

Don't Assume 'Physical Loss' Language Bars Virus Coverage

By **Stacy Tucker** (April 1, 2020)

The global pandemic of COVID-19, or coronavirus, has affected individuals and businesses worldwide. The mandatory shelter-in-place orders issued by many U.S. have resulted in the shutdown of millions of businesses nationwide, as business owners and customers alike are forced to stay at home.

These businesses cannot serve customers or manufacture nonessential goods. While these measures are necessary to protect the health of our citizens, it creates an enormous economic problem.



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Many business owners rely on their commercial insurance policies to support them during times of catastrophe. These policies often include insurance for business income during forced interruptions of the business for various reasons. But most policies are unfortunately vague on how, or if, they provide coverage for lost business income during a pandemic.

Numerous articles are already opining on the likelihood of insurance coverage for these claims. A recent Law360 article, "Barriers to Insurance Coverage for COVID-19 Impact," summarily concluded that most general commercial policies would have no coverage without a specialized endorsement, as most commercial policies limit business income coverage to situations where there is "direct physical loss or damage" to the business premises.

The article devoted exactly three sentences to its cursory dismissal of the possibility of coverage under most commercial policies because of the physical loss or damage requirement. They similarly dismissed the likelihood of coverage under the civil authority language that typically provides coverage for business income interruption when a civil authority bars a business from using its premises because of direct physical loss or damage to another premises.

Where the premises of the business owners have sustained no structural damage, insurers and their counsel argue there cannot be physical loss of or damage to the building and therefore there is no coverage.

But the question is not that simple, because that article ignored that many courts have concluded that physical loss includes airborne contaminants, odors and bacteria, and is not limited to structural damage.

Direct Physical Loss

The phrase "direct physical loss" is not defined in most policies. Courts have adopted a wide range of approaches to interpreting the term in different circumstances. Some of those that most closely mirror the COVID-19 anticipated claims are claims relating to contamination.

Numerous courts have agreed that physical contamination of a property is considered a physical loss that triggers coverage of business income. In Minnesota, appellate courts confirmed that the presence of asbestos in a building was a physical loss, as was the presence of gasoline in the soil around a building.[1]

Courts in the Ninth Circuit have looked at the undefined term "direct physical loss." As the U.S. District Court for the Northern District of California noted, "The word 'physical' is defined as 'of or relating to material nature, or to the phenomenal universe perceived by the senses; pertaining to or connected with matter; material; opposed to psychological, mental, spiritual.'"[2]

An Oregon federal court took the analysis one step further. When an open-air theater shut down because of ambient wildfire smoke and poor air quality, it filed a claim for business income loss. The insurer denied the claim based on the lack of direct physical loss to the theater. The court noted that air was a physical thing, explaining that "certainly air is not mental or emotional, nor is it theoretical."

Structural damage was not required for there to be a loss and it was a stretch on the part of the insurer to impute that requirement where it was not in the policy. The theater had to be cleaned and air filters replaced repeatedly before business could resume, and the air quality had to improve. The court found coverage for the loss of business income.[3]

While courts have not considered whether viruses or pandemics constitute direct physical loss, bacteria has been determined to be the cause of direct physical loss triggering insurance coverage.[4] Gas leaks, ammonia spills, unpleasant odors and mold have all been found to be bases for direct physical loss that triggers the business income coverage in policies.[5] While myriad courts have found that these sorts of airborne or bacterial issues constitute physical loss, there are also courts that have disagreed and held that physical loss requires a structural component.[6]

While there is no clear precedent holding that viral contamination constitutes physical loss, there is ample precedent to confirm that many courts nationwide agree that physical loss does not require structural damage and can include airborne contaminants, and bacteria, because they can make inhabitants ill.

Given these facts, there is certainly a basis for arguing that a potentially deadly virus in the building constitutes a physical loss. This is especially true when the state government has come to the same conclusion and ordered most businesses to be closed.

Civil Authority and Physical Loss

Where most damage to business is currently occurring in the wake of the shelter-in-place orders around the country, an immediate question is whether or not these orders will create business income claims that fall under the civil authority coverage provided in many commercial policies.

Business interruption claims after evacuations provide a window into how courts may view such claims. Results have varied around the nation.

Georgia held that business income loss related to an evacuation in expectation of a hurricane was a covered loss, as a civil authority determined that buildings needed to close to protect against expected harm as seen in other areas first hit by the hurricane.[7]

Texas courts, meanwhile, came to the opposite conclusion, holding that the threat of damage did not meet the policy requirements of direct physical loss to other premises.

A court in South Dakota held that where a town was evacuated due to approaching wildfire,

the civil authority order to evacuate the town would have been covered as anticipating physical loss (had it not been for a 72 hour waiting period in the policy), but not the days after the order was lifted where many roads were still closed, as there was no order prohibiting customers from coming to the business.[8]

After the 9/11 terrorist attacks, some businesses made claims for business income interruption due to civil authorities shutting down the airlines, which impacted their businesses in airports or in the travel or hospitality industries. Courts across the nation uniformly held that the link there was too tenuous, because while the Twin Towers had been destroyed, the civil orders grounding flights did not prohibit people from visiting the premises of the harmed businesses.

COVID-19 Insurance Claims

With the shelter-in-place directives from the government, all people have been directly ordered not to visit the premises of businesses, including their own. Depending on the policy wording of the civil authority coverage for business income interruption insurance, coverage may require that the order be based on physical loss of or damage to other property.

