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A Perfect Storm

Business Interruption in the Wake of COVID-19 and Hurricanes Laura and Sally

By Francine M. Giugno and Jerry Provencher

The pandemic adds another complicating layer atop the already complex claims adjustments that follow in the wake of destructive storms.

The effects of Hurricanes Laura and Sally, combined with the COVID-19 pandemic, present unprecedented challenges to insurers receiving property damage and loss of business income claims. The adjustment of a business's claim after the devastation from the hurricanes is directly affected by the COVID-19 pandemic. The necessary repairs are more costly and time consuming. This article will consider the effects of COVID-19 and business interruption claims following Hurricanes Laura and Sally.

In the spring of 2020, the COVID-19 virus caused a health emergency in the United States and the world. Governors across the states have issued emergency proclamations, nearly all of which remain in effect to varying degrees. As a result of the crisis, government "shut-down orders" forced millions of businesses to cease or reduce operations for extended periods of time. Given the vast economic impact that COVID-19 has had on businesses, policyholders are looking to their insurance carriers for reimbursement under business interruption coverages in their policies. Now, in the wake of Hurricanes Laura and Sally, policyholders are going to be filing property and business interruption claims.

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Business interruption insurance is usually purchased as a component of a package that bundles basic insurance coverages or is endorsed to a custom package policy. "Open Perils," commonly called "All Risk" property policies, are the broadest form of property insurance available because they cover all losses the policyholder suffers, unless the loss is specifically excluded. Conversely, a named perils policy provides coverage only for those types of losses stemming from specific perils identified within the policy. Insurers have similar language in policies because they often use policy forms prepared by the Insurance Services Office, Inc. (ISO).

Virtually all policies require that the insured premises suffer direct physical loss. Business Interruption policy forms typically provide that the insurer will pay for loss of income "caused by direct physical loss at the described premises" and that "[t]he loss must be caused by a covered cause of loss." Notably, in order to recover for business income loss, a two-prong test must be met for coverage to be provided: (1) there must be direct, physical damage and (2) the physical damage must be caused by a covered peril.

The policyholder bears the burden of proving that direct physical damage was sustained to the covered premises within the policy period, or that damage was caused by a named peril. The insurer bears the burden of proving the applicability of a policy exclusion within the policy. Accordingly, a threshold question is how courts are responding to arguments that COVID-19 and/or the related government shutdowns constitute "direct physical loss."

In a recent case, *Gavrilides Management Co., LLC v. Michigan Insurance Co.*, a Michigan court squarely addressed the issue and granted a motion for summary judgment in favor of the insurer defendant, ruling that a restaurant was not entitled to its claims for business interruption losses as a result of COVID-19 because the property did not suffer physical damage. 2020 Mich. Cir. LEXIS 395. The court held that the phrase "accidental direct loss of or damage to property" required "some physical alteration to or physical damage or tangible damage to the integrity of the building." The Michigan ruling, while favorable to the insurance industry, provides a caveat in that the court twice references the fact that the policyholder admitted that the restaurant did not experience any confirmed cases of COVID-19 at the insured location.

Also, in *Rose's 1, LLC v. Erie Insurance Exchange,* the court granted the insurer's summary judgment motion, holding that a COVID-19, government shutdown itself does not constitute a direct physical loss or damage. 2020 D.C. Super. LEXIS 10. In arriving to its ruling, the court relied on cases where a contaminant existed. In short, the court held that there cannot be a hypothetical contaminant; the insured must show that it actually existed in the covered premises. Accordingly, the decision implies that confirmed cases of COVID-19 would meet the physical loss requirement.

The Central District of California dismissed loss of business income claims in *10E, LLC v. Travelers Indem. Co.* because no facts were alleged wherein the insured property suffered physical loss of or damage to its property. 2020 U.S. Dist. LEXIS 156827. The business claimed that it lost income when restrictions were placed that limited its services to take-out and delivery. In *10E, LLC,* the court held that physical loss occurs where the property undergoes a distinct, demonstrable alteration. The court reasoned that even if the virus contaminating the surfaces can be considered physical alteration, there were no facts alleged by the restaurant that supported an inference that the virus physically altered the insured property.

