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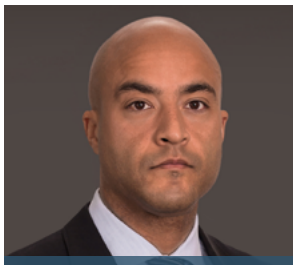
Anticipating Business Interruption Coverage Issues Arising From Covid-19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By Aaron Peterkin

Canadians are responding bravely to an unprecedented world event. States of emergency have been declared in provinces, municipalities, and cities; temporarily closing businesses with a view to reducing community transition of COVID-19.

Many of us continue to work from home, which is a privilege given widespread business closures across Canada. Undeniably, most Canadian businesses will experience loss and damage or reduced profits directly or indirectly arising from present events. In the months and years to come, many businesses will look to their insurers for indemnification. Indeed, property insurers will soon be considering a multitude of very challenging claims that raise issues of causation, interpretation, mitigation, and valuation under commercial property and business interruption coverage forms.

Too casual an approach to coverage questions leads to costly litigation, bad faith claims, public disapproval, and legislative intervention. The duty of good faith requires a fair interpretation of the policy and prompt payment of a claim when it has merit. In evaluating any claim arising from the COVID-19 pandemic, it will be vitally important to ensure your policy's language is properly considered and clearly understood. In the below discussion, we envisage a variety of reasonably possible "grey area" scenarios that might trigger coverage under common property wordings.

Covered & Uncovered Causes

The issue of concurrent causation (i.e. where loss arises from both a covered and excluded cause) is likely to be one of the most vexing in the coming days. Many commercial property policies exclude losses arising from "*pathogens*", "*viruses that pose a hazard to human health*", governmental action, and utility failures, all of which are soon to form part of complicated causal chains.

For example, we can easily envisage a concurrent cause scenario whereby a governmentally ordered business closure or a utility failure leads to the temporary absence of employees and the failure of a fire suppression system at an insured property, which then sustains a loss by fire or flood. In such an instance, the insurer must ascertain whether the relevant exclusionary clause incorporates "*anti-concurrent causation*" language (i.e. the respective use of "*directly or indirectly*" and "*directly*" in the exclusionary and excepting phrases), which may dramatically impact indemnity obligations.

To illustrate, the British Columbia Court of Appeal's reasoning in *Canevada Country Communities Inc. v. GAN Canada Insurance Co.*[1], is authority for the following interpretative propositions:

- The concepts of "direct cause" and "proximate cause" are <u>not</u> synonymous. The terms "*directly*" and "*indirectly*" … "*are intended to capture the sense in which an event leads straight or immediately to its consequence*."

- When the exclusionary phrase withdraws coverage for property damage "*directly or indirectly*" by an excluded peril (e.g. order of a civil authority or utility failure), but excepts property damage caused "*directly*" by another peril (e.g. fire or flood) then:

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1. 1999 BCCA 339

- Property damage caused **directly** by the excluded peril (e.g. order of a civil authority or utility failure) **is still excluded**, when the excepted peril forms only an indirect part of the causal chain (e.g. fire or flood);

- Property damage caused **indirectly** by the excluded peril (e.g. order of a civil authority or utility failure) **is not excluded if the** excepted cause (e.g. fire or flood) interposes itself between the excluded peril and the property damage. Coverage is preserved only if the excepted peril is the direct cause of the property damage at issue.

With these principles in mind, we observe that a loss excluded by a policy that employs "*directly or indirectly*" phrasing might indeed be covered under a "plain language" policy that doesn't incorporate "*anti-concurrent causation*" language.

The lesson? Don't jump to conclusions based on "general principles" before you review the coverage form to figure out the policy mechanics.

