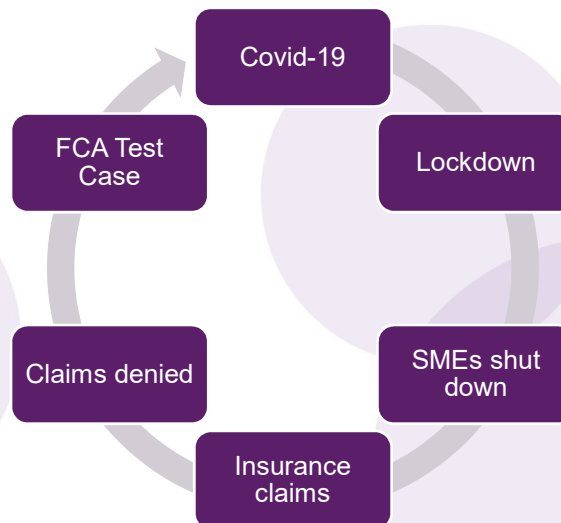


# COVID-19: business interruption insurance – the FCA test case and beyond

Katharine Harle and Michael Calladine

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## Background



## The FCA Test Case

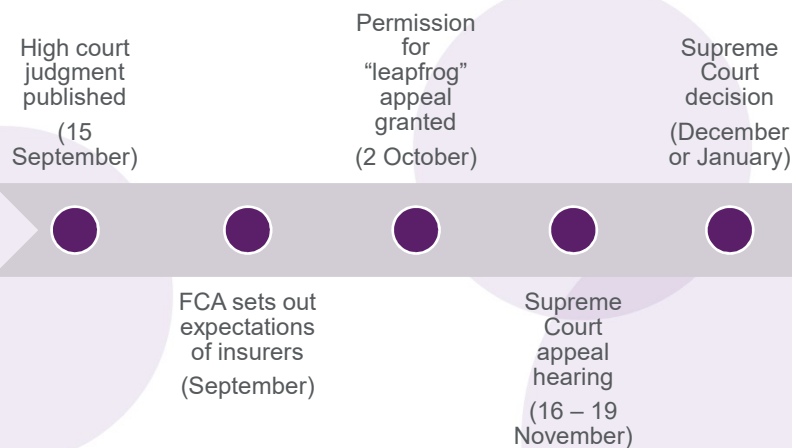
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- First case brought under UK's Financial Markets Test Case Scheme
- Expedited proceedings with agreed set of facts
- Decision binding on parties to case but persuasive guidance for other insurers
- Selected policies involve non-damage extensions to standard business interruption cover
- Other litigation involving property damage - *TKC London Limited v Allianz Insurance plc*

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## Timeline since High Court judgment

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## Disease Clauses

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Business interruption as a result of the occurrence of a notifiable disease within a specified radius of the insured premises



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## Prevention of access clauses

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Business interruption as a result of a prevention or hindrance of using premises following public authority action



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## Hybrid clauses

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Business interruption as a result of restrictions imposed by a public authority following an outbreak of disease

Disease clauses

Prevention of access clauses

Hybrid clauses

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## Trends clauses

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No coverage where business interruption would have been caused by wider trends which would have impacted the business anyway had the matters giving rise to the claim not occurred

Occurrence of disease

Government response

Impact on business

Insured peril

Public Response

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What is the correct counterfactual when considering the cause of business interruption?



- Judgment in December 2020 or January 2021
- Potential for High Court decision to be overturned and for a complicated judgment with dissenting opinions
- Insurers will have to react very quickly
- Will this be the end of the matter?

Impact on policy  
drafting

Approach in other  
jurisdictions

The *Orient Express*  
decision and multiple  
causal events

Causation in property  
damage cases

Questions?



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Katharine advises on all aspects financial markets and regulatory work. She previously spent nearly five years as an in-house lawyer with the UK Financial Conduct Authority (FCA) including working in its insurance legal team. From her time at the regulator, Katharine has significant experience of litigation involving regulators having acted for the FCA on the multi-billion pound payment protection insurance litigation and the "bank charges" test case. Through her experience with the FCA, Katharine has a detailed understanding of regulatory processes and policy-making enabling her to advise clients on a broad range of regulatory and strategic issues including insurance conduct of business, Part VII transfers of business, Brexit and FCA investigations in respect of both firms and individuals.

