Updates
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COVID-19 Business Interruption Litigation: Lessons Learned So Far

Since the start of the pandemic, hundreds of businesses of all sizes have been forced to file lawsuits against their property insurers for failing to honor their contractual obligations to provide business interruption, extra expense, civil authority, and other coverage for the substantial losses caused by the COVID-19 pandemic. Unfortunately, this onslaught of litigation has produced little progress thus far, leaving hundreds of business-owner plaintiffs and thousands more interested outside observers waiting for the funds they are rightfully owed. At this point, the insurance industry's steel-curtain strategy towards America's businesses seems to be working. The insurer strategy has been further fueled by two recent early-stage rulings in Michigan, Texas, and the District of Columbia favoring insurers in disputes involving COVID-19 business-interruption claims. A recent decision from Missouri, on the other hand, favors policyholders and allows a claim to proceed to discovery. The following update discusses the lessons that businesses can learn from these early decisions and proposes guidance on how to generate meaningful progress towards timely resolution of such COVID-19 coverage disputes. Given the continuing prevalence of COVID-19 in our communities and the overreaching sense of economic uncertainty pervasive in the country right now, it is incumbent upon courts and both the policyholder and insurer bars to reach speedy, but accurate, resolutions of such claims.

Lessons Learned From the First Wave of COVID-19 Business-Interruption Coverage Decisions

Before delving into the business interruption coverage decisions handed down in recent weeks, we offer several words of caution. First, each of these cases involved early pleading motions. Second, several of these decisions come from jurisdictions with unclear lines of authority on property insurance coverage disputes. Finally, the issue of whether COVID-19 causes "property damage" likely needs discovery and a trial—not just resolution on a motion. Some of the related issues, such as whether civil authority coverage can be triggered by orders without "property damage" at an insured location, or the meaning of various policy exclusions, might be resolvable by summary procedures, but the threshold issue in many instances will remain. We discuss below the options for policyholders to reach these more fact-intensive issues in a timely fashion.

First, if there is any clear message from the first set of decisions, it is that policyholders need to plead very specifically that COVID-19 caused property loss or damage in order to trigger their property policies. In both *Gavrilides Management Co., et al. vs. Michigan Insurance Co.*, No. 20-258-CB, 2020 WL 4561979 (Mich. Cir. Ct. July 21, 2020), and *Rose's 1, LLC v. Erie Ins. Exchange*, No. 2020 CA 002424 B, 2020 WL 4589206 (D.C. Super. Aug. 6, 2020), the judges ruled that the policies at issue required some evidence of actual physical damage to property that had structurally altered the property. These rulings were made even though the policies at issue used extraordinarily broad, undefined policy terms and contained no provisions that mention, much less require, "structural," "alteration," or structural "integrity." The complaints in *Gavrilides* and *Rose's 1* alleged some type of damage to property from COVID-19, but both courts determined that there was no adequate claim of "property damage" because both complaints also alleged that losses incurred after government orders shuttered the properties were covered under the policies civil authority clauses. Both courts additionally believed that the policies at issue required physical alteration to property *before* the civil authority orders were issued in order to trigger coverage. Thus, policyholders must plead plainly and clearly that COVID-19 caused actual, physical damage or loss to their property to overcome these hurdles.

Second, policyholders must plead allegations explaining the nature of COVID-19 to the court, including describing in detail *how* COVID-19 caused a "loss" of, or "damage" to, property. In *Gavrilides*, the court ignored the policyholder's basic allegations that COVID-19 caused physical damage to the property. Even more concerning, the court found that the presence of COVID-19 is not "direct physical loss" because the virus is not "something that is tangible, something … that alters the physical integrity of the property." The policyholder attorney chose to argue instead that loss of access to the property from civil authority orders was the cause of loss, rather than focusing on the factual issue of physical loss and damage caused by COVID-19. The court also denied leave to amend to allow the business to cure any alleged "loss or damage" pleading defects. Although this is an issue of first impression in Michigan, a prior U.S. Circuit Court for the Sixth Circuit case applying Michigan law had required structural alteration to the property or that the property be "rendered uninhabitable or substantially unusable," which makes this decision less surprising. In *Universal Image Productions, Inc. v. Federal Ins. Co.*, 475 Fed.Appx. 569, 575 (6th Cir. 2012) mold and bacterial contamination were not considered "physical loss" to property. At the same time, other Michigan cases have reached different conclusions, albeit in instances where other property had been physically damaged. In *Sloan v. Phoenix of Hartford Ins. Co.*, 46 Mich. App. 46 (1973), an executive order imposing curfew and closing businesses due to widespread riots considered physical loss. Although the implicated movie theater did not sustain physical damage, the policy provided for coverage against interruption of business due to riots. As determined in *Southlanes Bowl, Inc. v. Lumbermen's Mut. Ins. Co.*, 46 Mich. App. 758, 760 (1973), "where the insured businesses were closed by order of a civil authority, physical damage to the insured premises was not a prerequisite to the insurer's obligation to reimburse the insured for the net losses resulting therefrom." Many other jurisdictions have found that structural alteration is not required for there to be "physical loss or damage" triggering coverage, especially where the words "structural" and "alteration" neither are anywhere in any property policy nor constitute the common meaning of the policy terms.

