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Business Interruption Coverage in Light of COVID-19

Government and health authorities all over the world are responding to a pandemic caused by a novel coronavirus, named “coronavirus disease 2019”, also known as “COVID-19”. The United States now leads worldwide with the most confirmed COVID-19 cases reported to the Center for Disease Control and Prevention (“CDC”).

In an attempt to stop the spread of the virus, government officials all over the U.S. have issued “stay home” orders, or “shelter in place”, mandating all residents to stay at home and requiring non-essential businesses to stop operating in-person services. Many businesses forced to shut down may seek to cover their losses through their property insurance policies. However, the COVID-19 global pandemic is an unprecedented situation that will raise novel issues in the insurance industry on physical damage, civil authority provisions, and virus exclusions.

A. BUSINESS INTERRUPTION COVERAGE REQUIRES PHYSICAL DAMAGE.

Insurance for business interruption may provide coverage when a business must suspend its operations due to some type of disaster or unexpected event. It is intended to provide coverage for operating expenses and compensation for loss of business during the period of time the business were affected by the loss. The Insurance Services Office (“ISO”) form for commercial property coverage, which is the basis of many policies, states generally:

> We will pay for the actual loss of Business Income you sustain due to the necessary “suspension” of your “operations” during the “period of restoration.” The “suspension” must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations…

Business interruption only covers an Insured's loss if it results from a covered peril. *See e.g*, *Nat’l Union Fire Ins. Co. v. Texpak Group*, 906 So. 2d 300, 302 (Fla. 3d DCA 2005). Further, most policies require actual physical damage to trigger business interruption coverage. Policyholders are likely to argue that the coronavirus contaminated the insured property, therefore alleging property damage. One of the main issues the insurance industry will soon face is whether COVID-19 constitutes “physical loss or damage”.

While most jurisdictions construe “physical loss or damage” to mean damage causing physical alteration to the property, others interpret the term more broadly, *extending* coverage with the loss of use or habitability of insured property.

i. Narrow Interpretations Likely to Negate Coverage.

In *Mama Jo’s Inc. v. Sparta Ins. Co.*, 2018 WL 3412974 (S.D. Fla. June 11, 2018), the insured was not entitled to Business Income Coverage because the insured failed to show a direct physical loss or damage resulted in a suspension of its operations. Here, the insured argued that dust and construction debris from nearby roadwork caused “direct physical loss” to the property. The scope of the alleged *physical damage* included cleaning of the floors, walls, tables, chairs and countertops. The court found that cleaning is not a direct physical loss, but rather an economic one. A direct physical loss “contemplates an actual change in insured property then in a satisfactory state, occasioned by accident or other fortuitous event directly upon the property causing it to become unsatisfactory for future use or requiring that repairs be made to make it so.” *Mama Jo’s, Inc.*, 2018 WL 3412974 *8 (quoting *MRI Healthcare Ctr. of Glendale, Inc. v. State Farm Gen. Ins. Co.*, 187 Cal. App. 4th 766, 779 (2010) (“For there to be a ‘loss’ within the meaning of the policy, some external force must have acted upon the insured property to cause a *physical change* in the condition of the property, i.e., it must have been ‘damaged’ within the common understanding of that term”)).

In *Universal Image Prods. V. Chubb Corp.*, 703 F. Supp. 2d 705 (E.D. Mich. 2010).the court found there was no physical loss where the insured property developed mold in the ventilation systems rendering the property uninhabitable. The Insured relied on intangible harms as strong odors and the presence of mold and/or bacteria in the air and ventilation system within its building. The court held that “even physical damage that occurs at the molecular or microscopic level must be distinct and demonstrable.” *Universal Image Prods.,* 703 F. Supp. 2d at 710. Therefore, because there was no structural or other tangible damage to the insured property, there was no physical loss.

