EimerStahl LLP

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EimerStahl Client Alert

PANDEMIC COVERAGE LITIGATION

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I. THE COVID-19 PANDEMIC BEGINS COVERAGE LAWSUITS & CLASS ACTIONS

As of this writing, more than 40 states had issued some kind of state-wide stay at home order. Local jurisdictions have closed nonessential businesses even in those states without such an order. Taken together, these measures have closed down large sections of the national economy. Demands for insurance coverage of associated losses are therefore rising. *See Pressure Mounts on Insurance Companies to Pay Out for Coronavirus*, The Wall Street Journal, April 5, 2020. Litigation inevitably has begun. On March 31, for example, a Chicago restaurant chain filed a class action on behalf of food and beverage companies denied coverage. *See Billy Goat Tavern I, Inc. v. Society Insurance*, No. 1:20-cv-02068 (N.D. Ill. Mar. 31, 2020); *Big Onion Tavern Group, LLC et al. v. Society Insurance, Inc.,* 1:20-cv-02005 (N.D. Ill. Mar. 27, 2020); *see also Cajun Conti LLC v. Certain Underwriters at Lloyd's, London*, No. 2020-02558 (La. Dist. Ct., Orleans Parish Mar. 16, 2020).

The decision to bring a class action is interesting in this context. Motions to certify insurance coverage class actions often do not fare well. The circumstances of the likely business interruption coverage claims, very generally discussed below, outline some reasons why.

II. OVERVIEW OF BUSINESS INTERRUPTION

Business interruption or business income insurance is optional coverage that may be included in a comprehensive commercial property insurance policy or program. The insurance comes in several different variations, and normally does not exist in a stand-alone policy. It is intended to indemnify business continuity losses arising from physical damage to a place of business. Policies typically come with varying requirements, definitions and exclusions, and list or describe the types of causes of losses covered. The actual language of a policy is, of course, the critical determinant of the question of coverage.

Business interruption insurance provisions generally have physical damage triggers, such as fires or floods. *See, e.g.*, *Port Auth. of N.Y. & N.J. v. Affiliated FM Ins. Co.*, 311 F.3d 226, 235 (3d Cir. 2002) ("[i]n ordinary parlance and widely accepted definition, physical damage to property means 'a distinct, demonstrable, and physical alteration' of its structure."); *Pamperin Rentals II, LLC v. R.G. Hendricks & Sons Constr., Inc.*, 825 N.E. 2d 297 (Wis. Ct. App. 2012). That physical damage must itself be a covered loss, and generally must interrupt normal business operations and result in unanticipated costs and lost profits. Judicial decisions have varied on whether coverage is triggered by a total or partial suspension of operations. The minority rule appears to be that a complete suspension is required. *See, e.g., GBP Partners Ltd. V. Md. Cas. Co.*, 2013 U.S.App.LEXIS 563 (5th Cir. Jan. 4, 2013) (Texas law) (no business interruption coverage because there was no complete cessation of operations).

Coverage is limited to a period of restoration or recovery. That generally is the time it reasonably should take to repair, rebuild, or replace damaged property. Policies often have specific damage mitigation requirements. For example, some policies will reduce claims payments to the extent operations could be resumed, in whole or part, using damaged or undamaged equipment. Operations, in short, must be resumed "as quickly as possible." Claim notice requirements are strictly enforced by many courts. *See, e.g., Mitchell Buick & Oldsmobile Sales, Inc. v. Nat'l Dealer Servs, Inc.*, 485 N.E.2d 1281 (Ill. App. 2nd Dist. 1985). The burden is on the insured to establish both coverage and the amount of benefits due.

A related coverage option is found in civil authority clauses, which detail whether lost net income may be reimbursed after the government denies access to a business in the event of a natural disaster or other public emergency. An insured who is barred from business interruption coverage, due to the lack of physical damage, might seek coverage under such a civil authority clause. Time limits for coverage can vary, sometimes from a week to 30 days.

The loss of income must be caused by the civil authority's order. *See, e.g. Bamundo, Zwal & Schermerhorn, LLP v. Sentinel Ins. Co.*, No. 13-cv-6672 (RJS), 2015 WL 1408873, *1, 2015 U.S. Dist. LEXIS 39409 (S.D.N.Y., Mar. 26, 2015) (the coverage is for loss of business when access to property is "specifically prohibited by order of a civil authority as a direct result of a Covered Cause of Loss to property in the immediate area" of the property); *Dickie Brennan & Co., v. Lexington Ins. Co.*, 636 F.3d 683 (5th Cir. 2011). In general, the civil authority must prohibit all access to the premises, the prohibition order must have been caused by a direct physical damage to property other than the covered premises, and the prohibition must be the cause of the loss to the covered premises. *Id*. at 685. In other words, the closure order must have been caused by damage off the covered premises, and must have been issued to prevent further damage to the covered premises.