However, in *Studio 417, Inc., v. Cincinnati Insurance Company,* the court denied the insurer's motion to dismiss because it determined that the salon and restaurants' allegations were sufficient to plead a showing of "accidental [direct] physical loss or accidental [direct] physical damage." 2020 U.S. Dist. LEXIS 147600. The policyholders alleged that it was likely that an infected person entered and infected the premises with the COVID-19 virus. They alleged that the presence of the virus "renders physical property…. unsafe and unusable," causing them to have to reduce or suspend their business. Further, the government authorities required the retail businesses to cease and/or reduce operations significantly. The insurer made the argument that the policies provide coverage only for income losses tied to physical damage to property, not for economic loss caused by governmental authorities to protect the public from disease. The court determined that it has to give meaning to all words in the policy, including both direct physical loss and direct physical damage and determined that they do not mean the same thing. Loss was taken to mean "the act of losing possession" and "deprivation." The court determined that policyholders have alleged a causal relationship between COVID-19 and their losses, as they alleged that the COVID-19 is a "physical substance" and that it lives on and is "active on inert physical surfaces" and is also "emitted in the air." In so ruling, the court cited cases that held that even absent a physical alteration, a physical loss may occur when the property is uninhabitable or unusable for its intended purposes. Specifically, the court cited *Port of Authority of New York and New Jersey v. Affiliated FM Ins. Co.*, 311 F.3d 226 (3rd Cir. 2002), affirming the denial of coverage, but recognizing the presence of large quantities of asbestos in the air of a building is such as to make the structure uninhabitable and unusable, and *General Mills Inc., v Gold Medal Ins. Co.*, 622 N.W.2d 147 (Minn. Ct. App. 2001), wherein the court ruled "[w]e have previously held that direct physical loss can exist without actual destruction of property or structural damage to property; it is sufficient to show that insured property is injured in some way." The policyholders alleged physical

Notably, in order to recover for business income loss, a two-prong test must be met for coverage to be provided: (1) there must be direct, physical damage and (2) the physical damage must be caused by a covered peril.

contamination due to COVID-19, and the court ruled that the matter could proceed to discovery in order for the policyholders to show that COVID-19 was physically in the premises. Unaddressed is the issue that most decontamination or cleaning can be accomplished relatively quickly and that 72-hour waiting periods before business income coverage begins are common.

The anti-concurrent causation clause states that the insurer does not provide coverage for a loss regardless of "whether other causes acted concurrently or in any sequence within the excluded event to produce the loss." The concurrent causation doctrine holds that when two or more causes of loss, one covered and one excluded combine to cause a loss, the loss is covered.

In Louisiana, the governor issued 30 JBE 2020, wherein it stated, "[w]hereas, these measures relating to gaming establishments, restaurants, bars, cafes, and coffee shops are necessary because 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." In *Widder v. La. Citizens Prop. Ins. Corp.*, the Fourth Circuit Court of Appeals held that the intrusion of the inorganic lead that made the home inhabitable constituted "direct physical loss." 82 So.3d 294 (La. App. 4 Cir. 8/10/11), (citing *In re Chinese Manufactured Drywall Prods. Liab. Litig.*, 759 F. Supp.2d 822 (E.D. La. 12/16/10), wherein the U.S. District Court for the Eastern District of Louisiana found that the Chinese-manufactured drywall from which gaseous fumes were released caused a "distinct, demonstrable, physical alteration" of the policyholder's home; therefore, the policyholders met their burden of proving that the contaminant caused "direct physical loss" of their homes (covered property). While a Louisiana court has not ruled on any cases to date, it appears that allegations that the COVID-19 virus is present on the premises and has contaminated the premises may be sufficient to survive a Rule 12(b) motion; however, the policyholder will still have to show actual contamination either through an infected individual who entered the premises or by submitting proof, such as testing results, that the virus was on the premises. Additionally, the waiting period before coverage starts, wherein decontamination cleaning can be accomplished, still applies.

The Anti-Concurrent Causation Clause

The anti-concurrent causation clause states that the insurer does not provide coverage for a loss regardless of "whether other causes acted concurrently or in any sequence within the excluded event to produce the loss." The concurrent causation doctrine holds that when two (or more) causes of loss—one covered and one excluded—combine to cause a loss, the loss is covered. Under this theory, when a non-excluded contributing cause, no matter how remote, concurrently occurs with excluded events such as earthquake or flood, the loss is covered. In developing theory, many courts have recognized the efficient proximate cause rule, permitting recovery under conflicting causation when the primary, or moving, cause of loss was covered. In response to these developing doctrines, the anti-concurrent causation clause was developed to keep excluded causes of loss excluded.

In *Diesel Barbershop, LLC v. State Farm Lloyds*, the U.S. District Court for the Western District of Texas ruled against barbershop owners who suffered losses as a result of ordered state and county closure. 2020 U.S. Dist. LEXIS 147276. The barbershop owners had sought coverage under the civil authority clauses. The court found that the damages must entail the distinct, demonstrable, physical alteration of property and COVID-19 did not qualify. However, the language in the policy at issue in *Diesel, supra*, provided coverage only for "accidental direct physical loss" as opposed to the broader "accidental physical loss or accidental physical damage" language in the policy at issue in *Studio 417, supra,* and the barbershop owners did not allege that the COVID-19 virus attached to the premises and caused damage by doing so. The policy at issue in *Diesel, supra,* also contained a virus exclusion that excluded coverage for "[v]irus… capable of inducing physical distress, illness or disease." Further, in ruling for the insurer, the court was also persuaded by the anti-concurrent causation clause, which stated that the insurer did not insure for a loss regardless of "whether other causes acted concurrently or in any sequence with the excluded event to produce the loss." Since the anti-concurrent causation clause led into the language of the virus exclusion, the court held that this clause excluded coverage for the losses incurred, even if the plaintiffs had pled direct physical loss to property.