Business Interruption

As many of us know, commercial property policies often include an additional coverage for lost business income arising from covered perils that cause "damage" to the insured's business. Of course, the question of whether an insured's business interruption coverage is triggered by a COVID-19 related loss will often turn on how the wording defines "damage" for the purposes of business interruption and how particular perils are excluded (e.g. "*pathogens*", "*viruses*" and "*anti-concurrent causation*" language).

Firstly, many business interruption wordings define "damage" as requiring "*direct physical loss of or damage to*" the insured's property, the scope which will soon be the subject of vociferous debate. Canadian authorities reflect that the terms "*'physical loss' and 'damage' denote an alteration in the appearance, shape, colour or other material dimension of the property insured*"[2], which should not be especially helpful to insureds seeking coverage for a COVD-19 related closure (time will tell). The following decisions provide analogous guidance:

- In *Transfield Constructions v GIO Australia*[3], the Court of Appeal of New Zealand ruled that the City council's order prohibiting occupation due to a significant ongoing risk of post-earthquake rock fall was not "*physical loss of or damage to*" the insured properties for the purposes of insurance coverage. The Court observed: "*it is loss or damage that reaches and touches [the insured property] and not loss or damage to objects other than the property, such as the insured person or that person's enjoyment of the property, that is covered. … Nothing physical of relevance to this claim has happened "to" the property. It has not been hit by a boulder or suffered other injury resulting from destabilization of the hill. The only reason the house cannot be used is because there are legal prohibitions on its use. Those legal prohibitions in themselves are not physical loss.*"

- *In Source Food Technology, Inc. v. U.S. Fidelity and Guar. Co.*[4], an insured beef wholesaler sought business interruption coverage for lost revenue flowing from the US Department of Agriculture's embargo of Canadian

2. *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Co., 2015 BCCA 347*
3. *[1996] NSWCA 538.*
4. *(2006) 465 F.3d 834*

beef (i.e. imposed after reports of bovine spongiform encephalopathy or "mad cow" disease). The Eighth Circuit Court of Appeals held there had been no physical loss to the insured's property arising from the federally ordered embargo, explaining: "*Although [the insured's] beef product in the truck could not be transported to the United States due to the closing of the border … [it] was not … physically contaminated or damaged in any manner. To characterize [the insured's] inability to transport its truckload of beef product across the border and sell the beef product in the United States as direct physical loss to property would render the word "physical" meaningless. … the policy's use of the words "to property" further undermines [the insured]'s argument that a border closing triggers insurance coverage under this policy. [The insured] did not experience direct physical loss to its property. Therefore, [the insured] cannot recover the loss of business income resulting from the embargo on beef products under insurance policy provisions requiring direct physical loss to its property*."

- *In PBM Nutritionals, LLC v. Lexington Ins. Co.*[5], the insured manufactured baby formula that became contaminated with unsafe levels of a particular organic compound. All batches manufactured during a certain period were determined to be unfit for human consumption and were unmarketable. The contamination exclusion in the insured's business interruption policy withdrew coverage for damage resulting from "*any material which after its release can cause or threaten damage to human health or human welfare or cause or threaten damage, deterioration, loss of value, marketability or loss of use to property insured hereunder, including, but not limited to, bacteria, fungi, virus, or hazardous substances*." The Supreme Court of Virginia agreed that the exclusion was not limited to environmental or "outdoor" contamination scenarios, stating: "*No language … suggests the discharges or dispersals of pollutants or contaminants must be into the environment or atmosphere. ... According to their plain language, the pollution exclusions are not restricted to traditional environmental pollution. The circuit court did not err in refusing to limit the Insurers' pollution exclusion endorsements to traditional environmental contamination losses*."

