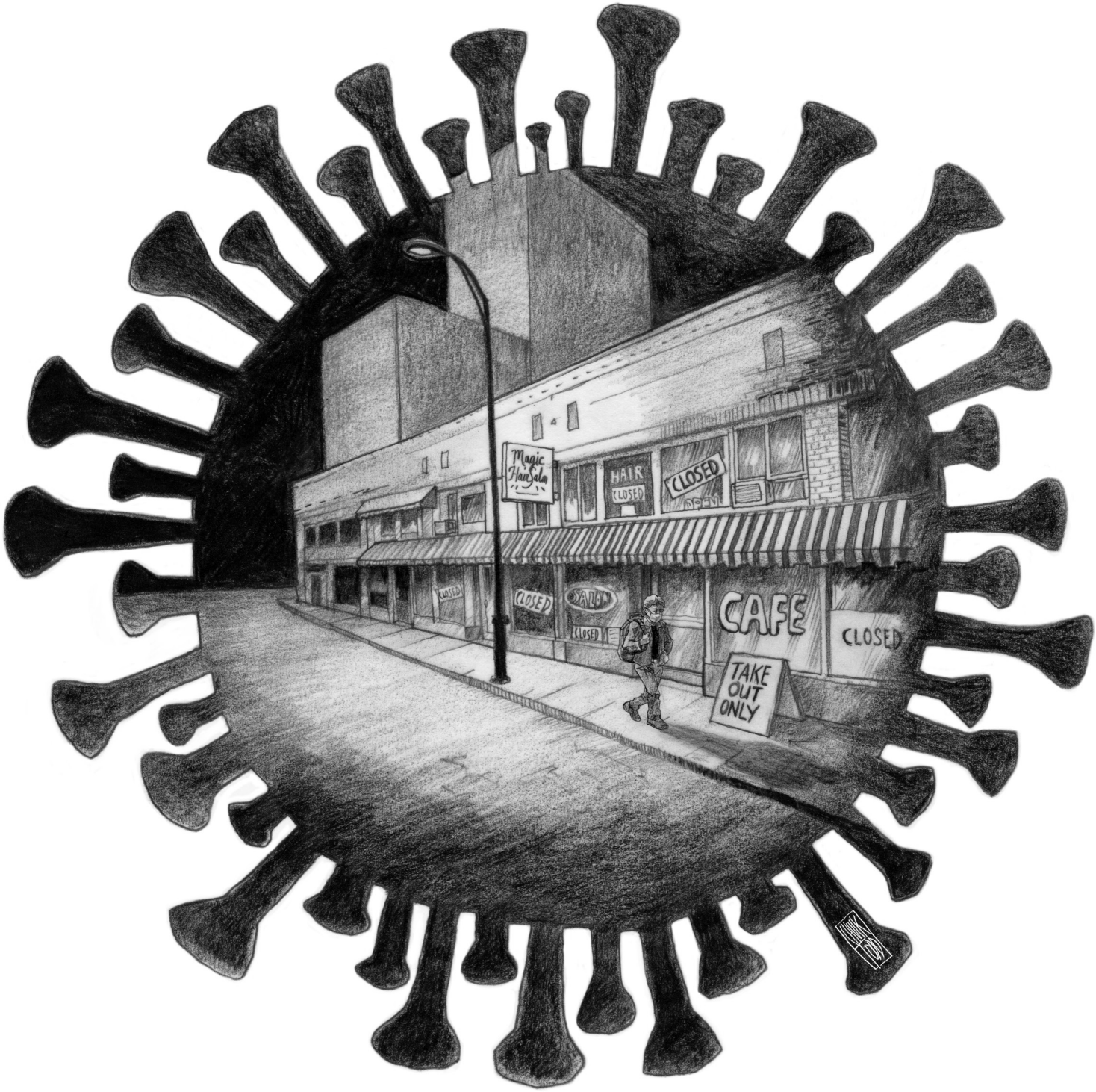

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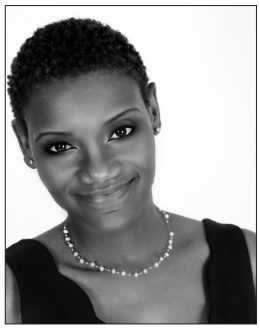
Business Interruption Insurance in the Era of Covid-19

by Racquel Brown-Gaston, Esq.



