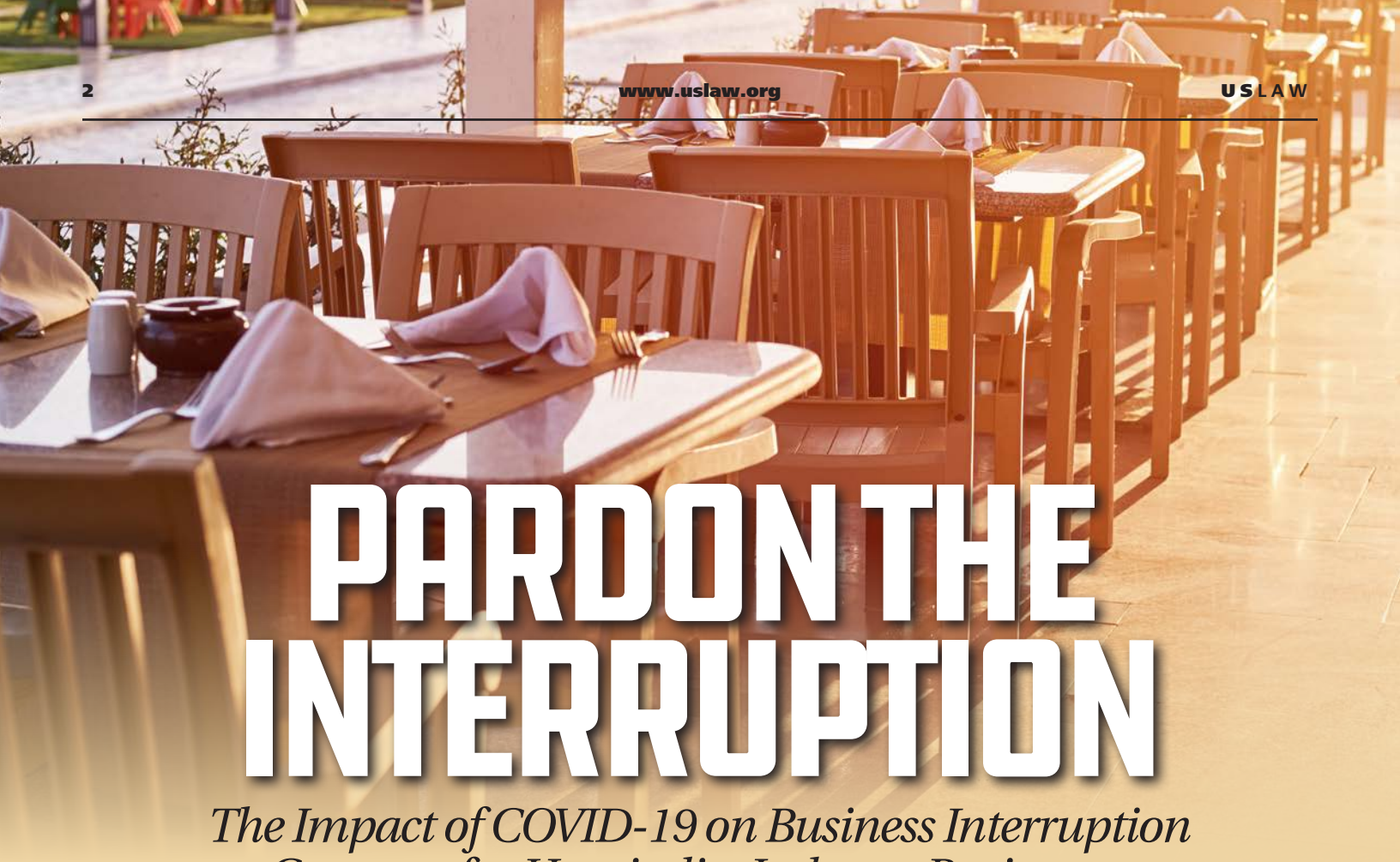

PARDON THE INTERRUPTION

The Impact of COVID-19 on Business Interruption Coverage for Hospitality Industry Businesses