The question remains unanswered — does a viral contamination constitute physical loss of a property? While actual contamination likely can constitute such a loss, how will courts view the repeated potential contamination by COVID-19 carried by individuals each time they enter the building?

Governments around the country have urged citizens to assume “they’re infected and everyone around is infected.” Per that directive, a building is repeatedly contaminated by individuals until the virus is eliminated in the region. This would seem to support the position that business income interruption coverage should extend until quarantine is lifted and the workplace can be sanitized.

The first known lawsuit related to a COVID-19 insurance claim was filed in the Civil District Court for the Parish of Orleans, State of Louisiana, on March 16 by a restaurant, Oceana Grill.[9] In *Cajun Conti LLC et al. v. Certain Underwriters at Lloyd's London et al.*, Oceana Grill sued Lloyd’s of London for a declaratory judgment that the insurer would be responsible for covering loss of business income under its policy during the pandemic.

The New Orleans mayor’s office filed an emergency declaration in court that same day limiting restaurant operations because COVID-19 “cause(s) property loss and damage in certain circumstances.”

Meanwhile, in the past two weeks, lawmakers in New Jersey, Ohio and Massachusetts have introduced bills in their state legislatures to retroactively mandate that commercial business interruption policies include COVID-19 as a covered loss. While these efforts demonstrate the widely held belief that insurance should provide coverage for COVID-19 claims, the bills may be unnecessary.

They may even prove harmful to insureds seeking coverage, as the lawmakers’ efforts suggest that currently there may be no coverage, a legal conclusion that no court has yet reached.

Will courts only find viral contamination if there is proof that a sick worker was in the building? Will the illnesses and deaths of thousands of Americans be enough to constitute physical loss at other premises, thus triggering the civil authority coverage? These questions

will be at the forefront of litigation on this subject and the answers are not yet clear.

The only answer that is clear? It is a mistake to assume that COVID-19 business interruption claims will be denied by the courts simply because they are not based on structural physical damage.

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[1] *Western Fire Ins. Co. v. First Presbyterian Church*, 165 Colo. 34, 437 P.2d 52, 55 (1968) (concluding plaintiff suffered direct physical loss to insured building when gasoline infiltrated soil surrounding basement, contaminating foundation and rooms and rendering use of building dangerous); *Sentinel Mgmt. Co. v. New Hampshire Ins. Co.*, 563 N.W.2d 296, 300 (Minn. Ct. App. 1997) (asbestos in building made use of the building dangerous which constituted "physical loss" of the building).

[2] *Patel v. Am. Econ. Ins. Co.*, No. 12-CV-04719-WHO, 2014 WL 1862211, at *5 (N.D. Cal. May 8, 2014) (defining "direct physical loss" when determining that feng shui consultant fees were not covered under business income expenses).

[3] *Oregon Shakespeare Festival Ass'n v. Great Am. Ins. Co.*, No. 1:15-CV-01932-CL, 2016 WL 3267247, at *9 (D. Or. June 7, 2016), vacated, No. 1:15-CV-01932-CL, 2017 WL 1034203 (D. Or. Mar. 6, 2017).

[4] *Cooper v. Travelers Indem. Co. of Illinois*, No. C-01-2400-VRW, 2002 WL 32775680, at *3 (N.D. Cal. Nov. 4, 2002) (when a tavern was forced to close by the health department because of water contaminated with e-coli, that constituted a physical loss that triggered the business income coverage, though plaintiff failed to prove their losses and costs); *Motorists Mut. Ins. Co. v. Hardinger*, 131 F. App'x 823, 828 (3d Cir. 2005) (where a well was contaminated by bacteria, it was a factual question for the jury to determine if that constituted a physical loss.).

[5] *Matzner v. Seaco Ins. Co.*, 1998 WL 566658 (Mass. Super. 1998) (holding that carbon monoxide levels in an apartment building sufficient to render building uninhabitable were a "direct, physical loss"); *Mellin v. N. Sec. Ins. Co., Inc.*, 167 N.H. 544, 115 A.3d 799 (2015) (smell of cat urine from neighboring apartment caused direct physical loss); *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of America*, Civ. No. 2:12-cv-04418 (WHW), 2014 WL 6675934, at *2, *3, *8 (D.N.J. Nov. 25, 2014) (ammonia spill physically transformed the air until it could be dissipated, causing physical loss); *Sullivan v. Standard Fire Ins. Co.*, 956 A.2d 643 (Del. 2008) (mold contamination in the walls constitutes a physical loss).

[6] *Universal Image Prods., Inc. v. Chubb Corp.*, 703 F. Supp. 2d 705 (E.D. Mich. 2010), aff'd sub nom. *Universal Image Prods., Inc. v. Fed. Ins. Co.*, 475 F. App'x 569 (6th Cir. 2012) (bacteria in duct work that needed to be cleaned and caused building to be shut down was not structural and therefore not a physical loss).

[7] Assurance Co. of Am. v. BBB Serv. Co., 265 Ga. App. 35, 36, 593 S.E.2d 7 (2003).

[8] By Dev., Inc. v. United Fire & Cas. Co, No. CIV. 04-5116, 2006 WL 694991, at *6 (D.S.D. Mar. 14, 2006), aff'd sub nom. BY Dev., Inc. v. United Fire & Cas. Co., 206 F. App'x 609 (8th Cir. 2006).

[9] Cajun Conti, LLC et al. v. Certain Underwriters at Lloyd's of London, et al.(La. Dist. Court, Orleans Parish).