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The Constitutionality of Government Action Mandating COVID-19 Business Interruption Coverage

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On March 16, 2020, a committee of the New Jersey General Assembly advanced a bill that would force insurers to cover certain COVID-19 business interruption claims even if not covered by the terms and conditions of the insurance policy.[1] Although the bill was pulled from a vote by the General Assembly, it has generated serious concerns about the constitutionality of such a law if adopted by any government body.

The bill, as written, would substantially modify standard business interruption coverage under commercial property policies. The bill would require that commercial property insurance policies issued to small businesses with less than 100 eligible employees be construed to provide coverage for loss of business or business interruption due to global virus transmission or pandemic during the Public Health Emergency and State of Emergency declared by the New Jersey Governor on March 9, 2020. As such, it would eliminate the requirement that there be physical loss or damage to property – a requirement in most property policies. Further, it would void any applicable virus exclusions.[2]

Although New Jersey is the only state so far to propose such legislation, it is not the only state looking for ways to address the financial impact of COVID-19 to the business community. For example, on March 10, 2020, the New York Department of Financial Services ("DFS") instructed insurers to provide information about the terms and conditions of business interruption coverage provided in their policies. The inquiry suggests that the DFS may seek to regulate how New York-licensed insurers apply business interruption and civil authority coverages.

There is no question that the New Jersey bill, if enacted as written, or similar legislation would substantially impair existing contract rights. The question is whether such government action would violate the Contract Clause of the United States Constitution and parallel clauses in individual state constitutions.[3]

Contract Clause Challenges

The Contract Clause provides that "[n]o State shall … pass any … Law impairing the Obligation of Contracts."[4]

Over the years, judicial interpretation of the Contract Clause has evolved, with the United States Supreme Court holding in the seminal case, *Home Building & Loan Association v. Blaisdell*, that a Minnesota statute allowing the postponement of foreclosure sales and the extension of redemption periods did not violate the Contract Clause, even though the statute retroactively changed the terms of mortgages.[5] In that decision, the Supreme Court enumerated five factors for analyzing whether a government act violates the Contract Clause. These were: (1) whether the governmental act was an emergency measure; (2) designed to protect a basic societal interest rather than particular individuals; (3) was tailored appropriately to its purpose; (4) imposed reasonable conditions; and (5) was limited to the duration of the emergency.

The Court has since balanced the language of the Contract Clause against the State's interest in exercising its police power, narrowing its focus to three factors, which are:

1. whether the law substantially impairs a contractual relationship;

2. whether there is a significant and legitimate public purpose for the law; and

3. whether the adjustment of the rights and obligations under the contract is reasonable and appropriate given the public purpose justifying the law.[6]

In addition, whether the industry at issue is "heavily regulated" is a substantial factor in the Contract Clause analysis.[7]

Government Action Following States of Emergency

In the past 30 years, the Contract Clause was used to challenge legislation that retroactively modified the terms of then-existing insurance policies following states of emergency. For example, in 1993, in the aftermath of Hurricane Andrew, the Florida Legislature adopted a law that prohibited an insurer from canceling or not renewing more than 5% of its residential policies in Florida or more than 10% of its residential policies in a single Florida county during a twelve-month period. In *Vesta Fire Insurance Corp. v. State of Florida,* the Eleventh Circuit Court of Appeals upheld the statute, stating that "the protection and stabilization of the Florida economy, particularly the real estate market," was a significant and legitimate public purpose for the law.[8]

In 2005, following Hurricanes Katrina and Irene, the Louisiana Legislature extended the statute of limitations for insureds to sue their insurers to cover the damage that occurred during or in the aftermath of the hurricanes. In *State v. All Property & Casualty Insurance Carriers Authorized & Licensed To Do Business In State*,[9] insurance companies challenged the extensions on multiple grounds, including that the extensions violated the state and federal contract clauses because the extensions substantially impaired their contract rights. The statute survived the challenge. The Louisiana Supreme Court concluded that the statute substantially impaired contract rights, but that it also was a reasonably proportionate measure to advance a significant and legitimate public purpose, namely to protect the rights of Louisiana citizens after one of the worst natural disasters in U.S. history. The court also specifically considered that "state law has traditionally regulated insurance as a matter of public policy, even including the precise procedural mechanism for filing claims at issue herein."[10]

Government Action Unrelated to States of Emergency

Even when public safety was not a concern, courts have upheld statutes that impaired contract rights and obligations where the intent of the law was to improve public health and welfare.[11] For example, in *Chicago Board of Realtors, Inc. v. City of Chicago*, the Seventh Circuit Court of Appeals found that a Chicago ordinance regulating the landlord-tenant relationship, including a $10 cap on late payment fees, did not run afoul of the Contract Clause, despite the estimated $4 million revenue impact on landlords. The court acknowledged that the financial burden on landlords was substantial, but stated "[t]he level of scrutiny given the law varies directly in accordance with the severity of the impairment of existing contracts, and varies inversely in accordance with the degree of prior regulation in a particular field of activity."[12] Because landlord-tenant relationships were heavily regulated, the court gave the challenged law a relaxed level of scrutiny and concluded that legitimate and significant purposes supported the ordinance.[13]

Additionally, in *ABN Amro Bank N.V. v. Dinallo*, the New York State Supreme Court upheld the decision by the DFS to approve the restructuring of a financial guaranty insurer, even though that restructuring divided the insurer into two companies, with one entity taking on the core business and the other entity taking on the allegedly much riskier portion of the business.[14] The court deferred to the judgment of DFS, at one point holding that "this Court will not read into the Insurance Law such requirements or disturb the actions of the Superintendent, which were made in his discretion and were not affected by an error of law."[15]

Government Action That Materially Modifies Insurance Contracts

While the heavily regulated nature of insurance makes Contract Clause challenges difficult, governmental action that materially modifies the coverage provided, or not provided, under an insurance contract may be a bridge too far even in the context of the coronavirus emergency.

