Coverage for Business Interruption Losses Caused by the COVID-19 Pandemic from the Policyholder's Point of View

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INTRODUCTION

Thousands of policyholders across the country have made claims on their property insurance policies to recover business interruption losses resulting from suspended operations due to the COVID-19 pandemic. Their insurers have denied coverage with near uniformity. This paper outlines some of the policyholders' strongest arguments in favor of coverage under "all risk" property insurance policies for business interruption losses. A few caveats are in order. First, this paper does not purport to present a balanced view of the issues – a Google search or two will reveal hundreds of blog posts and articles written from the perspectives of insurers and policyholders. Second, with policyholders already having filed more than 1,000 lawsuits against their property insurers seeking to recover business losses caused by the pandemic, courts are issuing new rulings every day. The arguments discussed in this paper will continue to evolve, and some arguments will enjoy greater traction with the courts than others. Third, an understandable but incorrect conclusion after reading this paper would be that there is a clear path to coverage in every jurisdiction. That is not the case. Indeed, courts have ruled against policyholders on many of the issues discussed herein, and some jurisdictions have more favorable case law to policyholders than others.

Three key takeaways from this paper are: (1) insurance coverage law is state-specific, and with courts issuing sometimes conflicting rulings regarding coverage for COVID-19 business income losses, choice of law is a very important tenet of any coverage analysis. Along these lines, as pro-policyholder and pro-insurer lines of case law become more developed, policyholders and insurers should expect litigation

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maneuvering designed to secure a favorable court, jurisdiction, or judge; (2) there are compelling arguments in favor of coverage for business income losses arising out of the COVID-19 pandemic; and (3) in arguing in favor of coverage, policyholders should be mindful of the black letter rule of policy construction that ambiguous policy provisions must be interpreted in favor of coverage. As more courts issue conflicting rulings regarding whether property policies cover pandemic-related business interruption losses, the argument that the relevant language in those policies is ambiguous will continue to become stronger.

A. Insurance Law Is State-Specific, So Choice of Law Is an Important Consideration in Evaluating Coverage.

After carefully reviewing a complete copy of the policy, the first step in evaluating coverage for COVID-19 business interruption losses is determining which state's substantive law will apply to the interpretation of the policy at issue. The interpretation of some of the key policy provisions can vary from state to state, as can the interpretative principles used to evaluate coverage. Some of the earliest COVID-19 insurance decisions bear this out, with courts granting some insurers' motions to dismiss and denying others, despite similar policy language and facts.

Determining the substantive law that applies to a claim under a policy issued in the same state where the insured property is located is typically straightforward: the law of the location of the insured property usually will apply. However, many commercial policyholders buy property policies that cover properties in a multiple states, which can complicate choice of law issues.

Some property insurance policies contain choice of law clauses that specify the applicable state law that applies to the interpretation of the policy. Such clauses are not always enforceable, however.[2] In some jurisdictions, choice of law clauses are typically enforceable regardless of whether the policy has any connection to the specified state.[3] In other jurisdictions, a contractual choice of law provision may not be enforceable if the specified jurisdiction has no relation to the policies, the insured property, the insurer, or the insured.[4]

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[2] *See, e.g., Sturgeon v. Allied Prof'ls Ins. Co*., 344 S.W.3d 205, 210 (Mo. Ct. App. 2011) (declining to apply choice of law provision that would allow arbitration clause in an insurance policy to be enforced, which is contrary to Missouri public policy)

[3] *See, e.g,* GOL § 5-1401 (New York) ("The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection (a) of section 1-301 of the uniform commercial code , may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state")

[4] *Accord See Jones v. SWEPI L.P.*, 2020 U.S. Dist. LEXIS 7390 (W.D. Pa. Jan. 16, 2020).