In *Columbiaknit, Inc. v. Affiliated FM Ins. Co.*, No. CIV. 98-434-HU, 1999 WL 619100 (D. Or. Aug. 4, 1999), the court held that mere exposure to high humidity, mold, and mildew does not equate to physical damage and is insufficient to trigger coverage. While “physical damage or alteration of property may occur at the microscopic level does not obviate the requirement that physical damage need be distinct and demonstrable.” *Columbiaknit, Inc.*, No. CIV. 98-434-HU, 1999 WL 619100, at *7. The court explains that physical damage may be demonstrated by persistent, pervasive odor. However, in the absence of odor, “the mere adherence of molecules to porous surfaces, without more, does not equate physical loss or damage.” *Id.*

Similarly, in *Mastellone v. Lightning Rod Mut. Ins. Co.*, 175 Ohio App.3d 23, 41 (Oh. Ct. App. 2008), the court held that mold staining on exterior wood sliding did not constitute “physical damage” because the presence of mold did not alter or otherwise affect the structural integrity of the siding. Here, experts agreed that the mold could have been removed by bleaching and chemically treating the affected areas. “Absent any specific alteration of the siding, the [Insured] failed to show that their house suffered any direct physical injury as required by the homeowners' policy.” *Mastellone*, 175 Ohio App.3d at 42.

Finally, in *Newman Myers Kreines Gross Harris P.C.*, 17 F. Supp. 3d 323 (S.D.N.Y 2014), the court held that “direct physical loss or damage” required an element of actual physical damage to trigger business interruption coverage. Here, in anticipation of Hurricane Sandy, a utility company preemptively shut off power to certain of its service networks for several days, including the Insured’s law firm. The court found that

the Insured was not entitled to recover under the policy because its inability to access the building during the outage. The court rejected the Insureds argument that "direct physical loss or damage" should include the mere loss of use where there was no physical damage to the property.

ii. Broad Interpretation Which May Trigger Coverage.

Other courts interpret "direct physical loss or damage" more broadly, and find coverage in the absence of actual physical damage. For example, in *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.,* 2014 WL 6675934 (D.N.J. Nov. 25, 2014), the court held physical loss did not have to be structural change to the property. Here, the court found "physical loss or damage to" the insured property where ammonia was released into the facility from the refrigeration system, rendering "the facility temporarily unfit for occupancy." *Gregory Packaging, Inc.,* 2014 WL 6675934, at *8; *see also Matzner v. Seaco Ins. Co.*, No. 96-0498-B, 1998 WL 566658 (Mass. Super. Aug. 12, 1998) (finding that carbon monoxide contamination constitutes direct physical loss even though it did not produce tangible damage to the structure of the insured property); *Essex v. BloomSouth Flooring Corp.*, 562 F.3d 399, 406 (1st Cir. 2009) (under Massachusetts law, an odor rendering the property unusable constituted physical injury to the property).

Likewise, in *Western Fire Ins. Co.v. First Presbyterian Church,* 165 Colo. 34 (Colo. 1968), the Colorado Supreme Court held that a church sustained a "physical loss" when the accumulation of gasoline around the building rendered it uninhabitable and highly dangerous, which "equates to a direct physical loss." *W. Fire Ins. Co.,* 165 Colo. at 39. The court acknowledged that loss of use alone did not constitute a "direct physical loss". However, "loss of use" cannot be viewed in insolation. Rather, it "must be viewed in proper context", and here, the gasoline around and under the church was a physical loss. *Id.* at 38-39.

The Supreme Court of New Hampshire held that a "physical loss" is not limited to only tangible changes to the insured property, but also includes changes perceived by the sense of smell even in the absence of structural damage. *Mellin v. Northern Security Ins. Co.*, 167 N.E. 544 (N.H. 2015).

In *Mellin*, the Insureds alleged that cat odor emanating from a neighboring condominium unit caused a direct physical call to their unit. The court held that the Insureds were not required to demonstrate a "tangible physical alteration." Rather, to demonstrate a physical loss, the Insureds must establish a distinct and demonstrable alteration to the unit. Here, this was established by the changes perceived by the sense of smell.

Most policies require actual physical damage to the property for business interruption coverage. However, even where there no physical or tangible loss, a policyholder asserting damages from COVID-19 will have to demonstrate that the property was in some way affected or altered by the virus. We anticipate in the near future there will be scientific expert opinions on both sides weighing in on this issue – that is, can COVID-19 cause physical damage or alter the property for some period of time?

