COVERAGE OF CORONAVIRUS LOSSES

ISSUE BRIEF

LPRO: LEGISLATIVE POLICY AND RESEARCH OFFICE

The Coronavirus pandemic has caused many Oregon businesses to lose revenue, some directly because of a mandatory closure order issued by the Governor and others indirectly from the impacts of social distancing, orders to stay at home, and supply chain disruptions. The Joint Special Committee on Coronavirus Response (JSCVR) has considered requiring that Property and Casualty (P/C) policies cover business losses that are a direct result of the Coronavirus pandemic.

SUMMARY

Business P/C policies designed to insure against lost revenue typically cover only business losses that are a direct result of physical damage, usually for specified events like a fire. Alteration of existing policies will most likely face constitutional hurdles and result in solvency issues for insurers. Any regulations which expand existing coverage to include losses due to the pandemic will most likely need to include public funding to ensure the viability of Oregon's P/C market.

P/C COVERAGE

There are two primary types of P/C coverage designed to compensate the policy holder for lost revenue and operating expenses due to a disaster. Those policies typically cover only losses due to on-site physical damage from specified events like a fire. Policy holders should review their policies and contact their insurers to determine if their coverage includes losses due to the Coronavirus pandemic. There will most likely be litigation around policies that are silent on covered events or not limited to physical damages.

Business Interruption (BI)[1, 2]

BI coverage compensates the holder for lost revenue and operating expenses if a covered event, such as fire or theft, shuts down the business. BI coverage is priced based on the likelihood of risk. For example, a restaurant is more likely to experience a fire than a real estate agency because of the nature of the business and equipment on-site. BI coverage is generally limited to losses which are a direct result of physical

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[1] Insurance Information Institute (III), *Do I need business interruption insurance?*, https://www.iii.org/article/do-i-need-business-interruption-insurance (last visited March 23, 2020).
[2] Oregon Department of Consumer and Business Services, *Oregon Small Business Guide to Insurance and Worksite Safety*, March 2019, *available at* https://dfr.oregon.gov/help/Documents/4967.pdf (last visited March 23, 2020).

damage caused by a covered disaster, and the types of disasters are often explicitly noted in the policy.

According to the insurance industry, most BI policies specifically exclude coverage for losses caused by communicable disease, including viral and bacterial infections.[3] Coverage that specifically includes viral and bacterial infection is available but can only be purchased for future events, not retroactively applied to the current event.

CONTINGENT BUSINESS INTERRUPTION (CBI)[4]

CBI coverage insures against business losses caused by supply chain disruptions at the locations of suppliers or downstream customers. Like BI, CBI is typically limited to losses directly related to physical damage caused by specified events. Broader supply chain coverage is also available for a wide range of events like natural disasters, labor issues, political upheaval, and public health emergencies like pandemic or quarantine.

These policies are generally tailored to companies who rely on global supply chains in unstable regions and may not have been marketed to or purchased by the majority of Oregon businesses harmed by Coronavirus. Coverage is limited to losses that are a direct result of supply chain disruption; harmed policy holders will need to work directly with their insurers to identify the scope of loss that may be covered.

P/C Exposure[5]

Industry analysts believe that P/C insurers are currently financially strong and should be able to pay covered claims related to the Coronavirus pandemic. This is partly because of the minimal exposure in BI and CBI coverage. The industry does anticipate litigation from policyholders who believe that their policies will cover losses due to Coronavirus-caused business closures, though it also anticipates prevailing in those cases.

