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Memorandum

COVID-19 and Insurance Coverage: Limitations on Civil Authority Provisions

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Businesses are being advised to examine potentially available insurance coverage to address the impacts of the coronavirus disease 2019 ("COVID-19"). Given the proliferation of government directives resulting in restrictions on business operations, civil authority coverage provisions are likely to be invoked by policyholders.

Many property insurance policies include civil authority provisions, which cover loss of income resulting from restrictions on access to insured premises by a government or civil authority. A typical civil authority provision states:

> We will pay for the actual loss of Business Income you sustain and necessary Extra Expense 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 described premises, caused by or resulting from any Covered Cause of Loss.

There are important limitations to such coverage. As a preliminary matter, the prohibition of access must be imposed by action of civil authority.[1] Policyholders can be expected to argue that recent state and local directives restricting activities of certain businesses satisfies this requirement. However, where restrictions to access are self-imposed by businesses, civil authority coverage is not likely to be unavailable. *See Zurich Am. Ins. Co. v. ABM Indus., Inc.*, 397 F.3d 158 (2d Cir. 2005) (civil authority coverage depends on whether access to property was restricted by civil orders or instead by policyholder's internal company policies). Similarly, if the prohibition is not mandatory and instead is phrased as an advisory or recommendation, civil authority coverage may not be implicated. *See Kean, Miller, Hawthorne, D'Armond, McCowan & Jarman, LLP v. National Fire Ins. Co. of Hartford*, 2007 WL 2489711 (M.D. La. Aug. 29, 2007) ("prohibits access" requirement of civil authority clause is not satisfied where residents are encouraged or advised to remain off streets during hurricane).

[1] Some civil authority clauses use the phrase "order of civil authority" or "order or action of civil or military authority." In some cases, courts have distinguished an "action" from an "order." *See Penton Media, Inc. v. Affiliated FM Ins. Co.*, 2006 WL 2504907 (N.D. Ohio Aug. 26, 2016) (ruling that FEMA takeover of convention center pursuant to lease contract after September 11 terrorist attack does not constitute an "order of civil authority" and distinguishing cases with different civil authority language); *Kean, Miller, Hawthorne, D'Armond, McCowan & Jarman, LLP v. National Fire Ins. Co. of Hartford*, 2007 WL 2489711 (M.D. La. Aug. 29, 2007) (ruling that "action of civil authority" does not require a formal order and encompasses a Governor-declared state of emergency, together with statements by police and government officials "asking" and "encouraging" residents to stay off streets).

In addition, for coverage to apply, most civil authority provisions require the government action or order to be the direct result of physical loss or damage to property not owned by the policyholder and caused by a covered peril. In this respect, there is a significant difference between legal precedent involving civil authority orders after natural disasters, such as earthquakes or storms (which are likely to implicate predicate physical damage caused by a covered peril), and losses stemming from a viral outbreak (which arguably do not involve covered physical loss or damage). If physical loss or damage is a prerequisite to civil authority coverage, lost income arising from closures and interruptions due to COVID-19 is arguably outside the scope of civil authority provisions. In particular, in the absence of a virus or other applicable exclusion, the question that will arise is whether the contamination of air or surfaces by COVID-19 constitutes direct physical loss or damage.

If policy language or applicable law construes physical loss or damage to include property that is rendered unusable due to contamination, policyholders will take the position that civil authority coverage is applicable. Some courts have employed such reasoning in cases involving other contaminants, finding that the uninhabitability of property satisfies the physical loss requirement and/or that contaminants cause physical damage by "altering" or "transforming" property. *See Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2014 WL 6675934 (D.N.J. Nov. 25, 2014) (ammonia leak that rendered property unusable for a period of time caused physical damage); *Farmers Ins. Co. of Oregon v. Trutanich*, 858 P.2d 1332 (Or. Ct. App. 1993) (odors from methamphetamine laboratory are physical because they damage the structure).

