BURR FORMAN LLP

Business Interruption Coverage in the Year of COVID-19

COVID-19
12.15.2020

COVID-19 has certainly been a devastating and disrupting force for businesses in 2020. Since the pandemic began, a major point of contention between corporate policyholders and insurers is whether these disruptions rise to "business interruptions" as defined under insurance policies offering business interruption (BI) coverage. Companies often purchase BI coverage as part of traditional "all-risk" commercial property policies., and the coverage is generally designed to cover lost income (often in the form of reduced gross earnings) arising from disruptions to an insured's business operations. This update serves as a brief summary of how coronavirus-related BI coverage litigation has panned out thus far.

According to the University of Pennsylvania Carey Law School's "Covid Coverage Litigation Tracker" service, at least 1,260 lawsuits over the availability of BI coverage had been filed in state and federal courts throughout the country as of mid-October, 2020.[1] A recent article in the *National Law Review* offered some perspective around this number by noting that, by way of comparison, only 150 BI coverage cases related to losses stemming from 2012's Superstorm Sandy were filed in the year following that event.[2] Essentially, then, the level of COVID-19 BI cases filed to-date would rival the number of cases that the insurance industry might expect if significant hurricanes had battered the U.S. each month of 2020. The number of new virus-related BI cases has declined significantly since its peak in August, but the sheer volume of these coverage matters is remarkable.

RELATED PROFESSIONALS

Robert S. Given

Business Interruption Coverage in the Year of COVID-19

As of December 08, 2020, commentators have identified 80 merits-based rulings on motions to dismiss in COVID-19 coverage cases (practically all of which have featured BI claims). Insurers have prevailed in 3 in every 4 of such rulings to-date, but a number of rulings in favor of insureds this past fall may embolden policyholders to continue filing claims as the virus continues to spread.

At the outset of the pandemic, many insureds determined that COVID-19 related losses would be precluded under virus/bacteria exclusions in their policies. In response to the SARS outbreak in the early 2000s, a number of insurers added policy endorsements excluding losses stemming from communicable diseases from business interruption coverage. For instance, ISO form CP 01 40 07 06, titled "Exclusion for Loss Due to Virus or Bacteria", provides that the insurer "will not pay 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." For the most part, policies containing virus exclusions have been fully enforced by courts that have reached merits-based decisions in coronavirus-related BI coverage cases. Of the 60 motions-to-dismiss rulings in favor of insurers thus far, 45 involved policies containing these virus exclusions. However, an appreciable number of BI coverage cases brought in 2020 involved policies that either did not contain such exclusions, or contained virus exclusions that were arguably ambiguous as-applied to the facts of a given loss.

Another hurdle for policyholders seeking BI coverage for COVID-19 related losses has been alleging a "direct physical damage or loss" as required under many of these coverage parts. BI insurance generally only applies where a business has to suspend operations due to a "physical loss or damage" resulting from specific perils, such as fire, theft, vandalism, or natural disasters. While some courts construe the phrase "physical loss/damage" to mean the loss or impairment of covered property's "use" or habitability, others adopt a more narrow approach, interpreting "physical loss" to mean some type of tangible harm or alteration to property's physical integrity or condition. Policyholders have an uphill battle in jurisdictions applying the latter approach. For example, the first substantive BI coverage litigation order this year involved a luxury magazine publisher seeking BI coverage for lost revenues it sustained due to COVID-19. The insured sought a preliminary injunction on the grounds that it would not be able to meet its planned print run without proceeds from its insurance policy, but U.S. District Judge Valerie Caproni denied the motion, pointing out that the virus "damages lungs. It doesn't damage printing presses." *Social Life Magazine, Inc. v. Sentinel Insurance. Co. Ltd.*, No. 20 C 3311 (S.D.N.Y. 2020), ECF No. 25, Ex. B at 5:3-4.

A more recent decision in favor of an insurer also underscores the preclusive effect of both policy virus exclusions and "physical loss" requirements well. In *Kessler Dental Associates, P.C. v. The Dentists Insurance Company*, No. 2:20-cv-03376-JDW, Dkt. No. 18 (E.D. Pa. Dec. 07, 2020), U.S. District Judge Joshua D. Wolson granted an insurer's motion to dismiss claims for BI and Civil Authority coverage brought by Kessler Dental, a Phoenixville, PA dental practice. Kessler Dental's policy provided that the insurer would pay for "direct physical loss of or physical damage to covered property, subject to all limitations and exclusions...." *Id.* at 2. The policy further excluded from coverage any "loss or damage, including economic loss, cause by" any "virus, bacteria or other microorganism that cause or could cause physical illness, disease or disability...." *Id.* at 3. Citing another recent decision in favor of an insurer from the Eastern District of Pennsylvania,[3] the *Kessler* court determined that this exclusion unambiguously "applies to Covid-19, which is caused by a coronavirus that causes physical illness and distress." *Id.* at 6.

