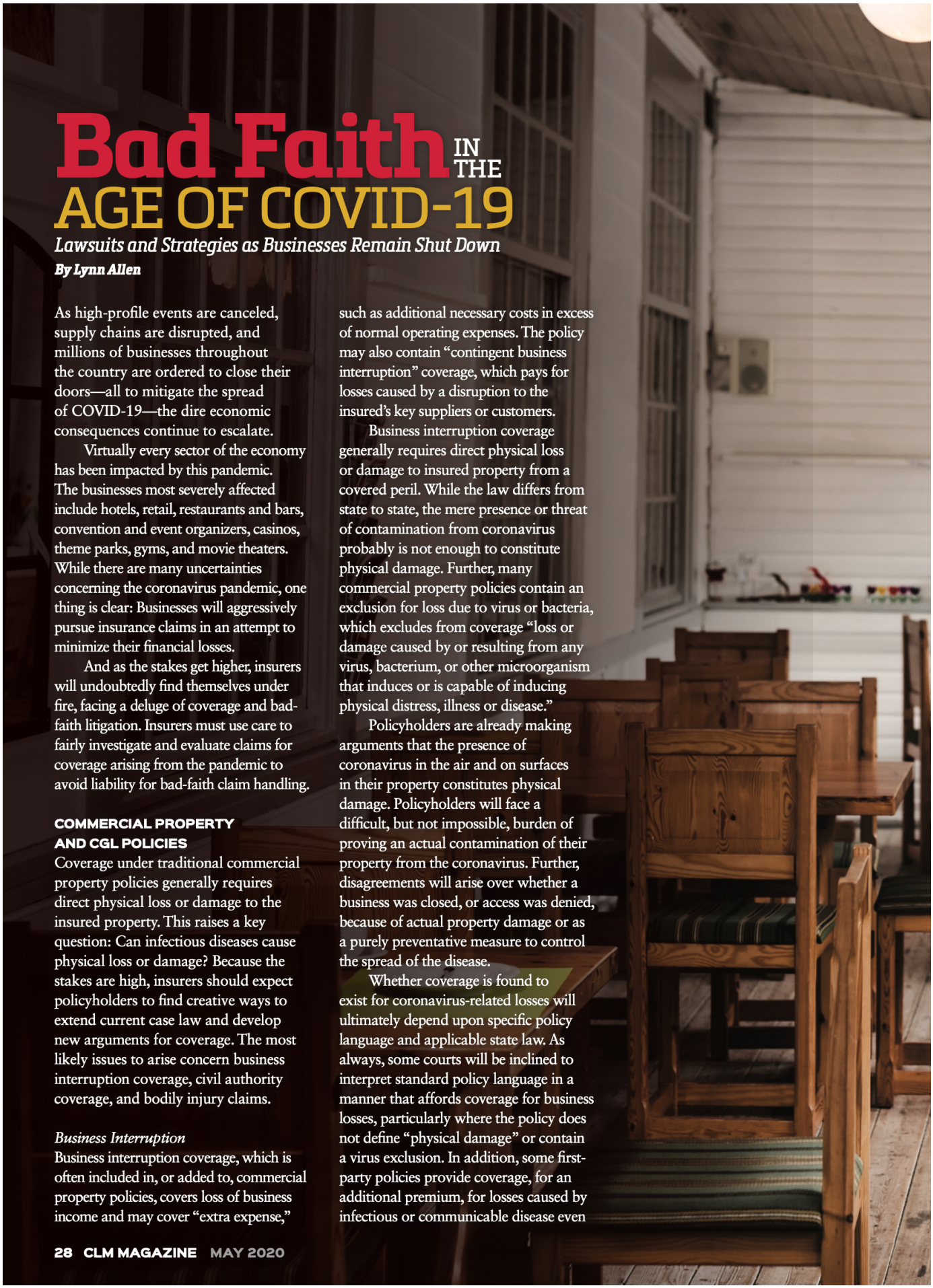
Bad Faith IN THE AGE OF COVID-19

Lawsuits and Strategies as Businesses Remain Shut Down

By Lynn Allen



As high-profile events are canceled, supply chains are disrupted, and millions of businesses throughout the country are ordered to close their doors—all to mitigate the spread of COVID-19—the dire economic consequences continue to escalate.

