



## Business-income insurance and COVID-19

### A LOOK AT THE “DIRECT PHYSICAL LOSS OF OR DAMAGE TO PROPERTY” REQUIREMENTS IN ISO FORM BUSINESS-INCOME POLICIES

It is now a certainty that the coronavirus epidemic will have a disastrous impact on American businesses and industries. Indeed, “[t]he National Restaurant Association . . . wrote to President Trump and congressional leaders estimating that the industry’s sales will decline by \$225 billion during the next three months, which will prompt the loss of between five and seven million jobs.” (Gangitano, Alex, “Restaurant industry estimates \$225B in losses from coronavirus,” *The Hill*, March 18, 2020). Similar impacts can be anticipated in the hotel and airline industries, as well as many others.

Faced with staggering losses, American businesses and industries are desperately seeking relief from many sources. One of those sources is likely to be their business-income insurance. Many businesses and industries, in addition to carrying first-party property insurance, also carry business-income insurance. The purpose of this article is to set forth the reasons why business-income insurance may provide coverage for losses arising from the coronavirus.

There are numerous and differing business-income insurance policy forms. Not all of these forms and their differing provisions can be addressed here. Accordingly, this article will focus on the Insurance Services Office (“ISO”) business-income policy forms. ISO publishes the most widely used policy forms, so it is an excellent starting point for examining the availability of business income coverage for coronavirus claims.

In addition, the article will address the various components of business-income insurance. These include the business-income coverage itself, which provides coverage for loss of income, as well as the civil authority, contingent business-income, and extra-expense coverages, all of which may provide

coverage for businesses that have and will suffer losses from the coronavirus.

#### Business income insurance

##### *The ISO business income policy*

The standard ISO business income policy provides:

We will pay for the actual loss of Business Income you sustain due to 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 premises which are described in the Declarations and for which a Business Income Limit Of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss. (ISO CP 00 30 10 12; emphasis added)

##### *Several courts have held that business income coverage extends to an insured’s inability to use the covered property*

A critical issue is whether “direct physical loss of or damage to property” includes the presence of or contamination by the coronavirus. In other words, do you need a fire, flood, or some similar damage to have a covered business-income claim? The insurance industry is likely to answer: Yes. The answer, however, should be a clear “No!”

Numerous courts have held that “direct physical loss of or damage to property,” or similar language, provides coverage not only for actual physical damage but also for the inability to operate or use the business. For example, in *Travco Ins. Co. v. Ward*, No. 2:10cv14, 2010 WL 2222255, at \*8-\*9 (E.D. Va. June 3, 2010), the court considered whether a house built with drywall that emitted toxic gases, causing the policyholder to move out, had suffered direct physical loss, despite the fact that the house remained “physically intact, functional and ha[d] no visible damage.”

The court held that there was coverage, noting that the majority of cases nationwide find that “physical damage to the property is not necessary, at least where the building in question has been rendered unusable by physical forces.” Similarly, in *Cook v. Allstate Ins. Co.*, No. 48D02-0611-PL-01156, slip op. at 6-8 (Indiana Super. Nov. 30, 2007), the court held that the infestation of a house with brown recluse spiders constituted “sudden and accidental direct physical loss” to the house. The court stated that “the undisputed evidence demonstrates a ‘sudden and accidental direct physical loss’ as a matter of law. . . . Case law demonstrates that a physical condition that renders property unsuitable for its intended use constitutes a ‘direct physical loss’ even where some utility remains and, in the case of a building, structural integrity remains.”

Other courts have also held that the presence of bacteria in a home constitutes direct physical loss. In *Motorists Mutual Insurance Co. v. Hardinger* (3d Cir. 2005) 131 F. App’x. 823, 827, the court addressed whether the infestation of a home with *E. coli* bacteria constituted direct physical damage, and held that there was “a genuine issue of fact whether the functionality of the [policyholder’s] property was nearly eliminated or destroyed, or whether their property was made useless or uninhabitable.” The court then reversed the lower court’s ruling in favor of the insurance company. Likewise, in *Cooper v. Travelers Indem. Co.*, No. C-01-2400, 2002 WL 32775680, at \*5 (N.D. Cal. Nov. 4, 2002), the court held that the policyholder could make claim for Business Income and Extra Expense losses arising from contamination of a well with *E. coli* bacteria.