However, several courts have ruled that physical loss is not established by virtue of a contaminated substance in the insured property. In *Universal Image Products v. Federal Insurance Company*, 475 F. App'x 569 (6th Cir. 2012), the court ruled that bacterial and mold contamination in a ventilation system was not "direct physical loss." The court emphasized that the record did not establish that an evacuation was necessary and that other parts of the building remained usable and unaffected. Additionally, the court noted that the policy defined "building" and "personal property" to exclude "air, either inside or outside of a structure." *Universal Image* provides strong support for coverage denials where property closures occurred as a preventative measure or where policy language excludes "air" from insured property or otherwise limits the scope of physical damage. *See Source Food Technology, Inc. v. U.S. Fidelity & Guar. Co.*, 465 F.3d 834 (8th Cir. 2006) (business losses not covered under civil authority or business interruption provisions where policyholder was restricted from shipping beef to due potential contamination; no physical loss because record did not establish that policyholder's beef was actually contaminated); *Cleland Simpson Co. v. Firemen's Ins. Co.*, 140 A.2d 41 (Pa. 1958) (civil order closing stores due to threat of fires does not trigger coverage absent an actual fire).

As scientific knowledge evolves, insurers may be on solid footing in asserting that COVID-19, even if present in insured property, does not cause physical loss or damage. According to recent reports, the virus does not cause actual damage or harm to surfaces or structures and can be removed with standard household cleaning products.

In this respect, claims for COVID-19-related losses may be factually distinct from losses stemming from mold, asbestos, defective drywall or other contaminants that might necessitate repair or replacement of property.[2]

Further, even where there is physical loss or damage, civil authority coverage may nonetheless be unavailable based on other prerequisites to coverage. In *United Air Lines v. Insurance Co. of the State of Pa.*, 439 F.3d 128 (2d Cir 2006), the court rejected United's assertion of coverage under a civil authority provision that covered a "situation when access to the Insured Locations is prohibited by order of civil authority as a direct result of damage to adjacent premises." United alleged that it was forced to close its ticket counter at Ronald Regan National Airport due to damage to the Pentagon during the September 11 terrorist attacks. The court held that civil authority coverage was inapplicable because the airport was not "adjacent" to the ticket counter. The court also emphasized the lack of causation between the physical damage and the civil authority order, explaining that the airport closure was not "a direct result of damage" to the Pentagon, but instead was implemented because of fears of future attacks. *See also Kelaher, Connell & Conner, P.C. v. Auto-Owners Ins. Co.*, 2020 WL 886120 (D.S.C. Feb. 24, 2020) (civil authority coverage is not available unless there is a causal nexus between the civil authority order and the damage to adjacent property); *Syufy Enterprises v. Home Ins. Co. of Indiana*, 1995 WL 129229 (N.D. Cal. Mar. 21, 1995) (movie theater not entitled to civil authority coverage based on city curfews imposed in wake of Rodney King riots because, among other things, there is no causal link between damage to adjacent property and denial of access to theater; curfews were imposed to prevent "potential" looting and rioting). Thus, to the extent that state-mandated closures are implicitly or explicitly enacted as prophylactic measures, based on concerns about potential contamination (rather than actual, existing damage), resulting income losses may be outside the scope of civil authority coverage provisions.

A lack of a sufficient causal connection between physical damage and a government-ordered closure was also fatal to a claim for civil authority coverage in *Dickie Brennan & Co., Inc. v. Lexington Ins. Co.*, 636 F.3d 683 (5th Cir. 2011). There, a mandatory evacuation order in Louisiana required the policyholder to close its business. The order was based on the threat of a hurricane that had caused damage to the Caribbean islands. Although the civil authority provision at issue did not include any specific requirement that the damaged property be "adjacent" or near the covered property, the court held that coverage required a "close causal link between the evacuation order and damage to property 'other than at the described premises.'" These and similar rulings lend support to the notion that closures initiated by civil authority may be outside the scope of coverage where such directives are instituted as preventative measures, rather than as a result of actual damage to nearby property.[3]

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[2] Notably, in some cases, courts have ruled that losses caused by mold or asbestos do not satisfy the physical loss or damage requirement where the property remained intact and where the contaminant could be removed. *See, e.g., Mastellone v. Lightning Rod Mut. Ins. Co.*, 884 N.E.2d 1130 (Ohio Ct. App. 2008) (mold that did not affect structural integrity of building and which could be removed by cleaning is not physical damage)*; Great N. Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan Ass'n,* 793 F. Supp. 259 (D. Or. 1990) (asbestos contamination is not a physical loss where building remained "physically intact and undamaged").

[3] Numerous state COVID-19 orders use language citing prevention as a primary purpose of the restrictive measure. *See, e.g.*, California Executive Order N-33-20 (instituting restrictive measures to "preserve the public health and safety, and to ensure the healthcare delivery system is capable of serving all").

