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Constitutional Questions Presented by Proposed State Legislation Requiring Retroactive Business Interruption Insurance Coverage for COVID-19 Related Claims

by Sean T. Keely and Matthew T. Connelly

A FREEBORN & PETERS LLP CLIENT ALERT

ABOUT THIS CLIENT ALERT

State legislatures in New Jersey, Ohio, Massachusetts, New York, and Louisiana have introduced bills seeking to require business interruption insurance policies to cover claims relating to the COVID-19 pandemic. This Alert details what those bills could mean for insurers.

Recently, state legislatures in New Jersey, Ohio, Massachusetts, New York, and Louisiana have introduced bills seeking to require business interruption insurance policies to cover claims relating to the COVID-19 pandemic, even if those policies might not otherwise cover such claims based on their terms and conditions. Essentially, the proposed laws would retroactively require insurers to provide such coverage. Specifically, New Jersey Bill No. 3844, Ohio H.B. 589, Massachusetts S.D. 2888, New York A.10226, and Louisiana House Bill No. 858/Senate Bill No. 477 all seek to retroactively require insurance policies currently in effect that provide coverage against loss or damage to property, including the loss of use and occupancy and business interruption, to cover "business interruption due to global virus transmission or pandemic."[1]

While state legislatures generally have broad authority to mandate coverage for certain types of insurance policies, the retroactive application of the proposed bills raises significant constitutional questions. Although the Constitution's prohibition of ex post facto laws only bars retroactive penal legislation, several other clauses may provide grounds for insurers to challenge these proposed laws.

First, the retroactive revision of insurance policies to require coverage for COVID-19-related losses may run afoul of the Contracts Clause. Article I, section 10, clause 1 of the Constitution states that "No State" shall pass any law "impairing the Obligation of Contracts." However, despite its absolute language, the Supreme Court has clarified that "it is well settled that the prohibition against impairing the obligation of contracts is not to be read literally."[2] The Supreme Court has found that the Contracts Clause prohibits a state from imposing any "substantial impairment" on a contractual relationship. What is a "substantial impairment"? To answer that question, courts look to "the extent to which the law undermines the contractual bargain, interferes with a party's reasonable expectations, and prevents the party from safeguarding or reinstating his rights."[3] However, even if there is a substantial impairment, the law may survive scrutiny if the state can show this impairment is "necessary and reasonable" to further a "significant and legitimate public purpose."[4] Courts will normally defer to a state legislature's judgment as to the necessity and reasonableness of the impairment.[5]

1 While the New Jersey and Ohio bills use the quoted language, Massachusetts SD 2888 states that such insurance policies must cover "business interruption directly or indirectly resulting from the global pandemic known as COVID-19, including all mutated forms of the COVID-19 virus." New York A.10226 similarly states that such policies must provide "coverage for business interruption during a period of a declared state emergency due to the coronavirus disease 2019 (COVID-19) pandemic." The Louisiana legislature has introduced two competing bills, both of which would require coverage for "business interruption due to" the threats posed by COVID-19, as provided in the Louisiana governor's emergency order regarding the virus.

2 *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 502 (1987).

3 *Sveen v. Melin*, 138 S.Ct. 1815, 1822 (2018).

4 *Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411–12 (1983).

5 *Keystone Bituminous Coal Ass'n*, 480 U.S. at 505.

Second, the proposed legislation may also violate the Due Process Clause.[6] Under the Fourteenth Amendment, no state can "deprive any person of life, liberty, or property, without due process of law." The Supreme Court has opined, though, that retroactive economic legislation must only pass a "rational basis" test to satisfy the Due Process Clause. This is generally not a difficult standard to meet.

Finally, the proposed legislation arguably constitutes a regulatory taking in violation of the Takings Clause. The Fifth Amendment provides that "private property [shall not] be taken for public use, without just compensation." The Supreme Court has recognized that courts may strike down legislation as an unconstitutional regulatory taking where the proposed law, in effect, "takes property from A and gives it to B." Whether a court will strike down a law as an unconstitutional regulatory taking is a fact-intensive analysis that relies on several factors, including "the economic impact of the regulation, its interference with reasonable investment backed expectations, and the character of the governmental action."[7] However, some of the proposed legislation at issue here envisions the state reimbursing the insurance companies and then charging the industry for losses through an assessment. These provisions may undercut any argument that the legislation violates the Takings Clause.

As a result, the Contracts Clause is the likeliest foundation of any challenge to a law passed requiring such retroactive coverage. Insurers would likely argue that the laws impair their contracts by requiring coverage for risks that the insurers never underwrote, never priced, and for which policyholders never paid any premium. They might also argue that the laws would retroactively re-write policies to remove exclusions (such as pandemic or virus exclusions). Insurers could in some cases point to the fact that state regulators approved many of the insurance policy forms and exclusions that the laws aim to retroactively rewrite or remove.

