Business Interruption Insurance Lawsuits Related to

COVID-19 SHUTDOWNS EXPLODE

William B. Graham and **Melisa C. Zwilling** Carr Allison

The coronavirus disease pandemic came out of nowhere and has literally shaken almost every individual and business to the core. While the scientific and medical communities bear the tremendous burden of saving human lives, the insurance industry is being called upon, in essence, to save the economic lives of businesses across the country by way of business interruption insurance claims.

The insurance industry has overwhelmingly taken the position that business interruption policies do not cover claims related to COVID-19. As a result of coverage denials, businesses are filing lawsuits requesting that courts force insurance companies to pay. In fact, business interruption lawsuits filed in federal courts increased by 300% from March through June 2020, according to one legal analytics firm. Experts expect the number of cases ultimately filed to be in the thousands.

DIRECT PHYSICAL LOSS OF OR DAMAGE TO PHYSICAL PROPERTY

Many standard business policies provide coverage only for losses caused by direct physical damage. Some plaintiffs have argued that the presence of the coronavirus on their premises constituted physical damage. Others have argued that the forced closure of their business was sufficient to have directly affected the use of the property as required by their policy. Insurers have, in turn, argued that COVID-19 has not caused a direct physical loss and, therefore, the claims are not covered under the policies at issue. Whether a direct physical loss has been suffered by an insured will likely be a key issue in almost all COVID-19 business interruption litigation.

VIRUS EXCLUSIONS

Many commercial policies specifically exclude "loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease." This language, insurance companies assert, clearly applies to the coronavirus and supports the denial of business interruption claims. Thus, even if a business suffered a direct physical loss or damage, insurers argue that claims for COVID-19 would still be excluded from coverage.

COURT DECISIONS

With several months having passed since the first business interruption cases were filed, some courts across the country have begun to issue decisions which provide some insight into how the novel coverage issues may be resolved. The first opinion came from a circuit court judge in Michigan in *Gavrilides Management Company, et al. v. Michigan Insurance Company.* The court held that no coverage was owed under

the policy because there was no direct physical loss of or damage to property. The court noted that the loss or damage "has to be something with material existence. Something that is tangible. Something . . . that alters the physical integrity of property." According to the court, "direct physical loss or damage" requires more than a loss of use or access. The plaintiff in this case did not allege any physical loss of or damage to the actual restaurants. Instead, the claim was based specifically on closures related to government orders prohibiting restaurants from being open.

The court also noted that, while government acts would have been covered under the policy, those government actions would have to result in direct physical loss or damage. In the *Gavrilides* case, no such loss or damage was alleged. In addition, the court held that the virus exclusion in the policy unambiguously excluded coverage for losses which resulted from COVID-19. Therefore, even if there was physical damage, the virus exclusion would have precluded coverage. Accordingly, the court granted the insurer's motion for summary judgment. That first decision was a big win for the insurance industry.

While state courts in California and the District of Columbia, as well as federal courts in Texas and California, have similarly ruled on behalf of insurance companies, not all courts have been as favorable. In August, a federal court in Missouri declined to grant an insurer's motion to dismiss a business interruption claim in S*tudio417, Inc. v. Cincinnati Insurance Company.* The plaintiffs in that case, a group of restaurant and hair salon owners, asserted that the properties were likely infected with COVID-19 from customers who had visited the properties. They argued that the coronavirus was a physical substance that actually attached itself to and rendered the properties unsafe and unusable, resulting in a suspension of or reduction in operations. The Missouri court decided that the plaintiffs in that case had adequately pleaded a "direct physical loss" to their properties. Central to the court's decision was the distinction between the terms physical damage and physical loss. In the court's opinion, loss meant "the act of losing possession" and "deprivation." The court found that the allegations that COVID-19 was a physical substance that deprived them of use of the property by making it unsafe and unusable was sufficient at that stage of the litigation to survive the motion to dismiss.

