The COVID-19 Shutdown: Coverage Down the Line

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Our actions seem to have their lucky and unlucky stars, to which a great part of that blame and that commendation is due which is given to the action themselves.

— Francois de la Rochefoucauld

I. Background

No business exists in a vacuum. Car manufacturers rely on the parts manufacturers, who rely on resource manufacturers. Since the beginning of the 20th century, industrial engineers have devoted countless hours of research into optimizing production through mechanization and later supply chain management. Fueled by globalization and technological improvement, supply chain logistics is a multi-disciplinary field studying how to efficiently move goods and products to meet global demand.

But businesses that depend on other businesses can suffer a loss through no fault of their own. More alarmingly, business disruptions can create severe shortages in supplies vital to the health and welfare of a nation. In the wake of the COVID-19 pandemic, we have seen empty shelves in supermarkets for goods we take for granted, like toilet paper, and heard of shortages of necessary medical supplies to address the ill among us. Some of these shortages are due to the shutdown of overseas suppliers. This raises the question: ***can a business recover losses arising from another business's inability to provide goods as ordered?***

Enter two newer coverages: contingent business interruption coverage; and leader property coverage.

II. Legal Analysis and History

A. *The Policy's Language*

Contingent business interruption coverage protects an insured from business income loss resulting from physical damage to property owned by others, including direct suppliers of goods or services and direct receivers of goods or services manufactured or provided by the insured.[1] This coverage is calculated to protect against loss resulting from damage to others in a supply chain, and the relevant language may read as follows:

> **This policy covers against loss of earnings and necessary extra expense resulting from necessary interruption of business of the insured caused by damage to or destruction of real or personal property, by the perils insured against under this**

[1] See, e.g., *Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of New York*, 936 F.Supp. 534 (S.D. Ill. 1996); *Arthur Anderson, LLP v. Federal Ins. Co*., 416 N.J.Super. 334, 3 A.3d 1279 (2010).

> **policy, of any supplier of goods or services which results in the inability of such supplier to supply an insured['s] locations.[2]**

In order to establish coverage, an insured must demonstrate that a supplier or receiver can no longer supply or receive goods or services as a direct result of physical damage caused by a covered risk.[3] Some policies require a complete cessation of business, but this is not uniform.[4] Also, it is important to point out that contingent business interruption coverage may contain higher limits than the policy's business interruption coverage, and therefore should be treated as an excess insurance claim that is raised at the same time the insured claims coverage for the business interruption.[5]

Leader property coverage is similar to contingent business interruption coverage, except that it covers businesses which do not provide goods or services directly to the insured business.[6] It covers business losses as the result of direct physical damage by a covered risk to property owned by another located nearby that attracts business to the insured, such as nearby amusement parks, casinos, malls, or destination retail stores. Such language may read as follows:

> **This policy also insures against loss resulting from damage to or destruction by causes of loss insured against, to property not owned or operated by the Insured, located in the same vicinity as the Insured, which attracts business to the Insured.[7]**

As with contingent business interruption coverage, the insured must demonstrate that the other business has suffered physical damage to its property as a result of a covered risk; unlike such other claims, an insured seeking coverage under leader property has to demonstrate that the other property attracts business.[8]

(I have written extensively as to whether COVID-19 or the state's order to close certain businesses qualify as "covered risks," so I will not repeat the same here. If you want a copy of my prior article, please contact me jfhung@green-law.com.)

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[2] Id. at 540.
[3] See, e.g., *Philadelphia Parking Authority v. Federal Ins. Co*., 385 F.Supp.2d 280 (S.D.N.Y. 2005); Pentair, Inc. v. American Guarantee and Liability Ins. Co., 400 F.3d 613 (8th Cir. 2005) (suppliers which had no power due to damage caused to local power plant as a result of an earthquake did not suffer damage as a direct result of a covered risk).
[4] See, e.g., *Arthur Daniels Midland Co. v. AON Risk Services, Inc. of Minnesota*, 356 F.3d 850 (8th Cir. 2004).
[5] *Duane Reade, Inc. v. St. Paul Fire and Marine Ins. Co*., 600 F.3d 190, 197-8 (2nd Cir. 2010) (res judicata bars a claim for contingent business interruption coverage where the insured failed to raise the claim in an action for declaratory judgment regarding its business interruption coverage.)
[6] In the context of retail stores, this coverage is alternately called "anchor store" coverage or "attraction properties" coverage. See, e.g., *Retail Brand Alliance, Inc. v. Factory Mut. Ins. Co*., 489 F.Supp.2d 326, fn. 3 (S.D.N.Y. 2007), *Duane Reade, Inc.*, supra.
[7] See, e.g., *Zurich American Ins. Co. v. ABM Indus., Inc*., 265 F.Supp.2d 302 (S.D.N.Y. 2003).
[8] Id. at 308.

