
Unmasking COVID Coverage Problems: Federal Court Decides Business Interruption Issue

Business interruption insurance coverage is typically provided as part of a company's commercial property insurance. It is intended to protect businesses against income losses and extra expenses sustained as a result of certain disruptions in their operations arising from a covered cause of loss. As a result of COVID-19 pandemic shutdowns, there has been a flood of litigation brought by policy holders against insurance carriers arising from insureds' business interruptions. While several state legislators have proposed legislation aimed at addressing business interruption issues, insureds have sought more immediate relief from coverage denials by asserting claims of coverage for COVID-19 related business interruption.

In the last year and a half there have been more than 1,500 COVID-19 business interruption cases brought in both state and federal courts around the country. Many courts have made it challenging for insureds to recover business interruption expenses, finding that lost business income must be contingent upon some direct physical loss or physical damage to insured property.

The first federal appellate court to speak to issues of COVID-19 business interruption coverage came on July 2, 2021, when the United States Court of Appeals for the Eighth Circuit affirmed the decision of the district court and held that an insurance company was not required to indemnify a dental clinic for losses incurred as a result of government imposed COVID-19 restrictions.

In *Oral Surgeons, P.C. v. Cincinnati Insurance Company*, No. 20-3211 (8th Cir. July 2, 2021), Oral Surgeons ("OS"), a company offering oral surgery services, stopped performing non-emergency procedures from late March 2020 until May 2020, after the governor of Iowa declared a state of emergency and imposed restrictions on dental practices because of the COVID-19 pandemic. *Slip Op.* at 2. OS thereafter submitted a claim to its property insurance carrier, The Cincinnati Insurance Company ("CIC"), for losses it suffered as a result of the suspension of non-emergency procedures.



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The all-risk policy in *Oral Surgeons* insured OS against lost business income and certain extra expense sustained due to the suspension of operations “caused by direct ‘loss’ to property.” *Id.* The policy defined “loss” as “accidental physical loss or accidental physical damage.” *Id.* CIC responded that the policy did not afford coverage because there was no direct physical loss or physical damage to OS’s property. The district court granted CIC’s motion to dismiss, concluding that OS was not entitled to declaratory judgment and that it had failed to state claims for breach of contract and bad faith. *Id.*

The appellate court held that the CIC policy required direct “physical loss” or “physical damage” to trigger business interruption and extra expense coverage, and therefore, some physicality to the loss or damage of property—e.g., a physical alteration, physical contamination, or physical destruction was required. *Slip Op.* at 3. The court further found that the policy could not reasonably be construed to cover the mere loss of use when the insured’s property has suffered no physical loss or damage. *Slip Op.* at 4.

That the loss or damage be physical in nature was determined to be consistent with the policy’s coverage of lost business income and incurred extra expense during the “period of restoration.” *Slip Op.* at 4. According to the policy, the “period of restoration” began at the time of “loss” and ended on the earlier of: (1) the date when the property at the “premises” should be repaired, rebuilt or replaced with reasonable speed and similar quality; or (2) the date when business is resumed at a new permanent location. *Slip Op.* at 4.

The court found that property that had suffered physical loss or physical damage required restoration. The policy provided coverage until property “should be repaired, rebuilt or replaced,” or until business resumes elsewhere assuming physical alteration of the property, not for mere loss of use. *Slip Op.* at 4.

Given its similarities to Iowa law, the court looked to Minnesota case law regarding the interpretation of “direct physical loss” and found that since OS had not alleged any physical alteration of the property and failed to allege facts to show that it had suspended activities due to direct “accidental physical loss or accidental physical damage,” the lost business income and extra expense sustained as a result of the suspension of the non-emergency procedures were not “caused by direct loss to property.” *Slip Op.* at 4-6. The CIC policy did not provide coverage for OS’s partial loss for its use of its offices absent a showing of direct physical loss or physical damage. *Slip Op.* at 6.

Oral Surgeons marks the first federal appellate decision on the issue of COVID-19 business interruption. While the opinion is a win for insurance companies, the court made clear that the appeal presented only a question of whether the COVID-19 pandemic and the related government-imposed restrictions constitutes “direct accidental physical loss or accidental physical damage” under the policy at issue in the case. *Slip Op.* at 6, fn. 2. Appeals have been filed in over 150 federal COVID-19 business interruption cases, and while we will continue to see how courts tackle these issues, it is likely that cases will continue to be fact-sensitive and based on the allegations in the complaint and the language of the policy at issue.

The *Oral Surgeons* decision did not address any issues related to potential policy exclusions. It is important to note that many commercial insurance policies contain exclusions. See e.g., ISO form CP 01 40 07 06, titled “Exclusion for Losses Due to Virus or Bacteria” (virus exclusion). This virus exclusion precludes business interruption coverage “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.” *Id.* Exclusions can act as a bar to coverage even if an insured otherwise demonstrates coverage.

In an attempt to address some of the thorny COVID-19 coverage issues prospectively, Governor Murphy recently signed into law a bill requiring certain insurers to provide explanations of whether business interruption insurance policy provides pandemic coverage. See 2021 NJ Sess. Law Serv. Ch. 98 (ASSEMBLY 4805) (the “May 2021 Bill”). The May 2021 Bill provides that:

The Department of Banking and Insurance shall publish a ... summary of common insurance clauses concerning coverage for the loss of use and occupancy of a commercial property and business interruption that may be used in a commercial insurance policy. The summary shall:

- a. be developed through a public stakeholder process;
- b. be written in easily understandable language; and
- c. include: (1) information concerning common coverage triggers; (2) examples of perils typically covered; (3) a summary of common exclusions; (4) the following statement, in a prominent place in the summary: “Your policy may not cover pandemics or viruses”; (5) the following statement: “Most business interruption insurance policies cover losses sustained due to a suspension of business where the suspension was caused by direct physical loss of or damage to property or the insured’s premises, and where the loss or damage is caused by or results from a specified peril or covered cause of loss. For such policies, a government ordered shutdown may not trigger business interruption insurance coverage in the absence of physical damage to the insured property.”; and (6) the following disclaimer: “This summary is not a replacement for the terms of the policy of insurance, shall not have the effect of altering the coverage afforded by the policy, and shall not confer new or additional rights beyond those expressly provided for in the policy. This information is only provided as guidance to the policyholder in understanding the terms of the policy of insurance. You should consult your policy, agent and insurer if you have questions about your particular coverage.”

Pursuant to the May 2021 Bill, insurers are to provide the summary referenced above (which is due to be published in August) to “any potential purchaser of, or any policyholder seeking renewal of, a policy that provides coverage for the loss of use and occupancy of a commercial property and business interruption in this State.”

The May 2021 Bill comes after the New Jersey Legislature aborted efforts to introduce legislation that would have retroactively required commercial insurance carriers to provide business interruption insurance coverage despite the presence of a virus exclusion. The purpose of the May 2021 Bill is an attempt at more transparency by insurance companies in New Jersey regarding the extent of business interruption coverage.