

Business Interruption Claims: Provide Prompt Notice and Document Your Losses

A White Paper by Taft's Insurance Coverage and Recovery Industry Group

I. Introduction

As corporate counsel consider the ways to mitigate the financial impact from the COVID-19 crisis, Taft's Insurance Coverage and Recovery Practice recommends that they look closely at whether their insurance can be a source of assistance. Outside of specific coverages designed to cover losses from pandemics, many businesses may find that their commercial property insurance policy provides coverage to offset their lost income and extra expense under the coverages for business interruption, contingent business interruption, extra expense, and civil authority.

And even if your policy specifically excludes losses from viruses, there are various legislative efforts and lawsuits underway challenging those exclusions. For example, a bipartisan group of members of Congress recently asked insurance industry groups to recognize COVID-19 as a covered claim under business interruption insurance notwithstanding any exclusions. Not surprisingly, the insurance industry promptly rejected this effort.¹ A bill proposed in New Jersey, since withdrawn, would have required insurers to pay COVID-19 losses as business interruption claims.² Given the mounting losses, additional legislative efforts to cover COVID-19 losses through insurance are expected.

Taft attorneys have successfully obtained insurance benefits in many cases where insurers have denied coverage to our clients on the basis of policy terms, conditions, and exclusions, or have refused to defend our clients from lawsuits. We expect to fight insurers on coverage issues in response to an expected wave of denial letters from insurers in response to the COVID-19 crisis. For instance, a lawyer in Louisiana stated that insurance companies are telling brokers to advise policyholders that they are not covered for any losses resulting from civil authority orders closing businesses.³ The Louisiana case, which Taft is not involved in, involves a coverage dispute over whether these losses result from "direct physical loss or damage" to covered property. Insurers are of the position that only tangible structural damage to

¹ Insurers Reject House Members' Request to Cover Uninsured COVID Business Losses, Insurance Journal, March 20, 2020, available at <https://www.insurancejournal.com/news/national/2020/03/20/561810.htm>.

² Proposed N.J. Bill Would Require Insurers to Pay COVID-19 Business Interruption Claims, E. Blossfield, Insurance Journal, March 19, 2020, available at <https://www.insurancejournal.com/news/east/2020/03/19/561643.htm>.

³ Restaurant Suit Tests Business Interruption Insurance for Coronavirus Shutdowns, J. Sams, Insurance Journal, March 19, 2020, available at <https://www.insurancejournal.com/news/national/2020/03/19/561638.htm>.

property constitutes “direct physical loss or damage” covered under a policy. But, we have litigated and won many cases in which contamination that does not affect the tangible structure of property has been held to result in property damage triggering insurance coverage.

Below we describe some of the key policy provisions, provide examples of how they may apply in unexpected ways to allow our clients to obtain coverage, set out important considerations for making, preserving, and proving your claims, and explain why it is so important to give timely notice. Note that this white paper is not intended to advise you on your policies, but rather to encourage you to speak with your Taft attorney and members of our Insurance Coverage and Recovery Practice about your ability to recover your lost earnings and extra expense.

II. Insurance Coverages That May Pay Your Financial Losses

Your company’s commercial property insurance offers additional coverages that may pay for your company’s lost earnings, certain continuing expenses, and extra expense incurred as a result of the COVID-19 crisis. The coverages that require examination include business interruption, contingent business interruption, civil authority, and extra expense coverage. Each is briefly described below with the issues that can arise when presenting such claims.

A. Business Interruption Coverage

1. What does this insurance cover?

Business interruption insurance is designed to cover your company’s lost profits and certain continuing expenses following a covered loss. For example, if your business suffered a fire and had to remain closed for several weeks during repairs, your business interruption insurance would pay you for your loss of earnings and for certain continuing expenses, such as employee compensation, until you could reopen for business.

2. What are the coverage issues for this type of insurance?

The most common policy forms cover lost profits and continuing expenses attributable to “direct physical loss or damage” to “insured property” at the “insured premises” or premises near the insured premises caused by a “covered cause of loss.” The three key questions are under this policy language are:

- 1) is there direct physical loss to insured premises;
- 2) was it caused by a “covered cause of loss”; and
- 3) has the insured proven it has suffered covered losses.

Other formulations of this coverage exist and the extent of the coverage will depend on the specific policy language. But in some cases, the trigger may be as broad as was there “injury to property.”

