

New Jersey's Proposed COVID-2019 Business Interruption Insurance Legislation Fails to Socially Distance Itself From Constitutional Prohibitions

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Without question, the Coronavirus disease 2019 (COVID-19) has caused a world-wide pandemic and paralyzed the United States economy in the first quarter of 2020. Many businesses have been forced to shut down or modify their day-to-day practices in order to minimize the spread of COVID-19 through the concept of "social distancing." Thus, first-party insurance coverage issues involving business interruption are hot and timely.

ISO form CP 01 40 07 06, titled "Exclusion for Losses Due To Virus or Bacteria" ("virus exclusion"), excludes business interruption coverage payments "for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease." [<https://www.whiteandwilliams.com/resources-alerts-ISO-Excluded-Coronavirus-Coverage-15-Years-Ago.html>]. However, New Jersey's General Assembly has introduced proposed legislation which would require an insurer's "business interruption" coverage to indemnify eligible insured businesses facing a loss of business *regardless* of any such exclusion.[1] Bill A-3844 was voted out of the New Jersey Assembly Homeland Security and State Preparedness Committee on March 16, 2020. However, no further action has been taken on this bill, as there is a push to have insurers work out these issues privately without the "heavy hand" of government.[2]

Nevertheless, this sort of law would face almost certain constitutional challenges from insurers and trade groups. Both the New Jersey and United States Constitutions prohibit the passage of laws impairing the obligations of contracts. U.S. Const. art. 1, § 10, cl. 1; N.J. Const. art. IV, § 7, ¶ 3. The Supreme Court of New Jersey has recognized that both sets of constitutional clauses provide "parallel guarantees." *Burgos v. State*, 118 A.3d 270, 281 (N.J. 2015). "Legislation unconstitutionally impairs a contract when it (1) 'substantially impair[s] a contractual relationship,' (2) 'lack[s] a significant and legitimate public purpose,' and (3) is 'based upon unreasonable conditions and . . . unrelated to appropriate governmental objectives.'" *Farmers Mut. Fire Ins. Co. of Salem v. N.J. Prop.-Liability Ins. Guar. Ass'n*, 74 A.3d 860, 874 (N.J. 2013); see also *Energy Reserves Grp. v. Kan. Power & Light Co.*, 459 U.S. 400, 411 (1983).

Under the first prong, insurers would argue that retroactively eviscerating the virus exclusion would be a substantial impairment of the insurance contractual relationship. The insurers assessed the risk of loss when pricing their policies for their insured and factored in the viral coverage exclusion. Bill A-3844's language partially disrupts this complex assessment. *Energy Reserves Grp.*, 459 U.S. at 411 (a substantial impairment may be found without the total destruction of contractual expectations). More court scrutiny is required for more severe impairments to a contract. *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 245 (1978). Since the magnitude of the COVID-19-induced business interruption could have a significant economic impact on insurers forced to cover any such losses, the bill should be carefully scrutinized.[3]

Furthermore, the necessary prerequisite for business interruption coverage is the suspension of an insured business' operations "caused by direct physical loss of or damage to" the insured's premises. However, the widespread shut-down and limitation of the economy by civil authorities is the primary reason for a suspension of business, not any direct physical loss or damage caused by a virus. Thus, if the legislature wants to compel insurer indemnification of shuttered businesses, it would not only eviscerate the virus exclusion, but also the physical damage requirement. [<https://www.whiteandwilliams.com/resources-alerts-COVID-19-The-Real->

Operation-of-New-Jerseys-Proposed-Insurance-Legislation.html].

The second and third prong focus on whether A-3844 is reasonably necessary to serve a significant and legitimate public purpose. Certainly, the State of New Jersey (and the country) are continuing to suffer serious economic effects from the coronavirus pandemic. However, this proposed bill would arguably benefit individual, private businesses more than some broader, societal goal. Essentially, it would shift the economic burden caused by COVID-19 to the insurers who had fairly bargained for a policy excluding such coverage.

Admittedly, an impairment may be constitutional if it is viewed as reasonable and necessary to serve an important public purpose. *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 25 (1977). However, it is inappropriate to completely defer to a legislative assessment of reasonableness and necessity when the state's self-interest is at stake. *U.S. Trust Co. of N.Y.*, 431 U.S. at 25-26. New Jersey has a self-interest in shifting the economic burden of such losses onto private insurers. Otherwise, the state could be required to pass a major, taxpayer-funded bailout package for affected businesses. Thus, the courts should not completely defer to the New Jersey legislature with respect to its assessment of the reasonableness and necessity of this legislation.

Furthermore, the second and third prong, evaluating whether legislation is reasonable and necessary to serve a significant and legitimate public purpose, involves a balancing test. Five factors are deemed significant in this analysis and involve "whether the Act (1) was an emergency measure; (2) was one 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." *Energy Reserves Grp.*, 459 U.S. at 410 n.11. While this bill does appear to be an emergency measure, it is primarily driven to protect private actors rather than the public at large. The bill is also not narrowly tailored or reasonable with respect to the conditions it imposes.

Plus, while the bill may be proposed and perhaps passed during an emergency, and may be seeking to recompense financial losses incurred during that emergency, the bill almost assuredly will not result in monies being paid soon to the businesses in need of financial rescue. As noted, insurers and trade organizations will challenge this bill in the court (many of which are closed) and that litigation will not likely be resolved in 2020, or even perhaps 2021.

The bill is likely to have effects well beyond the current emergency. Commercial insurance premiums will likely skyrocket due to this bargain-disrupting law or even make commercial insurance unavailable to businesses in the future. This would undermine some of the supposed goals of this bill. For these reasons, expect insurers and their trade groups to aggressively challenge such legislation if and when enacted. And if the goal of the New Jersey Legislature is to provide a timely financial lifeline to small business employers, the better way to get monies into the hands of needy businesses quickly is not through insurance – it is from direct support and lending from the federal and state governments.

If you have questions or would like further information, please contact Edward M. Koch (koche@whiteandwilliams.com; 215.864.6319) or Felix S. Yelin (yelinf@whiteandwilliams.com; 215.864.6317).

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates [here](#).

[1] 2020 Bill Text NJ A.B. 3844; [see also](https://www.whiteandwilliams.com/resources-alerts-NJ-Legislature-May-Force-Insurers-To-Pay-COVID-19-Claims-Despite-Exclusion.html) <https://www.whiteandwilliams.com/resources-alerts-NJ-Legislature-May-Force-Insurers-To-Pay-COVID-19-Claims-Despite-Exclusion.html>, March 15, 2020. The bill would apply to business covered with less than 100 eligible employees in the State of New Jersey, with and "eligible employee" defined as a "full-time" employee who works a normal work week of 25 or more hours."

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[2] *Sarlo Urges NJ Bankers to Grant 'Payment Holiday' to Restaurants & Bars During Public Health Emergency*, Insider NJ, <https://www.insidernj.com/press-release/sarlo-urges-nj-bankers-grant-payment-holiday-restaurants-bars-public-health-emergency/>, March 18, 2020.

[3]The proposed bill does state that insurers indemnifying their insureds under this proposed act may apply to the Commissioner of Banking and Insurance for "relief and reimbursement by the commissioner from funds collected and made available" under this bill. 2020 Bill Text NJ A.B. 3844. However, this is a vague provision with no specific details as to how much "relief and reimbursement" would be available to insurers.

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