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STATE OF OREGON
LEGISLATIVE COUNSEL COMMITTEE

May 15, 2013

Senator Chip Shields
900 Court Street NE S421
Salem OR 97301

Re: Impairment of contract issues under SB 814

Dear Senator Shields:

You asked whether Senate Bill 814 constitutes an unconstitutional impairment of contract under either the Oregon Constitution or the United States Constitution. The answer is no, SB 814 is not on its face unconstitutional on impairment of contract grounds. As I indicated in testimony before the Senate Committee on General Government, Consumer and Small Business Protection on April 5, 2013, there may be circumstances under which particular provisions of SB 814 could be in conflict with express provisions of an insurance contract. Under such circumstances, SB 814 provides that the insurance contract controls over the conflicting statutory provision;[1] it is principally for this reason that SB 814 is not an unconstitutional impairment of contract as a matter of law.

Senate Bill 814

SB 814 modifies the Oregon Environmental Cleanup Assistance Act (OECAA), ORS 465.475 to 465.480. In enacting the OECAA, the Legislative Assembly found that there are many insurance coverage disputes with regard to polluted sites in this state and that the State of Oregon has a substantial public interest in promoting fair and efficient resolution of environmental claims. ORS 465.479. Briefly, SB 814 modifies the OECAA by (1) permitting any insured to assign environmental claims without obtaining the consent of an insurance company; (2) prohibiting reductions of policy limits on account of prior insurance; (3) providing that insured property owners' efforts at undertaking certain specified actions with respect to hazardous substance effects on property owned by third parties constitute remedial action costs covered by insurance; (4) prohibiting certain environmental claims settlement practices and establishing a cause of action to enforce those prohibitions; and (5) establishing a right for insureds to be represented by independent legal counsel and independent environmental consultants.

Significantly, section 8 (1) of SB 814 provides—with limited exceptions—that the bill applies to environmental claims arising before, on or after the effective date of the Act. Thus, the bill has retroactive application to insurance contracts that were previously bargained for and executed by insureds and insurance companies.

In the context of impairment of contract concerns, however, the most significant provision of SB 814 is section 4 (8), which provides that "[t]he rules of construction set forth in this section and sections 2 and 7 of this 2013 Act do not apply if the application of the rule results in an interpretation contrary to the intent of the parties to the [insurance policy in question]." An example may assist in illustrating how

[1] *See* ORS 465.480, as amended by section 4 (8) of SB 814 (hereinafter "section 4 (8)").

section 4 (8) works. Assume an insured has assigned the insured's rights under an environmental claim to another. Section 2 would permit that assignment unless there is an express provision in the insurance contract at issue or other evidence that the bargained for intent of the parties prohibited such an assignment. If evidence of the parties' intent to prohibit assignment exists, the prohibition against assignment would control in lieu of section 2.

Finally, it is worth noting that many of the insurance contracts affected by SB 814 are comprehensive general liability policies that covered industrial sites in Oregon decades ago, during which contaminants were routinely released but for which the environmental harm and associated liability from these releases has emerged since the 1980s.[2] These types of comprehensive policies are designed to require the insurer to pay sums the insured is required to pay for injury or property damage that is caused by occurrences that occur during periods the policies are in effect. When the insurance contracts were executed, the parties did not envision that the routine release of contaminants at these sites would cause liability decades later. Therefore, the precise terms of these historic insurance contracts and the scope of coverage of these policies are often ambiguous and difficult to determine today.

Constitutional prohibitions on the impairment of contracts

Federal and state provisions interpreted similarly

Article I, section 21, of the Oregon Constitution, provides, in part, that no law "impairing the obligation of contracts shall ever be passed." Article I, section 10, of the United States Constitution, is similarly worded, providing, in part, that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts." The Oregon Supreme Court has held "that the framers of the Oregon Constitution intended to incorporate the substance of the federal provision, as it was . . . interpreted by the Supreme Court of the United States [at the time the Oregon Constitution was adopted in 1859], though not necessarily every case decided under the federal provision." *Eckles v. State*, 306 Or. 380, 389-390 (1988). In challenges brought on impairment of contract grounds that involve the effects of legislation on existing contracts between private parties, the court applies the same analysis under the Oregon impairment of contract provision as under the federal provision. *See Wilkinson v. Carpenter*, 277 Or. 557 (1977) (statutory increase in homestead exemption from execution of judgment that arose from contract between parties that was entered into before legislative change was not unconstitutional impairment of that contract); *Towerhill Condominium Association v. American Condominium Homes, Inc.*, 66 Or. App. 342, 347 (1983) (federal Constitution's limitation on law impairing obligation of contract is to be interpreted consistently with similar restriction in Oregon Constitution, *citing Wilkinson*).

