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webinar

Narrative

COVID-19's Impact on the Hospitality Industry

I. First-Party Business Interruption Litigation

By far, the hospitality sector has suffered the most from COVID-19. Many entertainment, dining, lodging and personal wellness businesses have been shut down either due to the existence of the virus on their premises or by related government orders resulting from the pandemic. In addition, many retail establishments have been forced to limit customer capacity and reduce hours of operation. All of this has resulted in a significant decline in revenue and a large number of business closures. As a result, many businesses have sought relief from their commercial property insurers for their business income losses. In the food services area alone, there have been 551 COVID-19 related insurance cases filed as of February 2021.[1] Similarly, there have been 71 cases initiated regarding amusement, gambling, and recreational businesses;[2] and nearly 40 cases related to performing arts, spectator sports, and related industries. In all of these cases addressing business interruption coverage under first-party policies, courts must initially determine whether COVID-19-related closures fall within the coverage grant of the relevant policy. In nearly all of these cases, the key language to be evaluated is whether the business interruption was caused by "direct physical loss of or damage" to the covered premises.

As to these first-party claims, insurers have almost uniformly taken an aggressive posture (hoping to avoid a swath of future claims), routinely responding by filing dispositive motions seeking to dismiss the policyholder's claims, either by way of a motion to dismiss or a motion for summary judgment/adjudication. Professor Tom Baker of the University of Pennsylvania Carey Law School provides a "COVID-19 coverage ligation tracker" that provides the latest developments, weekly filings, and judicial rulings on all COVID-19 related claims.[3] Thus far, insurers have won the majority of these dispositive motions, either by the court concluding that the virus itself or the related government-mandated closures

[1] https://cclt.law.upenn.edu/
[2] Id.
[3] Id.

do not constitute “physical loss or damage” to the premises or by virtue of an applicable exclusion negating coverage for any such loss (Id).

Recently, however, policyholders have secured key victories where the courts have held that the government orders have forced the businesses to lose the physical use of and access to their property which is sufficient to satisfy the “direct physical loss of or damage to” requirement. These cases deserve a closer look.

The first substantive victory for policyholders in a COVID-19 related business interruption case was North State Deli, LLC v. Cincinnati Ins. Co., 20-cv-02569, (N.C. Sup. Ct., Oct. 9, 2020), where the court granted the plaintiffs’ motion for summary judgment despite the policy requiring “direct physical loss or damage.” There, the plaintiff, an operator of sixteen restaurants in North Carolina, was forced to close its restaurants after COVID-19 shutdown orders. Following those orders, it filed business interruption claims with its insurer, Cincinnati Insurance Company (“Cincinnati”). Cincinnati denied their claims; the insured promptly filed suit.

In the plaintiff’s motion for summary judgment, the insured argued that the COVID-19 related shutdown orders forced them to lose the physical use of and access to their restaurants, which constitutes “direct physical loss" covered by their all-risk property policies. Cincinnati countered that the policies are triggered by “direct physical loss," which requires "some form of physical alteration to [the] property." Thus, Cincinnati maintained that the policies "do not provide coverage for pure economic harm" that does not include physical alteration.

The court granted the plaintiff’s motion for summary judgment. In its decision, the court stated that "even if Cincinnati's proffered ordinary meaning [of the phrase 'direct physical loss'] is reasonable," the policyholders' interpretation of that phrase is also reasonable, "rendering the Policies at least ambiguous," and "any ambiguity or uncertainty as to the words used in the policy should be construed against the insurance company." Moreover, "it is well-accepted that 'the various terms of the policy are to be harmoniously construed,' " and "every word and every provision is to be given effect." Here, the policies provide coverage for "accidental physical loss or accidental physical damage," and the use of the conjunction “or” "means-at the very least-that a reasonable insured could understand the terms 'physical loss' and 'physical damage' to have distinct and separate meanings." "In the context of the policies at issue," said the court, " 'direct physical loss' describes the scenario where business owners and their employees, customers, vendors, suppliers, and others lose the full range of rights and advantages of using or accessing their business property. This is precisely the loss caused by the government orders. Plaintiffs were expressly forbidden by government decree from accessing and putting their property to use for the income-generating purposes for which the property was insured.