STATE FINANCIAL REGULATION

Insurance companies are regulated primarily by the state where the company is chartered.[6] Oregon insurers are required to maintain sufficient assets "necessary to avoid injury or prejudice to the interest of policyholders or creditors."[7] An insurer who fails to maintain assets that exceed its liabilities plus required capitalization is considered "impaired" and may be placed under state supervision in order to protect consumers and avoid insolvency.[8]

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[3] Testimony from NW Insurance Council, National Association of Insurance Companies, and the American Property Casualty Insurance Association to the JSCVR (March 20, 2020), *available at* https://olis.oregonlegislature.gov/liz/2019I1/Downloads/CommitteeMeetingDocument/220859 (last visited April 13, 2020).
[4] III, *Protecting your business against contingent business interruption and supply chain disruption*, https://www.iii.org/article/protecting-your-business-against-contingent-business-interruption-and-supply-chain-disruption (last visited March 23, 2020).
[5] III, *The Impact of COVID-19 on P/C Insurance: Triple-I Presentation to NAIC, Friday March 20, 2020*, *available at* https://www.iii.org/sites/default/files/docs/pdf/naic-covid19_03202020.pdf (last visited March 23, 2020).
[6] 15 U.S.C. 1011-1015 (McCarron-Ferguson Act).
[7] ORS 732.225.
[8] ORS 732.230, ORS 734.043.

This authority was exercised in 2016 when the Oregon Division of Financial Regulation placed Moda Health Plans under supervision "because of concerns over its financial condition."[9] The supervision order prohibited Moda from issuing or renewing policies and allowed the state to place a representative in control of all financial decisions and ensure consumers were protected. Moda was able to avoid receivership by entering into a consent order that included generating over $170 million in additional assets.[10]

Consumer Protection in the Event of Insolvency

Each insurer that transacts P/C business in this state is required to be a member of the Oregon Insurance Guaranty Association, a nonprofit funded by an assessment on member insurers that is obligated to pay covered claims of up to $300,000 to Oregon consumers if a member insurer becomes insolvent.[11] Assessments may be up to two percent of the annual written premiums of each member insurer and are only enacted as necessary to cover the obligations of the Association.[12]

CONSTITUTIONAL HURDLES

Insurance companies that object to the amendment of existing contracts could seek relief under at least three constitutional provisions: the Takings Clause of the Fifth Amendment, the Contracts Clause in both the state and federal constitutions, and the Substantive Due Process rights guaranteed under the Fourteenth Amendment. Courts will use the tests outlined below to determine if any enacted regulations pass constitutional muster.

Takings Clause

The Takings Clause of the Fifth Amendment prohibits "private property to be taken for public use, without just compensation."[13] "The Fifth Amendment's guarantee…was designed to bar [the] Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[14] "[I]f regulation goes too far it will be recognized as a taking."[15]

The remedy for a Takings Clause violation is just compensation for the public use, which is typically the market value of the property.[16] Valid insurance contracts are considered property for the purposes of the Fifth Amendment.[17]

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[9] Oregon Newsroom, *State places Oregon health insurer under supervision* (January 28, 2016), https://www.oregon.gov/newsroom/Pages/NewsDetail.aspx?newsid=947 (last visited April 6, 2020).
[10] Oregon Newsroom, *Moda agreement ensures no changes to coverage for consumers* (February 8, 2016), https://www.oregon.gov/newsroom/Pages/NewsDetail.aspx?newsid=971 (last visited April 6, 2020).
[11] ORS 734.510 to 734.710.
[12] ORS 734.570(3).
[13] U.S. Const. amend. V.
[14] *Armstrong v. United States*, 364 U.S. 40, 49 (1960).
[15] *Pa. Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).
[16] *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 243-252 (2003).
[17] *Lynch v. United States*, 292 U.S. 571, 579 (1934).

Per Se Takings. Regulation which grants the government direct, total control of private property, or which denies all economically beneficial or productive use of property, is a categorical or *per se* taking.[18] The 11th Circuit Court of Appeals ruled that state regulations which effectively prohibited insurers from withdrawing from a state's insurance market did not meet the threshold, as the insurer still owned the insurance contracts, collected premiums, and could apply for rate increases.[19]

Whether or not regulations amending existing policies to expand coverage would rise to the level of a *per se* taking would depend on the specifics of the proposed regulation. For example, regulations where the state expressly or effectively took control of existing policies may rise to that level, while less stringent regulations which allowed for insurance companies to seek and retain appropriate premiums may not.