Outside the context of a national emergency, courts have held that laws which retroactively change substantive terms of insurance contracts violate the Contract Clause. In *Harleysville Mutual Insurance Co. v. State*,[16] the South Carolina Supreme Court held that a statute defining "occurrence" to include "faulty workmanship" violated the state and federal contract clause if applied retroactively to then existing commercial general liability policies. [17] Further, in *Kirven v. Central States Health & Life Co., of Omaha*,[18] the South Carolina Supreme Court held that the retroactive application of a statutory definition of "actual charges" to an insured's supplemental health insurance policy violated the state's contract clause because it did not support a legitimate public purpose, which was argued to be the "societal problem related to the affordability of specified disease policies going forward."[19]

In *Society Insurance v. Labor & Industry Review Commission,* the Wisconsin Supreme Court held that the retroactive application of a statute eliminating a 12-year statute of limitations violated the state and federal contract clauses.[20] The court wrote: "The legislation here modified a basic term of an insurance contract – the extent of an insurer's liability for traumatic injury claims – which was bargained for and reasonably relied upon by the parties, and [t]his 'result[ed] in a completely unexpected liability' to [the insurer] after its original period of liability had expired, namely, new liability on [the insured] claim until his death," exposing the insurer "to potentially significant losses." [21]

Conclusion

Even with the well-being of the public in mind in the wake of a national emergency, the New Jersey bill appears to exceed what is permissible under the Contract Clause. While "minor reallocations, *not going to the heart of the bargain*, have been permitted to accomplish an overriding public purpose,"[22] forcing insurers to cover losses that were not contemplated or bargained for appears extreme. While no state has addressed this issue, especially in the context of a health crisis that affects the financial well-being of thousands of business owners and their employees, we believe that a viable constitutional challenge can be asserted with respect to Bill A-3844 and similar governmental action.

For More Information:

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[1] *See* New Jersey Bill A-3844.

[2] It is not clear whether the proposed legislation is intended to override waiting periods and deductibles that might apply to business interruption coverages under existing policies.

[3] *See e.g.*, N.J. Const. art. IV, § 7, ¶ 3("The Legislature shall not pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or depriving a party of any remedy for enforcing a contract which existed when the contract was made.").

[4] U.S. Const. art. 1, § 10.

[5] 290 U.S. 398, 434 (1934).

[6] *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 US 400, 410-413 (1983).

[7] *Id.* at 413.

[8] *Vesta Fire Ins. Corp. v. State of Fla.*, 141 F.3d 1427 (11th Cir. 1998). The Taking Clause of the Fifth Amendment of the U.S. Constitution is also used to challenge laws that substantially infringe on contract rights. In *Vesta Fire Insurance Corp.,* the insurers challenged the statutes as a regulatory taking. The Eleventh Circuit held that the district court granted summary judgment in favor of the state without considering the following three factors: (1) the economic impact of the challenged rule, regulation, or statute on the plaintiff; (2) the extent to which the regulation interferes with investment-backed expectations; and (3) the nature of the challenged government action. *Id.* at 1431.

[9] 937 So. 2d 313 (La. 2006).

[10] *Id.* The insurers also argued that the statute violated the Supremacy Clause and the Due Process Clauses of the U.S. Constitution.

In 2012, following Superstorm Sandy, New Jersey and several other states each declared that hurricane deductibles should not be utilized because Sandy did not qualify as a hurricane-level storm. There appear to be no reported cases challenging those laws as a violation of the Contract Clause.

[11] *Chicago Bd. of Realtors, Inc. v. City of Chicago*, 819 F.2d 732, 737 (7th Cir. 1987).

[12] *Id.* at 736 (citations omitted).

[13] *Id.* at 737.

[14] *ABN AMRO Bank N.V. v. Dinallo*, 40 Misc. 3d 180, 181, 962 N.Y.S.2d 854, 857 (N.Y. Sup. Ct. 2013).

[15] *Id.* at 872.

[16] 401 S.C. 15, 736 S.E.2d 651 (S.C. 2012).

[17] *Id.* at 28, 658.

[18] 409 S.C. 30, 41-43, 760 S.E.2d 794-801 (S.C. 2014).

[19] *Id.* at 40, 799. The policy promised to pay a "defined benefit equal to, or based on a percentage of, the 'actual charges' for certain medical and pharmaceutical cancer treatments." *Id.* at 35, 797. The policy did not define "actual charges." The challenged statute would have resulted in reduced payments to the insured.

[20] 2010 WI 68, 326 Wis. 2d 444, 786 N.W.2d 385 (Wis. 2010).

[21] *Id.* at 482 (internal citations omitted). The court also found the statute to violate the due process clauses of the state and federal constitutions.

[22] *S. Terminal Corp. v. E.P.A.*, 504 F.2d 646, 680 (1st Cir. 1974) (emphasis added).