Freeborn

Your Future Is Our Purpose

COVID-19 Insurance Update: Possible Government Solutions to the Debates over Insurance Coverage for Business Interruption Losses

by Patrick Frye

A FREEBORN & PETERS LLP CLIENT ALERT

ABOUT THIS CLIENT ALERT

This Alert details three possible government solutions to how insurance coverage will handle business interruption losses due to COVID-19.

Property insurance policies generally provide coverage for physical damage to property and the resulting loss of business income. They can also provide coverage for loss of business income in the event that a government order prohibits access to the insured property due to damage to nearby property. The latter is particularly noteworthy because for many insured businesses today, their lost profits are immediately attributable to a government order limiting or outright closing the business. But, as we explained in previous alerts, it is debatable whether COVID-19 has caused any property damage, which is generally a precondition of any insurance recovery.

Property insurers have not conceded coverage, and so long as coverage is disputed, the insured businesses will not receive payment from their insurers. Already many courts have postponed most deadlines in civil actions for at least 30 days, and it is likely civil actions will remain largely stalled until the COVID-19 pandemic has passed. This will not be soon enough for many businesses whose survival depends on receiving income during the pandemic. Whereas COVID-19 losses create solvency concerns for many businesses, coverage of COVID-19 losses threatens the solvency of property insurers, as recently pronounced by the insurance commissioners of some states and by the National Association of Insurance Commissioners.

State and federal governments have discussed possible solutions that would ensure payment to insured businesses. In each proposal, the payment would initially come from the insurer of the business; but the proposals vary in the extent to which the insurance industry or instead the government would ultimately fund those payments.

Proposal #1: Ad Hoc Insurance Guaranty Fund for This Pandemic (Insurers Pay 100%)

The first proposal involves possibly funding payment of COVID-19 losses through an arrangement similar to state insurance insolvency guaranty funds. These funds partially protect insureds against their insurer's insolvency through assessments collected by the state regulator from the insurance industry, so that the industry essentially shares the risk of any one insurer's default. Various states – namely Massachusetts, New Jersey, New York, and Ohio – have proposed that under already-existing property insurance policies issued to small businesses, property and business-interruption coverage will apply to COVID-19 losses. These proposals would allow insurers to ask the insurance commissioner for reimbursement and authorize the commissioner to pay that reimbursement by collecting an assessment from insurers generally.

If these laws are enacted, insurers would ultimately bear 100% of the losses despite the terms and conditions of the insurance policies. The NAIC "oppose[s] proposals that would require insurers to retroactively pay unfunded COVID-19 business interruption claims that insurance policies do not currently cover." The NAIC reasons that business interruption coverage

usually excludes losses from communicable disease, because those policies "were generally not designed or priced to provide coverage against communicable diseases," and contends that insurance generally "is not typically well suited for a global pandemic where virtually every policyholder suffers significant losses at the same time for an extended period."

Proposal #2: Terrorism Risk Insurance Act for Pandemics (the Federal Government Subsidizes Insurers)

In a second proposal, COVID-19 losses might be covered by adapting the Terrorism Risk Insurance Act, which the federal government enacted in the aftermath of 9/11 as a backstop of the insurance industry's losses due to an act of terrorism. In contrast to the current debate over coverage of COVID-19 losses, it was not generally disputed that terrorism losses involved property damage (or bodily injury). Further, many if not most policies in 2001 lacked any term or condition that would exclude coverage of terrorism losses. Intended to both stabilize the insurers that covered terrorism losses and ensure the availability of insurance for future terrorist acts, the Act has the federal government pay for 80% of an insurer's additional covered terrorism losses that exceed both an aggregate amount for claims for the insurance industry as a whole (not quite $40.9 billion today) and the insurer's individual deductible (20% of its premiums). Once total payments reach $100 billion for losses from a terrorist act, the government has no obligation to pay for further losses. Neither does any insurer that paid its deductible. Government payments may be at least partially recouped by surcharging all insureds' premiums. The taxpayers fund any balance, as the insurers do not pay any premiums.

As explained by an early proponent for a comparable "Pandemic Risk Insurance Act" (PRIA), a "pandemic is like terrorism in that the severity is too high and probability too incalculable to be (re)insurable." This echoes the NAIC's point that insurance is not meant for this type of event. The PRIA apparently would create coverage retroactively, despite policy language requiring property damage or excluding coverage for viruses or communicable diseases; and it would shift the risk of disastrously excessive losses away from the insurance industry and onto the government.

Proposal #3: National Flood Insurance Program for This Pandemic (the Federal Government Pays Virtually 100%)

In a third proposal, COVID-19 losses might be covered through an arrangement similar to the National Flood Insurance Program. Ever since 1968, the federal government has backed flood insurance through the Program, which was created because the private market had stopped selling flood insurance. Under the Program, insureds buy flood insurance policies from insurers, who pay the government part of the premiums received for these policies. When any of those insureds makes a claim for flood coverage, the insurer administers and pays all covered claims, while the government later reimburses the insurer 100% for all covered claim payments. In this arrangement, the insurers risk the government refusing to reimburse part of their payments, and they lose the time value of money between their payment of claims and their receipt of reimbursement. The government otherwise bears the cost of paying flood insurance claims.

This option is likeliest to gain the insurance industry's support, as it gives insurers certainty that their exposure is fairly limited; and this takes advantage of cooperative insurers' pre-existing administrative processes that should issue payments to businesses relatively quickly. However, it is the most costly option for the taxpayer. The government has not collected any premium for this coverage, the insurance industry would retain none of the losses, and there is no apparent mechanism for limiting or recouping the government's losses.

Key Takeaways

Under these three proposals, only businesses that purchased certain types of insurance policies would receive payment. Because the first two proposals would have insurers pay recoveries with no or only partial government reimbursement, implicit in them seems to be the belief that such insurance policies do (or should) cover business losses caused by COVID-19. However, the third proposal arguably assumes that these losses are not insured under the policies, which is why the government would step in to fund them. That view and such a program could prompt additional public policy questions. If even standard property insurance policies with business interruption coverage do not cover COVID-19 business losses, why only save businesses that bought those types of policies? Why would the government not save all businesses regardless of insurance? Indeed, many insurance and business associations now openly advocate for the federal government to fund relief payments to all businesses and their employees. Those questions are only starting to be addressed in the federal CARES Act and other developing legislation.

If you have any questions, contact Patrick Frye or visit Freeborn's COVID-19 webpage for more information as this situation develops.

Freeborn

Your Future Is Our Purpose

ABOUT THE AUTHOR

Patrick Frye
Partner

Chicago Office
(312) 360-6785

pfrye@freeborn.com

Patrick Frye is a Partner in the Litigation Practice Group and member of the Insurance/Reinsurance Industry Team. He represents clients in commercial litigation, including coverage disputes and antitrust claims. He advises clients on litigation strategy and appears before arbitration panels and state and federal courts.

CHICAGO
311 South Wacker Drive
Suite 3000
Chicago, IL 60606
(312) 360-6000
(312) 360-6520 fax

NEW YORK
230 Park Avenue
Suite 630
New York, NY 10169
(212) 218-8760
(212) 218-8761 fax

SPRINGFIELD
217 East Monroe Street
Suite 202
Springfield, IL 62701
(217) 535-1060
(217) 535-1069 fax

RICHMOND
901 East Byrd Street
Suite 950
Richmond, VA 23219
(804) 644-1300
(804) 644-1354 fax

TAMPA
1 Tampa City Center
201 North Franklin Street
Suite 3550
Tampa, FL 33602
(813) 488-2920