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Legislation Enabling Policyholders to Obtain Insurance Coverage for Coronavirus Claims is Constitutional (Part 2)

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In Part One of this post, we discussed proposed legislation addressing the rights of policyholders to business interruption coverage for coronavirus claims and the insurance industry's objection that this legislation would violate the Contracts Clause of the United States Constitution. Below, we discuss the test for whether a state law violates the Contracts Clause, the application of that test to insurance issues, and the constitutionality of the proposed legislation.

The Test for Whether a State Law Violates the Contracts Clause

The Supreme Court has developed a two-part test to balance the police power against the rights of contracting parties. *Sveen v. Melin*, 138 S. Ct. 1815, 1821 (2018).

Under the first part of the test, the Court asks "'whether the state law has, in fact, operated as a substantial impairment of a contractual relationship.' The severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected." *Energy Reserves Group v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983) (citation omitted). In determining the extent of the impairment, the Court considers "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." *Sveen*, 138 S. Ct. at 1822. The Court also "consider[s] whether the industry the complaining party has entered has been regulated in the past." *Energy Reserves*, 459 U.S. at 411 (in upholding state legislation that affected price of natural gas against claim that it violated the Contracts Clause, Court relied in part on fact that natural gas industry was regulated by the state).

When there is a substantial impairment of contractual obligations, the Court applies the second part of the test, which examines the purpose of the challenged law and the means used to achieve that purpose. *Sveen*, 138 S. Ct. at 1822. The Court has held that the state "must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem. . . . [T]he public purpose need not be addressed to an emergency or temporary situation. . . . The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests." *Energy Reserves*, 459 U.S. at 412. With respect to means, the Court has stated that "the adjustment of 'the rights and responsibilities of contracting parties [must be based] upon reasonable conditions and [must be] of a character appropriate to the public purpose justifying [the legislation's] adoption.' Unless the State

itself is a contracting party, . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.'" *Id.* at 412–13 (citations and notes omitted). However, where "the State's self-interest is at stake," as it is when the state takes on a financial obligation such as a bond covenant, complete deference is not appropriate. *United States Trust Co.*, 431 U.S. at 26.

Applying this two-part test, the Court has upheld numerous state statutes that allegedly interfered with contractual rights. The leading modern case is *Home Building & Loan Association v. Blaisdell*, 290 U.S. 398 (1934), which involved a challenge to a state law passed at the height of the Great Depression to give relief to homeowners unable to pay their mortgages. The law authorized local courts to extend the period of redemption from foreclosure sales "for such additional time as the court may deem just and equitable." The Court concluded that the statute was constitutional. The Court reasoned that "An emergency existed in Minnesota which furnished a proper occasion for the exercise of the reserved power of the State to protect the vital interests of the community." *Id*. at 444. The Court further reasoned that "The legislation was addressed to a legitimate end, that is, the legislation was not for the mere advantage of particular individuals, but for the protection of a basic interest of society." *Id*. And, the Court observed that "The conditions upon which the period of redemption is extended do not appear to be unreasonable," because while the time to pay the mortgage was extended, the debt was not extinguished, and the legislation had a sunset provision. *Id*. at 445–46.

More recent cases have rejected Contracts Clause challenges even when the legislation was not "adopted pursuant to a declared emergency in the State, and strictly limited in duration." *United States Trust Co. v. New Jersey*, 431 U.S. at 22 n.19. *See, e.g.*, *City of El Paso v. Simmons*, 379 U.S. 497 (1965) (Court upheld a Texas law that shortened the period in which delinquent landowners could redeem their properties);

Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470 (1987) (Court upheld a Pennsylvania statute that allowed landowners to sue coal companies for environmental damage, even though the landowners had waived their rights to damages when they conveyed mineral rights to the coal companies).

