CONSTITUTIONAL LIMITS ON RETROACTIVELY EXPANDING INSURANCE COVERAGE FOR LOSSES RELATED TO COVID-19

Robert N. Weiner
ARNOLD & PORTER
601 Massachusetts Avenue, NW
Washington, D.C. 20001
(202) 942-5000

John Terzaken
Abram J. Ellis
Bryce L. Friedman
SIMPSON THACHER & BARTLETT LLP
900 G Street, NW
Washington, D.C. 20001
(202) 636-5500

May 3, 2020

Proposed Retroactive Business Interruption Coverage Legislation in Washington, D.C.

1. Summary

On May 5, 2020, the Council of the District of Columbia is expected to consider passing legislation entitled the "Coronavirus Omnibus Emergency Amendment Act of 2020." Section 2 of the Act would require insurers to cover businesses with fewer than 250 full-time employees for business interruption during the state of emergency declared in connection with the COVID-19 pandemic, subject to reimbursement at some indefinite time via an assessment levied against those same insurers. This proposed legislation appears to follow the model of New Jersey Bill A-3844, introduced on March 16, 2020, but goes even farther than the New Jersey bill in nullifying contracts on which parties relied. Neither New Jersey Bill A-3844 nor any other comparable legislation has been passed into law.

It is undisputed that the economic hardship imposed on businesses, both in Washington, D.C., and nationwide, as a result of the ongoing COVID-19 pandemic, calls out for legislative solutions. However, this proposed legislation would most likely be unconstitutional under federal law and should not be enacted. It imposes massive liability on the insurance industry for a risk insurers explicitly did not assume and in most cases specifically excluded from risks covered by their contracts of insurance. Under Supreme Court precedent, legislative solutions to social problems cannot "single out certain [parties] to bear a burden that is substantial in amount ... and unrelated to any commitment that [those parties] made or to any injury they caused."[1] Such legislation contravenes "fundamental principles of fairness" embedded in the Due Process, Takings, and Contracts Clauses of the federal Constitution.

2. Background

Commercial property insurance policies that include business interruption ("BI") coverage generally are not intended to cover disease- or pandemic-related losses. First, policies typically require "direct physical loss of or damage to property," such as from fire or wind damage, to trigger coverage. Where business interruptions arise from decreased economic activity as a result of a virus or preventative public safety measures enacted to mitigate transmission, no direct physical loss or damage has occurred that triggers coverage.

Moreover, since 2006, commercial property policies have often included virus, bacteria, and contamination exclusions. The virus and bacteria exclusions preclude coverage 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." This exclusion was submitted to regulators, including the District's Department of Insurance, Securities and Banking, by the Insurance Services Office (ISO) in 2006 and adopted by the industry following regulatory approval.[2] The exclusion is drafted so as to apply to all coverage, including forms or endorsements that cover "property damage … business income, extra expense, or action of civil authority." In explaining the concerns that motivated the drafting of the Virus Exclusion, ISO specifically referenced the "specter of pandemic."

By retroactively creating BI coverage "notwithstanding the terms of any policy of insurance subject to this section (including any endorsement thereto or exclusions to coverage

---

1 *Eastern Enterprises v. Apfel*, 524 U.S. 498, 537 (1998) (plurality op.).

2 *See* ISO form CP 01 75 07 06 (Exclusion Of Loss Due To Virus Or Bacteria).

included therewith)" and stating that insurers may not deny claims on the basis of "[l]osses arising from actions an insured takes in response to a Mayor's Order issued during a Public Health Emergency" or "there being no physical damage to the property of the insured or to any other relevant property," the proposed legislation imposes a massive financial obligation on property and casualty insurers for an essentially uninsurable risk that they specifically foresaw and determined not to include among the risks for which they were willing and able to provide coverage. Losses that result from a pandemic cannot be underwritten affordably for small businesses, because those losses are not spread out over time across a subset of policyholders (like losses from fire damage) but instead have a widespread impact on a substantial percentage of all policyholders all at the same time. Standard form policies also generally exclude loss resulting from nuclear disasters and terrorism for similar reasons. The price that businesses paid for their insurance reflected this exclusion.

Preliminary analysis recently conducted by the American Property Casualty Insurance Association (APCIA) currently estimates Washington, D.C. COVID-19-related BI losses for businesses with fewer than 250 employees – should coverage be mandated – in the range of $300 million to $1.1 billion per month. By comparison, total monthly commercial property written premiums in the District of Columbia amount to only $16 million, of which business interruption premiums constitute a small fraction. Nationwide, APCIA estimates these types of losses for businesses with fewer than 100 employees – the threshold for coverage in the New Jersey draft bill and several others – to range from $52-$223 billion per month for those with BI coverage and $255-$431 billion per month for those with or without BI coverage. APCIA estimates the total property casualty industry surplus, for companies of all sizes, is currently about $800 billion to protect auto, home, and business policyholders for all types of future insured losses.

In sum, if enacted, the proposed legislation would retroactively impose massive liability on insurers for coverage policyholders did not purchase, and for which insurers did not collect premiums or set aside reserves. The magnitude of this liability could render insurers financially incapable of making timely payment on covered claims. If similar legislation were enacted in more than one jurisdiction, the financial burden could pose a significant threat to insurers' solvency. No reimbursement from an assessment levied against insurers would be sufficient to address the widespread threat of insurer solvency even if it were collectable, which is far from certain. Property and casualty insurers would be unable to continue their important role in risk transfer going forward, thereby impeding the recovery of the District's economy from the economic impact of the COVID-19 pandemic.

