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## BUSINESS INTERRUPTION INSURANCE: SHOULD YOUR BUSINESS FILE A CLAIM?

How will the insurance industry handle the COVID-19 pandemic?

By Alan C. Bradshaw, Esq.

# BUSINESS INTERRUPTION INSURANCE COVERAGE FOR COVID-19 IS GREATER THAN INSURERS ACKNOWLEDGE

As the death toll and infection numbers associated with **Covid-19** climb worldwide, the economic impact of the Coronavirus on businesses is hard to comprehend. What is clear is that insurance companies, businesses, and legislators are preparing to do major battle over the scope of coverage provided under Commercial Property insurance policies that provide **“business interruption” insurance**.

A leading insurance company has already staked out its position that business interruption coverage “is generally designed to cover losses that result from direct physical loss or damage to property and it is not designed to apply in the case of a virus.” The New Jersey legislature, however, is poised to pursue legislation to make business interruption coverage available, and the recent stay home order of New York’s mayor acknowledges “property damage” from Coronavirus, an apparent nod to **“triggering”** this coverage. Members of Congress have written to the largest insurance companies encouraging them to provide the business interruption coverage promised to policyholders.

The playbook for the insurance companies’ inevitable denial of most business interruption claims is already written. It involves **two central arguments**. First, insurance companies argue that the language which triggers potential business interruption coverage requires a type of physical “damage” to tangible real or

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personal property that does not occur with a virus. Second, insurance companies argue that a host of exclusions applicable to “direct physical loss or direct physical damage” to tangible “*property*” caused by certain excluded items, are also applicable to the intangible lost income and additional expense covered by business interruption insurance, specifically the defined terms “**Business Income**” and “**Extra Expense.**”

The industry’s arguments, as described more fully below, confuse an important distinction between tangible and intangible property. While business interruption coverage is triggered by either “**damage**” to or “**loss**” of the use of physical-tangible real or personal property, the coverage provided under business interruption coverage is purely economic, intangible loss, specifically, reduced net income—“**Business Income,**” and increased expenses—“**Extra Expense.**” Consequently, this intangible economic injury should be paid even if there is no coverage for the “**damage**” to or “**loss**” of physical real or personal property as a result of the exclusions that apply to such tangible “*property.*” Indeed, income and expenses are not “*property.*” at all, or at a minimum, they are not tangible property that can be physically damaged or lost.

The insurance industry’s use of the critical distinction between tangible and intangible property to draw coverage lines is also well understood and pursued by the industry regularly. The industry’s business interruption playbook, however, **confuses this established distinction** and, for that reason, appears to be unprincipled. For example, under Commercial General Liability (“CGL”) insurance, “Coverage A” is applicable to “Property Damage” or “Bodily Injury” and it is well understood and argued by insurance companies that the coverage provided applies only to damage to tangible property or to a person’s bodily injury, not to economic harm. The industry argues this point consistently. In contrast, “Coverage B” is applicable to certain “Personal Injury” torts such as defamation or to “Advertising Injury,” and it is well established that economic loss is potentially recoverable and tangible property need not be damaged for coverage to exist.

In light of this important drawing of lines as between economic loss and damage to tangible property, it is worth reviewing the **typical language** used by the industry to provide business interruption insurance with an eye towards how this language applies or doesn’t apply to tangible “*property*” as opposed to intangible loss.

### Policy Language

A typical business interruption insuring clause states:

*We will pay ... for the actual loss of Business Income you sustain and the actual, necessary and reasonable Extra Expense you incur due to the necessary interruption of your business operations during the Period of Restoration due to direct physical loss or direct physical damage to property caused by or resulting from a Covered Cause of Loss at “Scheduled Premises.”*

Typical definitions of “**Business Income**” and “**Extra Expense**” state:

*Business Income means:*

*... Net Income (Net Profit or Net Loss before income taxes), including Rental Income and Royalties, that would have been earned or incurred; and*

*... Continuing normal operating expenses incurred, including Payroll Expenses.... For manufacturing business, Net Income also includes the net sales value of production.*

*Extra Expense means the actual, necessary and reasonable expenses you incur during the Period of Restoration that you would not have incurred if there had been no direct physical loss of or direct physical damage to property caused by or resulting from a Covered Cause of Loss at “Scheduled Premises.”*

A typical definition of a “**Covered Cause of Loss**” states:

*Covered Causes of Loss means direct physical loss or direct physical damage ... unless the loss or damage is excluded or limited in this policy.*

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Finally, typical exclusions for a “**Covered Causes of Loss**” state:

We will not pay for loss or damage caused directly or indirectly by any of the following .... Presence, growth, proliferation, spread or any activity ... of ... virus.

