COVID-19

The Past, Current, and Future

By Karen K. Karabinos

Landscape of COVID-19-Related Business Interruption Claims and Litigation

Hundreds of opinions have been rendered by state and federal courts on the issue of insurance coverage for business interruption losses related to COVID-19. Some of these rulings have now made their way to the appellate courts. Insurance carriers, insureds, and their attorneys anxiously await the result of these appeals. Will most of the cases that have been rendered in favor of insurance companies be upheld? Or will they be reversed? Or will the federal appellate courts seek guidance from the state supreme courts? To answer these questions about the future, we must first review the past and the current landscape of litigation arising out of the business interruption claims.

The Past

Less than four months after COVID-19 shut down the nation, a Michigan circuit court issued the first U.S. court decision in an insured's first-party property lawsuit against an insurance carrier, seeking business interruption coverage as a result of a governor's shelter-in-place order. *See Gavrilides Management Co. v. Michigan Ins. Co.*, No: 20-000258-CB (Circuit Court of Ingham County, MI, July 1, 2020). The insurer filed a motion for summary disposition, asking the Michigan court to rule as a matter of law that its policy did not provide coverage for business interruption losses caused by a COVID-19 shelter-in-place order. The court agreed with the insurer.

Michigan Insurance Company argued that the policy provided coverage only for "direct physical loss of or damage to" the insured's properties and noted that missing from the insured's complaint was any allegation that the property had been damaged. Rather, the insured only focused on the governor's shelter-in-place order that prevented physical access to the insured's properties, causing it to lose business income. In the hearing posted on YouTube, counsel for the insurer noted that nothing in the governor's order prevented access to the insured's properties. In fact, the insured was able to enter the properties and operate as restaurants, albeit only for take-out after the order. The insurer's counsel also focused on the affidavit submitted by the insured's owner in which he admitted that there was no physical damage to its locations. As a result, counsel argued that there was no physical loss because the property existed in the same condition as it did before the shelter-in-place orders went into effect.

Michigan Circuit Court Judge Draganchuk ruled from the bench. She stated that the first inquiry concerned the coverage afforded under the policy, which in this case provides for actual loss of business income sustained during a suspension of operations. The judge noted that the suspension must be caused by a "direct physical loss of or damage to property." Further, the loss of or damage must be caused by a covered cause of loss.

"Direct physical loss of or damage to" property requires something that alters the physical integrity of the property, ruled Judge Draganchuk. She also found that the term "direct physical" applied to both the "loss" and "damage" terms, such that the policy provision should be read as "direct physical loss or direct physical damage" to covered property. The court agreed with the insurance company that the insured failed to allege in the complaint any direct physical loss of or damage. In fact, the owner had admitted in his affidavit in opposition to the carrier's motion that at no time had the virus entered the insured locations. According to Judge Draganchuk, a restriction preventing dine-in business is not the required direct physical loss of or damage to covered property. The court further rejected the insured's request to amend its complaint, finding that there no facts that could be developed that could change the fact that the business loss was not caused by a direct physical loss of or damage.

Next, Judge Draganchuk addressed the policy's coverage for losses caused by governmental acts. She held that the coverage provision required the same direct physical loss of or damage to covered property. Because there was no evidence or any allegation of such physical loss, there was no coverage under the governmental acts provisions of the policy. Finally, the court rejected the insured's argument that the virus exclusion was vague. Even if the exclusion did not apply, the court held that there still would be no coverage due to the lack of any alteration of the physical integrity of the property.

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The COVID-19 related business interruption opinions issued after *Gavrilides* generally focus on the same coverage provisions and exclusion—business loss and extra expense, civil authority, and the virus exclusion.

The Present

Thirteen months after businesses closed their doors due to shelter-in-place orders issued by various state and local governmental entities, approximately two out of every three U.S. courts that have issued opinions have sided with the insurance carriers. While the cases typically turn on the issue of whether the insured has suffered a "direct physical loss of or damage to property" under the Business Loss and Civil Authority provisions, courts have interpreted the phrase differently and, in some instances, judges within the same court have issued different interpretations.

