BURR ALERT

If there Is Coverage: Other Business Interruption Considerations and Issues from the Coronavirus Pandemic

By Mike Strasavich March 2020

There is a tremendous issue shaping up already on whether the spread of the coronavirus can constitute "direct physical loss or damage to" a business premises so as to give rise to coverage under a business interruption policy. While this is no doubt an important issue, it is not the only issue. This article gives some details on available coverages, how a loss is calculated, and potential coverage which may be available in some policies in the absence of "physical damage" to a particular business premises.

I. The Essentials:

When first analyzing a business interruption claim, it is of paramount importance to read and understand the particular coverages within the policy. There are an infinite variety of available coverages and coverage forms, many of which are tailor-made for a particular company or line of business. Just a few of the prevalent coverages are:

Civil Authority: Covers loss of Business Income sustained from governmental denial of access to your property due to physical damage to separate property nearby.

Business Income: Replaces income to the business that would have been earned had no loss event occurred.

Extra Expense: Pays necessary additional expenses incurred during the Period of Restoration that would not have been incurred absent physical loss or damage to the property. This includes additional expenses to resume operation of the business at the original location, or at a temporary replacement location while the original location is repaired.

Contingent Business Interruption: Covers loss of income incurred in the insured's business due to a property loss at the location of a key supplier or customer. Sometimes called supply chain insurance.

Leader Property: Covers losses of Business Income stemming from damage to a third-party property that attracts business or customers to the insured's location.

II. Interruption by Order of Civil Authority:

One common misconception of civil authority provisions is their perceived application to any act of government which causes a loss of income. This broad view is generally incorrect. Coverage under a typical civil authority provision requires physical damage to a nearby property, coupled with an action of a civil authority which prevents access to the insured's undamaged business location. The key inquiry is: has a civil authority order "prohibited access" by requiring the business to close or to suspend operations? See *Southern Hospitality, Inc. v. Zurich American Insurance Co.*, 393 F.3d 1137 (10th Cir. 2004)(FAA's order on 9/11 grounding air traffic had not prohibited access to the insured's hotels, which remained open at all times).

Further, the prevention of access must be total, not partial or a mere hindrance. See *St. Paul Mercury Insurance Co. v. Magnolia Lady*, No. CIV. A. 297CV153BB, 1999 WL 33537191 (N.D. Miss. Nov. 4, 1999)(no coverage for casino-hotel whose business decreased 80% but which remained open during closure and repair of bridge); *Abner, Herrman & Brock, Inc. v. Great Northern Insurance Co.*, 308 F. Supp. 331 (S.D.N.Y. 2004)(no coverage for Manhattan business where access was maintained though admittedly made more difficult after 9/11).

It should be noted that one court has resolved a civil authority provision and the "property damage" requirement quite differently. *Assurance Company of America v. BBB Service Company, Inc.*, 593 S.E.2d 7 (Ga. Ct. App. 2003)(property damage requirement met by hurricane that did not make U.S. landfall as it caused property damage in Caribbean). However, many business interruption policies will detail in a civil authority provision a requirement that the property damage causing the civil authority order must occur within a certain geographic radius from the insured's business location.

III. The Loss Must Be Caused by Physical Damage to the Described Location from a Covered Peril:

Coverage for a business interruption claim will ordinarily be found where there is physical damage to the insured's business location caused by a Covered Cause of Loss named in and not excluded by the subject policy, and which causes business to cease for a time. Each of these criteria is important in analyzing a business interruption claim.

First, the loss of business income must be caused by physical damage to a Described Location, which commonly means a business premises named in the policy declarations. Not all conditions interrupting business qualify as physical damage. See *Keetch v. Mutual of Enumclaw Insurance Co.*, 831 P.2d 784 (Wash. Ct. App. 1992)(volcanic ash falling at hotel after Mount St. Helens eruption burying hotel in six inches of ash not physical damage where hotel remained open); *National Children's Expositions Corp. v. Anchor Insurance Co.*, 279 F.2d 428 (2nd Cir. 1960)(snowstorm causing reduced attendance at exposition did not trigger coverage where building holding the expedition was undamaged).

