Insurer Liability for Business Closures due to COVID-19
Will Courts Find "Physical Loss or Damage"?

Approximately one-third of U.S. businesses have "business interruption" insurance, intended to cover losses from events that force them to suspend or stop operations. Many of these policies also contain specific "civil authority" clauses, which cover losses when a government agency stops a business from operating.

However, in the wake of unprecedented business interruptions – caused by the spread of COVID-19 and government orders shutting down "non-essential" businesses – major insurers have uniformly denied businesses owners coverage for their losses. A joint statement from the American Property Casualty Insurance Association, Council of Insurance Agents and Brokers, Independent Insurance Agents & Brokers of America, and National Association of Mutual Insurance Companies claims that "business interruption policies do not, and were not designed to, provide coverage against communicable diseases such as COVID-19."

But despite insurers' current denial of COVID-19 related claims, there is a strong legal argument that many business interruption policies *do* in fact provide coverage for current shutdowns. Over the past month, there has been a wave of litigation across the country testing this question. And although we have yet to see any cases filed in Washington, they're likely coming.

Legislatively, efforts are underway at both the state and federal levels to require that insurers provide coverage to businesses facing interruptions from COVID-19. For instance, on April 14, Rep. Mike Thompson (CA-05) introduced HR 6494, titled the "Business Interruption Insurance Coverage Act of 2020," which would require business interruption insurers to cover COVID-19 related closures, and would void any exclusions for viral pandemics in existing business interruption policies. Though not currently a cosponsor of HR 6494, Washington's Rep. Jayapal (WA-07) has also publicly criticized major insurers for "refusing to pay up during this economic and public health crisis." At the state level, legislators in Pennsylvania, Ohio, New Jersey, and Massachusetts have introduced legislation to similar effect.

So, what are the issues being argued in these cases? And what does the litigation landscape look like so far? This article examines two issues common to most claims being filed and provides a brief overview of representative cases from across the country.

I. The primary issue in dispute is whether COVID-19 shutdowns constitute "physical loss or damage" to property.

A typical business interruption policy compensates businesses for lost income due to a necessary suspension of operations if the suspension of operations is caused by "physical loss of or damage to" property at the business' premises. The trillion-dollar question currently facing businesses and insurers is whether the spread of Covid-19 and attending shutdowns constitutes "physical loss or damage" within the scope of business interruption policies.

Business owners seeking coverage have argued that the inability for employees and customers to physically enter their premises constitutes "physical loss," and widespread contamination by a deadly virus such as Covid-19 constitutes "physical damage." There is substantial legal authority to back up these arguments.

For instance, in 2016, the Oregon Shakespeare Festival won a case against Great American Insurance Company, following Great American's denial of coverage for loss of business income due to wildfire smoke, which had infiltrated OSF's theater and rendered it temporarily uninhabitable. *See Oregon Shakespeare Festival Ass'n v. Great Am. Ins. Co.*, No. 1:15-CV-01932-CL, 2016 WL 3267247, at *1 (D. Or. June 7, 2016). In that case, Great American Insurance unsuccessfully argued that such smoke was not a "physical" loss or injury, implying that loss or damage had to be structural in order to trigger coverage. In a colorful rebuke, the Court held that such damage was physical because "air is not mental or emotional, nor is it theoretical . . . while air may often be invisible to the naked eye, surely the fact that air has physical properties cannot reasonably be disputed."

Likewise, the 8th Circuit Court of Appeals initially held in 2006 (before vacating its own decision) that the federal government's restriction on imports of Canadian beef due to concerns over mad cow disease constituted physical loss, even without actual proof that the plaintiff's beef had been contaminated. *See Source Food Tech., Inc. v. U.S. Fid. & Guar. Co.*, 460 F.3d 995, 998 (8th Cir.), *reh'g granted and opinion vacated* (Oct. 5, 2006).

