Business Interruption Coverage Amidst the COVID-19 Pandemic

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I. Introduction

The outbreak of the novel coronavirus SARS-CoV-2, which causes the disease known as COVID-19, presents an unprecedented challenge to individuals, governments, and businesses across the world. Because of the global scale of the COVID-19 pandemic, businesses worldwide have been forced to cease operations, either due to government restrictions and orders or concerns about the spread of COVID-19.

The pandemic has been particularly problematic for the energy industry, which is already struggling to contend with the low oil prices and production declines accompanying the recent Russia-OPEC oil price war. For the energy sector, the pandemic has posed serious concerns regarding maintaining global supply chain operations, decreased demand due to less activity across the globe and plummeting consumer confidence, and business continuity issues caused by health and safety concerns.

Another unique challenge presented by COVID-19 is the obstacle it may present to those energy companies evaluating business interruption insurance policies. This article examines these challenges primarily in the context of Texas law. However, it is important to keep in mind that the application of these policies to COVID-19 will turn on the specific facts and policy language at issue.

II. What is Business Interruption Insurance?

Business interruption insurance, which is also known as "business indemnity" or "business income" insurance, covers losses caused by the interruption of a business, usually caused by an unexpected calamity. Typically, the coverage replaces the net profit which would have been earned if no loss had occurred.

Energy companies generally rely on business interruption coverage when their work stops due to an accident or natural disaster. However, coverage under a business insurance policy is ultimately dependent on policy language. And business interruption insurance can be nebulous and confounding due to the varying nature of coverage and the lack of generally applicable case law. For example, unlike typical liability insurance, business interruption insurance does not necessarily follow the principle that an ambiguity in the policy is construed in the insured's favor.

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III. Key Business Interruption Policy Issues

Business interruption coverage will likely turn on a few common issues. Understanding these issues may help energy companies evaluate coverage for losses caused by the COVID-19 outbreak.

A. "Unexpected" Events

Business interruption coverage typically requires an underlying triggering event, which is often an "accident" or "occurrence" such as a fire, storm, hurricane, tornado, flood, or earthquake. Coverage may also be triggered by any number of more unexpected types of events or occurrences depending on the language of the policy. *See, e.g.*, *SR Intern. Business Ins. Co., Ltd. v. World Trade Center Properties LLC*, 222 F. Supp.2d 385 (S.D.N.Y. 2002) (examining business interruption claim relating to the September 11, 2001 terrorist attacks).

A recent Pennsylvania Supreme Court decision examined the state's emergency laws to hold that the "COVID-19 pandemic is, by all definitions, a natural disaster and a catastrophe of massive proportions," along the lines of tornado, hurricane, fire, flood or earthquake. *See, e.g.*, *Friends of DeVito v. Wolf*, 2020 WL 1847100, at *5 (Pa. Apr. 13, 2020). While this case did not directly address whether there would be business interruption coverage, cases like this strengthen the argument that the COVID-19 pandemic is an unexpected calamity like those usually covered by business interruption policies.

B. "Direct Physical Loss"

Most business interruption policies require that the interruption result from "direct physical loss" or damage. Insurers frequently take the position that coverage requires tangible damage to property. *See Quality Oilfield Products, Inc. v. Michigan Mut. Ins. Co.*, 971 S.W.2d 635, 637 (Tex. App.—Houston [14th Dist.] 1998, no pet.) (addressing a policy that provided "business interruption coverage . . . for 'loss resulting directly from the necessary interruption of business caused by damage to or destruction of real or personal property'"). However, the term "direct physical loss" is rarely (if ever) defined in a policy but it has been interpreted to cover "external event[s]" that transform property "in an initial satisfactory state . . . into an unsatisfactory state" that is unfit for future use. *See N. Am. Shipbuilding, Inc. v. S. Marine & Aviation Underwriting, Inc*., 930 S.W.2d 829 (Tex. App.—Houston [1st Dist.] 1996, no writ).

Whether COVID-19 will be considered a "direct physical loss" will likely be a hotly contested issue between insurers and insureds. There are no Texas cases directly on point, but there are cases that support arguments for and against coverage. For example, under Texas law, business interruption coverage has extended to "accidental direct physical loss to business personal property" caused by a computer virus that rendered an insured's system inoperable for a period of time. *See, e.g., Lambrecht & Assocs., Inc. v. State Farm Lloyds*, 119 S.W.3d 16, 19 (Tex. App.—Tyler 2003, no pet.). However, business interruption coverage usually applies in distinctly more "physical" circumstances, such as in *Finger Furniture Company Inc. v. Commonwealth Insurance Company* where flooding caused by Tropical Storm Allison blocked access to a central computer system which resulted the insured being unable to operate any of its Houston stores. 404 F.3d 312, 316 (5th Cir. 2005).

In other jurisdictions, courts have held that policies cover "direct physical loss" caused by contaminants even in the absence of structural damage. *See, e.g., Cooper v. Travelers Indem. Co. of Illinois*, 2002 WL 32775680, at *3 (N.D. Cal. Nov. 4, 2002) (holding that leak of e-coli-contaminated water was a "direct physical loss" triggering business interruption coverage). However, other courts have held that contamination in the absence of structural damage is not a direct physical loss. *See Universal Image Productions, Inc. v. Chubb Corp.*, 703 F. Supp. 2d 705, 710 (E.D. Mich. 2010) (holding that the "presence of . . . bacteria in the air and ventilation system" was an "intangible harm" that did not trigger business interruption coverage in the absence of evidence of "structural or any other tangible damage to the insured property.")

