Lawyer Insights

Setting the Correct Prism for Construing Policy Language in COVID-19 Business Interruption Cases Can Be Outcome Determinative

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Much of the national discussion regarding whether COVID-19 causes "direct physical loss or damage" has been incorrectly cast as binary – either policyholders' construction is correct or insurers' construction is correct. This approach has led some judges to approach the issue as though there is only one correct meaning and they must choose. This is a false choice. In most jurisdictions, the issue is not whether the policyholder's position is *correct* but whether the policyholder's construction is a *reasonable* one. Insurers must establish that the policyholder's interpretation of the policy terms is unreasonable, and that theirs is the only reasonable one, to deny coverage. However, this foundational point has been lost in the binary, "who is right" discussion currently playing out before the courts.

1. Common Legal Principles for Interpreting Insurance Policies

1. General Principles

Business-interruption insurance is a standard-form coverage that is part of commercial property-insurance policies. These forms are written by insurance-industry organizations and cannot be used without approval by insurance regulators in most jurisdictions around the country. The standardization of insurance policy terms allows for "apples-to-apples" comparisons and, thus for the mass-marketing of insurance. Because they are offered on a "take-it-or-leave-it" basis, insurance policies qualify as adhesion contracts, and, under black-letter law, ambiguities are construed in favor of coverage, against the insurance-company drafter.

Courts around the country have adopted the following principles of interpretation regarding standard-form policy language:

- The plain meaning of policy terms apply, subject to the refinements below.
- Coverage grants and related terms are interpreted broadly, in favor of coverage.
- Exclusions and limitations of coverage are interpreted narrowly, against the insurer.
- Ambiguous terms are construed against the insurer, who drafted them.
- Ambiguity exists if the language has two or more reasonable interpretations.

- The insurer must prove its interpretation is the only reasonable one.
- Insurance policies are construed as a whole, and every term is given effect. No term should be ignored as mere surplusage.
- Insurance policies are construed to avoid rendering contractual obligations illusory.

2. Court Decisions Can Establish the Reasonableness of an Interpretation

The issue of whether there is coverage is based on whether the policyholder's interpretation of the policy terms is "a" reasonable construction, and not whether it is the "only" reasonable construction. Courts commonly use dictionary definitions and contemporaneous publications in resolving the issue, and both sides cite to these.

However, policyholders also may assert that another court's finding in favor of the interpretation advanced by the policyholder establishes the interpretation is "a" reasonable one. This approach enables the policyholder to rely on any cases which support its construction and avoid the scorecard of wins and losses. Insurers are hard pressed to take exception to this approach, which they routinely use in defending against charges of bad-faith conduct *(viz., asserting decisions from other jurisdictions support the reasonableness of their conduct*.)

2. COVID-19 Reasonably Results In Direct Physical Loss or Damage

Having set the prism for construing insurance wording, we turn to the central language bearing on COVID-19 business-interruption insurance coverage. All-risks property policies, which protect against all risks not expressly excluded, commonly require "direct physical loss of or damage to" property.

Policyholders have argued that "damage" is a broad concept and encompasses COVID-19 related shutdowns, to which insurers argue there must be physical damage to infrastructure (which term does not appear in policies). Policyholders reply there is such damage. This dispute is outside the scope of this article, which, focuses instead on the position that COVID-19 can cause "direct physical loss of" property.

1. Loss

An expansive approach to the term "damage" is not policyholders' only position. Policyholders argue in the alternative that, based on the rule that every word in a contract should be given a meaning, the disjunctive in "physical loss of or damage to" property, means the coverage grant applies where there is loss *or* damage. Here, "loss" would mean something different than "damage."

Courts routinely construe the phrase to encompass various types of losses that may not present physical damage, such as:

Loss of use or function: In *Western Fire Insurance Co. v. First Presbyterian Church,* 165 Colo. 34 (1968), gasoline fumes under a church rendered it uninhabitable, constituting direct physical loss. In *Hughes v. Potomac Insurance Co.,* 199 Cal. App. 2d 239 (1962), after a landslide, a home situated on cliff was intact but nonetheless uninhabitable and useless; denying coverage for a useless facility would render coverage

illusory. And, in *Matzner v. Seaco Insurance Co*., 1998 WL 566658 (Mass. Super. 1998), carbon monoxide levels rendering an apartment building uninhabitable constituted direct physical loss.