In the Spring of 2020, millions of small and medium-sized businesses in the U.S. — from restaurants to retailers — came to a sudden halt at the direction of civil authority to shut down. Cities, suburbs and rural areas became ghost towns as many state governments, one after another, issued stay-at-home orders. The Coronavirus, hereafter COVID-19, has introduced pure devastation as death tolls, and the number infected, continued to surge. Employment plummeted. Businesses closed. America had not seen the likes of this since the Great Depression of the 1920s. Bankruptcy courts became too popular and small businesses — the engine of America — faced a ruinous future. According to "Yelp: Local Economic Impact Report," 60% of them would remain permanently closed.[1] Nationwide, CNBC estimated in April, 2020 that 7.5 million small businesses could close permanently.

For the others, hope lies with the interpretation of a contract entered into with their insurers. The battle for deciphering the intent of this contract takes center stage, as state and federal courts begin to rule on the avalanche of suits brought against insurance companies for business interruption claims. This article explores business interruption insurance — what it is, how it came about, the role of the Plain Meaning Rule in such contracts and the intent of the insurer's role in mitigating the loss of business income through COVID-19 government mandated shutdowns.

The Origins and Evolution of Business Interruption Insurance

In the 1600s, insurance companies in Germany, followed by those in England, began insuring businesses, but only the physical structure of a business in case of a fire.[2] Although for a business to survive the aftermath of a natural calamity, it required protection against loss of income, insurance companies hesitated to do so, as they needed assurance with certainty that the payout would amount to the actual loss.[3]

In the early 1800s, some insurance companies began offering insurance for loss of rent due to fire as well as daily compensation for time lost.[4]

Three accounting entities formed in the mid-1850s merged in 1951 to form the Institute of Chartered Accountants of Scotland to create uniform accounting standards for the continued development of business interruption insurance.[5] As Great Britain was focusing on uniformity in numbers, France in the 1800s introduced insurance covering loss of profits.[6] In 1880, this type of insurance became available in the United States, but instead of business interruption insurance, it was known as "use and occupancy," providing a fixed indemnity per day for each day a company was unable to operate after a fire.[7] In 1899, Ludovic MacLellan Mann, in Scotland, introduced the Consequential Loss Insurance or Profits Insurance, covering both profit and the "standing charges" of a business.[8]

In 1938, the U.S. Model — the Gross Earnings Policy — covered the reduction in the insured's gross earnings due to the direct damage to the business leading to a disruption. Insurers still needed to verify business accounting to ensure accuracy of loss. Hence, in 1939, Cuthbert Heath developed the UK model of business interruption insurance, which became the first modern policy form. It is still widely used today — restoring the business owner to the position he or she was in before the loss.[9]

In 1986, instead of continuing to attach the Gross Earnings Policy form to a Direct Damage Property form, the United States Insurance Services Office, Inc. (ISO) recommended use of the Business Income Coverage form, which became the basis for business insurance coverage.[10] However, modifications of this coverage have taken place repeatedly. In order to gain exclusions on the policies, insurance companies must gain approval from the applicable state insurance regulator. They must prove that any exclusion requested will not be something for which the business was already paying a premium or that such coverage was

