



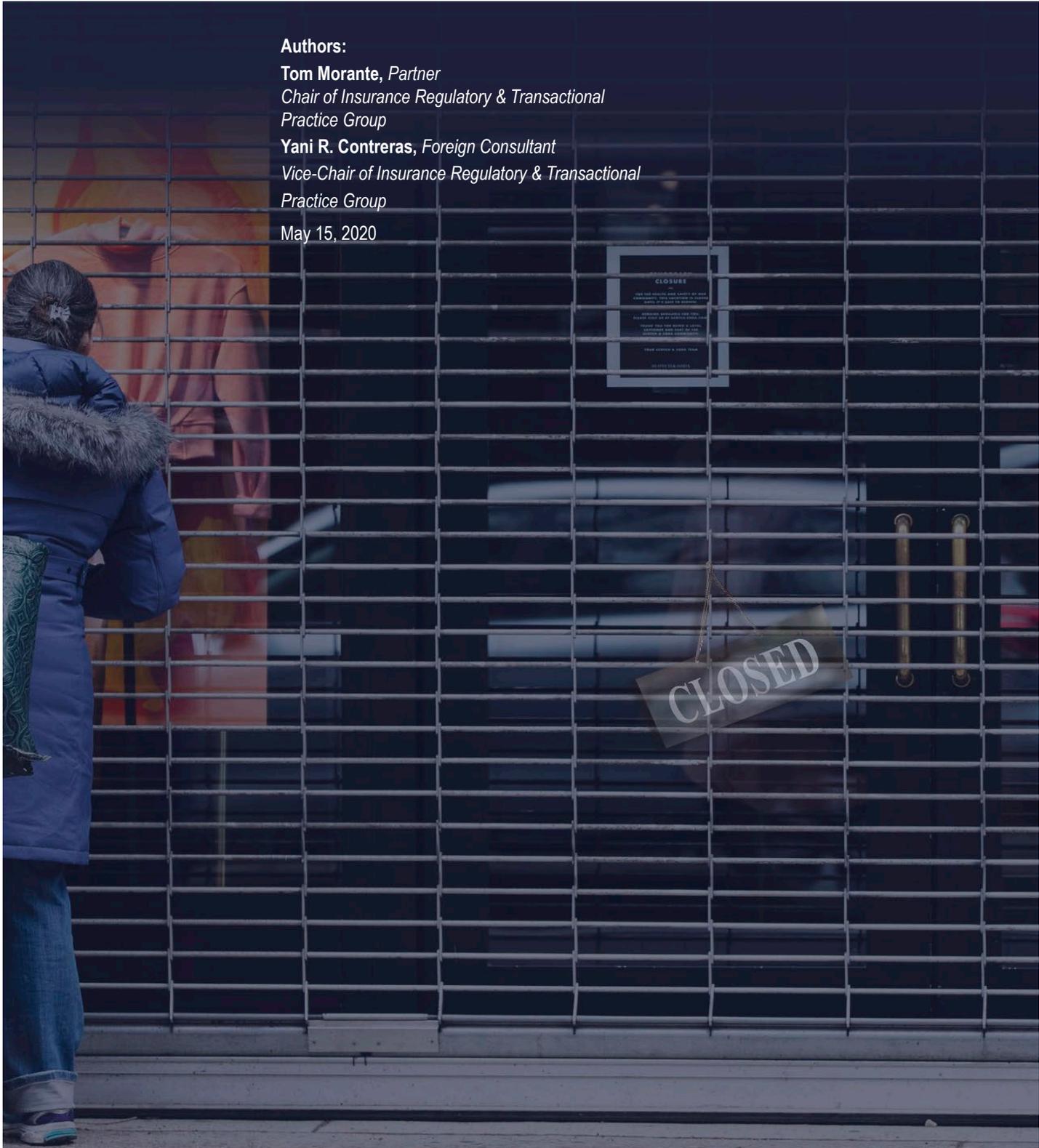
# Business Interruption Coverage: Proposed Legislative Initiatives

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## Business Interruption Coverage: Proposed Legislative Initiatives

### Introduction

Business interruption coverage, typically found in commercial property insurance policies, is designed to cover “actual” loss of business income for a period of time after a loss has occurred. Most business interruption provisions require direct physical loss or damage to property insured under the policy as a prerequisite to business interruption coverage, which usually triggers the period of restoration (most often defined as the length of time required with the exercise of due diligence and dispatch to rebuild, repair or replace the damaged premises). The coverage generally also requires an “interruption” or “suspension” of operations during the period of restoration. Where a suspension of business operations is not caused by direct physical loss or damage, the courts have generally held that there is no business interruption coverage. This then raises the question of whether COVID-19 as a global pandemic, would trigger coverage under a business interruption policy.

