

Welcome and thank you for joining us for today's presentation. Our topic is “**Moving Forward: Weathering the Storm – Part 2.**”

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Moving Forward: Weathering the Storm Insurance Market Update – Part 2

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Moving Forward: Weathering the Storm



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Agenda

1. Insurance market update and impact of COVID-19
2. COVID-19 and business interruption insurance 2.0 – lessons learned
3. Recent Legislative Activity
4. Recently filed insurance cases in the U.S. and abroad
5. 831(b) Captives 2.0 – what is it, how does it work and is it a fit for my business?

Insurance Market Overview

Property & Casualty Rates in the United States were up an average of 7.5% overall through the 4th quarter of 2019 according to the Council of Insurance Agents & Brokers (CIAB). “Large and medium sized accounts experience significant increases at 9.4% and 8.0%, respectively.” The CIAB noted that “Umbrella pricing was impacted the most, with premiums increasing by an average of 13.6%, alongside the perennially problematic Commercial Auto, which saw an increase of 10.5%”. In addition to rate increases, carriers are reducing capacity, changing terms and conditions, and restricting their appetite.

Commercial Auto rates continue to be assessed with more aggressive increases of up to 8% in Q4, according to MarketScout. The CIAB reported Commercial Auto renewal premium rate increases of 10.5% during the same timeframe. The increase is being driven by large jury verdicts as well as distracted driver claims, the costs per auto claim, due in large part to increasingly expensive repair parts for vehicles, and more people on the road.

The Umbrella/Excess market continues to make corrections. Social inflation is leading to larger jury verdicts and Umbrella/Excess policies are being called upon to pay more settlements and judgments. Through the 4th quarter, the CIAB reported average increases of 13.6%. Expect rate increases, higher attachment points, and reductions in capacity. This is especially true for risks in high hazard industries and those with large fleets.

Individual insurance program structures, exposures and loss results continue to ultimately determine cost and coverage. Generally, we see increases in pricing through continuing through 2020.

Workers Compensation Renewals

- Medical and prescription drug costs surpassing wage costs
- Increased last-time claims
- An aging workforce
- Rate reductions in some jurisdictions

Property Renewals

Property pricing is increasing due to reinsurance costs, flood/earthquake/windstorm exposure and loss history. For tougher risks, carriers are looking to change terms and conditions, and reduce capacity.

Liability Renewals

Auto rates and retentions are increasing. Increased focus on loss control measures. General Liability Rates fluctuate based on class of risk. Excess market is seeing the most rate pressure. Expect higher attachment points and rate increases.

Executive Liability Renewals

- Rate Increases of 10% with higher increases for Healthcare & Public D&O
- Retentions Up
- Restrictions in Coverage
- Wage & Hour Limitations/Exclusions

Cyber Liability

Cyber crime continues to dominate the news and property & casualty insurance landscape. All businesses now have some form of a cyber security exposure. Governmental authorities are taking notice, as some jurisdictions are implementing cyber security legislation, which continue to bring about new compliance rules for businesses. Key coverage considerations include Notification Costs, Regulatory Fees, Cyber Extortion and Network Business Interruption. Most Cyber Liability policies also include immediate access to experts, including attorneys, IT specialists and breach coaches. Premiums remain competitive and coverage is readily available in the marketplace.

COVID Impact on Insurance Market

- Reduced exposures (payroll, sales, vehicles, etc.)
- Minimum premiums
- Collateral review
- Potential reduction in umbrella limits
- Premium financing
- New York State Department of Financial Services premium deferral

COVID Impact on Insurance Market

- Potential for increased class action suits
- Potential for reduction in claim reserves
- Digital transformation
- Increase on technology in underwriting process
- Business interruption insurance market viability

Hurdles to Obtaining Business Interruption Coverage for Contractors

1. Can a contractor really suffer a BI Loss? The work has been delayed, not lost.
2. Is there a virus exclusion on the policy? Other problematic exclusions?
3. Does the presence of a virus constitute “direct physical loss of or damage to property”?
4. If no direct impact from the virus at the insured’s premises, does the loss fall under civil authority?
5. Does a jobsite qualify as a described premises in the policy?

BI Loss for a Contractor?

1. Intent of BI to make an insured whole from a net income standpoint, doesn't just replace lost revenue.
2. Not intended to put insured in a better position.
3. Favorable court case in NY – *Binghamton Precast & Supply vs. Liberty Mutual (Appellate Division, 3rd D. April 9, 2020)*
4. How do you prove the amount of the loss?

Various Exclusions

1. Virus or bacteria exclusions
2. Loss of market exclusions
3. Pollution exclusions

BI Coverage in the Standard Property Insurance Policy

“We will pay for the actual loss of Business Income you sustain due to the necessary **suspension** of your **operations** during the **period of restoration**.”

The “suspension” must be caused by direct physical loss of or damage to property at premises which are described in the Declarations...

The loss or damage must be caused by or result from a Covered Cause of Loss (i.e., not otherwise excluded).