Courts employ a three-level analysis to determine if a law unconstitutionally impairs an obligation of contract. A threshold question is whether the law operates to create a substantial impairment of a contractual relationship. The total destruction of the contractual relationship is not necessary for substantial impairment, but regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment. The degree to which an industry is regulated is also considered in ascertaining the extent of the impairment. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983). If the law at issue constitutes a substantial impairment, the impairment may be constitutionally justified if the state has a significant and legitimate public purpose behind the law creating the impairment. Once a significant and legitimate public purpose has been identified, the final inquiry is whether the adjustment of the rights and responsibilities of the contracting parties is based upon reasonable conditions and is of appropriate character to the public purpose justifying the regulation. *Energy Reserves*, 459 U.S. at 411-412.

Impairment of contracts claims can arise in the context of contracts to which the state is a contracting party and in particular in the context of contracts created by legislative act. *See, e.g., Hughes*

[2] *The Unanswered Question of Environmental Insurance Allocation in Oregon Law*, 39 Willamette L. Rev 1131, 1132 (2003).

v. Oregon, 314 Or. 1 (1992). The analysis undertaken to determine if a law unconstitutionally impairs the obligation of contract, under either the federal Constitution or the state Constitution, is modified when the contract at issue is one established by legislation or in which the state is a party. Specifically, in these circumstances a court will not consider the balancing of a legitimate public purpose against an impaired contract right to uphold legislation that alters contractual obligations. *Energy Reserves,* 459 U.S. at n.14. Balancing and deference to a legislative assessment of reasonableness and necessity is inappropriate in these circumstances because the state's self-interest is at stake. *United States Trust Co. v. New Jersey*, 431 U.S. 1, 25-26 (1977). Rather, a court will consider only whether the statute in question changes contractual obligations in existence at the time of the statutory enactment, without regard to balancing any countervailing public purpose behind the enactment. *Hughes*, 314 Or. at 56. We note that SB 814 will only affect contracts between private parties or in which a governmental entity is a party only due to the entity being a property owner and hence acting in a nongovernmental capacity. Accordingly, any analysis of whether SB 814 unconstitutionally impairs the obligation of contracts appropriately should include a balancing of the impairment against the state's interests in achieving any significant and legitimate public purposes the legislation is designed to address.

SB 814 does not impair existing contracts

As a threshold matter, to violate constitutional Contracts Clause protections, the state law in question must operate to substantially impair a contractual relationship. *Allied Structural Steel Co. v. Spannaus,* 438 U.S. 234, 244 (1978). Minimal alteration is insufficient to constitute impairment. Rather, to impair an existing contract means to modify the vested rights and duties of the parties to the contract. *Id.* at 243. Thus, a law that retroactively modified the compensation a company had agreed to pay its employees was found to violate constitutional protections against impairment of contract, but a law that required insurers to obtain the written consent of insureds to substitute replacement parts not made by an original manufacturer was not an unconstitutional impairment of existing contracts. *Compare Spannaus,* 438 U.S. at 249-250, and *State Farm v. Wyoming Ins. Dept.*, 793 P.2d 1008, 1013 (Wy. 1990). By its terms, SB 814 is only capable of merely clarifying the terms of an existing contract, and cannot impair the underlying obligations of that contract, because of the operation of section 4 (8). Under section 4 (8), if any provision of section 2, 4 or 7 of the bill actually modifies a right or duty to a preexisting policy, the terms of the policy control. Only if the preexisting policy is silent or ambiguous on matters addressed by section 2, 4 or 7 and there is no other evidence that the contracting parties had intended a different result, does section 2, 4 or 7 apply. Accordingly, SB 814 by its terms cannot be said to "impair" a preexisting insurance policy.