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In 2019, if you took a poll of businesses in the hospitality industry about the business interruption risks they anticipate and strategically plan for, almost none of them would say "a global pandemic." However, to insurers, pandemics are a well-known risk. In fact, in 2008, a global insurer who underwrites some of the largest risks in the world dedicated an entire publication to this issue because a "pandemic is inevitable." In its report, the insurer predicted a "repeat" of the 1918 pandemic with the two largest GDP reductions in the arts and entertainment and accommodations and food sectors.[1]

To address the rapid spread of COVID-19 in early 2020, governments issued myriad shelter-in-place orders and pandemic restrictions. The hospitality industry, from restaurants to hotels to casinos, was effectively shuttered. These establishments were thought to greatly contribute to the spread of the virus and could not be safely operated and, consequently, suffered significant income losses. These establishments did not even have to have a confirmed case of COVID-19 to be closed; the hospitality industry primarily suffered from pandemic-related restrictions implemented by governmental and civic authorities.

In an attempt to recoup losses incurred as a result of pandemic-related restrictions and closures, businesses in the hard-hit hospitality industry turned to the business interruption coverage in their insurance's property/casualty policies. This type of insurance coverage replaces lost income in the event that the business is halted due to direct physical loss or damage, typically resulting from a fire or natural disaster. However, to these businesses' dismay, their insurers denied coverage for these losses, leaving the businesses reeling. Many have not and will never recover. Searching for a lifeline, hundreds of businesses in the hospitality industry sought relief from courts all over the country. In the overwhelming majority of cases, the courts have sided with the insurers. Many of these cases involve "all risks" policies that automatically cover any risk that the insurance contract does not explicitly omit. In addition to the interpretation of the common business income coverage provision, many cases involve policies that also include a "virus exclusion."

BUSINESS INCOME AND VIRUS EXCLUSION PROVISIONS

Business interruption coverage is premised on the business income policy provision that requires: 1) a covered event causing physical loss or damage to the insured's property, 2) suspension of operations, and 3) loss of business income.

The provenance of virus exclusions stems from the SARS outbreak in 2003. Virus exclusions typically state that the insurer will not pay for loss, damage or both caused by or resulting from any virus, bacterium, or other microorganism that induces or is capable of inducing physical distress, illness, or disease. The exclusion goes on to specifically state that it applies, among other things, to "business income," i.e., business interruption.

A handful of policyholders have successfully argued that COVID-19-related shutdowns caused the closure of their business, caused their business to operate at limited capacity, or caused them to modify floor plans to allow for social distancing, if there is no virus exclusion in the policy. In cases where there is a virus exclusion in the policy, most policyholder claims have been summarily dismissed.

For example, in a COVID-19-related business insurance dispute brought in federal court in California, two separate policyholders, one a salon and the other a restaurant, brought suit against their insurance carrier who previously determined that both losses were not covered.[2] While both policies provided virtually the same coverage for loss of business income, the

restaurant's policy contained a virus exclusion.

Consistent with the majority of rulings on this issue so far, the court dismissed the restaurant's claim, as its policy had a virus exclusion. However, the beauty salon's policy was an all risks policy with no virus exclusion. The court looked at the policy language to interpret the phrase "caused by direct physical loss or damage to property." The main question addressed was: If the COVID-19 pandemic mandated business closures, did those closures result in "direct physical loss or damage to property?"

Insurers typically argue that the phrase "direct physical loss or damage" unambiguously requires some actual, physical damage to the insured premises. In this case, the insurer argued that the presence of the word "physical" precludes any claim for intangible changes to a property, such as the potential presence of a virus or order which disrupts business but does not change the property. The policyholder successfully argued that physical loss is different than physical damage.

While it appears to be difficult to argue that neither the virus itself nor the accompanying governmental orders and restrictions caused physical damage to businesses' properties, businesses have successfully argued that it is possible that these orders caused physical loss. At various points throughout the pandemic, businesses were forced to shutter, rendering their properties unsuitable for their sole purpose—the operation of a business. If a business was not allowed to operate or invite others onto its property, it was "disposed" of in some way. The result very much depends on how an insurance policy defines physical loss, and this varies by jurisdiction. The definition must allow that physical alteration to the property is not necessary to constitute a physical loss.

