



COVID-19: BUSINESS INTERRUPTION CLAIMS IN A GLOBAL PANDEMIC

On March 11, 2020, the World Health Organization declared the Coronavirus (COVID-19) outbreak a pandemic. In light of the declaration, a majority of businesses in the United States were forced to temporarily close their doors, experiencing business disruptions.



The pandemic is an unprecedented event that has caused wide spread economic disruption. COVID-19 has impacted businesses in a variety of ways including: increased sanitizing and testing costs; loss of or significant curtailment of income due to compliance with civil orders; contingent business interruption due to the cancellation or closure of hospitality operations; large scale public events/meetings; spectator sports; and similar public gatherings.

In the wake of the COVID-19 crisis, there has been a surge of business interruption claims and lawsuits, including class action filings. For instance, a COVID-19 based business interruption claim filed by renowned chef Thomas Keller of the French Laundry on behalf of his restaurant group has received significant media attention.¹ Various national media outlets such as CNN and the New York Times have run stories concerning business interruption claims.

Many commercial property insurance policies include coverage for business interruptions, which often is not well understood. While any coverage analysis is based on the wording of the specific policy and the applicable law, the following issues often arise in a business interruption claim.

As a general matter, Business Interruption (BI) is a temporary suspension in business operations on either a partial or a complete basis due to the result of a specific or catastrophic event. BI coverage is often implicated when “direct physical loss of or damage to” the insured’s property has occurred due to a covered cause of loss. BI coverage, if purchased, will vary depending on the language of the policy. Most property policies, including the Insurance Service Office (ISO) form, do not cover losses stemming from a virus.

There are several types of coverages that fall within the BI umbrella:

Business Income Coverage (BIC)

BIC provides coverage for loss of income due to the suspension of the policyholder’s operations

Contingent Business Interruption (CBI)

CBI covers a policyholder’s losses resulting from the loss, damage or destruction of the property owned by others so long as the underlying cause of damage is covered by the insured’s own policy

Civil Authority Coverage (CAA)

CAA coverage covers BI losses when

a governmental order prohibits or impairs access to the policyholder’s premises

What constitutes direct physical loss or damage?

In many of the COVID-19 coverage suits filed thus far, one of the main issues in dispute is whether COVID-19 causes “direct physical loss of or damage to property.” The issue of whether a covered direct physical loss has occurred will depend on the specific circumstances giving rise to the claim, the policy language involved as well as the applicable law and forum deciding the issue.

Whether the effects of a virus can be considered a physical loss will be a hotly litigated issue. Toxic mold cases are somewhat analogous to the current COVID-19 environment. In *Mastellone v. Lightning Rod Mut. Ins. Co.*, 884 N.E.2d 1130 (Oh. App. 2008), an Ohio court found that mold did not constitute physical damage to property and thus did not trigger coverage under the policy.

Similarly, in *Universal Image Productions, Inc. v. Chubb Corp.*, 703 F. Supp. 2d 705 (E.D. Mich. 2010), the court determined that the policyholders would need to show that it “suffered...structural or...tangible

¹ *French Laundry Partners, LP., v. Hartford Fire Ins. Co.*, Sup. Ct. CA, County of Napa (2020).

damage to the insured property” rather than rely on “proof that it suffered such intangible harms as strong odors and the presence of mold and/or bacteria....”.

In a string of recent lawsuits, policyholders have argued that COVID-19 contamination causes physical damage. For example, Oceana Grill, a restaurant in New Orleans, filed a lawsuit² against its underwriters requesting that its BI policy cover its damages in light of COVID-19 contamination. Specifically, the policyholders ask that the “physical damage” requirement be broadened to include COVID-19, even though the policy does not expressly include infectious disease language. Oceana Grill argues that the virus physically infects and stays on surfaces for up to twenty-eight days and that a contamination of the insured premises by the virus would be a “direct physical loss needing remediation to clean the surfaces of the establishment.” Oceana Grill relies on *Widder v. Louisiana Citizens Property Ins. Corp.*,³ as authority to state that Louisiana courts have interpreted the intrusion of lead or gaseous fumes to constitute a direct physical loss under insurance policies. There are also cases addressing whether various types of dust falling on or impacting a property constitutes physical damage which reach differing determinations centered on whether the physical characteristics of the property change.

Another avenue policyholders have embraced is the argument of the “unfitness” of property for its intended purposes. Several courts across the U.S., held that contamination that caused property to be unfit could qualify as a physical loss to trigger BI coverage. For instance, in *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*,⁴ a District Court in New Jersey held that ammonia released inside an insured’s facility constituted “direct physical loss of or damage to” the insured’s property, meeting the physical damage threshold. In *TRAVCO*

Ins. Co. v. Ward,⁵ the United States District Court for the Eastern District of Virginia determined that toxic gases that were released by drywall, even though the drywall remained intact, rendered the defendant’s residence uninhabitable so that a “direct physical loss” had been suffered.

Conversely, under *Mastellone and Universal*, the presence of the virus on an insured property would potentially not qualify as physical damage because COVID-19 does not damage the structural integrity of a building. Under *Widder, Gregory Packaging and TRAVCO Ins. Co.*, the “intangible” harm caused by COVID-19 under these and similar lines of cases could potentially trigger coverage. These decisions illustrate the potential for vastly different results in COVID-19 suits that arise out of analogous fact patterns.