In some jurisdictions, statutes specify the law that will apply to the interpretation of an insurance policy.[5] By way of example, a North Carolina statute provides that "[a]ll contracts of insurance on property, lives, or interests in this State shall be deemed to be made therein, and all contracts of insurance the applications for which are taken within the State shall be deemed to have been made within this State and are subject to the laws thereof."[6] Such a statute may result in the application of the law of a state other than the insured's principal place of business.[7]

In the absence of an enforceable contractual choice of law provision or statute, a choice-of-law analysis may be required. As a general matter, if there is no conflict between the substantive law of the forum state and the potentially applicable law of other states, the substantive law of the forum state will control. However, if there is an actual or potential conflict between the relevant substantive law of more than one state, then the court will be required to perform a choice-of-law analysis. Because choice of law rules are considered to be procedural, the choice of law rules in the forum state in which a coverage action is filed will control. There are a variety of tests that courts across the country use to determine the applicable law that applies to an insurance policy, including *lex loci contractus*,[8] the Restatement (Second) of Conflicts[9], the most significant contacts test,[10] Professor Leflar's "better law" analysis[11], the "governmental interest" test,[12] or some combination thereof.[13]

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[5] *See, e.g.,* Mont. Code. Anno., § 28-3-102 (Montana); 15 O.S. § 162 (Oklahoma); S.C. Code Ann. § 38-61-10 (South Carolina); S.D.C.L 53 1-4 (South Dakota); Va. Code. Ann. § 38.2-313 (Virginia).

[6] N.C. Gen. Stat. § 58-3-1

[7] *See, e.g., Collins & Aikman Corp. v. Hartford Accident & Indem. Co*., 106 N.C. App. 357 (1992), aff'd, 355 N.C. 91 (1993) (North Carolina law applied to insurance policy covering trucks located in North Carolina even though policy application and insured's principal place of business were located outside of North Carolina).

[8] *See Cherokee Ins. Co., Inc. v. Sanches*, 975 So.2d 287 (Ala. 2007).

[9] *See, e.g., Reichhold Chems, Inc. v. Hartford Acc. and Indem. Co*., 703 A.2d 1132, 1136 (Conn. 1997).

[10] *See, e.g., Lapham-Hickey Steel Corp. v. Prot. Mut. Ins. Co*., 655 N.E.2d 842 (Ill. 1995).

[11] *See, e.g., Schoffman v. Cent, States Diversified, Inc*., 69 F.3d 215, 219 (8th Cir. 1995).

[12] *See, e.g., Vaughan v. Nationwide Mut. Ins. Co*., 702 A.2d 198 (D.C. App. 1997).

[13] *See, e.g., Robert McMullan & Son, Inc. v. U.S. Fid. & Guar. Co*., 162 Cal. Rptr. 720 (Cal. App. 1980).

B. Triggering Coverage Under an "All Risk" Property Insurance Policy.

1. *"All Risk" Policies Cover Physical Loss or Damage from Non-Excluded Causes.*

Many, but not all, commercial property policies are "all risk" policies, sometimes referred to as "special form" policies. An "all risk" policy insures against all direct physical loss or damage to covered property resulting from any non-excluded cause of loss.[14] Relevant provisions can vary widely from policy to policy, and many commercial property policies are written on manuscript forms drafted by the insurer. Such manuscript forms must be read carefully, as a word or two can mean the difference between coverage and no coverage. Given that commercial property policy forms promulgated by the Insurance Services Organization ("ISO") are widely used in the insurance industry, this section of the paper sets forth relevant language from the ISO forms for illustrative purposes. It should never be assumed, however, that the ISO language is found in a policyholder's property policy, which must be reviewed on its own terms.

The ISO "special form" commercial property insuring agreement provides as follows:

> We will pay for direct physical loss of or damage to Covered Property at the premises described in the Declarations caused by or resulting from any Covered Cause of Loss.[15]

The ISO "Causes of Loss – Special Form" policy form provides, in turn, that "[w]hen Special is shown in the Declarations, Covered Cause of Loss means direct physical loss unless the loss is excluded or limited in this policy."[16]

By its terms, this insuring agreement does not extend coverage to business income losses caused by direct physical loss or damage. As discussed below, however, there are other insuring agreements commonly found in commercial property policies that do cover such losses.