Katharine's clients include both public organisations and regulated firms including insurers and brokers. Work is often confidential, focusing on achieving a successful outcome on complicated and sensitive matters.

Katharine chairs an industry working group, is co-Chair of Dentons Regulatory & Trade Accelerator Group and regularly writes and speaks on regulatory topics. She is recognised by Legal 500 as 'an expert on regulatory matters', "incredibly bright and fearlessly tenacious" and 'exciting and innovative'. She was previously identified as a "rising star" on Thomson Reuters' Super Lawyers List in Financial and Investment Services.



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Michael is an associate in Dentons' Regulatory, Trade and Investigations team in London. He joined Dentons as a trainee lawyer in 2018 and qualified in September 2020.

Michael advises on all aspects of financial markets and regulatory work, with insurance being a particular area of focus. He has advised (re)insurers on a range of regulatory issues, most notably recently in connection with Brexit. Michael has experience of court procedures and applications (at all levels) and has interacted with the UK financial services regulators, including on changes of control.

Michael recently returned from a secondment to the M&A team at a multi-national insurance firm. He assisted with the underwriting of warranty and indemnity insurance and has specific experience of corporate transactions and of carrying out due diligence on both UK and cross-border acquisitions.

## COVID-19 Business Interruption Litigation Developments

### Gotham Insurance Symposium: Webinar Series

## Speakers



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## Key Coverages Under Commercial Property Insurance Policies

### 1. Business Interruption

- Physical loss or damage to insured property causes interruption to operations
- Timed off a period of restoration required to repair (damage) or replace (loss)

### 2. Extra Expense

- Expenses required to repair or replace

### 3. Civil Authority

- Government order closing property that
  - Prohibits access
- In response to physical damage or loss at or near property

### 4. Communicable Disease Endorsement

- Outbreak on insured property

### 5. Virus Exclusion

- Anti-concurrent cause language



## Litigation Trends:

### Direct Physical Loss or Damage

#### Direct Physical Loss or Damage - Policyholder Theories

**Policyholder theory:** Physical Presence of COVID  
“infects” property causing direct physical loss or  
damage (the mold analogy)



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- Some Plaintiffs intentionally avoid this theory:
  - Harder to get around than the virus exclusion.
  - Even when the claim survives dismissal, a difficult path to recovery.

- *Studio 417*: Initial hope for Plaintiffs:
  - Finding coverage where: “Plaintiffs allege that COVID-19 is a highly contagious virus that is physically ‘present . . . in viral fluid particles,’ and is “deposited on surfaces or objects.’ . . . Plaintiffs further allege that this physical substance is likely on their premises and caused them to cease or suspend operations.”
  - “Courts have similarly recognized that even absent a physical alteration, a physical loss may occur when the property is uninhabitable or unusable for its intended purpose.”
  - No virus exclusion
- Some courts have followed *Studio 417* (*Nevada, Ohio*)

## Post-Pleadings: An Uphill Battle



Image: Pixabay.com

- **Reality:** Most businesses closed because of government orders, not physical presence of COVID.
- **Causation:** To the extent businesses closed from COVID's presence, the duration was short.
- **Proof:** Expensive and difficult to prove presence; science doesn't support mold-like remediation.

## Growing Body of Cases Rejecting Physical Presence

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- *Uncork & Create LLC v. Cincinnati Ins. Co.*, 2020 WL 6436948, at \*5 (S.D.W. Va. Nov. 2, 2020)
- “COVID-19 poses a serious risk to people gathered in proximity to one another,” but “even when present, **does not threaten the inanimate structures** covered by property insurance policies.”
- “In short, the **pandemic impacts human health and human behavior**, not physical structures. **Those changes in behavior, including changes required by governmental action, caused the Plaintiff economic losses.**”
- “The mere presence of Covid-19 on business premises does not constitute a direct physical loss of or damage to property.” *Dab Dental PLLC v. Main Street America Protection Ins. Co.*, (Hillsborough Cnty. Ct., Fla. Nov. 10, 2020)
- “The coronavirus **does not physically alter the appearance, shape, color, structure, or other material dimension of the property.**” (*Sandy Point Dental, PC*, 2020 WL 5630465, at \*2 at \*3).



