Legal Issues Raised by COVID-19: Business Interruption Insurance

By: John Hughes, Esq. | **April 8, 2020**

Many small businesses have as part of their package of insurance coverage what is known as business interruption or business income loss coverage. Unfortunately, a survey of insurance trade association websites[1] and defense law firm blog postings indicates that Big Insurance has been making a concerted effort to convince regulators and customers alike that their policies cannot be expected to cover the business interruptions caused by COVID-19. The truth is that this is not always the case. Plaintiffs' lawyers have challenged contentions that business closures due to the virus are never covered, and litigation on other virus-related issues is welling up.[2]

In fact, even with the pandemic only weeks old as a crisis, we are already seeing an uptick in lawsuits regarding restaurants, the hospitality industry, and other small businesses who are making claims against their insurance companies under business interruption coverage. A summary of the issue and the legal considerations is below.

FAQs

What is Business Interruption Insurance? It is insurance coverage that replaces business income lost in a disaster or other event that causes a shutdown and loss of income for the business.

[1] See https://www.travelers.com/about-travelers/covid-19-business-interruption; https://content.naic.org/article/statement_naic_statement_congressional_action_relating_covid_19.htm; https://www.pciaa.net/pciwebsite/cms/content/viewpage?sitePageId=59762; https://www.zelle.com/Commercial_Property_Insurance_Coverage_and_Coronavirus.

[2] See https://www.reuters.com/article/us-health-coronavirus-insurance-director/insurers-fret-as-company-bosses-face-coronavirus-legal-claims-idUSKBN21J60R; https://chicago.eater.com/2020/3/31/21201699/covid-19-insurance-chicago-denial-lawsuit; https://www.law.com/2020/03/27/lawyers-watch-for-consumer-class-actions-as-covid-19-hits-pocketbooks/; https://www.natlawreview.com/article/class-actions-during-covid-19; https://www.ft.com/content/2d388a77-8706-4387-85b7-09c7bd16a0a8; https://www.mwe.com/insights/covid-19-impact-on-class-action-litigation/; https://www.insurancejournal.com/news/midwest/2020/04/03/563177.htm.

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The event giving rise to the claim could be a fire, a flood, storm damage, a natural disaster, as toxic gas release or as here, a pandemic. Claims can arise when government actions or shutdown orders cause operations to cease temporarily, which results in business loss. Business interruption coverage may be sold as a separate policy, added to a property/casualty policy, found in "all risks" coverage or included in a comprehensive package policy as an add-on or rider.

What does Business Interruption Insurance Cover? The coverage may allow benefits such as:

- *Lost profits*. Based on prior months' performance, a policy may provide reimbursement for profits that would have been earned had the event not occurred.
- *Fixed costs*. These can include operating expenses and other incurred costs of doing business.
- *Temporary relocation*. Some policies cover the costs involved with moving to and operating from a temporary business location.
- *Commission and training costs*. A company will often need to replace equipment and retrain personnel. Business interruption insurance may cover these costs.
- *Extra expenses*. Business interruption insurance may reimburse reasonable expenses (beyond the fixed costs) needed to continue operating while the business gets back on solid footing.
- *Government closure loss*. A business interruption event may result in government-mandated closure of business premises. Examples include forced closures because of government-issued curfews or street closures related to an event.
- *Employee wages*. Coverage of wages is essential if a business does not want to lose employees while shutting down. This coverage can help a business owner make payroll until the crisis passes.
- *Taxes*. Businesses may still have to pay taxes, even when disaster hits. Tax coverage may ensure a business can pay taxes on time and avoid penalties.
- *Loan payments*. Loan payments are often due monthly. Business Interruption coverage can help a business make those payments even when they are not generating income.