The next day, a federal court in Texas reached a completely different result in *Diesel Barbershop, LLC v. State Farm Lloyds.* The court determined that "tangible injury to property" was required in order to establish a "direct physical loss" within the meaning of the policy at issue. While the court acknowledged that other substances such as ammonia, carbon monoxide and E. coli had been deemed sufficient to establish direct physical loss in prior cases, the court opined that a "distinct, demonstrable physical alteration of the property" was required and that it had not been established in the case before the court. In addition, the court noted that the policy language excluded coverage for losses caused by a virus so even if the plaintiffs could have proven direct physical loss, the virus exclusion in the policy would bar the claims. Accordingly, the court granted the defendant's motion to dismiss.

BAD FAITH AND UNFAIR TRADE PRACTICES CLAIMS

In addition to the rapid increase in business interruption litigation, courts have seen a dramatic increase in the number of bad faith and unfair trade practice claims related to COVID-19. Several lawsuits have been filed alleging that insurers have been acting in bad faith by not properly evaluating the facts and circumstances surrounding individual claims before denials are issued. In addition, several complainants have alleged that insurers have engaged in unfair or deceptive trade practices by promising coverage and wrongfully denying claims for which they never had an intention of actually providing coverage.

EFFECT ON INSURANCE INDUSTRY

Most insurers argue that business interruption policies were written to cover natural disasters, not global pandemics, and that paying on the massive volume of claims would likely bankrupt the industry. "Pandemics are not insurable because they are too widespread, severe, and unpredictable to underwrite," said David Sampson, president and CEO of the American Property Casualty Insurance Association (APCIA). The APCIA has estimated that small businesses with 100 or fewer employees were losing between $255 billion and $431 billion per month due to COVID-19 closures. Premiums collected by insurance companies for business interruption coverage only amount to between $6 to $8 billion per month. If insurers had to pay on all of the losses, the insurance industry argues it would be completely gutted. At the very least, the APCIA argues, paying the claims would cause tremendous downstream effects for all Americans who use insurance because the business interruption losses would have to be made up by other policyholders.

STATE AND FEDERAL LEGISLATION

Because most insurance companies are responding to claims for business interruption coverage related to COVID-19 with denials, countless business are left with losses that very well may lead to permanent closure. In an attempt to prevent that, legislators in nine states, the District of Columbia and Puerto Rico have introduced bills that would mandate retroactive business interruption coverage for COVID-19 claims. None of those bills have proceeded very far through the legislative process.

Similarly, the federal government is considering legislative action. The Business Interruption Relief Act, which would create a program whereby insurers who pay claims voluntarily could obtain reimbursement from the federal government, is pending in the House. The Pandemic Risk Insurance Act is also being floated in Congress. It would require insurers to cover the losses up to $250 million, at which point the federal government would step in and serve as a backstop. The National Association of Insurance Commissioners has strongly opposed such legislation, arguing that it is unconstitutional for the government to essentially re-write private contracts. Instead, the insurance industry is urging Congress to do more to provide direct financial relief for small businesses.

OTHER SOLUTIONS

Some believe that businesses, insurance companies and the federal government will likely have to work out some type of resolution to keep both businesses and insurers going. Reaching an agreement on the complex issues involved will not likely be a quick process. In the meantime, the number of COVID-19 business casualties will continue to rise.

Bill Graham, a shareholder with Carr Allison in Tallahassee, Florida, focuses his practice on Commercial Litigation, Insurance, Insurance Regulatory Law, Government Torts and Public Liability and Governmental Relations. He can be reached via bgraham@carrallison.com.

Melisa C. Zwilling is a shareholder with Carr Allison in Birmingham, Alabama. A national authority on Medicare Secondary Payer compliance, Melisa has refocused her passion for the law on the myriad issues clients are facing related to COVID-19. Her ability to understand and clearly communicate complex laws have proven invaluable. She can be reached via mzwilling@carrallison.com.