

UPDATES ON BUSINESS INTERRUPTION COVERAGE DISPUTES RELATING TO COVID-19



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INSURERS are being sued nationwide relating to business interruption losses resulting from COVID-19 and the subsequent government orders requiring business closures and operating restrictions. Some insureds are asserting claims for breach of contract, unfair settlement practices, violations of state laws, and breach of good faith and fair dealing. As the cases wind through the courts, insurers are filing dispositive motions. Many have yet to be decided, but there are clear trends in the insurers' arguments.

In response to breach of contract claims, insurers are making the argument that business interruption policies require a direct physical loss or property damage, and COVID-19 does not constitute the physical loss or damage required to trigger coverage. Insurers identify damage caused by fires and storms as examples of the types of tangible damage anticipated by the policies.

For policies that contain specific "virus exclusions," insureds are essentially asking courts to re-write policies and nullify the plain language of contracts on public policy grounds. In response, insurers explain that the risk of pandemics was not part of the actuarial analysis to calculate premiums. The insured's attempt to void the virus exclusion retroactively to impose liability for an excluded loss is not only inequitable, but it raises issues of due process and implicates other constitutional rights.

Insureds also claim coverage under the "civil authority" provisions of their policies. However, in most cases, insureds have not shown damage to nearby property, which is a prerequisite to obtain coverage under most civil authority provisions. Civil authority coverage is meant to apply to situations in which access to an insured's property is prevented by a civil authority order issued as a direct result of physical damage to nearby property, such as when a building is closed for safety reasons because an adjoining building that was damaged by a fire is now under repair. The government orders issued in connection with COVID-19 concern public health emergencies and fear of the threat of the virus, not actual physical property damage to nearby properties. Indeed, many orders expressly permit access to property for security and maintenance purposes, and access to "necessary businesses" such as hospitals, grocery stores, and gas stations remains completely unrestricted.

Some insureds are exploring claims based on state laws such as fraud, misrepresentation, unfair settlement practices, violations of prompt payment laws, and breach of good faith and fair dealing. However, these types of claims require clear liability of the insurer. The proliferation of lawsuits and proposed legislation addressing coverage disputes in and of itself demonstrate that liability is far from clear.

CONSOLIDATION AND EXPEDITED REVIEW

Some insureds are pursuing strategies involving case consolidation and expedited review.

Many new cases are proposed federal class actions. However, in these cases the insureds will have to satisfy the commonality, typicality, and adequacy requirements of Federal Rule of Civil Procedure 23(a), which is expected to be difficult due to the factual differences among the cases, including policy terms, underlying factors, state insurance laws and the civil authority orders involved. It remains to be seen whether the insureds will be successful.

In April, two groups of plaintiffs' lawyers filed motions with the United States Judicial Panel on Multidistrict Litigation seeking to coordinate or consolidate pending cases relating to COVID-19 business interruption claims¹. In an unusual alliance, both insurers and certain leading MDL plaintiffs' firms filed briefs in opposition. Many insurers oppose an MDL because the cases simply are not the same, including the fact that different insurers are involved, and MDL will complicate and prolong litigation. Plaintiffs' firms that filed briefs in opposition echo the insurers' concerns about delay, pointing out that business policyholders continue to suffer losses and need speedy resolutions, as it may ultimately affect their survival. On August 12, 2020, the MDL panel decided against consolidating the pending COVID-19 business interruption litigation cases, in part because of differences between policies². However, the panel left open the possibility of combining litigation against individual insurers.

At the state court level, in *Joseph Tambellini Inc. v. Erie Insurance Exchange*³, an insured requested that the Pennsylvania Supreme Court exercise its "extraordinary jurisdiction powers" to assume authority over the state's COVID-19 litigation in order to "immediately resolve all legal insurance coverage issues." This outcome would prevent the litigation of these issues at the trial court and intermediate appellate levels and secure an expedited ruling that would be binding on all lower courts. On May 14, 2020, the court, without explanation, denied the request.

RECENT RULINGS

One of the first dispositive motion rulings in the United States on COVID-19 related business interruption coverage litigation has been favorable to insurers.

In Gavrilides Management Co. v. Michigan Insurance Co.,⁴

a Michigan state court judge granted the insurer's motion to dismiss an action brought by a restaurant owner who closed his businesses in response to COVID-19 related government orders. At a Zoom hearing on July 1, 2020, Judge Joyce Draganchuk ruled that business interruption coverage is provided for actual loss of business income sustained during a suspension of operations, and the suspension must be caused by direct physical loss of or damage to property. Judge Draganchuk concluded that the direct physical loss or damage "has to be something with material existence. Something that is tangible. Something . . . that alters the physical integrity of property."

Judge Draganchuk rejected the insured's argument that the physical damage requirement was met because patrons could not physically enter the property, characterizing it as "simply nonsense." Judge Draganchuk further held that even if direct physical loss or damage existed, the policy's "virus exclusion" would have barred coverage anyway.

