

Corporate Governance

INSIGHT: Companies May Be Thwarted by These Business Interruption Defenses

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Businesses turning to their insurance contracts for financial help due to business closings and interruptions in the coronavirus pandemic may find themselves up against common defenses to payment. Crowell & Moring attorneys look at three defenses and how courts have interpreted them.

Businesses that have shut down or reduced operations due to the coronavirus pandemic may look to their insurance to pay their losses, but insurance coverage may not be available under “business interruption” coverage in commercial property policies.

Below are the most frequently used terms and defenses used by insurers and a look at how some courts have interpreted them.

Coronavirus Doesn't Cause 'Direct Physical' Loss or Damage to Property

While the specific terms of a policy always control, commercial property policies typically require that any suspension of business operations be “caused by direct physical loss of or damage to” covered property. Examples of direct physical loss include damage caused by fire, flooding, lightning, or vandalism.

Coronavirus causes harm to persons, but is not reported to cause physical damage to property. Courts in analogous situations have often denied coverage.

Looking at examples, many restaurants today are still operating, selling take-out orders but not seating customers. Their revenue fall-off is not due to physical damage to their property, even if more frequent cleaning is required. (*Mama Jo's Inc. v. Sparta Ins. Co.* (S.D. Fla. June 11, 2018) (no coverage where restaurant remained open, even if more regular cleaning was required because of nearby road construction))

A business that shuts or reduces hours because it anticipates the possibility of physical injury occurring in the future has not suffered physical injury qualifying for coverage. (*Phoenix Ins. Co. v. Infogroup, Inc.* (S.D. Iowa 2015) and *Travelers Ins. Co. v. Eljer Mfg. Inc.* (Ill. 2001))

And while offensive odor or excessive heat occurring during remediation of an HVAC system may, like concerns about exposure to coronavirus, cause customers to stay away, there is no “tangible damage” to property supporting a finding of coverage. (*Universal Image Prods., Inc. v. Federal Ins. Co.*, 457 Fed. App'x. 569 (6th Cir. 2012))

Finally, where business losses are associated with conditions affecting the community at large, but are not directly caused by property damage at an insured location, business interruption coverage may be unavailable. (*White Mountain Communities Hosp. Inc. v. Hartford Cas. Ins. Co.* (D. Ariz. Apr. 17, 2015) (no coverage for lost business income during a general slowdown caused by local wildfire))

'Stay at Home' Orders Don't Obviate Requirement for 'Direct Physical' Loss or Damage

Insureds are already seeking coverage under "civil authority" provisions of their business interruption policies as a result of government "stay-at-home" mandates. But such civil authority provisions typically require that losses be caused by "action of civil authority that prohibits access to the described premises due to *direct physical loss of or damage to property*, other than at the described premises."

Thus, courts have found no coverage unless insureds demonstrate a nexus between the civil authority order and *direct physical damage* to property other than the insured premises.

For example, a court found that a New Orleans restaurant chain that lost business during a mandatory evacuation for an approaching hurricane was not entitled to coverage because the insured failed to show "that the issuance of the order was 'due to' physical damage to property, either distant property in the Caribbean or property in Louisiana." (*Dickie Brennan & Co. Inc. v. Lexington Ins. Co.* (5th Cir. 2011))

Likewise, where a U.S. embargo on importation of Canadian beef due to concerns over "mad cow disease" blocked an insured's shipment of uncontaminated beef from Canada, the court found that coverage was not available because the beef was not physically damaged. (*Source Food Tech. Inc. v. USF&G* (8th Cir. 2006))

Insurers May Prevail Based on Lack of Evidence of Coronavirus Contamination

Business interruption claims related to coronavirus could also founder because insureds seeking coverage are unable to bear their burden of proving with evidence that their losses were directly and physically caused by coronavirus.

Where courts have previously found business loss coverage for "contamination" of insured premises, such contamination (from substances such as E-coli or ammonia) was generally confirmed by testing and it was undisputed that the contamination rendered the premises unfit for occupancy and use. (*Gregory Packaging Inc. v. Travelers Property Cas. Co.* (D.N.J. Nov. 25, 2014); *Oregon Shakespeare Festival Ass'n. v. Great Am. Ins. Co.* (D. Or. March 6, 2017) (air quality at outdoor theater documented to be "very unhealthy" due to smoke from surrounding wildfires))

Here, however, it is likely that few businesses conducted tests to document actual contamination by the coronavirus. And because coronavirus reportedly remains detectable on hard surfaces for only a limited time, even positive tests conducted in the future should not be sufficient to support a coverage claim for past losses, because such tests would not prove earlier contamination.

So even if a business could document that its property was contaminated with coronavirus at a particular point in time, the fleeting nature of the contamination should limit the amount of any covered business interruption to a few days' losses.

Specific facts could lead to different outcomes. For example, Colorado's stay-at-home order expressly presumes that coronavirus can cause property damage because of its "propensity to attach to surfaces." (See e.g. Colorado Dept. of Public Health & Environment Third Updated Public Health Order 20-24 Implementing Stay at Home Requirements (April 1, 2020).)

It remains to be seen, however, whether a presumption stated in an order could overcome the contractual requirement that an insured prove that property damage directly and physically resulted from coronavirus contamination.

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