The terms “insured property” at “insured premises” are usually defined in the policy. “Insured premises” is often defined by address. But in some cases, this may include real and personal property used, leased, or controlled by the insured. For example, a building maintenance contractor servicing the World Trade Towers was found entitled to coverage for lost profits otherwise earned servicing the World Trade Towers. In that case, the policy defined insured property to include “the interest of Insured in all real and personal property owned, controlled, used, leased or intended for use by the Insured.” Rejecting the carrier’s arguments that the insured did not use the World Trade Towers because the insured’s headquarters was elsewhere, the court found that the insured “used” the World Trade Towers sufficiently to trigger coverage.⁴ Arguments like this may help service providers obtain business interruption coverage even though access to their actual offices has not been proscribed.

Courts formulate the “direct physical loss or damage” requirement in a broad number of ways. Some courts require distinct, demonstrable, physical alteration of the property and as a result, for example, the presence of mold is not sufficient.⁵ Courts also often say that “direct physical loss or damage” does not encompass mere economic losses untied to physical injury.⁶ But in a host of other decisions, courts have found coverage when a building is uninhabitable or substantially unusable. Based on this formula, courts have found the requirement satisfied when, for example, asbestos is present in the air of the building,⁷ the building contains mold,⁸ or gasoline fumes have infiltrated the building.⁹ One means of meeting this requirement would be to have test data to show that an insured building’s surfaces are contaminated by COVID-19. While insurers might challenge this by saying that the building can simply be cleaned, a counter argument might be that continued use of the building would result in ongoing presence of the virus that could not be successfully prevented by use of the building as intended. This is akin to the presence of asbestos inside the air of the building where although the building can perhaps be continually ventilated, the asbestos always returns. Courts might also be receptive to arguments, especially in policies that also provide coverage for losses due to physical injury at nearby premises, that the generally pervasive presence of the coronavirus is enough to satisfy this requirement. Evidence of the pervasive presence of the virus may be found in epidemiological data that, as suggested by recent articles, a high percentage of people in a given area have the virus even if they are not symptomatic. This kind of argument also might be accepted as to policies requiring “direct physical loss or damage”. Finally, as to policies that simply condition the coverage on “loss” or “damage” to “property”, the general presence of the

⁴ *Zurich American Ins. Co. v. ABM Industries, Inc.*, 397 F.3d 158 (2nd Cir. 2005).

⁵ *MRI Healthcare Ctr. Of Glendale, Inc. v. State Farm Gen. Ins. Co.*, 187 Cal. App. 4th 766, 115 Cal. Rptr. 3d. 27, 37-38 (Cal. Ct. App. 2010).

⁶ *Verrill Farms, LLC v. Farm Family Cas. Ins. Co.*, 18 N.E.3d 1125, 1129 (Mass. App. 2014).

⁷ *Port Auth.,. Of New York and New Jersey v. Affiliated FM Ins. Co.*, 311 F.3d 226, 236 (3rd Cir. 2002)

⁸ *Prudential Prop. & Cas. Co. v. Lillard-Robers*, CV-01-1362-ST, 2002 WL 31495830, at *9 (D. Or. June 18, 2002)

⁹ *W. Fire Ins. Co. v. First Presbyterian Church*, 165 Colo. 34, 437 P.2d 52, 55 (1968).

COVID-19 virus within the community or the effect the virus has on an insured's business may satisfy the "loss" or "damage" requirement.

Also, the word "direct" is frequently said to mean not "but for" or remote causation but an immediate or proximate causation.¹⁰ Carriers will likely argue that COVID-19 does not directly cause losses suffered here. The examples and discussions above, however, provide useful rebuttal argument.

As for the requirement that the loss is due to a "covered cause of loss", some policies list specific covered causes of loss (e.g., fire, lightning, windstorm, etc.). Other policies cover "all risks" of loss. It is generally easier to obtain coverage under an "all risks" policy than one that covers specified causes of loss, especially as related to COVID-19.

3. How do you prove your losses?

Proof of lost profits generally requires proof of the profits that would otherwise have been earned. Courts often require that policyholders demonstrate their lost profits to a "reasonable certainty,"¹¹ but this standard is not necessarily as daunting as it sounds. This can be a complicated analysis and forensic accountants usually work with the insureds and their attorneys to put this portion of the claim together. But experts can be hampered by an insured's failure to properly document the reason for a particular action or cost in the middle of a crisis. This is particularly true when insureds continue to operate but to a reduced degree. For instance, if an airline can't perform required daily maintenance on all aircraft due to an insured event, but records the reason why a particular flight is canceled as simply "maintenance," which is a common event, or another category that's even less helpful, it may be difficult to recover all of the losses suffered. Depending on the type of business, it may be worthwhile to examine business processes to assess whether changes need to be made to ensure full documentation. As a further example, in proving the extent of lost profits, certain expenses incurred during the loss period that would not have been incurred but for the insured event likely can be excluded from the analysis of business profits. Such expenses should be tracked in a specific general ledger of accounts or subaccounts tracking expenses. As discussed below in more detail regarding coverage for extra expenses, to ensure these expenses are excluded it may be advisable to set up specific accounting mechanisms to track losses. Documentation of other decisions related to choices made in connection with the crisis can be extremely helpful.