Racquel Brown-Gaston is an Associate Professor of Law & Ethics in the School of Business and Public Administration at the University of the District of Columbia. She previously taught at Medgar Evers College, a City University of New York institution. She is a graduate of Boston University and the University of Miami School of Law in Miami, Florida and is admitted to the practice of law in New York. As an attorney for the past 20 years, Ms. Brown-Gaston specializes in business formations, contracts, commercial law, estate planning, mediation, non-profit law and real estate. Her clients include non-profit corporations, closed corporations, partnerships, LLCs, small businesses seeking government contracts, and individuals. She is both a published scholar and a commercial author and has continuously served on non-profit boards. She also donates her time as a pro bono *attorney for the most vulnerable in society, including as a member of New York State Coalition of Concerned Legal Professionals.*

never offered, and based on catastrophic outbreaks, it was foreseeable that the insured could request coverage beyond the original intent of the insurance company. The regulators usually grant changes of this type.

In 2006, subsequent to the Severe Acute Respiratory Syndrome (SARS) epidemic, ISO and the American Association of Insurance Services (AAIS), representing hundreds of insurers, sought such a change to the typical business interruption policy.[11] The standard business income or business interruption policy covers "direct physical loss," or "direct physical damage," as opposed to loss of physical use of property.[12] Coverage includes income loss, as well as continued expense due to the "direct physical loss," or, for others, "direct physical damage."[13] The new ISO form CP 01 40 07 06/*Exclusion of Loss Due to Virus or Bacteria* was added to most commercial property policies as standard.[14]

In 2020, the year of COVID-19, many business interruption policies include the following:

> *A. The exclusion set forth in Paragraph B. applies to all coverage under all forms and endorsements that comprise this Coverage Part or Policy, including but not limited to forms or endorsements that cover property damage to buildings or personal property and forms or endorsements that cover business income, extra expense or action of civil authority.*
>
> *B. We will not pay for 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. However, this exclusion does not apply to loss or damage caused by or resulting*

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from "fungus," wet rot or dry rot. Such loss or damage is addressed in a separate exclusion in this Coverage Part or Policy.

C. With respect to any loss or damage subject to the exclusion in Paragraph B., such exclusion supersedes any exclusion relating to "pollutants."

D. The following provisions in this Coverage Part or Policy are hereby amended to remove reference to bacteria:

1. Exclusion of "Fungus," Wet Rot, Dry Rot And Bacteria; and

2. Additional Coverage — Limited Coverage for "Fungus," Wet Rot, Dry Rot and Bacteria, including any endorsement increasing the scope or amount of coverage.

E. The terms of the exclusion in Paragraph B., or the inapplicability of this exclusion to a particular loss, do not serve to create coverage for any loss that would otherwise be excluded under this Coverage Part or Policy.[15]

The Civil Authority Enforcement Effect

In late January 2020, China put into action a quarantine of its citizens as an effort to combat the breakout of the new COVID-19. Countries in Europe soon followed this practice. In March, California became the first state in the United States to order residents to stay at home.[16] All businesses, except for those deemed essential, were to be closed.[17] In an effort to mitigate the loss to businesses, the federal government allocated $350 billion to fund the Paycheck Protection Program (PPP) to aid small businesses that had experienced a loss due to the mandatory shutdown by civil authorities as a result of COVID-19.[18] Money for the program dried up after 1.6 million U.S. businesses, only 5.7% of the total of U.S. businesses, received funding; applications were then closed. [19]

To assist small business owners who were not able to receive funding, Senators Marco Rubio and Susan Collins sponsored the Continuing Small Business Recovery and Paycheck Protection Act, providing federally backed loans.[20] The Small Business Administration facilitated 5 million loans totaling $519 billion.[21] To be deemed forgivable, a minimum of 60% of the loan has to go toward payroll costs.[22] Many businesses, however, could not maintain staffing levels at the pre-COVID level, with about 22% of PPP loan borrowers having to or anticipating having to lay off one or more employees after using their loan.[23] In addition, some employees declined to return to work, due to COVID-19 safety or necessity to stay home with young children now out of school, coupled with the availability of unemployment insurance. Given the inadequacy of the government program, many small businesses who had paid for a business interruption "all-risk" policy, decided to seek relief in court, in some cases challenging their business interruption insurance contracts.