For example, in *South Texas Medical Clinics, PA v. CNA Financial Corp*., 2008 WL 450012 (S.D. Tex. 2008), Hurricane Rita was moving through the Caribbean and predicted to hit Wharton County, Texas. The county issued a mandatory evacuation order that the insured obeyed. Before the order was issued, Rita made landfall and damaged property in Florida. Although property in Wharton County suffered no actual damage, the insured suffered business losses due to the evacuation and sought coverage from its policy's civil authority provision. The record showed, however, that the evacuation order was issued because Rita was threatening the Texas coast, not because Rita had already damaged property in Florida. Accordingly, the court concluded that the necessary nexus between the property damage and the evacuation order had not been established.

III. COVERAGE & RELATED CLASS CERTIFICATION ISSUES

Proving physical harm will be challenging for an insured. A likely argument, reflected in the recent case filings involving Covid-19 closures, is that the presence of the virus on property constitutes contamination qualifying as covered physical damage.

Notable insured success stories have come with courts finding coverage in situations involving asbestos or ammonia admissions at a factory. *See, e.g., Gregory Packing, Inc. v. Travelers Prop. Cas. Co of Am.,* Civ. No. 2:12-cv-04418 (WHW) (CLW) (D.N.J. Nov. 25, 2014) (not for publication) (Ammonia contamination). In *Gregory Packing*, the court held that an ammonia release triggered business interruption coverage even though no physical alteration to the facility took place: "There is no genuine dispute that the ammonia release on July 20, 2010 rendered Gregory Packaging's facility physically unfit for normal human occupancy and continued use until the ammonia was sufficiently dissipated." *Id.* at 5-6. Multiple witnesses testified that the ammonia rendered the facility unsafe, reflecting the highly fact-specific nature of these sorts of claims. *Id.* at 6.

There is also an analogous line of cases, outside the context of contamination, finding coverage without a physical alteration of a business in the context of electrical disruptions or blackouts. *See, e.g., Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co.*, 968 A.2d 724, 727 (N.J. Super. Ct. App. Div. 2009) (temporary and non-structural interruption in electrical grid constituted "physical damage" that let to damage to food company from blackout); *Se. Mental Health Ctr., Inc. v. Pac. Ins. Co.*, 439 F. Supp. 2d 831, 838 (W.D. Tenn 2006) ("physical damage" could include loss of "functionality" even if the affected machinery remained intact); *Am. Guar. & Liab. Ins. Co. v. Ingram Micro, Inc.*, No. 99-185 TUC ACM, 2000 WL 726789, *2 (D. Ariz. April 18, 2000) (in a power outage, a computer system had sustained direct physical damage because "'physical damage' is not restricted to the physical destruction or harm of computer circuitry but includes loss of access, loss of use, and loss of functionality."); *Western Fire Ins. Co. v. First Presbyterian Church*, 437 P.2d 52, 53 (Colo. 1968) (holding a church's saturation with gasoline vapors constituted a "direct physical loss" when the building could no longer be occupied or used).

In *Western Fire*, the court found that "physical damage" to a house occurred where a mudslide down to the end of the insured's property left "the house proper perched precipitously on the edge of a very newly created cliff." *Id.* at 55. The insurer argued that no covered loss occurred, because the house itself was not damaged, but the court rejected that argument. *Id.* at 55-6 (citations omitted). Other cases have likewise accepted the view that "damage" includes loss of function or value. *See Dundee Mut. Ins. Co. v. Marifjeren*, 587 N.W.2d 191, 194 (N.D. 1998); *Gen. Mills, Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147, 152 (Minn. Ct. App. 2001); *Pepsico, Inc. v. Winterthur Int'l Am. Ins.* Co., 24 A.D.3d 743, 806 N.Y.S.2d 709, 711 (2005).

"...significant coverage obstacles still exist ..."

However, even if an insured prevails in classifying contamination as property damage, significant coverage obstacles still exist. First, questions will arise whether the business closure was due to actual, provable contamination on the premises, or was instead caused by an effort to prevent the virus spread from reaching the property. Indeed, the closures arguably were not caused by the businesses themselves being contaminated, but instead because they are gathering places that cause "social spread" of the virus. The closures, in short, may not be deemed to involve actual contamination at all. Of course, some of this "social spread" in a business would be caused by patrons leaving the virus on physical surfaces within a business.

Second, proving the existence of the virus on a premises may itself be a challenge, if sufficient time passes before the claim is evaluated. It appears, based on current data that the virus only lives on surfaces for a relatively short time.

Third, policies will only cover damage for a short period in which to remediate. Cleaning surfaces of possible Covid-19 contamination likely could be rapid in many instances. Thus, disputes likely will result over whether re-contamination extends coverage. Some policies may provide for extended interruption coverage to address continuing lost business after remediation is complete. Whether that would allow coverage to reach far into a prolonged period of business shut-down is unclear.