Also, be aware that not every policy wording requires that the impugned "damage" be to insured property. Imagine a scenario where uninsured perishable "stock" or "goods" are lost or damaged while the business is closed due to COVD-19 restrictions (e.g. from water damage from a burst pipe). Even though no covered property was damaged, could there still be coverage for lost profits? The short answer is maybe. Put simply, some policy wordings don't require physical damage to covered property to trigger business interruption coverage. In every case, the particular wording needs to be examined. To illustrate:

- *In J.K. Expressions Jewellery Inc. v. Gerling Global General Insurance Co.*[6], the question was whether the loss of uninsured stock (i.e. theft of jewelry) triggered business interruption coverage where the insuring agreement provided coverage "*against loss directly resulting from necessary interruption of business caused by destruction or damage by the perils insured against, to building(s), structure(s), machinery, equipment or stock on the described premises*." With respect to this particular wording, BC's Court of Appeal agreed with counsel's submission that "*if [the insurer] did not wish to insure [the insured business] against business interruption related to uninsured stock, all the insurer had to do was insert the word "insured" before the word "stock" in the business interruption coverage*."

Review your policy's specific wording before making any conclusions about how coverage is triggered.

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5. 724 S.E.2d 707
6. 2002 BCCA 86

Contingent Business Interruption

Many insurers offer "contingent business interruption coverage", which protects insureds against "*losses sustained as a result of interruption of their own business caused by an interruption in the flow of goods or services*."[7] With that in mind, imagine a scenario where an "upstream" supplier of raw materials to an insured's business suffers a fire loss while its warehouses are vacant or understaffed, which in turn delays the insured's return to profitability after a COVD-19 related closure. Could there be coverage for lost or reduced profits even though the insured suffers no property damage? Yes but, again, it depends.

There are relatively few Canadian authorities that consider contingent business interruption coverage wordings, the most notable being *Neste Canada Inc. v. Allianz Insurance Co. of Canada*.[8] In this case, the Alberta Court of Appeal considered the scope of coverage against "*loss resulting from interruption of business due to damage to or destruction of property of … the facilities of suppliers of the insured; [or] … transport companies*." "Supplier" was defined as "*an entity not owned or operated by the Insured that delivers goods or services (other than purchased services) to the Insured or to others for the account of the Insured*." The Court of Appeal considered whether the particular wording covered damage to "suppliers of suppliers" and concluded that it did.

The takeaway? Not every policy includes contingent business interruption coverage. When it does, read the wording carefully (including the definitions) to understand the scope and triggers of coverage.

Prevention of Access Clauses

Some policies include "prevention of access" or "ingress/egress" coverage, which indemnifies against lost income arising from an inability to access the business premises. The coverage may not require damage to the insured's own property. With that in mind, imagine a scenario where a utility failure and subsequent fire at an unattended neighboring business doesn't cause any damage to the insured's property, but prevents access to the business for an extended period of time. Can there be coverage in this scenario without damage to insured property? Again, it depends on the wording. For example:

- *In Royal Indem. Co. v. Retail Brand Alliance, Inc.*[9], the policy at issue insured against loss "*resulting from interruption of or interference with the Business in consequence of loss destruction or damage to property*" in the vicinity of the premises which shall "*prevent or hinder the use of the Premises or access thereto*," and "*cause a fall in the number of customers attracted to the vicinity of the Premises*." After the September 11, 2001 attack, the insured sought to rely upon this coverage because its business premises were in proximity to the World Trade Centre. In the New York Appellate Division's view, there was no coverage under the form because "*it is clear that destruction of the World Trade Center has not "prevented" the use of or access to the store after it reopened. … while the World Trade Center is no longer in existence, there is no indication that its absence hampered or delayed anyone's ability to enter the store and make a purchase, or prevented suppliers from delivering merchandise.*"

7. *Neste Canada Inc. v. Allianz Insurance Co. of Canada 2006 ABQB 922 at para. 15*
8. *2006 ABQB 922, aff'd 2008 ABCA 71*
9. *(2006), 33 A.D.3d 392*

- *The issue in Fountain Powerboat Industries, Inc. v. Reliance Ins. Co*.[10], arose from a hurricane that flooded the roads leading to the insured's facility. While the business responded by providing alternate transportation for its workers, production at its facility fell to one-third of full capacity. The business sought indemnification under its lack of ingress/egress coverage, which provided indemnification for "*loss sustained during the period of time when, as a direct result of a peril not excluded, ingress to or egress from real and personal property not excluded hereunder, is thereby prevented*." On the wording of this clause, the American Court found "*that no requirement for physical loss to the property is required under the contract of insurance in order to trigger business interruption coverage under the ingress/egress clause*."