Moreover, policyholders may face barriers to civil authority coverage where civil orders cause a consequential limitation or reduction in traffic to insured property, but do not actually prevent access. *See 730 Bienville Partners Ltd. v. Assurance Co. of Am.*, 67 F. App'x 248 (5th Cir. 2003) (FAA closure of airports after September 11 terrorist attacks did not "prohibit access" to policyholder's hotels even though they significantly reduced hotel capacity); *54th St. Ltd. Partners LP v. Fidelity & Guaranty Ins. Co.*, 306 A.D.2d 67 (N.Y. App. Div. 1st Dep't 2003) (diversion of traffic that adversely affected policyholder's restaurant was not a denial of access for purposes of civil authority coverage). Similarly, where the civil authority does not include an absolute prohibition on access to insured property, but instead only limits or regulates access in certain respects (*i.e.*, precludes non-essential traffic), insurers may argue that the "prohibition" requirement is not met.

Finally, even where the insuring civil authority provision arguably could provide coverage to the losses at issue, many insurers have taken the position that exclusions pertaining to viruses, contamination or pollutants bar coverage. In the wake of the 2003 SARS outbreak, some insurance companies began incorporating specific viral/bacterial outbreak or "communicable disease" exclusions in their policies. While virus and other similar exclusions will be a significant hurdle to COVID-19 coverage claims, a standard pollution exclusion, which typically encompasses the "dispersal or discharge" of "contaminants," will likely lead to more hotly-contested issues of policy interpretation. In other, arguably analogous contexts involving contagious contaminants, courts have reached differing conclusions as to the applicability of a pollution exclusion. *See, e.g., Connors v. Zurich Am. Ins. Co.*, 2015 WL 5972551 (Wis. Ct. App. Oct. 15, 2015) (pollution exclusion ambiguous as to whether it applies to claims arising out of exposure to Legionnaires disease bacteria); *First Specialty Ins. Corp. v. GRS Mgmt. Assocs., Inc.*, 2009 WL 2524613 (S.D. Fla. Aug. 17, 2009) (pollution exclusion bars coverage for claim alleging that individual contracted virus by ingesting contaminants in swimming pool water); *Landshire Fast Foods of Milwaukee, Inc. v. Employers Mut. Cas. Co.*, 676 N.W.2d 528 (Wis. Ct. App. 2004) (pollution exclusion bars coverage for losses caused by bacteria that rendered food unfit for consumption); *Nova Cas. Co. v. Waserstein*, 424 F. Supp. 2d 1325 (S.D. Fla. 2006) (finding that "airborne and microbial contaminants" fall within scope of "contaminant" in pollution exclusion).

Within the past few weeks, several complaints seeking civil authority coverage for COVID-19-related losses have been filed:

- A Louisiana restaurant alleged that statewide orders relating to public gatherings and on-site dining resulted in business losses covered by a civil authority provision, among others. *Cajun Conti LLC v. Certain Underwriters at Lloyd's of London*, No. 20-02558 (La. Civ. Dist. Ct. filed Mar. 16, 2020).
- The Chickasaw and Choctaw nations brought suit against several insurers in Oklahoma, seeking coverage for losses stemming from casino closures, invoking the civil authority provision, among others. *Chickasaw Dep't of Commerce v. Lexington Ins. Co.*, No. CV-20-35 (D. Okla. filed Mar. 24, 2020).

- Two restaurants owned by famed chef Thomas Keller filed a suit seeking civil authority coverage following the state-mandated closures in California. *French Laundry Partners LP v. Hartford Fire Ins. Co.*, (case number not yet available) (Cal. Super. Ct. filed Mar. 25, 2020).
- A group of Chicago restaurants and movie theater owners alleged that their insurer wrongfully denied coverage for business interruption losses in the wake of the state-mandated closures. *Big Onion Tavern Grp., LLC v. Society Ins., Inc.*, No. 1:20-cv-02005 (N.D. Ill. filed Mar. 27, 2020).
- A Florida sports bar sued its insurer after it denied coverage for business income losses incurred as a result of the state-wide shut down. *Prime Time Sports Grill, Inc. v. Certain Underwriters at Lloyd's London*, No. 8:20-cv-00771 (M.D. Fla. filed Apr. 2, 2020).

The outcome of these and other similar suits will ultimately turn on the specific language of the operative provisions, as interpreted under governing law.

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