Fourth, unless a policy contains a specific benefit amount, valuing the loss can be very insured-specific. Calculation of lost profits, under policies which provide coverage for lost profits, can be particularly complex and can require analyses of financial, accounting, tax and other operational or business records. *See, e.g., Firemen's Fund Ins. Co. v. Mitchell-Peterson, Inc.*, 578 N.E. 2d 851 (Ohio Ct. App. 1991) (discussing complex business issues). In the process, accounting would be necessary for fixed expenses that continue during the business suspension (which might not be covered), as well as expenses incurred to mitigate the loss (which might be). Such insured-specific issues normally are reserved for a jury. *See, e.g., W. Am. Inc. v. Aetna Cas. & Surety Co.*, 915 F.2d 1181 (8th Cir. 1990) (jury denies profit claim based on insufficient proof); *Cohen Furniture Co. v. St. Paul Ins. Co. of Ill.*, 573 N.E.2d 851 (Ill. App. 3d Dist. 1991) (discussing fact issues associated with a property depreciation claim); *Grevas v. United States Fid. & Cas. Co.*, 604 N.E.2d 942 (Ill. 1992) (same).

Fifth, most carries have taken steps to exclude virus outbreaks and pandemics. While some policyholders may have negotiated relief from those exclusions in particular programs, the exclusions nonetheless pose a major barrier to Covid-19 coverage. A growing list of state legislatures, however, have begun to introduce bills specifically requiring pandemic coverage. *See, e.g.*, New York (A-10226) ("requiring certain perils be covered under business interruption insurance during the coronavirus disease 2019 (COVID-19) pandemic."); New Jersey (A-3844); Massachusetts (SD No. 2888); Ohio (HB 589) ("require[ing] insurers offering business interruption insurance to cover losses attributable to viruses and pandemics …."). It is possible that some or all of this legislation will be limited to very small businesses, and may ultimately target restrictive "property damage" interpretations, biomedical exclusions, or both.

IV. CLASS ACTIONS?

At the outset of a case brought as a class action, the court would likely be asked to determine whether the claim of the representative plaintiff is covered by the policy. If not, the litigation should conclude. If the court allows the claim, the issue of certifiability of the claim as a class action will ripen. The above discussion should illustrate the highly individualized nature of these types of coverage disputes, requiring detailed factual inquiries into the nature of the damage, its cause or causes, the efforts to mitigate it, and quantifying the amount of indemnity payments due. For example:

- Loss causation will be a huge issue. Can a business closure order be linked to contamination, and can that contamination, in turn, be characterized as covered property damage? To what extent can a business closure be construed as a preventative measure for the future, which arguably would not enjoy coverage? In a situation like this, where the contamination is transitory,

what impact would a new closure in the future, due to a new outbreak or hotspot, impact coverage?

- Can actual virus contamination even be proven, if there is a significant passage of time between the business interruption and the claim investigation or the discovery in litigation?

- Was the business subject to a complete or partial closure? Some policies require complete disruptions, whereas many affected businesses are instead engaged in partial or limited operations. Would telecommuting, for example, interfere with obtaining coverage?

- Was the damage subject to an exclusion, such as a virus/pandemic exclusion? If so, were limitations to the exclusion negotiated into the policy? Is the exclusion subject to any relevant pandemic insurance legislation?

- Mitigation: Some policies will reduce claims payments to the extent operations could be resumed, in whole or part, using damaged or undamaged equipment. Operations, in short, must be resumed "as quickly as possible." The speed of business resumptions, coupled with official orders or mere recommendations that impact resumption efforts, could be a source of litigation.

- Mitigation: Coverage is limited to a period of restoration or recovery that generally is the time it reasonably should take to repair, rebuild, or replace damaged property.

- Some policies only pay for measurable repair and replacement costs, while others also include lost profits.

- Contingent business interruption insurance: This is a variant of the coverage that applies to business that is interrupted do to damage sustained by suppliers or customers, raising further far-flung individual issues that involve multiple parties. *See, e.g., Archer-Daniels Midland Co. v Phoenix Assurance Co.*, 936 F. Supp. 534 (S.D. Ill. 1996) (contingent business interruption coverage afforded to food processor because of property damage to farmers who lost crops that would have indirectly been sold to the insured through intermediaries).

- In a civil authority coverage dispute, was there a complete exclusion from the property by the order, and was the exclusion issued as a direct result of an otherwise covered loss?

- If the insured is a renter, do renters enjoy coverage under the policy?

- In the class action context, there could be significant policy language variation, which is a bar to class certification.

- Similarly, there will be insured-specific choice of law issues, and variations in state law on key coverage questions.

- To the extent a policy ambiguity is found, that could require a jury to evaluate claim-specific extrinsic evidence that would undermine the ability to try a coverage dispute on a class basis. Indeed, some states require or permit the admission of such extrinsic evidence even if there is no policy ambiguity.

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