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## Growing Body of Cases Rejecting Physical Presence

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- *Zwillo V, Corp. v. Lexington Insurance Co.*, at \*6 (W.D. Mo. Dec. 2, 2020).
- “Whether the complaint is couched in terms of COVID-19’s presence on the premises or of loss of use of premises due to the stay-at-home orders (or the virus itself), Plaintiff has failed to state a claim upon which relief may be granted because the policy does not cover the alleged claim.”
- “To the extent this Court’s ruling – finding the language in the policy plainly and unambiguously does not cover the claims – conflicts with *Studio 417* [and other cases decided by that same judge], this Court respectfully disagrees with those cases.”

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**Policyholder Theory:** Inability to use property because of preventative measure to avoid spread of disease is direct physical loss or damage (“use it or lose it” theory).

- Courts have been more dismissive of this theory at the MTD stage: bigger departure from existing case law
- But, if allowed and holds up on appeal, would present an easier factual proof for insureds



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### Loss of Use Theory: Early and Consistent Successes for Insurers in Many States

- *Gavrilides Mgmt. Co. v. Michigan Ins. Co.*, (Mich. Cir. Ct. July 1, 2020) (transcript): argument that government orders “physically” restricted use of property was “nonsense.”
- *Henry’s Louisiana Grill, Inc., et al., v. Allied Insurance Company of America*, 2020 WL 5938755 (N.D. Ga. Oct. 6, 2020)
  - The court found that under plaintiffs’ logic, “one minute before the Governor issued the Order, the dining rooms existed in one state,” and “[a] minute later, the Governor issued the Order, and the restaurant underwent a direct physical change that left the dining rooms in a different state.” This interpretation of the contractual language, according to Judge Thrash, “exceed[ed] any reasonable bounds of possible construction.”
  - A holding that the Governor’s orders led to a “physical loss of” the dining rooms would “massively expand the scope of the insurance coverage at issue.

## Loss of Use Theory: Minority Approach

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- *Hill and Stout PLLC v. Mutual of Enumclaw Ins. Co.*, (King Cnty. Ct., WA Nov. 13, 2020); *Perry Street Brewing Co. LLC v. Mutual of Enumclaw Ins. Co.*, (Spokane Cnty. Sup. Ct. Nov. 23, 2020); *North State Deli, LLC dba Lucky's Delicatessen, et al. v. The Cincinnati Ins. Co., et al.*, (Durham Cnty. Ct., N.C. Oct. 7, 2020)
- Rationale:
  - Direct physical loss OR damage;
  - Physical loss must mean something different than physical damage;
- Wrongly decided:
  - Loss of use of a physical thing is not the same as loss of a physical thing.



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## Scorecard

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- Trial court decisions: More than 60 cases decided addressing whether direct physical loss or damage has been established, more than 45 favorable to insurers
- Of the 11 cases specifically addressing whether physical presence of COVID on property is direct physical loss of damage, 6 are favorable and 5 are unfavorable (but 3 unfavorable decisions from the same judge).
- BUT:
  - Appellate decisions: 0
  - Selection bias
  - Unsuccessful may be underrepresented

<https://previews.123rf.com/images/alancotton/alancotton1410/alancotton141000056/32348834-outline-map-of-the-state-of-north-carolina.jpg>

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## The Bunt

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- Most courts allowing cases to go forward despite motions to dismiss have bunted.
- No analysis or one line analysis; no explanation of rationale.
- Risk of a “bunt” is greater in state court than federal court.



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## Affirmative Disease Coverage

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- No decisions yet; no direct physical loss or damage requirement, but some concepts from the decided law may be relevant.
- **Presence Requirement:** Most affirmative coverage requires a showing that COVID-19 is present on the property
  - *Promotional Headwear Int'l v. The Cincinnati Ins. Co.* (D. Kan. Dec. 3, 2020) (allegation of “likely” presence did not “raise the “right to relief beyond a speculative level”); *but see Studio 417* (allegations of “likely presence were enough given widespread nature of the disease).
- **Causation Requirement:** Most affirmative coverage requires a showing that presence of the virus on the property caused a loss.
  - *Social Life Magazine, Inc. v. Sentinel Ins. Co., Ltd.* 2020 WL 2904834 (S.D.N.Y. May 14, 2020) (transcript) (even if virus had been present on the property, cause of damage was government orders to address virus run amuck in the community).

