising subrogation rights by eliminating their ability challenging vehicle forfeitures on their own behalf could represent a significant impairment of contractual rights—"[w]hile it may be true that states have broad authority to regulate the insurance industry, [the law] is a civil forfeiture statute and the purpose of the statute has nothing to do with the regulation of the insurance industry. The particular type of regulation must still be foreseeable."); *State v. All Prop. and Cas. Ins. Carriers Authorized and Licensed To Do Bus. In State*, 937 So. 2d 313, 325 (La. 2006) (laws which altered the contractual provisions of insurance policies regarding the time period in which to bring a claim in the wake of Hurricanes Rita and Katrina substantially impaired insurers' contractual rights); *Hellinger v. Farmers Group, Inc.*, 91 Cal.App.4th 1049, 1066 (2001) (Statute that revived certain claims arising out of the Northridge earthquake that otherwise were time-barred did not violate Contracts Clause; "[w]e agree that reviving contract-barred claims constitutes an impairment of contract. But the impairment goes to the remedy for a breach of the insurance contract, rather than to its core provisions. Insurers will still have available all applicable defenses to such revived claims other than the limitations defense.").

The above cases suggest proposed legislation that forces insurers to pay uncovered losses would "undermine[] the contractual bargain, interferes with [the insurer's] reasonable expectations, and prevents the [insurer] from safeguarding or reinstating [its] rights." *Sveen*, 138 S. Ct. at 1821-22; *see also Allied*, 438 U.S. at 245 (finding that Minnesota Private Pension Benefits Protection Act, which obligated Allied to pay a pension funding charge for employees without vested pension rights, "nullified[d] express terms of the company's contractual obligations and impose[d] a completely unexpected liability in potentially disabling amounts.").

Insurers may therefore be able to establish a "substantial impairment" of contractual rights if the proposed legislation is enacted.

b. The Proposed Legislation Is Not an Appropriate and Reasonable Means to Advance a Significant and Legitimate Public Purpose

Saving thousands of small businesses is indisputably a noble cause and in the public interest. While invalidating contractual provisions and forcing insurers to pay uncovered claims is neither appropriate nor a reasonable response to the economic harm caused by coronavirus, courts have sometimes given legislatures significant latitude to alter insurance policies in response to emergent situations.

For example, a Florida statute enacted shortly after Hurricane Andrew preventing insurers from canceling or non-renewing a certain percentage of residential policies and compelling insurers to contribute to a reinsurance fund was held not to violate the Contracts Clause. The plaintiff insurers in *Vesta* argued that the subject legislation prevented them from withdrawing from the Florida market and violated, among other things, the Contracts Clause. *Vesta*, 141 F.3d at 1434. While the Eleventh Circuit recognized that the legislation significantly impaired the insurers' contractual rights, it held that Florida "demonstrated a legitimate public purpose: protection and stabilization of the Florida economy, particularly the real estate market." *Id.* (citations omitted). Since the State was not a party to the policies, the Court deferred to the legislature's judgment as to whether the steps taken to effect that public purpose were reasonable and necessary.

In *All Prop.*, the Louisiana Supreme Court rejected a Contracts Clause challenge to legislation that extended the insureds' time to bring claims resulting from damage caused by Hurricanes Rita and Katrina under policies issued before the storms, writing:

> While we find that the contractual obligations of the defendant insurers under the 2006 Acts may be substantially impaired, we also note the fact that state law has traditionally regulated insurance as a matter of public policy, even including the precise procedural mechanism for filing claims at issue herein. On balance…the impairments in these cases constitute more than minimal alteration of the insurers' contractual obligations and are therefore of constitutional dimension. However, we also find that the impairments constitute considerably less than total destruction of the insurers' contractual expectations. Consequently, when we inquire into the public purpose underlying the legislation, we will give considerable deference to the legislature's judgment.
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> ...
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> We have determined that, while of constitutional dimension, the substantial impairment is of the type that may be anticipated in this highly regulated industry. We note that the legislature's extension of the prescriptive period for filing claims in these types of insurance cases is limited in both time and scope. The prescriptive period is extended for only one additional year and is limited to certain types of claims arising out of damage caused by Hurricanes Katrina and Rita. Consequently, we find that the measures taken by the legislature in the enactment of the 2006 legislation at issue are both appropriate and reasonable in order to protect the rights of the citizens of Louisiana and their general welfare.

All Prop., 937 So. 2d at 323-27 (citations omitted).

Advocates of the proposed legislation will rely on both of these cases (as well as decisions upholding insurance laws and regulations enacted to respond to non-emergent situations and concerns). Nonetheless, insurers can argue that extending claim reporting deadlines and limiting non-renewals and cancellations are not analogous to the rewriting of insurance policies to provide coverage where none exists as suggested by advocates of much of the proposed legislation.