Operations slowdown

Either complete shutdowns or slowdowns in business operations have been felt across numerous industries. The issue of whether the BI clause applies to a shutdown or slowdown is another potential area for litigation. For example, in *Quality Oil Field Prods., Inc. v. Michigan Mut. Ins. Co.*, 971 S.W.2d 635 (Tex. App.—Houston [14th Dist.] 1998, no pet.), the policyholder suffered a theft loss of data and engineering drawings that reduced its ability to perform its operations. After pursuing a claim for BI, the dispositive issue addressed by the Texas Court of Appeal for the Fourteenth District was whether an operation slowdown or a “work slowdown” triggered coverage under a BI claim.

The Court held that when the policy does not define “interruption of business,” a work slowdown would not be covered; instead, an actual suspension of operations would be required. In respect of reduced productivity caused by “working from home”, shelter-in-place or “work safe, stay home” orders, the potential exists for BI losses to be sustained. Whether coverage exists for such losses should

be vetted against your policy wording.

Pandemic Event Endorsement

A recently filed Texas suit illustrates potential arguments over the application of a Pandemic Event Endorsement. On April 3, 2020, SCGM Inc. filed a lawsuit against its underwriters in the United States District Court for the Southern District of Texas requesting that the underwriters cover BI under the “Pandemic Event Endorsement” clause.⁶ SCGM Inc. operates a chain of movie theatres and restaurants in the Greater Houston Area. According to the pleading, SCGM Inc. explains that they paid a significant premium under the Pandemic Event Endorsement policy, which was purported to provide coverage for financial damages experienced from a BI during pandemics.⁷ Under the policy, a “Pandemic Event” is defined as “the announcement by a Public Health Authority that a specific Covered Location is being closed as a result of an Epidemic declared by the [Centers for Disease Control and Prevention] or [World Health Organization].”⁸ SCGM claims the underwriters argue that the policy does not specifically contemplate or cover “coronavirus related diseases.” Similar lawsuits are anticipated to be filed all across the country asking courts to decide whether a policy that covers a Pandemic Event without specifically stating coronavirus related diseases would cover BI claims.

Legislative Action

A significant intangible for BI claims is political. A growing number of state legislatures are considering statutory changes to force the industry to provide retroactive coverage to policyholders, regardless of the language of their insurance contracts. Lawmakers in multiple states, including Massachusetts, Louisiana, New York, New Jersey, Ohio, Pennsylvania, and South Carolina have introduced such bills, though no law has yet been enacted.

2 *Cajun Conti, LLC et al. v. Certain Underwriters at Lloyd's London et al.*, Civ. Dist. Ct. La. (2020).

3 2011-0196 (La. App. 4 Cir. 8/10/11); 82 So.3d 294, writ denied, 2011-2336 (La. 12/2/11).

4 2012-CV-04418, 2014 WL 6675934 (D.N.J. June 11, 2014).

5 715 F. Supp. 2d 699, 708, 709 (E.D. Va. 2010), *aff'd*, 504 F. App'x 251 (4th Cir. 2013).

6 *SCGM Inc., v. Certain Underwriters at Lloyd's, S.D.Tex.* (2020).

7 *Id.* at 4.

8 *Id.* at 5.

In these states, legislators are proposing laws that would impose liability on insurers for BI without considering exclusions for a virus in the policy or whether there is property damage or loss. For instance, in New York, a proposed bill would require coverage for BI losses as a result of the COVID-19 pandemic. The bill would only apply to policyholders with fewer than 100 full-time employees. In New Jersey, a proposed bill would require insurers to retroactively include virus transmission as a covered peril in BI policies.

At the national level, a bi-partisan group of 18 House of Representatives members wrote to four insurance industry trade groups urging insurers to recognize financial loss due to COVID-19 for small business policyholders.⁹ In response, the industry group stated that BI policies were not designed to cover communicable diseases and suggested that the cost of covering small business BI claims would be \$110 billion to \$220 billion monthly. There also has been discussion surrounding the formation of a federally backed program to provide pandemic coverage. On April 14, 2020, the Business Interruption Insurance Coverage Act of 2020 was introduced by US Representative Mike Thompson.

While not meant to apply directly to COVID-19 BI claims, the Act would require that insurance policies provide BI insurance coverage for: losses resulting from any viral pandemic, any forced closure of business, or

mandatory evacuation, by law or order of any government or governmental officer or agency, including the Federal Government and State and local governments; or any power shut-off conducted for public safety purposes.

The global economic disruption caused by COVID-19 undoubtedly will result in changes being contemplated and/or made by federal or state governments to address BI coverage. If so, the passing of these BI legislative proposals will likely cause a mass of legal challenges from its opponents including assertions that government mandating coverage for BI claims interfere with the freedom to contract under Article I of the US Constitution.¹⁰

Conclusion

The resolution of the numerous BI claims arising out of the COVID-19 pandemic will impact thousands of business owners and the insurance industry. The scope and extent of BI coverage will certainly be tested in numerous lawsuits filed across the US. Insurance policies are each their own separate contracts created and entered into under the laws of varying states, results may vary greatly by – and even within – a given jurisdiction. Insurance policies are creatures of contract whose specific wording determines available rights and remedies. Accordingly, interested stakeholders should carefully review their policies and seek the advice of legal counsel when considering a COVID-19 related BI claim.

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⁹ https://cunningham.house.gov/sites/cunningham.house.gov/files/wysiwyg_uploaded/Signed%20BII%20Letter_Final.pdf

¹⁰ "No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility." Art. I, Sec. 10, cl. 1 of the US Constitution.

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