Importantly, it has been held that the fear of damage can be a direct physical

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loss. In *Murray v. State Farm Fire & Cas. Co.* (W. Va. 1998) 509 S.E.2d 1, 17, the court there found a “physical loss” where the policy provided coverage for “direct physical loss to the property,” because the policyholder lost the complete use of the home because occupancy was rendered dangerous by the presence of falling rocks.

Similarly, in *Hughes v. Potomac Ins. Co.* (1962) 199 Cal.App.2d 239, *disapproved on other grounds, Sabella v. Wisler* (1963) 59 Cal.2d 21, 34, the court addressed a case in which the insured’s home became perched on the edge of a cliff after a sudden landslide caused a large chunk of the ground surrounding the property to fall into a creek, depriving the home of lateral support and stability. The court held that, even though the house itself had not been damaged, the insured could make a claim for direct physical damage because the insured could no longer live in the home.

### Actual or threatened presence of coronavirus constitutes physical damage

The import of these decisions for coronavirus claims can readily be seen. Where a business can no longer use its property for its intended use because of the actual or threatened presence of the coronavirus, that business could have a valid claim for its business income losses.

*California precedent similarly supports an insured’s business income claim where the insured is no longer able to use the covered property.* California law should follow the general rule that the inability to use a property constitutes direct physical damage to that property.

In *Total Intermodal Services, Inc. v. Travelers Property Casualty Co. of Am.*, 2018 WL 3829767 (C.D. Cal. July 11, 2018), the court was faced with the following facts: Total, the insured, contended that Travelers, its insurer, wrongfully denied Total’s claim. The claim was “for cargo that was lost because instead of delivering it to the customer, Total mistakenly caused it to be sent it back [sic] to China where the customer eventually agreed to have it destroyed” (*Id.*, p. 1). Travelers

contended that the loss of the cargo was not “direct physical loss or damage” to the cargo. (*Ibid.*)

The court denied Travelers’ motion for summary judgment, finding that there was coverage based on the policy’s language. The court wrote:

The Coverage clause provides coverage for the “direct physical loss of or damage to Covered Property caused by or resulting from a Covered Cause of Loss” (emphasis added). Thus, the Coverage clause applies to the “loss of” Covered Property. Under an “ordinary and popular meaning,” *Ward Gen. Ins. Servs. Inc. v. Employers Fire Ins. Co.*, 114 Cal.App.4th 548, 554, *as modified on denial of reh’g.* (Jan. 7, 2004), the “loss of” property contemplates that the property is misplaced and unrecoverable, without regard to whether it was damaged. Further, to interpret “physical loss of” as requiring “damage to” would render meaningless the “or damage to” portion of the same clause, thereby violating a black-letter canon of contract interpretation – that every word be given a meaning (citation omitted).

(*Id.*, p. 3; emphasis added.)

Based on the foregoing, the court concluded that the “phrase ‘loss of’ includes the permanent dispossession of something.” (*Ibid.*) Likewise, because of the coronavirus epidemic, the owners of business and industrial properties have also been dispossessed of their properties. Although the court held that Total had incurred a “permanent dispossession,” that should not preclude coverage, we all hope that in this coronavirus epidemic property owners may not be permanently dispossessed of the use of their properties. This is because the business-income coverage contemplates that the insured will, at some point, resume their business at the income levels they had before the loss occurred, and therefore provides coverage for both permanent and temporary business closures. Indeed, the definition of “period of restoration,” which defines the period of covered loss, is:

“Period of restoration” means the period of time that:

a. *Begins:*

(1) 72 hours after the time of direct physical loss or damage for Business Income Coverage; or

(2) Immediately after the time of direct physical loss or damage for Extra Expense Coverage;

caused by or resulting from any Covered Cause of Loss at the described premises; and

b. *Ends on the earlier of:*

(1) The date when the property at the described 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.