2. *Many Commercial Property Policies Cover Economic Losses Resulting from the Inability to Use Property for Its Intended Purpose Due to Covered Physical Loss or Damage.*

In addition to covering physical loss of or damage to covered property, commercial property policies often provide "time element" coverage, which covers

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[14] *See Churchill v. Factory Mut. Ins. Co.*, 234 F. Supp. 2d 1182, 1189 (W.D. Wash. 2002) ("under an all-risks policy, the insured bears the burden of showing that it suffered a loss and that the loss is fortuitous . . . . However, the insured need not demonstrate the precise cause of damage for the purpose of proving fortuity.")

[15] ISO form No. CP 00 10 10 12, at p. 1

[16] ISO form No. CP 10 30 09 17, at p. 1.

economic losses incurred due to such physical loss or damage. For example, the ISO "Business Income (and Extra Expense) Coverage Form" provides such coverage as follows:

> We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit Of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss . . . .[17]

The term "suspension" is defined to mean "**a.** [t]he slowdown or cessation of your business activities; or **b.** That a part or all of the described premises is rendered untenantable, if coverage for Business Income Including 'Rental Value' or 'Rental Value' applies."[18] The "Period of Restoration" refers generally to the time period during which the "suspension" occurs.[19] And as noted above, "Covered Cause of Loss" means direct physical loss unless the loss is excluded or limited in this policy."[20]

An example of a non-ISO time element insuring agreement is set forth below:

> [We] will pay the actual business income loss sustained by you due to the necessary partial or total interruption of your business operations, services or production during the period of indemnity as a result of direct physical loss or damage to: (1) covered property by a covered cause of loss or (2) property of the type insured under this Policy by a covered cause of loss which directly affects your use of the covered property, provided that you are a lessee or occupant of the premises where the direct physical loss or damage occurred . . . [C]overed cause of loss means a peril or other type of loss, not otherwise excluded under this Policy.

Notwithstanding differences between time element coverage provided by ISO forms and manuscript policy forms, many commercial property policies contain the phrase "direct physical loss of or damage to" (sometimes worded "direct physical loss or damage to") in their time element insuring agreements. Accordingly, the threshold disputed issue between policyholders and insurers in nearly every time element coverage dispute arising out of the COVID-19 pandemic is what constitutes "direct physical loss or damage."

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[17] ISO form No. CP 00 30 10 12, at p. 1.

[18] *Id*. at p. 9.

[19] Determining the duration of the Period of Restoration and quantifying business interruption losses can entail a complicated analysis and is outside the scope of this paper.

[20] ISO form No. CP 10 30 09 17, at p. 1.

3. *Many Commercial Property Policies Cover Economic Losses Resulting from the Inability to Use Covered Property for Its Intended Purpose Due to A Civil Authority Order Barring or Limiting Access Due to Physical Loss or Damage to Non-Insured Property Occurring Within a Specified Distance of the Covered Property.*

A second type of time element coverage often found in commercial property policies is referred to as "Civil Authority" coverage. This coverage applies when access to insured property is barred or limited by a governmental order resulting from loss or damage to non-insured property located a specified distance from the insured premises. By way of example, the ISO "Business Income (and Extra Expense) Coverage Form" provides such coverage as follows:

> 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, provided that both of the following apply:
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> **(1)** Access to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the described premises are within that area but are not more than one mile from the damaged property; and
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> **(2)** The action of civil authority is taken in response to dangerous physical conditions resulting from the damage or continuation of the Covered Cause of Loss that caused the damage, or the action is taken to enable a civil authority to have unimpeded access to the damaged property.[21]

In evaluating for time element losses, it is important to bear in mind that each policy must be evaluated on its own terms, with some commercial property policies containing similar language providing broader or narrower coverage from others. For example, the "Civil Authority" coverage in one manuscript commercial property form is triggered "if the prohibition of access by a civil authority [is] the result of direct physical loss or damage to non-insured premises." This is different from the ISO form, which is triggered by "damage" to non-insured premises.

