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Commentary

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In the wake of punishing economic losses caused by COVID-19-related shutdown orders, business owners across the country have turned to their insurers for relief in the form of business interruption coverage.[1] In New York, the state hit hardest by the pandemic,[2] the need for this relief is particularly urgent.

If recent reports are any indication, however, New York businesses hoping to receive coverage under their business interruption policies will face an uphill battle. In particular, insurers and courts may deny relief to business owners on the basis of: 1) an absence of direct physical damage to the insured's property; and/or 2) policy provisions that exclude coverage for damage attributable to viruses.[3]

Despite these challenges, New York law may offer a potential path to recovery for at least some businesses struggling with the devastating impact of COVID-19. Of course, the viability of any insurance claim will depend on the specific terms of the insured's policy. And, as explained below, New York courts have typically been reluctant to grant business interruption coverage in cases where a property suffered no direct physical damage.

While finding a path to coverage may prove difficult, at least two principles of New York law suggest that COVID-19-induced losses could be recoverable under the business interruption (and related) clauses of some insurance policies. In short, coverage could be available because: 1) an insurable loss of use could occur even if there were no physical damage to the covered property; or 2) the business was the subject of a governmental shutdown order that satisfies the policy's civil authority clause.

I. Loss of Use Limitations

Most business interruption policies limit recovery to losses attributable to some "direct physical loss or damage" to the business owner's property.[4] Not surprisingly, litigation tied to business interruption coverage frequently centers on the question of what constitutes "direct physical loss or damage" under an insured's policy.

Insurers may argue that "direct physical loss or damage" necessarily refers to actual, tangible damage to an owner's property. Indeed, in some policies, the definition of "physical loss or damage" may be narrow enough to preclude coverage for any "loss or damage" other than

actual, physical alteration to the subject property. In other policies, however, the language may be expansive enough to include losses that do not directly result from direct, tangible damage.

In *Willets Point Contracting Corp. v. Hartford Insurance Group*, for example, the Court of Appeals recognized that, in some cases, an insurance policy's definition of "property damage" may be "broad" enough to "provide[] coverage for *loss of use* of tangible personal property *without* physical damage thereto."[5] In *Willets Point*, a business owner sued a contractor for failing to maintain a means of access to the plaintiff's business during a construction project. The contractor later sought a declaration that its insurer had a duty to defend it in the suit; while the court ultimately found (on unrelated grounds) that the insurer had no duty to defend, the court also noted that the contractor's "general liability policy's broad definition of property damage" extended to "coverage for loss of use of" the subject property, even without evidence of tangible, physical damage.[6]

Courts in other jurisdictions have applied this same principle to business interruption policies. For example, in *American Guarantee & Liability Insurance Co. v. Ingram Micro, Inc.*, a U.S. District Court in Arizona ruled that the plaintiff was entitled to business interruption coverage after a brief, hours-long power outage had rendered its computer systems unusable.[7] Although the insurer argued that the systems "were not 'physically damaged' because their capability to perform their intended functions remained intact," the court held "that 'physical damage' is not restricted to the physical destruction or harm of [the disputed property] but includes loss of access, loss of use, and loss of functionality."[8]

Likewise, in *Western Fire Insurance Co. v. First Presbyterian Church*, the Supreme Court of Colorado held that the plaintiff, a church, had suffered a "direct physical loss" when the local fire department ordered an evacuation of the church due to gasoline fumes in the building.[9] The insurer argued that the church had suffered no physical injury and instead experienced a "mere 'loss of use' of the church premises occasioned by the 'closing down' of the building by the fire authorities."[10] But the court found that the church's "loss of use" was "the consequential result of . . . the accumulation of gasoline around and under the church building," which "equate[d] to a direct physical loss" because it made the church "uninhabitable" and rendered "further use of the building highly dangerous."[11] Other courts have reached similar conclusions.[12]