How do I know if I have Business Interruption Insurance? You must locate your insurance policies and read through them carefully. If you cannot find them, contact your insurance agent or broker who may have copies. Or, contact the insurer directly. Remember that this coverage might be in a separate standalone policy but might also be buried within an all-risk, property or casualty policy or comprehensive package. Also remember to check for add-ons, riders and amendments. If the insurer or agent will not cooperate with getting you information, contact a lawyer or the NC Department of Insurance (website: www.ncdoi.gov).

What if my insurance carrier denies my claim? As a result of COVID-19, there have already been lawsuits filed by insureds against carriers who deny coverage. For example, some restaurant businesses have brought lawsuits against their insurers for refusing to cover losses due to having to shut down their restaurants until the

pandemic and local government closure orders pass. If you have concerns that your Business Interruption Insurance coverage has been denied without good grounds, you should contact an attorney.

Nationwide Lawsuits Re: COVID-19

Below we summarize some examples of the legal claims that have appeared arising out of COVID-19 brought by business owners who had to close their business due to the virus.

- ***French Laundry Partners, LP v. Hartford Fire Insurance Co*., Superior Court for the State of California, County of Napa, complaint filed March 2020.**

Two high-class restaurants (The French Laundry and Bouchon Bistro) sued asking that the Court rule that their insurance coverage had to pay out for COVID-19 closure losses. Their operations were shut down by a March 2020 directive from the Napa County health officer. This was a stay-at-home order for those who did not perform essential services.

The restaurants claim they are insured under an "all risks" policy issued by Hartford. They claim that their policy provides "civil authority" coverage for lost business income and extra expenses incurred if access to the restaurants is prohibited by an order of civil authority as a result of a covered loss in the area.

The restaurants assert that their policy coverage was triggered by the closure order issued by their local government authorities. Further, the restaurant owners allege their policies do not include a "virus exclusion."

An issue brewing in that case is whether the insurance company can argue that to implicate the "civil authority" coverage, the claimant has to show that there was physical damage to property other than the premises. The insurer may argue that the reason why businesses have been closed is for social distancing, not physical damage. The reason why the government ordered businesses in the area to shut down was not due to something like a tornado or other natural disaster that wrecked property in the neighborhood.

That crux of the insurance company's defense in this and other cases is expected to be that for business interruption coverage to apply (that is, coverage for the economic losses to an insured business owner arising out of having to close the business for a period of time), there has to be underlying physical property damage of a blatant, structural nature, such as fire damage after a lightning strike or an explosion.

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But this oversimplifies the issue. Look at it through the claimant's eyes. The small business owner who buys business interruption coverage pays an extra premium for the peace of mind of knowing that if an unforeseen event forces a temporary shutdown, he has insurance coverage to help get him through it. If main street was closed down due to a flood of toxic waste, that could trigger coverage. Here, there has been another flood, only this time, of invisible virus particles. And the whole reason why government authorities are ordering shutdowns is because of the physical fact of the virus itself landing and staying on surfaces and people, floating through the air and causing infection and even death.

Thus, in the *French Laundry Partners* complaint, the restaurants allege that the COVID-19 virus has physically impacted "public and private property, and physical spaces in cities around the world and in the United States." Further, the virus "physically infects and stays on surfaces of objects or materials, 'fomites,' for up to twenty-eight days." And, "China, Italy, France and Spain have implemented the cleaning and fumigating of areas" before allowing those areas to re-opened to the public. Thus, the government's stay-at-home order was "issued based on evidence of physical damage to property."

The claimants allege that they "faithfully paid policy premiums" to Hartford. The coverage, known as "The Property Choice Business Income and Extra Expense Form," was to be triggered "in the event of business closures by order of Civil Authority." (Complaint para. 14). The coverage applies "to the actual loss of business income sustained and the actual, necessary and reasonable extra expenses incurred when access to the scheduled premises is specifically prohibited by order of civil authority as the direct result of a covered cause of loss to property in the immediate area of plaintiffs' scheduled premises." (Complaint para. 15). "The policy is an all-risk policy, insofar as it provides that covered causes of loss under the policy means direct physical loss or direct physical damage unless the loss is specifically excluded or limited in the policy." (Para. 16). And, according to the plaintiffs, the "policy's Property Choice Deluxe Form specifically extends coverage to direct physical loss or damage caused by virus." (Para. 17).

