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Business Interruption Coverage

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How Is It Calculated

Business interruption coverage typically covers "actual" loss of business income for a period of time after a loss has occurred. "Business income" typically means Net Income that would have been earned and continuing normal operating expenses including payroll. It is calculated by determining the earnings of the business prior to the loss, as well as the potential earnings thereafter, had no loss or damage occurred. The purpose of this coverage is to put the insured in the earnings position it would have been in had the insured peril not occurred. When calculating business income loss, an insurer must consider the amount of the business's income which would have been realized had no loss or damage occurred. An income increase that may have been earned as a result of favorable conditions caused by the Cause of Loss is not included.

The Coverage

Most business interruption provisions require direct physical loss or damage to property insured under the policy as a prerequisite to business interruption coverage, which usually triggers the period of restoration (typically defined as the length of time required with the exercise of due diligence and dispatch to rebuild, repair or replace the damaged premises). The coverage typically also requires an "interruption" or "suspension" of operations during the period of restoration. Like "all-risk" physical damage coverage, it is the insured's burden to prove that business income losses fall within the coverage. *Admiral Indem. Co. v. Bouley Int'l Holding, LLC,* 2003 U.S. Dist. LEXIS 20324 (S.D.N.Y. Nov. 10, 2003).

Where a suspension of business operations is not caused by direct physical loss or damage, there is no business interruption coverage. *Philadelphia Parking Auth. v. Federal Ins. Co.*, 385 F.Supp.2d 280, 289 (S.D.N.Y. Jan. 14, 2005); *United Airlines, Inc. v. Ins. Co. of the State of Penn.*, 385 F.Supp 2d 343, 349 (S.D.N.Y. March 31, 2005); *National Children's Expositions Corp. v. Anchor Insurance Co.*, 279 F.2d 428 (2d Cir. 1960) (no business interruption coverage due to lost attendance from snowstorm because no portion of building damaged); *Port Auth. Of New York & New Jersey v. Affiliated FM Ins. Co.*, 245 F. Supp. 2d 563 (D.N.J. May 1, 2001).

Courts nationwide have held that time element coverage applies only to a discrete period of time, and losses sustained or expenses incurred after that time period are not compensable. *Pennbarr Corp. v. Ins. Co. of N. Am.*, 976 F.2d 145 (3rd Cir., 1992). It is based on the "period of restoration" which is the time period (less any waiting period, typically 72 hours) between the loss and when the condition causing the loss *should* have been able to be repaired with reasonable speed. Generally, coverage applies to "actual loss sustained" over this period of time and there is no separate limitation on coverage.

Several states require that the "suspension" of operations be a complete cessation of activity. The inability of an insured to fully perform their operations is not a necessary suspension. *National Children's Expositions Corp. v. Anchor Insurance Co.*, supra; *Madison Maidens, Inc. v. Am. Mfrs. Mut. Ins. Co.*, 2006 U.S. Dist. LEXIS 39633 (S.D.N.Y. June 14, 2006); *Apartment Movers of America, Inc. v. OneBeacon Lloyd's of Texas*, 2005 WL 106477 (N.D.Tex. 2005); *Royal Indem. Ins. Co. v. Mikob Properties, Inc.*, 940 F.Supp. 155, 156 (S.D.Tex. 1996) (holding that if the insured's premises are still operating, a Business Interruption clause will not cover a decrease in income).

Extra Expense

Extra Expense is an element in business interruption coverage that reimburses an insured for expenditures it would not have incurred but-for the loss necessary to keep the business operating. Extra Expense typically must reduce the loss otherwise payable. Direct physical loss or damage is still a prerequisite and an insured is only entitled to loss of business income during the period of restoration. *Dictiomatic, Inc. v. U.S. Fidelity & Guar. Co.*, 958 F.Supp. 594 (S.D.Fla. 1997).

Extended Business Income Coverage

This is otherwise known as "ramp-up" coverage and applies to a time period after business operations resume. It pays for business income loss beginning on the date the covered property is actually repaired/replaced and ends at that time when, using reasonable speed, the business would have returned to pre-loss income levels. There is typically a time limitation placed on this coverage such as 30 days.

Civil Authority Coverage

Civil Authority coverage is an extension to business interruption coverage which provides indemnity for the actual loss of business income and extra expense incurred as a result of actions of civil or military authority that prohibit or, in some instances, impair access to the insured's property due to direct physical loss or damage to a different property.

