Retail Tenants and COVID-Related Business Interruption Insurance Claims: Where Things Stand After the Big Fight

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As states issued emergency restrictions on businesses and stay-at-home orders in March 2020 because of the public health threat caused by COVID-19, commercial landlords helplessly watched the businesses of their formerly rent-paying tenants crater. Those tenants, forced by the public health orders of state authorities to cease or reduce operations at their physical locations, sought legal advice on the potential for filing property insurance claims to cover COVID-19-related losses. After all, they had "paid hundreds, if not thousands of dollars in monthly premiums under the impression that they would be protected in the event a calamity forced them to close their doors to the public." *Kahn v. Pa. Nat'l Mut. Cas. Ins. Co.*, No. 1:20-CV-781, 2021 WL 422607, at *1 (M.D. Pa. Feb. 8, 2021). Some tenant businesses even paid extra for a special endorsement expanding certain coverages to include loss or damage caused by bacteria or virus. *Digital Age Mktg. Grp., Inc. v. Sentinel Ins. Co., d/b/a the Hartford*, No. 20-61577-CIV-DIMITROULEAS, 2021 WL 80535, at *1 (S.D. Fla. Jan. 8, 2021).

Many lawyers advised that insurers would likely not pay such claims. The lawyers were concerned about a long line of cases before the onset of the virus that found loss of use not to be the "direct physical loss of or damage" typically required to pay claims. *E.g., Phoenix Ins. Co. v. Infogroup, Inc.*, 147 F. Supp. 3d 815 (S.D. Iowa 2015) (finding no insurance coverage arising out of loss of use from threat of flooding). Insurance companies routinely denied claims under various theories to recover lost business income due to COVID-19. *Business Interruption/Businessowner's Policies (BOP)*, Nat'l Ass'n of Ins. Comm'rs (Dec. 9, 2020), https://bit.ly/39jxMuA (stating as of October 22, 2020, 201,285 coronavirus claims were received and 3,001 were paid). An absolute flood of litigation throughout the country over the past year tested such denials. That these cases number in the thousands is doubtless a testament to the widespread effect of various governmental closure orders and other restrictions on businesses. Now that many courts have weighed in on COVID-19 insurance coverage, where do tenants stand on recovering money from their insurers?

Common Threads

A survey of cases reveals many common threads in the arguments made and defenses raised. Businesses mostly brought cases in state courts challenging denials of coverage under business interruption and other related types of insurance. The insurance company defendants used their favorite tactic of removing these cases to the federal courts using diversity jurisdiction. Regardless whether the cases proceed in state or federal court, state law controls. Most of the court rulings to date have been on motions; they are not full trial outcomes. The decisions are primarily on motions to dismiss for failure to state a claim by the insurers, *e.g.*, *Diesel Barbershop, LLC v. State Farm Lloyds*, 479 F. Supp. 3d 353 (W.D. Tex. 2020), but in some cases they are on insurers' motions for judgment on the pleadings, *e.g.*, *Whiskey River on Vintage,*

Inc. v. Ill. Cas. Co., 503 F. Supp. 3d 884 (S. D. Iowa 2020). These motions require the court to assume that the facts alleged by the insured businesses are correct, but not their conclusions of law. See e.g., *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009). The court then determines whether the law provides the business with a sufficient legal basis to establish insurance coverage under those facts.

All of these cases concern breach of contract. The business sues for damages because the insurer did not pay as required under the policies, or the business seeks a ruling from the court instructing the insurer to declare coverage under the insurance policy. Even though these disputes turn on precise contract language in the policy at hand, most insurance policies are written on standard Insurance Services Office, Inc. (ISO) forms. As a result, the cases are about the interpretation of similar language and should (in theory) be good precedent for other COVID-19 coverage disputes. The type of business or nature of the COVID-related closure in each dispute tends to be irrelevant because all of these cases deal with similar COVID concerns and similar governmental orders across the country. A few court decisions have tried to make factual distinctions between essential businesses that did not have to physically close their operations and those businesses that were forced to close.

Bases for Insurance Claims

The bases for businesses to seek coverage in COVID-19 situations are primarily under business interruption insurance (more properly termed "business income" insurance), extra expense coverage (related to business income), and civil authority coverage. In a few cases, businesses have also claimed entitlement to monies under sue and labor, ingress and egress, and dependent property coverage. Under each of these types of insurance, for an insurance company to be required to pay a claim, there must be a covered loss (i.e., actual loss of business income during suspension of operations), a cause of loss that is a covered cause of loss (in these cases, direct physical loss of or damage), and no exclusion from coverage (that applies to defeat the claim even if it is a covered cause of loss).