- ***Cajun Conti, LLC v. Certain Underwriters at Lloyd's London*, Civil District Court for the Parish of Orleans, Louisiana, complaint filed March 16, 2020.**

This is said to be the very first lawsuit filed by any small business on the business interruption insurance coverage issue.

Oceana Grill is a New Orleans restaurant located in the French Quarter. The restaurant alleges that the insurer provided business property and business income insurance as "all risks" coverage. The restaurant contends that while the policy excludes coverage for things such as terrorism, the insurance covers a closure for a period of time due to contamination by a virus. The business owners note that the Louisiana governor issued a

restriction on public gatherings, and the mayor of New Orleans issued a restriction on restaurant operations. They allege that this triggers the Civil Authority provision of the Lloyd's policy.

The complaint also notes that in Louisiana, there is case law stating that when a property suffers from lead or gaseous fumes intrusion, that event may trigger coverage. The lawsuit alleges that the restaurant had no choice but to close down due to the government's orders once the virus hit.

- ***Big Onion Tavern Group LLC v. Society Ins. Co.*, No. 1:20-cv-02005, U.S. District Court for the Northern District of Illinois, complaint filed March 27, 2020.**

This is an insurance coverage lawsuit brought by numerous businesses in the Chicago area. One thing they all have in common is that they all purchased business interruption coverage from Society Insurance. The businesses suing include restaurants, taverns and pizzerias.

They claim that they were forced to close their operations by government authorities as a result of the COVID-19 pandemic. The plaintiffs contend the insurer engaged in improper claims handling by issuing blanket denials for losses due to the closures. They claim that the insurer did not conduct any meaningful investigation before saying the claims were barred. The complaint also alleges that the CEO of the insurer sent around a memorandum stating that his insurance company was likely not going to accept coverage in connection with losses caused by government-imposed shutdowns due to COVID-19.

Specifically, according to the lawsuit, the Society Insurance CEO issued a memorandum to "agency partners" saying that under Illinois law the policies would likely not cover such stoppages. That memo advised agents that "the current circumstances are unlikely to result in facts that support first-party coverage under our policies, or liability to a policyholder."

The memo stated: "Whether it be a full shutdown of business, a partial suspension of operations or an alteration in business operations that remain open, Business Income coverage must be due to a suspension caused by direct physical loss of or damage to covered property at the described premises. The loss or damage must be caused by or result from a Covered Cause of Loss. Extra Expense coverage also requires the same coverage triggers. In general, a quarantine of any size, or brought about by a governmental action without a Covered Cause of Loss, would likely not trigger Business Income or Extra Expense coverages under our policies." (See Insurance Journal, Illinois Lawsuits Challenge Society Insurance's Coronavirus Claim Denials, April 3, 2020, https://www.insurancejournal.com/news/midwest/2020/04/03/563177.htm).

The complaint challenges the insurer's argument that the COVID-19 facts cannot trigger coverage. The claimants argue that "Illinois courts have consistently held that the presence of a dangerous substance in a property constitutes 'physical loss or damage.'" (Complaint para. 8).

- ***Billy Goat Tavern I v. Society Ins.*, No. 1:20-cv-2068, U.S. District Court for the Northern District of Illinois, complaint filed March 31, 2020.**

This lawsuit is brought by restaurant/hospitality industry small business owners who purchased business insurance from Society Insurance. The claimants are also pursuing class action status seeking to represent all similarly-situated businesses in in Illinois.

