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BUSINESS INTERRUPTION LOSSES: WHO IS TO PAY DURING THE PANDEMIC?

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The ongoing COVID-19 pandemic and its associated restrictions on businesses have led to an increase of insurance coverage disputes, raising unique issues for the insurance industry.

Of particular concern is the denial of coverage for COVID-related "business interruption losses", raising questions about insurer liability for losses as a result of the pandemic.

Emergence of Litigation Regarding Business Interruption Losses

Insurance coverage for business interruption losses has become a notable subject of litigation. Indeed, several pandemic-related claims are currently making their way through Canadian and global courts for business interruption losses as a result of businesses seeking to mitigate their financial burden from reduced or complete cessation of business activity.

Summarily, the plaintiffs allege, either in an individual or class action lawsuit, that insurers have breached their contractual obligations by refusing to honor policy agreements and provide coverage for business interruption losses due to federal, provincial and regional authorities either restricting or closing non-essential business operations.

Many of the policies at issue are "all-risk";[1] limited coverage to "direct physical loss or damage" to the policyholder's property;[2] or explicitly contained infectious disease coverage[3]. The analysis of whether pandemic-related losses are covered under business interruption insurance is based on underwriter policies and contractual interpretation principles, whereby coverage is dependent on the extent and impact of the interruption, as well as the relevant policy language stipulating any express definitions, exclusions, exceptions, extensions, contingencies or circumstances requiring special coverage (see our prior bulletin for a more fulsome description of these principles).

The requirement that a business interruption must result from "direct physical loss or damage" is a standard term in most insurance policies, and the interpretation of this term by the courts will likely determine whether or not specified insurance policies for business interruption cover losses resulting from COVID-related

interruptions.

The *MDS Inc. v Factory Mutual Insurance Company* Decision

The most recent and notable Canadian jurisprudence on the interpretation of "physical damage" are the trial and appeal decisions in ***MDS Inc. v. Factory Mutual Insurance Company***[4] ("***MDS***"). At the trial level, the insured brought a claim for business interruption coverage under an all-risks policy after the nuclear research reactor facility from which the insured purchased radioactive isotopes shut down for 15 months due to a leak of radioactive materials caused by corrosion. Importantly, the shut down was ordered by the Canadian Nuclear Safety Commission. The all-risk business interruption policy excluded losses resulting from corrosion, but that exclusion was subject to an exemption for "physical damage". The issue before the Court was whether "physical damage" included *loss of use* of the radioisotopes.

In its analysis, the Ontario Superior Court of Justice reviewed two interpretations of the meaning of resulting physical damage:

1. a narrow view where "physical loss or damage" is a material or tangible alteration to the insured's property, specifically "an alteration in the appearance, shape, colour or other material dimension of the property insured"[5]; and
2. a broader view triggering coverage for loss of use of a business' premises or equipment because of the presence of dangerous substances and subsequent shutdown orders.[6]

In ***MDS***, the Superior Court concluded that a broad definition of resulting physical damage was appropriate in the factual context and interpreted the words in the relevant policy to include impairment of function or use of tangible property caused by the unexpected leak.[7] Specifically, the Court noted that this interpretation was in accordance with the purpose of the all-risks property insurance to provide broad coverage.[8]

Prior to the appeal, the Superior Court's decision in ***MDS*** paved the way for the application of a broader interpretation of "physical damage." It also opened the door for the argument that losses resulting from the shutdown of a business could constitute "physical damage" under an all-risks insurance business interruption policy.

However, the Superior Court's decision was overturned by the Ontario Court of Appeal, which held that the exception to the corrosion exclusion for resulting physical damage did not apply to economic losses caused by the inability to use the equipment during the shutdown.[9] Most notably, the Court stated that "while economic loss may result from physical damage, it is not physical damage".[10]

The Court of Appeal's decision signals the Canadian courts' preference of a strict and narrow interpretation of physical damage in favour of insurance providers. This is a win for insurers, but may have negative implications

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on the ability of insureds to bring successful claims for coverage from COVID-related business interruption losses in the future.

Other Jurisdictions

Foreign jurisdictions have also begun to examine the intersection of COVID-related losses and business interruption policy interpretation. Recent American case law supports the view that the mere presence of COVID-19 on insured premises does not amount to "direct physical loss". Generally, coverage for COVID-19-related losses has been denied on the basis that physical loss or damage occurs only when property undergoes a "distinct, demonstrable, physical altercation"[11], not simply a loss of use[12].

Comparatively, the United Kingdom Supreme Court recently rendered a decision regarding the test case brought by the Financial Conduct Authority. This case aimed to seek legal clarity about the meaning and effect of a wide range of insurance policy wordings in the context of COVID-19 claims and business interruption losses. In analyzing disease, prevention of access, hybrid and trends clauses, the Supreme Court held in favour of policyholders and concluded that such clauses, in principle, provide coverage for business interruption losses caused by the COVID-19 pandemic.

Even more recently, the Superior Court of Quebec refused to authorize a class action of dentists who argued that their insurance coverage protected them from losses experienced as a result of government limitations on their practice during COVID-19. The dentists were unable to show that their claim was "relate[d] to loss of income occasioned by material loss or damage to its insured property."[13]

Takeaway

Overall, the rise in pandemic-related insurance litigation has led businesses and insurers to focus on whether relevant policy language provides coverage arising from the COVID-19 pandemic. It also highlights the need for insurance underwriters to develop clear and detailed business interruption loss policies that carefully consider exclusions and potential extensions for government-mandated closures, as well as capacity restrictions attributed to viral outbreaks.

Based on the example of ***MDS***, it is likely that the specific policy language, as well as the relevant factual matrix (including the reasonable expectations of the parties) will inform any future decisions on whether damages arising from business stoppages and slowdowns, or damage to commercial property as a result of the pandemic, triggers coverage under business interruption insurance. Given the confirmation of the Court of Appeal in ***MDS*** that "physical damage" in all-risk business interruption policy does not include loss of use or economic loss, it is likely that this decision will be highly persuasive in determining pending and future COVID-related business interruption insurance claims in Canada.

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[1] *Matrix Production Services Ltd. v. Economical Mutual Insurance Company*, Case No. VLC-S-S-208574, in the Supreme Court of British Columbia, Canada.
[2] *Workman Optometry Professional Corporation, et. al. v. Aviva Insurance Company of Canada, et. al*., Case No. CV-20-00643488-00CP, in the Ontario Superior Court of Justice, Canada.
[3] Ibid.
[4] *MDS Inc. v. Factory Mutual Insurance Company*, 2020 ONSC 1924 (Ont. S.C.J.) rev'd 2021 ONCA 594 ["*MDS*"].
[5] *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Co*., 2015 BCCA 367 [*Acciona*] at para 38.
[6] *Jessy's Pizza v. Economical Mutual Insurance Co*., 2008 NSSM 38 (N.S. Small Cl. Ct.); *MDS*, supra note 4.
[7] *MDS*, supra note 4 at para 518.
[8] Ibid at para 519.
[9] Ibid at para 12.
[10] Ibid at para 97.
[11] *10E, LLC v. Travelers Indemnity Co. of Connecticut*, 483 F.Supp.3d 828 (C.D. Cal. 2020) at 836.
[12] *Diesel Barbershop, LLC v. State Farm Lloyds*, 479 F.Supp.3d 353 (W.D. Tx. 2020).
[13] *Gendron Delisle dental health center Inc vs The Personal general Insurance Inc*, 2021 QCCS 3463 at paras 73-76.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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