3. Analysis

Legislation like the proposed bill that seeks to retroactively impose liabilities on specific private parties is subject to greater constitutional scrutiny than typical economic regulation. The Due Process Clause "generally does not permit the retroactive application of a statute if it has especially harsh and oppressive consequences, or results in manifest injustice."[3] Laws that substantially interfere with existing contractual rights and obligations are also subject to challenge under the Contracts Clause and can constitute uncompensated regulatory takings under

---

[3] *Greenberg v. Comptroller of the Currency*, 938 F.2d 8, 11 (2d Cir. 1991); *see also Bank Markazi v. Peterson*, 136 S. Ct. 1310, 1325 (2016) ("The Due Process Clause also protects the interests in fair notice and repose that may be compromised by retroactive legislation.") (internal quotations omitted).

the Takings Clause, which applies where government action "has unfairly singled out the property owner to bear a burden that should be borne by the public as a whole."[4] For example:

- In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244–47 (1978), the Supreme Court struck down a statute that imposed pension obligations on employers beyond what had been negotiated in their contracts. In terms directly applicable to this legislation, the Court found that the statute violated the *Contracts Clause* because it "nullifies express terms of the company's contractual obligations and imposes a completely unexpected liability in potentially disabling amounts."[5]
- In *Eastern Enterprises v. Apfel*, 524 U.S. 498, 537 (1998), the Supreme Court struck down a statute that retroactively assessed premiums for retirement benefits against certain coal operators because the statute "singles out certain employers to bear a burden that is substantial in amount . . . and unrelated to any commitment that the employers made or to any injury they caused." A plurality of the Court found that this constituted an *uncompensated regulatory taking*, and a concurring opinion concluded it violated the *Due Process Clause*.
- In *Vesta Fire Ins. Corp. v. Florida*, 141 F.3d 1427, 1429–32 (11th Cir. 1998), the Eleventh Circuit held that Florida laws enacted in response to Hurricane Andrew that prevented insurance companies from withdrawing from the marketplace to avoid costs from the hurricane, and required them to pay into a disaster fund, could constitute *uncompensated regulatory takings*. The laws did not provide an effective mechanism for insurers to recoup losses, and fell outside what insurers might reasonably expect based on the pre-existing regulatory scheme.
- In *U.S. Fidelity & Guar. Co. v. McKeithen*, 226 F.3d 412–18 (5th Cir. 2000), the Fifth Circuit struck down, as an *uncompensated regulatory taking*, a Louisiana law that retroactively imposed workers compensation costs on insurers who previously only served as administrators, finding it unreasonable to shift on a retroactive basis the cost of funding from employers to insurers.
- Most recently, in *Ass'n of Equip. Mfrs. v. Burgum*, 932 F.3d 727, 730–732 (8th Cir. 2019), the Eighth Circuit struck down as a violation of the *Contracts Clause* a North Dakota law that retroactively imposed requirements on transactions between farm equipment manufacturers and dealers "notwithstanding the terms of any contract."[6]

---

[4] *Yee v. City of Escondido*, 503 U.S. 519, 523 (1992).

[5] The Contracts Clause, which applies directly to State legislation, is made applicable to laws passed by the Council of the District of Columbia by section 1-203.02 of the Home Rule Act. *See, e.g.*, *W. End Tenants Ass'n v. George Washington Univ.*, 640 A.2d 718, 732 n.29, 735 (D.C. 1994) (striking down D.C. statute retroactively regulating rental conversions where statute "could negate the parties' reasonable expectations of the contract").

[6] By contrast, in cases in which the Supreme Court rejected Contracts Clause challenges, the court found either that contracts were not substantially burdened, or that the burden imposed was "an appropriate and reasonable way to advance a significant and legitimate purpose." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400 (1983); *General Motors Corp. v. Romein*, 503 U.S. 181 (1992); *Sveen v. Melin*, 138 S. Ct. 1815 (2018). Unlike the situation presented by the proposed D.C. legislation, the laws at issue in those cases did not significantly disrupt the parties' contractual expectations or impose substantial, unforeseen liabilities.

The proposed retroactive business interruption coverage legislation at issue, like the legislation struck down in these cases, singles out property and casualty insurers to bear the economic consequences of COVID-19, even though those insurers expressly excluded this risk from their insurance contracts. The insurers made no commitments, and caused no injuries, that could provide a reasonable basis for imposing this disabling financial burden. Such sweeping retroactive legislative changes to insurance contracts were not enacted after 9/11, Hurricane Katrina, the H1N1 outbreak, the Boston Marathon attack, the California Wildfires, or, to the best of our knowledge, any other statewide, national, or global crisis.

Moreover, not only is the proposed mechanism for reimbursement uncertain, it is not actually compensatory. It assesses the insurers for the funds to pay themselves back, merely transferring money from the left pocket to the right, which does not ameliorate concerns about an uncompensated taking.

The D.C. Council should seriously consider the substantial constitutional and economic issues presented by such legislation before moving forward with any proposed retroactive business interruption coverage bill or similar legislative proposal.