Insurers will likely argue that COVID-19 has not physically damage an insured's property, while. insureds will cite recent scientific evidence that the COVID-19 virus lives on surfaces for days, rendering property unusable, and therefore has damaged their property. *See Friends of DeVito*, 2020 WL 1847100, at *12 ("The virus can live on surfaces for up to four days and can remain in the air within confined areas and structures."). Insureds may also rely on state and local restrictive orders such as Harris County's Stay Home Work Safe order, which expressly states that COVID-19 causes property damage and loss, lending support to the position that COVID-19 contamination causes directly physical loss. *See* Order of County Judge Lina Hidalgo, "Stay Home, Work Safe" (updated 4/3/2020) (recognizing that "COVID-19 virus causes property loss or damage due to its ability to attach to surfaces for prolonged periods of time."). Ultimately, coverage will turn on the policy language and the facts at issue.

C. "Civil Authority" Coverage

While business interruption policies customarily cover interruption directly caused by an unforeseen event, some policies provide "civil authority" coverage for losses caused by government-mandated shutdowns responding to a disaster, such as an evacuation imposed by a state or local government in response to a disaster. In Texas, civil authority coverage usually applies when a shutdown is in response to actual physical damage in the area. *See Dickie Brennan & Co., Inc. v. Lexington Ins. Co.*, 636 F.3d 683, 687 (5th Cir. 2011) (establishing as a "general rule" that coverage for business interruption caused by "civil authority" "is intended to apply" only when the restrictive order is issued as a direct result of physical damage to other premises near the insured property). Texas courts have held that there was no business interruption coverage where a "civil authority" shutdown was imposed in response to the risk of disaster rather than actual damage. *See, e.g., South Texas Medical Clinics PA v. CNA Financial Corp.*, No. H–06–4041, 2008 WL 450012 (S.D. Tex. Feb. 15, 2008) (denying business interruption claim where interruption was caused by the mandatory evacuation order "issued due to the anticipated threat of damage to the county and not due to property damage").

Further complicating matters for energy businesses is the fact that energy businesses are considered "critical and essential infrastructure and, therefore, exempt from the in-effect orders in Texas and other places. It is therefore not clear whether the in-effect orders regarding COVID-19 will trigger civil authority coverage for energy businesses.

D. Complete Shutdown of Business

Under Texas law, business interruption claims require a complete shutdown or cessation of business. Claims seeking to recover for work slowdowns or economic downturns caused by a calamity are generally not recoverable. *See Quality Oilfield Prods. Inc. v. Michigan Mut. Ins. Co.*, 971 S.W.2d 635, 638 (Tex. App.—Houston [14th Dist.] 1998, no pet.) (holding that business interruption coverage did not extend to a "work slowdown" occurring after a business was burglarized and key documents stolen because there was not an "interruption of business"—*i.e.*, a complete "'cessation or suspension of business'").

E. Historical Lost Earnings

Even if there is business interruption coverage, proving losses may be another challenge energy companies face, especially determining whether losses result from the pandemic or the Russia-OPEC price war.

Importantly, courts applying Texas law have held that businesses should rely on historical earnings in proving lost earnings. In *Finger Furniture, supra*, flooding that caused the insured's business to shut down for several days, caused its competitors to shut down even longer, resulting in the insured quickly recovering its lost sales. 404 F.3d at 316. The Fifth Circuit rejected the insurer's argument that there were no losses due to recovered sales volume, holding that earnings and losses should be calculated based on historical sales leading up to the interruption. *Id.*; *see also Catlin Syndicated, Ltd. v. Imperial Palace of Mississippi, Inc.*, 600 F.3d 511 (5th Cir. 2010) (calculating coverage and lost earnings based on historical data where casino was shut down for several days due to Hurricane Katrina but recovered sooner than its competitors). Therefore, under Texas law, an insured seeking business interruption coverage may not receive the benefit of increased sales or the detriment of decreased sales following the interruption.

How this plays out for energy companies dealing with both the impacts of both COVID-19 and the Russia-OPEC price war is currently unknown. Insurers may argue that losses to net profit are due to the drop in the price of oil as a result of the Russia-OPEC price war. Insureds may argue that historical earnings are the relevant data point for determining damages for a business interruption policy. In the meantime, insureds should keep certain practical guidelines in mind, including carefully reviewing policy language, cataloguing costs associated with restoring business, and understanding the net profit projections both before and after COVID-19 and the Russia-OPEC price war.

IV. Conclusion

The COVID-19 pandemic has presented an unprecedented challenge to the energy industry, compounding difficulties presented by the global oil market downturn. One certainty among all of the current uncertainties is that there will be coverage disputes regarding COVID-19. There are already several cases pending across the country where insureds are seeking declaratory judgments that COVID-19 is a covered event under business interruption policies that cover epidemics or communicable diseases. *See, e.g., SCGM, Inc. v. Certain Underwriters at Lloyd's*, No. 4:20-cv-01199 (S.D. Tex. 2020); *Cajun Conti, LLC et al. v. Certain Underwriters*

at Lloyd's of London, et al. (La. Dist. Court, Orleans Parish). Despite the added obstacle of distinguishing between lost profits due to COVID-19 and the Russia-OPEC price war, energy companies and their counsel should conduct a thorough review of individual policy language and circumstances to determine whether a claim for business interruption caused by COVID-19 would be covered.