Although these out-of-state rulings may offer some hope to New York business owners, to date, no New York court has extended business interruption coverage to circumstances where a property owner suffered only a loss of use of the subject property. In fact, the First Department rejected such a claim for coverage in *Roundabout Theatre Co. v. Continental Casualty Co.*[13] In *Roundabout*, the plaintiff, a theater company, sought coverage under a business interruption policy after the City of New York temporarily denied access to the theater due to a nearby construction accident.[14] The plaintiff theater argued that the "loss of use of the premises" constituted a "direct physical loss" within the meaning of the policy.[15] However, after reviewing multiple interdependent sections of the policy, the court found that the policy language "clearly and unambiguously provide[d] coverage only where the insured's property suffer[ed] direct physical damage."[16]

In one of the few cases to consider the relevance of business interruption policies to COVID-19-related shutdown orders, the U.S. District Court for the Southern District of New York recently relied on *Roundabout* in rejecting an insured's claim for coverage. In *Social Life Magazine, Inc., v. Sentinel Insurance Company Limited*, [17] the plaintiff, a printer of a monthly magazine, claimed substantial business income losses resulting from Governor Andrew M. Cuomo's shutdown order in New York.[18] At a preliminary injunction hearing, U.S. District Judge Valerie E. Caproni found the plaintiff had not suffered a "loss of use" that would be covered under the policy. Citing *Roundabout*, the court reasoned that the plaintiff's business was not actually uninhabitable; instead, any claimed damage had resulted from the Governor's order "to stay home"—not from "any particular damage to [the plaintiff's] specific property."[19] The court thus held that the plaintiff was unlikely to succeed on the merits and denied the preliminary injunction request.[20] The case is now on appeal to the Second Circuit.[21]

Like the unsuccessful plaintiff in *Social Life*, business owners seeking COVID-19-related coverage in New York will face the difficult task of explaining why *Roundabout*'s reasoning does not dispose of their claims. While doing so will likely prove challenging in many

cases, there are at least three plausible reasons to question *Roundabout*'s broad applicability to all claims for COVID-19-related business interruption coverage.

First, to the extent that *Roundabout* suggests the term "physical loss or damage" necessarily excludes loss of use of an insured's property, this reasoning appears to be at odds with the Court of Appeals' decision in *Willets Point*. There, New York's highest court recognized that the definition of "property damage" in certain policies may be "broad" enough to "provide[] coverage for *loss of use* of tangible personal property *without* physical damage thereto."[22]

Second, the genesis of the shutdown order in *Roundabout* was an "off-site" construction accident, and the plaintiff *conceded* that nothing about the conditions in its own building had rendered the property uninhabitable or unsafe. The court thus limited its analysis to the question of whether the insured's policy included loss of use "resulting from off-site property damage"—not loss of use resulting from unsafe conditions in the insured's own property.[23] In the case of COVID-19, by contrast, the loss of use arguably flows from a concern that the insured's property is itself unsafe for use.

Third, the *Roundabout* court reached its conclusion only *after* canvassing multiple interdependent sections of the insured's policy which, combined, suggested the policy solely covered "physical damage."[24] In future suits involving language that is not identical to *Roundabout*'s, courts will need to conduct a different analysis tailored to the specific policy terms at issue.

Ultimately, then, *Roundabout* instructs courts to look closely at the precise language of a given business interruption policy in order to determine the scope of the coverage provided. As the Court of Appeals made clear, at least some of these policies may be "broad" enough to include "coverage for loss of use," even "without physical damage thereto." [25] And if, in making this assessment, the court determines that the policy language is ambiguous, that ambiguity may "be construed in favor of the insured and against the insurer."[26]

These principles of insurance policy interpretation, coupled with on-point rulings from other jurisdictions (as discussed above), provide one potential path to coverage in New York. Nevertheless, the First Department's reasoning in *Roundabout*—along with the court's recent ruling in *Social Life*—will pose significant roadblocks for plaintiffs hoping to recover under a policy's business interruption clause.

