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State Business Interruption Coverage Bills Likely Contain Constitutional Infirmities

We have recently learned that a number of states were or are considering legislation to mandate that insurers who issued policies to small businesses in those states must accept and cover risks that were not within the scope of coverage to begin with and were, in some cases, also subject to exclusions from coverage. Specifically, the proposed legislation would require that policies that are issued to small businesses and that contain business interruption coverage be construed to provide coverage for losses resulting from the COVID-19 pandemic. This legislation would effectively remove the standard requirement that the business interruption loss result from a "direct physical harm" to the insured's property. One of the bills would also specifically override any exclusion for losses arising out of the spread of a virus.

This proposed legislation is significant. By unilaterally changing the terms of private contracts, the legislation attempts to shift fiscal responsibility for the economic disruption caused by the COVID-19 pandemic to the insurance industry and to saddle insurers with obligations for which they never bargained or received premiums. The legislators who proposed this legislation—in Massachusetts, New Jersey and Ohio—were certainly well meaning; they wanted to find a way to keep small businesses operating. The method they seek, however, is unfair and is likely unconstitutional, as it appears to run afoul of the Contracts Clause of the Constitution.

The Contracts Clause provides that "[n]o State shall… pass any…Law impairing the Obligations of Contracts." U.S. Const. art 1., § 10. The Supreme Court has set forth a two-part test for evaluating whether a state law violates the Contract Clause. *See Sveen v. Melin*, 138 S. Ct. 1815, 1821-22 (U.S. 2018). First, the court must determine "whether the state law has operated as a substantial impairment of a contractual relationship." *Id.* (quotations omitted). Second, the court must determine "whether the state law is drawn in an appropriate and reasonable way to advance a significant and legitimate public purpose." *Id.* at 1822 (quotations omitted).

Here, there can be little dispute that the proposed legislation would substantially impair insurance policies, as the legislation would operate to rewrite policies to cause them to cover a risk they do not currently cover. The closer question is whether the legislation is an "appropriate and reasonable way" to achieve a "legitimate public purpose." Because the legislation operates to merely benefit one private sector of the expense of another, states may face difficulty establishing that such legislation satisfies a "legitimate public purpose." Further, the legislation arguably benefits only a narrow class of businesses; the public at-large is only an indirect beneficiary. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 248-249 (1978) (finding that a Minnesota law did not advance a legitimate public purpose where the law was enacted to protect "a narrow class" of employers rather than a "broad societal interest").

As to whether the proposed legislation is an "appropriate and reasonable way" to achieve its purpose, in the past states have been successful in justifying state laws modifying insurance policies on the basis of governmental emergency. *See e.g., Vesta Fire Ins. Corp. v. State of Fla.*, 141 F.3d 1427, 1434-35 (11th Cir. 1998) (Florida law prohibiting insurers from canceling or nonrenewing a certain percentage of residential policies in Florida in the wake of Hurricane Andrew); *State v. All Prop. & Cas. Ins. Carriers Authorized & Licensed To Do Bus. In State*, 937 So. 2d 313, 326-27 (La. 2006) (Louisiana law extending the statute of limitations for filing property insurance claims arising from Hurricanes Katrina and Rita). The nature of the interference those laws imposed—a required renewal of coverage or an extension of a limitations period for an otherwise covered loss—pale in comparison to the substantial coverage obligations that the proposed legislation seeks to create. Indeed, the proposed legislation attempts to shift the responsibility of providing financial assistance to small businesses from the government to certain insurance companies. A court should find that such extreme action is not "appropriate and reasonable."

In conclusion, the proposed legislation would fundamentally rewrite policies to incorporate COVID-19 as a covered peril, thereby imposing on insurers the obligation to cover the business interruption loss many small businesses are presently incurring as a result of the COVID-19 pandemic. Such substantial interference with private contracts raises significant issues under the Contracts Clause of the United States Constitution.

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