COVID-19 "HARMS PEOPLE, NOT PROPERTY"

In a contrasting example, the federal court in Massachusetts denied a major restaurant group's claim for business interruption coverage when there was no virus exclusion in the policy.[3] The court analyzed the business income provision with the very same language—that the lost income and expenses were caused by "direct physical loss or damage" to the businesses' properties—but concluded that the virus harms people, not property. The policyholder buttressed this argument by contending that the civil authority clause in the policy (government entity prohibits access) required the insurer to pay for business interruption losses resulting from action of a civil authority. However, the court concluded that the policyholder was not prohibited from carry-out and delivery options.

CHECK THE POLICY LANGUAGE

In a case filed by a tribal casino in state court in Oklahoma, the court determined that the policyholder was entitled to indemnity on business interruption coverage under its tribal property insurance policy (TPIP).[4] The casino, like many other businesses, closed its business operations to implement mitigation protocols and modifications to safely operate. Even though the TPIP all risks policy does not use standard ISO language,[5] the court determined that insurers cannot assign special meaning to the triggering proposition in the casino's TPIP policy. The court accepted the casino's proposition that "loss of use" is sufficient to establish business interruption without physical impairment of the property. The loss was determined to be that the casino property was rendered useless due to the reasonable precautionary measures implemented in response to the COVID-19 pandemic.

This case highlights further distinguishable issues. The policy also included a virus exclusion. Is a pandemic loss different than a virus loss, and should the virus exclusion definition be expanded to include pandemics? Does the business close because of the presence of the virus, or is the closure due to pandemic restrictions? In this case, the court agreed that virus exclusions only apply where there is proof of actual viral presence.

STAY TUNED

In March, a large casino and entertainment company sued its insurers in Nevada state court for denying its business interruption claims for over $2 billion in losses due to the COVID-19 pandemic. The casino alleges that it paid $25 million in premiums to its insurers for all risk insurance and that there was no applicable exclusion for the denial of coverage. It claims that all of its properties were shut down in March 2020 (including its 47,000 hotel rooms) under order of the gaming control board and other civil authorities. Most of the properties reopened with limited operations in May and June 2020. This may be the largest suit filed so far regarding a COVID-19 coverage dispute. Therefore, it is expected that the outcome will have a significant impact on how insurers write coverage for the hospitality industry in the future.

CONCLUSION

Although there appears to be some limited success for policyholders in the arguments regarding the definition of "direct physical loss" in the business income provision of their insurance policies, there has been very little success when the policies contain a virus exclusion. When insurers utilize standard ISO form policy language, the special meaning assigned to "direct physical loss of property" varies by jurisdiction. In the meantime, in an apparent attempt to address virus exclusion and civil authority provision loopholes, insurers are now issuing coverage with exclusions, including a new policy endorsement limiting coverage for certain civil authority orders relating to COVID-19. Do not be surprised to see this or similar endorsements in new policies and renewals or even an expansion of the virus exclusion to specifically exclude direct physical loss or damage due to pandemics. Businesses seeking policies should anticipate additional scrutiny by insurers in business contingencies and risk planning to procure coverage.

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1 See "Pandemic: Potential Insurance Impacts," Lloyd's, May 2008.

2 See *Kingray Inc. v. Farmers Grp. Inc.*, 2021 U.S. Dist. LEXIS 41300, 2021 WL 837622.

3 See *Legal Sea Foods, LLC v. Strathmore Ins. Co.*, 2021 U.S. Dist. LEXIS 43097, __ F. Supp. 3d __, 2021 WL 858378.

4 See *Choctaw Nation of Oklahoma v. Lexington Insurance Company*, Bryan County, OK, CV-2020-00042 (2/15/21).

5 ISO is a national insurance policy drafting organization that develops standard policy forms and then files them with each state's insurance regulators.