Regulatory Takings. Regulatory takings are evaluated on three factors: 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 government action.[20]

Regulations which serve an important public interest and work to minimize the financial impact to insurers are more likely to survive a regulatory takings challenge without providing compensation.[21]

Potential Impact of Procedural Changes. In a 2019 decision, the U.S. Supreme Court overturned precedent which required a plaintiff to exhaust their remedies at the state level before seeking relief in federal court under the Takings Clause.[22] The case appears to allow "some takings claims to ripen with the mere enactment of a law" and could encourage public entities to "provide immediate compensation" or "refrain from passing laws impacting property owners' rights to avoid lengthy, costly federal court processes."[23]

Contract Clause

Section 21, Article I of the Constitution of the State of Oregon prohibits passage of any "law impairing the obligation of contracts."[24] This language mirrors the Contract Clause, Section 10 Article I of the Constitution of the United States, which prohibits states from passing "any Law impairing the Obligation of Contracts."[25] Regulations which are found to violate the Contract Clause may be declared constitutionally invalid.[26]

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18 *Lucas v. S.C. Coastal Council*, 505 U.S. 1003, 1015 (1992).
19 *Vesta Fire Ins. Corp. v. State of Florida*, 141 F.3d 1427, 1431 (1998).
20 *Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211, 224-225 (1986).
21 For discussion on the nature of the public interest, *see Keystone Bituminous Coal Ass'n. v. Debenedictis*, 480 U.S. 470, 485-488 (1987).
22 *Knick v. Township of Scott*, 139 S.Ct. 2162 (2019).
23 Case Comment, *Fifth Amendment: Knick v. Township of Scott*, 133 Harv. L. Rev. 322 (2019).
24 Or. Const. art. I sect. 21.
25 U.S. Const. art I sect. 10, cl 1.
26 *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 240, 250-251 (1978).

Federal Contract Clause. Federal courts recognize a public purpose exemption to the "facially absolute" language of the Contract Clause to accommodate "the inherent policy power of the state 'to safeguard the vital interests of its people.'"[27]

A court reviewing an alleged federal Contract Clause violation will consider: 1) whether the law substantially impairs a contractual relationship; 2) whether there is a significant and legitimate public purpose behind the regulation; and 3) whether the adjustment of the rights and responsibilities of contracting parties is based on reasonable conditions and is appropriately tailored to the public purpose.[28]

Regulations which minimize the impact to existing contracts and focus on achieving clearly defined policy goals are more likely to survive a challenge under the federal Contract Clause.

State Contract Clause. The Oregon Supreme Court has considered application of the public purpose defense to Oregon's Contract Clause but declined to positively affirm an exemption.[29] Without precedent, it is not clear if a measure altering the terms of existing insurance contracts would survive a challenge under the state's Contract Clause.

Due Process

The Due Process Clause of the Fourteenth Amendment prohibits states from depriving "any person of life, liberty, or property, without due process of law."[30] While the right to make contracts is a liberty guaranteed by the Constitution, that right is not absolute and contracts are subject to "reasonable regulations and prohibitions imposed in the interests of the community."[31] "Government has always had a special relation to insurance" and states have broad authority to regulate the industry without violating the Due Process Clause.[32]

When considering Due Process challenges to regulations that impact property, courts evaluate if there is a rational basis for the regulation and will only overturn if it is "clearly arbitrary and unreasonable, having no substantial relation to the public health, safety, morals, or general welfare."[33] Regulations even loosely tailored to a public policy goal would likely survive a Due Process challenge.