SB 814 does not violate constitutional Contracts Clause protections because it is aimed at achieving a legitimate public purpose

Assuming only for the sake of argument that SB 814 does "impair" certain existing contracts, we conclude that such an impairment is unlikely to rise to the level of being an unconstitutional impairment of contracts. Both the federal and state prohibitions on impairment are not absolute, and instead must be balanced against a state's inherent power to safeguard the vital interests of its people. Pursuant to exercising that power, a state may, without violating the Contracts Clause, restrict or even destroy the performance of duties that were created by contracts entered into before the enactment of the legislation restricting or destroying those contractual duties. *Exxon Corp. v Eagerton*, 462 U.S. 176, 189-190 (1983). Laws that regulate existing contractual relationships must serve a legitimate public purpose. Legislation that adjusts the rights and responsibilities of contracting parties must be reasonable and appropriate to the public purpose justifying the legislation. *Home Bldg. & Loan Asso. v Blaisdell*, 290 U.S. 398, 444-447 (1934). However, courts properly give deference to legislative judgment in determining the necessity and reasonableness of particular legislation. *East New York Savings Bank v. Hahn*, 326 U.S. 230 (1945).

In *Energy Reserves*, the U.S. Supreme Court considered whether the contract rights of a natural gas supplier were impaired when state legislation placed price controls on natural gas prices, including prices established under existing contracts between suppliers and utilities. *Energy Reserves*, 459 U.S. at 407. The court rejected the claim that the legislation unconstitutionally impaired the obligation of contracts because (1) the natural gas industry was historically a heavily regulated industry in which contracting parties could expect extensive state regulation; and (2) the impairment was justified when balanced against legitimate state interests to protect consumers from the effects of unregulated gas prices. *Id*. at 413-417.

The insurance industry is a heavily regulated industry. The Insurance Code, which the Legislative Assembly declared in ORS 731.008 to be for the purpose of protecting the insurance-buying public, comprises thirteen chapters of the *Oregon Revised Statutes*. In *Campanelli v. Allstate Life Insurance,* 322 F.3d 1086 (9th Cir. 2003), the court considered whether a California law that retroactively revived insurance claims that otherwise would have been barred by applicable statutes of limitation was an unconstitutional impairment of contract.[3] The court concluded that the statute in question did impair contracts between insureds and insurers but, significantly, concluded that the impairment was mitigated by (1) the fact that the insurance industry is heavily regulated and that all parties to contracts affected by the legislation could reasonably anticipate further regulation; and (2) the legitimate public purpose of ensuring that earthquake victims be fairly compensated for their losses after having been misled by the insurance industry on the extent of those losses. *Campanelli*, 322 F.3d at 1098-1099.

In *Vesta Fire Ins. Corp v. Florida*, the 11th Circuit Court of Appeals considered whether a Florida law that required insurers to continue to offer residential lines policies even when insurers sought to not renew existing policies and sought withdrawal from the Florida marketplace, constituted an unconstitutional impairment of contract under the federal Contracts Clause. 141 F.3d 1427 (11th Cir. 1998). In effect, the Florida law altered existing contracts by automatically extending the duration of policy coverage, over the objection of insurers. The court concluded that, while the law operated to substantially impair the insurers' contracts, the impairment was not a constitutional violation because the state had a legitimate public purpose—protection and stabilization of the Florida economy, particularly the real estate market—and it was appropriate for the court to defer to the legislature's judgment on the necessity and reasonableness of the law in promoting that public purpose. Accordingly, the court found that the statute's impact on existing insurance contracts, while a substantial impairment, could not be said to be an unconstitutional impairment. *Vesta*, 141 F.3d at 1434.