The plaintiffs seek coverage under their insurance policies for losses as a result of closure orders issued by the Governor of Illinois. The complaint anticipates the likely defense that the insurance providers will raise, to the effect that the claimants must prove there was direct physical loss to recover under first-party property policies. The complaint alleges that COVID-19 "rendered the covered property at the premises … unsafe and inaccessible for dine-in customers." (Complaint para. 53).

Also, according to the complaint, the insurance policy does not contain a virus exclusion.

The plaintiffs request relief not just for themselves but also for other restaurants, taverns and hospitality providers who 1) offer food or beverages for on-premises consumption, 2) pay premiums under insurance policies with the relevant business interruption coverage language, 3) who made a claim for lost business income as a result of COVID-19 and the shutdown orders, and 4) whose claims were denied.

- ***Choctaw Nation of Oklahoma v. Lexington Ins. Co.*, No. CV-20-42, District Court of Bryan County, Oklahoma, complaint filed March 24, 2020; and *Chicasaw Nation Dept. of Commerce v. Lexington Ins. Co.*, No. CV-20-35, District Court of Pontotoc County, Oklahoma, complaint filed March 24, 2020.**

These two lawsuits were filed like the others above due to business interruption losses resulting from the COVID-19 pandemic and the failure of the insurance companies to pay on the claims. The plaintiffs are the Chickasaw and Choctaw Native American nations. They sued in Oklahoma state court against multiple insurance companies, including Arch, Liberty Mutual, Homeland and Lloyds.

The lawsuits seek an order that any financial losses suffered by the tribal casinos, restaurants and other businesses as a result of the coronavirus pandemic are covered. The tribes allege that these were "all risk"

policies. The Choctaw complaint goes on to allege at paragraph 16: "On or about March of 2020, the United States of America became infected by COVID 19 resulting in a pandemic. As a result of this pandemic and infection, the Nation's Property sustained direct physical loss or damage and will continue to sustain direct physical loss or damage covered by the policies, including but not limited to business interruption, extra expense, interruption by civil authority, limitations on ingress and egress, and expenses to reduce loss. As a direct result of this pandemic and infection, the Nation's Property has been damaged, as described above, and cannot be used for its intended purpose."

The Tribes have had to temporarily close their casinos, restaurants and other businesses to help stem the spread of the coronavirus. They have fallen into the same business losses that are also affecting other companies in the hospitality industry.

Highlights and Take-aways from Lawsuits Filed:

1. The claims were filed by small business owners in the hospitality and restaurant industries.

2. Some businesses have claimed that their "all risks" insurance policies allow coverage for losses occurring as a result of COVID-19. Such policies may provide coverage for "civil authority"-directed closures. They have no virus exclusions,

3. Insurers are denying coverage, claiming the loss "must be caused by physical loss of or damage to covered property at the described premises," however, small business owners are challenging that interpretation and noting that some courts have held that the presence of a dangerous substance can trigger the coverage.

4. Claimants argue that the whole reason why government authorities are ordering shutdowns is because of the physical fact of the virus itself landing and staying on surfaces and people, floating through the air and causing infection.

What is "Direct Physical Loss or Damage"?

There are many cases in which courts have analyzed the meaning of "direct physical loss or damage" terms in insurance policies. Some include:

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- Power outage, blackout – *Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co.*, 968 A.2d 724, 727 (N.J. Super. Ct. App. Div. 2009) – the claimants were supermarkets. Their business was interrupted by a power outage. The court considered whether an electrical grid had experienced physical damage during the blackout. The Court determined that the electrical grid was physically damaged because, due to a physical incident or series of incidents, the grid and its component generators and transmission lines were physically incapable of performing their essential function of providing electricity. The Court rested its decision on the loss of function of the system as a whole. The parties were an insurance company, in the business of covering risks, and a group of supermarkets that paid for what they believed was protection against a serious risk — the loss of electric power to refrigerate their food. The Court concluded that an average policy holder in plaintiffs' position would not have the narrow definition of physical damage which the insurer urged. “In this context, we conclude that if Liberty intended that its policy would provide no coverage for an electrical blackout, it was obligated to define its policy exclusion more clearly.”