Likewise, in *Rose's 1*, the policyholder's briefs plainly argued that there was property damage and that no structural alteration was required to trigger the business interruption coverage, but the court yet again seemed to think that the case involved mainly the effect of government orders. The court explained its ruling for the insurer by reasoning that "[s]tanding alone and absent intervening actions by individuals and businesses, the orders did not effect any direct changes to the properties." *Rose's 1*, 2020 WL 4589206, at *2. The court also observed that the policyholder "offer[ed] no evidence that COVID-19 was actually present on their insured properties at the time they were forced to close," *Id.* and the mayor's orders directing the business to close did not have any affect on the material or tangible structure of the insured properties. The *Rose's 1* analysis (or lack thereof) was echoed in *Diesel Barbershop LLC et al. v. State Farm Lloyds*, No. 5:20-cv-00461-DAE (W.D. Tex. Aug. 13, 2020). In that case, the court similarly concluded based on a cursory review of selective case law that "direct physical loss" policy language requires a physical alteration of property and determined with almost no explanation that COVID-19 did not cause any "alteration."

These rulings did not even attempt to understand how COVID-19 and any related governmental orders affected businesses. For one, the government orders themselves materially affected direct changes to the properties, because the properties were deemed unfit for use for their intended purposes due to the presence of COVID-19. The outcome would have been no different than if the District of Columbia Department of Health had shut the property down because of a health hazard in the kitchen, or if the district's Department of Energy and Environment had shut the property down due to the presence of a biohazard. Moreover, the court's conclusions in *Rose's 1* ignored the fact that, at the relevant time, COVID-19 was present everywhere in the District of Columbia and that the district lacked adequate testing capacity to truly evaluate the scope of the community spread. Thus, the policyholder presented at least a cognizable, colorable claim for loss.

Third, policyholders whose policies are triggered by "direct physical loss or damage" must use their pleading to explain the difference between "loss" and "damage" and plead separate allegations for both. In the *Rose's 1* case,

the court opined on the distinction between "loss" and "damage" and concluded that the words "direct" and "physical" modify "loss" such that "any 'loss of use' must be caused, without the intervention of other persons or conditions, by something pertaining to matter—in other words, a direct physical intrusion on to the insured property." *Id.* at *3. This analysis turns "loss" and "damage" into a distinction without a difference. But, more importantly, it ignores that there was an intrusion: COVID-19 physically "intruded" into the property and all properties in the greater D.C. area. As a result, Mayor Muriel Bowser was compelled to shut down all businesses, because the omnipresence of COVID-19 and the potential for additional community spread made it dangerous for the businesses to operate.

Many courts have opined on the difference between "loss" and "damage" and, of equal importance, the need to read an insurance policy to give meaning to every word in the policy. Policyholders can avoid the fate of the *Rose's 1* plaintiffs by making a clearer record on this critical issue from the outset.

The wisdom of fulsome pleading on the subject of property damage and loss as well as civil authority is underscored by the one victory for policyholders so far in defeating a Motion to Dismiss in *STUDIO 417, et al. v. The Cincinnati Insurance Company*, No. 20-CV-03127-SRB, 2020 WL 4692385 (W.D. Mo. Aug. 12, 2020). In *Studio 417*, the court found that both a restaurant and a hair salon adequately alleged, in more than 10 detailed paragraphs, the presence of COVID-19 in their premises, which presence caused physical loss to the property because it remained on surfaces; there was no need for actual physical damage or structural alteration. The court cited numerous decisions from various jurisdictions such as *Port Authority v. AFM*, 311 F.3d 226 (3d. Cir. 2002) , and *Gregory Packaging v. Travelers Insurance Co.*, No. 2:12-cv-04418, 2014 WL 6675934 (D.N.J. Nov. 25, 2014), to support its conclusion that the mere presence of a virus on the property can meet the physical-loss requirement. For purposes of ruling on the motion to dismiss, the court also correctly presumed that the allegations in the complaint were true (which the *Gavrilides*, *Diesel Barbershop*, and the *Rose's 1* decisions did not seem to do) and said that there needed to be discovery on the issues. The *Studio 417* court further found that the same allegations supported claims for civil authority, ingress and egress, dependent property, and sue and labor coverage. The court also rejected the carrier's attempt to require a complete ban on access to the premises as part of a civil authority claim.

