

Insurance Recovery & The Corona Effect: Responding To Coverage Defenses For Business Interruption Claims

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While the financial impact of quarantines and shelter-in-place orders will inevitably reach into every industry and every corner of the economy, companies in the hotel, restaurant, travel, retail and manufacturing sectors have already sustained significant business interruption losses. Much of the commentary from insurers and even some government agencies has been presumptively negative about the prospects for coverage. However, after reviewing numerous commercial property and builders' risk policies over the past several weeks, many policyholders have good reason to pursue claims for recovery.

Corporate policyholders are likely to face at least two coverage defenses in response to claims for COVID-19-related business interruption loss: (1) denial of "physical loss or damage"; and (2) the alleged application of "communicable disease" or related "virus" exclusions. Subject to individual policy terms, these defenses are not insurmountable, and the potential exists for substantive recovery for those businesses suffering loss of income.

"Physical Loss or Damage"

First, most general lost profits/business income coverage will require "physical loss or damage," and sublimited coverages for civil authority, ingress/egress and related provisions may also require that a governmental order or loss of access be the result of "physical loss or damage" to another property within some proscribed distance of the insured premises. In response to COVID-19 claims, insurers will inevitably deny the existence of any "physical loss or damage" for purposes of these coverage grants.

Some governmental shelter-in-place orders have already confirmed that COVID-19 causes property loss or damage due to its ability to attach to surfaces for prolonged periods of time. But even businesses without confirmed presence of the coronavirus also may be able to demonstrate "physical loss or damage." There is nothing in our modern history to compare with the widespread quarantine, shelter-in-place and lockdown orders imposed on businesses and communities, to say nothing of the well-founded social anxiety that has left businesses without the customers, employees or resources needed to operate. There is precedent for the notion that absent actual physical injury to property, property may be "physically lost" for purposes of commercial property coverage.

As a threshold matter, the Fifth Circuit has defined "physical loss or damage" broadly to include "an initial satisfactory state that was changed by some external event into an unsatisfactory state." *Trinity Industries, Inc. v. Insurance Co. of North America*, 916 F.2d 267, 270-271 (5th Cir. 1990). Under even this basic definition, there is no denying that over the past month, businesses around the country have been transformed by external events from sustainable, profitable operations to the unsatisfactory state of reduced operations and, in too many cases, closure.

Here in the context of the current pandemic, there are potentially two sources of "physical" loss that bear separate analysis: (1) justifiable social anxiety over public and individual health causing consumers to avoid crowds and public spaces, regardless of whether the coronavirus is present (the "COVID Effect" or "Corona Effect"); and (2) unprecedented quarantine, shelter-in-place and lockdown orders issued by state and local authorities.

The Corona Effect

With regard to the “Corona Effect,” there is again precedent for the notion that social anxiety over public health can create “physical loss” for purposes of commercial property coverage—even with respect to property that has sustained no physical injury or damage. For example, following Hurricane Katrina, property that was otherwise undamaged was claimed as “lost” because of the “Katrina Effect,” *i.e.*, the perception of consumers that any property in New Orleans had been damaged or impaired from the hurricane. *See, e.g., Fireman's Fund Ins. Co. v. Cmty. Coffee Co., L.L.C.*, 2007 U.S. Dist. LEXIS 26521, at *9 (E.D. La. Apr. 9, 2007) (“Although the Port Cargo Warehouses did not suffer flooding or significant structural damage as a result of the hurricane, and scientific testing of green coffee in the Port Cargo Warehouses did not show elevated mold or bacteria levels among samples tested, when Community Coffee attempted to sell the green coffee from the Port Cargo Warehouses, offers from buyers to purchase the green coffee were discounted below the then existing market value of green coffee of comparable origin, grade and quality because of a general perception or concern among buyers regarding the condition of green coffees stored in the New Orleans area during Hurricane Katrina (the ‘Katrina Effect’).”).

Similar “effects” have occurred in other contexts and resulted a compensable “loss” under commercial property coverage. *See, e.g., Frupac Int'l Corp. v. Fireman's Fund Ins. Co.*, 1990 U.S. Dist. LEXIS 16807 (E.D. Pa. Dec. 11, 1990) (claim for loss of uncontaminated fruit that no consumer would buy after isolated cases of cyanide poisoning in Chilean fruit in 1989); *see also Customized Distribution Services v. Zurich Insurance Co.*, 373 N.J. Super. 480, 490-91 (N.J. Super. Ct. App. Div. 2004) (holding that misrotated goods sustained compensable loss, not because of a physical change in composition, but because of a change in perception by the insured's consumers: “Here, what occurred was that the Splash beverage changed. Granted, it was not a change in material composition but in how the product was perceived by Campbell's customers as a result of an undue passage of time. The charge stemmed from CDS's alleged fault in handling the task of product rotation. In our view, such a change is the functional equivalent of damage of a material nature or an alteration in physical composition. By reason of this change, and of the ensuing new perception of the covered property and its nature, the product lost value as much from the outdating as if it had turned sour or gone bad in some more tangible or material way. It occurred essentially in the same manner and with virtually the same effect. We conclude that the policy is clear as a matter of law in this respect, but that if it were deemed to be susceptible of a contrary reading, the policy is nevertheless at least ambiguous, and as we have already observed, the ambiguity in such circumstances results in a construction in favor of coverage.”); *S. Wallace Edwards & Sons v. Cincinnati Ins. Co.*, 353 F.3d 367, 374-375 (4th Cir. 2003) (destruction of product due to safety concerns constitutes direct physical damage); *General Mills, Inc. v. Gold Medal Ins. Co.*, 622 N.W.2d 147, 150-152 (Minn. Ct. App. 2001) (inability to lawfully distribute products because of failure to meet Food and Drug Administration regulations establishes direct physical loss).