Similarly, in *Franklin EWC, Inc. et al. v. The Hartford Financial Services Group, Inc.*, the U.S. District Court for the Northern District of California held that the virus exclusion in the policy bars the policyholder's business income losses. 2020 U.S. Dist. LEXIS 174010. The virus exclusion in the policy stated that the insurer would not pay for

> loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributed concurrently or in any sequence to the loss: (1) Presence, growth, proliferation, spread, or any activity of 'fungi,' wet rot, bacteria or virus.

The court held that the insurer met its burden of proving that the exclusion applies because the complaint unambiguously alleged that any covered cause of loss was directly or indirectly caused by COVID-19. However, in *Urogynecology Specialist of Florida, LLC v. Sentinel Insurance Company, Ltd.*, the U.S. District Court for Middle District of Florida denied the insurer's motion to dismiss, relying heavily on the novelty of the factual issues presented

by the COVID-19 pandemic and the settled principle that requires any ambiguity in an insurance policy be construed against the insurer. 6:20-cv-1174-Orl-22EJK. According to the court, "[d]enying coverage for losses stemming from COVID-19, however, does not logically align with the grouping of the virus exclusion with other pollutants such that the Policy necessarily anticipated and intended to deny coverage for these kinds of business losses." In finding the same virus exclusion language as that contained in the policy at issue in the *Franklin EWC* matter to be ambiguous, the court noted that it did not have the coverage forms that the "Limited Fungi, Bacteria, or Virus Coverage" section of the policy modified.

In cases where property is physically damaged by hurricane or other covered cause of loss during the time when the business was shut down because of the COVID-19 pandemic, does the period of restoration start seventy-two hours from the time that there was physical damage to the property from the hurricane or must an insurer first determine whether the COVID-19 virus was present at the premises?

The anti-concurrent causation clause has gained most attention with regard to hurricanes, where one commonly encounters both wind and flood damage. Adjusters and insurers typically try to separate the resultant damage from these two events, a difficult chore when only a slab remains. When excluded flood and covered wind are involved, the traditional evaluation has to be made as to what damage was caused by covered versus excluded damage and the theoretical time necessary to repair only the covered damage. In *JAW The Pointe LLC v. Lexington Ins. Co.,* the Texas Supreme Court held that because the covered wind losses and excluded flood losses combined to cause the enforcement of the ordinances concurrently or in a sequence, the policy's anti-concurrent causation clause excluded coverage for *JAW's* losses. 460 S.W.3d 597, 610 (Tex. 2015). It appears allegations of COVID-19 loss of business income in a petition would be sufficient to trigger the applicability of the anti-concurrent causation clause, pending investigation as to whether the virus was actually present. That said, the anti-concurrent causation clause with the virus exclusion will most likely not preclude coverage for hurricane damage.

Civil Authority Additional Coverage

Civil authority is a commonly found additional coverage that has been ground zero in early COVID-19 litigation. Civil authority coverage is designed to provide loss of income protection when a covered cause of loss results in an off-premises, localized event that causes the authorities to prohibit or limit access to the described premises. The period is generally limited to a matter of weeks, and there are often geographic limitations on how far the damage must be from the insured property. A typical clause reads, in part:

> When a Covered Cause of Loss causes damage to property other than property at the described premises, we will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises.

CP 0030 (10/12) at 5. Additional Coverages a. Civil Authority.

Many litigants have claimed loss of income due to civil authority orders to stay at home that reduced business activity. The argument relies on the virus being physical damage and the stay-at-home orders being the exercise of civil authority that prohibits access to the business. However, the threshold issue remains that the initiating cause must be a "Covered Cause of Loss" defined as: "Covered Causes of Loss means direct physical loss unless the loss is excluded or limited in this policy."

Period of Restoration

With the COVID-19 pandemic, questions arise as to what exactly the projected period of restoration is. If two claims are made—loss of business income due to COVID-19 and loss of business income from a hurricane—should both claims be considered together or are they handled separately? If a business was closed due to COVID-19 stay-at-home orders, how is the period of restoration projected? Does the period of restoration extend through the closure order of the governmental authorities or does the period of restoration end once the premises are disinfected?