Virtually every sector of the economy has been impacted by this pandemic. The businesses most severely affected include hotels, retail, restaurants and bars, convention and event organizers, casinos, theme parks, gyms, and movie theaters. While there are many uncertainties concerning the coronavirus pandemic, one thing is clear: Businesses will aggressively pursue insurance claims in an attempt to minimize their financial losses.

And as the stakes get higher, insurers will undoubtedly find themselves under fire, facing a deluge of coverage and bad-faith litigation. Insurers must use care to fairly investigate and evaluate claims for coverage arising from the pandemic to avoid liability for bad-faith claim handling.

COMMERCIAL PROPERTY AND CGL POLICIES

Coverage under traditional commercial property policies generally requires direct physical loss or damage to the insured property. This raises a key question: Can infectious diseases cause physical loss or damage? Because the stakes are high, insurers should expect policyholders to find creative ways to extend current case law and develop new arguments for coverage. The most likely issues to arise concern business interruption coverage, civil authority coverage, and bodily injury claims.

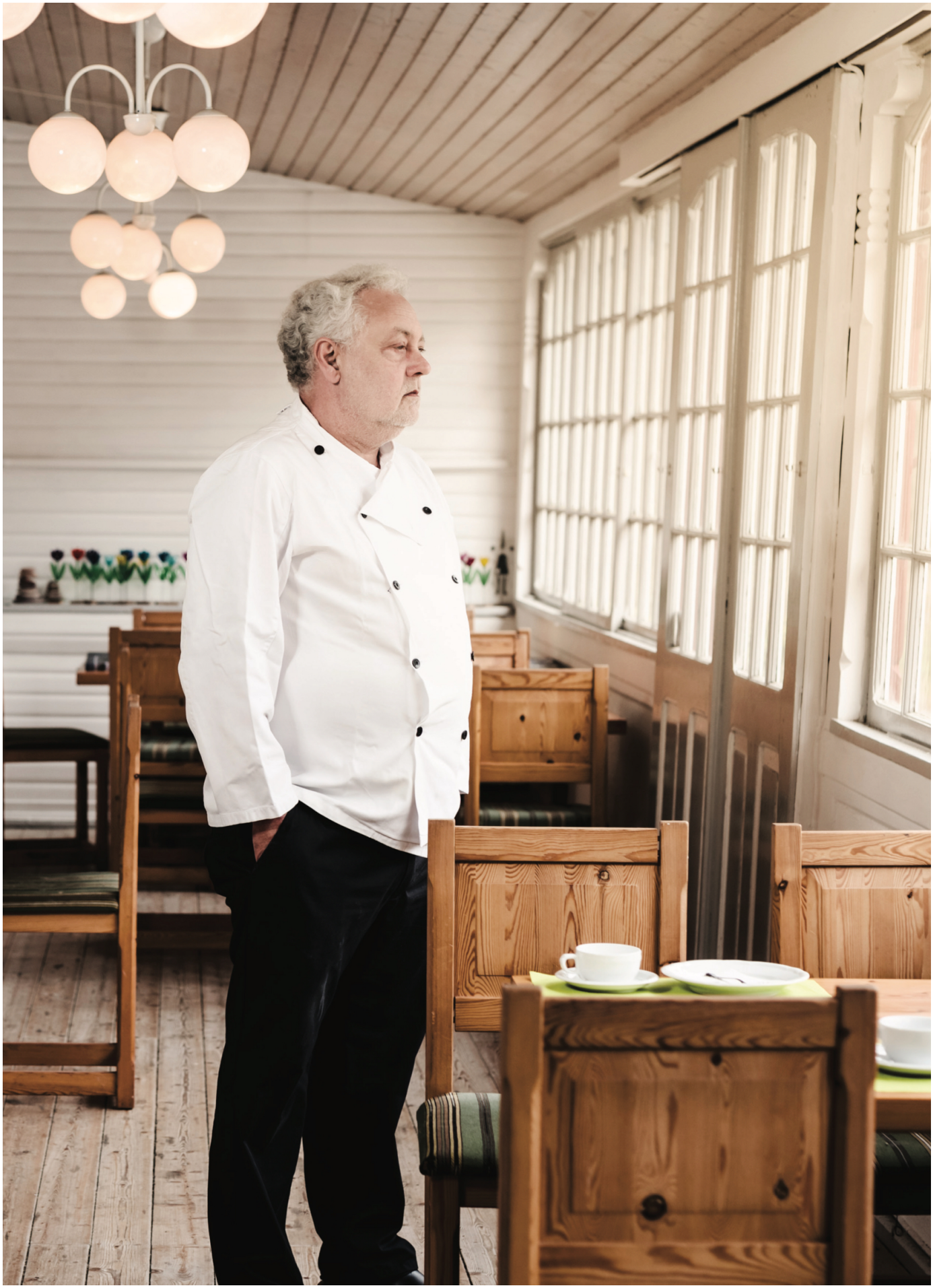
Business Interruption

Business interruption coverage, which is often included in, or added to, commercial property policies, covers loss of business income and may cover "extra expense," such as additional necessary costs in excess of normal operating expenses. The policy may also contain "contingent business interruption" coverage, which pays for losses caused by a disruption to the insured's key suppliers or customers.

Business interruption coverage generally requires direct physical loss or damage to insured property from a covered peril. While the law differs from state to state, the mere presence or threat of contamination from coronavirus probably is not enough to constitute physical damage. Further, many commercial property policies contain an exclusion for loss due to virus or bacteria, which excludes from coverage "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."

Policyholders are already making arguments that the presence of coronavirus in the air and on surfaces in their property constitutes physical damage. Policyholders will face a difficult, but not impossible, burden of proving an actual contamination of their property from the coronavirus. Further, disagreements will arise over whether a business was closed, or access was denied, because of actual property damage or as a purely preventative measure to control the spread of the disease.

Whether coverage is found to exist for coronavirus-related losses will ultimately depend upon specific policy language and applicable state law. As always, some courts will be inclined to interpret standard policy language in a manner that affords coverage for business losses, particularly where the policy does not define "physical damage" or contain a virus exclusion. In addition, some first-party policies provide coverage, for an additional premium, for losses caused by infectious or communicable disease even