Under the current circumstances, given the intense public and individual concerns for health and safety, many businesses, including those without any confirmed exposure to COVID-19, suffered reduced operations and loss of income even prior to the issuance of any orders from civil authorities. For the businesses so impacted, the “Corona Effect” has caused substantial “physical loss” to insured premises and products.

Civil Authority Orders

With respect to the second source of loss—government quarantine, shelter-in-place and similar lockdown orders—there is also authoritative support for the argument that such orders can cause “physical loss” to corporate policyholders. For example, in response to similar, albeit lesser civil authority orders in response to riots in Detroit in 1967, at least two Michigan courts recognized that a curfew limiting the operations of Detroit businesses, resulted in a covered loss of access to insured businesses, without the necessity of physical

damage under the terms of the subject policies. See, e.g., *Sloan v. Phoenix of Hartford Ins. Co.*, 207 N.W.2d 434 (Mich. Ct. App. 1973); *Southlanes Bowl v. Lumbermen's Mut. Ins. Co.*, 208 N.W.2d 569 (Mich. Ct. App. 1973); see also, e.g., *Houston Cas. Co. v. Lexington Ins. Co.*, 2006 U.S. Dist. LEXIS 45027, *21 (S.D. Tex. Jun. 15, 2006) (holding that coverage extended for business interruption resulting from a state evacuation order was reasonably within the terms of a policy addressing civil authority coverage, absent actual damage to the insured premises, and collecting authorities); *US Airways, Inc. v. Commonwealth Ins. Co.*, 65 Va. Cir. 238, 245, 2004 Va. Cir. LEXIS 121, *14 (Va. Cir. Ct. 2004) ("Since MWAA's orders denied access to Reagan National Airport and denied 'access to real or personal property' of US Airways the orders qualify under the Civil Authority provision of the Policy."). To the extent that government curfews and evacuation orders create a loss of access to insured premises for purposes of civil authority coverage, such orders and those orders issued in connection with the current COVID-19 pandemic arguably can result in "physical loss" for purposes of commercial property/business interruption coverage.

Where specific "civil authority", "ingress/egress" or similar grants of coverage exist in individual policies, the terms accompanying this coverage often require that the civil authority order or lack of ingress/egress be the result of covered "physical loss or damage" to property within a defined radius of the insured premises. Here, for the reasons outlined above, where there is actual exposure to COVID-19 or interrupted operations from the Corona Effect, the conditional "physical loss or damage" to other property may be satisfied. Existing civil authority orders in Dallas and Harris Counties in Texas, for example, are both compulsory (as opposed to mere recommendations) and are based on the assertion that COVID-19 causes property loss and damage.

Depending on individual circumstances, "physical loss" to either insured property or other property for purposes of Civil Authority or Ingress/Egress coverage may also be established by evidence of labor shortages and inadequate supplies to continue operations resulting from the Corona Effect and/or governmental quarantine, shelter-in-place and lockdown orders.

Communicable Disease & Virus Exclusions

As a second potential coverage defense, some policies may include the ISO Form (CP 01 40 07 06) "virus or bacteria" exclusion, which refers to "loss or damage caused by or resulting from any virus, bacterium or other micro-organism that induces or is capable of inducing physical distress." Variations of this type of exclusion may include references to "communicable disease" and may or may not include anti-concurrent causation terms. Still other policies may include "pollution" exclusions, which expressly define pollutants to include a "virus."

As a threshold matter, in responding to coverage defenses relating to these exclusions, the interpretation of the "exclusion" should arguably dovetail with the interpretation of any corresponding grant of coverage for "communicable disease," including viral and bacterial exposure. Here, specialized coverage for such risk almost inevitably requires actual infection or exposure to persons or property. By the same token, a "virus" exclusion should be construed to apply only to instances of actual contamination, exposure or infection to insured property. In most cases, including those properties impaired by the Corona Effect, there is no evidence of actual exposure and no basis on which to apply any exclusion.

Moreover, particularly where a "virus" exclusion is included in a policy without anti-concurrent causation language, it is important to distinguish between COVID-19 as a "cause" and the distinct "Corona Effect" and civil authority orders that have proximately resulted in business interruption losses to so many businesses. After all, COVID-19 causes loss of health, not loss of income. At any given time, there are countless viral and bacterial agents, including the coronavirus, that may be present at any given place of business. COVID-19 is not the cause of business interruption loss any more than any other virus or bacteria that causes illness. It is the well-founded public reaction, by individuals, institutions and governments, in the current public health crisis that has

curtailed spending, employment and business operations across the country. Without anti-concurrent causation language, a “virus” exclusion arguably does not preclude coverage for losses resulting from such causes. Risk managers, brokers and in-house counsel communicating with carriers over business interruption claims should be as precise as possible in describing claims and losses to account for the distinction between COVID-19 and the actual, proximate cause of insured business interruption.

In summary, given the magnitude of business interruption losses facing corporate America, coverage defenses from insurers can be anticipated. Nonetheless, subject to individual policy terms, the basic coverage defenses that can be foreseen at this time—“physical loss or damage” and “virus” exclusions—are not insurmountable. Risk managers, brokers and in-house counsel should carefully consider the above-referenced responses to these anticipated coverage defenses in giving notice and pursuing business interruption and related claims arising out of the current public health crisis.