Set forth below is another example of a time element insuring agreement found in manuscript commercial property form:

> [We will p]ay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration." The "suspension" must be caused by direct physical loss of

[21] ISO form No. CP 10 30 09 17, at p. 2.

or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss.

C. Defining "Direct Physical Loss or Damage."[22]

1. *Policyholders and Insurers Disagree About the Meaning of "Physical Loss or Damage."*

As noted above, the threshold coverage issue is whether policyholders' business income losses arising from the COVID-19 pandemic were the result of "physical loss or damage." On an industry-wide basis, insurers have taken the position that the actual presence, or imminent threat of the presence, of SARS-CoV-2 or COVID-19 is not covered direct physical loss or damage.[23] A common formulation of property insurers' position on this issue is that "physical loss or damage" requires an "actual, tangible, permanent, physical alteration"[24] of covered property. Insurers then argue that the presence of SARS-CoV-2 is not a tangible and permanent alteration of property, and thus the insuring agreement has not been triggered. This position makes no attempt to distinguish between "physical loss" and "physical damage," essentially treating "loss" and "damage" as synonyms.

Although policyholders' responses have not been uniform, the strongest policyholder arguments have focused on the meaning of "direct physical loss" which is rarely, if ever, defined in property policies. Courts have recognized that "loss" and "damage" are not synonyms,[25] and each term must be afforded its own meaning. A reasonable interpretation of "direct physical loss" is the loss of the ability to safely use insured property for its intended purpose. The proliferation of COVID-19, the actual and imminently threatened presence of SARS-CoV-2, and resulting governmental shutdown orders precluded many commercial property policyholders from safely using their premises for their intended purposes.

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[22] For ease of reading, unless otherwise noted, this paper discusses the phrase "physical loss or damage to" and "physical loss of or damage" interchangeably. That is not to say, however, that these phrases are synonymous.

[23] *See, e.g.,* https://www.chubb.com/microsites/covid19-resource-center/_assets/pdf/covid-commercial-property-policyholder-notice-4-1-2020.pdf

[24] *See, e.g., Studio 417, Inc. v. The Cincinnati Ins. Co.*, No. 20-cv-03127 (W.D. Mo. Aug. 12, 2020).

[25] *Total Intermodal Servs. v. Travelers Prop. Cas. Co. of Am.,* No. CV 17-04908 AB, 2018 U.S. Dist. LEXIS 216917, *9 (D.C. Ca. July 11, 2018) ("to interpret 'physical loss of' as requiring 'damage to' would render meaningless the 'or damage to' portion of the same clause . . . ."); *Manpower Inc. v. Ins. Co. of Pa.*, No. 08C0085, 2009 U.S. Dist. LEXIS 108626, *19 (E.D. Wis., Nov. 3, 2009) ("the policy cover[s] physical losses in addition to physical damage, and if a physical loss could not occur without physical damage, then the policy would contain surplus language.").

2. *A Compelling Interpretation of "Direct Physical Loss" Is the Inability to Safely Use Covered Property for Its Intended Purposes Due to COVID-19 and/or Associated Governmental Shut-Down Orders.*

This position was explained cogently by the United States District Court for the Western District of Missouri in *Studio 417, Inc. v. The Cincinnati Insurance Co.*, No. 20-cv-03127. In *Studio 417*, a group of restaurants and hair salons that were shut down during the COVID-19 pandemic due to state closure orders issued in March and April 2020 sued their property insurers to contest a denial of coverage for business interruption losses. The policyholders alleged in their complaint that COVID-19 "'is a physical substance' . . . that allegedly attached to and deprived Plaintiffs of their property, making it 'unsafe and unusable, resulting in direct physical loss of the premises and property." The insurer filed a motion to dismiss, arguing that the policyholders had not suffered "direct physical loss" because there was no "tangible, physical alteration."

