

CONTACT

POLICY DEPARTMENT

ELIZABETH KOCIENDA

212.382.4788 | ekocienda@nycbar.org

MARY MARGULIS-OHNUMA

212.382.6767 | mmargulis-ohnuma@nycbar.org

REPORT ON LEGISLATION BY THE INSURANCE LAW COMMITTEE

**A.10226-B
S.8211-A**

**M. of A. Carroll
Sen. Gounardes**

AN ACT in relation to requiring certain perils be covered under business interruption insurance during the coronavirus disease 2019 (COVID-19) pandemic

BACKGROUND

New York State Assembly bill 10226-B and its identical companion Senate bill 8211-A (“the bill”), would require certain commercial property insurance policies to cover business interruption during a period of a declared state emergency due to the COVID-19 pandemic (a “COVID-19 Emergency Period”). The bill would expressly void any exclusion in such a policy for losses based on a virus-caused disease. These requirements would extend to any policy meeting all of the following criteria – (i) in force on or after March 7, 2020, (ii) issued to an insured with fewer than 250 eligible employees (defined as employees working a “normal week of 25 or more hours”) and (iii) covering business interruption.¹ In addition, every such policy expiring during a COVID-19 Emergency Period would be subject to automatic renewal with no increase in premium.

The bill also provides that every insurance policy insuring against loss to an insured’s business income² resulting from loss or damage to property owned by others (such as the insured’s suppliers or “receivers” of the insured’s products) is construed to cover contingent business interruption during a COVID-19 Emergency Period. Any such policy that expires during a COVID-19 Emergency Period would be subject to automatic renewal at the current level of premium.

The coverage required by the bill would indemnify the insured, subject to policy limits, for any loss of business or business interruption and contingent business interruption for the duration of a COVID-19 Emergency Period.

An insurer, including an excess lines carrier, paying a claim pursuant to the bill’s coverage requirement would be entitled to reimbursement from the Department of Financial Services (the “DFS”) using funds collected and made available for such purpose as follows. The Superintendent

¹ However, this presumed scope of this provision is not explicitly clear, and the mandate could be read to cover all property policies. *See* section 8 below.

² This would expressly include, in the case of non-profit insureds, donations and grants.

of Financial Services (the “Superintendent”) would be authorized to impose upon, distribute among, and collect from “the companies, including excess lines insurers, engaged in business pursuant to the insurance law”³ amounts necessary to recover the amounts paid to insurers as reimbursement. The reimbursement would be distributed proportionately based on an individual insurer’s “net written premiums received” (as defined in the bill) compared to net written premiums of all insurance companies within the state. In the case of an excess lines insurer, the reimbursement would be distributed proportionately based on excess line premium tax.⁴

The Insurance Law Committee of the New York City Bar Association (the “Committee”) believes that, unless amended to address the issues listed below, the bill would present numerous ambiguities in practice, raise potential questions of constitutionality and produce an unacceptable level of uncertainty in insurance markets.⁵ While we recognize and appreciate the interest and need within the business and nonprofit sectors to address the availability of business interruption coverage for pandemics, the purpose of this statement is to identify certain deficiencies in the language and administration of the subject bill as presently conceived and drafted. As lawyers experienced in New York insurance law, we would be happy to meet with the Assembly and Senate sponsors, and with industry and policyholder representatives, to discuss a productive path forward.

RECOMMENDATIONS

1. Constitutional and interference with contract issues.

Article I, Section 10 of the U.S. Constitution prohibits a state from passing any “Law impairing the Obligation of Contracts.” The bill, and similar proposed legislation in other states, would alter in-force insurance policies, thus changing the legal rights and obligations of parties to an existing contract and arguably constituting an unconstitutional impairment of contract. On the other hand, there are circumstances where courts in New York and other states have upheld a state’s authority to invoke police power to alter existing contracts in the name of “public welfare”. These and other constitutional issues have been raised in lawsuits in New York and other states and are likely to be litigated extensively over the coming months. Further, insurance companies that would be required to pay claims as a result of the legislation, without certainty that they would be entitled to full reimbursement from the Superintendent (see section 5. below), can be expected to assert colorable claims that the law deprives them of property without due process and without

³ While the sponsors’ memoranda contemplate that those amounts would be collected from companies “other than life and health insurance companies,” the language of the bill does not contain such exclusion.

