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Business Interruption Claims Arising Out of the COVID-19 Pandemic

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By March 11, 2020, the World Health Organization deemed COVID-19, the disease caused by a novel coronavirus, SARS-CoV-2, a pandemic. In response, much of the world went into "lockdown" and businesses across the globe shuttered their operations.

Since then, the effects of the pandemic have been devastating not only to people's health but also to the world economy. According to some experts, the economic downturn is already worse than the Great Depression.

Businesses suffering income losses filed what some have called an unprecedented wave of business interruption insurance claims. Many insurers denied these claims. Policyholders, in turn, filed lawsuits asserting that the insurers' claim denials breached their contracts and constituted bad faith.

These claims are so numerous that paying them could seriously impact the solvency of insurers. On the other hand, without coverage, many policyholder businesses' very existence will be threatened.

Below, some (though by no means all) of the key business income coverages, as well as trends to watch in the courts and other government branches, are discussed.


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Key Time Element Coverages and Exclusions

Business interruption insurance is a relative newcomer in the insurance world, having been introduced about 50 years ago. Generally available as an optional add-on to commercial property policies, business interruption and related coverages are sometimes called time element insurance. These coverages are designed to help (often for a specified amount of time) a business get back on its feet after losses caused by a covered risk outside policyholder's control.

Although the wording of these time element coverages is not standard, there are common coverage provisions. For example, a covered business interruption must often be "caused by direct physical loss of or damage to [the insured's] covered property." Thus, a key issue is whether the threat, or even the actual presence, of SARS-CoV-2 on the premises meets this requirement.

Time element coverages frequently include a civil authority extension for lost business revenue "caused by the action of a civil authority that prohibits access to the policyholder's place of business." These provisions often require "damage to property other than" the policyholder's premises. Therefore, under this coverage as well, an analysis of whether SARS-CoV-2 causes physical damage to property is critical.

Policies may also provide contingent business interruption coverage, covering losses sustained when a supplier (or a customer) has to suspend operations, affecting the policyholder's business. These provisions often require that the losses be sustained "due to physical loss or damage at the premises"—this time of the supplier. Here again, the prerequisite of physical loss of or damage to property is likely to be central.

In rarer instances, policies may contain more specific coverage extensions; for example, covering "contamination" (often defined as "a dangerous condition at your premises") or for a "pandemic event."

In terms of exclusions, most policies contain a "pollution" exclusion, which bars coverage for loss or damage caused by "pollutants," generally defined as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste." Some insurers have asserted that this broad definition encompasses viruses.

Some policies contain a virus exclusion. Created in the wake of the SARS epidemic (2002 –2004), this exclusion is relatively recent and generally provides the following: "We will not pay for loss or damage resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease."

Executive and Legislative Responses to Business Interruption Coverage Limitations

Cognizant of the common "physical damage to or loss of property" coverage requirement, some governmental shelter-in-place orders specifically reference physical damage. For example, on March 18, 2020, Napa County, California's order specifically stated: "This Order is issued based on evidence of increasing occurrence of COVID-19 throughout the Bay Area, increasing likelihood of occurrence of COVID-19 within the County, *and the physical damage to property caused by the virus*." (Emphasis added.)

At least eight state legislatures, the District of Columbia, and the U.S. Congress have examined the possibility of passing legislation requiring insurers to provide coverage for COVID-19-related business interruption losses. In general, these laws purport to vitiate the virus exclusion's effect with regard to COVID-19 and to specify that the virus causes physical loss of, or damage to, property within the meaning of various time element coverages. Some of the legislative proposals under consideration provide for reimbursement to insurers but many of those also require that the fund established for such reimbursement come from the insurance industry.

Insurers have questioned the constitutionality of such laws under, among other provisions, the Contracts Clause of the United States Constitution. However, some commentators have pointed out that, notably during the Great Depression, certain state laws that altered contractual rights have been upheld where they advance a "significant and legitimate public purpose" in an "appropriate" and "reasonable" manner.

It is too soon to know how these legislative efforts will fare but they are worth continuing to watch and assess.

COVID-19-Related Business Interruption Claims in the Courts

Historically, courts have been split on the key issue of what constitutes "physical loss of or damage to" property. Some jurisdictions have construed the phrase to require some physical alteration of the property. Other jurisdictions have held that the presence of, for example, smoke, toxic fumes, E-coli bacteria or even a foul odor may constitute the requisite property damage without tangible physical injury, if it renders the property unusable.

Although COVID-19-related lawsuits have been filed at an unprecedented rate, decisions from the courts are just starting to trickle in. So far, the decision tally favors insurers. For example, several jurisdictions (Michigan, Texas, and Washington, D.C.) have upheld the insurers' positions that, because the virus does not cause any physical alteration of property, it does not trigger business interruption coverage. Some courts have also held that virus exclusions would bar coverage even if property damage could be established.

Additionally, the U.S. Judicial Panel on Multidistrict Litigation recently rejected policyholders' efforts to consolidate COVID-19-related business interruption lawsuits. As the panel pointed out, the "cases involve different insurance policies with different coverages, conditions, exclusions, and policy language, purchased by different businesses in different industries located in different states."

Nonetheless, the panel left open whether consolidation might be appropriate when the insurance policies contain the same or similar language. The panel ordered the insurers to show cause why actions against each of them should not be centralized.

Moreover, not all the substantive rulings have favored insurers' interpretations of the property damage requirement. In a recent Missouri case, the court rejected the insurers' motion to dismiss, finding that the plaintiff hair salons and restaurants had plausibly argued that COVID-19 was not a "benign condition" and its physical particles were a "physical substance" that damaged their properties, rendering them unsafe and unusable. The policy in this case did not contain a virus exclusion.

Looking Ahead

Both insurers and policyholders see COVID-19 as threatening their bottom lines—and possibly their very existence. Therefore, the prospects for settlement may seem bleak.

However, at least one COVID-19-related business interruption lawsuit has already settled. In that case, the owner of a group of theaters added a "pandemic event endorsement" to its policy after the 2014 Ebola outbreak. Although COVID-19 was not specifically mentioned in the endorsement, "mutations or variations" of the "Severe Acute Respiratory Syndrome-associated Coronavirus (SARS-CoV) disease" were. When the insurer denied the policyholder's COVID-19-related claim, the policyholder sued. Two months later, the parties settled and jointly dismissed the case.

While such a quick negotiated resolution may not yet be the norm, as time goes on, the appeal of early settlement may well grow. Meanwhile, insurers and risk managers alike should continue to review their policies' specific language and assess carefully how it may pertain to the claim at hand, while staying informed about legislative enactments and case law developments in this area.

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