Many Civil Authority provisions do not require the physical loss or damage to be at or even near the insured's property to implicate the Civil Authority coverage, as long as other requirements are met. However, damage to an insured's property is required when the Civil Authority provision states that the order of civil authority must be caused by physical loss or damage to insured property. *See, Roundabout Theatre Company, Inc. v. Continental Cas. Co.,* 302 A.D.2d 1 (App. Div., 1st Dep't 2002). In the absence of specific policy language requiring physical loss or damage to insured property, most modern courts interpret Civil Authority provisions as not requiring physical loss or damage to insured property. *Broad St. LLC v. Gulf Ins. Co.*, 832 N.Y.S.2d 1 (App. Div., 1st Dep't 2006).

Where a business interruption coverage extension requires that the loss be caused by property damage, other social or economic factors are not sufficient to trigger coverage. *See, Philadelphia Parking Auth. v. Federal Ins. Co.*, 385 F.Supp.2d 280 (S.D.N.Y. 2005) (the FAA's nationwide ground stop, which was issued for fear of future terrorism and barred all airplanes at all airports from taking off or landing, "temporarily obviated the need for [the insured's] parking services").

There are various other issues which affect coverage under Civil Authority provisions, including the following: (1) the order must be caused by actual physical damage to property other than the insured's premises; (2) there must be an order of Civil Authority, and the order must prohibit access to the premises in the nature of a cordoning off; (3) the physical damage must be caused by a covered peril; (4) the order must cause an interruption of business; and (5) the interruption resulting from the order must cause a loss of income. Furthermore, the language contained within both the insurance policy and the orders of authority play a critical role in determining coverage.

There are a number of cases which discuss the application of Civil Authority provisions where a municipality issues an evacuation order in advance of an approaching catastrophe. *See, Dickie Brennan & Co. Inc. v. Lexington Ins. Co.,* 636 F.3d 683 (5th Cir. 2011); *South Texas Medical Clinics, P.A. v. CNA Financial Corp.*, 2008 U.S. Dist. LEXIS 11460 (S.D.Tex. 2008). In *Dickie Brennan*, the United States Court of Appeals for the Fifth Circuit addressed whether the mandatory evacuation of New Orleans prior to the arrival of Hurricane Gustav could trigger the policy's civil authority provision. The civil authority provision at issue in *Dickie Brennan* stated:

> We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil or military authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss. . . .

Dickie Brennan at 685. One of the elements the insured must prove under the wording of this provision is that "the action of civil authority prohibiting access to the described premises must be caused by direct physical loss of or damage to property other than at the described premises." *Id.* The Court held that the insured needed to prove "a causal link between [the] prior damage and [the] civil authority action." *Id.* at 687.

The reasoning employed by the courts in *Dickie Brennan* is similar to the logic employed by courts analyzing the application of civil authority provisions after 9/11. *See, United Air Lines, Inc. v. Ins. Co. of the State of Pa.,* 439 F.3d 128 (2d Cir. 2006); *The Paradies Shops, Inc. v. Hartford Fire Ins. Co.* 2004 U.S. Dist. LEXIS 30124 (N.D.Ga. 2004).

In *United Air Lines*, the airline sought to recover its loss of earnings under the policy's civil authority provision during the government's suspension of flights into and out of Ronald Regan Washington National Airport. *United Air Lines* at 134. Under the civil authority provision at issue in *United Air Lines*, the airline was required to demonstrate that the order of civil authority was a direct result of physical damage to property adjacent to the airline's insured property at the Airport. *Id.* at 131. The airline claimed that this provision was satisfied because the Pentagon was adjacent to the Airport and sustained damage. The United States Court of Appeals for the Second Circuit held that even if the Pentagon was considered "adjacent" to the airline's property at the Airport, the airline could not show that the airport was shut down "as a direct result of damage to" the Pentagon. *Id.* at 134. The Court found that the civil authority order was issued based on "fears of future attacks" and had nothing to do with "repairing, mitigating, or responding to the damage caused by the attack on the Pentagon." *Id.* at 135. Therefore, the Court held that there was no causal relationship between the civil authority order and the damage to other property, as required for coverage, and upheld the insurer's denial of coverage. *Id.*

Civil authority provisions usually require a "prohibition" of access to insured property, meaning that there must be an order that actually prohibits access to insured property in the nature of a complete and specific cordoning off. *See, 730 Bienville Partners v. Assurance Co. of North Am.*, 2002 WL 31996014 (E.D.La 2002), aff'd 67 Fed.Appx. 248, 2003 WL 21145725 (5th Cir.); *Syufy Enter. v. Home Ins.Co.*, 1995 WL 129229 (N.D.Cal.).