⁴ It is not clear from the bill’s language how the calculation is to be made in the case of excess lines carriers (*i.e.*, carriers unlicensed in New York writing specialized coverages that are not subject to rate and form regulation by the DFS). The bill refers to premium taxes “received” by such a carrier, a misnomer. Excess line insurers do not receive premium taxes; brokers pay an excess line premium tax to the State on each excess line policy placed by the particular broker with a New York insured. Excess line carriers do receive premiums which could be included in the calculation if the Legislature so decided. Excess line premium taxes are owed to the state in which the insured is located.

⁵ Two bills in the U.S. Congress would also address the availability of business interruption coverage for pandemics. H.R. 7011, the Pandemic Risk Insurance Act of 2020, was introduced on May 26 by Rep. Carolyn B. Maloney (D-NY) and would provide for a mechanism similar to the current Terrorism Risk Insurance Act enacted after the Sept. 11, 2001 attacks (*available at* <https://www.congress.gov/bill/116th-congress/house-bill/7011>). H.R. 6494, the Business Interruption Coverage Act of 2020, introduced on April 14 by Rep. Mike Thompson (D-Calif.), is similar to the New York bill discussed herein, but does not include any reimbursement mechanism (*available at* <https://www.congress.gov/bill/116th-congress/house-bill/6494>) (all websites last visited June 3, 2020).

providing them with just compensation. Such claims could fall under the Fifth Amendment to the U.S. Constitution and/or Article I, Section 7 of the New York State Constitution. While these issues are of paramount significance to the affected parties, including insurers and policyholders, fully vetting these issues is beyond the scope of this Committee's intent to provide helpful commentary to the legislators on the practical issues and concerns raised by the wording of the bill.

2. Solvency concerns for carriers.

Even though an insurer might be able to recover losses from funds collected by the Superintendent, any single insurer might incur such severe losses under this bill as to imperil its financial condition. The National Association of Insurance Commissioners therefore “caution[s] against and oppose[s] proposals that would require insurers to retroactively pay unfunded COVID-19 business interruption claims. . .”, adding that “if insurance companies are required 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.”⁶ Recent letters to President Trump from members of Congress have echoed this view.⁷ In a May 8, 2020 response to one such letter, a U.S. Treasury official agreed that such bills would “introduce stability risks” to the insurance industry.⁸

Estimates from a major insurance trade association of business interruption losses suggest that it is untenable for the insurance industry to absorb COVID-19 losses on a categorical basis as envisaged by the bill. According to this early estimate, on a nationwide basis, business interruption losses just for small businesses with 100 (let alone 250 as set forth in the bill) or fewer employees are approximately \$255 billion to \$431 billion per month.⁹ The total surplus for all U.S. property-casualty insurers is roughly only \$800 billion.¹⁰ Although these are national figures, not limited to New York, it can be inferred that U.S. insurance company surplus is sufficient to bear these losses only a very short period of time, following which affected insurers would become insolvent. Further, payment of any such funds to the business intended to benefit from the bill would result in those funds' becoming unavailable to cover other insured risks, including catastrophic events for which coverage was purchased, such as fire, wind or other damage.

Insurance policies containing the exclusions that would be invalidated by the bill were priced by the companies, using expert actuaries, reasonably expecting that the exclusions would

⁶ See https://content.naic.org/article/statement_naic_statement_congressional_action_relating_covid_19.htm.