Another recent ruling favorable to insurers, *Social Life Magazine Inc. v. Sentinel Insurance Co.*,⁵ filed in the U.S. District Court for the Southern District of New York, also addressed the key issue of whether the actual or potential presence of COVID-19 and/or government orders prohibiting access to property is enough to trigger the "direct physical loss or damage" requirement of most business interruption policies.

The insured, a magazine publisher, sought business interruption coverage for losses allegedly sustained due to government orders requiring the suspension of operations. Shortly after commencing the action, the insured requested a preliminary injunction to require the insurer to pay the insured's business interruption claim pending resolution of the case.

At an Order to Show Cause hearing on May 14, 2020, Judge Valerie E. Caproni denied the emergency request, ruling that the insured failed to show that physical damage, within the meaning of the policy, prevented the policyholder from entering the property. Judge Caproni explained that "New York law is clear that this kind of business interruption needs some damage to the property to prohibit you from going [in]." In response to the insured's counsel's argument that the virus caused on-site property damage, Judge Caproni pointed out that COVID-19 "damages lungs. It doesn't damage printing presses." While expressing sympathy "for every small business that is having difficulties during this period of time," Judge Caproni indicated that there simply is not coverage pursuant to the terms of the policy.

However, in a recent ruling in the U.S. District Court

for the Western District of Missouri, the court denied the insurer's motion to dismiss, and decided to allow plaintiffs' claims to proceed. This appears to be the first victory for policyholders. In *Studio 417 Inc. v. The Cincinnati Insurance Co.*⁶, Judge Stephen Bough agreed with the plaintiffs' arguments that COVID-19 is not a "benign condition" and particles carried in by staff and guests were a "physical substance" that attached to and damaged the property, rendering it "unsafe and unusable." Judge Bough distinguished the case from *Gavrilides*, where the plaintiffs failed to allege that COVID-19 had actually entered the property. Judge Bough did not rule on the merits of the case.

REGULATORY & LEGISLATION

In addition to the litigation cases described above, state insurance regulators have taken or recommended action on various aspects of COVID-19. Numerous states have given or considered extensions on health insurance premium deadlines. This will reduce the number of possible uninsured individuals.

Regulators have also been concerned about the growing number of business interruption claims related to COVID-19 outages. Many such insurance policies have pandemic exclusions which would allow insurers to deny claims for loss of business. Regulators and legislators that specialize in insurance are concerned that insurers would suffer enormous financial harm unless pandemic related exclusions under their existing policies are enforced fully.

Similarly, regulators are concerned with any material changes to policies they have approved. Insurers and their actuaries rely on currently approved policy provisions to underwrite and price the policies. Retroactive changes in those provisions can cause significant financial harm to insurers.

Regulators also oversee underwriting and administration of disability insurance claims. Questions will be raised about whether individuals are actually out of work because they are unable physically to perform the duties of their own or a similar job. If the person is out of work because the business is closed, the disability claim may be questioned.

A common regulatory concern is whether COVID-19 will affect the solvency of insurance companies. Business interruption insurance claims are primarily underwritten by property and casualty insurers. If those insurers pay unexpectedly high amounts of business interruption, their solvency could well be questioned.

Other affected lines are health and long term care

insurance. Thus far, while COVID-19 has increased some medical care costs, reductions in elective surgery and care initially reduced other more regular medical costs. Currently more COVID-19 deaths and cases are being verified while elective procedures are resuming. In summary, the COVID-19 effect on health insurance experience is evolving.

Life and annuity lines can also be impacted. It will take a while to determine whether the now 130,000 plus COVID-19 deaths in the U.S. decrease the average life expectancy of insureds or annuity holders. If so, there could be more life insurance claims paid but fewer future annuity payments.

Finally, regulators will need to consider rate increase requests by insurers for the business interruption and health insurance lines. That process can include actuarial, business and political elements. Depending on other regulatory responsibilities, rate increase determinations can take several months or more to process.

The regulatory process that addresses COVID-19 related claims is described in numerous websites. For instance, the National Association of Insurance Commissioners coordinates many of the regulatory approaches nationally. Below is the NAIC statement relating to federal aid provided in relation to COVID-19. https://content.naic.org/article/statement_naic_statement_congressional_action_relating_covid_19.htm

The National Conference of Insurance Legislators is a group of state legislators specializing in insurance. Its link below includes discussions of the regulatory aspects of COVID-19. <http://ncoil.org/2020/04/21/ncoil-and-rutgers-center-for-risk-and-responsibility-to-host-webinar-to-discuss-legislative-responses-to-business-interruption-insurance-and-covid-19/>

The New York Department of Financial Services and the New Jersey Department of Banking and Insurance, like other state Insurance Departments, have COVID-19 related sections. The NY and NJ coronavirus websites are: <https://www.dfs.ny.gov/industry/coronavirus> and <https://www.state.nj.us/dobi/covid/index.htm>.