...[or] Seizure or destruction of property by order of government authority.

...[or] The enforcement of, or compliance with, any ordinance or law ... Regulating the construction, use or repair of any property.

..[or] Discharge, dispersal, seepage, migration, release or escape of “**Pollutants and Contaminants.**” [Defined to include] ... solid, liquid, gaseous or thermal irritant or contaminant, including

...any other material which causes or threatens to cause physical loss, damage, impurity to property, unwholesomeness, undesirability, ... loss of use of property or which threatens human health or welfare.

...[or] We will not pay for loss or damage caused by, resulting from, or arising out of delay, loss of use, or loss of market.

### Analysis

The first and most critical coverage issue related business interruption coverage for “**Business Income**” and “**Extra Expense,**” is to “**trigger**” this insurance by demonstrating the existence of a “necessary interruption of your business operations ... due to direct physical loss or direct physical damage to property caused by or resulting from a Covered Cause of Loss....” Because the policy language uses the **disjunctive conjunction “or,”** an argument exists that actual “property damage” need not have yet occurred to trigger coverage because coverage is triggered by “direct physical loss or direct physical damage” and “if a physical loss could not occur without physical damage, then the policy would contain surplus language.” *Manpower, Inc. v. Ins. Co. of the State of Pa.*, 2009 WL 3738099, \*5 (E.D. Wis. Nov. 3, 2009); see also *Hampton Foods, Inc. v. The Aetna Cas. And Sur. Co.*, 787 F.2d 349, 352 (8th Cir. 1986) (finding “direct physical loss” to be ambiguous and construing language to apply to a building vacated due to danger of collapse before collapse occurred).

In other words, if tangible real or personal property (i.e., physical property as opposed to intangible property) cannot be used as normal, a “loss” of use of such tangible (or physical) property has occurred and the “or” alternative is triggered even if actual “damage” to such physical property has not yet occurred. Despite this straightforward interpretation that “**loss**” of use of tangible property is one of two alternative triggers of coverage, courts appear to generally require either (1) some physical damage somewhere even if outside the policyholder’s property, or (2) a direction from a **governmental entity** that impacts the real or personal property thereby triggering business interruption coverage. Courts also sometimes offer a confusing statement that the words “direct physical loss” do not apply to a “pure” “loss of use” claim. In reality, such a statement is more carefully understood as a recognition that the property not being operated as normal must be tangible property, not intangible property.

But even if loss of use without any “property damage” is insufficient to trigger coverage despite the “or” policy language, a number of cases have nonetheless held that a “physical” damage to tangible property occurs even when the damage is **non-structural or microscopic.** See *Mellen v. Northern Security Ins. Co.*, 115 P.3d 799, 802-03 (N.H. 2015) (cat odor that rendered apartment uninhabitable constitutes direct physical loss); *Farmers Ins. Co. v. Trutanich*, 858 P.2d 13323, 13335-36 (Ore. Ct. App. 1993) (methamphetamine odor physically damaged home); *Trevco Ins. Co. v. Ward*, 715 F. Supp. 2d 699, 709-10 (E.D. Va. 2010) (toxic gas from drywall that rendered property uninhabitable is a “**direct physical loss**”); *In re Chinese Manufactured Drywall Products Litigation*, 759 F. Supp. 2d 822, 832-33 (E.D. Co. 2010) (sulfur gas from drywall that rendered property uninhabitable constitutes physical injury to property); *Motorists Mut. Ins. Co.* 131 Fed Appx. 823, 825-26 (3rd Cir. 2005) (bacteria that allegedly made home uninhabitable can be considered “physical loss to property.”); *Oregon Shakespeare Festival Assoc. v. Great Am. Ins. Co.*, 2016 WL 3267247, \*5-6 (D. Or. June 7, 2016) (smoke from wildfire that entered outdoor venue resulting in **canceled performances** is a “direct physical loss of or damage to covered property including measures to clean were undertaken”);

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*Western Fire Ins. Co. v. First Presbyterian Church*, 437 P.2d 52, 55 (Colo. 1968) (accumulation of gasoline that rendered church uninhabitable pursuant to direction of fire authorities was “direct physical loss” even if “‘loss of use’ ... standing alone, does not in and of itself constitute a ‘direct physical loss.’”).

In addition, cases support that even if the property that suffers a physical damage is not owned by the policyholder, but instead, for example, by a neighbor, the policyholder’s “Business Income” and “Extra Expense” losses may be from the policyholder’s real or personal property that has not been physically damaged at all. See *Manpower*, 2009 WL 3738099, \*5 (coverage for “Business Income” and “Extra Expense” arising out of undamaged real and personal property of the policyholder); *Hampton*, 787 F.2d at 352 (same).