Business income provides that a policyholder will be paid for the actual loss of business it sustains due to "the necessary suspension of your 'operations' during the 'period of restoration.'" The "period of restoration" is usually defined as the period of time that begins "72-hours after the time of direct physical loss or damage for Business Income Coverage" or "immediately after the time of direct physical loss or damage for Extra Expense." Coverage must be caused by or resulting from a covered cause of loss at the described premises, although not necessarily to insured property. The period of coverage ends the earlier of "the date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality" or "the date when business is resumed at a new permanent location." The period of restoration is a theoretical period for the time with which the repairs should be reasonably accomplished using due diligence and dispatch.

In cases where property is physically damaged by hurricane or other covered cause of loss during the time when the business was shut down because of the COVID-19 pandemic, does the period of restoration start seventy-two hours from the time that there was physical damage to

the property from the hurricane, or must an insurer first determine whether the COVID-19 virus was present at the premises? Consider also that the excluded pandemic will likely affect the time required to repair the premises with due diligence and dispatch. COVID-19 has directly constricted building supplies and the experienced labor available. Further, job safety in the age of the pandemic means workplace distancing and personal protection equipment (PPE) that markedly increase costs and project inefficiencies. These multiplied costs and repair times, although a direct result of a perhaps excluded virus, remain a component of the covered loss. They are our current economic realities.

How Loss Is Calculated

In the event that it is determined that a covered cause of loss resulted in direct physical loss or damage and the period of restoration is also determined, the loss of business income has to be calculated. Loss of business income is defined in most policies as:

1) Net income (net profit or loss before income taxes) that would have been earned or incurred; and
2) Continued normal operating expenses incurred, including payroll.

Calculating business income loss starts with a projection of the likely revenue that the business would be projected to generate during the "period of restoration." This will include analysis of sales history in prior periods, as well as consideration for economic conditions, planned sales events, and all other relevant factors. For example, a florist who only opened its doors on January 1 can reasonably project a spike in sales around February 14.

Once a projection of the lost revenue that would have been generated during the "period of restoration" is achieved, past operating results will indicate what the projected profit or loss on that revenue would be expected to be. That lost net income (profit or loss) is added to the continuing, normal operating expenses incurred during the "period of restoration." What constitutes a "reasonable" continuing expense is often a point of contention. The business should be allowed continuing expenses that are required for reopening at the end of the period of restoration with the same level of service and production as was experienced before the covered loss occurred. Of course, this is subject to policy terms and conditions, such as a payroll exclusion or other limiting factors.

Many businesses were shuttered or operating at reduced capacity before Hurricanes Laura and Sally. Therefore, reviewing the net income of the previous year and the trends of the years before will not necessarily be an accurate baseline of projected revenue going forward. A business operating at 50 percent to 67 percent capacity will have less production and will likely have less operating expense, including payroll. Analysis of a COVID-19 business interruption claim would necessarily take account of state and local restrictions on occupancy or stay-at-home orders. Should a court deny a summary judgment motion by an insurer that argues there is no payout for loss of business income because the business was closed at the time that the wind damaged the premises? If the policyholder presents evidence that the business would have opened at some point during the period of restoration, should summary judgment be denied? What if the business would have remained closed during the period of restoration? These are difficult questions that will be presented as claims for hurricane damages are made along with either new or previously made COVID-19 claims. However, the old adage should be remembered—in the event of loss, the policy should do for the insured what his or her business would have done had no loss occurred.

Paycheck Protection Program

Considerable debate has ensued on the effect of the Paycheck Protection Program (PPP) on any business income claim occurring during the pandemic. Per policy conditions, the business income claim will be determined based on the likely net income of the business if no physical loss or damage had occurred, along with "[t]he operating expenses, including payroll expenses, necessary to resume 'operations' with the same quality of service that existed just before the direct physical loss or damage." CP 0030 (10/12) Loss Determination a (3).

Any sums provided by the Paycheck Protection Program are not a component of the income statement, they are shown as a liability on the balance sheet. The PPP sum received by a policyholder does not represent operating income, nor will it be considered income, even if forgiven. To the extent a loan is forgiven, a likely scenario is that businesses will move the PPP loan from a liability to additional paid-in capital in the owner's equity portion of the balance sheet and move payroll from the income statement to offset the additional paid-in capital. The mechanics of this are not currently well established and taking a credit for PPP payments would be a daunting endeavor.

What is clear is that the unprecedented circumstances of adjusting claims from business owners making those claims for business income losses caused by COVID-19 and now Hurricanes Laura and Sally places the insurance industry in new, uncharted territory where the traditional analysis of wind versus water in adjusting these claims are complicated by the COVID-19 pandemic.