The Courts Take on Business Interruption Policies and COVID-19

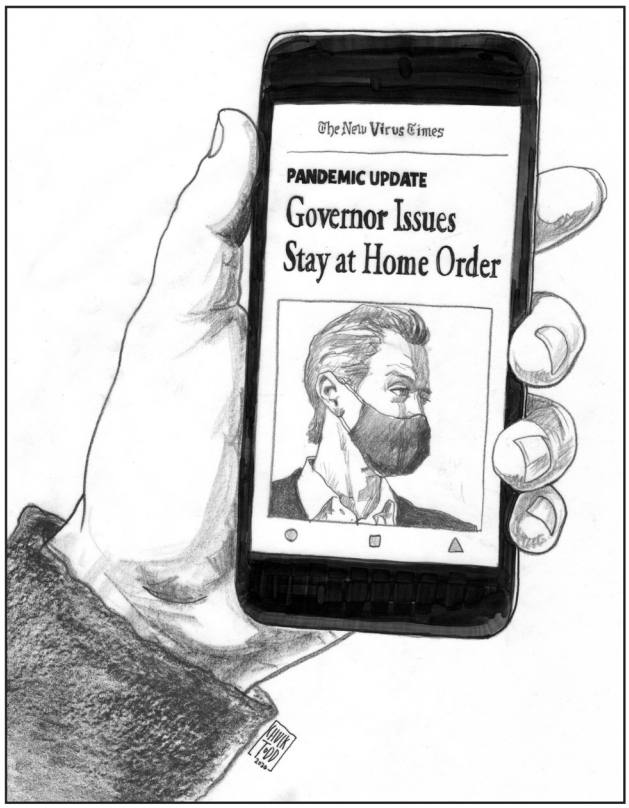
The first COVID-19 case, *Cajun Conti, LLC et al. dba Oceana Grill v. Certain Underwriters at Lloyd's London et al.*,[24] was filed in Louisiana by Oceana Grill, a popular restaurant in the French Quarter of New Orleans that operates 365

days a year and accommodates approximately 500 guests between the hours of 8 am and 1 am. Its "all risk" policy, effective June 2019 - June 2020 with Certain Underwriters at Lloyd's, London, was a Special Form that designated loss as "direct physical loss," unless "the loss is specifically excluded or limited in the policy .... The policy does not provide any exclusion due to losses, business or property, from a virus or global pandemic."[25]

The Court of Appeals of Louisiana, Fourth Circuit, had previously ruled in *Marcia Widder v. Louisiana Citizens Property Insurance Corporation D/B/A Louisiana Citizens Fair Plan*,[26] that an exorbitant amount of lead in the walls and on the physical contents within the home was contamination and dangerous for the appellants and was thereby designated as physically damaged property resulting in physical loss, and the property had to be gutted and remediated.

Comparing the COVID-19 infection to such contamination, Cajun asserted that COVID-19 had already physically impacted public and private property and physical spaces around the world, causing physical damage and loss,[27] and any effort by Lloyd's to deny that reality "would constitute a false and potentially fraudulent misrepresentation that could endanger policyholders and the public."

Cajun's attorney, John W. Houghtaling II, said that insurance agents have been telling business owners that their business interruption policies won't cover the shutdowns caused by COVID-19, and that it does not cause damage to or contaminate property. "I've talked to restaurant owners from here [in Louisiana] to New York City and they [are] all being told the exact same thing by their agents," stated Houghtaling.[28]



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On March 13, 2020, Louisiana Governor John B. Edwards issued a statewide civil authority order banning a gathering of 250 or more people, except for airports and medical facilities.[29] This order undoubtedly affected Cajun Conti as it was now limited to 50% capacity, thus affecting its income. The Mayor of New Orleans, Latoya Cantrell, on May 15, issued restrictions on all full-service restaurants to cease operations at 9 pm and limit capacity to 50%.[30] This also affected Cajun Conti as the establishment closed at 1 am. Fewer hours and less capacity equated to less income.