In light of these cases, we conclude that it is likely that SB 814 would be upheld and would not be considered an unconstitutional impairment of contract. First, as noted above, SB 814 does not create an impairment of existing contracts because of the operation of section 4 (8) of the bill. However, even if one were to assume for the sake of argument that SB 814 substantially impaired existing insurance policies, that impairment would not be unconstitutional. First, the insurance industry in Oregon is heavily regulated and has been for decades. *Lovejoy v. City of Portland*, 95 Or. 459, 479 (1920) (purpose of Insurance Code is to provide for the entire state a uniform and complete system of regulation). Like the California insurers in *Campanelli*, Oregon insurers would have had the expectation that insurance regulation would continue, at the time that all comprehensive general liability policies affected by SB 814 would have been entered into. Second, SB 814 is designed to achieve a legitimate public purpose: facilitating the cleanup of polluted sites in Oregon and enhancing the predictability of liability for cleanup costs. Finally, a court is unlikely to substitute its judgment for that of the Legislative Assembly's judgment that SB 814 is the most reasonable and appropriate means to achieve that legitimate public purpose.

[3] Article I, section 9, of the California Constitution, provides that a "law impairing the obligation of contracts may not be passed." Like Oregon, California courts use the federal Contracts Clause analysis for determining whether a statute violates the parallel California provision. *Campanelli*, 322 F.3d at 1097, *citing Calfarm Ins. Co. v. Deukmejian*, 771 P.2d 1247, 1262-1263 (Cal. 1989).

Holloway v. Republic Indemnity Co. has no bearing on the constitutionality of SB 814

In *Holloway v. Republic Indemnity Co.*, the Supreme Court considered whether an express anti-assignment clause in a workers' compensation and employers' liability policy would nevertheless allow the insured to assign the insured's rights under the policy arising from a sexual harassment claim brought against the insured. 341 Or. 642 (2006). The anti-assignment clause at issue in that case provided "Your rights or duties under this policy may not be transferred without our written consent." *Id.* at 645. The court found that the anti-assignment clause was broadly worded but unambiguous, and expressly prohibited the insured from assigning rights or duties to someone else. *Holloway*, 341 Or. at 652.

Section 2 (1) of SB 814 provides:

> A general liability insurance policy that contains a provision that requires the consent of an insurance company before the rights under an insurance policy may be assigned may not prohibit the assignment without consent of an environmental claim for payment under the policy for losses or damages that commenced prior to the assignment. The assignment and any release or covenant given for the assignment may not extinguish the cause of action against the insurer unless the assignment so provides.

Opponents of SB 814 have cited *Holloway* as standing for the principle that all anti-assignment clauses in insurance policies may not be modified by a subsequent statutory direction. We agree with that characterization in circumstances where an insurance policy contains an express anti-assignment clause that is worded identically to the policy in *Holloway*. Significantly, however, SB 814 would require an anti-assignment clause worded the same as in *Holloway* to be given effect anyway, in lieu of section 2, because of the operation of section 4 (8) of the bill. Section 2 governs only those policies where the policy language is ambiguous concerning the intent of the parties. For example, a policy to which SB 814 applies could provide that an insured could not assign coverage under the policy without the written consent of the insurer. It is certainly arguable that such language is ambiguous with respect to whether it reflects an intent of the parties to require written consent before an assignment of an insured's rights with respect to a claim—as distinguished from coverage—could be assigned. *See Quemetco v. Pacific Automobile Ins. Co.*, 24 Cal. App. 4th 494, 502 (1994) (clause requiring consent rendered assignment of insurance coverage ineffective, but assignment of right to recover for loss that occurred before assignment was effective without insurer's consent). In these circumstances, section 2 eliminates the ambiguity by expressly providing that an assignment of a claim is valid without an insurer's consent.

Meaning of "rules of construction" as used in section 4 (8)

As noted above, section 4 (8) of SB 814 is an amendment to ORS 465.480. As amended, ORS 465.480 (8) provides:

> The rules of construction set forth in this section and sections 2 and 7 of this 2013 Act do not apply if the application of the rule results in an interpretation contrary to the intent of the parties to the general liability insurance policy.

Section 2 is the assignment provision discussed above. Section 7 is a direction to provide independent legal and environmental counsel. ORS 465.480, as otherwise amended by section 4, provides numerous rules of construction including, briefly, rules clarifying rights of contribution between co-insurers and rules clarifying responsibilities for costs incurred in mitigating damage to third-party property. One could

perhaps argue that the provisions referenced in section 4 (8) are substantive law provisions, leading one to conclude that section 4 (8) has no operative effect. We disagree with that conclusion.