¹⁰ *Norwich Union Fire Ins. Soc. V. Bd. of Comm'rs of Port of New Orleans*, 141 F.2d 600, 601 (5th Cir. 1944).

¹¹ *Polytech, Inc. v. Affiliated FM Ins. Co.*, 21 F.3d 271, 276 (8th Cir. 1994)

B. Contingent Business Interruption Coverage

1. What does this insurance cover?

Contingent business interruption insurance covers loss of earnings and certain continuing expenses resulting from a covered cause of loss to premises of third parties, such as key suppliers or distributors for your products and services. For example, if your key supplier's building was closed as a result of a fire, your contingent business interruption insurance could be triggered. Like business interruption coverage, this type of coverage often requires "direct physical loss" to the third party premises, but not always. Another variant of this coverage covers losses due to the closure of something like a stadium on which the business is dependent.

2. What are the coverage issues for this type of insurance?

One of the main coverage issues for contingent business interruption claims is whether the supplier's inability to supply products or services resulted from a covered cause of loss. One issue with respect to COVID-19 losses will be whether the supplier closed because of the presence of the virus at its place of business or in response to a stay at home order or for some other reason.

3. How do you prove your losses?

Documentation of the reason for the third-party's inability to perform can be challenging. So, it is important to retain documentation received from the third-party – and in some cases to affirmatively and timely request it – to be sure it is possible to support the claim.

C. Civil Authority Coverage

1. What does this insurance cover?

Civil authority coverage covers loss of earnings and certain continuing expenses when a civil authority prohibits access to, ingress to, or egress from your place of business because of a covered cause of loss. For example, if there was a substantial fire down the street from your company and the fire department or health department ordered all access to your street closed for two weeks, this coverage would be triggered.

2. What are the coverage issues for this type of insurance?

Many policies require direct physical loss or damage to property, other than the insured property, caused by a covered cause of loss, within a certain distance of your place of business (e.g., within one mile of the insured property), and have time limits for when the coverage begins (e.g., 12 to 72 hours after the order prohibiting access) and when the coverage ends (e.g., 3 to 6 weeks after the order was issued).

3. How do you prove your losses?

Given the typical requirements of this coverage, an order documenting prohibited access to, ingress to, or egress from an insured's premises, can be critical. Obtain copies of any formal order. These are often available on government websites now and may be more difficult to find later. Keep copies of newspaper articles and similar media.

D. Extra Expense Coverage

1. What does this insurance cover?

Some kinds of extra expenses, such as renting a new building while your main business premises are restored, are easy to identify. But that is not true as to all expenses that may qualify for coverage. For instance, if the claim includes cleaning expenses, the insurer may claim the cleaning would have been done anyway. While it can be possible after the fact to explain how this cleaning was more extensive or wholly additional, it is far better to document the need contemporaneously. In fact, among the first recommendations forensic accountants make is to establish specific general ledger of accounts or subaccounts to track all expenses associated with the crisis and establish processes to retain documentation supporting the expenses and reasons they are incurred. This ensures that the documentation remains accessible.

2. What are the coverage issues for this type of insurance?

Extra expense coverage issues often turn on whether the expense results from "direct loss or damage" to covered property, similar to the issues listed above.

3. How do you prove your losses?

To prove your losses, you should keep detailed accounting records for all expenses incurred in response to COVID-19.

E. Coverage for Calculating Your Losses

Some policies provide coverage for claim preparation costs and crisis management costs. Claim preparation costs typically include professional fees incurred to prove the cause of a loss and the amount of the loss, such as forensic accountants and, in some cases, lawyers. Crisis management costs, most typically found in directors and officers (D&O) and cyber liability policies, usually cover fees to hire a crisis management firm. Both are often subject to low sub-limits but are nonetheless worth including in any claim where policy language permits.

