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Business interruption insurance: Battle lines have been drawn

INSURANCE LAW

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The minute it was apparent the pandemic would temporarily shut down businesses, insurance coverage counsel everywhere knew we were headed for a war within a war. As the war with coronavirus rages, the longer battle in the courts has just begun between insurers and businesses — and possibly state legislatures — over applicability of business interruption coverage for economic loss caused by Covid-19.

Under strict policy time limits for submitting notice of claims and proof of loss, waiting to join the fray could be fatal to BI coverage claims where they might otherwise eventually prevail.

Most commercial property policies include some form of BI coverage. Applicability of this type of coverage, and recoverability of loss for pandemic disruption will depend on specific policy wording, particular circumstances of each insured business, and reliable substantiation of specific causation, and quantification (i.e., revenue and cost projection) of lost profits and "extra expense."

BI coverage triggering events widely vary

Coverage is typically triggered when "direct physical loss of or damage to" insured property occurs due to fire, explosion or natural disaster. Other triggering events might be disruption to a business's customers or suppliers, or civil emergency action by government. Many policies will contain "contaminant" or "pollutant" exclusions that will negate BI coverage. Specialized policies for certain industries (e.g., food production, packaging, distribution and retail service; hospitality; travel; and health care) may include specific coverage of communicable disease risk. Another possible scenario is "all risk" coverage triggered by all perils falling outside of more or less expansive policy exclusions.

Why BI coverage for Covid-19 claims will be decided by the courts

The law is unsettled as to whether all forms of contamination rendering property unfit for its intended use constitutes physical damage. In 2018, a Florida court held that construction debris and dust interrupting operations of a nearby business until its premises were sanitized did not amount to "direct physical loss or damage" for lack of an "actual change in insured property" requiring repairs or making the property permanently unusable.

Court rulings in Ohio, California and New York have followed this rationale as a basis for denying coverage. Yet this logic has been rejected by courts in New Jersey, Massachusetts and Oregon, which have ruled that insured property can be physically "damaged" without structural alteration if essential functionality of physical property is lost due to certain types of contamination.

The Illinois appellate court in 1999 held that asbestos fiber contamination in school buildings constituted "physical loss or damage" to real property within the meaning of "all risk" policies. In BI coverage cases interpreting "pollutant" and contamination" exclusions, these exclusions have been held inapplicable to property damage caused by viruses and other microscopic substances not specifically included in the definition of "pollutant" or "contamination."

Another variable potentially affecting rulings on whether Covid-19 contamination constitutes "physical loss or damage" to property is the chemical makeup of the virus, which Johns Hopkins University researchers describe as not a living organism but a protein molecule that is not killed, but decays on its own with disintegration time dependent on temperature, humidity and type of material where it lies.

New BI coverage test case lawsuits have been filed for Covid-19 claims

Soon after the pandemic outbreak these lawsuits were filed in Louisiana, California, Oklahoma, Illinois and Florida. A policyholder restaurant in Louisiana is contending that Covid-19 contamination has physically damaged the surfaces of its furnishings and equipment. The policyholder restaurant suit in California contends that a countywide "stay at home" order triggers BI coverage under the "civil authority" coverage part of its policy. Both cases involve "all risk" policies — neither of which contains a "virus" or "viral pandemic" exclusion.

In Oklahoma, a BI coverage lawsuit filed by a Native

American tribe contends that its policy applies to economic loss due to the shut down of its casinos during the pandemic.

New BI coverage suits in Illinois thus far include a class-action on behalf of policyholders who serve food or beverages on their premises, and a multi-plaintiff suit by owners and operators of restaurants and movie theaters alleging not only improper denial of coverage, but also bad faith by the insurer for all but ruling out coverage of losses resulting from a "government imposed shut-down" due to Covid-19 without first conducting an investigation despite the absence of a virus exclusion in its policies.

The most recently filed BI coverage suit by a sports bar in Tampa, Fla., contends that "direct physical loss" under its "all risks" policy includes "any fortuitous event that is unintended from the perspective of the insured" including a government order shutting down businesses. While more lawsuits like these are certain to follow in coming weeks and months, it likely will be at least 12-18 months before courts issue final rulings in these cases.

Validity of brewing preemptory legislation, if enacted, likely will be decided in the courts

Legislatures in New Jersey, New York, Ohio and Massachusetts, have taken the lead toward forcing insurers to pay Covid-19-based BI claims of small and mid-size businesses up to policy limits for loss suffered during a state of emergency, regardless of policy provisions that would or might negate coverage. Under the proposed New York, Ohio and Massachusetts legislation, insurers could seek reimbursement from a fund created by assessments on all insurers selling policies in those states.

Legislatures in other states are likely soon to follow this initiative. Although unclear whether this proposed legislation will be enacted into law, if enacted, legal challenges to their validity is almost certain to follow. At stake will be the sanctity of an insurer's fundamental right to enforce its lawful contract terms.

Prompt action by policyholders will be key to potential BI coverage recovery

However these evolving issues may be resolved, and however long it takes for resolution, policyholders must act promptly to preserve their BI coverage claims. Failing to do so could result in an insurer's coverage denial based on late notice — even though all details of most BI claims cannot be determined when the existence of a claim is first known. After careful review of relevant policy provisions by coverage counsel, brokers can help with providing notice to insurers. Additionally, where possible, economic loss caused by Covid-19 should be mitigated — which some insurance policies expressly require. Equally important is keeping detailed records of all economic loss resulting from Covid-19 and preserving source information and documents needed to calculate and prove this loss.

To be sure, the outcome of this war within a war will be unknown for quite some time, and outcomes may vary from state to state. The only certainty is that the battle will be lost for businesses that have BI coverage but fail to assert their insurance contract rights promptly after it becomes apparent that business interruption caused by Covid-19 has begun inflicting significant financial loss.