Again, not every policy includes ingress/egress coverage, which varies significantly from wording to wording. Know what coverages your policy includes and read the wording.

Interruption by Civil Authority

On March 23, 2020, the Ontario Government ordered the mandatory closure of all non-essential workplaces for an interim specified period. As other provincial and municipal authorities follow suit, insurers can readily anticipate a multitude of such claims under "*Interruption by Civil Authority*" coverage. In each such instance, coverage will turn upon the specific directions of the governmental order and, again, the particular wording at issue. A few high-profile American cases illustrate the potentially different outcomes:

- In *Syufy Enterprises v Home Ins. Co.*[11], the Court considered losses arising from a "dawn-to-dusk curfew" ordered by civil authorities following the Rodney King verdict. In this instance, the insured movie theatre business could not recover under an Interruption by Civil Authority Clause that insured against business interruption "*resulting directly from an interruption of business … when as a direct result of damage to or destruction of property adjacent to the premises herein described by the perils insured against, access to such described premises is specifically prohibited by order of civil authority*." The California Court observed the policy's requirement that governmental authorities specifically deny access to the described insured premises. In this instance, governments hadn't specifically prohibited any from entering the insured's business, explaining "*Under the clear terms of the policy, a civil authority must specifically deny access to [the insured's] theater. Here, no civil authority ever specifically prohibited any individual from entering a theater; rather, the cities imposed dawn-to-dusk curfews to reduce the possibility of rioting and looting. Because access to a [the insured's] theater was never specifically denied, coverage for a business interruption loss was never triggered.*"

- In *Allen Park Theatre Co. v Michigan Millers Mut. Ins. Co*.[12], another insured theater owner claimed indemnification for business interruption losses following closure of theaters pursuant to an "*executive order closing all places of amusement within Wayne County due to the civil disturbance which occurred subsequent to the death of Martin Luther King*." The policy at issue provided business interruption cover for "*Interruption By Civil Authority: This policy is extended to include the actual loss As covered hereunder, during the period of time, not exceeding 2 consecutive weeks, When as a direct result of the peril(s) insured against, access to the premises described is prohibited by order of civil authority*." Finding coverage in favour of the insured, the

10. *(2000), 119 F.Supp.2d 552*
11. *(1995, ND Cal) 1995 US Dist LEXIS 3771*
12. *(1973) 48 Mich App 199, 210 NW2d 402,*

> majority of the Court of Appeals of Michigan explained "*if the insurer wanted to be sure that the payment of business interruption benefits had to be accompanied by physical damage it was its burden to say so unequivocally*."

Again, the result will turn on how your policy directs that coverage is triggered and the manner in which the insured experienced loss. Don't guess in preference of a particular result.

Concluding Remarks

The aftermath of the COVID-19 pandemic will be an incredibly sensitive period, which will require clear understanding of operative policy language and a fulsome appreciation of the duty of good faith. While the scrutiny and denial of uncovered claims is always permissible, as never before, it will be important to avoid even the merest perception that the insurer's own interests are being preferred over the insured's. Coverage decisions must be based on reasonable investigations and founded in the clear wording of the policy. Insurers, adjusters, and coverage counsel can't "shoot from the hip" as we consider COVID-19 pandemic related claims. Too much is riding on how we handle this. Let's take the time it takes to get it right.

Questions?

Should you have any questions with respect to this bulletin, or if you would like more detailed information on how COVID-19 may be affecting the insurance industry, please contact Aaron.

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