In *Kean, Miller, Hawthorne, D'Armond McCowan & Jarman, LLP v. National Fire Ins. Co. of Hartford,* 2007 WL 2489711 (M.D.La. 2007), an insured law firm with multiple locations contended that as a result of Civil Authority advisories and recommendations related to Hurricane Katrina, it was forced to close down one of its offices. The insured subsequently filed a claim under the "Civil Authority" coverage provision of its policy. The Court reasoned that in order to trigger the civil authority clause, there must be a loss of business income: (1) caused by an action of Civil Authority; (2) the action of Civil Authority must prohibit access to the described premises of the insured; (3) the action of Civil Authority prohibiting access to the described premises must be caused by direct physical loss of or damage to property other than at the described premises; and (4) the loss or damage to property other than the described premises must be caused by or result from a covered cause of loss as set forth in the policy. In dismissing the insured's claims, the Court found that the second element was not met as the "advisories and recommendations given did not 'prohibit access' to the insured premises." The Court held that the language of the policy unambiguously required that the premises be "prohibited" by civil authority and that there was no evidence that the insured was prevented from accessing the premises due to an order of civil authority.

Civil Authority provisions typically require that there be an actual "order" or "action" that prohibits or impairs access to the insured property. A general evacuation recommendation is likely not enough to constitute an "order" for purposes of the Civil Authority provision. *See, e.g., Kean, Miller, Hawthorne, D'Armond McCowan & Jarman, LLP v. National Fire Ins. Co. of Hartford,* 2007 WL 2489711 (M.D.La. 2007). The order must specifically apply to the premises. *See, Syufy Enter. v. Home Ins.Co.,* 1995 WL 129229 (N.D.Cal.); see also, *By Development, Inc. v. United Fire & Cas. Co.*, 2006 WL 694991 (D.S.D.).

Civil Authority coverage also requires that the order must arise from direct physical loss caused by or resulting from a covered cause of loss. Thus, where an excluded peril and a covered peril combine to cause physical loss or damage, and the policy contains anti-concurrent causation language, the Civil Authority coverage should also be excluded. *Narricot Indus. v. Fireman's Fund Ins. Co.*, 2002 U.S. Dist. LEXIS 19074 (E.D. Pa. Sept. 30, 2002) (unpublished).

It should be noted that civil authority provisions are often sublimited to a specific period of time (i.e., 30 consecutive days, 4 consecutive weeks, etc.). Moreover, it has been held in *Aztar Corp. v. U.S. Fire Ins. Co.,* 223 Ariz 463, 224 P.3d 960 (Ariz.App. 2010) that the extended period of indemnity in many BI policies does not apply to a Civil Authority provision. Thus, the coverage will end when the order of authority expires, or the specific time period in the policy is exhausted, whichever is earlier. *See generally, Broad St. LLC v. Gulf Ins. Co.,* 832 N.Y.S.2d 1 (App. Div., 1st Dep't 2006); *Abner, Herrman & Brock, Inc. v. Great Northern Ins. Co.*, 308 F.Supp 2d 331 (S.D.N.Y. 2004).

In *Broad Street,* an apartment complex in Manhattan was cordoned off by the city after the terrorist attack on 9/11, forcing the residents of the apartment to evacuate. The entire area suffered power outages and was covered in soot. The city allowed residents back about a week after the attack. Even though the building was open and accessible, apartment management was losing money from missing tenants and a lack of new potential tenants. Therefore, the insured claimed BI due to civil authority coverage for an extended period of restoration. The court agreed that business interruption due to civil authority coverage applied, but only until the city allowed residents to return. After that, the access was no longer prohibited.

Contingent Business Interruption

Contingent Business Interruption insurance provides coverage for business interruption losses caused by physical loss or damage to "dependant" properties that interrupt the flow of goods or service and causes a "necessary interruption" of the insured's business. Contingent Business Interruption is meant to provide coverage to "[e]ntities that rely on 'third parties'… in case their income is disrupted by damage to third party property. *Zurich Am. Ins. Co. v. ABM Indus.*, 397 F.3d 158, 168 (2d Cir. N.Y. 2005).