Denying the insurer's motion to dismiss, the *Studio 417* court sided with the policyholders, finding that that the preceding allegations "plausibly allege[] a 'direct physical loss.'" Noting that the insurance company could have defined "direct physical loss or damage" in its policy but failed to do so, the *Studio 417* court looked to the Merriam-Webster dictionary for guidance. Based on the dictionary definitions of "direct," "physical," and "loss," the court held that allegations that the insureds were deprived of the use of their premises due to the presence of COVID-19 on their properties were sufficient to withstand the insurer's motion to dismiss.

In consulting the dictionary to determine the meaning of "direct physical loss," the *Studio 417* court followed an approach to policy interpretation that is followed in most jurisdictions across the country: when a term is undefined in a policy, the court must rely on the term's plain and ordinary meaning. To be sure, the *Studio 417* decision was simply a ruling denying the insurer's motion to dismiss, and that does not necessarily mean that the insureds will recover their business interruption losses in that case. As the court explained, the insureds "have merely pled enough facts to proceed with discovery . . . all rulings herein are subject to further review following discovery." Regardless of whether the insureds' prevail on their coverage action, the *Studio 417, Inc.* court's interpretation of "direct physical loss" is rooted in fundamental principles of policy interpretation and should be persuasive to other courts addressing the same issue.

A similar interpretative approach was adopted by a North Carolina trial court in *North State Deli, LLC v. The Cincinnati Insurance Co.*[26] Awarding summary judgment to a group of insured restaurants seeking coverage from their property insurers for business interruption losses caused by governmental

[26] No. 20-cvs-02569 (Circuit Court for Durham Cty, NC, Oct. 9, 2020).

shutdown orders, the *North Street Deli* court looked to the Merriam-Webster dictionary guidance in interpreting "direct physical loss." Based on the dictionary definitions of "direct," "physical," and "loss," the court found that "'direct physical loss' describes the scenario where businessowners and their employees, customers, vendors, suppliers, and others lose the full range of rights and advantages of using or accessing their business property."

Noting that the "[p]laintiffs were expressly forbidden by government decree from accessing and putting their property to use for the income-generating purposes for which the property was insured," the court concluded that [t]hese decrees resulted in the immediate loss of use and access without any intervening conditions" and, therefore, "[i]n ordinary terms, this loss is unambiguously a 'direct physical loss,' and the Policies afford coverage." Rejecting the insurer's argument that "physical loss" requires "structural alteration to property," the court noted that such an interpretation would render meaningless the term "physical damage."

Despite similar reasoning, the *Studio 417* and *North State Deli* holdings are slightly different: the *Studio 417* court focused primarily on the potential presence of COVID-19 on the insureds' premises as causing direct physical loss, whereas the *North State Deli* court focused on the governmental orders as causing direct physical loss. However, as noted above, "all risk" policies do not require the policyholder to prove the cause of the "direct physical loss or damage." Rather, they require the policyholder to show that it incurred fortuitous "direct physical loss or damage," thereby shifting the burden of proof to the insurer to provide that the "direct physical loss or damage" was the result of an excluded cause of loss. Thus, both decisions lend support to the proposition that business interruption losses causes by the COVID-19 pandemic fall within the insuring agreement of an "all risk" property insurance policy.

3. *Pre-Pandemic Case Law Supports the Position That A Structural Alteration of Property Is Unnecessary for a Finding of Physical Loss or Damage.*

Support for the proposition that "direct physical loss or damage" can include a physical condition that renders property unsafe or unfit for its intended purpose

without a structural alteration of the property can be found in case law decided before the COVID-19 pandemic.[27] As one court explained:

> To accept [the insurance company's] interpretation of its policy would be to conclude that a building which has been overturned or which has been placed in such position as to overhang a steep cliff has not been "damaged" so long as its paint remains intact and its walls adhere to one another. Despite the fact that a "dwelling building" might be rendered completely useless to its owners, [the insurer] would deny that any loss or damage had occurred unless some tangible injury to the physical structure itself could be detected. Common sense requires that a policy should not be so interpreted in the absence of a provision specifically limiting coverage in this manner.[28]