The first of the various theories of covered loss is under business interruption insurance. Most policies contain the following business income provision: "We will pay for the actual loss of business income you sustain because of 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 the described premises. The second basis, extra expense coverage, is from a statement in the policy that the insurer "will pay necessary Extra Expense that you incur during the 'period of restoration' that you would not have incurred if there had been no direct physical loss or damage to the property at the described premises." *Blue Springs Dental Care, LLC v. Owners Ins. Co.*, 488 F. Supp. 3d 867 (W.D. Mo. 2020). The third theory of recovery is the civil authority coverage provision, which usually states that "[w]hen 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," *Palmer Holdings & Invs., Inc. v. Integrity Ins. Co.*, No. 4:20-CV-154-JAJ, 2020 WL 7258857, at *2 (S.D. Iowa Dec. 7, 2020), provided that both access to the immediately surrounding area is prohibited as a result of the damage and the civil authority's action is in response to dangerous physical conditions resulting from a covered cause of loss that caused the damage.

There are two exclusions from coverage that are typically brought up in the COVID-19-related cases: the virus exclusion and the ordinance or law exclusion. The virus exclusion states that the company will not pay for loss or damage caused directly or indirectly by any virus that induces or can induce physical distress, illness, or disease, regardless of whether it is otherwise a covered cause of loss. The ordinance or law exclusion denies coverage of losses as a result of the enforcement of any ordinance or law regulating the construction, use, or repair of the property.

Physical Cause of Loss

There must be a direct physical loss or damage for coverage to apply. This issue is at the heart of all the COVID-19-related cases. Many of the cases involve businesses claiming that government proclamations that prohibit access or limit use cause physical loss. Many other cases entertain the argument that coronavirus droplets on the insured premises (or assumed to be on the insured premises) create physical loss to the premises. The plaintiff businesses in these cases seize on the "loss or damage" policy language and seek to distinguish physical loss from physical damage as a covered cause of loss.

No Coverage in Most Cases

How have tenants fared so far in their insurance litigation? Not well. Although most decisions are currently under appeal, the majority of these decisions have held that there is no insurance coverage under any of the theories of covered loss because there is no direct physical loss of or damage to the premises. These decisions do not equate the government-mandated limits on access to a physical loss such as a fire. Most of the courts that have not found a covered cause of loss have also stated that the virus exclusion would defeat the claim, even if they had found a covered cause of loss. For example, in a case involving hotels, the US District Court for the Central District of California ruled that the virus exclusion prevents any business income or civil authority coverage because the executive orders to close the hotels were the result of a virus: the desire to halt the physical spread of COVID-19. *W. Coast Hotel Mgmt., LLC v. Berkshire Hathaway Guard Ins. Cos*., 498 F. Supp. 3d 1233 (C.D. Cal. 2020).

In another example, the US District Court for the Middle District of Pennsylvania granted the insurance company's motion to dismiss, finding no basis existed for the case to proceed under business income, extra expense, and civil authority coverages. *Kahn v. Pa. Nat'l Mut. Cas. Ins. Co*., No. 1:20-CV-781, 2021 WL 422607 (M.D. Pa. Feb. 8, 2021) (applying Pennsylvania law to the closure of a South Carolina restaurant). Predictably, the court based its denial on the lack of physical loss of or damage to property. *Id.* at *8. The case focused on policy language requiring some issue with the physical premises that impedes business operations. *Id.* at *5. Like other courts, the court in *Kahn* used ordinary meaning to define the otherwise undefined phrase "physical loss" in the policy: "The word 'physical'—which modifies both 'loss' and 'damage' … means '[o]f, relating to, or involving *material* things; pertaining to *real, tangible* objects.'" *Id.* (citing Black's Law Dictionary).

Similarly, among many other rulings, coverage has also been denied to optometrists by a court in Alabama, *Hillcrest Optical, Inc. v. Cont'l Cas. Co*., 497 F. Supp. 3d 1203 (S.D. Ala. 2020) (holding that temporary inability to use property due to governmental intervention does not constitute direct physical loss; there was no tangible alteration requiring period of repair); an online marketing firm in Florida, *Digital Age Mtg. Grp., Inc. v. Sentinel Ins. Co., d/b/a the Hartford*, No. 20-61577-CIV-DIMITROULEAS, 2021 WL 80535 (S.D. Fla. Jan. 8, 2021) (finding no coverage for business losses even with virus endorsement; no civil authority coverage due to virus exclusion); restaurants in Iowa, *Palmer Holdings & Invs., Inc. v. Integrity Ins. Co*., No. 4:20-CV-154-JAJ, 2020 WL 7258857 (S.D. Iowa Dec. 7, 2020) (finding no coverage under business income and extra expense due to lack of physical loss or damage, no civil authority coverage, and that the virus exclusion applies); barber shops in California, *Pappy's Barber Shops, Inc. v. Farmers Grp., Inc*., 487 F. Supp. 3d 937 (S.D. Cal. 2020) (finding no direct physical loss or damage for business income and extra expense coverage; order prohibiting operations did not prevent access as required for civil authority coverage); restaurants in New York, *Michael Cetta, Inc. v. Admiral Indem. Co*., No. 20-CIV-4612-JPC, 2020 WL 7321405 (S.D.N.Y. Dec. 11, 2020) (holding that the lack of physical loss or damage prevented business income coverage; prerequisites to civil authority coverage not satisfied); a law firm in Pennsylvania, *Wilson v. Hartford Cas. Co*., 492 F. Supp. 3d 417 (E.D. Pa. 2020) (holding that the virus exclusion bars coverage); and barber shops in Texas, *Diesel Barbershop*, 479 F. Supp. 3d 353 (holding that lost business income not covered under policy requiring accidental direct