Although Cajun Conti had not filed a claim against Lloyd's, it sought declaratory judgment to determine if the two orders triggered the civil authority provision of the policy and were applicable to the restaurant. A declaratory judgment suit is "one in which the plaintiff's requested relief from the court is a statement of the parties' rights."[31] A civil authority provision "extends coverage to losses resulting from an interruption of the insured's business when actions by local, state or federal authorities in response to damage to property other than the insured's property prohibit access to the insured's property... the insured is not required to suffer direct property damage, but ... the damage must result from a covered cause of loss."[32] Cajun Conti also sought court confirmation that the policy has no viral pandemic exclusion preventing a claim of physical loss due to the government-ordered shutdown.[33] The Plaintiff's pleadings asked for the following:

> *34. Plaintiffs seek a Declaratory Judgment on whether the Governor's March 13, 2020 Civil Authority Order applies to restaurants whose capacity exceeds 250 people.*
>
> *35. Plaintiffs also seek a Declaratory Judgment to determine whether the Governor's March 13, 2020 Order and the Mayor's March 15, 2020 restrictions trigger the civil authority provision of the policy issued to the plaintiffs.*
>
> *36. Plaintiffs ask the Court to affirm that because the policy provided by Lloyd's does not contain an exclusion for a viral pandemic, the policy provides coverage to plaintiffs for any future civil authority shutdowns of restaurants in the New Orleans area due to physical loss from coronavirus contamination and that the policy provides business income coverage in the event that the coronavirus has contaminated the insured premises.*

As of November 4, 2020, the court denied the insurer's motion for summary judgment and the case is proceeding forward.

On April 29, 2020, Simon Wiesenthal Center, Inc., and Moriah Films also filed for declaratory relief in California federal district court (*Simon Wiesenthal Center, Inc., et al. v. Chubb Group of Insurance Companies/Federal Insurance Company)*.[34] Similar to the *Cajun Conti* case, the parties entered into a one-year contract providing coverage from August 1, 2019 – August 1, 2020.[35] This "all-risk" policy covered the loss of business income and extra expenses in the event of loss of property resulting from civil authority prohibiting another within one mile of said premises to use its property.[36] The policy did not exclude viruses, but has the standard provision that loss means direct physical loss or damage unless the loss is specifically excluded or limited in the policy.[37]

The Center also asserted that COVID-19 had a physical impact causing a dangerous property condition and created loss of property due to its limited use.[38] Los Angeles Mayor Eric Garcetti, on March 19, 2020, issued the Safer at Home Emergency Order (the "Order") prohibiting all gatherings.[39] This affected the Center and its ability to fundraise, leading to loss of substantial income.[40] The Center asserted that the virus physically caused loss of property because it attached itself to surfaces and that this created a dangerous condition.[41] The plaintiffs voluntarily dismissed the claim on June 1, 2020, "based in part on the fact that the Chubb Group had 'yet to conclude its claim investigation.'"[42]