(ISO Form 0032; emphasis added)

As is readily apparent, the period of business-income coverage is the duration of time between when the property is first damaged and when it is repaired.

Similarly, in *American Alternative Ins. Corp. et al. v. The Superior Court* (2006) 135 Cal.App.4th 1239, the insured sought recovery of attorney’s fees incurred in recovering possession of an airplane that had been seized by law enforcement. The court observed that the policy provided coverage for physical damage, which was defined as “direct and accidental physical loss of or damage to the *scheduled aircraft.*” The court concluded that the loss of the aircraft was a “direct and accidental physical loss.” (*Id.*, at p. 1249.) The court based its holding on “the term ‘physical damage’ [which] encompasses both injury and physical loss.” (*Id.*, at p. 1248.)

In *Pacific Coast Engineering Co., v. St. Paul Fire & Marine Co., et al.* (1970) 9 Cal.App.3d 270, the court upheld the insured’s claim for business-income loss coverage arising out of a barge fire, which included claims for additional loan interest expenses, damages for the delayed delivery of the damaged barge, and related damages. In so doing, the court observed:

[I]t is well settled that the purpose and nature of “business interruption”

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or “use and occupancy” insurance is “to indemnify the insured against losses arising from this inability to continue the normal operation and functions of his business, industry, or other commercial establishment . . .” (Annot. 83 A.L.R. 2d 885, 889). In other words, “to indemnify the insured for any loss sustained by the insured because of his inability to continue to use specified premises . . . [that is] for loss caused by the interruption of an ongoing business consequent upon the destruction of the building, plant, or parts thereof . . .” (1 Couch on Insurance (2d ed.) § 1:108, p. 102; § 1:25, p. 53). (*Id.*, at p. 275.)

Other courts have taken the same position. The insured is entitled to business-income insurance where the insured is unable to continue the normal function of his/her business. (See also *Cooper v. The Travelers Indem. Co. of Ill.*, 2002 WL 32775680).

Even those California decisions that have concluded that there was no direct physical loss actually contain language that could support coronavirus business-income loss claims. In *Ward General Ins. Services, Inc. v. The Employers Fire Ins. Co.* (1997) 114 Cal.App.4th 548, the insured made a claim for “the loss of stored computer data not accompanied by the loss or destruction of the storage medium.” The trial court found that the claim did not constitute a “direct physical loss,” as required by the policy, and the appellate court affirmed.

The policy provided business-income coverage for “direct physical loss of or damage to” property. Unlike the court in *Total*, the *Ward* court refused to adopt the interpretation of “direct physical loss or damage to property” as including the loss of use of property, because:

The word “physical” is defined, inter alia, as “having material existence” and “perceptible esp. through the senses and subject to the laws of nature.” (Merriam-Webster’s Collegiate Dict. (10th ed. 1993) p. 875) “MATERIAL” implies formation out of tangible matter. (*Id.* at p. 715)

“Tangible” means, inter alia, “capable of being perceived esp. by the sense of touch.” (*Id.* at p. 1200.) Thus, relying on the ordinary and popular sense of the words, we say with confidence that the loss of plaintiff’s database does not qualify as a “direct physical loss,” unless the database has a material existence, formed out of tangible matter, and is perceptible to the sense of touch. (*Id.*, p. 556, emphasis in original.)

In holding that there was no coverage, the court observed that the “loss suffered by plaintiff was a loss of information,” and not the loss of tangible material. (*Ibid.*) The court in *MRI Healthcare Center of Glendale, Inc. v. State Farm Gen. Ins. Co.* (2010) 187 Cal.App.4th 766, relied on a similar analysis, holding that failure of an MRI machine to ramp back up after being shut down was not a “physical loss” because there was no “distinct, demonstrable physical alteration of the MRI machine.”