Another policyholder victory occurred in the case of Henderson Rd. Rest. Sys., Inc. v. Zurich Am. Ins. Co., No. 1:20-CV-1239, 2021 WL 168422 (N.D. Ohio Jan. 19, 2021). In contrast to North State Deli, the Henderson Rd court made a small yet critical distinction in the relevant policy language, which required “direct physical **loss of** or damage to real property.” (emphasis added). The court employed a fundamental rule of contract interpretation-- all words of a policy must be afforded meaning--and concluded that there must be a difference between “physical loss of” and “damage to” real property. The insured restaurants argued that even if there were no actual “damage” to real property there was indeed a “loss” of property. Also, that the term “physical loss of … real property” could include situations “when the state government ordered that the properties could no longer be used for their intended purpose.” The court agreed. Ultimately, the court concluded that the relevant Zurich policy language was susceptible to more than one reasonable interpretation. Therefore, the language was ambiguous and must be construed in favor of coverage; the court ruled, as a matter of law, that the restaurant closures resulted in “direct physical

loss of … real property." Accordingly, the restaurant was entitled to coverage for its losses from state-mandated COVID-19 closures.

Cherokee Nation et al. v. Lexington Insurance Co. et al., No. CV-2020-00150, (Okla. Dist. Ct., Cherokee Cnty. Jan. 14, 2021) represents a third recent policyholder victory. There the insured, Cherokee Nation, obtained a partial summary judgment ruling that its property policy afforded business interruption coverage for COVID-19-related losses. The policy provided coverage for "all risks of direct physical loss or damage," which the Cherokee Nation contended was triggered when the property was "rendered unusable for its intended purpose." Like the insureds in North State Deli and Henderson Rd, Cherokee Nation argued that a distinction exists between "physical loss" and "physical damage" and that the physical presence of COVID-19, which deprived the Cherokee Nation of the use of its covered property for its intended purpose, triggered a covered loss. The court agreed.

As business interruption claims related to COVID-19 continue to be litigated, the specific policy language involved will play an integral role in whether the insureds can secure insurance coverage for their losses.

II. Not All Exclusions Are Created Equal

In addition to the argument that business shutdowns from COVID-19 do not involve "direct physical loss," insurers have also utilized a variety of exclusions to deny coverage for COVID-19 claims. Some of the more common exclusions relied-upon include virus exclusions, pollution exclusions, microbe or microorganism exclusions, epidemic/pandemic exclusions, and communicable disease exclusions. (Even specific Coronavirus (COVID-19) exclusions are being developed for future use.)[4] Here, it is very important to review the particular policy language. While almost all first-party policies contain some form of pollution/contamination exclusion, only some specifically exclude viruses, communicable diseases, or microbial matter. A few of these exclusions are examined in more detail below.

A. Virus Exclusions

Virus exclusions may be a challenge for policyholders when it comes to COVID-19 business interruption claims. In Boxed Foods Corp. v. California Capital Ins. Co., 3:20-cv-04571-CRB (N.D. Cal. Oct. 26, 2020), the court agreed with the insurer that the virus exclusion bars the plaintiff's claims,[5] holding that the exclusion "is only subject to one reasonable interpretation: that coverage does not extend to any claim premised on virus-induced damage, regardless of the virus's magnitude." The relevant exclusion stated, in part, precluded coverage for loss or damage "caused by, resulting from, contributing to or made worse by the actual, alleged or threatened presence of any pathogenic organism." The insured tried to argue around the virus exclusion by alleging that the loss was caused by the shutdown order and not solely by the virus. However, the court disagreed because "nothing in the virus exclusion suggests that it is limited to property damage."

[4] Notably, unlike the "direct physical loss" requirement, for which the insured bears the burden of proof, the insurers bear the burden of proving the application of any policy exclusions, which in most-jurisdictions require a narrow interpretation.

[5] Boxed Foods owns and operates two restaurants in the San Francisco area. It shut those restaurants in March 2020 after California issued several COVID-19 related emergency orders. It submitted a claim to its insurer, California Capital Insurance ("California Capital"), alleging it could not operate its restaurants as a direct consequence of COVID-19 and California's civil authority orders. California Capital denied coverage, and Box Foods filed suit.