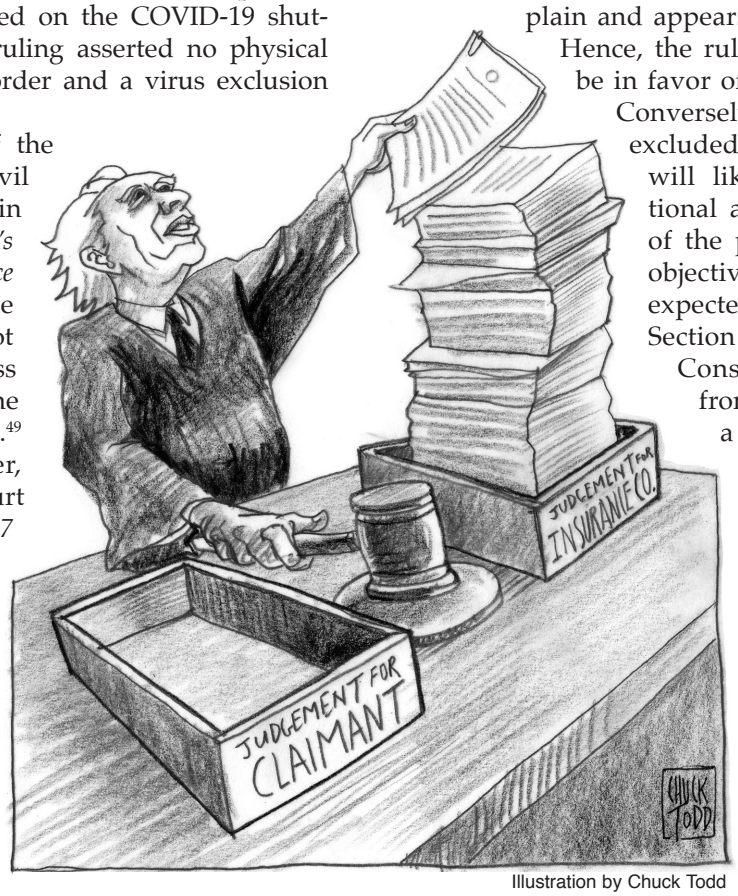
The first COVID-19 ruling occurred in Michigan on July 1, 2020. In *Gavrilides Management Co. LLC v. Michigan*

Insurance Co.,[43] Judge Joyce Draganchuk of Michigan's 30th Circuit Court ruled in favor of the insurance company against the restaurant, citing that there must be physical damage to the property as a result of the shutdown orders. Additionally, she ruled that the virus exclusion clause would have nonetheless barred recovery.[44]

The same result occurred in favor of the insurer in *Diesel Barbershop LLC v. State Farm Lloyds*.[45] The U.S. District Court for the Western District of Texas dismissed claims by barbershop policyholders that their policies covered loss of income based on the COVID-19 shutdown orders.[46] Again, the ruling asserted no physical damage as a result of the order and a virus exclusion clause barred recovery.[47]

The Superior Court of the District of Columbia, Civil Division similarly found in favor of the insurer in *Rose's 1 LLC et al. v. Erie Insurance Exchange*,[48] ruling that the group of restaurants did not suffer any direct physical loss as they did not prove that the virus was on their properties.[49]

In Missouri, however, for the first time, the court changed course. In *Studio 417 Inc. v. Cincinnati Insurance Co.*,[50] the court ruled that the plaintiffs stated a direct physical loss. The plaintiff asserted that the customers were likely to have been infected with the virus and then visited the property, thus infecting the property.[51] Moreover, this caused the plaintiff to suspend its operations due to the physical harm it could cause others.[52] The policy had no exclusions nor was there a definition of physical loss.[53] The court also agreed with Plaintiff's allegations that "customers cannot access the property due to the Stay at Home Orders or fear of being infected with or spreading COVID-19"; and that "COVID-19 is physically transmitted by air and surfaces through droplets, aerosols, and fomites that remain infectious for extended periods of time."[54] The court also noted that other courts have recognized that even "absent a physical alteration, a physical loss may occur when the property is uninhabitable or unusable for its intended purposes."[55]



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COVID-19 Case Analysis

Policyholders will continue to challenge business interruption/business income contracts throughout the country. As insurance policies are subjected to applicable state law, the specific language will vary, and so will their interpretations, based on applicable precedents. Not all property insurance policies have the same language. Not all of them include the definition of "physical loss" or "physical damage." In the absence of such specifications in contracts, courts are left to look at both the Plain Meaning Rule to interpret contracts and the trade or custom of the industry to interpret these contracts. In these cases, the virus exclusion clause is plain and appears standard in the industry. Hence, the rulings will more than likely be in favor of the insurance companies. Conversely, when such a clause is excluded from a policy, it can and will likely be viewed as intentional and thus a ruling in favor of the policyholder based on the objectivity of contracts should be expected. Furthermore, Article 1, Section 10 of the United States Constitution prohibits states from impairing contracts, so a virus exclusion clause will likely result in victory for the insurer.