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# Virus Exclusion

COMMERCIAL PROPERTY  
CP 01 40 07 06

THIS ENDORSEMENT CHANGES THE POLICY. PLEASE READ IT CAREFULLY.

## EXCLUSION OF LOSS DUE TO VIRUS OR BACTERIA

This endorsement modifies insurance provided under the following:

COMMERCIAL PROPERTY COVERAGE PART  
STANDARD PROPERTY POLICY

- A. The exclusion set forth in Paragraph B applies to all coverage under all forms and endorsements that comprise this Coverage Part or Policy, including but not limited to forms or endorsements that cover property damage to buildings or personal property and forms or endorsements that cover business income, extra expense or action of civil authority.
- B. "We will not pay for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease. However, this exclusion does not apply to loss or damage caused by or resulting from 'fungus', wet rot or dry rot. Such loss or damage is addressed in a separate exclusion in this Coverage Part or Policy."
- D. The following provisions in this Coverage Part or Policy are hereby amended to remove reference to bacteria:
1. Exclusion of "Fungus", Wet Rot, Dry Rot And Bacteria; and
  2. Additional Coverage – Limited Coverage for "Fungus", Wet Rot, Dry Rot And Bacteria, including any endorsement increasing the scope or amount of coverage.
- E. The terms of the exclusion in Paragraph B., or the inapplicability of this exclusion to a particular loss, do not serve to create coverage for any loss that would otherwise be excluded under this Coverage Part or Policy.

## Virus Exclusion



Vast majority of courts have generally held business income, civil authority and extra expense claims barred by virus exclusion.

## Virus Exclusion - Fun Facts

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- As of December 4, 2020, Motions to Dismiss were granted in **44 of 53** cases where a Virus Exclusion was included in the Policy—a **success ratio of 83%**.
- Where there was no virus exclusion, **14 out of 25** Motions to Dismiss were granted—a success ratio of 56%.



## Challenges to Virus Exclusion

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- Indirect loss
- Communicable disease coverage/endorsement
- Public policy
- Regulatory estoppel

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## Venue and Choice of Law

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- Federal court
  - Declaratory judgment claims and discretionary jurisdiction under DJA
- State courts
  - Pleading standard matters
- Substantive jurisdictions
  - Negative:
    - Missouri federal court?
    - Washington
  - Positive
    - California state/federal courts,
    - Florida/11<sup>th</sup> Circuit
- Choice of Law
  - Regulatory estoppel

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## Consolidation and Class Actions

## Consolidation

- Efforts at industry-wide consolidation at federal and state levels have been unsuccessful
- Some limited carrier-specific consolidation has been ordered
  - JPML has consolidated suits against Society Ins. in six-state region
  - PA Court of Common Pleas has consolidated suits against Erie Ins. in three counties
- Informal case coordination
  - Judicial assignments within jurisdiction

## Federal Jurisdiction Under Class Action Fairness Act

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- Minimal Diversity
- \$5,000,000 aggregate amount in controversy

## Hurdles to Class Certification

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- No typicality and commonality under 23(a)
- Damage actions
  - No predominance or superiority under Rule 23(b)(3)
- Declaratory or injunctive actions
  - No risk of inconsistent adjudication under Rule 23(b)(1)
  - No uniformity under Rule 23(b)(2)

## Special Class Action Issues

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- Motion to strike class allegations pursuant to Rule 23(d)(1)(D)
- Issue certification under Rule 23(d)(1)(D)
- Rule 23(f) interlocutory appeal

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## Appeals

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- No decisions so far
  - Mama Jo's in Eleventh Circuit
- Appeal or Dismiss?
  - California
  - New Jersey
  - What to appeal?
    - Virus on property v. government orders

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## CLE CODE WORD

### IMPACT

- If you are licensed in **New Jersey or New York**, please write the code word in the **pop up box** that appeared on your screen.

(If you don't have a license in any of those states, you don't have to worry about this step - it is only required for Kansas, New Jersey and New York)

Lasting Impact?

## Direct Physical Loss or Damage

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- Dramatic expansion of body of case law addressing direct physical loss or damage.
- Many cases reinforcing “tangible” requirement; impact on property not people.
- Will it be harder to show coverage for asbestos and odors - a “COVID analogy”?

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## Virus Exclusions, Contamination Exclusions

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- Body of law on virus exclusions being developed.
- Pollution and contamination exclusions being tested in first-party cases.

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