The purpose of the government shutdown orders (civil authority orders) and the specific facts alleged, can impact the application of a virus exclusion. For example, in Boxed Foods, the court determined that the virus exclusion was triggered because the civil authority orders would not exist if not for the presence of COVID-19. However, in the above-noted Henderson Rd case, the court stated that the government orders "responded to a public health crisis" and were not related to any damage at the plaintiffs' properties caused by COVID-19. There the plaintiff did not allege the presence of COVID-19 on its property. Similarly, in Elegant Massage LLC v. State Farm Mut. Auto. Ins. Co. et al., No. 20-cv-265, Order, (E.D. Va. Dec. 9, 2020), the district court denied State Farm's motion to dismiss the COVID-19-related business interruption claim. Elegant Massage alleged that civil authority orders were "the sole cause" of its loss of business income and extra expense. Elegant Massage's complaint did not allege that COVID-19 was present at the covered property nor that COVID-19 was the direct cause of its loss.

B. Microorganism Exclusions

Some policies contain exclusions that apply to losses involving "microorganisms" and, when present, carriers have sought to apply them to COVID-19 claims. Recently, in Henderson Rd, the defendant-insurer, Zurich, asserted that its policy's microorganism exclusion applied. The exclusion states, "we will not pay for loss or damage consisting of, directly or indirectly caused by the, contributed to, or aggravated by the presence, growth, proliferation, spread, or any activity of "microorganisms", unless resulting from fire or lightning…" Notably, both parties stipulated that none of the plaintiffs' insured premises were closed as a result of a known or confirmed presence of COVID-19 at any of the insured premises. Normally, such a stipulation would favor insurance carriers because insureds have commonly relied on the presence of the virus to satisfy the requirement of physical loss or damage to the property. But, in Henderson Rd, the plaintiffs argued that government orders caused their closures, rather than the direct presence of the virus. Under the plaintiffs' argument, they did not need the direct presence of the virus to satisfy the coverage grant. The stipulation barred Zurich from using the microorganism exclusion to preclude coverage. In addition, the plaintiffs argued that COVID-19 is not technically a microorganism.

C. Pollution exclusions

Insurers have also attempted to use pollution exclusions to preclude COVID-19 coverage. See, e.g., Atma Beauty, Inc. v. HDI Global Specialty SE, et. al., 20-cv-21745, (S.D. Fla. Dec. 30, 2020) (The court granted the insurer's motion to dismiss on other grounds, not reaching the question of whether the pollution exclusion prevented coverage); Cynthia's Ristorante v. The Cincinnati Ins. Co., 20-CI-00335 (McCracken Circuit Ct., May 11, 2020); (Cincinnati asserted that its pollution exclusion precludes coverage); Food for Thought Caterers Corp. v. Hartford Financial Services Group, Inc., No. 1:20-cv-03418 (S.D.N.Y, May 1, 2020). Naturally, policyholders argue the pollution exclusion does not apply to COVID-19-related losses because COVID-19 is not a pollutant or contaminant. A narrow construction of these exclusions, as required by most courts, supports the policyholder's position. Furthermore, the existence of virus and microorganism exclusions found in some policies further supports the idea that a virus or microorganism is not a pollutant or contaminant; otherwise, these separate exclusions would be unnecessary and redundant.

D. Coronavirus exclusions

Almost one year since the pandemic was declared a national emergency in the United States, insurers are proposing specific "coronavirus exclusions" be included on policy renewals. One such COVID-19-specific exclusion broadly defines "COVID-19" to include "the coronavirus disease, novel coronavirus-2019, severe acute respiratory syndrome coronavirus 2, or any mutation or variation thereof, and includes any fear or threat thereof" … and "any and all derivative strains of the foregoing." Negotiating these types

of endorsed exclusions off of the policy may prove to be extremely difficult, even for an added premium, especially in a hard market.

III. Liability Coverage for COVID-19 Claims

As the pandemic continues, we can expect to see a surge in liability claims related to COVID-19. There have already been a variety of liability claims filed, alleging various forms of bodily injury, property damage, or employment-related claims. General liability insurance and employment practices liability insurance come to mind as the obvious sources of potential coverage for these anticipated claims.

