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

Lauren E. Jones
**JONES ASOCIATES**
72 South Main St.
Providence RI 02903
401/274-4446 x-11

Bryce L. Friedman
Isaac Rethy
SIMPSON, THACHER & BARTLETT LLP
425 Lexington Ave.
New York NY 10017
(212) 455-2000

***Proposed Retroactive Business Interruption Coverage Legislation In Rhode Island***

## 1. Summary

On March 30, 2020, the Rhode Island General Assembly issued a press release announcing that Rep. Joseph M. McNamara was drafting legislation to "help businesses that are hit hard by the COVID-19 crisis by guaranteeing that business interruption insurance would cover their losses regardless of policy language."[1] This proposed legislation appears likely to follow the model of New Jersey Bill A3844, introduced on March 16, 2020. The New Jersey bill would change the language of existing property and casualty policies that provide business interruption coverage to businesses with fewer than 100 employees. It would add COVID-19 losses to the "covered perils under that policy" and require insurers who issued those policies to cover business interruption losses during the state of emergency declared in connection with the COVID-19 pandemic, subject to reimbursement via an assessment levied against those same insurers. Neither New Jersey Bill A3844 nor any other comparable legislation has been passed into law.

The economic hardship imposed on businesses, both in Rhode Island and nationwide, as a result of the ongoing COVID-19 pandemic calls out for legislative solutions. However, this proposed legislation would almost surely be unconstitutional and void under federal and Rhode Island law and should not be enacted. It would impose massive liability on the insurance industry for a risk property and casualty 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."[2] Such legislation contravenes "fundamental principles of fairness" embedded in the Due Process, Takings, and Contracts Clauses of the federal Constitution, as well as Rhode Island constitutional equivalents. The legislation would be contrary to the Rhode Island Constitution's directive to the state legislature that "[a]ll laws . . . should be made for the good of the whole; and the burdens of the state ought to be fairly distributed among its citizens."[3]

## 2. Background

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

Second, since 2006, commercial property policies have typically included a specific, separate "Loss Due to Virus or Bacteria" endorsement that expressly excludes 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 endorsement was submitted to regulators by the Insurance Services Office (ISO) in 2006 and adopted by the industry following

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[1] http://www.rilin.state.ri.us/pressrelease/_layouts/RIL.PressRelease.ListStructure/Forms/DisplayForm.aspx?List=c8baae31-3c10-431c-8dcd-9dbbe21ce3e9&ID=370869.

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

[3] R.I. Const. art. I, Section 2.

regulatory approval.[4] The exclusion was expressly approved by the Rhode Island Department of Business Regulation-Insurance Division and has been used in Rhode Island property and casualty policies. The virus exclusion applies to all coverage, including forms or endorsements that cover "property damage to buildings or personal property and forms or endorsements that cover business income, extra expense, or action of civil authority." In explaining the concerns that motivated the drafting of the virus endorsement, ISO specifically stated that "[w]hile property policies have not been a source of recovery for losses involving contamination by disease-causing agents, the specter of pandemic or hitherto unorthodox transmission of infectious material raises the concern that insurers employing such policies may face claims in which there are efforts to expand coverage and to create sources of recovery for such losses, contrary to policy intent."[5]

By creating business interruption coverage retroactively "regardless of policy language"—including a standard-form endorsement that specifically excludes virus-related losses from coverage—the proposed legislation would impose a massive financial obligation on property and casualty insurers for an *uninsurable risk* that they specifically foresaw and excluded from 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. Those losses are not spread out over time across a subset of policyholders for separate loss incidents occurring at various times (like losses from fire damage). Instead, such losses have a widespread impact on a substantial percentage of *all* policyholders *all at the same time*. Standard-form policies also generally do not cover loss resulting from nuclear disasters for similar reasons. The premiums that businesses paid for their insurance reflected the Loss Due to Virus or Bacteria endorsement and exclusion of such loses.

To illustrate this point, New Jersey bill A3844 (on which Rhode Island legislation may be based) would expand existing business-interruption insurance (BI) to cover small businesses with fewer than 100 employees during the COVID-19 state of emergency. An analysis recently completed by the American Property Casualty Insurance Association (APCIA) currently estimates New Jersey COVID-19-related business-interruption losses for businesses with fewer than 100 employees in the ranges of $1.5-$6.6 billion *per month* for those with BI coverage. Likewise, APCIA currently estimates *monthly* business interruption losses for Rhode Island businesses with fewer than 100 employees with BI coverage in the ranges of $191-$814 million. Nationwide, APCIA estimates these types of losses for businesses with fewer than 100 employees to range from $52-$223 billion per month for those with BI coverage. APCIA estimates the *total* property-casualty industry surplus—for companies of all sizes—is currently about $800 billion, and that surplus protects auto, home, and business policyholders for *all* types of future insured losses.

If enacted by New Jersey, Rhode Island, and other states the proposed legislation would retroactively impose hundreds of billions of dollars of 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 would likely render many insurers financially incapable of making timely payment on valid claims and could pose a threat to insurers' solvency. No reimbursement from an assessment levied against insurers, as is provided by the New Jersey bill, would be sufficient to address the widespread threat of insurer solvency, even if it were collectable. Property and casualty insurers would be unable to continue their important role in

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[4] *See* ISO form CP 01 40 07 06 (Exclusion Of Loss Due To Virus Or Bacteria).

[5] ISO Circular, *New Endorsements Filed to Address Exclusion of Loss Due to Virus or Bacteria*, LI-CF-2006-176 (July 6, 2006).

risk-transfer going forward, thereby impeding the recovery of the Rhode Island economy from the economic impact of the COVID-19 pandemic.