B. OTHER POLICY ISSUES. i. Policy Exclusions.

Even if coronavirus contamination was found to cause physical damage, the policy may limit or exclude coverage for COVID-19. A policy may explicitly exclude damage arising from "bacteria" or "virus", thus excluding damages from coronavirus.

Coverage may also be excluded under "pollution" or "contamination" provisions. If the policy is ambiguous and does not define terms such "pollution" or "contaminants", courts may look to alternate sources such as the dictionary to give the words their plain meaning. *Gen. Fid. Ins. Co. v. Foster*, 808 F. Supp. 2d 1315, 1320 (S.D. Fla. 2011). "[When] determining whether something constitutes a 'pollutant', a court should determine whether it fits the policy's definition of 'pollutant', as the definition is understood in plain, ordinary language." *Nova Cas. Co. v. Waserstein,* 424 F.Supp.2d 1325, 1331 (S.D.Fla.2006); *see e.g. Deni Assocs. of Fla., Inc. v. State Farm Cas. Ins. Co.,* 711 So.2d 1135, 1138 (Fla. 1998) (holding ammonia was a pollutant under policy pollution exclusion).

In *Deni Asscs. of Fla., Inc. v. State Farm Cas. Ins.,* the Florida Supreme Court held a policy to be clear and unambiguous where the words "irritant" and "contaminant" were not defined in the policy, however, the word "pollutant" was defined as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalines, chemicals and waste." The Court found that "applying the policies' language to the context of the claim here does not produce an uncertain or ambiguous result, but leads only to one reasonable conclusion." *Deni Asscs.,* 711 So.2d at 1140 (quoting *Nat'l Union Fire Ins. Co. v. CBI Indus., Inc.,*907 S.W.2d 517, 521 (Tex. 1995); *see also Landshire Fast Foods, Inc. v. Employers, Mut. Cas. Co.*, 269 Wis. 2d 775 (Ct. App. 2004) (the Wisconsin Supreme Court held that losses caused by bacteria were excluded by the policy's pollution exclusion clause where the bacteria at issue fell within the ordinary definition of a "contaminant," and had an effect commonly referred to as "contamination").

ii. Remediation.

Generally, business interruption insurance compensates for income lost during the restoration period or the time necessary to repair the physical damage to the covered property. In cases where the insurer is liable for the lesser of either the cost to repair the damage property, or the cost to replace the damaged property, the question will be what is the cost to remediate coronavirus. To clean and disinfect households with confirmed COVID-19 cases, the CDC states that most common Environmental Protection Agency ("EPA") registered household disinfectants are effective to kill germs on the surface. Moreover, another issue is how long the virus was actually present on the property. Although information on COVID-19 is new and developing, there is evidence that coronavirus can live on plastic and stainless steel for up three days, four hours on copper, and twenty-four hours on cardboard. Therefore, the period of restoration in which the property was contaminated with COVID-19 is relatively short.

C. GOVERNMENT ORDERS.

Another novel issue the insurance industry will soon face is the effect of government orders due to COVID-19. Several emergency orders

throughout the state of Florida, including Broward County, Panama City, Hillsborough County, City of Aventura, and the City of Plantation, provide that COVID-19 is causing physical damage to property due to its proclivity to attach to surfaces for prolonged periods of time. Policyholders may attempt to establish the requirement of a direct physical loss with these orders that specifically state that COVID-19 causes physical damage to property. This issue has not been previously litigated. Therefore, it will be up to the courts to determine whether the closure of a business due to government orders will be interpreted as a direct physical loss which resulted in damages.

i. Civil Authority.

Policyholders may also seek coverage pursuant to civil authority policy provisions. This coverage applies when an order of civil authority (e.g., state, local, or federal government entity), prevents or prohibits access to the Insured's premises due to direct physical loss or damage to property other than at the insured's premises, from a covered cause of loss. Policyholders will cite to the government orders described above to meet the direct physical loss requirement.

