2020 Fall Conference LIVE Virtual: The Case Goes On

COVID-19 and Business Interruption Claims

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LAWYERS

In March 2020, businesses across Canada were interrupted as a result of COVID-19, a contagious and infectious disease caused by the SARS-CoV-2 novel coronavirus. Provinces, territories, and municipalities across Canada have experienced outbreaks of COVID-19 and civil authorities have imposed a variety of measures to respond to outbreaks

The financial losses as a result of COVID-19 are astounding. In April 2020, Statistics Canada released data showing that more than 50% of Canadian companies had lost at least one-fifth of their revenue due to COVID-19. Estimates in the United States indicate that small businesses lost $255 to $431 billion per month as a result of government-ordered closures.

As a result of these devastating losses, many businesses have filed claims with their insurers under business interruption insurance policies.

The vast majority of these claims have been denied. Most business interruption policies require physical damage to the insured's premises in order to provide coverage. However, there are variations of policy language and circumstances that need to be closely considered when reviewing coverage.

What is Business Interruption Insurance?

Business interruption insurance has traditionally covered losses of profits and additional expenses that an insured business suffers due to damage to physical property. For example, if your favourite coffee shop has a fire and must close for a few weeks as a result, a business interruption insurance policy should compensate the coffee shop for the business it lost as a result of the fire.

A policy may insure against a "named peril" (i.e. fire or flood) or "all risks", subject to any exclusions specifically listed. Typical perils insured include:

- Fire,
- Floods and natural disasters,
- Power outages,
- Ice storms,
- Fidelity claims (crime, employee dishonesty, cyber breach)

The indemnity period under each policy must be specifically reviewed. Some policies have limited indemnity periods with maximum monetary amounts and durations of coverage. Other policies contain extended indemnities with coverage continuing until the business resumes "normal operations" and no maximum monetary amounts.

Specific policies will provide details as to what is considered a 'loss', with examples including:

- Loss of profits (sales, customers, profit margin)
- Loss of stock (damaged, destroyed, or spoiled)

- Additional costs
    - Reasonable costs incurred to mitigate loss and/or resume normal operations

Claims for Physical Loss and COVID-19

Most business interruption policies provide coverage where there has been “direct physical loss” or “physical damage” to the insured’s premises. Some insureds have submitted claims on the basis that COVID-19 outbreaks either at the premises or in the community meet this definition. We understand that these claims are being denied by Canadian insurers and Ontario Courts will likely be considering this issue soon. The critical question is whether COVID-19 causes physical loss or damage to property? And if so, in what circumstances?

In support of these claims, insureds will likely rely on the recent decision in *MDS Inc. v. Factory Mutual Insurance Company* (“*MDS*”) 2020 ONSC 1924, where the Ontario Superior Court considered the policy term ‘physical damage’ and whether its interpretation included the loss of use of premises.

The Plaintiff, MDS, purchased radioisotopes from Atomic Energy of Canada Limited’s Nuclear Research Universal Reactor, which MDS then processed and sold for use in medical products. In 2009, the Plaintiff’s nuclear facility experienced a leak of heavy water containing radioactive material (though the facility did not sustain physical damage). The facility was proactively shut down, without a government order, but was later ordered to be shut down by the regulator, the Canadian Nuclear Safety Commission (“CNSC”). The shut-down, originally estimated to last 36 hours, ended up lasting 15 months and the Plaintiff incurred loss of profits in the amount of $121,248,000.

Wilson J. noted that "there is no definitive decision defining the meaning of resulting physical damage in all-risks policies in Canada". The Court further noted that neither Black's Law Dictionary, Halsbury's Laws of Canada, or any Canadian textbook, defines "physical damage" or "resulting physical damage". However, based on the facts of the case, and relying on a decision which held that fumes resulting from an oil spill constituted physical damage (*Jessy's Pizza (Bedford) v. Economical Mutual Insurance Co*., [2008] N.S.J. No. 319), the Court found that the term "physical damage" was broad enough to include loss of use of a property (even when direct physical damage to property was absent).

The Court referenced three US decisions where coverage was considered in its analysis (coverages was denied in the first two decisions and granted in the third decision noted below):

1) *Port Authority of New York and New Jersey v Affiliated FM Ins* (2002), 311 F.3d 226 (U.S. C.A. 3rd Cir.)

- Holding that "physical damage" to property means a distinct, demonstrable, and physical alteration of its structure; therefore buildings with asbestos in them did not sustain "physical loss or damage" as the asbestos were not in form or in quantity to make the building unusable or unhabitable and nothing indicated an "imminent threat" of contamination.

