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PERSPECTIVE

Business property insurance may cover COVID-19-related losses

By Ryan McCarl and John Rushing

Do all-risk business property insurance policies cover losses related to COVID-19? A recent decision out of the Western District of Missouri in the case *Studio 417, Inc. v. Cincinnati Ins. Co.*, 20-cv-03127-SRB (W.D. Mo. Aug. 12, 2020), suggests that some courts will hold that the answer is "yes" if the policy's coverage language is broad enough and if the policy does not exclude losses due to viruses or pandemics. The *Studio 417* ruling is vitally important to business owners, insurers, and their counsel.

Background

A first-party property insurance policy compensates the insured for certain forms of loss. The term "loss" typically denotes the amount that the insured is entitled to receive in order to repair or replace the damaged property to the condition it had before the loss. *See* Bruce Cornblum, 2 Cal. Ins. Law Dict. & Desk Ref. Section L55 (2020 ed.). Some policies require that the loss be "physical," a term that excludes compensation for intangible losses such as purely economic harm. *Id.*; *see also Doyle v. Fireman's Fund Ins. Co.*, 21 Cal. App. 5th 33, 38 (2018) (holding that an insured who was sold counterfeit products did not suffer a compensable "loss" under the first-party valuable property insurance policy).

Business owners who have been hurt by COVID-19 — whether by voluntary shutdowns, government- mandated shutdowns, or workplace outbreaks — are increasingly confronting the question of whether their insurance policies cover those harms. Insurers, courts, and legal counsel are grappling with the same issue.

In light of the rule that every word in a policy should be given effect, it is critical for insurers to exercise care in drafting the coverage provisions.

Studio 417, Inc. v. Cincinnati Ins. Co.

The *Studio 417* plaintiffs brought a class action against their insurer for refusing to cover COVID-19 losses. The court denied the insurer's motion to dismiss the insured's complaint, holding that the plaintiffs had stated a plausible claim that the policy — an "all-risk" policy covering all non-excluded "accidental physical loss or accidental physical damage" — covered COVID-19-related harms. The policy did not define "physical loss" or "physical damage"; nor did it exclude losses from viruses, pandemics, or communicable diseases.

The policy at issue provided for "business income" coverage, "civil authority" coverage, "ingress and egress" coverage, "dependent property" coverage, and "sue and labor" coverage, and the court held that all five coverages potentially encompassed the alleged COVID-19 losses.

The insurer contended that the policy covered only income losses tied to "actual, tangible, permanent, physical alteration of property" and that COVID-19 hurts people rather than property. However, the court accepted as reasonable the plaintiffs' argument that the policy covered not only "physical damage" but also "physical loss," and that the COVID-19 harms counted as "physical loss" even if they did not "damage" any property.

The court cited cases holding that even if property is not physically altered, a "physical loss" can occur if the property is made uninhabitable or unusable for its intended purpose. One case, for example, stated that if asbestos so contaminated a property as to make it useless or uninhabitable, that would count as a "physical loss." *See Port Auth. of New York & New Jersey v. Affiliated FM Ins. Co.*, 311 F.3d 226, 236 (3d Cir. 2002). Other cases have reached a similar conclusion where gasoline vapors (*Western Fire Ins. Co. v. First Presbyterian Church*, 165 Colo 34, 36-37 (1968)), methamphetamine odors (*Farmers Ins. Co. of Oregon v. Trutanich*, 123 Or. App. 6, 10 (1993)), and carbon monoxide levels (*Matzner v. Seaco Ins. Co.*, 1998 WL 566658 (Mass Super. 1998)) made a structure unusable.

Analyzing the *Studio 417* order

Intuitively, loss resulting from COVID-19 closures is arguably more analogous to pure economic harm than to physical damage caused by,

for example, a fire or flood. Certainly insurers and their counsel will likely see it that way.

Edge cases involving intangible or semi-tangible phenomena such as odors and asbestos dust are arguably distinguishable, because COVID-19 is usually transmitted directly from person to person through respiratory droplets. Although the virus can live on surfaces, scientists remain uncertain as to whether humans can be infected by physical contact with those surfaces.

However, COVID-19 is arguably "physical," even if intangible, because it can attach to surfaces and because the transmission of virus-containing droplets can be partially blocked by masks. Further, the *Studio 417* order comports with several canons of contract interpretation: that ambiguous policy terms are construed against the insurer and in favor of coverage (*Garamendi v. Mission Ins. Co.*, 131 Cal. App. 4th 30, 42 (2005) (noting that this rule applies only if an inquiry into the plain meaning of the terms and the reasonable expectations of the insured does not otherwise resolve the ambiguity)), and that every word in an insurance policy should be given effect. (*Gray1 CPB, LLC v. Kolokotronis*, 202 Cal. App. 4th 480, 487 (2011) ("The Court has a duty to construe every provision of a written instrument as to give force and effect, not only to every clause but to every word in it, so that no clause or word may become redundant.")).

In light of the rule that every word in a policy should be given effect, it is critical for insurers to exercise care in drafting the coverage provisions. Specifically, they should not unintentionally expand coverage by pairing near-synonyms such as "loss" and "damage" unless they intend those terms to cover different risks. All too often, contract drafters unthinkingly include synonym strings without considering how a court might differentiate each term. Some synonym strings, such as "each and every" and "any and all," are merely redundant; they are unlikely to affect substantive interpretation. Other synonym strings, such as "damage and loss," can significantly expand the way a provision is interpreted.

Relatedly, insurance counsel should monitor industry drafting practices so that they do not unwittingly neglect to draft exclusions for risks that they do not intend to cover. Had the insurer in *Studio 417* drafted an exclusion for viruses and pandemics, this dispute might never have arisen. (However, some insured parties appear to be seeking compensation even when their policy covers virus-related losses. *See* Defendant's Br. in Support of Mot. to Dismiss Class Action Compl., *Fountain Enterps., LLC v. Markel Ins. Co.*, 1:20-cv-03689 (N.D. Ill., filed Aug. 19, 2020)). Alternatively, the insurer might have been able to define "physical loss" in a way that reduced the vagueness of that term and thereby excluded virus-related losses from its scope.

Lessons for counsel

In evaluating whether an all-risk insurance policy covers COVID-19 business interruption claims, counsel should follow a two-step analysis. First, they should consider whether the broad coverage language — covering, for example, "physical damage or loss" — can be interpreted as encompassing business income loss resulting from COVID-19 or COVID-related closures. Counsel should then consider whether the policy contains any exclusion for loss resulting from viruses or pandemics.

In future litigation, the first question — whether COVID-related income loss falls within the broad coverage provisions — will be vigorously disputed whenever the policy, like the policy in *Studio 417*, covers physical "loss" in addition to physical "damage." Litigation and insurance counsel should carefully monitor the fast-moving developments in this area. ■

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