A. CGL

Coverage A of the standard CGL policy covers third-party claims for bodily injury or property damage caused by an occurrence (accident). In connection with COVID-19, CGL insurers can expect to see suits filed by individuals against businesses for a variety of alleged negligent conduct, including failure to take proper precautions to mitigate the spread of COVID-19 or individuals contracted COVID-19 while on the premises of a business. For example, cruisegoers on the Princess Cruise Lines filed suit in early March 2020 claiming the company knew "at least one of its passengers from the prior voyage ... had symptoms of coronavirus, and yet it made the conscious decision to continue sailing the voyage that began February 21, 2020 with another three thousand passengers on an infected ship."[6] The cruisegoers complained that the cruise line was negligent in failing to ensure that passengers would not be exposed to coronavirus, failing to have proper COVID-19 screening protocols prior to passengers boarding the ship, and failing to adequately warn the cruisegoers about the potential exposure to COVID-19 prior to boarding the ship.

Similarly, product suppliers, retailers, and food and beverage businesses face potential exposure from those claiming injuries due to COVID-19 from their products or services.

B. EPL

COVID-19 claims in the employment context are also expected. Employment Practice Liability ("EPL") may be a source of recovery for such claims. EPL insurance provides coverage for claims by workers alleging violation of their legal rights as employees of a company, i.e., discrimination, harassment, wrongful termination, defamation, and invasion of privacy. As businesses are closed, temporarily shut down, or are forced to reduce capacity due to COVID-19, this will inevitably lead to a proliferation of claims by employees negatively impacted. These employee claims will likely be couched in various state and federal laws protecting workers' rights such as Workers Compensation Acts, Families First Coronavirus Response Act, Americans with Disabilities Act, Equal Employment Opportunity, as well as statutes protecting against retaliation by employers. In addition, employees have already sought protection from exposure to COVID-19 by requesting that their employers offer personal protective equipment (PPE) and adhere to social distancing measures. See, e.g., Allen et. al. v. Krucial Staffing, LLC et. al., 20-cv-02859, (traveling nurses filed suit against their staffing agency for allegedly luring to unsafe work during COVID-19). EPL insurance will remain front and center in response to these types of claims.

IV. Conclusion

[6]. See Weissberger et al. v. Princess Cruise Lines, Ltd., 2020 WL 3977938 (C.D. Cal. Jul. 14, 2020)(dismissed on July 14, 2020).

Policyholders will need to remain vigilant in documenting losses due to COVID-19, providing timely notice to their respective insurers, and demanding diligent and reasonable investigations of their claims by their insurers. Also, insureds need to be mindful of any limitation of suit provisions in their first-party policies, which can be as short as one year from the date of loss. Where appropriate, it is advisable to request a tolling agreement to allow additional time to adequately assess the claim and discuss a resolution with the insurer. In the liability context, insureds should pursue both defense and indemnity, where warranted, to ensure they are maximizing the protections they purchased. As courts continue to wrestle with insurance coverage for COVID-19 losses, the following factors should be considered in assessing potential coverage:

- Although first-party policies apply to accidental "physical loss or damage," those terms are often undefined, leaving courts free to apply plain and ordinary meaning to those terms.
- Policy language which is subject to more than one reasonable interpretation is generally deemed ambiguous, which requires an interpretation in favor of the insured.
- Many first-party policies are "all-risk" policies, meaning that they cover all risks of direct physical loss or damage unless specifically excluded.
- Whether the virus is present on the premises or not may be relevant to satisfying the direct "physical loss or damage" requirement.
- "Physical Loss" and "physical damage" may be two separate things, each of which should be covered.
- Government-mandated closures deprive the owner of access to and use of the premises, which may satisfy the "physical loss" requirement in the policy's insuring agreement.
- Are there virus, pathogen, microbe, pandemic, or communicable disease exclusions?

As the legal landscape for COVID-19 coverage suits continues to evolve, policyholders and insurers alike will keep a close eye on recent developments to assess these novel coverage issues.