Proponents will also argue that the current crisis calls for insurers to "do their part" to address a worldwide emergency, most small business owners were unaware of the limitations of their business interruption coverage, insurers reasonably should have expected regulatory and legislative action in the wake of an emergency, and the insurers may be able to recoup some or all of their losses from an established fund. While legislatures can and should take steps to protect its residents from unexpected catastrophes, such concerns cannot justify the transfer of billions of dollars of uninsured losses to insurers in derogation of unambiguous, state-approved insurance contracts.

While insurers have strong Contract Clause arguments, the nature of the economic emergency caused by the pandemic may make courts loath to step into a public policy debate between insurers and the legislative branch. Courts may respond to insurer challenges by simply deferring to the legislatures. Courts may focus on the allegedly "narrowly drawn" nature of certain of the provisions (based on temporal limitations, as well as limitations as to the scope of impacted insureds in some of the proposed legislation) and compare those limitations to the magnitude of the economic crisis being addressed. Insurers must successfully demonstrate that the re-writing of private contracts and the possible economic demise of the insurance markets would harm policyholders, shareholders and the public. Insurers might not have the resources to pay legitimate claims. Certain coverages would become prohibitively expensive and perhaps unavailable. Responding to one economic crisis by creating another is simply not an appropriate or reasonable means to advance a significant and legitimate public purpose.

Indeed, insurers can and should argue that federal and state economic relief for business is the appropriate remedy. The scope of the losses caused by a pandemic call for the solution to be a governmental one. Insurance was not meant to solve a public policy problem of this magnitude, and, for these reasons, the legislation requiring insurers to pay uncovered business interruption claims is not an appropriate or reasonable means to respond to this economic and public health crisis.

The Proposed Legislation Would Result in an Improper "Taking" of Insurers' Property

The Fifth Amendment to the United States Constitution prohibits taking of private property without just compensation. Private property includes contractual rights, including rights under policies of insurance. *Lynch v. U.S.*, 292 U.S. 571, 579 (1934) ("The Fifth Amendment commands that property be not taken without making just compensation. Valid contracts are property, whether the obligor be a private individual, a municipality, a state, or the United States"). But "the fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an illegal taking." *Connolly v. Pension Ben. Guar. Corp.*, 475 U.S. 211, 224 (1986)

(citations omitted). The Supreme Court has "identified three factors which have 'particular significance': (1) 'the economic impact of the regulation on the claimant'; (2) 'the extent to which the regulation has interfered with distinct investment-backed expectations'; and (3) 'the character of the governmental action.'" *Id*. at 224-25 (citations omitted).

In *Vesta*, the plaintiff insurers also argued that a Florida statute that compelled insurers to renew or refrain from the cancellation of policies following Hurricane Andrew and pay into a reinsurance fund was a regulatory taking.[9] *Vesta*, 141 F.3d at 1431. The Court found issues of material fact with respect to each factor. First, the Court found that the record was insufficient to establish (or refute) the economic damage claimed by the insurers, including effect of future premium increases. *Id*. at 1431-32.

As to the second factor—the insurers' "investment-backed expectations"—the Court observed that "[i]interference with investment-backed expectations occurs when an inadequate history of similar government regulation exists: where the earlier regulation does not provide companies with sufficient notice that they may be subject to the new or additional regulation.…Plaintiffs contend that whatever regulation Plaintiffs may have anticipated when they entered the Florida market they could not anticipate that withdrawal from that market—should additional regulation become too burdensome—would be prohibited." *Id*. at 1432. The Court further observed:

> Plaintiffs contend that the compulsory nature of the legislation alone results in a taking; but all government regulation is compulsory in nature.…When important public interests are served, a taking is less likely to have occurred.
>
> No doubt can exist that the general regulation of insurance is within the State's police powers.…The moratorium was intended as a stabilizing force in the market and was within the State of Florida's police power. The government interest in this case was the public welfare of the residents of Florida. But the nature of the government interest and its importance, given all the circumstances, as well as the extent of the regulations' harsh impact on Plaintiffs' interests must be determined by the district court.

Id. at 1432-33.

Insurers will therefore need to develop detailed information regarding the economic impact of the proposed legislation as a prerequisite to a takings challenge, including the likely impact of any reimbursement claims and the impact on future premiums. Armed with that information, insurers can then argue that the proposed legislation is at odds with its reasonable and "distinct investment-backed expectations." While insurance is a heavily regulated industry, insurers can assert they could not have reasonably expected one or more states to order insurers to rewrite existing insurance contracts to provide coverage for uncovered claims, including claims that were specifically excluded by state-approved forms. Insurers have a solid basis to assert that legislation

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[9]The insurers also argued that "these statutes effect a government takeover of private insurance companies, resulting in *per se* takings." The Court rejected those arguments holding that "[t]his case does not present that kind of occupation or takeover, and it does not present a per se taking." *Vesta*, 141 F.3d at 1431.

that purports to delete or rewrite insurance contract terms is an unconstitutional taking, irrespective of the important governmental interest it was intended to serve.