II. Civil Authority Coverage

Even if an insured can demonstrate that loss of use qualifies as "physical loss or damage" within the meaning of a business interruption policy, some policies may still contain express exclusions for damage attributable to viruses. While those exclusions might extend to losses covered under the terms of the business interruption coverage itself, most policies also contain a closely related provision known as "civil authority coverage."[27] This type of coverage generally applies in cases where a government order "forbids or prevents access to the insured's premises."[28]

For two reasons, coverage for the impact of a government order could be a natural fit for some COVID-19-related losses suffered by New York businesses that were subject to shutdown orders.[29]

First, if a policy's virus exclusion does not expressly extend to orders of a governmental authority, then the insured could potentially recover under the civil authority provision *even if* the policy otherwise excludes coverage for viruses. New York "courts typically apply the efficient proximate cause rule—meaning that the insured is entitled to coverage . . . if the covered peril is the 'predominant cause of the loss or damage.'" *Parks Real Estate Purchasing Group. v. St. Paul Fire & Marine Insurance Co.*, 472 F.3d 33, 48 (2d Cir. 2006). Insureds could thus argue that Governor Cuomo's shutdown orders—not the virus itself—constitute the "predominant cause" of the losses affecting New York businesses during the pandemic. The court in *Social Life* made a similar point when it posited that the plaintiff's losses had resulted from the Governor's order "to stay home," not from "any particular damage to [the plaintiff's] specific property."[30]

Second, civil authority coverage may permit a business owner to avoid the question of whether its property suffered "physical loss or damage" within the meaning of the policy. Some policies may not require any physical damage to receive civil authority coverage. In *Abner, Herrman & Brock, Inc. v. Great Northern Insurance Co.*, for example, the insured's civil authority coverage specified that it would "pay for the actual business income loss you incur due to the actual impairment of

your operations . . . when a civil authority prohibits access to your premises."[31] Although the insured had "suffered no physical damage to its property" due to the events of September 11th, the court found that the plaintiff was still entitled to business income losses incurred while its operations were inaccessible.[32]

In other policies, civil authority coverage may require some demonstration of physical loss or damage. Business owners will therefore run into the same problems discussed with respect to business interruption clauses—namely, the lack of tangible, physical damage to the covered property. But, unlike traditional business interruption coverage, civil authority coverage does not necessarily require damage to the insured's *own* property; in some policies, the loss or damage need only apply to "adjacent premises."[33] In a recent claim for COVID-19-related coverage filed in New York County's Commercial Division, for example, the insured's policy extended civil authority coverage to cases where "[a]ccess to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the [insured's] premises are within that area but are not more than one mile from the damaged property."[34]

Even if courts are reluctant to find that a particular business was contaminated with COVID-19—such that it suffered "physical loss or damage" within the meaning of the policy—courts may be willing to find that at least *some* businesses within a short distance of the insured's premises were so contaminated. That is particularly true in New York City, where a one-mile radius will likely sweep in thousands of businesses subject to the shutdown. In fact, this very assumption arguably formed the principal basis for the shutdown order—even if the government could not pinpoint specific businesses where the virus was present, it concluded that a critical mass of properties were so affected that a general shutdown order was necessary. In this case, then, COVID-19-induced shutdown orders could fall squarely within the ambit of some civil authority coverage provisions.

III. Takeaways

New York courts will likely face a flood of new business interruption coverage cases in the coming weeks and months. Ultimately, the viability of these claims will depend on the particular terms of each policy. And the courts' decisions in *Roundabout* and *Social Life* signal that, regardless of the policy language at issue, New York courts may be reluctant to extend business interruption coverage to the current pandemic.

At the same time, certain principles of New York law suggest that at least some business interruption (and potentially related) policies could provide coverage for COVID-19-related losses. In particular, insureds may argue that 1) the loss of a property's intended use counts as "physical loss or damage" within the meaning of a business interruption policy and/or 2) a policy's civil authority coverage extends to the insured's business closure, regardless of whether the property itself suffered physical damage. Though largely untested in the courts, these two strategies, individually or in combination, offer a potential path forward for business owners hit hard by government shutdown orders in the wake of the pandemic.

Endnotes

1. Some businesses have also invoked their property insurance coverage, which may raise related coverage issues. This article does not address property insurance or other forms of insurance, e.g., event cancellation insurance written to cover cancellation of scheduled events for enumerated reasons that may or may not include the consequences of a pandemic.

2. As of the time of this article, New York had over 397,000 COVID-19 cases and had suffered almost 25,000 deaths. *See Our Data*, The Covid Tracking Project, https://covidtracking.com/data (last accessed July 7, 2020).

