

Executive Order Closures May Trigger Business Interruption Coverage for New Jersey Insureds

A tectonic battle is about to begin between corporate policyholders and their insurers. The business interruption occasioned by recent nationwide Executive Orders, requiring the shuttering of businesses due to concern about the spread of Covid-19, has already spawned the first lawsuit. If the past is prologue, the battle will play out in courts across the country, with wildly varying decisions about the application of business interruption insurance for these closures.

In the courts of New Jersey, corporate policyholders should prevail on their claims to collect on this coverage. Here are the reasons why.

The Coverage Grant in the Standard Business Owners' Property Policy

The standard business owner's policy provides that the insurer "will pay for direct physical loss of or damage to Covered Property at the premises caused by or resulting from any Covered Cause of Loss." Most such policies provide "all-risk" coverage, which means that all physical loss or damage is covered, unless a specific exclusion in the policy applies.

The New Jersey Appellate Division – the intermediate court of appeals – has held that the language "physical loss of or damage to" is ambiguous in a case where the insured premises had been shut down on account of an event that did not result in any structural harm to the building. In *Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co.*, 406 N.J.Super. 524, 968 A.2d 724 (App. Div. 2009), a group of supermarkets made claims for food spoilage and business interruption as a result of a four-day power outage. None of the supermarkets suffered any physical structural harm, but all of them suffered significant loss of income. The insurers convinced the trial court that coverage was precluded because the power grid had suffered no physical damage and was returned to service after only a temporary interruption. The Appellate Division disagreed, finding that the trial court's decision was "inconsistent with well-settled principles of insurance law."

The heart of the decision, for purposes of coverage for the recent Executive Order closures, was a finding that the phrase "physical loss of or damage to" was ambiguous. The analysis starts with the universal insurance principle: "Coverage clauses are interpreted liberally, whereas exclusions are strictly construed." Moreover, the court noted that "it is well settled that those purchasing insurance 'should not be subjected to technical encumbrances or to hidden pitfalls,' and that insurance policies "should be construed liberally in their favor to the end that coverage is afforded 'to the full extent that any fair interpretation will allow.'"

The Appellate Division previously held that, "[s]ince 'physical' can mean more than material alteration or damage, it was incumbent on the insurer to clearly and specifically rule out coverage in the circumstances where it was not to be provided." The *Wakefern* court cited for support decisions where, for example, there was coverage for a dwelling that had become uninhabitable, although no "tangible injury to the physical structure itself could be detected." The court cited other decisions where "'physical damage' is not restricted to the physical destruction or harm" to covered property "but includes loss of access, loss of use, and loss of

functionality.” The court noted that “[o]ther cases have likewise accepted the view that ‘damage’ includes loss of function or value.”

In light of *Wakefern*, the closures of businesses as the result of the recent Executive Orders have caused a covered loss of access, a loss of use, and a loss of functionality of the insured premises. Faced with this settled conception of coverage, insurers will then have to point to an exclusion if they hope to avoid coverage.

The Standard Form Virus or Bacteria Exclusion Endorsement

The standard Insurance Services Office, or ISO, virus exclusion endorsement says: “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.”

For the uninitiated, it would appear that this exclusion might preclude coverage for closures resulting from concerns about Covid-19. The issue, however, is not so straightforward. Exclusions such as this one will not apply under New Jersey law if there is more than one cause of a loss in a chain of causation, and either the first or the last cause is from a covered event, even if one of the causes in the chain is excluded. This is referred to as the “Efficient Proximate Cause” doctrine. It is also sometimes called “Appleman’s Rule,” after the eponymous insurance treatise. The leading case on the issue, *Franklin Packaging Co. v. California Union Ins. Co.*, 171 N.J.Super. 188, 408 A.2d 448 (App. Div. 1979), described the operation of the doctrine thus:

An incidental peril outside the policy, contributing to the risk insured against, will not defeat recovery. ... In other words, it has been held that recovery may be allowed where the insured risk was the last step in the chain of causation set in motion by an uninsured peril, or where the insured risk itself set into operation a chain of causation in which the last step may have been an excepted risk.

There is more than one cause of the recent closures of insured premises. The first cause, the spread of Covid-19, set in motion the ultimate cause of the closures: the issuance of the Executive Order by the Governor requiring closure of New Jersey retail businesses. While the first cause, the virus, is excluded, the last cause -- the one that is indeed the most direct cause of the closures -- was the Executive Orders. That last cause is not the subject of any exclusion in the standard policy. Under Appleman’s Rule, if the first cause in a chain of causes of a loss (the virus) is excluded but the last cause in the chain (the Executive Order to close) is covered, then the policy provides coverage and the exclusion will not apply.

In 2006, ISO presented the virus exclusion to the various state insurance regulators for approval, as it was required to do before insurers could include it in their policies. In a July 26, 2006 circular, ISO represented to regulators that the exclusion was intended to preclude coverage due to direct contamination from a virus or from bacteria: “[W]e are presenting an exclusion relating to contamination by disease-causing viruses or bacteria or other disease-causing microorganisms.” While some Executive Order closures expressly provide that Covid-19 has caused physical loss or damage, which certainly triggers coverage, they were not issued because

the affected insured premises were or are, in fact, “contaminated” with Covid-19. The Orders were issued prophylactically to prevent people from gathering in groups and spreading the virus.

Thus, the cause of the current interruptions in business was not consistent with the stated intent of the virus exclusion. To the extent that carriers attempt to argue that the reach of the exclusion should now be expanded to include indirect losses resulting from governmental attempts to contain the spread of the virus, the New Jersey doctrine of “regulatory estoppel” should preclude such an argument. Under the regulatory estoppel doctrine, the insurance industry may not apply an exclusion in a way that is inconsistent with the representations ISO made to state insurance regulators at the time it presented the exclusion for approval.

The Absolute Pollution Exclusion

The final issue that insurers might raise in defense could be the standard-form pollution exclusion, which generally precludes coverage arising from the discharge, dispersal, release, or escape of pollutants and contaminants. In New Jersey, courts should readily dispense with such a defense.

The New Jersey Supreme Court addressed the meaning, intent, and application of the so-called “absolute pollution exclusion” in the standard commercial general liability policy in the case *Nav-Its Inc. v. Selective Ins. Co.*, 183 N.J. 110 (2005). *Nav-Its* involved the accidental release of toxic fumes inside an office building, which allegedly caused injury to the occupants. Selective argued that the release fell squarely within the application of the pollution exclusion’s prohibition for coverage of damage resulting from the release or escape of a polluting or contaminating vapor.

The New Jersey Supreme Court concluded that it would be both fair and consistent with statements made by the insurance industry to the regulators to limit the reach of the pollution exclusion to “injury or property damage arising from activity commonly thought of as traditional environmental pollution,” that is, those hazards that were historically thought of as “environmental catastrophe(s) related to intentional industrial pollution.” Since the claim there, an in-door pollutant release, was not a “traditional” or “intentional” form of environmental pollution, the exclusion was held not to apply. Likewise, here, there is no reasoned or good-faith basis for concluding that the release or spread of Covid-19 constitutes traditional or intentional industrial pollution.

A strong argument can be made that settled New Jersey law entitles corporate policyholders to business interruption coverage for the recent Executive Order closures. They should not take “No” for an answer.