The *Kessler* court went on to state that the insurer's motion to dismiss was due to be granted even in the absence of the virus exclusion because of the BI coverage part's "direct physical loss of or physical damage" requirement. According to the court, this provision made clear that "there must be some sort of physical damage to the property" to trigger BI coverage. *Id*. at 9. Construing the plain meaning of the undefined term "physical damage", the *Kessler* court stated:

"[P]hysical damage to property means 'a distinct, demonstrable, and physical alteration' of its structure." *Port Auth. of New York & New Jersey v. Affiliated FM Ins. Co*., 311 F.3d 226, 235 (3d Cir. 2002). Allegations of physical damage to a building from "sources unnoticeable to the naked eye must meet a highest threshold." *Id*. at 235. In *Port Authority of New York and New Jersey*, the Third Circuit held that that "asbestos causes physical damage if it is present in such large quantities that it makes the structure "uninhabitable and unusable," but "the mere presence of asbestos, or the general threat of future damage from that presence," is not enough to trigger coverage. *Id*. at 236. There is no reason to think that this would not apply to Covid-19. *See, e.g., Motorists Mut. Ins. Co. v. Hardinger, 131 F. App'x 823, 826 (3d Cir. 2005)*; *Brian Handel D.M.D*., 2020 WL 6545893, at *3.

Although Kessler Dental asserts in its complaint that "Covid-19 virus caused direct physical loss of or damage" to its business (ECF No.11 at ¶ 49), such legal conclusions are not entitled to the presumption of truth. Kessler Dental does not allege that Covid-19 was present on its premises or that it made the structure unusable. Instead, Kessler Dental complains that "[b]ecause business is conducted in an enclosed building, [it] is more susceptible to being or becoming contaminated. . ."(ECF No. 11 at ¶ 103.) But these are indirect "general threat[s] of future damage" and do not demonstrate "physical damage." *Port Auth. of New York & New Jersey*, 311 F.3d at 235.

Kessler Dental's allegation that it was "forced to close the doors of its nonlife sustaining business" fails for similar reasons. (ECF No. 11 at 90.) Kessler Dental did not close its dental practice. In fact, no order ever required dental practices to close. Rather, Kessler Dental was able to stay open for emergency procedures. Kessler Dental's business structure was inhabitable and usable, though on a limited basis. Thus, Kessler Dental has not pled facts that Covid-19 caused physical damage to its business to trigger Dental Practice Income coverage under the Policy.

Id. at 9-10.

In *Henry's Louisiana Grill, Inc. v. Allied Insurance Co. of America*, No. 1:20-cv-2939-TWT, (N.D. Ga. Oct. 06, 2020), U.S. District Judge Thomas W. Thrash reached a similar result in a matter involving BI claims brought by Henry's, a Cajun restaurant. Henry's sought to avoid the preclusive effect of a virus exclusion in its policy by pleading that there was never, at any relevant time, "any virus located at, on, or in [its] premises." Rather, Henry's based its claim on a March 2020 "Public Health State of Emergency" executive order issued by Georgia Governor Brian Kemp, which did not mandate Henry's closure but did, according to Henry's, prompt the insured to close its dining room. Henry's took the position that its dining area suffered a "physical change" in that the space was no longer "physically available to patrons" following its voluntary closure. Rejecting this argument, the *Henry's* court stated:

Business Interruption Coverage in the Year of COVID-19

Every physical element of the dining rooms — the floors, the ceilings, the plumbing, the HVAC, the tables, the chairs — underwent no physical change as a result of the order. The only possible change was an increased public and private perception of the existing threat, which cannot be deemed a physical change that rendered the property unsatisfactory. The Plaintiffs' construction would potentially make an insurer liable for the negative effects of operational changes resulting from any regulation or executive decree, such as a reduction in a space's maximum occupancy.

The court likewise rejected the insured's bid for "civil authority" coverage, noting that, while the executive order at issue "advised" residents to stay at home, it did not directly limit access to private business or inhibit their operations.

As in *Henry's*, most of the BI claims discussed in this article were brought alongside claims for "Civil Authority" coverage, which generally applies where an insured loses access to its property due to physical damage at or about a nearby property (i.e., not the insured's) that leads a government entity to close or prohibit access to the affected areas. A typical civil authority coverage part reads as follows:

When a Covered Cause of Loss causes damage to property other than property at the described premises, we will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises, provided that both of the following apply: (1) Access to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the described premises are within that area but are not more than one mile from the damaged property; and (2) The action of civil authority is taken in response to dangerous physical conditions resulting from the damage or continuation of the Covered Cause of Loss that caused the damage, or the action is taken to enable a civil authority to have unimpeded access to the damaged property.

ISO Form CP 00 30 10 12. This form of coverage differs from BI coverage in many respects and has been addressed in greater detail in prior Burr & Forman articles. But notably, as with BI coverage, civil authority coverage for coronavirus-related losses may be precluded in policies containing a well-drafted virus exclusion. A policy with such an exclusion frustrates the threshold requirement for civil authority coverage mentioned in the ISO excerpt above: that a "*Covered Cause of Loss*" cause some type of publicly mandated closure or restriction. Civil authority coverage is also similar to BI coverage in that some type of physical loss or damage is required. Thus, policyholders seeking coverage under both provisions (BI and civil authority) face somewhat recurrent/overlapping hurdles.

