

Business Interruptions Claims Amid COVID: Wins, Losses and How to Move Forward

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There was much speculation at the beginning of the COVID-19 shutdown about how insurers would respond to the pandemic. Would business interruption insurance cover losses and what those payouts would actually look like? Six months later and the picture is becoming clearer as a wave of suits have been brought by companies denied coverage and decisions are starting to come down.

Since the inception of COVID-19 and the state shutdown orders that followed, businesses have filed hundreds of lawsuits against their insurers seeking coverage for lost revenue and other business interruption losses. In the ensuing six months we have seen a handful of court decisions mostly favoring insurers but with some policyholder wins.

On the opposite side of the spectrum, states continue to propose legislation that would require insurers who provide property insurance to cover business interruption during the coronavirus pandemic. As businesses reopen and the country braces for a potential second wave, insurers and policyholders alike can learn from these early legal developments and proactively respond to business interruption.

Insurers v. Policyholders

To appreciate the initial court rulings and proposed laws it is worthwhile to first visit what insurers and policyholders disagree about with business interruption coverage. Generally, property insurance provides coverage for physical loss or damage to an insured's property. The business interruption insurance parts of these policies cover revenue loss from a covered event. Such policies typically require a direct relationship between the underlying physical loss or damage and the loss of income.

Insurers argue the coronavirus is not a direct physical loss or damage to the insured property and even if it were, exclusions like those for virus or bacteria bar coverage. On the other hand, policyholders maintain the coronavirus caused physical damage to their premises, policies cover shutdown orders, and exclusions are not on point.

Considering the above, it is unsurprising most court decisions on business interruption coverage center on whether a policyholder alleges direct physical loss.

Alleging Direct Physical Loss is Key

Most of the initial court decisions found policyholders failed to adequately allege COVID-19 caused a direct physical loss to their insured premises which is a pre-requisite to coverage. That said, at least one court has ruled in favor of policyholders and permitted the case to move forward to discovery. Though each case has its own

policy language, applicable law, and underlying facts, their review can be instructive for future litigation.

Wins for Insurers

Courts in California, Michigan, the District of Columbia, and Texas have granted summary judgment to insurers or dismissed complaints finding policyholders failed to adequately allege direct physical loss to their business from COVID-19. Similarly, in New York, a judge stated during oral argument that a policyholder failed to demonstrate physical loss (the insured withdrew its complaint before a formal decision). Although every policy is different the following cases demonstrate legal challenges businesses could face.

Restaurant owners in *Rose's 1, LLC et al. v. Erie Insurance Exchange*, Case No. 2020 CA 002424 B, sued their insurer for losses following shutdown orders. Washington, D.C. Superior Court Judge K. Higashi granted the insurer's motion for summary judgment finding the property insurance policy did not provide business interruption coverage where shutdown orders did not direct any physical change to the restaurants and the policyholders provided no evidence that COVID-19 was at their properties when they were forced to close.

Similarly, restaurant owners in *Gavrilides Management Co. et al. v. Michigan Insurance Co.*, Case No. 20-258-CB-C30, filed in the Thirtieth Judicial Circuit Court of Ingham County, Michigan, did not allege the coronavirus was at their premises but argued shutdown orders satisfied the policy's physical loss requirement by physically limiting their dine-in service. Judge J. Draganchuk granted the insurer's summary judgment motion finding the allegations on shutdown orders are not physical loss which is "something with material existence, something that is tangible, something...that alters the physical integrity of the property."

Another restaurant also failed to persuade a judge that a ban on in-person dining was physical damage. In *10E, LLC v. Travelers Indemnity Co. of Connecticut et al.*, Case No. 2:20-cv-04418, Judge S. Wilson of the U.S. District Court for Central California dismissed the restaurant's lawsuit citing caselaw finding physical loss is a "distinct, demonstrable, physical alteration."

Barbershops met a similar fate in Texas in *Diesel Barbershop, LLC et al. v. State Farm Lloyds* Case No. 5:20-cv-461, where United States District Court Judge D. Ezra dismissed their complaint seeking coverage for losses from shutdown orders noting that they failed to plead a direct physical loss and that even if they had, the policy's virus exclusion applies.