Many of the pre-pandemic cases finding "direct physical loss or damage" due to the insured's inability to safely use its property for its intended purpose involve the presence of fumes, odors, smoke, or other substances that render the insured property temporarily or permanently unusable for their intended purpose. In one such case, the United States District Court for the District of Oregon held that an open-air theater that had to suspend performances until smoke from a nearby forest fire dissipated had sustained a "physical" loss even though the theater itself was structurally undamaged.[29] The court explained that the theater suffered a "loss of essential functionality" when smoke fumes rendered the property unusable, which is physical loss.[30]

In another case, the United States District Court for the District of New Jersey held that insured premises incurred direct physical loss when an accidental release of ammonia into the insured premises, a packaging facility, caused the

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[27] *See, e.g., Travco Ins. Co. v. Ward*, 715 F. Supp. 2d 699, 708 (E.D. Va. 2010) (discussing cases holding that physical damage to property is not necessary to trigger coverage when the property has been rendered unusable by a covered cause of loss); *Prudential Prop. & Cas. Ins. Co. v. Lillard-Roberts*, CV-01-1362-ST, 2002 WL 31495830, at 9 (D. Or. June 18, 2002) ("the inability to inhabit a building [is] a 'direct, physical loss' covered by insurance"); *Wakefern Food Corp. v. Liberty Mut. Fire. Ins. Co.*, 406 N.J. Super. 524 (N.J. App. Div. 2009) (Electrical grid that incurred temporary, non-structural damage was "physically damaged" until it was restored to service because "the grid and its component generators and transmission lines were physically incapable of performing their essential function of providing electricity.").

[28] *Hughes v. Potomac Ins. Co.*, 18 Cal. Rptr. 650, 655 (Cal. Dist. Ct. App. 1962).

[29] *See Oregon Shakespeare Festival Ass'n v. Great Am. Ins. Co.*, 2016 U.S. Dist. LEXIS 74450, at *13-15 (D. Or. June 7, 2016), vacated pursuant to parties' joint stipulation, 2017 U.S. Dist. LEXIS 33208 (D. Or. 2017).

[30] *Id.* at *15

facility to be shut down for one week while the ammonia dissipated.[31] To remedy the problem, the insured facility had to "air the property" and hire an outside company "to do the cleanup. . . Wash down anything with water . . . [They] brought in dry ice, trying to neutralize the [ammonia] inside the plant. Set up fans and all that."[32] The insurer argued that the ammonia contamination was not covered because "physical loss or damage" necessarily involves a "physical change or alteration to insured property requiring its repair."[33] The court disagreed, holding that "while structural alteration provides the most obvious sign of physical damage, . . . property can sustain physical loss or damage without experiencing structural alteration."[34] As such, the court concluded that the packaging facility incurred "physical loss of or damage" when ammonia gas was discharged into the facility's air. . . and rendered the facility temporarily unfit for occupancy."[35]

Other cases also have recognized that contamination or odors that render property uninhabitable, temporarily or permanently, can constitute "physical loss." For example:

- *Arbeiter v. Cambridge Mut. Fire Ins. Co.*, No. 94-00837, 1996 Mass. Super. LEXIS 661 (Mass. Super. Ct., Mar. 15, 1996) (presence of oil fumes in a building constituted a "physical loss" to the building);
- *Mellin v. N. Sec. Ins. Co.*, 115 A.3d 799 (N.H. 2015) (extreme odor caused by cat urine in downstairs apartment's plumbing system could constitute physical loss if it rendered the unit "uninhabitable.");
- *Farmers Ins. Co. of Ore. v. Trutanich*, 858 P.2d 1332, 1335–36 (Or. Ct. App. 1993) (finding that rental property sustained a direct physical loss because it was rendered uninhabitable by the odors from an illegal drug laboratory);
- *Cincinnati Ins. Co. v. German St. Vincent Orphan Ass'n*, 54 S.W.3d 661 (Mo. Ct. App. 2001) (Release of asbestos into the interior of a building constituted direct physical loss);
- *W. Fire Ins. Co. v. First Presbyterian Church*, 165 Colo. 34 (1968) (Accumulation of gasoline in church's foundation that led to the

[31] *See Gregory Packaging v. Travelers Prop. Cas. Co. of Am.*, 2014 U.S. Dist. LEXIS 165232 (D. N.J., Nov. 26, 2014).