Direct Physical Loss

The federal courts are generally consistent with the interpretation of what constitutes "direct physical loss," finding the ordinary and popular meaning of that phrase means that the property must undergo a distinct, demonstrable, physical alteration. *See, e.g., 10E LLC v. Travelers Indem. Co. of Connecticut, No:* 483 F.Supp.3d 828 (C.D. CA Sept. 2, 2020); *Diesel Barbershop v. State Farm Lloyds*, 479 F.Supp.3d 353 (W.D. TX Aug. 13, 2020). Some federal courts require the loss be a "tangible" damage or alteration to a structure. *See, e.g., Malaube v. Greenwich Ins. Co.,* 2020 WL 5051581 (S.D. FL, Aug. 27, 2020); *Turek Enterprises, Inc. v. State Farm Mut. Auto. Ins. Co.*, 484 F.Supp.3d 492 (E.D. MI Sept. 3, 2020). Under these interpretations of what constitutes a "direct physical loss," a businessowner's temporary inability to use the property would not be covered. *See MudPie, Inc. v. Travelers Cas. Ins. Co. of America*, 487 F.Supp.3d 834 (N.D. CA Sept. 14, 2020).

What is interesting is that even within the same courts, there have been different interpretations by the judges of what constitutes a "direct physical loss." As an example, in December 2020, one federal court judge in the northern district of Ohio held that policy provision requires there be some type of tangible physical alteration, a "physical force [that] has altered or otherwise affected the property." The court found that the local orders did not create any physical damage, and there was no physical force that caused its property to become unusable or inaccessible. *Santo's Italian Café LLC v. Acuity Ins. Co.*, 2020 WL 7490095 (N.D. OH Dec. 21, 2020).

In the cases in which a court has found in favor of policyholders, the courts have held "direct physical loss" means "the act of losing possession" and "deprivation." Courts applying these definitions would find coverage in scenarios—even where an insured's operation is able to continue albeit at a reduced volume or capacity.

A month later, another federal court judge in the northern district of Ohio held that the business income provision can also reasonably be read to extend coverage in instances where the policyholder merely loses its ability to use its insured properties for their intended purpose. *Henderson Road Restaurant Systems, Inc. v. Zurich American Ins. Co.*, 2021 WL 168422 (N.D. OH Jan. 19, 2021).

Less than thirty days later, another judge in the same federal court rejected that loss of use, without any physical loss is sufficient to meet the policy requirement that the insured suffered "direct physical damage." That judge held that "physical damage to" means material, perceptible harm. The court cited to the period of restoration provision that ended with the terms "repair, rebuilding or replacement." According to the judge, those terms made sense that the loss be a material or physical loss, not a loss of use with no effect on the property's structure. *MIKMAR Inc. v. Westfield Ins. Co.*, 2021 WL 615304 (N.D. OH Feb. 17, 2021).

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Civil Authority Provision

Civil authority coverage triggers payments for loss business income, but the "direct physical loss of or damage" requirement must be loss of or damage, not to the insured location, but to other premises. The shelter-in-place orders are the most often cited civil authority in support of this coverage.

Such coverage was cited as the grounds for the complaint for declaratory judgment filed by owners of the Oceana Grill, a restaurant in New Orleans, against its insurer, the Governor of Louisiana, and the State. *Cajun Conti, LLC et al. v. Certain Underwriters at Lloyd's London*, No. 2020-02558 (Civil District Court for the Parish of Orleans, Louisiana 2020). That case was the first known legal action by policyholders seeking business interruption coverage for the shutdown orders. At issue was the governor's order that provided, in pertinent part:

> [b]ecause of the ability of the COVID-19 virus to spread via personal interactions and because of physical contamination of property due to its propensity to attach to surfaces for prolonged periods of time…. some business establishments are unable to continue current operations without unacceptable risks to the health and safety of the public.

The restaurant's insurer, Lloyds of London, sought a dismissal of the lawsuit on the grounds that the restaurant had not suffered a direct physical loss. The New Orleans Parish judge denied the motion; but after a bench trial, the judge ruled in favor of Lloyds but did not issue a written order detailing the basis for her decision.

One federal court has held the insured must show "a causal link between any physically damaged or dangerous surrounding properties proximate to the insured property and a civil authority prohibiting [it] from accessing or using their property." *Elegant Massage, LLC v. State Farm Mut. Auto. Ins. Co.*, 2020 WL 7249624 (E.D. VA Dec. 9, 2020). The court in *Elegant Massage* found that the orders were issued due to the threat of COVID-19, not because of any prior actual physical damage to the plaintiff's property or surrounding properties. Numerous courts agree that to invoke civil authority coverage, the orders must have prevented the insureds from accessing the insured premises due to direct physical loss to other surrounding properties. *See, e.g., Henry's Louisiana Grill, Inc. v. Allied Ins. Co. of America,* 2020 WL 5938755 (N.D. GA Oct. 6, 2020); *Hajer v. Ohio Security Ins. Co.,* 2020 WL 7211636 (E.D. TX Dec. 7, 2020).