in the absence of physical loss or damage. Insurers should therefore evaluate coverage for COVID-19 claims on a case-by-case, state-by-state basis.

Civil Authority
Civil authority coverage comes into play when a civil authority prohibits access to the insured business' premises, resulting in loss of business income. Access to premises must be prohibited, and government prohibition must stem from physical damage to property other than the insured premises due to covered peril. Additionally, coverage limitations include geographical proximity to the shuttered business and time limitations. The same issues regarding what constitutes "physical damage" will arise in claims under civil authority coverage.

Bodily Injury
Bodily injury claims may arise under commercial general liability policies. Parties contracting COVID-19 may claim that a business failed to take reasonable measures to prevent customers' exposure to the virus. The recent lawsuits filed against cruise lines argue that the companies failed to warn of prior sailings with COVID-19-positive passengers and misrepresented the seriousness of the pandemic to their passengers. However, many CGL policies contain a communicable disease exclusion. Policyholders have argued in different contexts that the exclusion is ambiguous, but have largely been unsuccessful.

RECENT LAWSUITS

The wave of insurance coverage litigation over COVID-19 losses is inevitable. As policyholders seek to recoup business-related losses, business interruption claims will be the new normal. With insurance companies denying such claims for lack of physical damage or loss to property, businesses are suing their insurance companies in increasing numbers. A few examples include:

- Marking the first known lawsuit related to a COVID-19 insurance claim, a restaurant, Oceana Grill, filed suit against Lloyd's of London on March 16. Oceana Grill seeks a declaratory judgment that the insurer must cover loss of business income after an order by the governor of Louisiana restricting public gatherings, and the New Orleans mayor's order closing restaurants.
- In a federal suit filed in Chicago, Big Onion Tavern Group—a group of Chicago-based restaurants and movie theaters—sued its insurer seeking coverage for lost revenue due to forced closures following the Illinois governor's COVID-19 shutdown order. Plaintiffs also seek damages for statutory bad faith.
- A Washington, D.C. eatery recently filed suit against its insurer alleging breach of contract and bad faith for wrongful denial of its claim under the policy's business interruption coverage.
- An Illinois dental group sued its insurer, after it was forced to close as a "nonessential business," for failing to honor its obligations under the insurance policy, not conducting a meaningful investigation of coverage, and creating an expectation of coverage by not including a virus exclusion in its policy. The dental group seeks coverage for loss of revenue and damages for statutory bad faith.