In order for policyholders to win, they should argue unconscionability as opposed to, in essence, a breach of contract. Under the notion of unconscionability, one party has no choice but to accept what is granted as it lacks bargaining power. After the SARS virus made its debut in the early 2000s, it was foreseeable that another virus could be anticipated, creating loss for millions and destroying businesses. Instead of adding a premium to grant relief to policyholders, the ISO and AAIS requested that state regulators add *exclusion of loss due to virus or bacteria* to most commercial property policies as standard.

Policyholders are not in the position to challenge that exclusion, as policyholders do not appear before state regulators. In essence, this process creates a contract similar to a contract of adhesion; while insurance companies may offer options on coverage, many provisions are non-negotiable, regardless. Requests are not made of state regulators unless such conditions or events are foreseeable. The intent of a business interruption contract should be to put the business in the position it once was prior to the devastation. Devastation, though foreseeable, is unpredictable, and the role of insurance

is to cover loss in cases of unpredictable foreseeability. Insurance is an $800 billion industry that is cemented in risk of loss accounting, leading one to presume the profit margin would be in peril from foreseeable virus losses, hence, the exclusion.

The Business Interruption Insurance Coverage Act of 2020

Congressman Mike Thompson (D-CA) introduced H.R. 6494, the Business Interruption Insurance Coverage Act of 2020 to the House of Representatives on April 4, 2020.[56]

> *This bill requires insurers that provide business interruption coverage to insure, as part of this coverage, losses from a viral pandemic, a government-ordered business closure or evacuation, or a power disruption conducted for public safety purposes.*[57]

It voids the exclusion policy unless the insured authorized such exclusion in writing or failed to make premium payments after notification of a premium increase.[58] Congressman Thompson also introduced the Business Interruption Relief Act of 2020, H.R. 7412, June 29, 2020 "To establish a temporary voluntary program for support of insurers providing business interruption insurance coverage during the COVID-19 pandemic, and for other purposes."

Under this bill, a program would be created where the federal government would reimburse insurers who paid the business interruption claims. "Eligible businesses would be limited to those with (a) business interruption insurance that (b) includes civil authority shutdowns but (c) excludes virus-related damages."[59] Bills in California, Louisiana, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania, Rhode Island and South Carolina are under consideration.[60]

The challenge that may be posed is justifying why the federal government would reimburse the insurer if the insured paid a premium to the insurance company for this service. Why would it be optional to pay a claim for which there was consideration? Why preclude the insured from going directly to the federal government? Where is the Federal Emergency Management Agency (FEMA) in this? When all else fails, the United States can consider Pandemic Insurance for which the All-England Lawn Tennis Club at Wimbledon submitted a claim and is set to receive $141 million due to loss of income based on the COVID–19 pandemic.[61]

Author's Note: The author thanks CCLP volunteer Daihui Meng, a third-year law student at Columbia Law School, for his assistance with research for this article.

Editor's Afterword: In a year of unprecedented losses in income to both working people in the United States and to businesses, particularly small businesses, with no overarching plan enacted by the U.S. government to protect the physical and economic health of the population, businesses are finding they cannot even turn to their insurance companies to make them whole for their losses, despite paying for business interruption insurance. The author points out that the role of insurance is to cover loss in case of unpredictable foreseeability. Yet increasingly regulators allow insurance companies to simply write exclusions and the courts provide interpretations that immunize the insurance companies from covering that which would appear to be at the very heart of property and business insurance.

