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PERSPECTIVE

Will COVID-19 business interruption suits really bankrupt the insurance industry?

By Bradley Wallace

On July 30, the United States Judicial Panel on Multidistrict Litigation heard oral arguments in advance of deciding whether to coordinate over 300 pending federal cases against nearly 100 insurers. *See In re COVID-19 Business Interruption Protection Insurance Litigation*, Dkt. No. MDL-2942 (COVID-19 MDL).

Since the COVID-19 pandemic began, the property and casualty insurance industry repeatedly has misstated that their insurance contracts do not, will not, and cannot cover the business income losses of their policyholders from the forced government closures. The industry has emphasized that these business interruption claims pose an existential threat to their sustained viability. The industry continues to threaten doomsday scenarios of insurance bankruptcy and liquidation.

For example, during a congressional hearing on May 21, Insurance Information Institute CEO Sean Kevelighan told lawmakers that "any efforts to rewrite business interruption policies are not only unconstitutional, but would imperil the insurance industry's ability to pay covered insurance claims filed by American homeowners, drivers, and injured workers." In support of their one-sided, pre-judicial determination of no coverage, the National Association of Mutual Insurance Companies and the American Property Casualty Insurance Association unveiled their plan: Create a federal fund for future pandemics. In other words, just make the federal government, i.e., the American taxpayers, foot the bill while the industry sits on its surplus and pays nothing.

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The problem with this viewpoint is that the scope of the loss cannot drive the determination of whether something is insurable or not. If the language of the insurance contract entitles a policyholder to benefits, then the insurance company must pay. An insurance company cannot lose on the language of their own contract and refuse to pay just because the exposure is too big. That's not how it works.

Most American business property policies, which include business income (business interruption) coverage, are all-risk policies, which provide coverage for all covered risk unless *explicitly excluded* in the policy contract. While the policyholder has the burden to prove the loss is a covered loss, all ambiguities in the policy language must be construed in favor of the insured business.

Once coverage has been established under an all-risk policy, the burden shifts to the insurance company to prove that there is a specific exclusion in the policy which applies to the insured's loss claim. If there is ambiguity in a phrase or term in the exclusion, extrinsic evidence can be introduced to prove the intent of the drafter and the contract is strictly construed against the insurance carrier in determining whether the exclusion should be enforced.

Despite these contract interpretation principles, and the hundreds of federal and state lawsuits pending around the country seeking to enforce insurance contracts, the industry continues to hold the line on blanket denials and is failing to issue payments to policyholders.

The industry is stuck between a rock and a hard place: They know they have exposure, but paying out would significantly deplete their assets and surplus. In March, David Sampson, president and CEO of American Property Casualty Insurance Association, alleged that small business continuity losses could total $220 billion to $383 billion per month, which he warned could quickly deplete the industry's $800 billion surplus.

But is this threat real? At the May 21 hearing, Kevelighan said the costs of requiring insurers to pay on business interruption policies, even if only for businesses that bought business interruption coverage, would be about $485 billion through the end of the year. This equates to $65 billion per month, which is certainly a far cry from the $383 billion per month that Sampson was claiming. Using these numbers, if the industry were to honor and make payments on all claims through December, it would only deplete a little over half of the industry's $800 billion surplus. Put another way, $485 billion in claims through the end of the year is only 70% of last year's collected premiums and will be easily covered by their 2020 premium revenue alone!

The insurance industry, enjoying record profits for years, is now faced with COVID-19 business interruption liabilities that insurers say they cannot afford. While the industry's ability to pay is still up for debate, the re-insurance industry knew the industry had potential

exposure and was vulnerable, as prophetically detailed by the International Risk Management Institute in February.

Does this all sound familiar? The industry has continuously increased premiums while ignoring risk. In 2019 alone, the top 25 insurance groups in the industry earned $691.53 billion in direct premiums with a direct loss to earned premiums ratio of 59.71%. In other words, record profits.

The 2018 National Association of Insurance Commissioners report of the "Combined Property/Casualty Insurance Industry" lines reveal total net premiums earnings of $602.78 billion. However, commercial multi-peril lines, which includes business interruption insurance, earned total net premiums of just $36.61 billion.

In 2018, the industry showed over $22 billion in profit for "Commercial Multiple Peril lines" on 1,007,846 reported claims. Despite this, they continued to write policies on these lines that contained risk they were not prepared to cover despite their policies leaving them horribly exposed. Most of the business interruption insurance lines were packaged and sold with promised coverage for 12 to 18 months, rather than putting a specific monetary cap on the claim. It seems clear that many carriers wrote these policies without actually underwriting the policyholder's ordinary expenses, payroll and net revenue. Perhaps they never intended to pay out that much but the coverage and policy language clearly allows for it.

More than four months into this crisis, in word and deed, the industry is largely refusing to pay these claims and offering inaccurate statements to defend the widespread denial of these COVID-19 business interruption claims.

Beyond the threats of widespread insurance company insolvency, the industry has tried to perpetrate the myth that a business must suffer property damage in order to bring a property loss or business interruption claim. Property insurance case law around the country, over the last 25-plus years, debunks that rather easily. So easy in fact, it should make one question why the industry would come out of the gate so aggressively with a media talking point that they knew was misleading and inaccurate.

The industry has continuously alleged that policy exclusions for "loss due to virus or bacteria," which they sought approval for and began inserting in 2007 to clarify their previous pollution and contaminants exclusion, should extend to now exclude forced government closure claims. This is false and misleading because most of the COVID-19 business interruption claims are based on *forced government closures* with the imminent and immediate *risk* of viral presence at the property. Without actual virus contamination at the property, this narrow exclusion, which the industry pushed through the California Department of Insurance without reducing premiums, does not apply to these loss claims.

In addition, for most claims, the government shut down orders are the predominant cause of the loss. California, like many other states, has clear statutory and case law in first party insurance claims which requires that when the loss is caused by a combination of covered and excluded risks, the loss must be covered if the predominant or most important cause is a covered risk. *See* California Civil Jury Instructions – CACI No. 2306 (Covered and Excluded Risks – Predominant Cause of Loss (2020)). It is clear that the forced closures are the predominant cause because we have seen, with the lifting of government orders across the country, businesses scramble to re-open, even partially, in order to mitigate their damages by generating partial revenue once again.

Since the "pandemics are not insurable," "property damage is required," "there is a virus exclusion," and "this will bankrupt us" talking points from the industry are, at best, questionable and at worst, material misrepresentations of fact, it is easy to see why their messaging on this has been pervasive since March. In an effort to preserve their bottom line at all costs, it is an obvious attempt to quell and dissuade legitimate claims from ever being filed and to deter businesses from believing they can or should file a claim under their policy.

So the question remains; Will COVID-19 business interruption litigation really bankrupt the insurance industry, and should it even matter? ■

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