Indeed, there are only two Supreme Court cases in the past 40 years that have found Contracts Clause violations. *See United States Trust Company v. New Jersey*, 431 U.S. 1 (1977) (striking down state laws that retroactively repealed bond covenant that limited the use of bond revenues); *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978) (striking down state law that imposed a retroactive charge on companies that terminated pension plans or closed their in-state offices). Taken together, these cases indicate that the Court, though generally inclined to defer to state legislative judgments about the need for laws that may affect contracts, will not simply rubber-stamp such laws. To the contrary, where the state is a party to a contract and thus presumably acts in a self-interested manner, legislation that impairs contractual rights will be carefully scrutinized to ensure that the means chosen by the legislature are appropriate to its stated goals. *See United States Trust Co., supra.* And, likewise, where the legislation affects a narrow group of beneficiaries, as opposed to the general public, it will likewise be carefully examined. *See Spannaus, supra.*

Application of the Caselaw to Cases Involving Insurers

In the insurance context, as in other contexts, state laws can affect contracts in numerous ways. The cases discuss legislative efforts to regulate premiums, policy terms, and other aspects of the relationship between policyholder and insurer.

Not surprisingly, many Contracts Clause challenges in the insurance context involve legislative responses to natural disasters. For example, in *Vesta Fire Ins. Corp. v. State of Fla.*, 141 F.3d 1427 (11th Cir. 1998), the court upheld remedial legislation enacted by Florida in response to Hurricane Andrew that restricted the ability of insurers to withdraw from the market for residential insurance. Similarly, in *State v. All Property and Casualty Insurers*, 937 So. 2d 313 (La. 2006), the court upheld legislation enacted to give policyholders in Louisiana relief from the devastating effects of Hurricanes Katrina and Rita by extending the statute of limitations for policyholders to sue their insurers for coverage. And, in *20th Century Ins. Co. v. Superior Court*, 90 Cal. App. 4th 1247, 1255–56, 109 Cal. Rptr. 2d 611, 617 (2d Dist. 2001), the court rejected a Contracts Clause challenge to a state law that, in response to the Northridge earthquake of 1994, had retroactively negated a policy that required the policyholder to sue within one year of the denial of his claim. *See also Campanelli v. Allstate Life Ins. Co.*, 322 F.3d 1086, 1097–99 (9th Cir. 2003) (upholding the same California legislation against another Contracts Clause challenge).

These cases make clear that, when natural disasters cause great financial hardship to policyholders, legislation designed to address that hardship will be upheld by the courts, even if it alters pre-existing policy rights. In each of these cases, prior to the passage of the statute at issue, the insurer had a clear legal and/or contractual right to cancel its policy (*Vesta*) or to refuse to pay an untimely claim (*All Property & Casualty Insurers*; *20th Century Ins. Co*.; *Campanelli*). And in each case, a subsequent state law altered that right by restricting the insurer's right to cancel or to rely on a limitations period specified in the policy or in prior state law. Yet in each case, the court rejected the insurer's argument that the state law violated the Contracts Clause. Whether because of the highly regulated nature of the insurance industry, or the remedial purpose of the legislation, or the presumption that the means used to achieve that purpose are permissible, or the existence of emergency conditions created by a natural disaster, or all of the above, the courts held that the state legislation passed constitutional muster.

Application of the Caselaw to the Proposed Legislation

The same result should apply to the legislation aimed at mitigating the effects of the coronavirus pandemic on policyholders. The insurers that issued business interruption coverage, like those in the cases cited above, were in a highly regulated industry. Indeed, the heavy degree of regulation arguably lowered (or even defeated) any expectation the insurers may have had that their contracts would not be altered by state legislative action, as did the extensive caselaw approving retroactive modifications of policy provisions.

But even assuming that the proposed legislation substantially impairs existing contracts between insurers and their policyholders, there is still no constitutional violation. The proposed legislation has a legitimate purpose: protecting millions of business owners and their customers from the devastating effects of the coronavirus pandemic. Indeed, although a crisis is not required for a state law to withstand attack, there can be no question that the pandemic has created a crisis, one arguably as serious as the Great Depression in *Blaisdell* or the hurricanes in the insurance cases discussed above. And, the number of beneficiaries of the proposed legislation precludes any suggestion that it is targeted to help only a limited class of beneficiaries. *Compare Spannaus*. Nor can there be any doubt that the legislation is rationally related to resolving that crisis. The legislation seeks to abate the crisis by targeting major victims of the pandemic, i.e., businesses forced to shut down by the coronavirus and the customers that patronize those businesses. Thus, the proposed legislation should pass muster under the Contracts Clause.

Read Part One on Legislation Allowing Policyholders to Obtain COVID-19 Coverage.

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