Finally, insurance insolvencies are addressed by state-based guaranty associations. The National Conference of Insurance Guaranty Fund (NCIGF) is the national association of GAs that covers property and casualty insurance including most business interruption insurance. Its counterpart National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) addresses life and health insurance lines and Long Term Care. <https://www.ncigf.org/>, <https://www.nolhga.com/> Both sites have regular entries on COVID-19 and its financial impact.

We will provide further information as the COVID-19 claims evolve.

INTERNATIONAL ASPECTS

The U.S. is not the only country dealing with business interruption litigation.

In the U.K., on June 9, 2020 the Financial Conduct Authority (FCA) filed a test case against several insurers before the High Court in London relating to business interruption insurance policies.⁷ The FCA pointed out that the “test case is not intended to encompass all possible disputes, but to resolve some key contractual uncertainties and ‘causation’ issues to provide clarity for policyholders and insurers.” The FCA hopes that a decision will “provide persuasive guidance for the interpretation of similar policy wordings and claims, that can be taken into account in other court cases.” The trial of the test case took place during the last two weeks of July. A judgment is expected as early as mid-September.

At the end of May, the Paris Commercial Court ruled that AXA must pay Stéphane Manigold, a restaurant owner, two months’ worth of coronavirus-related revenue losses. While this ruling may be of interest to the global legal community, AXA CEO Thomas Buberl told the French newspaper *Le Monde* that this case involved very specific policy language contained in only about 1,700 contracts out of the 20,000 contracts AXA has with restaurants, so the worldwide precedential value of the decision would be limited.

RECENT EVENTS

COVID-19 related business interruption coverage disputes are being compounded by the protests and demonstrations over social justice issues that continue across the country, including the looting, vandalism and arson in June by individuals using the largely-peaceful events as an opportunity to engage in criminal conduct.

Unlike pandemic-related losses where the “physical damage requirement” is at issue, the situation is clearer for property damage resulting from riots, civil commotion and vandalism. However, coverage disputes may still arise. For example, some businesses may have been completely closed, others had reduced operations, and some remained open and operating normally. Insurers may argue that if a business was not planning on being fully open and operational due to the pandemic, it should not be entitled to coverage. Insureds are likely to assert that the two causes of loss should be viewed separately, and businesses should not lose coverage for a covered cause of loss just

because a non-covered cause of loss exists at the same time.

Calculating business interruption losses will likely be complicated by the effects of the pandemic. Revenue is typically the basis for determining business interruption values. Insurers typically determine income loss based on a past 12-month assessment of income. However, many businesses have suffered revenue losses attributable to both the pandemic and civil commotion: businesses have been forced to close or chose to do so out of safety concerns, curfews reduced operations, and occupancy restrictions and street and sidewalk closures caused declines in business. Many income loss calculations will be negatively affected by these conditions. Government assistance, including the federal Paycheck Protection Program, may factor into revenue calculations as well. For example, questions may arise as to whether PPP funds should be treated as loans or income, and whether payroll would be a covered expense under an insured’s business interruption policy.

It is likely that pandemic-related problems will cause losses to be greater than they otherwise would. Businesses may have to remain closed longer if suppliers are delayed in manufacturing and shipping goods. Property damage may linger due to the unavailability of construction and repair professionals and struggling businesses’ lack of access to capital in order to front the costs of repairs. Further, some businesses have allowed their insurance policies to lapse under financial pressure and may now find themselves without any coverage.

CONCLUSION

The future will bring many complicated and novel issues arising from unprecedented factual and legal circumstances. Clients and attorneys will continue to monitor these important and complex issues to determine legal challenges and opportunities that may arise.

¹ In re COVID-19 Bus. Interruption Ins. Coverage Litig., No. 2942 (J.P.M.L. Apr. 20, 2020).

² In re COVID-19 Bus. Interruption Ins. Coverage Litig., No. 2942 (J.P.M.L. Aug. 12, 2020), Doc. No. 772.

³ Joseph Tambellini, Inc. v. Erie Insurance Exchange, No. 52 WM 2020 (Pa. Sup. Ct.).

⁴ Gavrilides Management Co. v. Michigan Insurance Co., No. 20-258-CB-C30 (Mich. Cir. Ct.).

⁵ Social Life Magazine, Inc. v. Sentinel Insurance Co. Ltd., No. 20-cv-3311 (VEC) (S.D.N.Y.).

⁶ Studio 417 Inc. v. The Cincinnati Insurance Co., No. 20-03127 (W.D. Mo. Aug. 12, 2020).

⁷ <https://www.fca.org.uk/firms/business-interruption-insurance>