Virus Exclusion

Generally, courts have held that the virus exclusion is clear and unambiguous, and bars coverage because the governmental entity exercised its civil authority in response to the health concerns related to COVID-19. *See, e.g., Mac Property Group, LLC. v. Selective Fire & Cas. Ins. Co.,* No: L-2629-20 (Super. Ct. NJ Nov. 5, 2020). *Toppers Salon & Health Spa, Inc. v. Travelers Property Cas. Co. of America,* 2020 WL 7024287 (E.D. PA Nov. 30, 2020).

For those insureds whose policies contain a virus exclusion, the rejection of coverage by insurance carriers has generally been upheld by the courts, and especially if the virus exclusion provides there is no coverage for losses *directly or indirectly* caused by COVID-19. *See, e.g., Riverwalk Seafood Grill v. Travelers Cas. Ins. Co. of America,* 2021 WL 81659 (N.D. IL Jan. 7, 2021); *Franklin EWC, Inc. v. The Hartford Financial Services Group, Inc.,* 488 F.Supp.3d 904 (N.D. CA Sept. 22, 2020); *Vizza Wash, LP v. Nationwide Mut. Ins. Co.,* 2020 WL 6578417 (W.D. TX Oct. 26, 2020). Therefore, where the virus exclusion contains such language, any claim in which the virus is part of the causal chain will likely be excluded.

Some insureds have attempted to avoid the application of the virus exclusion by alleging that the loss resulted from respiratory droplets on surfaces at the building, and it was those droplets, not the virus, that were the focus of the shelter-in-place orders. A northern district California federal court rejected that attempt, finding that there "is no meaningful difference between the virus itself and droplets that contain the virus," and found that the virus exclusion barred coverage. *Karen Trinh, DDS v. State Farm Gen. Ins. Co.* 2020 WL 7696080 (N.D. CA Dec. 28, 2020).

Appellate Courts

Several insureds have sought relief by appealing the COVID-19 business interruption cases to either the state or federal appellate courts, but currently no rulings have been issued by the appellate courts. While COVID-19 was not an issue, the Eleventh Circuit Court of Appeals issued an opinion in *Mama Jo's Inc. v. Sparta Ins. Co.*, 823 F. App'x 868 (11th Cir. Aug. 18 2020) that arguably supports the insurers' position that COVID-19 business income claims are not covered under typical commercial property policies. In that case, construction on a road adjacent to the Mama Jo's restaurant, Berries, caused dust and debris to migrate into the restaurant. *Id.* at 871. While the restaurant remained open, the number of customers decreased, and the restaurant had to perform increased daily cleaning due to the construction dust and debris. Sparta, its insurer, denied the entire claim, taking the position that there was no "direct physical loss of or damage to property" as required to trigger coverage. *Id.* at 872.

The district court ruled that under Florida law, Mama Jo's cleaning claim was not covered because property that must be cleaned is not damaged and therefore has not sustained "direct physical loss." The district court also concluded that the loss of income claim was not covered because Mama Jo's could not prove that it suffered a "necessary 'suspension'" of its "operations" as the result of a "direct physical loss." *Id.* at 875. The Eleventh Circuit affirmed the district court's findings. *Id.* at 879–80.

The Future

When Mama Jo's filed a petition for certiorari with the United States Supreme Court, attorneys for policyholders and insurance carriers pondered whether the Court would provide any direction. On March 29, 2021, the Supreme Court weighed in but only by refusing to hear Mama Jo's case, thus passing up an opportunity to clarify whether businesses could make the same arguments that property that must be cleaned is a "direct physical loss."

Denying Mama Jo's petition does not mean that the Supreme Court either agrees or disagrees with the decision of the Eleventh Circuit, the denial only means that the case will not be reviewed, and the Eleventh Circuit's opinion stands. The denial is not a surprise to many attorneys who recognized that each jurisdiction has developed its own process on how to construe and interpret policy provisions. In fact, some jurisdictions have previously addressed what does and does not constitute a "direct physical loss of or damage to" covered property. Thus, practically speaking, the Supreme Court's denial means that the issue of coverage for COVID-19 related business interruption insurance claims will still be decided by the individual state and federal courts in the foreseeable future. As the last year has demonstrated, most of the courts should continue to find there is no coverage for these types of losses under the language of the provisions of current business policies.