LESSONS FROM FLORIDA'S REGULATION OF HURRICANE COVERAGE

Hurricanes have become the most reliable and costly catastrophic events for insured U.S. property and present a unique regulatory challenge for impacted states

[27] *Energy Reserves Grp., Inc. v. Kan. Power and Light Co.*, 459 U.S. 400, 410 (1983) (citing *Home Bldg. and Loan Assn. v. Blaisdell*, 290 U.S. 398, 434 (1934)).
[28] *Id* at 411-413.
[29] *Moro v. State of Oregon*, 357 Or. 167, 228 (2015).
[30] U.S. Const. amend. XIV, sect 1.
[31] *Chi., Burlington and Quincy R.R. Co. v. McGuire*, 219 U.S. 549, 566-567 (1911).
[32] *Osborn v. Ozlin*, 310 U.S. 53, 65 (1940), *Cal. Auto. Ass'n. Inter-Ins. Bureau v. Maloney*, 341 U.S. 105, 110-111 (1951).
[33] *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 391-395 (1926).

(Figure 1).[34] Insurance regulations enacted by the State of Florida in response to hurricane losses provide both precedent for mandating coverage in the wake of a catastrophe and an understanding of how mandating coverage of costly catastrophic events can impact a state's insurance market.

Figure 1: 10 Most Costly Insured Property U.S. Catastrophes through 2018

Rank	Date	Peril	Dollars when Occurred (millions)	In 2018 Dollars (millions)*
1	Aug. 2005	Hurricane Katrina	$41,100	$51,882
2	Sep. 2017	Hurricane Maria **	25,000-30,000	25,600-30,700
3	Sep. 2017	Hurricane Irma **	20,000-25,000	20,400-25,600
4	Aug. 2017	Hurricane Harvey **	18,000-20,000	18,400-20,400
5	Sep. 2001	World Trade Center, Pentagon terrorist attacks	18,779	25,958
6	Oct. 2012	Hurricane Sandy	18,750	20,688
7	Aug. 1992	Hurricane Andrew	15,500	25,404
8	Jan. 1994	Northridge, CA earthquake	12,500	19,595
9	Sep. 2008	Hurricane Ike	12,500	14,631
10	Oct. 2005	Hurricane Wilma	10,300	13,002

Property losses only. Excludes flood damage covered by the federally administered National Flood Insurance Program

Source: NAIC

Catastrophes Create Solvency Risks

Even anticipated catastrophes such as hurricanes can risk the solvency of insurers. In 1992, Hurricane Andrew inflicted $15.5 billion ($25.4 billion in 2018 dollars) in property damage across south Florida. (Figure 1) "The severity of losses from Hurricane Andrew caught many by surprise…one industry veteran predicted in advance of Andrew that a storm of similar strength would cause insured losses of $4 to $5 billion."[35]

Claims from Andrew exceeded the capital surplus and reinsurance of many companies. "Seven domestic insurance companies and one foreign company became insolvent…some companies became 'technically insolvent' and required the transfer of funds from parent companies to pay claims."[36]

Mandating Coverage May Require Investment

Insurers who remained solvent sought to reduce their exposure in the region through the cancellation or nonrenewal of existing policies, or by altogether withdrawing from the state's residential P/C market.[37] The Florida Legislature enacted several regulations and programs designed to protect consumers and stabilize the state's P/C market.

Moratorium on Cancellation and Nonrenewals. The Florida Legislature enacted several regulations designed to keep insurers in the state's P/C market. The first law enacted was a "moratorium on cancellation and nonrenewal of residential property

[34] National Association of Insurance Commissioners (NAIC), *Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owner's Insurance Report: Data for 2017*, 2 (2019), *available at* https://www.naic.org/prod_serv/HMR-ZU-19.pdf (2020).
[35] *Id*.
[36] *Id* at 5.
[37] McChristian *supra* note 32.

coverages" which temporarily prohibited insurers from closing out residential P/C policies unless they could "affirmatively demonstrate…that the proposed [was] necessary…to avoid an unreasonable risk of insolvency."[38]

The next was a "moratorium phaseout" which prohibited any insurer from cancelling or nonrenewing more than five percent of its mobile home and residential policies in the state, or more than 10 percent of its mobile home and residential policies in any county, in any 12-month period for the purpose of reducing the insurer's exposure to hurricane claims.[39] The phaseout requirements were "interpreted in such a liberal manner that virtually any reason given by an insurer for canceling or nonrenewing a particular homeowner's policy [was] deemed related to the risk of hurricane loss."[40]