F. Virus Exclusions

Many carriers have in recent years added exclusions in their policies barring coverage for viruses, pathogens, and communicable diseases. The applicability of these

exclusions will depend on the precise wording and many such provisions have not yet been tested. A common example of such an exclusion is as follows: “We will not pay for loss or damage caused by or resulting from any virus . . . that induces or is capable of inducing physical distress, illness, or disease.” While such explicit exclusions may bar coverage, exclusions that do not specifically refer to viruses should be found insufficient to do so. To the extent insurers seek to deny coverage based on a “Fungi, Bacterium, or Micro-Organism” exclusion, viruses are not fungi, bacterium, or microorganisms so that exclusion should not apply to any claims relating to COVID-19.

Likewise, viruses are not pollutants. Another common exclusion that insurers may try to invoke is the pollution exclusion. Policies with pollution exclusions may define “pollutants” to mean “[a]ny solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.” Just as a “virus” is not a fungus, bacterium, or microorganism, neither is it a “pollutant”. Although insurers have persuaded some states to interpret pollution exclusions broadly,¹² others only apply such pollution exclusions to traditional environmental pollution or substances identified with particularity.¹³ Thus, insureds should challenge any coverage denials of claims relating to the COVID-19 crisis that do not specifically refer to “viruses” or “pathogens.”

III. Examples of Recoveries Under the Additional Coverages

In the summer of 1993, the Mississippi River flooded affecting nine Midwestern states and leading to \$6.5 billion in crop damages. As a result of the flood, Archer Daniels Midland Company and its subsidiaries (“ADM”) suffered extra expenses and lost income because of increased transportation and raw material costs. The insurers paid \$11 million for losses, but denied another \$44 million in claims leading to a lawsuit. The policy covered extra expense “sustained by the insured as a result of direct physical damage caused by the perils insured against under this policy and not excluded elsewhere in this form....” Because ADM’s facilities were not damaged in the flood, the insurers denied the extra expense claim. The trial court and court of appeals rejected the insurers’ arguments because there was no language in the policy requiring that the policyholder suffer property damage to its property as a precondition to coverage. Likewise, the policy covered “loss of earnings and necessary extra expense resulting from necessary interruption of business of the insured caused by damage to or destruction of real or personal property, by the perils insured against under the policy, of any supplier of goods or services which results in the inability of such supplier to supply an insured location.” The insurers argued that because ADM had contracts with grain dealers as opposed to the actual farmers whose crops were damaged, there was no coverage. The trial court and court of appeals rejected this argument because there was no language in the policy that required privity of contract with the suppliers. In the end, ADM was able to recover its losses.

¹²*Colony Ins. Co. v. Victory Constr. LLC*, 239 F. Supp. 3d 1279, 1286-88 (D. Ore. 2017)

¹³ *MacKinnon v. Truck Ins. Exchange*, 73 P.3d 1205, 1216 (Cal. 2003)

IV. Provide Prompt Notice

Even if your company is not presently able to fully document its losses as required under your insurance policies, it is important to provide prompt notice of a claim because some policies require prompt notice as a precondition to coverage. As an example of the pitfalls of failing to give prompt notice, in one case where the policyholder had been sued, the policy required the business to provide notice as soon as practicable, but no later than 60 days after the end of the policy period. The policyholder notified the insurer several months after the claim and within the policy period, but the trial court and court of appeals held that the notice was not given as soon as practicable and thus was untimely. As a result, the insurer had no duty to defend the policyholder from a lawsuit, and had the policyholder been found liable in that lawsuit the insurer would have had no duty to indemnify. Don't miss what may be your only opportunity to recover your losses by failing to provide timely notice.

V. Conclusion

Taft's Insurance Coverage and Recovery Practice has represented clients in recovering property damage, lost earnings, certain continuing expenses, and extra expense claims from other disasters, including fires, floods, tornadoes, and hurricanes. Coverage determinations turn on the specific terms, conditions, and exclusions of the policies and controlling state law, which is why it is so important for corporate counsel to work with experienced attorneys in assessing their insurance recovery ability.

About Taft's Insurance Coverage and Recovery Industry Group

Taft's insurance coverage and recovery attorneys help clients maximize insurance recoveries through insurance program reviews, claims presentation and negotiation, litigation, alternative dispute resolution, trials and appeals. Our team of experienced attorneys have advised policyholders with traditional and emerging insurance products across many industries, including financial services, utilities, energy, natural resources, healthcare, chemicals, pharmaceuticals, consumer products, telecommunications, technology, e-commerce and manufacturing.

Taft's attorneys have earned recognition by peers and legal publications for our work in insurance law and our continued dedication to client service. Credentials include having earned the certification as a Chartered Property and Casualty Underwriter and recognition by *Best Lawyers in America* for Insurance Law.

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