[32] *Id*. at *11.

[33] *Id*. at *6.

[34] *Id*.

[35] *Id*. at *23.

intrusion of gasoline vapors into the building caused "direct physical loss");

- *Motorists Mut. Ins. Co. v. Hardinger*, 131 Fed. App'x 823, 825-27 (3d Cir. 2005) (Noting that bacterial contamination of well water could constitute direct physical loss (as opposed to direct physical damage) if the contamination rendered the house unusable);
- *TRAVCO Ins. Co. v. Ward*, 715 F. Supp. 2d 699, 709 (E.D. Va. 2010), *aff'd*, 504 Fed. Appx. 251 (4th Cir. 2013) (House incurred direct physical loss when toxic gas released by drywall rendered a home uninhabitable);
- *Mehl v. The Travelers Home & Marine Ins. Co.*, No. 16-CV-1325-CDP, 2018 U.S. Dist. LEXIS 74552 (E.D. Mo. May 2, 2018) (spider infestation in insured's home constituted "physical loss"); and
- *Yale University v. Cigna Ins. Co.*, 224 F. Supp. 2d 402 (D. Conn. 2002) ((asbestos and lead contamination constitute physical loss or damage).

For reasons similar to the preceding cases, some pre-pandemic decisions also recognize that the imminent threat of loss or damage at properties constitutes "physical loss or damage."[36] Moreover, some courts have recognized that governmental orders may trigger civil authority time element coverage when they are issued in response to an imminent threat of damage.[37]

D. Competing Lines of Case Law Render "Physical Loss or Damage" Ambiguous.

The cases discussed above support the policyholders' position that the business income losses of many policyholders arising out of the COVID-19 pandemic are the result of "physical loss or damage." The proliferation of COVID-19, the actual and imminently threatened presence of SARS-CoV-2, and resulting governmental shutdown orders precluded many commercial property policyholders from safely using their premises for their intended purposes. This loss of use is "physical loss or damage," which is covered by commercial property policies. To be sure, although not discussed herein, there are numerous cases upon which insurers will rely to attempt to defeat this position. Some of these cases are factually

[36] *See, e.g., Port Auth. of NY & NJ v. Affiliated FM Ins. Co.*, 311 F.3d 226 (3d Cir. 2002) (property may suffer physical loss or damage if "there is exists an imminent threat of the release of a quantity of asbestos fibers that would cause a loss of utility"); *Murray v. State Farm Fire & Cas. Co.*, 203 W.Va. 477 (1998) (rockfall that damaged neighboring property caused "direct physical loss" to insured's property because imminent threat of further rockfalls rendered property uninhabitable).

[37] *See, e.g., Assurance Co. of Am. v. BBB Serv. Co.*, 265 Ga. App. 35 (2003) (business income loss caused by evacuation in anticipation of imminent threat of hurricane constituted a covered loss because a civil authority determined that buildings needed to close to protect against expected harm as seen in other areas first hit by the hurricane).

distinguishable, whereas others are the result of unfavorable policyholder law in some jurisdictions (which is why choice of law analysis may become a key issue in many coverage disputes).