Policyholders and state regulators could likely point to the "significant and legitimate public purpose" of the laws against the backdrop of the Coronavirus crisis – the most significant public health emergency in generations with unprecedented government-mandated shutdowns. Arguments could be made that the public purpose far outweighs any impairment, although insurers and insurance-industry organizations may respond that such retroactively required coverage could overwhelm the insurance industry.

Currently, these bills are in the early stages of the legislative process, and will most likely go through multiple revisions before ever potentially becoming law. But everything about the COVID-19 crisis is moving swiftly, and such legislation may as well. Insurers and policyholders are well advised to keep a close eye on these developments.

Visit Freeborn's COVID-19 webpage for more information as this situation develops.

6 See *Gen. Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992).
7 *E. Enterprises v. Apfel*, 524 U.S. 498, 523–24 (1998).

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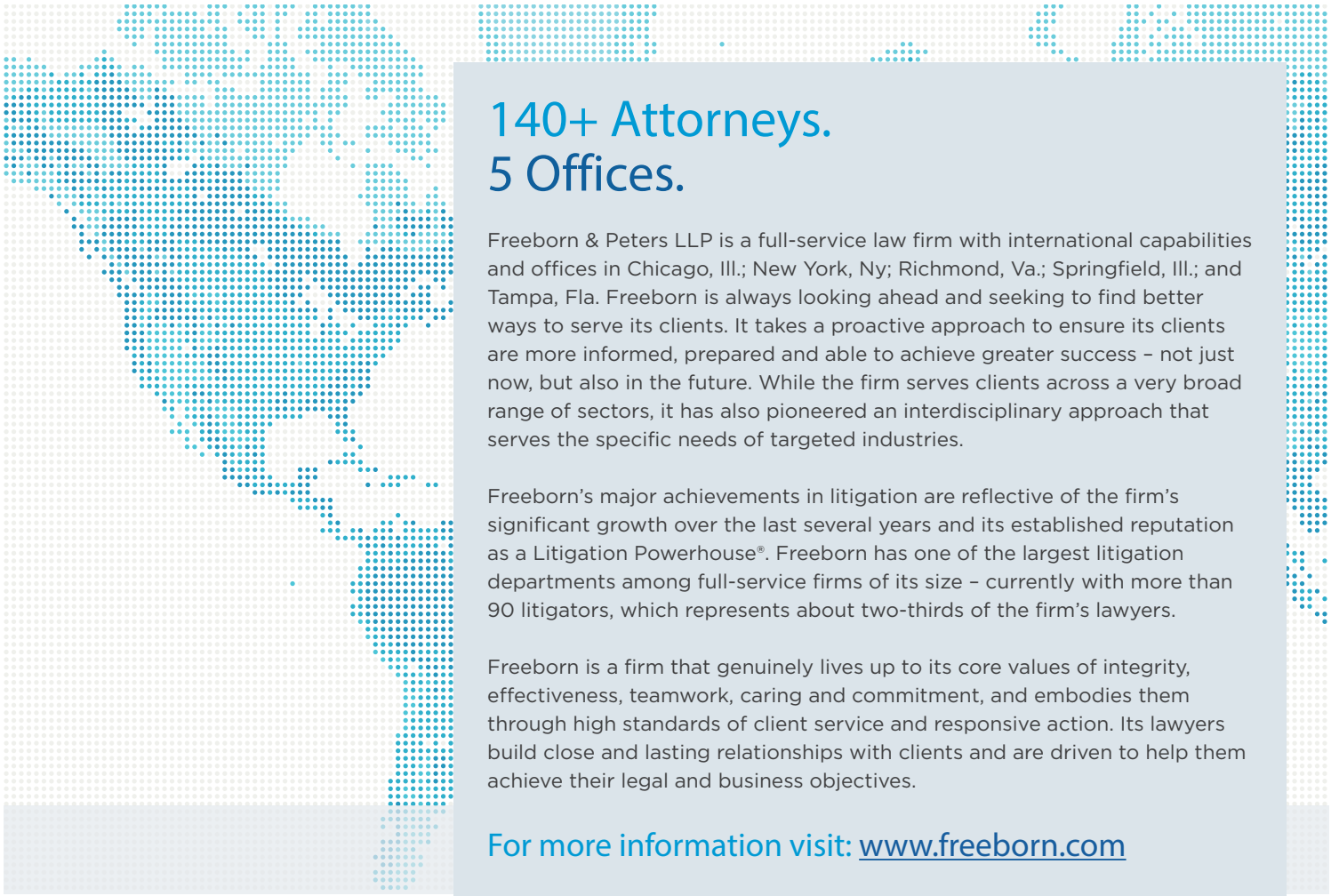

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