Finally, to avoid dismissal, policyholders must read these decisions as reinforcing the importance of building a strong factual record for their coverage cases, and of including sufficient explanations of that record in the complaint. Two courts (*Rose's 1* and *Gavrilides*) decided there was no factual proof that there was COVID-19 on the insured property. These courts should instead have allowed discovery on the existence of COVID-19 at the properties. After discovery, the carriers may have argued that an actual test proving the existence of COVID-19 was necessary to trigger their policies, while the policyholders could have presented evidence that COVID-19 was present everywhere in the area and thus in their properties. This would have given the courts a more fulsome record to review and provided a clearer case for appeal in the event of an unfavorable ruling.

None of these cases have fully reached what may be the more complex issue of enforcing various applicable exclusions, including the 2006 SARS 1 specific virus exclusion. The only case to evaluate a strict "virus" exclusion thus far, *Diesel Barbershop*, issued a very narrow ruling focused almost entirely on the anti-concurrent causation language in the policy. After determining that such language was valid and enforceable, the court determined that the virus exclusion applied because "[w]hile the [government] Orders technically forced the Properties to close to protect public health, the Orders only came about sequentially as a result of the COVID-19 virus spreading rapidly throughout the community. Thus, it was the presence of COVID-19 in Bexar County and in Texas that was the primary root cause of Plaintiffs' businesses temporarily closing." *Diesel Barbershop*, slip op., at 17. This decision presented a limited overview of the causation issue and of the exclusion's application, ignoring any relevant drafting history or potential ambiguity. The *Gavrilides* decision also addressed the SARS exclusion in cursory fashion and found it to be clear, but—as in *Diesel Barbershop*—the court was not presented with any information beyond the language of the exclusion itself. The application of the virus exclusion and the

causation language surrounding it will inevitably involve an inquiry into the history of each exclusion and the meaning of its language, especially as compared to other exclusions sold in the marketplace and industry custom and practice. Different insurers' policies also do not uniformly adopt the same exclusions, and the law differs from state to state. Thus, there is much left to litigate, and these issues may not, and likely should not, be resolved on early motions, further reinforcing the need to build a strong evidentiary record.

Where Do We Go From Here?

Given the likely need for costly and extensive litigation, businesses across the country that are already hurting must figure out how to traverse the unknown legal landscape. Courts and coverage attorneys must think critically about these issues, for the benefit of all parties involved. Several COVID-19 business interruption coverage disputes have been filed as class actions, but—unless these cases are segregated by type of business, type of policy form, and governing state law—there may be too many disparate issues and choice-of-law challenges to allow class treatment. Several motions arguing precisely that have already been filed by carriers.

The other usual method of dealing with a large number of similar cases, a federal multidistrict litigation (MDL), has also run into opposition. Policies are governed by state law, so that each of these legal and factual issues will have to be viewed through the lens of the law of 50 different states. As such, at a recent hearing on the first MDL petitions, the petitions were met with universal opposition from the carriers as well as many arguments in opposition from sophisticated policyholders that prefer to prosecute the special clauses of their policies, and the particular facts underlying their claims, in their own separate cases. Yet, if tens of thousands of cases are ultimately filed, courts may have to consider a consolidated procedure at least for discovery of common facts. For example, the current putative MDLs have pending requests for the legislative history of each of the relevant exclusions, which could streamline those issues in many other cases. In an order issued on August 12, the Judicial Panel on Multidistrict Litigation rejected full consolidation and suggested that some limited consolidation by carrier might be a good idea. The order suggests possible single-carrier MDLs for several major insurer groups: The Hartford, Society Insurance Company, Cincinnati Insurance Company, and Certain Underwriters at Lloyd's of London.

At some point, there may well be a need for test cases. As we have reported, the United Kingdom is engaging in this approach for COVID-19 claims. The UK test case proceeded to a hearing in the last two weeks of July, and a decision is expected in the fall. Based on the parties' submissions and the hearing transcript, it appears that several issues such as partial closure, proximate cause based on an order, *contra proferentem*, and proof of presence of a virus will be ruled on in the UK case, albeit under law different from any in the U.S. Still, United States courts have used similar test-case procedures before, including most recently in the highly visible *In Re: National Prescription Opiate Litigation* MDL. As we have discussed, policyholders might benefit from a similar procedure, even if the results of each test case were not binding on all other cases. Certainly, common discovery on issues present in most cases could accelerate resolutions.

In sum, both business policyholders and insurers have a long road to travel in resolving COVID?19 business interruption coverage disputes. Struggling businesses, however, do not have the luxury of time and must be thoughtful in advancing their insurance claims by maximizing lessons learned from other cases and pursuing the best litigation or negotiation strategy for their situation.

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