Assuming a business can **trigger business interruption** coverage either by convincing a court that “direct physical loss or direct physical damage” applies in a “loss of use” situation so long as the involved “property” is tangible, or that some “physical damage to property” occurred with **Coronavirus** as recognized, for example, in the order of New York’s governor, the next hurdle will be to navigate around the exclusions that apply to a “Covered Cause of Loss.” The good news is that coverage will exist for a “Covered Cause of Loss” under this “all-risk” language unless an exclusion takes away coverage.

As addressed below, the more difficult exclusions to overcome individually will be the exclusions for “virus” and the release or disposal of “Pollutants and Contaminants.” Policyholders, however, have a reasonable argument that none of these exclusions apply to “Business Income” or “Extra Expense,” as defined terms, at all. This is because these exclusions are applicable only to “physical” “damage” or “loss” “damage” to tangible “property” (real or personal), and these exclusions have no application to the intangible recovery of income or increased expenses embraced in the defined terms “**Business Income**” and “**Extra Expense**.” In addition, income and expenses are not “property” at all, and certainly not property that can be “physically” impacted.

Some business interruption policies expressly recognize this reality by drafting separate exclusions applicable to the defined terms “Business Income” and “Extra Expense,” thereby making clear that the exclusions for “physical” “loss” or “damage” to tangible property do not apply. While “standard” business interruption coverage language may not have these same separate exclusions applicable to “Business Income” and “Extra Expense,” such policies nonetheless imply that the tangible “physical” “property” exclusions have no application to intangible “Business Income” and “Extra Expense.”

For example, some policies include “**add on**” coverage for the cost to clean up virus, or to tear out property to gain access to virus, and the policy expressly deems these expenses to be “loss or damage to property.” This necessary additional language adds credence to the position that without such clarifying language, “physical” “loss” or “damage” to tangible real or personal “property” does not embrace expenses or income.

Similarly, and **perhaps even more importantly**, standard policies exclude “loss or damage caused by or resulting from . . . delay, loss of use or loss of market.”

If this exclusion is applicable to both tangible and intangible property, such as economic harm from lost “Business Income” or “Extra Expense,” what is covered? In other words, reading the words “direct physical loss or direct physical damage to property” to apply to intangible loss of money renders the coverage for “Business Income” and “Extra Expense” illusory.

While there is little authority addressing the issue of whether the exclusions for physical loss or damage to tangible property apply to “Business Income” or “Extra Expense,” one case has recognized that when a business is suspended, the insured can pursue “**Business Income**” **recovery** even if it does not seek “reimbursement for physical damages.” See *Fay v. The Hartford Ins. Co.*, 2019 WL 1014791, \*4-5 (D. N.M. March 4, 2019) (stating that endorsement for perils excepted may be ambiguous).

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If businesses do not prevail on the argument that the physical loss or damage exclusions simply do not apply to the terms “Business Income” and “Extra Expense,” such businesses nonetheless have additional arguments related to the exclusions that the industry will rely upon to deny business interruption coverage during the Coronavirus battle.

For example, the virus exclusion can be argued to be inapplicable because the loss of business income is not due to the spread of the virus among humans, but because of governmental directives (whether mandatory or precautionary) which have made it impossible to operate a business as previously operated, and ignoring even a precautionary directive could lead to legal liability if not followed, thereby demonstrating that the cause of loss is not excluded by the “**Covered Cause of Loss**” language. It is the absence of activity, not the infection of workers, for example, that causes the intangible loss of income and the additional expense.

Similarly, the pollution exclusion can be argued to not apply because the alleged pollution released (i.e., the virus) is again not the cause of the lost revenue. Lost revenue is due to the governmental directives and/or orders which have caused an absence of activity leading to lost revenues.

The exclusion for enforcement of ordinance or law can be argued to not apply because governmental directives or orders do not regulate property “use.” Instead, such orders direct individual human activity—stay at home if possible and at least six feet from other humans.

## Conclusion

If the insurance industry follows its history of drawing coverage lines based upon whether the particular policy language applies to tangible or intangible property, policyholders will likely have substantial coverage for business interruption losses. The insurance industry, however, will vigorously oppose coverage as foreshadowed by early efforts to distance themselves from the Covid-19 pandemic.



**Alan C. Bradshaw** is a founding member of Manning Curtis Bradshaw & Bednar PLLC. Mr. Bradshaw has assisted policyholders in obtaining the full benefits of insurance for over 30 years.

**Manning Curtis Bradshaw & Bednar PLLC**  
will continue to monitor the rapidly developing  
issues involving COVID-19.

**Contact your MCBB attorney for the latest and most  
current information.**

This newsletter is intended to provide an overview of specific federal guidance during the COVID-19 pandemic. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.

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