But there is tangible loss in coronavirus cases. As in *Total*, insureds are losing the use of their tangible property. The *Ward* decision merely sets out the parameters of what is tangible property. (See *Ward v. Employers*, 114 Cal.App.4th at 851 [“Plaintiff did not lose the tangible material of the storage medium. Rather, Plaintiff lost the stored information” (emphasis in original).] Indeed, the *Ward* court distinguished the facts before it from those cases which found direct physical loss because the insured had lost the use of tangible property (*Id.*, 114 Cal.App.4th at p. 558, citing *Hughes v. Potomac Ins. Co.* (1962) 199 Cal.App.2d 239, 248-249 [holding that the insured’s loss of use of their home, which was undamaged, constituted direct physical loss]; and *Western Fire Ins. Co. v. First Presbyterian Church*, (Co. 1968) 165 Colo. 34, 38-39 [holding that gasoline accumulating around a building made the building uninhabitable, affording coverage for the loss of use of the building even though the building itself was not damaged].)

Finally, in a case that was likely improperly decided, the Ninth Circuit held in an unpublished opinion that the

insured’s claim for business-interruption losses arising from a fire were not covered where the losses were attributable to tenants leaving after the fire from floors that were not actually damaged by the fire. (*Commonwealth Enterprises v. Liberty Mutual Ins. Co.* (9th Cir. 1996) 101 F.3d 705). The court found that,

Under the Policy, direct physical or damage to property at the insured premises is a condition precedent to coverage for lost business income. On its face, the language encompasses a requirement of some physical damage to the floor to recover lost profits for that floor. The record reveals that there was no damage caused by the fire (i.e., from smoke, water, flames or asbestos contamination) on any floors other than 14, 15, 16 and 19. It also shows that tenants on other floors vacated because of asbestos contamination or their perception that there was asbestos contamination because of fire damage.

It would appear that the court was wrong. There is no express requirement in the business-income coverage that the property had to suffer physical damage. Indeed, as noted in *Ward*, *American Alternative*, and *Pacific Coast*, all that is required is that the insured be unable to use the property in the same way he or she did before the loss. Here, before the fire there were tenants on the floors not directly damaged by the fire. After the fire those tenants left, as did the tenants on the fire-damaged floors. The insured, therefore, had suffered a covered business income loss for tenants on all floors.

Although California courts have yet to address a case involving business-income loss arising from virus contamination, it certainly appears that a strong argument can be made that, under existing precedent, those claims should be covered.

### Civil authority coverage and coronavirus claims

#### *The ISO business income civil authority coverage*

The ISO business income policy also provides the following coverage:

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When 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, provided that both of the following apply:

(1) Access to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the described premises are within that area but are not more than one mile from the damaged property; and

(2) The action of civil authority is taken in response to dangerous physical conditions resulting from the damage or continuation of the Covered Cause of Loss that caused the damage, or the action is taken to enable a civil authority to have unimpeded access to the damaged property.

Civil Authority Coverage for Business Income will begin 72 hours after the time of the first action of civil authority that prohibits access to the described premises and will apply for a period of up to four consecutive weeks from the date on which such coverage began.

Civil Authority Coverage for Extra Expense will begin immediately after the time of the first action of civil authority that prohibits access to the described premises and will end:

(1) Four consecutive weeks after the date of that action; or

(2) When your Civil Authority Coverage for Business Income ends; whichever is later.

(ISO CP 00 30 10 12)

The Civil Authority coverage applies where “the action of civil authority . . . prohibits access to the described premises.” Many orders by governors and mayors specifically address the risk of damage to property from the coronavirus as a basis for their orders. For example, the San Francisco mayor’s February 25, 2020, Order states: “WHEREAS, Conditions of extreme peril to the safety

of persons and property have arisen” (emphasis in original) Similarly, the City of New York Emergency Executive Order of March 15, 2020, provides: “WHEREAS, this order is given because of the propensity of the virus to spread person to person and also because the *virus physically is causing property loss and damage* [emphasis added].” Such orders should serve as the basis for seeking business-income loss coverage because of civil authority action.