Civil authority coverage arising under a business interruption policy is an extension to business interruption coverage which provides indemnity for the actual loss of business income and extra expense incurred as a result of actions of civil or military authority that prohibit or, in some instances, impair access to the insured’s property due to direct physical loss or damage to a different property. Many civil authority provisions do not require the physical loss or damage to be at or even near the insured’s property to implicate the civil authority coverage, as long as other requirements are met. However, damage to an insured’s property is required when the civil authority provision states that the order of civil authority must be caused by physical loss or damage to insured property. In addition, civil authority provisions usually require a “prohibition” of access to insured property, meaning that there must be an order that actually prohibits access to insured property in the nature of a complete and specific cordoning off. Policy language, therefore, is key to appreciating the availability of business interruption coverage under civil authority.

### The State and Federal Legislative Response

Legal challenges to coverage were initiated in earnest once the COVID-19 pandemic began to heat up, and litigation has surfaced regarding the extent of coverage under business interruption provisions. The battle, in simple terms, is between two arguments: loss due to physical damage to premises vs. loss resulting from lockdown orders affecting non-essential businesses. In light of coverage denials and recognizing the “going concern” challenges companies face, many businesses have sought relief in some form from their state legislatures. As a consequence, several states have proposed legislation which attempts to require policies of insurance to be construed to include “global virus transmission or pandemic” as a covered peril, which could potentially contradict typical property policies which require “direct physical loss or damage to covered property” to trigger coverage.

In light of the foregoing, the legislatures of New Jersey (A.3844), Massachusetts (S.D. 2888), New York (A.10226), Louisiana (HB. 858), Pennsylvania (SB. 1114), South Carolina (SB. 1118), and Ohio (H.B.589), among others, are considering bills on business interruption insurance coverage. The proposed bills are designed to encourage or require insurers to cover, either temporarily or permanently, COVID-19 business interruption claims to thus reduce the financial impact on businesses.

If adopted, the proposed laws would essentially amend the terms of property policies that otherwise expressly exclude coverage for losses due to viruses or bacteria. Some proposed bills would enable insurers to request reimbursement from their states for payments under these amended business interruption provisions, pursuant to which the states could then impose a surcharge on all insurers in the state offering business interruption coverage (akin to a guaranty fund.) Inevitably, this charge could eventually find its way into increased premiums in the future.



Under the proposed bills, the insured would be indemnified under policies that were issued before the declaration of a state emergency by the specific state, for any loss of business or business interruption starting on the date of the declared emergency. Several of the bills are similar, in that coverage would only be available to insureds with less than 100 full-time employees, although in Massachusetts, the proposed bill would cover insureds with up to 150 full-time employees.

The bills in New Jersey, Massachusetts, New York and Ohio further provide that insurers paying these expanded claims would be entitled to apply for reimbursement to the state insurance departments in those states. These states would secure the funding for reimbursement by charging domestic and foreign insurers issuing business interruption insurance coverage in those states, with assessments. The assessments would be charged to those insurance carriers in order to provide a backstop to enable recovery regarding the costs of the claims. Assessments would be in proportion to net written premiums received by each company for insurance written or renewed on risks in the state during the calendar year immediately preceding the effective date of the bill.



In light of the potential claims that could arise relating to business interruption in New York, the Department of Financial Services (DFS) has required licensed insurers to report the volume of business interruption, civil authority, contingent business interruption and supply chain coverages that the insurer has written and that has not lapsed as of March 10, 2020. In addition, the DFS has demanded that insurers prepare a clear explanation of benefits relating to coverage each policy offers relating COVID-19. The DFS website provides some general information about business interruption insurance explaining that the business interruption insurance policy should list or describe the types of events that are covered. The website further explains that business interruption coverage can only be triggered if property loss lead to the business interruption.

These state proposed laws would likely be subject to constitutional challenges and significant litigation by insurance carriers. A retroactive modification of an insurance contract would challenge the “Contracts Clause” of the U.S. Constitution, for example, which prohibits interference with such contract rights on a retroactive basis absent a legitimate public purpose where impairment is invoked for a public purpose and is appropriate in that context. Historically, the Contracts Clause has been relied on to support an argument that states do not have the power to retroactively modify or impair contracts. There may also be Due Process Clause arguments predicated on the need for any retroactive impairment to accommodate legitimate state interests.