2) *Universal Image Productions, Inc. v Chubb Corp*. (2010), 703 F.Supp.2d 705 (U.S. Dist. Ct. E.D. Mich.)

- Holding that the insured property suffered water damage causing 'pervasive odour, mould, and bacterial contamination' however the court did not consider this to be a "direct physical loss" as the premises did not suffer any structural or other tangible damage and the odour was not so pervasive as to render the premises uninhabitable and there was no "imminent risk of contamination".

According to Wilson J. of the Ontario Superior Court,

"These two cases are easily distinguishable from the facts of this case. In this case, the leak of heavy water required the shutdown of the NRU rendering it unusable. **With continued operation there was a very real imminent risk of harm."** (this writer's emphasis added)

3) *Western Fire Ins. Co. v. First Presbyterian Church* (1968), 437 P.2d 52 (U.S. Colo. S.C. "*Western Fire")*

- Holding that circumstances where insured property was rendered uninhabitable due to the infiltration and saturation of gasoline vapours from an adjacent property combined with a government declaration of uninhabitability amounted to a direct physical loss requiring coverage

According to Wilson J., *Western Fire*, confirms a broad interpretation of direct physical loss, granting coverage in a situation where a public body declared that the premises in question were uninhabitable.

In considering all of the above, Wilson J. held that as a result of the leak and the order from the CNSC that there was a "very imminent and real risk of harm" stating that coverage is available in a situation where a public body declared that the premises in question were uninhabitable.

We understand this decision is under appeal.

Insured's relying on MDS and on its broad interpretation of physical loss must consider whether they can establish that COVID-19 rendered their premises "uninhabitable" and whether there was a **"very real imminent risk of harm"** from their continued operation. To the extent that property was usable, even if restricted by government order, it is our

view that it will be difficult to successfully claim under the standard policy language requiring physical loss/damage to property, even if MDS is upheld on appeal.

Extended Policy Wordings

Some policies contain extensions or endorsements beyond the standard physical loss coverage.

In rare cases the extension may refer directly to “pandemic coverage.”

An Aviva policy, which provided limited coverage of up to $20,000 to Canadian dentists contained express coverage for pandemic outbreaks, combined with an interruption by order of a civil authority, as set out below.

"to help offset your income loss during a pandemic outbreak, the tripleguard™ insurance plan’s practice interruption coverage automatically provides up to $1,000 per day after the first 24 hours (up to a $20,000 aggregate annual limit) when you are prohibited from entering your office by an order from a civil authority or public health official... Pandemic outbreak means an outbreak of an infectious disease resulting in serious illness that becomes prevalent over the human population throughout a region."

The insurance industry's resistance to COVID-19 business interruption claims is illustrated by Aviva's alleged initial delay in responding to claims under its Tripleguard policy, which clearly provided coverage.

Other extensions may fall into the three broad categories as set out below which were recently described by the British High Court in *The Financial Conduct Authority v. Arch and Others (*the “UK Test Case”). This litigation was a test case instituted by the Financial Conduct Authority in respect of various policies issued in the United Kingdom.

- Disease wordings
- Civil Interruption/Restricted access wordings
- Hybrid wordings

a) <u>Disease wordings</u>

These coverage clauses provide for business interruptions and consequent losses as a result of disease. Policies provide specifications as to the nature of disease that would trigger coverage. Some common wordings are:

- notifiable disease
- infectious/contagious disease
- outbreak/occurrence of disease

These clauses often specify that the outbreak/occurrence must take place within a certain location. Examples include:

- within a specific radius from the insured premises (i.e. within 25 km or some other distance)
- within the "vicinity" of the insured premises
- at the insured location

b) Restricted Access/ Civil Authority Wordings

These policy wordings respond to interruptions as a result of restricted access to the insured premises due to an order of a civil authority. In some cases, these wordings are constrained by the nature of the order and an "incident" that must take place within a localized geographic region that causes the interruption. These coverages do not refer directly to disease.

c) Hybrid Wordings

Hybrid wordings are a hybrid of both of the disease and civil interruption wordings. The wording may require an interruption to business following restricted access as a result of an order related to an outbreak of infectious disease.

U.K. Test Case – *The Financial Conduct Authority v. Arch and Others*

In the UK Test Case the English High Court considered the three categories of policy wordings described above (disease wordings, restricted access wordings, and hybrid wordings). The High Court largely interpreted these clauses in favour of the insureds. A brief summary follows:

a) Disease wordings

An example of a disease wording considered by the Court was from a policy issued by MSA with the following language:

> *"We will pay you for: ...*
> *6. Notifiable disease, vermin, defective sanitary arrangements, murder and suicide Consequential loss as a result of interruption of or interference with the business carried on by you at the premises following:*
> *a)*
> *i. any notifiable disease at the premises or due to food or drink supplied from the premises;*
> *ii. any discovery of an organism at the premises likely to result in the event of a notifiable disease;*
> ***iii. any notifiable disease within a radius of twenty five miles of the premises***

MSA (and others with similar policies) argued that coverage for pandemics was separate from what they were offering – which they argued was coverage for losses only attributable to local outbreaks of local infectious diseases.