BECAUSE THE STAKES ARE HIGH, INSURERS SHOULD EXPECT POLICYHOLDERS TO FIND CREATIVE WAYS TO EXTEND CURRENT CASE LAW AND DEVELOP NEW ARGUMENTS FOR COVERAGE.

These lawsuits are just the beginning. In light of this unprecedented pandemic, insurers can expect a historic increase in business interruption and civil authority claims. As a result, insurance companies need to be prepared to defend against such claims.

EMERGING BAD-FAITH ISSUES

Insurance companies owe their insureds a duty of good faith and fair dealing when they investigate and respond to claims. Insurance bad-faith laws vary from state to state and may arise under statute, common law, or both. Generally, the law requires the insurer to conduct a timely and reasonable investigation, and have a reasonable basis for its coverage decision.

Bad-faith claims expose insurers to consequential damages, general damages for emotional distress and inconvenience, and punitive damages in egregious cases. With this in mind, insurers should be prepared to take proactive steps to handle claims fairly and consistent with state law.

At a minimum, insurers must have a reasonable, good-faith basis for disputing coverage on the ground that the presence of the COVID-19 virus at the insured's premises does not amount to "direct physical damage" of property. Assuming they have conducted a reasonably thorough factual investigation, property insurers that deny coverage on this basis are unlikely to face bad-faith liability—even if a court later disagrees with their coverage position.

Insurance carriers can minimize the risk of bad-faith litigation by considering the following when examining claims:

Conduct a reasonable investigation. A common theme in the recently filed COVID-19 lawsuits is the insurer's immediate denial of the claim based on an assumption of lack of physical damage or loss to the property. It is important to carefully consider the language in the insuring agreement and whether any exclusions apply. The insurer should address any evidence suggesting a physical contamination of the insured property and whether it would constitute physical damage or loss under the laws of the jurisdiction. The science surrounding COVID-19 changes on a daily basis. It may be necessary to consult with experts and review the specific civil-authority orders under which the business closed, as some reference physical damage as a basis for business closures.

Know the law of the jurisdiction. Case law interpreting "direct physical damage" varies from state to state. Plaintiffs in the recent lawsuits, and commentators, seek to draw analogies to cases where courts have found coverage involving bacterial contamination of well water, odor from a methamphetamine lab in a house, released asbestos fibers in a factory, and toxic gases released by defective drywall. Principles of policy interpretation vary from state to state. Some jurisdictions have adopted the "reasonable expectations doctrine" and may find coverage where the insurer or its agent led the insured to believe there would be coverage, or where the policy language, while not ambiguous, may lead a reasonable insured to believe the claim would be covered.

Disclose all applicable coverages to the insured. Disclosing and evaluating all potential coverages that may apply, even if the facts or law ultimately do not support coverage, will help avoid bad faith liability in the event of litigation.

Communicate the complete basis for the reservation of rights or denial. To avoid the potential for waiver, the insurer should communicate all known bases for the reservation of rights or disclaimer of coverage. This should include the facts supporting the application of a coverage exclusion to the loss. The insurer should follow up with supplemental reservations of rights or disclaimers of coverage when additional grounds supporting disclaimers of coverage become known.

Defend liability claims under a reservation of rights where appropriate. There is not much case law interpreting exclusions for communicable diseases and other similar exclusions. In determining whether to deny coverage, consideration should be given to how the particular jurisdiction construes the duty to defend, the rules of policy interpretation, and the ability of the plaintiff and the insured to enter into a stipulated judgment and assignment agreement.

Accurate and complete claim file documentation. Many jurisdictions require production of the insurer's claim file in bad faith litigation. Accurate and complete claim-file documentation will help explain the company's investigation and decision-making process in defending against a bad faith claim.

The impact of COVID-19 on the insurance industry could be significant, if the recent rash of lawsuits are an indication of things to come. Unlike natural disasters, such as hurricanes and fires, the impact of the governmental orders prohibiting large gatherings and closing nonessential business will be felt throughout the country by nearly all businesses, large and small. Insurers can prevent costly litigation by conducting reasonable investigations of coverage and the facts, anticipating the arguments policyholders may make in support of coverage, and being prepared to address those arguments if coverage is denied. ■

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