Insurers will likely seek to rely on *Syufy Enterprises v. Home Ins. Co. of Ind.*, (N. D. Ca. March 21, 1995) 1995 WL 129229, to deny coverage for business-income losses under the Civil Authority coverage. There, the district court, applying California law, held that an insured could not make a business-income loss claim when several municipalities issued orders following the Rodney King verdict that imposed dawn-to-dusk curfews. The court reasoned that the orders did not “*specifically deny access to*” the insured’s business, movie theatres, where the policy provided coverage only where access was specifically prohibited to the insured’s property because of damage or destruction of adjacent property. This language is, however, significantly different from that in the ISO form, and possibly other policy forms. The ISO form does not provide that the order must *specifically* prohibit access to the insured’s property, but rather that the order merely and generally “prohibits access to the described premises.” Clearly, orders shutting down businesses would fall within this coverage.

It is also important to note that, elsewhere, it has been held that the civil authority coverage, like the basic business-interruption coverage, applies where there is only the loss of the insured property. Therefore, in *Sloan v. Phoenix of Hartford Ins. Co., et al.*, (Mich. App., 1973) 207 N.W.2d 434, the court held that the civil authority provision did not require physical damage to property to trigger coverage. Owners and operators of movie theaters made a claim for business-interruption coverage following

a curfew ordered by the Governor of Michigan in response to widespread riots. After reviewing the plain language of the policy, the court held that there was business-interruption coverage under the civil authority provision for losses incurred to comply with the governor’s order.

Because of the great number of mayoral and gubernatorial orders requiring the affected residents to shelter in place and close nonessential businesses, the Civil Authority coverage will likely be the most commonly relied-upon coverage for business losses arising from the coronavirus epidemic.

### Extended business income coverage and the Coronavirus

#### *The ISO extended business income coverage*

The ISO business income policy also provides the following coverage:

1. If the necessary suspension of your “operations” produces a Business Income loss payable under this policy we will pay for the actual loss of Business Income you incur during the period that:

2. Begins on the date property (except “finished stock”) is actually repaired, rebuilt or replaced and “operations” are resumed

3. Ends on the earlier of:

(i) The date you could restore your “operations”, with reasonable speed, to the level which would generate the business income amount that would have existed if no direct physical loss or damage had occurred; or

(ii) 60 consecutive days after the date determined in (1)(a) above. (ISO CP 00 30 10 12.)

#### *The application of extended business income coverage to coronavirus claims*

As noted above, the Civil Authority coverage may be limited to only a few weeks. Further, it is likely that, once a business such as a restaurant or hotel reopens, it will take time for that business to get back to where it was before it had to close. That is where Extended

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Business Income coverage comes into play. Extended Business Income provides coverage for a period of time, usually limited, for the business to get back to where it was before the loss occurred.

An important issue with Extended Business Income is whether it can be “tacked onto” the Civil Authority coverage to, in effect, extend the time business-income coverage is provided. Several courts have held that this can be done. Therefore, in *Campo v. Allstate Ins. Co.*, No. 06-7182, 2008 WL 239831, at \*2 (E.D. La. 2008), the Court held that, because there was “no reference to physical loss in the 60 day provision,” it provided “for exactly what it says it provides for, and would include a loss of income once reopened after Civil Authorities had prevented the [policyholder] from operating their business.”

Similarly, in *Audubon Internal Medicine Group v. Zurich American Insurance Co.*, No. 07-4874, 2008 WL 2718928 (E.D. La. July 10, 2008), the court held that the severity of this [policyholder’s] losses indisputably triggered two independent coverage provisions. The court observed that, “[a]s a general rule the claimant may recover under all available coverages provided that there is no double recovery.” Likewise in *Wellmeyer v. Allstate Insurance Co.*, 2007 WL 1235042 (E.D. La., April 26, 2007), the court, quoting *15A Couch on Insurance* 2d S 56:34 (1983), noted that, “[a]s a general rule the claimant may recover under all available coverages provided that there is no double recovery.” (*Id.* at fn. 2). Other courts, however, have held that an insured cannot collect under both Civil Authority and Extended Business Income coverages. For example, in *Courtenay, Hunter & Fontana, LLP v. Massachusetts Bay Ins. Co.*, No. 07-976, 2008 WL 3876421, at \*3 (E.D. La. Aug. 19, 2008), the court appeared to hold that Extended Business Income coverage could not be claimed following a business-income claim under the Civil Authority coverage.