The combined effect of these regulations was an effective prohibition on insurers withdrawing from the state's residential P/C insurance market.[41] When challenged in federal court by P/C insurers, the regulations were upheld as constitutional.[42]

State Hurricane Reinsurance Fund. The Florida Legislature recognized that "many insurers are unable or unwilling to maintain reserves, surplus, and reinsurance sufficient to enable the insurers to pay all claims" and established a state reinsurance program to "provide reimbursement to insurers for a portion of their catastrophic hurricane losses" and "create additional insurance capacity sufficient to ameliorate the current dangers to the state's economy and the public health, safety, and welfare."[43] Capitalized by an assessment on P/C insurers and the sale of public bonds, the Florida Hurricane Catastrophe Fund ("Cat Fund") is a reinsurance fund designed to reimburse insurers for up to 90 percent of losses from hurricane-related claims in excess of the insurer's retention.[44]

Industry analysts note the Cat Fund "can offer prices far lower than private reinsurance alternatives" but "this benefit is not 'free' – those lower rates are made possible by exposing almost all Floridians to the risk of significant assessments in the future."[45]

Citizens Property Insurance Corporation (Citizens). In 2002, the Florida Legislature established Citizens as a not-for-profit, tax exempt, government entity to provide insurance coverage after it found insurers were unable or unwilling to provide affordable property insurance coverage.[46] Citizens is funded by the premiums of policyholders, the

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[38] 1993 Fla. Laws ch. 93-401 sect. 1. For a discussion of the regulation as applied, *see* *Prudential v. Dept. of Ins.,* 626 So.2d 994 (1993).
[39] 1993 Fla. Laws ch. 93-410 sect. 19.
[40] Jonathan Brennan Butler, *Insurers Under Fire: Assessing the Constitutionality of Florida's Resident Property Insurance Moratorium After Hurricane Andrew*, 22 FLA. ST. U. L. REV. 731 (1995), *available at* https://ir.law.fsu.edu/cgi/viewcontent.cgi?article=1503&context=lr (last visited April 7, 2020).
[41] *State of Fla.*, 141 F.3d at 1429-1430.
[42] *Id* at 1434.
[43] 1993 Fla. Laws ch. 93-409 sect. 1.
[44] Fla. Stat. 215.555(3)-(5).
[45] Rade Musulin and Jack Nicholson, *Tag Archives: Florida Hurricane Catastrophe Fund (FHCF or "Cat Fund")*, The Actuary, https://theactuarymagazine.org/tag/florida-hurricane-catastrophe-fund-fhcf-or-cat-fund/.
[46] Fla. Stat. 627.351(6), Citizens, *Who We Are*, https://www.citizensfla.com/who-we-are (last visited April 3, 2020).

sale of public bonds, and, if threatened by losses, by an assessment on P/C policyholders as necessary to capitalize against losses.[47]