In interpreting statutory provisions, Oregon courts employ the methodology first described in *PGE v. BOLI*, 317 Or. 606, 610-611 (1993), to discern the intent of the legislature in enacting the statute. Under this methodology, a court looks first to the text and context of a statute. A court may also consider proffered legislative history of a statute, but the court need only give that legislative history the evaluative weight that the court considers appropriate to shed light on legislative intent. *State v. Gaines*, 346 Or. 160, 171-172 (2009). Finally, if legislative intent remains unclear after examining the text, context and legislative history of a statute, general maxims of statutory construction may be used to resolve remaining uncertainty. *PGE*, 317 at 610-611. For purposes of the *PGE* analysis, the context of a statute includes relevant judicial decisions in existence at the time the legislature enacted the statute. *Fresk v. Kraemer*, 337 Or. 513, 520 (2004). When the express language of a statute is at odds with earlier case law, the wording of the statute controls. *King City Rehab, LLC. v. Clackamas County*, 214 Or. App. 333, 338-339 (2007).

The plain meaning of the phrase “rules of construction” is straightforward. The word “rule” is defined as a prescribed or required action. “Construction” means, in this context, the act of construing, interpreting or explaining a declaration or fact. *Merriam-Webster Unabridged Dictionary* (2013). A rule of construction is therefore a prescribed action to interpret or explain. The “context” of section 4 (8) includes existing case law governing how insurance policies are themselves interpreted or explained. In determining the meaning of an insurance contract, the primary and governing rule of interpretation is to ascertain the intention of the parties. *Totten v. New York Life Ins. Co.*, 298 Or. 765, 770 (1985). When policy language has a plain and ordinary meaning and is not reasonably susceptible to multiple interpretations, the policy language is unambiguous. *State Farm Mutual Auto Ins. Co. v. White*, 60 Or. App. 666, 672 (1982). When policy language is unambiguous and its meaning clear and subject to only one reasonable interpretation, no further interpretation may be made as a matter of law. *Hoffman Construction Co. v. Fred S. James & Co.*, 313 Or. 464, 469 (1992). An insurance policy is considered legally ambiguous when the policy is capable of more than one sensible or reasonable interpretation. *Kelch v. Industrial Indem. Co.,* 93 Or. App. 538, 542 (1988). Courts do not, however, consider extrinsic evidence—evidence relating to a contract but not appearing on the face of the contract—in determining the meaning of insurance policy terms. *Laird v. Allstate Ins. Co.*, 232 Or. App. 162, 167 (2009).

In light of the existing case law governing how insurance contracts are analyzed, it becomes apparent under a *PGE v. BOLI* analysis of section 4 (8) that the legislative intent in enacting section 4 (8) is to modify how insurance contracts are analyzed to permit, in situations where there is no relevant contract language or contract language that is ambiguous in meaning, use of the rules of construction in SB 814 to ascertain the rights and responsibilities of the parties. As noted above, most of the policies affected by SB 814 are historic comprehensive general liability policies designed to provide insurance against unspecified injury or property damage caused by occurrences taking place during coverage periods. The environmental liability arising from routine releases of pollutants during these periods was not anticipated by insurers or insureds, which in turn has led to considerable uncertainty, and the rules of construction set forth in SB 814 are designed to address that uncertainty. In situations where the provisions of SB 814 do conflict with existing contract language, section 4 (8) supplies a remedy to resolve the conflict; namely, the bill directs that the conflict be resolved by having the contract language govern and the statutory language give way.

To summarize, we conclude that SB 814 does not create an unconstitutional impairment of the obligation of contracts under either the Oregon or United States Constitution. The bill provides certain rules of construction to achieve a legitimate public purpose of facilitating resolution of environmental claims, and also establishes certain unfair environmental claims settlement practices, all of which are within the constitutional authority of the legislature to enact.

Please advise if we may be of further assistance in this matter.

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Very truly yours,

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