physical loss; civil authority provision not triggered; virus exclusion applies).

Businesses Allowed to Seek Coverage in Some Cases

There is a handful of decisions that have allowed coverage cases to move forward. These cases have received much publicity and offer a glimmer of hope for tenants (and their lawyers), but they are already meeting strong headwinds. Courts in Ohio and Washington have permitted restaurants to allege coverage under property insurance policies in cases involving suspension of operations. The judges in these cases determined that deprivation of use caused by loss of access to the property could constitute physical loss under the policies. *Perry St. Brewing Co. v. Mut. of Enumclaw Ins. Co.*, No. 20-2-02212-32, 2020 WL 7258116 (Wash. Super. Nov. 23, 2020) (trial order). In Ohio, the court found that the policy phrase "direct physical loss of or damage to property" was ambiguous and required the court to construe it in favor of the insured, considering ordinary definitions of those words. *Henderson Rd. Rest. Sys., Inc. v. Zurich Am. Ins. Co.*, No. 1:20-CV-1239, 2021 WL 168422 (N.D. Ohio Jan. 19, 2021). *Henderson,* however, has already been discredited by the same court in *Equity Planning Corp. v. Westfield Ins. Co.*, No. 1:20-CV-01204, 2021 WL 766802 (N.D. Ohio Feb. 26, 2021), which found the policy language to be unambiguous and dismissed the coverage case based on the lack of physical damage and the applicability of the virus exclusion.

In Missouri, two cases were allowed to proceed to trial over coverage. *Studio 417, Inc. v. Cincinnati Ins. Co.*, 478 F. Supp. 3d 794 (W.D. Mo. 2020) (involving a restaurant and salon); *Blue Springs Dental Care, LLC v. Owners Ins. Co.*, 488 F. Supp. 3d 867 (W.D. Mo. 2020) (involving dentists). These two Missouri law rulings are already in question due to a later case in the same court dismissing an action for restaurant coverage. *Zwillo V, Corp. v. Lexington Ins. Co.*, No. 4:20-00339-CV-RK, 2020 WL 7137110 (W.D. Mo. Dec. 2, 2020). The court purported to reach a different result because the policy interpreted in *Zwillo* contained the "Pollution and Contamination Exclusion," which excludes loss caused by, resulting from, contributed to, or made worse by actual, alleged, or threatened release of contaminants (including viruses), but the policies in the previous cases did not. *Id.* at *6. It also stated that to the extent its ruling conflicts with the previous cases, "this Court respectfully disagrees with those cases." *Id.* at *8.

Although the policies in some of these cases, including the two Missouri cases, did not have the virus exclusion, other cases dealt with the policies that did. These courts, however, found the virus exclusion not to apply because the loss of income was caused due to government shutdown orders and not COVID-19 itself.

Legislatures Weigh in

In 2020, 11 states and Puerto Rico introduced legislation that would force insurers to retroactively pay for business interruption losses from coronavirus shutdowns. Heather Morton, *Business Interruption 2020 Legislation*, Nat'l Conf. of St. Legislatures (Dec. 11, 2020), https://bit.ly/3u3hHBm. The text of the legislation varies a good bit from state to state, and some of these initiatives passed various assemblies. As of this writing, only the Illinois bill that established a task force to study the need for changes to business interruption insurance policies has been signed into law. *Id.* As of this writing, in 2021 similar legislation has been introduced in seven states. Heather Morton, *Business Interruption 2021 Legislation*, Nat'l Conf. of St. Legislatures (Feb. 12, 2021), https://bit.ly/31oRbpC. At the federal level, house resolutions regarding insurance and the pandemic legislation have also been introduced, but so far they have not been enacted and have been vigorously opposed by insurance groups. *BOP*, *supra*.

Conclusion

Although a few outlier cases have allowed businesses to proceed with business interruption insurance claims, after a year of litigation it is now clear that insurance has not been a reliable solution to the

current woes of retail tenants. Legislation to force coverage is unlikely to become law. Paycheck protection program loans, other initiatives provided by the Small Business Administration, and tax relief have been the best source of help to crippled retail tenants with rent payments—not insurance claims.