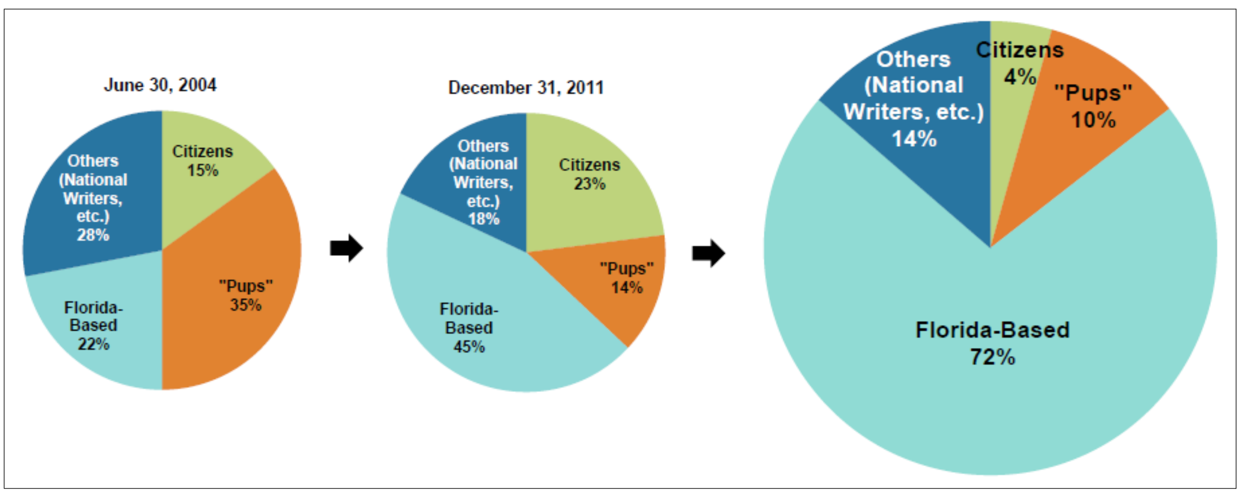
Citizens suffered a $1.6 billion deficit in 2004 resulting in a 6.8 percent deficit assessment on all policyholders, and then a $2 billion deficit in 2005 which required an 11 percent deficit assessment.[48] In 2006, the Florida Legislature appropriated $715 million from the state general fund to help cover the deficit, which allowed Citizens to reduce the 2005 deficit assessment to two percent.[49] A separate emergency assessment of up to 1.4 percent was implemented for all policies issued or renewed prior to July 1, 2015.[50]

Mandating Coverage May Create Market Shifts

Since the regulations enacted in the wake of Hurricane Andrew, Florida's residential P/C market has seen a significant shift from national to domestic insurers. Rates remain relatively high, as does the risk of insolvency.

Domestic Insurers Now Provide the Majority of Residential P/C Coverage. Before Hurricane Andrew, Florida's residential P/C market was dominated by national carriers who provided 94 percent of the state's coverage, compared to only six percent by domestic (Florida-based) insurers.[51] Today, Florida's residential P/C market is dominated by domestic insurers who provide 72 percent of the state's coverage.[52]

Figure 2: Florida Residential P/C Market Share from 2004 to 2019



Source: Citizens

National Insurers Have Reduced Exposure. National insurers have managed their hurricane exposure in Florida by significantly reducing market share. (Figure 2) Nearly

[47] *Id.*
[48] III, *Florida Citizens Property Insurance Corporation* 4, (May 2008), *available at* https://www.iii.org/sites/default/files/docs/pdf/FloridaCitizens08.pdf (last visited April 6, 2020).
[49] *Id.*
[50] Citizens, *2005 HRA Emergency Assessments*, https://www.citizensfla.com/emergency-assessment (last visited April 6, 2020).
[51] McChristian, *supra* note 32.
[52] Citizens, *Florida Residential Property Market Share* 4 (June 30, 2019).

half of the residential P/C premiums written by national insurers are under "pups" which are Florida-only subsidiaries used to shield a parent company's assets from exposure.[53]

Mandating Coverage May Not Resolve Systemic Problems

Even with heavy public investment and regulation, Florida homeowners pay the second highest insurance rates in the country.[54] Some analysts believe the domestic insurers who now provide the bulk of the state's residential insurance would become insolvent if a Category 4 storm were to strike the state's populous southeast coast, and that the state's public investment in the Cat Fund is insufficient to maintain the state's P/C market when measured against historic risks.[55]

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[53] McChristian, *supra* note 32, at 6-7.
[54] *Id* at 13.
[55] Jack E. Nicholson, Karen Clark, and Glen Daraskevich, *The Florida Insurance Market: An Analysis of Vulnerabilities to Future Hurricane Losses*, Journal of Insurance Regulation, Vol. 37, No. 3, *available at* https://www.naic.org/prod_serv/JIR-ZA-37-03-EL.pdf (last visited April 7, 2020).