Helpful Case Law

1. **Gregory Packaging Inc. v. Travelers, D. NJ 2014** – release of ammonia rendered property unusable for a time period
2. **Port Authority of NY and NJ v. Affiliated FM Ins. Co., 311 F.3d 226 (3rd Cir. 2002)** – property can sustain direct physical loss without structural damage
3. **Matzer v. Seaco Ins. Co. 1998 WL 566658 (Mass. Super. Ct., 1998)** – presence of carbon monoxide constitutes direct physical loss
4. **Western Fire Ins. Co. v. First Presbyterian Church, 437 P.2d 52, 55 (CO, 1968)** – gasoline infiltrated soil and building making use of property dangerous

Civil Authority Coverage

Business Income and Extra Expense coverage may also be available when a Covered Cause of Loss causes damage to property other than your property, provided that both of the following apply:

- (1) Access to the area immediately surrounding the **damaged property** is prohibited by civil authority as a result of the damage, and the **described premises** are within one mile from the damaged property; and
- (2) The action of civil authority is taken in response to dangerous physical conditions resulting from the Covered Cause of Loss that caused the damage, or the action is taken to enable a civil authority to have unimpeded access to the **damaged property**.

Anatomy of a Property Policy

1. The policy consists of several separate and distinct coverage parts, each with its own terms.
2. However, all coverage parts look to the declarations and the schedule of locations which is a part of the Declarations to determine if coverage applies.
3. The policy is very clear about covering specified locations and only offering the smallest of sub-limits for locations which are unscheduled (unnamed/unscheduled, dependent property sub-limits).
4. Jobsites aren't scheduled onto property policies.

Considerations for Owners

1. Does your Builders Risk policy have BI coverage endorsed onto it (ie Delayed Opening/Loss of Rents)?
2. What about Contingent BI for a key supplier?
3. Is Extra Expense included?
4. Force Majeure Coverage included?
5. Does the Soft Costs limit include interest expenses?

State Legislative Proposals (Retroactive)

New York Assembly Bill No. 10226:

- Forced BI coverage
- Overrides exclusions
- Coverage only applies during the duration of a declared state of emergency as a result of COVID-19
- Applies to NY companies with **no more than 250 full-time** employees who work **25 hours or more**
- Applies to policies that were in force on **March 7, 2020**
- Ohio, Massachusetts, Louisiana and New York have similar legislative proposals

State Legislative Proposals (Retroactive)

New Jersey Assembly Bill No. 3844:

- Forced BI coverage
- Overrides virus or bacteria exclusions
- Reimbursement to carriers via special assessment to all NJ insurers
- Applies to NJ companies **with less than 100 employees**
- OH (100 ee's), MA (150 ee's), LA (100 ee's), PA (100 ee's), NY (100/250 ee's) and SC have similar legislative proposals

State Legislative Proposals (Retroactive)

Pennsylvania House Bill No. 2372:

- Forced BI coverage
- Possible reimbursement available to insurers upon application to Commissioner
- PA companies **with less than 100 employees**, for employees that work at least 25 hours a week
- Applies to policies that were in force on March 6, 2020

Other Similar State Legislative Proposals

1. Massachusetts (SD2888)
2. Ohio (HB589)
3. Louisiana (HB858 and SB477)
4. South Carolina (SB1188)

Impact of Legislative Action

1. Short-term fix, long-term woes
2. Insurance companies will leave the states that pass legislation forcing them to pay claims retrospectively
3. Insurance companies will no longer offer the coverage
4. Rate increases that will make the price of coverage unaffordable to most insureds

Federal Legislative Proposal (Prospective)

One proposal is to mimic TRIA (Terrorism Risk Insurance Act)

Coverage:

- Prospective only
- Mandatory offer of coverage
- Triggered by some sort of National Emergency declaration
- Premium cost for coverage endorsement
- Federal backstop for insurers extending the coverage

Domestic Litigation Over COVID-Coverage Under Business Interruption Policies

- Insureds (largely restaurants and other consumer-facing businesses) have sued insurers under business interruption policies in state and federal courts in New York, New Jersey, California, Pennsylvania, Florida, Illinois, Ohio, Texas, Oregon, Kansas and Wisconsin.
- The lawsuits are increasingly being filed as class actions, on behalf of similarly situated insureds.
- There have also been requests filed with the Judicial Panel on Multidistrict Litigation asking that similar lawsuits be consolidated for consistency.

