HOW A 100-YEAR PANDEMIC CAUSES "DIRECT PHYSICAL LOSS" AND TRIGGERS BUSINESS INTERRUPTION INSURANCE COVERAGE

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Since the outset of the COVID-19 pandemic, the insurance industry has told anyone who will listen that business interruption insurance coverage is not available for coronavirus-related claims because there is no "direct physical loss or damage" necessary to trigger coverage.

While insurers insist that direct physical damage (for instance fire, hail, landslide, or explosion) is necessary, the policies they drafted, sold, and collected premia under may cover a broader category of loss. Business interruption claims do not require the destruction or wreckage that the insurance industry demands; any garden-variety hundred-year pandemic may be enough.

Business Interruption Coverage

Many companies purchase business interruption insurance coverage to cover business expenses and income if the company unexpectedly can no longer operate. Business interruption policies typically contain "direct physical loss or damage" requirements. Although the precise policy language overrides all else and is relatively diverse, these policies typically list one or more insured

premises (for instance restaurant, casino, concert hall, retail store, factory, etc.), and provide coverage for "business interruption" losses if those premises suffer any "direct physical loss or damage." The insurance industry has responded to the first wave of COVID-19 claims, arguing that direct physical loss or damage requires damage to the physical structure of the business.

Direct Physical Loss or Damage

Does not require battered and charred buildings; imperceptible hazards may suffice.

Despite the insurance industries assurance to the contrary, in many jurisdictions harmful conditions imperceptible to the naked eye can form the basis of "direct physical loss or damage."

TRAVCO Ins. Co. v. Ward, 715 F. Supp. 2d 699, 708 (E.D. Va. 2010), aff'd, 504 F. App'x 251 (4th Cir. 2013) For instance, in *TRAVCO Ins. Co. v. Ward,* a business closed because of the presence of toxic gases. These gases were released by defective drywall into the premises and rendered the building uninhabitable. Regardless of whether there was lasting damage to the structure of the building, the fact that the gases prevented workers and customers from accessing the building was undeniable, even if only for a limited time.

> *The District Court stated in part that, "he majority of cases support proposition that physical damage to property is unnecessary, at least where the building in question has been rendered unusable to physical forces."*

Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1335 (Or. Ct. App. 1993) In *Farmers Ins. Co. v. Trutanich*, a claimant sought recovery for damages caused by methamphetamine vapors. The parties disputed whether the methamphetamine created "vapor" or "smoke." If smoke had infiltrated the building, the insurer admitted, coverage would exist. If it were merely vapors, then there would be no coverage. The court held that vapor and smoke were functionally equivalent. No matter whether the methamphetamine created vapor or smoke, its smell had infiltrated the house. As to direct physical loss or damage, this court held that the cost of cleaning the house was a direct rectification of the problem, and therefore constituted a direct physical loss within the meaning of the policy.

Even if not deadly, conditions which render a structure practicably unusable may cause a direct physical loss. In *Western Fire Insurance Co. v. First Presbyterian Church*, coverage was found for a church that was forced to close after gasoline contaminated the area around the building. Vapors were emitted into the interior and made the air inside dangerous. In *Mellin v. N. Sec. Ins. Co., Inc.,* cat urine odor emanating from neighboring property was potentially sufficient to constitute "direct physical loss." In *Murray v. State Farm Fire & Cas. Co.* the mere threat "that rocks and boulders could come crashing down at any time" on the insured premises was potentially sufficient to constitute direct physical loss. After all, the insured property in that case could scarcely be used for its intended purpose where the new, unexpected condition caused a substantial risk of death.

How can a business suffer *loss* without *damage*?

Loss of functionality.

If "direct physical loss or damage" does not require a structurally damaged building, what does the term require? Insurance policies must be interpreted to give full effect to every word, and policies should not be interpreted to provide illusory or absurd coverage.

The word "loss" in the phrase "direct physical loss or damage" can have three meanings, but only one makes sense in the context of business interruption policies and would give meaning to every word in the typical policy.

1. Loss can mean destroyed or damaged ("the restaurant burned down; it was a total loss").
2. Loss can also mean misplaced or to have the thing relocated to such a place that it can no longer be found ("the loss of the ship at sea caused hardship for the investors").
3. Loss can also mean loss of functionality ("the untreated cataracts caused a loss of sight").

The first meaning cannot be appropriate because it would render the word "damage" in the term "direct physical loss or damage" an unnecessary surplusage. The second meaning cannot be correct because it is an absurd concept to lose or misplace a restaurant, casino, or factory. After all, a ship can be lost at sea, but a brick and mortar restaurant can always be found. The third definition, loss of functionality, is the only meaning of "loss" that results in neither absurdity nor surplusage and is the appropriate interpretation of the term in many business interruption policies.

Several courts concur with this reading and hold mere "loss of functionality" is sufficient to satisfy a "direct physical loss or damage requirement."

For example,

Plaintiff operated a restaurant in Taos, New Mexico that was forced to suspend operations because of damage to the city's sewer. The Court found this loss of use constituted a "direct physical loss of or physical damage."	*Fay v. Hartford Ins. Co.*, No. 17-1054 MV/SCY, 2019 WL 1014791, 3 (D. N.M. March 4, 2019).
A court found that sufficient loss had occurred when a drainage pipe had failed to fulfill its intended function.	*Homeowners Choice Property & Casualty v. Miguel Maspons*, 211 So.3d 1067, 1069 (Fl. App. Ct. 2017)
A power outage caused business interruption and data loss during policy period.	*Se. Mental Health Ctr., Inc. v. Pac. Ins. Co., Ltd.*, 439 F. Supp. 2d 831, 838 (W.D. Tenn. 2006)

Motorists Mut. Ins. Co. v. Hardinger, 131 Fed. Appx. 823, 827 (3d Cir. 2005) Although there was no substantial, direct physical damage to any of the properties in question, the properties could not reasonably be used for their intended purposes.

> *Many states, including New York, New Jersey, and Pennsylvania, conclude "direct physical loss" is present when "functionality of the property was nearly eliminated or destroyed, or whether property was made useless or uninhabitable."*

The COVID-19 business interruption claims are analogous. COVID-19's infection rate, combined with its relatively high risk of death and serious lasting medical complications, has made many types of public and commercial gatherings practicably impossible as the public maintains social distance. The presence or threatened presence of COVID-19 can render a building directly and physically unavailable. Business owners have been pushed out of their own businesses through government orders by objectively reasonable concern for the wellbeing of their customers, employees, and the greater public. This loss of functionality constitutes physical loss under many business interruption policies.

So, what to do about it?

Insurers have attempted to shoo away potential COVID-19 business interruption claimants with narrow interpretations of their policies and broad pronouncements of "no coverage here." However, in a state like Missouri, where there is little reported precedent interpreting the phrase "direct physical loss or damage," Courts will be unlikely to read insurance policies as narrowly as the insurers prefer. Insurer's initial comments that there cannot be coverage because there is no physical damage to the covered property cannot be taken at face value, and the insurer's pre-analysis rejection of COVID-19 claims should be independently evaluated. In light of longstanding rules of interpretation favoring coverage, impacted policyholders should stake aggressive positions.