D. PROPOSED COVID-19 LEGISLATION.

Several states, including New Jersey, Ohio, Massachusetts, New York, Louisiana, Pennsylvania, and South Carolina, are proposing legislation requiring insurers to cover business interruption losses due to COVID-19 even when the insurer has no contractual obligation to do so. For example, the New York State Assembly Bill states:

(a) *Notwithstanding any provisions of law, rule or regulation to the contrary, every policy of insurance insuring against loss or damage to property*, which includes, but is not limited to, the loss of use and occupancy and business interruption, shall be construed to include among the covered perils under that policy, coverage for business interruption during a period of a declared state emergency due to the coronavirus disease 2019 (COVID-19) pandemic.

(c) Any clause or provision of a policy of insurance insuring against loss or damage to property, which includes, but is not limited to, the loss of use and occupancy and business interruption, which *allows the insurer to deny coverage based on a virus*, bacterium, or other microorganism that causes disease, illness, or physical distress or that is capable of causing disease illness, or physical distress *shall be null and void*; provided, however, the remaining clauses and provisions of the contract shall remain in effect for the duration of the contract term.

This legislation affords coverage notwithstanding the requirement of a direct physical loss, and despite a virus exclusion in the policy.

i. Unconstitutional Legislation.

The legislation expanding the coverage obligations of insurers under existing policies will likely be challenged as unconstitutional.

a. The Contracts Clause.

The Contracts Clause in the state and federal constitution both prohibit laws impairing contracts. To determine whether a law pursuant to a State's police powers violates the Contract Clause, the Supreme Court has laid out a three-part test: 1) whether the law substantially impairs a contractual relationship; 2) whether there is a significant and legitimate public purpose for the law; and 3) whether the adjustment of the rights and obligations under the contract is reasonable and appropriate given the public purpose justifying the law. *Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983).

Further, the Supreme Court has enumerated five factors for analyzing whether legislation is reasonable and necessary to serve a significant and legitimate public purpose: 1) whether the governmental act was an emergency measure; 2) designed to protect a basic societal interest rather than particular individuals; 3) was tailored appropriately to its purpose; 4) imposed reasonable conditions; and 5) was limited to the duration of the emergency. *Id.* at 410-413.

Insurers will argue that the proposed legislation substantially impairs the parties' existing contract. It would provide retroactive coverage by eliminating the requirement that there be physical damage to the property. Further, void of any virus exclusions in the policies would financially burden insurers who had fairly bargained for a policy excluding such coverage when assessing the risk of loss.

Forcing insurers to extend coverage for losses that were not covered, specifically excluded, not contemplated or bargained for, shifts the economic burden caused by the COVID-19 pandemic to insurers. While such legislation may be an emergency measure, it appears to exceed what is permissible under the Contracts Clause.

b. Due Process.

The retroactive effect of the proposed legislation is an unconstitutional deprivation of the Insurers' property without due process of law. "Retroactive legislation presents problems of unfairness . . . because it can deprive citizens of legitimate expectations and upset settled transactions. For this reason, the retroactive aspects of economic legislation, as well as the prospective aspects, must meet the test of due process: a legitimate legislative purpose, furthered by rational means." *Gen. Motors Corp. Romein*, 503 U.S. 181, 191 (1991).

While providing financial assistance to businesses impacted by the COVID-19 pandemic may be a "legitimate legislative purpose", the proposed legislation should fail in that forcing insurers to provide coverage when there is no contractual obligation to do so, does not utilize "rational means". Additionally, while this legislation aims to financially assist businesses affected by COVID-19, considering the issues that may arise in these novel coronavirus claims, it is unlikely that policyholders will receive quick economic relief from insurance companies. Further, if such legislation is passed, it will likely significantly increase the cost of insurance premiums, or potentially make commercial insurance unavailable in the future.

E. CONCLUSION.

Like all insurance claims, COVID-19 claims will be evaluated based on the particular facts of each claim and the applicable insurance policy language. Without the trigger of direct physical loss or damage to the insured property, it is unlikely that insurers will extend business interruption coverage to policyholders. However, COVID-19 presents a unique set of circumstances. Government orders and state legislation may impact insurers' obligations under existing contracts. Given the unprecedented nature of these claims, the various civil authority orders, and the different language contained within the policies, it is uncertain how courts will interpret COVID-19 coverage disputes.

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