⁷ Letter to Pres. Donald Trump from seven U.S. senators, April 10, 2020, *available at* <https://www.scott.senate.gov/imo/media/doc/20.04.10%20Sen.%20Tim%20Scott%20Letter%20on%20BI%20Insurance.pdf>; Letter to Pres. Donald Trump from 22 U.S. Representatives, April 16, 2020; Letter to Pres. Donald Trump from Rep. Ted Budd (R-N.C.) *et al.*, April 17, 2020.

⁸ Letter to Rep. Budd from Frederick W. Vaughan, Principal Deputy Assistant Sec., Office of Legis. Affairs, U.S. Dept. of Treas., May 8, 2020, *available at* <https://www.iii.org/insuranceindustryblog/u-s-treasury-weighs-in-on-debate-surrounding-business-interruption-insurance/>.

⁹ Press Release: APCIA Releases New Business Interruption Analysis, American Property Casualty Insurance Association, April 6, 2020, <http://www.pciaa.net/pciwebsite/cms/content/viewpage?sitePageId=60052>.

¹⁰ *Ibid.*

apply in appropriate circumstances. If those companies are legally barred from invoking those exclusions, then the amount of premium received by the companies on those policies will be significantly below the level actuarially required to make the policies self-sufficient. Article 23 of the Insurance Law requires the Superintendent to ensure that rates on all policies issued by licensed insurers be adequate. It is not at all clear from the text of the bill that the amount of reimbursement to be provided to the insurers from the funds collected for such purpose will assure such adequacy. The bill's requirement to renew such policies, without affording the opportunity to re-price in order to accommodate pandemic coverage, exacerbates this issue.

3. Availability of other relief.

Recoveries may be (or become) available to businesses for pandemic-related losses under federal law, including by means of grants or loans under the Coronavirus Aid, Relief, and Economic Security (CARES) Act adopted by Congress in late March, in particular the CARES Act's Paycheck Protection Program, which is targeted to small businesses with fewer than 500 employees and covers up to two and one-half months of payroll and other related costs. Other sources of relief, either nationally or internationally, may also be available. In addition, states may choose to establish relief programs on their own for businesses incurring pandemic-related business interruption losses. Given the breadth of these relief programs and the fact that the losses experienced by U.S. businesses in connection with the pandemic may well dwarf the aggregate insurance industry's reserves, it is not clear that recovery through insurance policies that were not written to cover such perils is the best way to make businesses whole for COVID-related losses, or that doing so would lead to a socially acceptable outcome. The bill should address the possible interplay and redundancy between an insured's right to recover from an insurance carrier under the bill and the insured's ability to recover pandemic-related losses from these other sources.

4. Reinsurance.

The bill does not address the impact of reinsurance. Would reinsurers be obligated to pay losses to primary carriers now required to pay pandemic-related losses, where there had been an explicit pandemic exclusion? (This may hinge on whether the payment by the primary carrier is legally considered contractual or *ex gratia*, a matter on which the bill is silent.) Could the reinsurer recover from the funds collected by the Superintendent? How would reinsurance affect the primary carrier's ability to recover from such funds or the amount of recovery?

5. Quantifying and distributing reimbursement.

a. Extent of indemnity.

The bill entitles an insurer to reimbursement of losses paid pursuant to the coverage mandate. The bill separately states that distributions from the funds collected for this purpose are allocated "proportionately" based on an insurer's share of state-wide insurance premiums (or taxes, in the case of excess lines carriers, although this is ambiguous as discussed above in footnote 6). It is not self-evident from the legislative language how to harmonize and give effect to these two distinct statements. We believe that insurers would need assurance that the reimbursement would be for the *full* amount they are compelled to pay.

b. *Timing.*

Insurers should be assured of *immediate* reimbursement. Insurers should not be forced to liquidate portfolio assets at a time when capital markets are distressed. They also should be reimbursed for the cost of funds if they are required to advance payments before being reimbursed. This, in turn, raises the question of how the Superintendent will fund payments to insurers pending recovery of its disbursements through surcharges.