B. *Examination of Case Law*

Contingent business interruption and leader property coverages are relatively new products. The first opinions reviewing contingent business interruption coverage arise out of a series of complaints filed by Archer-Daniels-Midland Company ("ADM"), an agricultural corporation which processed and markets agricultural commodities.[9] ADM sought to recover losses related to unprecedented flooding in 1993.[10] In a series of decisions before the U.S. District Court for the Southern District of Illinois, ADM established that the Army Corps of Engineers and farmers from whom it purchased crops qualified as suppliers under their coverage, and that the period for which it could recover extra expenses extended beyond the termination date of its policies with its insurers.[11] Subsequent opinions involving ADM's related to the applicability of excess coverage and whether it could pursue claims against other insurers through its broker.[12]

Other opinions arise out of the September 11, 2001 attacks on the World Trade Center. In one case, the operator of a parking lot closed by the FAA's ground stop order following the attacks could not recover under its contingent business interruption coverage because there was no evidence of physical damage to its supplier, the airport.[13] In another, the Second Circuit found that a janitorial company operating in the World Trade Center could have had contingent business insurance coverage based on the destruction of its customers' property in the same building.[14] The Second Circuit also examined the insured's leader property coverage – the first instance of such coverage being reviewed – and found no coverage because the World Trade Center was the covered property, not a separate property that attracted business.[15]

Later opinions narrowed the definition of suppliers and receivers to a business. In order for a loss to be covered, it has to cause property damage that prevents the flow of goods and services to and from the insured.[16] An insured cannot prevail on its claim by merely showing a decline in income coupled with property damage to a supplier or receiver.[17] Further, an insured must have direct connection to the supplier or receiver; if property damage to a third-party on which a supplier depends that cuts the flow of goods, the insured cannot receiver.[18] But other opinions expanded the definition of "other property"; for example, in the absence of particular policy language, a subsidiary of a larger corporation can be considered a supplier or receiver.[19]

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[9] *Arthur Daniels Midland Co*., 356 F.3d at 852.
[10] *Archer-Daniels-Midland Co.*, 936 F.Supp. at 536.
[11] *Archer-Daniels-Midland Co.*, 936 F.Supp. at 544; *Archer-Daniels-Midland Co. v. Phoenix Assur. Co. of New York*, 975 F.Supp. 1124, 1128 (S.D. Ill. 1997).
[12] *Archer Daniels Midland Co. v. Hartford Fire Ins. Co*., 243 F.3d 369 (7th Cir. 2001); *Arthur Daniels Midland Co.*, 356 F.3d 850
[13] *Philadelphia Parking Authority*, 385 F.Supp.2d at 288.
[14] *Zurich American Ins. Co. v. ABM Indus., Inc*., 397 F.3d 158, 169-170 (2nd Cir. 2005).
[15] Id. at 171.
[16] *Arthur Andersen LLP*, 416 N.J.Super. at 348.
[17] Id.
[18] *Millennium Inorganic Chemicals, Ltd. v. National Union Fire Ins. Co. of Pittsburgh, PA*, 744 F.3d 279, 285-6 (4th Cir.2014) (dissenting opinion argued that there was an ambiguity as to what constituted a 'direct supplier').
[19] *Park Electrochemical Corp. v. Continental Cas. Co*., U.S. Dist. Ct. E.D.N.Y. No. 04-CV-4916, 2011 WL 703945, **5-6 (Feb. 18, 2011).

Every such opinion analyzes each policy carefully, so the decisions appear to be driven by the language used rather than well-established doctrines of construction; consequently, each case should be determined on a case-by-case basis.

As for leader property coverage, opinions examining it did so through in conjunction with a contingent business interruption claim.[20] This is because the difference between a "leader property" or "attraction property" and a supplier or retailer is that the latter has a direct, contractual relationship with the insured, whereas the former has an acknowledged effect on ability of the insured to draw in business. The World Trade Center itself draws substantial foot traffic and sales, for example, which would have an obvious effect on a nearby business's income, and the insurers did not contest that the World Trade Center could be considered a "leader property" or "attraction property." Consequently, there is no test to determine whether a property should be considered a "leader property," and no case law regarding the same.

C. *Other Considerations*

As with all insurance policies, there may be an issue as to what an insured's reasonable expectations might have been. This raises the specter of the reasonable-expectations doctrine, which has not been adopted in Ohio but which has been adopted in other jurisdictions to varying effect.[21]

(I have written extensively as to the reasonable-expectations doctrine in Ohio previously, so I will not repeat the same here. If you want a copy of my prior article, please contact me jfhung@green-law.com.)

