Court Renders First Decision Concerning Business Interruption Insurance Coverage for COVID-19 Shutdown Losses

Please contact our

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with any questions you may have.

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Beginning in March, 2020, countless businesses across the country were forced to close their doors, at least temporarily, to help combat the spread of COVID-19. The loss of income during that period of time has been crippling to many, particularly restaurants and small businesses. As government orders across the country extended the time during which businesses were forced to remain closed, the economic outlook became increasingly bleak. Business owners and managers began scrambling for a way to save their livelihood.

Thousands of those businesses have turned to their insurance companies seeking coverage for losses under business interruption policies. Generally, businesses are claiming that the government-mandated closures should be covered either because policies lacked a specific virus or pandemic exclusion or that coverage is required pursuant to a policy's civil authority coverage provision.

Upon receiving denials from their insurers in response to claims, almost one thousand businesses have turned to the state and federal courts requesting that judges force insurance companies to pay. In response, insurance companies have overwhelmingly denied responsibility under the policies at issue.

Direct Physical Loss of or Damage to Physical Property

Many standard business policies provide coverage only for losses caused by direct physical damage. Insurers argue that COVID-19 has not caused a direct physical loss as required by the policies and, accordingly, they assert that business interruption claims do not fall within a covered loss under the policies at issue. Whether a direct physical loss has been suffered by an insured will likely be a key issue in all COVID-19 business interruption litigation.

Virus Exclusions

Most commercial policies include a specific exclusion for "loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease." This language, insurance companies assert, clearly applies to COVID-19 and supports the denial of business interruption claims. Thus, even if a business suffered a direct physical loss or damage, claims for COVID-19 would still be excluded from coverage.

Case of First Impression

Earlier this month, a circuit court judge in Michigan entered an order granting an insurer's motion for summary judgment in a business interruption case resulting from COVID-19 related shutdowns. The order was issued following a hearing conducted via Zoom. The case of Gavrilides Management Company, et al. v. Michigan Insurance Company, centered around losses suffered by restaurants forced to close due to government shutdown orders related to COVID-19.

The plaintiff in the case asserted that the virus exclusion contained in the insurance policy did not apply because the loss of access to the restaurants was a result of the government mandated shutdown. Additionally, the plaintiff asserted that the loss of access to the restaurants constituted a "direct physical loss" within the meaning of the policy.

The court agreed with the insurer, however, and held that no coverage was owed under the policy. In this case of first impression, the court explained that insurance coverage would be required for actual loss of business income during times when business operations were suspended. Under the policy at issue, that suspension, in the court's opinion, must be caused by direct physical loss of or damage to property. The court noted that the loss or damage "has to be something with material existence. Something that is tangible. Something . . . that alters the physical integrity of property." According to the court, "direct physical loss or damage" requires more than a loss of use or access. The plaintiff in this case did not allege any physical loss of or damage to the actual restaurants. Instead, the claim was based on closures related to government orders prohibiting restaurants from being open.

The court also noted that, while government acts would have been covered under the policy, those government actions would have to result in direct physical loss or damage. In the Gavrilides case, no such loss or damage was alleged. The court would not allow the plaintiff to amend the complaint, which only alleged loss of access to the restaurants, to also include allegations of direct physical damage to the property as the policy required.

The court also held that the virus exclusion in the policy unambiguously excluded coverage for losses which resulted from COVID-19. Thus, even if there was physical damage, the virus exclusion would have precluded coverage. Accordingly, the court granted the insurer's motion for summary judgment. This decision is a big win for the insurance industry.

Bad Faith and Unfair Trade Practices Claims

Insurers have been denying business interruption claims without much delay. As a result, in addition for claims demanding coverage for business interruption losses, several lawsuits have been filed alleging bad faith in properly evaluating the facts and circumstances surrounding claims before denials are issued. In addition, several complainants have alleged that their insurers engaged in unfair or deceptive trade practices by promising coverage and wrongfully denying claims for which they never had an intention of actually providing coverage. The outcome of those cases will require a very fact-specific inquiry and examination.

Legislative and Regulatory Action

Because most insurance companies are responding to claims for business interruption coverage related to COVID-19 with denials, business are left with losses that very well may lead to permanent closure. In an attempt to prevent that, significant legislative and regulatory pressure is being applied to insurers to provide coverage, regardless of language in actual insurance policies. Legislators in nine states, the District of Columbia and Puerto Rico have introduced bills that would mandate retroactive business interruption coverage for COVID-19 claims. Those bills would essentially destroy the defenses that insurers have been asserting in response to claims. None of those bills, however, have proceeded very far through the legislative process. Insurers claim that such legislation would bankrupt the insurance industry, as claims would greatly exceed the amount of money collected in premiums annually. In addition, insurers argue that this type of legislative action violates the Contract Clause within Article 1 of the U.S. Constitution which prohibits the legislature from impairing the obligation of contracts.

Not a One-Size-Fits-All Situation

Insurance companies have overwhelmingly objected to attempts by several plaintiffs' attorneys to consolidate COVID-19 litigation and to states attempting to legislate mandatory coverage for COVID-19 business interruption claims. Insurers point to the varying types of policies at issue, the different types of businesses that purchased the policies, varying policy language and several other distinguishing factors as support for their request to handle each case on an individual basis when deciding whether coverage is appropriate. Insurers argue that unique facts require independent consideration of claims.

Conclusion

The controversies surrounding business interruption claims are sure to increase as more and more cases are filed and proceed through the legal system. We will continue to keep you apprised of further legal and regulatory developments with regard to business interruption insurance claims related to COVID-19.

If you have any questions or need assistance handling these claims, please do not hesitate to let us know. Carr Allison's insurance and coverage attorneys will be happy to assist.