After this initial hurdle is cleared, it is important to establish that the property damage at issue was caused by a covered peril. See *Valley Forge Insurance Co. v. Hicks, Thomas & Lilienstern, L.L.P.*, 174 S.W.3d 254 (Tex. Ct. App. 2004)(law firm's business interruption policy containing flood exclusion afforded no coverage for closure of building due to flooding from Tropical Storm Allison). Traditional exclusions which are applicable to other property coverages within the policy may also apply to the business interruption coverage. In particular to the pandemic, the policy may contain exclusions specific to communicable diseases or viruses which, coupled with anti-concurrent causation language, will likely present significant obstacles to coverage.

One should also examine whether the physical damage is the cause of the claimed business loss, or whether other factors are involved. Business losses caused by factors other than physical damage to property, such as poor weather, will typically not be covered under a business interruption policy. See *Harry's Cadillac-Pontiac-GMC Truck Co., Inc. v. Motors Insurance Corp.*, 486 S.E.2d 249 (N.C. Ct. App. 1997)(1993 snowstorm, not roof damage, caused business loss to a car dealership which was inaccessible for a week).

IV. The Described Location and the Period of Restoration:

The insured's business location(s) will usually be referred to as the Described Location (or Described Premises). The way the Described Location reads in the policy can be crucial in determining not only whether coverage is afforded for a loss, but the period of time for which benefits are payable (referred to as the Period of Restoration). For example, is the Described Location listed as a particular numbered suite or floor of a ten-story office building, or is it listed as the street address for the entire building?

Assuming there is a) physical damage to the Described Location caused by a covered peril, and b) a causal relationship between the physical damage and the lost business income, the question then becomes: how long is the period of time for which business losses are covered under the policy?

This Period of Restoration can be an actual period or a hypothetical period. Some policies define the Period of Restoration in terms of both an actual period and a hypothetical period. The Actual Period of Restoration is the period of time it takes the insured to actually repair or replace the damaged Described Location or to secure an alternate location of similar quality. The Hypothetical Period of Restoration, applicable when the insured does not repair or rebuild, is the period of time ending "when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality."

Calculation of the Period of Restoration can vary significantly depending upon the description of the insured's business location contained in the policy, as insurers of tenants in the World Trade Center learned in a series of cases following 9/11. The dispute central to many of these cases was the length of the Period of Restoration, with insureds typically contending that the Period of Restoration was the amount of time to rebuild the entire World Trade Center, and insurers contending the Period of Restoration is the amount of time it took the insured to secure an alternate, suitable business location.

The answer hinged largely on the description of the business premises in the policy and on the nature of the insured's operations at the business location. Generally, the more intertwined the insured's operations were with the particular damaged property, the broader courts tended to read the business interruption coverage. See *Zurich American Insurance Co. v. ABM Industries, Inc.*, 397 F.3d 158 (2nd Cir. 2005)(engineer and janitorial contractor at WTC complex with space on every floor held to have used entire complex); *International Office Centers Corp. v. Providence Washington Ins. Co.*, No. 3-04-CV-990

(JCH), 2005 WL 2258531 (D. Conn. Sept. 16, 2005)(period of restoration ends when WTC is rebuilt for exclusive provider of temporary WTC office space whose policy defined location as "One World Trade Center"); *Duane Reade, Inc. v. St. Paul Fire and Marine Insurance Company*, 411 F.3d 384 (2nd Cir. 2005)(period of restoration for drugstore at WTC limited to time it takes to build reasonably equivalent store in reasonably equivalent location); *Lava Trading, Inc. v. Hartford Fire Insurance Co.*, 365 F. Supp. 434 (S.D.N.Y. 2005)(period of restoration in policy which defined premises as Suite 8369 of World Trade Center ends when offices should have been replaced with other space of reasonable speed and similar quality).

V. Computation of Loss of Business Income:

Even when coverage is found, a business interruption policy does not replace business income. More properly stated, such policies replace the <u>profits</u> of a business. If a business has lost money for an extensive period of time prior to the loss, it may be unable to recover under a business interruption policy.