III. Discussion and Conclusions

A. *So where should a business start?*

The first step to do is go to one's policy and determine if there is coverage for contingent business interruptions and whether a virus is a covered cause of loss. If your business does not have the policy, request a copy from your insurance agent, including your declarations. Contingent business interruption coverage is usually found in commercial property insurance policies; however, it may be incorporated as an endorsement. Presuming the policy has the "all-risk" language stated earlier, the analysis will begin with the exclusions.

The next step is to determine whether there has been a loss of earnings or necessary extra expense resulting from an interruption of business resulting from damage to or destruction of real or personal property caused by a covered loss and suffered by a supplier or receiver of goods

[20] *Zurich American Ins. Co.*,supra.; *Duane Reade, Inc.*,supra.
[21] *Wallace v. Balint*, 94 Ohio St.3d 182, 189, 761 N.E.2d 598 (2002); compare with *Bailey v. Lincoln General Ins. Co.*, 255 P.3d 1039, 1048-9 (Colo. 2011) or *Luikart v. Valley Brook Concrete & Supply, Inc.*, 216 W.Va. 748, 755, 613 S.E.2d 896 (2005).

or services. As stated above, such damage must also result in the inability of such supplier or receiver to supply goods to the insured or receive goods from the insured. Whether the interruption to business must be a complete cessation of operations or can include a slowdown of business depends on the insured's policy.

The final step is to evaluate the extent of the business's losses. Every policy has a method for determining what losses are covered and what are not, but most, if not all, replace lost income to the business, rather than lost profits. How an insurer calculates a business's losses is in and of itself a complicated analysis, and a separate topic for another article. Regardless, having an idea of how much the business may be able to recover is important when determining the economic benefit of filing a claim at all.

If the virus is a covered loss, the business has suffered a suspension, and a claim is economically beneficial, then there may be a claim. But as I said in a prior article, this is the easy part.

B. ***What are the chances the business will prevail?***

As I also said in a prior article, there is a lack of certainty in the rule of law during these unprecedented times. Foreseeably, insurers will litigate two issues: (1) whether the virus has caused physical damage to a supplier's or receiver's property; and (2) whether the supplier or receiver was actually unable to supply or receive goods due to the virus or by the action of a civil authority, in Ohio's case, Dr. Acton's March 15, 2020 order.

The first issue is a matter of opinion that will see substantial litigation. Although there is no case law directly on point regarding a viral contamination, at least one case a court found physical damage to covered property where after a chemical was released that required remedial measures before property could be used again.[22] A jury may determine that physical damage occurs as the result of a contamination that requires remediation; on the other hand, a jury may also find that a virus, which is neither corrosive nor radioactive, does not actually cause physical damage to business property. But that raises the question of whether the supplier or receive could still supply or receive goods despite the virus' presence.

The second issue is that a matter of legal interpretation. If a supplier or receiver could not supply or receive goods or services because of Dr. Acton's March 15, 2020 order, such order may not be a covered risk. Many policies actually contain an exclusion for government acts, which may look like this:

> **We will not pay for the "loss" caused by or resulting from any of the following * * *.**

[22] *Gregory Packaging, Inc. v. Travelers Property Cas. Co. of America*, U.S. Dist. Ct. D.N.J. No. 2:12-cv-04418, 2014 WL 6675934, *3 (insurer admitted that remediation work was to reduce the ammonia gas to reach a safe level for occupancy).

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> **Acts or decision, including the failure to act or decide, of any person, group, organization, or governmental body.**

From its plain language, an extension of coverage for actions by a civil authority does not create a new covered risk; rather, it creates a new set of occurrences for which there could be coverage arising from damage caused by a covered risk:

> **We will pay for the actual loss of business income you sustain and necessary extra expenses caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the business' premises, caused by or resulting from any covered cause of loss.**

When reading both provisions together, the only reasonable conclusion is that an action by a civil authority is not a covered risk, but instead provides another set of circumstances under which an insured may have coverage. In this case, the insured must argue that its business interruption was the result of physical damage caused by the virus, not the state's action in response to the same.

Which brings us back to the first issue. Whether or not a virus causes physical damage will be the lynchpin of any contingent business interruption claim and will likely be the focus of such litigation.

C. *So what's the prognosis?*

As stated in my prior article, any conclusion as to success would be conjecture. What is certain is that litigation may be costly, so businesses seeking coverage will need to prepare for a prolonged battle in courts. That means that the ultimate issue will be whether litigation is economically reasonable. But given the uncertainty, should an insurance company deny a claim just because it believes that a virus cannot cause physical damage?

That's another topic for another day.

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