Finally, in New York, in *Social Life Magazine, Inc. v. Sentinel Insurance Company Limited*, Case 1:20-cv-03311, United States District Court Judge V. Caproni orally denied a publisher's motion finding it failed to demonstrate a probability of success on the merits because it was unlikely to show damage to its property. Notably during oral

argument, the policyholder's counsel argued "the virus exists everywhere" to which the judge responded "It damages lungs. It doesn't damage printing presses."

Wins for Policyholders

Not every case has favored insurers. A judge in Missouri recently permitted policyholders to proceed to discovery after denying an insurer's motion to dismiss finding they adequately alleged they suffered a direct physical loss and access to their businesses was prohibited by shutdown orders.

Operators of hair salons and restaurants sued their insurer in *Studio 417, Inc., et al. v. The Cincinnati Insurance Company*, Case No. 20-cv-03127, after sustaining losses from shutdown orders. District Court Judge S. Bough found that the businesses adequately alleged a direct physical loss by pleading a causal relationship between COVID-19 and their losses. Specifically, the businesses alleged COVID-19 "is a physical substance," that it "live[s] on" and is "active on inert physical surfaces," and is "emitted into the air." Further that it attached to their property making it "unsafe and unusable, resulting in direct physical loss to the premises and property." Additionally, even though the shutdown orders permitted take-out and delivery, because they prohibited inside dining the judge ruled the policyholders plausibly alleged access was prohibited to such a degree that coverage was triggered.

Aside from coverage litigation, another significant legal development is proposed legislation requiring insurers to provide coverage as discussed below.

Mandatory Business Interruption Coverage

As the COVID-19 pandemic continues, more states are introducing proposed bills mandating coverage for business interruption. California, Louisiana, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, Rhode Island, South Carolina and the District of Columbia introduced such legislation that generally require carriers insuring against loss or damage to property to cover business interruption during a declared state of emergency due to COVID-19 even if an exclusion applies.

To date none of the bills are law but if they were they are likely to face challenges for violating the contracts clause, the due process clause, and the takings clause of the U.S. Constitution. Given their benefits to insureds and burdens on insurers, tracking the proposed legislation is helpful for both.

Actions Policyholders Can Take Now

If there is coverage either through litigation or legislation, policyholders can be proactive by collecting documents to support their loss. Business interruption claims may generally be supported by demonstrating the financial health of a business before and after COVID-19, including profit and loss statements, tax returns, bank statements, expense reports, and budgets.

In addition, a business considering making a claim to its carrier should review their policy to determine when and how to provide notice. Generally, policies include a time frame when notice must be made and failing to meet this could bar an otherwise covered claim.

Considerations for Insurers

Insurers should consider their claims handling and reinsurance in addition to the above legal developments. Policyholders are suing insurers for bad faith where carriers issue denials of coronavirus related business interruption claims without conducting any investigation, some the same day they receive a claim. Carriers that evaluate each claim based on the underlying facts, policy language, and applicable law can mitigate their exposure to recoveries that can go beyond the policy benefits.

A second consideration for insurers is their reinsurance. Before an insurer makes a commercial payment to an insured, it should consider that reinsurance policies generally do not require reinsurers to pay claims that are ex-gratia or not covered by the insurance policy. Similarly, carriers can benefit from reviewing their reinsurance policy including any follow-the-fortunes and follow-the-settlements clauses in connection with a claim payment or settlement of coverage litigation.

Takeaway

While businesses and the insurance industry continue to navigate the coronavirus, initial court rulings demonstrate the importance of establishing direct physical loss to insured premises in business interruption claims. It is too early to tell whether state legislatures will succeed in enacting a first-of-its-kind law mandating coverage of coronavirus business interruption losses, but either way following their development is key to businesses and insurers alike.

As we near flu season and suggestions of a second wave are already trickling in, insureds and insurers can learn from these legal developments and take proactive steps from supporting their loss to visiting their reinsurance policies to achieve the best outcomes in coronavirus business interruption claims.

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