3. These denials could be subject to intervention by the state legislature. The New York State Assembly recently proposed legislation requiring that business interruption policies "be construed to include among the covered perils under that policy, coverage for contingent business interruption during a period of a declared state emergency due the coronavirus disease 2019 (COVID-19) pandemic." N.Y. State. Assembly, Proposed Bill No. A10226(1)(d) (2020). The bill is currently in committee, but its likelihood of passage is far from certain. *See* Peter Senzamici, "NYC Businesses Say Insurance Companies Shafted Them on COVID Claims," *The City* (July 5, 2018), https://www.thecity.nyc/2020/7/5/21312054/nyc-business-say-insurance-companies-shafted-on-covid-claims.

4. *See, e.g.*, *Roundabout Theatre Co. v. Cont'l Cas. Co.*, 302 A.D.2d 1, 3 (1st Dep't 2002) (describing policy that applied to "all risks of direct physical loss or damage to the [covered] property").

5. 53 N.Y.2d 879, 881 (1981) (emphases added).

6. *Id.* at 880–81.

7. 2000 U.S. Dist. LEXIS 7299, 2000 WL 726789, at *2 (D. Ariz. Apr. 18, 2000).

8. *Id.*

9. 437 P.2d 52, 55 (Colo. 1968).

10. *Id.* at 54.

11. *Id.* at 55.

12. *See, e.g.*, *TRAVCO Ins. Co. v. Ward*, 715 F. Supp. 2d 699, 708 (E.D. Va. 2010) ("The majority of cases appear to support Defendant's position that physical damage to the property is not necessary, at least where the building in question has been rendered unusable by physical forces."); *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2014 U.S. Dist. LEXIS 165232, 2014 WL 6675934, at *5 (D.N.J. Nov. 25, 2014) (noting "that property can sustain physical loss or damage without experiencing structural alteration").

13. 302 A.D.2d 1 (1st Dep't 2002).

14. *Id.* at 1.

15. *Id.* at 5.

16. *Id.* at 7. Citing *Roundabout*, a federal district court similarly held in 2014 that "'direct physical loss or damage' . . . unambiguously requires some form of actual, physical damage to the insured premises to trigger loss of business income and extra expense coverage." *Newman Myers Kreines Gross Harris, P.C. v. Great N. Ins. Co.*, 17 F. Supp. 3d 323, 331 (S.D.N.Y. 2014).

17. *See* S.D.N.Y., Case No. 20-cv-3311.

18. *See id.*, DE 8-19 at 8.

19. *Id.*, DE 24-1 at 8.

20. *See id.* at 14.

21. *See* Case No. 20-1587.

22. 53 N.Y.2d at 881 (emphases added).

23. 302 A.D.2d at 8.

24. *Id.*

25. 53 N.Y.2d at 881 (emphases added).

26. *Lend Lease (US) Const. LMB Inc. v. Zurich Am. Ins. Co.*, 28 N.Y.3d 675, 682 (2017).

27. *See* Peter E. Kanaris, *Analytical Approach to Business Interruption, Extra Expense, and Civil Authority Coverage Issues*, 43 Tort Trial & Ins. Prac. L.J. 113, 133 (2007).

28. *Id.*

29. In New York, Gov. Andrew M. Cuomo has issued a series of executive orders shutting down retail, food and beverage, and other non-essential businesses, and barring non-essential workers from going to their offices. *See* Exec. Order Nos. 202.1-40. Those orders are subject to a phased reopening plan, which will include different plans for different regions of the state. As of the date of this article, New York City has recently entered into Phase III of its reopening, which will allow restaurants and certain food-service businesses to reopen without indoor dining. *See* Press Release, "Governor Cuomo Announces New York City Enters Phase III of Reopening Without Indoor Dining and Subject to State Guidance Today," Office of Governor Andrew M. Cuomo (July 6, 2020), https://www.governor.ny.gov/news/governor-cuomo-announces-new-york-city-enters-phase-iii-reopening-without-indoor-dining-and (last visited July 8, 2020).

30. *Id.*, DE 24-1 at 8.

31. 308 F. Supp. 2d 331, 334.

32. *Id.* at 335.

33. Kanaris, *supra* note 22 at 137.

34. *Michael J. Redenburg, Esq., PC v. Midvale Indemnity Company*, No. 651869/2020 (Sup. Ct. N.Y. Cty.), DE 3 at 21. ■

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