Aside from the necessary causal relationship between the physical damage to the insured's business location and the business loss, courts will consider the pre-interruption performance of a business in determining the profits or income that a business would have had (if any) during the Period of Restoration.

In *Dictiomatic, Inc. v. United States Fidelity & Guaranty Company*, 958 F. Supp. 594 (S.D. Fla. 1997), a business claimed a loss of business income following Hurricane Andrew. The Court determined that the insured failed to prove that but for the suspension of operations, it sustained an actual loss of business income which was caused solely by the hurricane and not by other factors. The insured could recover only to the extent that it actually lost sales or business during the periods when the business premises and business property were not functioning, and could not put the insured in a better position than it would have occupied without the interruption.

In *American Medical Imaging Corp. v. St. Paul Fire and Marine Insurance Co.*, 949 F.2d 690 (3rd Cir. 1991), an ultrasound testing provider had a location suffer smoke and water damage from an adjacent fire, and immediately rented space in a new temporary location. The temporary location had fewer telephone lines. To demonstrate a loss of income during its relocation, the insured showed business projections for the year in question and the accuracy of such projections in the past.

VI. Contingent Business Interruption:

Typically, Contingent Business Interruption provisions provide coverage to an insured for damage to enumerated dependent properties such as those supplying materials for the insured, who purchase the insured’s goods, or which attract customers to the insured’s goods. In *Zurich American Insurance Co. v. ABM Industries, Inc.*, 397 F.3d 158 (2nd Cir. 2005), a case arising from insurance claims following the 9/11 attacks, the Court stated: “CBI coverage is a relatively recent development in insurance law and its scope has not yet been fully delineated by the courts. Entities that rely on ‘third parties’ sometimes purchase CBI coverage as a policy extension in case their income is disrupted by damage to third party property." *ABM Industries*, 397 F.3d at 168. CBI coverage is also typically referred to as supply chain insurance.

Contingent business interruption policies were used to great effect in one particular case, *Archer-Daniels-Midland Co. v. Phoenix Assurance Company of New York*, 936 F. Supp. 534 (S.D. Ill. 1996), which arose from the Mississippi River flood of 1993. This flood affected 20 million acres of farmland and inflicted damage of $15 to $20 billion, disrupting river, road and rail transport in the area on a large scale.

ADM incurred extra expenses and a loss of income because of increases in costs of transportation and raw materials. Contingent Business Interruption ("CBI") and Extra Expense Coverage ("EEC") were included in the policies at issue, with the pertinent language stating:

> This policy insures against loss of earnings and necessary extra expense resulting from necessary interruption of business of the insured caused by damage to or destruction of real or personal property, by the perils insured against under this policy, of any *supplier of goods or services* which results in the inability of such supplier to supply an insured locations [sic].

ADM contended that Midwest farmers and the federal government through the Army Corps of Engineers, which operated the Mississippi River system, were "suppliers of goods and services" under the policy. Barge traffic on the Mississippi River was halted due to the flooding, and more expensive rail traffic had to be arranged. "By constructing improvements on the Mississippi River, the Corps is undoubtedly providing a service." *Archer-Daniels-Midland Company*, 936 F. Supp. at 541. The Court agreed, stating that "[f]unding the construction and maintenance of the physical infrastructure of the Mississippi River system through the fuel taxes imposed on the users of that system easily brings the Corps and the Coast Guard within the plain meaning of the term 'any supplier of goods and services.'" *Archer-Daniels-Midland Company*, 936 F. Supp. at 542.

VII. Conclusion:

As with most other areas of insurance, it is of paramount importance to read and understand the provisions contained in a business interruption insurance policy. The details of the policy can influence tremendously the Described Location, the Period of Restoration, and the Computation of Business Income. The coronavirus pandemic continues and will likely continue to give rise to more issues, including the interplay between government assistance to businesses (which appears inevitable) and insurance payouts, as well as others still unseen.

To discuss this further, please contact:

For any insurance coverage questions or disputes that you may encounter as a result of COVID-19's impact, please contact Mike Strasavich in Mobile at mstrasavich@burr.com or at (251) 345 8206 or the Burr & Forman attorney with whom you normally consult.

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