### 3. Analysis

While state legislatures have broad authority to regulate economic activity, legislation like the proposed bill that seeks to impose liabilities retroactively on specific private parties is subject to greater constitutional scrutiny. 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."[6] Laws that substantially interfere with existing contractual rights and obligations are also subject to challenge under the federal Contracts Clause and can constitute uncompensated regulatory takings under 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."[7] For example:

- In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244–47 (1978), the Supreme Court held that a statute that imposed pension obligations on employers beyond what had been negotiated in their contracts 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."
- 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 Court of Appeals for 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 Court of Appeals for 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 Court of Appeals for the Eighth Circuit held that a North Dakota law that retroactively imposed

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[6] *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).

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

requirements on transactions between farm equipment manufacturers and dealers "notwithstanding the terms of any contract" violated the *Contracts Clause*.[8]

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' contracts do not cover this risk. The insurers made no commitments and caused no injuries that could provide a reasonable basis for imposing this disabling financial burden, much less doing so retroactively. 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. The Rhode Island General Assembly 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.

Rhode Island Law is consistent with federal law, and the Rhode Island Supreme Court is particularly clear in its rejection of retroactive legislation that purports to affect existing substantive or contractual rights upon which a party has reasonably relied. Rhode Island case law recognizes that retroactive legislation that impairs contractual obligations is void. For example:

- In *Pion v. Bess Easton Donuts Flour Co.*, 637 A.2d 367, 371 (R.I. 1994), the court set forth general propositions limiting retroactive application of statutory enactments:

  > Generally, it is presumed that statutes and their amendments are "to operate prospectively unless it appears by clear strong language or by necessary implication that the Legislature intended to give the statute retroactive effect." [Citation omitted.] If a statute lacks clear direction or necessary implication concerning its retroactive application, the difference between a substantive statute and a remedial or procedural statute becomes relevant.

- In *Depositors Economic Protection Corporation v. Brown*, 659 A.2d 95, 102 (R.I. 1995), the Court quoted the United States Supreme Court, that to determine whether a statute is retroactive one must look to see "whether the [statute] attaches new legal consequences to events completed before its enactment," quoting *Landgraf v. USI Film Products*, 114 S.Ct. 1483, 1499 (1994). The court noted that it "has traditionally employed a balancing test in cases involving retroactive statutes in which the court weighs the public interest in retroactivity against the unfairness created. The unfairness of a retroactive statute is 'measured best by the party's reliance on the preexisting state of the law.'"

- In *Gorham v. Robinson*, 57 R.I. 1, 42, 186 A. 832, 852 (1936), the court long ago recognized the essential limitations on retroactive application of a statute: "The general assembly is not prohibited by our State constitution from passing statutes that are merely retrospective in their

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[8] By contrast, in cases in which the Supreme Court rejected Contracts Clause challenges, the laws involved—unlike the proposed Rhode Island legislation at issue here—did not significantly disrupt the parties' contractual expectations or impose substantial, unforeseen liabilities. *See, e.g., 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).

operation. [Citation omitted.] If such statutes impair contractual obligations or vested property rights, they are void * * *." (Emphasis added.)

- In *State v. Healy*, 122 R.I. 602, 607, 410 A.2d 432, 435 (1980), the court held that a statute that purported to change an injured employee's right to workers' compensation benefits could not be applied retroactively:

  > In the field of Workers' Compensation, it is held that once an injury occurs and an agreement is executed, '"a contract right to compensation in the amount prescribed for the injury in question * * * may not be destroyed by subsequent retroactive laws.'" *Cipriano v. Personnel Appeal Bd.*, 114 R.I. 141, 145, 330 A.2d 71, 73-74 (1975) (quoting 2 Sutherland, Statutory Construction § 41.07 at 276 (4th ed. 1973)).

- In *Lawrence v. Anheuser-Busch, Inc.*, 523 A.2d 864, 869 (R.I. 1987), the court reiterated the principle: "[T]he Legislature is free to enact retrospective legislation as long as it does not impair contractual obligations or interfere with vested rights." The court held that a statute amending Rhode Island's Dram Shop statute could not be applied retroactively to injuries sustained in a motor vehicle collision that occurred before the amendment; otherwise the statute would interfere with the tavern owner's vested rights.

- In *Kelly v. Marcantonio*, 678 A.2d 873 (R.I. 1996), the supreme court rejected, as a violation of the Rhode Island Constitution's Due Process clause, an amendment to a statute of limitations extending the time within which certain tort claims could to be made: "retroactive enlargement of the applicable limitation period by this statute would be impermissible insofar as it applied to actions that already were time-barred when the statute was enacted." 678 A.2d at 883.

- In *Theta Properties v. Ronci Realty Co., Inc.*, 814 A.2d 907 (R.I. 2003), the supreme court applied the reasoning from *Kelly v. Marcantonio* and held that a statute extending the time within which a dissolved corporation has to wind up its affairs could not, as a matter of due process, be applied to a dissolved corporation that had already passed the time to be sued provided in the pre-amended statute and which had already wound up its affairs.

Any legislative attempt to rewrite existing property and casualty insurance policies to require the insurers to cover COVID-19 business interruption losses is bound to be void under Rhode Island law. The property and casualty insurance companies relied on existing law in writing their policies and determining the coverage provided, the premium charged, and the reserves to be maintained to cover the risks they insured. They relied on the validity under existing law of the contract terms in their policies: those very contract terms were approved by the Department of Business Regulations. The General Assembly cannot retroactively change the terms of insurance policies to cover claims that (1) were specifically excluded under the terms of the insurance policies and (2) create immense potential liabilities that did not exist at the time the insurance companies issued the policies to their insureds. Placing the financial burden of the COVID-19 pandemic on property and casualty insurers whose policies expressly do not cover such losses is a clear violation of due process, would be substantially unfair to the insurers, and will not stand up to judicial scrutiny.