Accordingly, there is authority for a policyholder to seek coverage beyond the

Civil Authority coverage for the period of time it takes the policyholder to “ramp” its business back up.

### Extra expense coverage

#### *The ISO extra expense coverage*

ISO provides two types of Extra Expense coverages. The first provides coverage for only the amount that the insured’s extra expenses reduce the period of restoration, but the second is not so limited. The former, Extra Expense coverage, provides:

2. Extra Expense
  - b. Extra Expense means necessary expenses you incur during the “period of restoration” that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss.

We will pay Extra Expense (other than the expense to repair or replace property) to:

- (1) Avoid or minimize the “suspension” of business and to continue operations at the described premises or at replacement premises or temporary locations, including relocation expenses and costs to equip and operate the replacement location or temporary location.
- (2) Minimize the “suspension” of business if you cannot continue “operations.”

We will also pay Extra Expense to repair or replace property, but only to the extent it reduces the amount of loss that otherwise would have been payable under this policy. (ISO CP 00 30 10 12.)

#### *Extra expense coverage and coronavirus claims*

The Extra Expense coverage could extend to costs arising from the coronavirus, such as providing for security at the property while it is unoccupied, advertising costs to resume the business, and costs incurred to disinfect the property before it is reoccupied. Indeed, in *Brand Mgmt., Inc. v. Maryland Cas. Co.*, No. 05-cv-02293, 2007 WL 1772063, at \*2 (D. Colo. June 18, 2007), the

court held that the policyholder, a sushi manufacturer which closed for 15 days to disinfect its premises after discovery of listeria contamination, could make a business income claim for “the period in which its premises was decontaminated.”

Although protocols for cleaning properties before reoccupancy are only now being propagated by the federal (CDC) and state governments, it is important to note that the International Institute of Cleaning and Remediation Contractors (“IICRC”), on March 19, 2020, issued its *Preliminary Report for Restoration Contractors Assisting Clients with COVID-19 Concerns*, in which the IICRC noted the following:

With the proper training, equipment, supplies and personal protective gear, restoration contractors who have experience dealing with other hazardous microorganisms, such as sewage mitigation and mold remediation, can offer valuable services to combat COVID-19. *The most basic service will likely be enhanced cleaning of touchpoints and application of disinfectants to other surfaces.* (Emphasis added.)

#### *Extra expense coverage and payroll expenses*

Extra Expense coverage may also extend to continuing payroll expenses. Although coverage for continuing payroll may be provided by endorsement (see ISO CP 15 04 06 07, “Discretionary Payroll Expense”), the Extra Expense coverage may also provide coverage for continuing payroll (See *Hampton Foods, Inc. v. Aetna Cas. & Sur. Co.*, 601 F.Supp. 58, 61 (E.D. Mo. 1984); and see Thayler, Gregory S., “Hurricane Insurance Claims: Key Coverages in the Property Policy,” Lexisnexis.com, November 6, 2008, “Even without [ordinary payroll] coverage, some policyholders announce that they include these costs in the claim as reasonable extra expenses especially if it reduced other losses in the claim”).

Coverage for payroll either under the Business Income coverage for continuing expenses or under the Extra Expense

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coverage is likely to be a point of great contention with the insurance industry. Nonetheless, it may also allow employers to keep their employees on salary or wages during the period of restoration, and thereby positively impact the nation's unemployment rate.

### **Claims that cannot wait**

By combining various components of the business-income coverage, the practitioner may be able to provide his or her client with substantial relief

from their significant business-income losses. This discussion does not, however, address the many other issues that will have to be faced, including the application of any virus or pandemic exclusions, as well as the pollution or mold exclusions, to claims arising out of the coronavirus. The practitioner is best advised to immediately communicate with clients and start calculating their business-income losses. Under the current circumstances, these are insurance claims that cannot wait.

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