Inaccessibility: In *Murray v. State Farm*, 203 W.Va. 477 (1998), the threat of future rock fall rendered homes uninhabitable or unusable. In *Manpower Inc. v. Insurance Co. of the State of Pennsylvania*, 2009 U.S. Dist. Lexis 108626; 2009 WL 3738099 (E.D. Wis. Nov. 3, 2009), where a portion of an office building collapsed, the insured's inability to inhabit the building was a covered "direct, physical loss."

Property lost through theft or in transit: In *Mangerchine v. Reaves*, 63 So. 3d 1049, 1056 (La. Ct. App. 2011), the court acknowledged that "loss" and "damage" were "not necessarily synonymous" and that "physical damage" was only one kind of "physical loss" of property. For example, "a person can suffer the physical loss of property through theft, without any actual physical damage to property." *Id*. In *Corbian v. U.S. Auto Ass'n,* 20 So. 3d 601, 612 (Miss. 2009), the court recognized that "loss" includes "deprivation of" property. And, in *Total Intermodal Services v. Travelers Property Casualty Co.,* 2018 WL 3829767 (C.D. Cal 2018), the court noted that reading "loss and "damage" synonymously would render "loss" surplusage. (Some recent decisions like *Mudpie, Inc. v. Travelers Casualty Insurance Co. of Am.*, No. 20-cv-03213 (N.D. Cal. Sep. 14, 2020), mistakenly limit *Total Intermodal* to permanent loss, a concept neither expressed in *Total Intermodal* nor consistent with case law.)

The policyholder need not establish that any of these is the "correct" meaning but only that it is a "reasonable" meaning.

2. "Direct"

Insurers argue that, while the pandemic must "directly" cause the loss or damage to property, there were superseding intervening events here which preclude coverage. However, courts tend to construe the term "direct" more flexibly and expansively to mean proximate cause, as distinct from remote or incidental. Therefore, the actual presence of COVID-19, the omnipresence of the pandemic, and governmental orders requiring closure, each, reasonably qualify as a "direct" cause of loss or damage in this context, as they are neither remote nor incidental to the loss or damage. Proximate cause is a triable issue of fact, which should not be decided in favor of insurers at early stages of litigation.

3. "Physical"

Insurers assert that the term "physical" modifies loss and damage, imbuing each with a physical component and effectively making both terms synonymous. This approach violates the requirement that every term be accorded a unique meaning. In the COVID-19 context, there are various instances in which the requisite physicality can be established. The virus itself is physical, and the property that has become useless or uninhabitable is physical in nature. Accordingly, the presence of COVID-19, the omnipresence of the pandemic, and/or the governmental orders requiring closure render property uninhabitable and/or unusable, constituting "direct physical loss" of property.

3. Ambiguity Should Be Construed in Favor of Coverage for COVID-19 Claims

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Combining these concepts, the question becomes whether the policyholder's position that it has sustained compensable business-interruption loss is a reasonable one. While some recent trial court decisions support insurers' position, courts also have accepted policyholders' construction, in *Studio 417 Inc. et. al. v. Cincinnati*, 2020 WL 4692385 (W.D. Mo. Aug. 12, 2020) and *Optical Services USA/JC1, et al. v. Franklin Mutual Insurance Co.*, No. BER-L-3681-20 (N.J. Super. Aug. 13, 2020). Insurers' assertion that *more* decisions go their way misses the point. These courts' acceptance of the policyholder position is compelling and dispositive evidence that policyholders' position is a *reasonable* one. While judges may differ as to whether COVID-19 causes "direct physical loss" of property, such disagreement among learned judges should refute insurers' argument that policyholders' position is an unreasonable interpretation of the policy terms.

To date, only a few courts in the United States have addressed coverage for COVID-19 losses. (In the UK the Financial Conduct Authority recently entered a sweeping decision that these policies cover policyholders' business interruption losses.) Most of these courts have focused on "damage" and whether it was adequately pled. In doing so, these courts have accepted insurers' representations about what critical policy terms mean, without applying the policy-interpretation analysis called for by black-letter law. Those decisions, in effect, ignore that there are at least two reasonable interpretations of the key – undefined – terms, "direct physical loss or damage to" property. Under generally accepted principles of policy interpretation, ambiguity in this policy language should be construed in favor of coverage.

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