- Gasoline vapors – *Western Fire Ins. Co. v. First Presbyterian Church*, 437 P.2d 52 (Colo. 1968). Gasoline vapors penetrated the foundation of the insured church and accumulated, rendering building uninhabitable. The Colorado Supreme Court held that the church building's saturation with gasoline vapors constituted a "direct physical loss" when the building could no longer be occupied or used.

- Asbestos -- *Port Authority v. Affiliated FM Ins. Co.*, 311 F.3d 226 (3rd Cir. 2002). The Court held that “sources unnoticeable to the naked eye,” such as asbestos in the air, can be direct physical loss if they render a building “uninhabitable and unusable.” The Court found that physical contamination of the building rendering it useless would constitute physical loss under New Jersey insurance law. The insurance company argued that physical loss or damage cannot occur without physical alteration. But the Court found that if "the presence of large quantities of asbestos in the air of a building is such as to make the structure uninhabitable and unusable, then there has been a distinct loss to its owner" which would constitute "physical loss." The concept here is that a property can be physically damaged, without undergoing structural alteration, when it loses its essential functionality.

- Bacteria -- *Motorists Mutual Ins. Co. v. Hardinger*, 131 Fed.Appx. 823, 825-27 (3rd Cir. 2005). The Court found that if a building was rendered uninhabitable by dangerous gases or bacteria, this could trigger insurance coverage despite “direct physical loss or damage” policy language. Applying Pennsylvania law, the Third Circuit found that the bacteria contamination of a home's water supply constituted a "direct physical loss" when it rendered the home uninhabitable.

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- Soot in the air – *Oregon Shakespeare Festival Ass'n v. Great Am. Ins. Co.*, No. 1:15-cv-01932-CL (D. Or. Jun. 7, 2016). The plaintiff Oregon Shakespeare Festival Association was insured by defendant Great American Insurance Company with a property insurance policy. The claimant alleged loss or damage to property when smoke from a nearby wildfire filled the theater in the summer of 2013, causing the insured to cancel performances and lose income. The insurer argued that "loss or damage must be physical," but the court found that there was no reason why the soot in the air was not physical. "Certainly, air is not mental or emotional, nor is it theoretical…. [W]hile air may often be invisible to the naked eye, surely the fact that air has physical properties cannot reasonably be disputed. Defendant's contention implies a different definition of 'physical' altogether. Defendant implies that, in order to be 'physical,' the loss or damage must be structural to the building itself. Defendant does not provide any evidence from within the policy to show that the plain meaning of the term 'physical' includes such a limitation."

- Odor -- *Essex v. BloomSouth Flooring Corp.*, 562 F.3d 399, 406 (1st Cir. 2009). The court found that, under Massachusetts law, a foul odor rendering property unusable could constituted physical damage to the property. The facts showed that during remodeling and carpet installation work, a foul odor emerged that was described as a "locker room" smell, a "playdough" smell, or a "sour chemical" smell. Some people complained that the odor caused headaches or other ill effects.

- Sulfuric gas -- *TRAVCO Ins. Co. v. Ward*, 715 F.Supp.2d 699, 709 (E.D.Va. 2010), *aff'd*, 504 F. App'x. 251 (4th Cir. 2013). This case found that there could be "direct physical loss" where a "home was rendered uninhabitable by the toxic gases" released by defective drywall.

- Carbon monoxide fumes -- *Matzner v. Seaco Ins. Co.*, 1998 WL 566658, 1998 Mass. Super. LEXIS 407 (Mass.Super.Ct. Aug. 12, 1998). The insureds claimed that carbon monoxide gas contaminated their apartment building, entitling them to coverage under an insurance policy that protected against direct physical loss or damage to property. The court first noted that the phrase "direct physical loss" was ambiguous and that it should be interpreted in the manner most favorable to the insured. The court ruled that carbon monoxide contamination constitutes a direct physical loss of or damage to property.