Notwithstanding the support provided by the cases cited herein, there is another path forward. In most jurisdictions, policyholders do not need to show that their interpretation in favor of coverage is the only correct interpretation of the relevant policy language. Rather, they must show only that their interpretation is reasonable. In arguing for coverage, policyholders should focus on the interpretative principal that an ambiguous policy provision must be interpreted in favor of coverage.[38] A provision is ambiguous if it is subject to more than one reasonable interpretation. Conflicting cases decided to date support the position that the phrase "physical loss or damage" and "physical loss of or damage" are ambiguous.[39] And if they are ambiguous, they should be interpreted against the insurer.

Conclusion

Establishing "direct physical loss or damage" does not necessarily mean that policyholders' business income losses will be covered. It is simply the first step in proving coverage; policyholders still will face complicated issues regarding calculation of damage and other issues. However, such a showing will shift the burden of proof to insurers to establish that such physical loss or damage was caused by an excluded cause of loss.

The most commonly-cited exclusions purport to eliminate coverage for certain sets of facts involving viruses. These exclusions are not uniformly worded and must be reviewed carefully. These exclusions will be subject to a variety of challenges,

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[38] *See Phillips v. Lincoln Nat'l Life Ins. Co*., 978 F.2d 302, 312 (7th Cir. 1992) ("[T]he *contra proferentem* rule . . . is followed in all fifty states and the District of Columbia, and with good reason. Insurance policies are almost always drafted by specialists employed by the insurer. In light of the drafters' expertise and experience, the insurer should be expected to set forth any limitations on its liability clearly enough for a common layperson to understand; if it fails to do this, it should not be allowed to take advantage of the very ambiguities that it could have prevented with greater diligence.").

[39] *See, e.g., Minkler v. Safeco Ins. Co. of Am.,* 232 P.3d 612, 624 (Cal. 2010) (The ambiguity created by competing lines of case law "must be resolved, if possible, in a way that preserves the objectively reasonable coverage expectations of the insured . . . ."); *Crawford v. Prudential Ins. Co. of Am*., 783 P.2d 900, 908 (Kan. 1989) ("[T]he reported cases are in conflict [and] the trial judge and the Court of Appeals reached different conclusions . . . . Under such circumstances, the clause is, by definition, ambiguous and must be interpreted in favor of the insured."); *Allstate Ins. Co. v. Hartford Accident & Indem. Co*., 311 S.W.2d 41, 47 (Mo. Ct. App. 1958) ("Since we assume that all courts adopt a reasonable construction, the conflict is of itself indicative that the word as so used is susceptible of at least two reasonable interpretations, one of which extends the coverage to the situation at hand.").

including regulatory estoppel[40], arguments that they apply only to traditional pollution[41], and arguments that internal inconsistencies in policy language render them ambiguous and unenforceable.

At bottom, however, there is strong support under the law of many jurisdictions – as well as persuasive support for jurisdictions that have not addressed the issues discussed herein – for the position that commercial property policies should cover business income losses arising out of the COVID-19 pandemic. To maximize coverage, policyholders are advised to review policy language carefully, focus on analogous case law, assert arguments based on ambiguities, and not accept as true the insurance industry's position that commercial property policies do not cover business income losses arising out of the COVID-19 pandemic.

[40] *Sunbeam Corp. v. Liberty Mut. Ins. Co.,* 781 A.2d 1189, 1192–93 (Pa. 2001) ("Thus, having represented to the insurance department, a regulatory agency, that the new language in the 1970 policies—'sudden and accidental'—did not involve a significant decrease in coverage from the prior language, the insurance industry will not be heard to assert the opposite position when claims are made by the insured policyholders."); *Morton Int'l, Inc. v. Gen. Accident Ins. Co. of Am.*, 629 A.2d 831, 875 (N.J. 1993) (applying regulatory estoppel to prevent the insurers from interpreting "sudden and accidental" in a manner that was inconsistent with their representations to state insurance commissioners).

[41] *See, e.g., Parks Real Estate Purchasing Grp. v. St. Paul Fire & Marine Ins. Co*., 472 F.3d 33, 44 (2d Cir. 2006) (word "contamination" is ambiguous because it is a term of art in environmental law that applies only to discharges of pollutants into the environment).