Policy Provisions Bolster State Biz Interruption Laws

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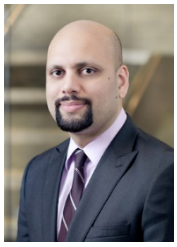

Some commentators have panned the legality of legislators' efforts to protect businesses by ensuring business interruption coverage for losses involving COVID-19. For the most part, those criticisms raise concerns based on the contract clause in the U.S. Constitution.

According to those authors, legislation that requires insurers to provide coverage under previously issued insurance policies would violate that clause. However, that theory overlooks the specific language of many insurance contracts, which provides for adjusting the policy provisions when there are changes in state law.

The contract clause states that "No State shall … pass any … Law impairing the Obligation of Contracts." The first part of the "two-step test for determining when such a law crosses the constitutional line" found in that clause is "whether the state law has 'operated as a substantial impairment of a contractual relationship.'"[1]

Relevant factors include "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."[2] Applying this test must be done with reference to the specific insurance contract at issue.

The actual policy language can undermine insurers' abilities to meet the first part of the constitutional test. In fact, at least two clauses can support the constitutionality of these proposed laws.

First, policyholders can rely on liberalization clauses. As one example, those clauses can state:

If during the period that insurance is in force under this Policy, any filed rules or regulations affecting the same are revised by statute so as to broaden the insurance without additional premium charge, such extended or broadened insurance will inure to the benefit of the Insured within such jurisdiction, effective the date of the change specified in such statute.[3]

Under these provisions, "filed rules and regulations affecting" the policy that are "revised by statute ... so as to extend or broaden" coverage will benefit the insured. Thus, policyholders can argue that any state law ensuring coverage for business interruption losses involving COVID-19 does not substantially impair the contractual relationship because the policy itself contemplates the possibility of such a law and affirms that it would benefit the policyholder.

Because of the liberalization clause, the law would not undermine the contractual bargain or interfere with a party's reasonable expectations. Indeed, the contractual bargain recognized and approved of post-contracting governmental changes and the party's reasonable expectations would have been consistent

with that language.

Second, policyholders can rely on provisions conforming policies with state law. One such provision states:

Any provisions required by law to be included in policies issued by the Company shall be deemed to have been included in this Policy.

If the provisions of this Policy conflict with the laws of any jurisdictions in which this Policy applies, and if certain provisions are required by law to be stated in this Policy, this Policy shall be read so as to eliminate such conflict or deemed to include such provisions for Insured Locations within such jurisdictions.

Based on provisions like this, policyholders can contend that the insurance contract specifically incorporates any state laws that conflict with the policy, at least with respect to insured locations within that particular state. Thus, the proposed statutes would not run afoul of the contracts clause because they would not operate "as a substantial impairment of a contractual relationship." Instead, the policyholder and insurer agreed to modify their contract, i.e., the policy, to incorporate and conform to any state law that is contrary to the policy provisions.

In addition to these arguments related to potential state legislation, federal action to ensure business interruption coverage for losses involving COVID-19 would not even raise the same constitutional issues. The contract clause is expressly limited to actions by a state.[4] And, the U.S. Supreme Court has recognized that the contract clause does not apply to federal actions.[5] Thus, any constitutional challenge to federal government action in this regard would not involve the contract clause.

Finally, the two provisions identified above can also undermine any reliance on substantive due process or the takings clause. To establish a due process violation, the opponent of the law must show that the legislature has acted in an arbitrary and irrational way. Insurance policy provisions that contemplate incorporation of post-contract changes in the law (like those above) support that any such post-contract changes in the law would not be arbitrary or irrational.

Reliance on the takings clause should fare no better. To begin with, legislatures routinely modify the economic relationship between parties without violating the takings clause.[6] Even ignoring that, the two provisions above support that the legislation being considered would not violate the takings clause.

The Supreme Court has identified these three particularly significant factors in evaluating whether a taking in this circumstance would be forbidden by the Fifth Amendment: "(1) the economic impact of the regulation on the claimant; (2) the extent to which the regulation has interfered with distinct investment-backed expectations; and (3) the character of the governmental action."[7]

Here, the policy provisions identified above specifically allow for modification of the contract based on post-contract changes in the law. Thus, any economic impact would be consistent with the parties' contract and there would be no interference with the parties' expectations.

Of course, none of this is to say that many policies do not already cover business interruption losses involving COVID-19. But, if a particular policy does not provide that protection already, these proposed statutes may very well help policyholders obtain that much-needed coverage.

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Notes

1. Sveen v. Melin, 138 S. Ct. 1815 (2018) (quoting Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978)).

2. Id.

3. See also Magnolia-Broadway Corp. v. Fire Ass'n of Philadelphia, 137 N.Y.S.2d 918, 922 (N.Y. City Ct. 1955) (involving policy that provided: "If during the period that insurance is in force under this policy, the policy, any authorized endorsements or filed rules and regulations affecting the same, are revised by statute or otherwise, so as to extend or broaden this insurance without additional premium charge, such extended or broadened insurance shall inure to the benefit of the insured hereunder.").

4. See Art. I, Sec. 10, Clause 1 ("*No State shall* enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility."

5. See Pension Ben. Guar. Corp. v. R.A. Gray & Co., 467 U.S. 717, 733 n. 9 (1984) ("It could not justifiably be claimed that the Contract Clause applies, either by its own terms or by convincing historical evidence, to actions of the National Government.").

6. See, e.g., Connolly v. Pension Ben. Guar. Corp., 475 U.S. 211, 223 (1986) ("Given the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another.").

7. Connolly, 475 U.S. at 225.

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