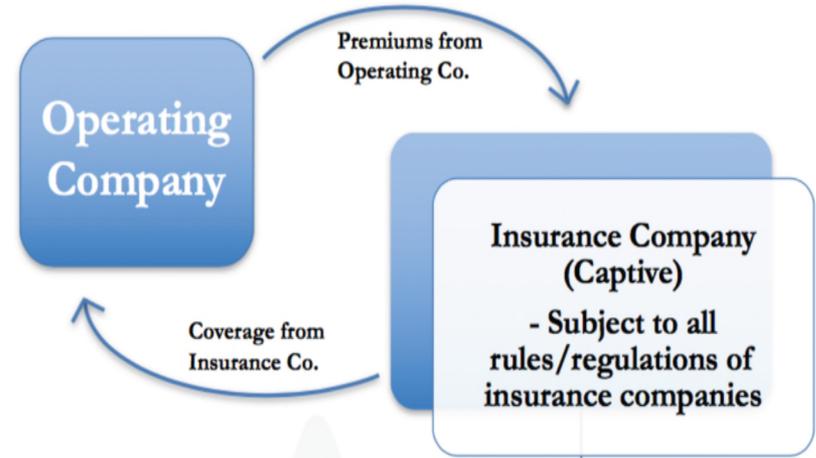
International Developments Over COVID-Coverage Under Business Interruption Policies

- United Kingdom: 200+ companies have collectively sued an insurer
- Canada: Class actions filed against insurers in Quebec and Saskatchewan

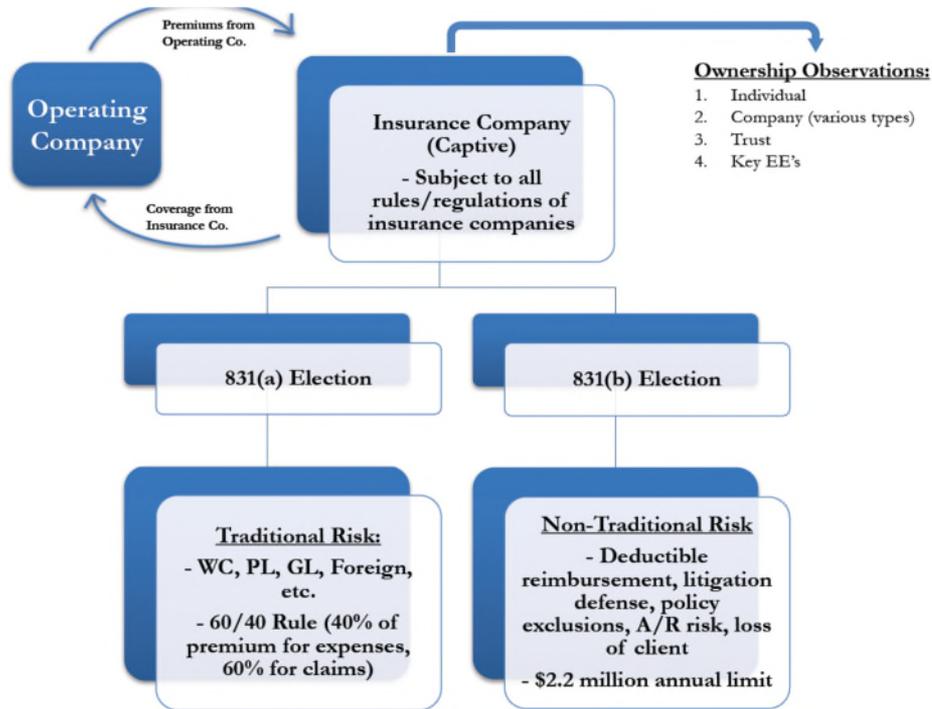
What is a Captive?

A captive is an insurance company that insures the risks of its owner, affiliates, or a group of companies.

- Issues policies, collects premiums, and pays claims.



831(b) Captives



- 831(b) (Micro-Captive) is a single parent captive that is designed for “un-insurable risk”
- Tax benefits, focused on mid-size businesses

831(b) Captives

1. Under Section 831(b) of the IRC, captives that write \$2.3 million or less per year (allowing for inflation adjustments) only pay tax on investment income
2. Underwriting profit accumulates tax deferred
3. Only investment income is taxed
4. Only actual risks to the business should be included
5. Actuarially supported premium

831(b) Captives cont'd

5. Not designed to replace traditional commercial P&C coverages
6. Not designed for high frequency lines of coverage (ie Workers Compensation, GL, Auto)
7. Think of risks that are not typically insurable or hard to find coverages

Types of Risk for 831(b) Captives

- Cyber Risk
- Supply Chain Risk
- Contractual Liability
- Product Warranties
- Litigation Defense
- Credit Default Risk
- Liquidated Damages
- Construction Defect
- Reputational Risk
- Loss of Key Employees
- Communicable Disease
- Loss of Major Client
- Punitive Damages
- Administrative Actions

Who Can Own the Captive?

1. Individuals/spouses
2. Families
3. Trusts
4. LLCs, partnerships, corporations

Be Careful!

1. Increased IRS scrutiny because of past abuses
2. Captive must have a non-tax, business purpose
3. Must meet the risk distribution requirements
4. Must pass one of two diversification tests
5. Shifting and sharing of losses must occur (risk pooling)
6. Captive must cover real risks and have actuarially determined premiums
7. Captive must pay claims

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