There are several limitations to coverage for Contingent Business Interruption: (1) There must be direct physical loss or damage to dependent property from a covered peril at the requisite location. Property which is owned or operated by an Insured may not qualify as a dependent property. *Zurich v. ABM*, 397 F.3d at 169-170; *but see, Park Electrochemical Corp. v. Continental Cas. Co.*, 2011 WL 703945 (E.D.N.Y.). (2) There must be a suspension of the insured's operations. It is not sufficient that the dependent property experience service interruption, civil authority, ingress/egress or other non-physical losses. *Pentair, Inc. v Am. Guar. & Liab. Ins. Co.,* 400 F.3d 613 (8th Cir. 2005) (service interruption); *Penton Media, inc. v. Affiliated FM Ins. Co.,* 2006 WL 2504907 (N.D.Ohio) (civil authority). (3) The insured must sustain an actual loss of business income during the period of restoration. (4) Actual loss of business income must be caused by the suspension that resulted from the physical loss or damage to dependent property.

Business Interruption Coverage for COVID-19 Claims

Several states have proposed legislation which attempts to require policies of insurance to be construed to include "global virus transmission or pandemic" as a covered peril. This would potentially contradict typical property policies which require "direct physical loss or damage to covered property" to trigger coverage. Limited case law exists with respect to the interpretation of direct physical loss or damage in a situation like COVID-19. While most courts have interpreted the term "direct physical loss or damage" narrowly, others have taken a broader approach.

Most courts have interpreted "direct physical loss" to require actual physical or visible damage to covered property. See, *Great Northern Ins. Co. v. Benjamin Franklin Federal Sav. & Loan Ass'n.*, 1992 WL 16749 (9th Cir. 1992) (unpublished) (asbestos contamination represents an economic loss and not a physical loss, as the building remained physically unchanged); *Mama Jo's, Inc. v. Sparta Ins. Co.*, 2018 WL 3412974 (S.D. Fla. 2018) (A direct physical loss 'contemplates an actual change in insured property then in a satisfactory state, occasioned by accident or other fortuitous event directly upon the property causing it to become unsatisfactory for future use or requiring that repairs be made to make it so.); *Mastellone v. Lightning Rod Mut. Ins. Co.*, 175 Ohio App.3d 23 (2008) (mold is not "physical loss" where it can be removed by bleaching and treating affected areas).

Some courts, however, have found coverage under property policies based on something less than actual "physical loss or damage." Proof

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that contamination or other relatively intangible conditions like bacteria or gases which "rendered the insured property temporarily or permanently unusable or uninhabitable may support a finding that the loss was a physical loss to the insured property." *Mellin v. Northern Sec. Ins. Co.,* 115 A.3d 799 (N.H. 2015); see also *Gregory Packaging, Inc. v. Travelers Property Casualty. Co.* of America, 2014 U.S. Dist. LEXIS 165232, (D.N.J. 2014).Under many commercial property policies, viruses, pandemics and contagious/infectious diseases such as COVID-19 are often excluded perils.

In our experience, while many municipalities have closed certain businesses or locations, the requirement of "physical loss or damage" must still be met in order for there to be business interruption coverage under a property policy. There is also a paucity of case law concerning interpretation of a Virus Endorsement.

As legislators move to retroactively create coverage, insurance industry have taken the position that business interruption coverage does not and is not "designed to, provide coverage against communicable diseases such as COVID-19." When asked about the proposed legislature, the National Association of Mutual Insurers ("NAMIC") stated that "retroactively requiring contractual changes for which no premium was collected is a dangerous, unprecedented and unconstitutional proposal that NAMIC emphatically opposes."

Forcing insurers to provide retroactive business interruption coverage could also impact the financial stability of the sector. Alternatively, insurers have begun to work with policyholders on flexibility in premium payments and charitable relief efforts. They have also called on federal assistance to provide funding to those individuals and businesses most in need.

Evaluation of COVID-19 business interruption claims should be made on a claim-by-claim basis.

About Kaufman Dolowich & Voluck LLP

KDV is a nationally recognized, AV-rated® law firm serving the business community in a number of practice areas. Originally founded over 33 years ago as a boutique labor and employment law firm, KDV has established a strong reputation in areas of commercial litigation, directors and officers liability (D&O), all matters involving financial institutions, professional liability coverage and defense, and insurance coverage and litigation. The firm's attorneys are seasoned legal practitioners and litigators who place clients first, think like business people, and provide viable, innovative solutions.

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