MSA argued it only intended to provide coverage when the insured could specifically link the loss to a local occurrence of a notifiable disease and only to a local occurrence of a notifiable disease.

The High Court rejected the insurers' position finding that notifiable diseases were by nature highly infectious diseases (such as COVID-19 or SARS) and they often require a global response as opposed to just a local response which is indivisible. To limit coverage to losses only caused locally would be unrealistic and far too restrictive. For coverage to apply the only requirement was that there was a local occurrence of the notifiable disease (i.e. an occurrence of COVID-19 within 25 miles of the insured premises).

b) Restricted access wordings

An example of restricted access wording considered by the High Court was from a policy issued by MSA with the following language:

> *"8. Prevention of access – non damage*
>
> *your financial losses and other items specified in the schedule, resulting solely and directly from an interruption to your business caused by* ***an incident within a one mile radius of your premises which results in a denial of access or hindrance in access to your premises*** *during the period of insurance, imposed by any civil or statutory authority or by order of the government or any public authority, for more than 24 hours.*

The High Court concluded that these clauses were to be interpreted more restrictively than disease clauses. These clauses generally contained key requirements such as "emergency in the vicinity", "danger or disturbance in the vicinity", "injury in the vicinity" and "incident within 1 mile/the Vicinity".

The High Court generally held that these requirements were specific to a particular time and in the local area and that such wordings were intended to provide narrow localized cover excluding global pandemics.

c) Hybrid wordings

The following is an example of a hybrid policy issued by Hiscox and referenced in the UK Test Case:

Public authority

your inability to use the insured premises ***due to restrictions imposed by a public authority*** *during the period of insurance following:*

a. a murder or suicide;

b. an occurrence of any human infectious or human contagious disease, an outbreak of which must be notified to the local authority;
c. injury or illness of any person traceable to food or drink consumed on the insured premises;
d. defects in the drains or other sanitary arrangements;
e. vermin or pests at the insured premises.

As these clauses are a combination of disease and restricted access wordings, the Courts adopted the approaches they had previously applied. If a business was closed as a result of legally enforceable government action referencing a notifiable disease (and there was a local occurrence of this disease), which lead to restrictions imposed by a public authority, then coverage was available.

Nordik v. Aviva Insurance Company

Thomson, Rogers is part of a consortium of law firms which has issued a class proceeding seeking compensation for Aviva Policy holders with a widely issued infectious/contagious disease endorsement coverage in *Nordik Windows Inc. v. Aviva Insurance Company of Canada ("Nordik")*:

Claims are advanced for losses under the 'negative publicity clause' – which is in essence a disease clause. The specific clause in dispute is as follows:

Negative Publicity Coverage:

III.C.2.a. This form is extended to insure the actual loss of "business income" sustained by the Insured as a direct result of any of the following circumstances:
…
ii. an outbreak of a contagious or infectious disease within 25 kilometres of the "premises" that is required by law to be reported by government authorities.

Claimed are also advanced under a restricted access coverage which is essentially a hybrid wording. One of the specific clauses in dispute is as follows:

Restricted Access coverage:

4.a. This form insures the actual loss of "business income" sustained by the Insured caused by the interruption of the "business" at the "premises" when ingress or egress from the "premises" is restricted in whole or in part:
…ii.(a) by order of civil authority resulting from any of the following occurrences:
…
(2) an outbreak of a contagious or infectious disease that is required by law to be reported to governmental authorities.

Aviva has denied claims under both coverages arguing that the contagious or infectious disease coverages do not apply to a global pandemic (i.e. that this was intended to be

localised coverage only). We are hopeful the Ontario Courts will follow the precedent by the British High Court and reject this argument. The action has not yet been certified.

Damages

Losses for each claimant will vary and are outside the scope of this paper. Policies often include coverage for accountant fees incurred when assessing these losses. We recommend that claims for loss of business income due to business interruption are valuated by a business/financial loss valuator for the greatest accuracy.

Conclusion

It remains unclear how Canadian Courts will evaluate business interruption claims arising from COVID-19. To date insurers appear to be rejecting these claims on a wholesale basis. It is anticipated that coverage will be available under some of these policies and all policies and endorsements must be carefully reviewed when considering this issue.