On the other side of the ledger, some courts have rejected insurer motions to dismiss in BI coverage cases, concluding that insureds have alleged "plausible" claims to support a "direct physical loss." The first case of this kind came from the U.S. District Court for the Western District of Missouri. In *Studio 417, Inc. v. Cincinnati Insurance Company*, No. 6:20-cv-03127-SRB (W.D. Mo. Aug. 12, 2020), a hair salon and group of restaurants brought a proposed class action against Cincinnati Insurance Company seeking coverage for BI and related coverage parts (e.g., Civil Authority coverage), each of which required a showing of a "direct physical loss/damage." The plaintiffs alleged that the coronavirus constituted a "physical substance" that is both "active on inert physical surfaces" and "emitted into the air", qualities

that "render[] physical property ... unsafe and unusable" and forced the plaintiffs to "suspend or reduce business" at their premises given the "likelihood" that persons infected with COVID-19 had entered their premises in the preceding months. U.S. District Judge Stephen R. Bough denied the insurer's motion to dismiss and permitted the parties to proceed with discovery, holding that the plaintiffs arguably suffered a "direct physical loss" as set forth in relevant policy provisions. The term "loss" was not defined in the policies, but the court noted that the ordinary meaning of the term encompasses "the act of losing possession" and "deprivation". According to the court, the plaintiffs sufficiently alleged that the virus had a physical presence at the plaintiffs' premises and rendered it unsafe and unusable.

More recently, a Nevada state-court judge cited *Studio 417* with approval in denying a motion to dismiss filed by Starr Surplus Lines Insurance Company in a BI coverage case initiated by JGB Vegas Retail Lessee LLC, the owner of Las Vegas' Grand Bazaar open-air mall. *JGB Vegas Retail Lessee LLC v. Starr Surplus Lines Insurance Co*., No. A-20-816628 (Clark Cnty., Nev. Dist. Ct. Nov. 30, 2020). The insured alleged certain "known facts about the coronavirus, including that it spreads through infected droplets that 'are physical objects that attach to and cause harm to other objects' based on its ability to 'survive on surfaces' and then infect other people." *Id*. at 3. The complaint further alleged that: (a) it was "highly likely that the novel coronavirus that causes COVID-19 has been present on the premises of the Grand Bazaar Shops, thus damaging the property JGB had leased to its tenants"; and (b) "because the presence of COVID-19 at or near the Grand Bazaar Shops and [Nevada] Governor Sisolak's March 20, 2020 Order restricting and prohibiting access to non-essential business, the Grand Bazaar Shops were forced to close and the few restaurants that remained open were severely limited in their operations, resulting in significant losses." *Id*. at 3-4.

Citing *Studio 417* and other state and federal cases that have allowed policyholders to proceed with claims for BI coverage,[4] Judge Mark Denton of Nevada's Clark County District Court ruled that the Complaint "sufficiently allege[d] losses stemming from the direct physical loss and/or damage to property from COVID-19 to trigger Starr's obligations under [applicable BI and civil authority coverage parts]." The court further held that a "Pollution and Contamination" exclusionary clause in the policy did not unambiguously exclude coverage for the insured's loss for the purposes of the motion to dismiss, as the insured's interpretation of the exclusion as only applying to "traditional environmental and industrial pollution and contamination" rather than a "naturally-occurring, communicable disease" appeared "reasonable." *Id*. at 5.

While insureds have achieved some modicum of success in coronavirus-related coverage litigation thus far, the presence of clearly worded virus exclusions and "physical loss/damage" coverage requirements in relevant policies have, by and large, been difficult for policyholders to overcome. With recent spikes in infection rates and renewed calls for certain shut-down or "stay-at-home" measures in some jurisdictions, a second wave of coverage suits may well ensue in 2021 as policyholders learn from the litigation currently progressing in courts across the country. Insurers will no doubt continue relying on the plain language of relevant coverage parts, exclusions, and/or limitations as bars to BI coverage, while insureds will likely advocate for potential policy ambiguities with respect to policy language should be construed in the insured's favor. The merits of these competing coverage positions must be carefully evaluated on a case-by-case basis, examining the facts of a given loss, the policy language at issue, and specific governing law.

Business Interruption Coverage in the Year of COVID-19

Download PDF

[1] https://cclt.law.upenn.edu/.

[2] https://www.natlawreview.com/article/covid-19-shutdowns-related-litigation-put-pressure-business-interruption-insurers.

[3] *Brian Handel D.M.D., P.C v. Allstate Ins. Co.*, Civ. No. 20-3198, 2020 WL 6545893, at *4 (E.D. Pa. Nov. 6, 2020).

[4] Namely: *Optical Servs. USA/JCI v. Franklin Mut. Ins. Co.*, No. BER-L-3681-20, 2020 WL 5806576 (N.J. Super. L. Aug. 13, 2020); *Blue Springs Dental Care, LLC v. Owners Ins. Co.*, No. 20- cv-00383, 2020 WL 5637963 (W.D. Mo. Sept. 21, 2020).