Complaints filed by business owners related to Covid-19 have gone to great lengths to emphasize they physical nature of the virus. For instance, in a U.S. District Court case filed in Alabama, plaintiff Wagner Shoes noted that "COVID-19 can and will reside on everyday surfaces . . . and cleaning is the necessary first step of any sterilization or disinfection process." The complaint goes on to describe cleaning as "a form of decontamination that renders the environmental surface safe to handle or use by removing organic matter and agents which interfere with microbial inactivation."

Contingent Business Interruption coverage

Insured business owners should also be aware of possible coverage for contingent business interruptions. Contingent business interruption coverage (CBI) covers lost earnings that are the result of a *third-party* supplier or distributor shutdown whose interruption in turn directly impacts the insured's ability to produce a product or provide a service. As a result, even if some businesses are able to continue operating – such as certain construction firms performing essential services – they may nevertheless have a valid claim for costs faced as a result of supplier or distributor shutdowns. Covered

business owners should look to the specific language of their policies to determine if CBI coverage is included.

Virus or pandemic exclusions

Following the outbreak of SARS in 2002-2003 many (but not all) insurers began including virus or bacteria exclusions from their policies. While these exclusions may preclude some claims for direct physical losses due to the virus, they may not be a complete bar to business owners' recovery. Rather, businesses owners which have faced shutdowns due to government order may argue that it is the order – not the virus itself – which has caused them to suspend operation.

Additionally, the existence of these exclusions in some policies undercuts insurers' argument that the COVID-19 pandemic is not an event causing "physical loss." Were that to be true – that the spread of a dangerous virus does not create "physical loss or damage" – no policy exclusions for such losses would be necessary.

II. The second issue is whether shutdowns caused government orders, such as "shelter in place" are within the scope of civil authority clauses.

Business interruption policies commonly contain a "civil authority" clause, which provides coverage when a civil authority prohibits access to the insured's premises resulting in a total loss of business income. Generally, such clauses still require underlying physical loss or damage – for instance if a building is locked due to a fire in an adjacent property. As a result, it will likely be necessary for covered business owners to prove that the spread of COVID-19 is a physical event, resulting in at least the risk of physical loss.

Even still, the parameters of such clauses are not always clear. For instance, in *Kilroy Industries v. United Pacific Insurance Co.* (1985, C.D. Cal), an 11-story office building in Seattle was vacated because it was determined by King County to be unsafe in the event of an earthquake. Following the insurer's denial of Kilroy Industries' claim, a district court in California found that the Kilroy's business interruption was compensable under its all-risk insurance policy, which contained a special endorsement for "loss from earthquake," even though no earthquake had actually occurred.

Given the nature of the coronavirus, it will likely be difficult for many businesses to prove whether their premises were actually contaminated by the virus. However, as *Kilroy Industries* shows, a government-ordered shut down due to concerns over physical safety may still trigger insurance coverage.

Jurisdictions with active cases

The following is a brief survey of some of the cases which have been filed related to this issue, including both class actions and individual suits. It is likely that dozens of similar cases will be filed in the coming weeks as covered business owners face further denials.

Alabama

In Alabama, a shoe retailer, Wagner Shoes, filed suit against its insurer for denial of coverage for losses caused by mandated retail closures. *See Wagner Shoes, LLC v.*

Auto-Owners Insurance Company, No. 7-20-v-00465-GMB (N.D. Ala. Apr. 7, 2020. Wagner Shoes' complaint argues, among other things that that, "direct physical loss can exist without actual destruction of property or structural damage to property: in analogous circumstances to the COVID-19 agent, the presence of harmful substances on a property can constitute 'property damage' or 'direct physical loss' that triggers first party property coverage."

California

In California, world-renowned, owners of the three-Michelin-starred restaurant The French Laundry filed suit against its insurers in California Superior Court, seeking a declaratory judgment that its policy provides coverage for civil authority closures of restaurants in Napa County due to "physical loss or damage from the Coronavirus." *See French Laundry Partners LP et al. v. Hartford Fire Insurance Co. et al. (Calif. Super., Napa County)*. This case is especially noteworthy because The French Laundry's policy contained no "viral pandemic" exclusion – and in fact contained a "property choice deluxe form" which specifically *included* coverage for loss or damage caused by a virus.

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