c. *Reimbursement funds.*

Unlike the State’s property-casualty security funds and the life guarantee fund, the bill does not include any cap on reimbursements from or assessments collected by the Superintendent. Because there is no reasonable way to estimate the potential claims against such funds, including the number and limit of policies affected and the unknown length of time the emergency could remain in place, the reimbursement obligations – and the extent of the Superintendent’s ability to collect funds for such purpose – could become an industry-wide economic and solvency flashpoint. On the other hand, if limitations on fund coverage or assessments were to be added, insurers could be saddled with substantial unreimbursed obligations that might also affect their financial stability or solvency.

In addition, the bill does not specify whether assessments will be imposed across the entire property-casualty industry (or even non-insurers subject to the Insurance Law such as agents or brokers), or only those insurers that write commercial property policies that include “time element” coverages.¹¹ It also raises the question of the extent to which (other than for the renewals specifically addressed) the law will authorize insurers to recover the costs through immediate rate increases or supplemental charges and, if so, over what period of time for recovery. The bill should specify whether any such additional charges would be subject to additional taxation under Article 91 of the Insurance Law (we believe that they should not be). The bill should also address whether assessments can be used to offset premium taxes.

d. *Administration.*

Any fund or entity to administer the reimbursement scheme must have appropriate structure and oversight, such as with an independent guaranty fund. Similarly, the bill should also require that these funds are not used for general State budgetary purposes and are appropriately “ringfenced” for the purposes set forth. A sunset date should also be considered in order to impose additional discipline over the process.

6. Jurisdictional reach.

The bill’s reimbursement provisions include excess lines carriers, as discussed above. Although excess lines carriers are not expressly included in the coverage mandate, this may be inferred. This should be clarified. The bill is also silent on whether captives and other self-procured coverages are included in its scope, as well as on policies covering risks located in multiple states.

¹¹ See also section 8.

7. Claims administration.

Business interruption claims require extensive expert work and documentation in order to determine and substantiate the value of lost income and extra expense. This is also necessary to avoid paying fraudulent claims. Insurers could be overwhelmed by claims volume to the extent that they may have not priced pandemic risks into rates (see section 2 above) and may therefore lack the infrastructure and other resources needed to adjust these claims. This will also have a collateral effect on other claims in the insurer's portfolio as internal resources are strained beyond expectation. As a result, there could be significant delay in payments to policyholders, which frustrates the public policy goal of helping small businesses that have immediate liquidity needs. The bill ought to contemplate this in some way, perhaps by providing for an assessment of the industry's capabilities prior to imposing this coverage mandate on it categorically.

8. Technical drafting issues.

Certain drafting issues are worth pointing out as well, including the following:

- The very scope of the bill's nullification of exclusions is ambiguously drafted – Section 1(a) reads in relevant part “every policy of insurance insuring against loss or damage to property, which includes, but is not limited to, the loss of use and occupancy and of use and occupancy and business interruption.” This could be read to mean all property insurance policies, including those that do not cover business interruption, whereas it appears that the intent was for the bill's nullification provision to cover only property policies with business interruption coverage. There are similar drafting flaws elsewhere in the legislative language that unnecessarily cloud the bill's intended scope.
- The mandated coverage is not limited to losses *caused by* or *arising from* COVID-19, but rather *any* losses *during* any COVID-19 Emergency Period, seemingly regardless of cause. This goes beyond the ostensible intent of the legislation, which is to cover pandemic-related loss.

Insurance Law Committee
Drexel B. Harris, Chair
Frederic M. Garsson, Secretary

Principally drafted by certain members of the
Committee's Legislative & Regulatory Watch Subcommittee:

Karen Baswell	Robert Negron
Peter Bickford	Frederick J. Pomerantz
David Biester	John S. Pruitt
Robert Fettman	Daniel A. Rabinowitz
Nicholas Kourides	Francine L. Semaya
Marion C. Leydier	Gary Svirsky
Richard Liskov	