Proponents will argue that the current economic emergency justifies an expansive exercise of state authority over insurers, which entered (and enjoyed the economic benefit of) their respective markets fully aware of the government's broad regulatory power. Accordingly, they will likely argue the proposed legislation is or should have been within the insurers' reasonable expectations and, while the economic impact will be significant in the short term, the insurers will recoup their losses through reimbursement claims and/or premium increases.

Any "takings" arguments—like challenges based on the Contracts Clause—will be made against the backdrop of economic damages and a pandemic that may become far worse during the coming months. As noted above, courts may give deference to legislatures as to how they may craft a public policy response to a system-wide economic collapse of small businesses.

The Proposed Legislation Would Violate Insurers' Right to Due Process

Most of the proposed legislation will impose a retroactive burden on insurers to pay benefits that were not bargained for or paid for at the time of contracting. It is well-recognized that retroactive legislation "presents problems of unfairness that are more serious than those posed by prospective legislation, because it can deprive citizens of legitimate expectations and upset settled transactions." *General Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992). Yet, while "[r]etroactivity is generally disfavored in the law," *E. Enterprises v. Apfel*, 524 U.S. 498, 532 (1998), retroactive civil economic legislation may violate the Due Process Clause only if it "particularly 'harsh and oppressive.'" *Welch v. Henry*, 305 U.S. 134, 147 (1938). Indeed, courts apply less searching standards to Due Process Clause challenges to economic legislation than even those limitations imposed on States by the Contract Clause. *Pension Ben. Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 732–33 (1984).

The standard that the retroactive aspects of economic legislation must meet to satisfy due process is not stringent: a legitimate legislative purpose furthered by rational means. *See Romein,* 503 U.S. at 182. "To put it another way, although the burden of justification is greater for legislation that operates retrospectively than for legislation having only future effects, 'that burden is met simply by showing that the retroactive application of the legislation is itself justified by a rational legislative purpose.'" *Liberty Mut. Ins. Co. v. Whitehouse*, 868 F. Supp. 425, 434 (D.R.I. 1994) (quoting *Pension Ben. Guar. Corp.* 467 U.S. at 730).

In the end, while courts will seek to balance the competing private and public interests at stake when the state seeks to adjust existing contractual relationships, the scales often tip in favor of deference to the public interests and the police powers of the state. *See Serrano v. Aetna Ins. Co.*, 664 A.2d 279, 284 (Conn. 1995) (taking into account the state's pervasive and longstanding regulation of the insurance industry to find that retroactive modification of the uninsured and underinsured motorist provisions of certain automobile liability insurance policies was neither arbitrary nor irrational and, accordingly, fully satisfied the requirements of due process); *see also Am. Econ. Ins. Co. v. State*, 87 N.E.3d 126 (N.Y. 2017) (any retroactive impact caused by amendment to Workers' Compensation Law that imposed unfunded liability costs on workers' compensation insurers for reopened claims with respect to policies issued prior to amendment was

justified by rational legislative purpose of providing financial relief to employers). *But see, e.g., Bay Farms Corp. v. Great Am. All. Ins. Co*., 835 F. Supp. 2d 1227 (M.D. Fla. 2011) (under Florida law, a statutory amendment providing a definition of "structural damage" could not be applied retroactively because the insured had a vested right to coverage).

The Due Process Clause is therefore an appropriate part of any constitutional challenge to much of the proposed legislation due to the substantial and retroactive burden that would be placed on insurers. That said, the Contracts Clause and Takings Clause arguments represent stronger challenges to the proposed legislation than those presented under the Due Process Clause. The courts will deem due process satisfied unless insurers can establish that particular legislation imposes an overly harsh and irrational regulatory scheme upon insurers. Insurers will have to demonstrate that the re-writing of private contracts and the significant, adverse and unfair economic impact on the insurance industry will do just that.

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Insurers can raise significant constitutional challenges to any law which purports to rewrite the terms of existing insurance policies so as to force the payment of uncovered losses. Federal and state legislators will also hopefully recognize that any attempt to nullify clear and unambiguous coverage limitations in existing insurance contracts in the name of COVID-19 would cause irreparable economic damage. As Stefan Holzberger, chief rating officer at AM Best Rating Services has observed, "legislation forcing insurers to pay for unintended business interruption losses would have a destructive impact on the industry's financial strength and affects its ability to fulfill policyholders' interests. In the long term, retroactive coverage could affect pricing, availability of insurance and confidence in underwriting." *Best's Commentary*: "Two Months of Retroactive Business Interruption Coverage Could Wipe Out Half of Insurers' Capital," May 5, 2020. Any short-term benefit to businesses—large or small—would be dwarfed by the turmoil and instability to the insurance marketplace that would result from forcing insurers to retroactively pay for uncovered business interruption losses.

The current status of the proposed legislation suggests that these arguments have already resonated with many lawmakers, who are hopefully considering the BCPP and other alternative ways to protect businesses from pandemic-related income losses.

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