For example, coverage for flood damage has become a major issue in natural disasters, given flood insurance is normally separate from hazard insurance homeowners purchase. Losses from gradual erosion, sinkholes or land movement are also not covered in many homeowner policies. New York State Coalition of Concerned Legal Professionals volunteer attorneys provided extensive pro bono *legal assistance to homeowners, renters and small businesses following Hurricane Sandy in 2012. In some instances, CCLP volunteers fighting for homeowners learned the insurance companies had claimed damage was caused by "erosion and shifting," not the hurricane, and refused to cover it.*

Moreover, with the United States Supreme Court consistently finding for mandatory arbitration contracts pushed by

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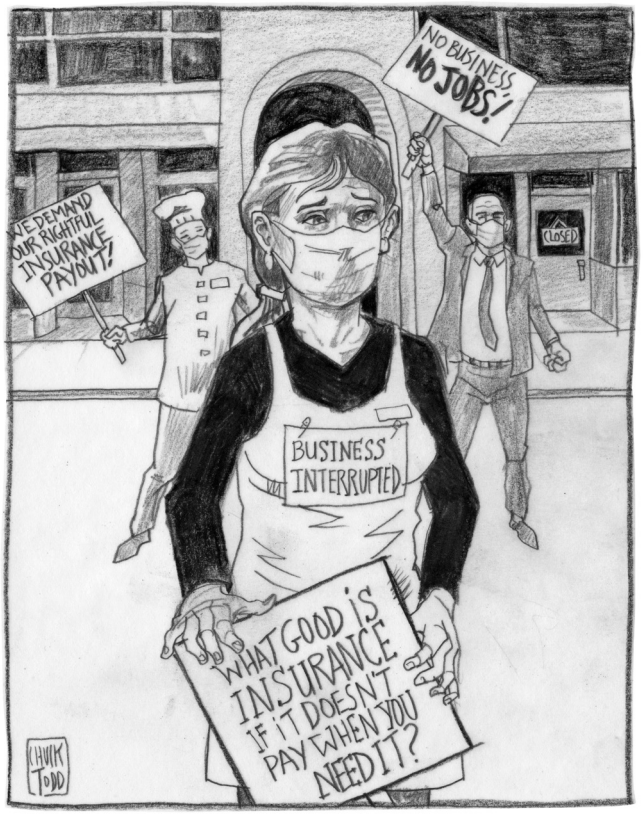
large corporations, it leaves the insured with no access to class actions or even class arbitration to resolve the larger issues of insurance (mal)practice. The author's points about contracts of adhesion caused by unequal bargaining power between the insured and insurer also apply to mandatory arbitration agreements forced upon consumers and job seekers. In the Supreme Court such arguments have met with little success, leading one federal judge to note that mandatory arbitration agreements leave the corporations free to misbehave with impunity.

The prognosis? With global warming hurling more disasters at us, from fires to earthquakes, tornadoes to "firenados" and pandemics; and with the courts and laws protecting corporate profits, individuals and businesses can expect to continue to bear the brunt of the costs, getting hit twice — first by the disaster, then by the government and insurance company response — unless we organize to change it.



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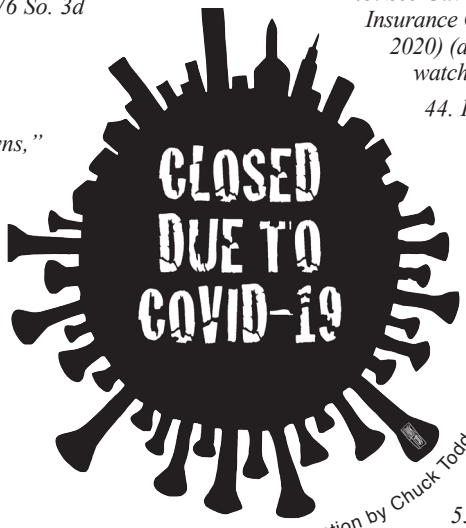

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