A counter argument arising is that the proposed legislative initiatives would be consistent with the reservation of police power to the states under the U.S. Constitution, such that states can exercise their broad regulatory powers even if private contracts would be impaired. What constitutes impairment and how much interference with contractual arrangements would be permissible, as well as whether sovereign immunity defenses would be available for governments or state officials or whether a particular party has “standing” to file a lawsuit to enjoin legislation after it is passed, is beyond the scope of this paper, but policyholder creativity is inevitable in this regard. A further counter argument that may arise would be with respect to insurance contract language requiring modification of policy terms in the event state laws change resulting in a conflict with provisions in the policy.



There are other alternatives being explored. As legislators move to retroactively create coverage, insurance industry have taken the position that business interruption coverage does not and is not “designed to, provide coverage against communicable diseases such as COVID-19.” When asked about the proposed legislature, the National Association of Mutual Insurers (NAMIC) stated that “retroactively requiring contractual changes for which no premium was collected is a dangerous, unprecedented and unconstitutional proposal that NAMIC emphatically opposes.” The National Council of Insurance Legislators (NCOIL) has reached out to all members of the U.S. House Committee on Financial Services to suggest a congressional act creating a COVID-19 Business Interruption & Cancellation Claims Fund (COVID Claims Fund) which would ensure that insurers’ current reserves are not put at risk.

In addition, the Reinsurance Association of America (RAA) joined by the American Property Casualty Insurance Association (APCIA) and other industry trade associations has asked Congress to support the COVID-19 Business and Employee Continuity and Recovery Fund, a federally funded program, envisioned by both the insurance and retail sectors, to help preserve jobs and employee benefits.

There is also discussion in Congress with respect to amending the Terrorism Risk Insurance Act (TRIA) to include coverage for pandemics along with risks associated with virus, communicable disease and quarantines, as well as consideration of a proposal to consider crafting a Pandemic Risk Insurance Act (PRIA) to “...“create a reinsurance program similar to [TRIA] for pandemics, by capping the total insurance losses that insurance companies would face.” Such a federal program might encourage insurers to write business interruption coverage going forward, but pricing this risk likely would pose a challenge given lack of historical data on pandemics, and the calculation as to the amount of reinsurance premiums insurers would need to pay to the federal government, would be difficult to determine. The higher the reinsurance premium, the more insurers would need to pass this cost on to insureds, thus pricing business interruption coverage for pandemics perhaps beyond acceptable levels among consumers.

In addition, on April 14, 2020, two additional bills were introduced in the U.S. House of Representatives: (i) HR 6494 (the “Business Interruption Insurance Coverage Act of 2020” or BIICA); and (ii) HR 6497 (the “Never Again Small Business Protection Act of 2020” or NASBPA), requiring that insurers make available, business interruption coverage for losses due to pandemics, forced business closures, and other emergencies.

BIICA requires “each insurer that offers or makes available business interruption insurance coverage” to “make available, in all of its policies, coverage for losses resulting from “any viral pandemic”; “any forced closure of business, or mandatory evacuation, by law or order of any government”; or “any power shut-off conducted for public safety purposes”. BIICA does not specifically tie in such losses to COVID-19. BIICA also renders “void” existing exclusions for losses resulting from the specific perils (i.e., losses resulting from “any viral pandemic”), and “preempts” any State approval of such exclusions.

BIICA provides for “reinstatement” of exclusions otherwise rendered void, under two circumstances. First, the insured may, in writing, affirmatively authorize its insurer to “reinstatement” the exclusions. Second, after providing notice that the insurer intends to “reinstatement” the exclusions or increase the premium for coverage afforded consistent with coverage for coronavirus-related damages and the insured fails to pay such increased premium, the insurer may “reinstatement” the exclusions. BIICA has been referred to the House Committee on Financial Services.

NASBPA would also require the Federal Advisory Committee on Insurance to study whether there should be a federal backstop to reinsure insurers for excessive business interruption losses.

Forcing insurers to provide retroactive business interruption coverage under the proposed state laws, arguably could impact the financial stability of the insurance industry, and the repercussions of such measures might likewise adversely affect the reinsurance industry, particularly if insurers, in the face of negative publicity or threat of legislative action, interpret their business interruption coverage and exclusions thereunder favorably to insureds. In response to COVID-19, insurance companies are working with policyholders on flexibility in premium payments as well as with respect to charitable relief efforts. Insurers are also lobbying on behalf of federal assistance to provide funding to those individuals and businesses most in need.



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