- Ammonia -- *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of America*, No. 2:12-cv-04418, 2014 U.S. Dist. LEXIS 165232 (D.N.J. Nov. 25, 2004). The court found a release of ammonia in an insured facility to be "direct physical loss or damage" despite no "structural alteration" to the facility

itself. There, "the ammonia release physically transformed the air within Gregory Packaging's facility so that it contained an unsafe amount of ammonia or that the heightened ammonia levels rendered the facility unfit for occupancy until the ammonia could be dissipated."

- Bacteria in home -- *Motorists Mut. Ins. Co. v. Hardinger*, 131 Fed. Appx. 823, 825-27 (3rd Cir. 2005). The court held *E.coli* contamination of a water supply could be "direct physical loss" if it rendered the home inhabitable. The question was whether bacteria caused direct physical damage under a homeowners policy. The homeowner had a private water well contaminated with *E.coli* bacteria. It caused illness to the insured's family, including respiratory, viral, and skin conditions. The insurer argued that the bacteria had not caused a "direct physical loss," which was necessary to trigger coverage under the policy. The Third Circuit denied the insurer's motion for summary judgment.

Commentary on the Case Law

Depending on the exact terms of the insurance policy language, there is a potentially compelling argument that the "physical loss" requirement can be satisfied by the prevalence of the potentially lethal COVID-19 virus on surfaces and in physical premises – similar to the manner in which toxic bacteria, gases, fumes, asbestos fibers or other toxic contaminants can affect properties and make them temporarily lose their essential function.

For example, assume that a railroad tanker car goes off the tracks and spills chemical gases throughout a community so that the nearby businesses must shut down. The situation caused by the virus is not that different. Like the toxic gas spill, the Coronavirus is an incursion of an unexpected toxic substance – the virus particles themselves – which rest and persist on surfaces, and travel through the air. Unlike things like the common cold or the flu, the COVID-19 virus particles can cause horrific percentages of hospitalization and mortality. When the prevalence of the virus leads to governmental temporary shutdown orders, it may be argued that the virus has caused physical loss or damage by its contaminating and destructive effect.

Unlike the common cold or the flu, the COVID-19 virus is not a common everyday occurrence that society has simply grown to live with. Rather, like the spill of toxic chemical gases into a community, or the detection of asbestos in a school building, the virus represents an unexpected, devastating, but temporary event, which will pass once it is controlled and recedes and once a vaccine is found.

This is the kind of unexpected damage that should be covered by business insurance because it falls into the range of what ordinary business owners thought they were paying for when they paid their premiums. They paid premiums for insurance to cover the unlikely event of a shutdown order and temporary business closures

due to an unexpected disaster. A small business owner needs this coverage because even though eventually the pandemic will pass and closure orders will lift, this may come too late for small businesses without deep cash reserves. For those who work in the people-serving, in-person-service, hospitality space, weeks of a shutdown may put them out of business forever. It is no surprise, then, that some have already filed claims in court.

What You Can Do

Small business owners are advised to consult their policies and see if they contain language that provides coverage for losses incurred due to a business interruption. The policy language must relate to events that trigger the suspension of their business operations, such as being forced to close due to a government order.

Also, one must check to see whether the insurance policy has an express exclusion for contamination due to communicable diseases or viruses. Such a "virus exclusion" may preclude a claim.

If the policy is broadly worded and does not contain such an exclusion, this is a point in the small business claimant's favor. This is because if the insurer had wanted to exclude pandemic-related losses under the policy, it could have sought to do so, but did not.

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If you need help analyzing your policy language or understanding if your business may have a valid claim, please do not hesitate to contact our firm for assistance. We know these are stressful financial times for most in the retail, restaurant, service, and hospitality industries. We look forward to seeing if we can help.