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New Jersey Court Greenlights Covid-19 Business Interruption Insurance Coverage Suit

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A New Jersey state court has now ruled on insurance coverage for Covid-19 business interruption, and its decision is favorable for policyholders. In *Optical Services v. Franklin Mutual Insurance Company*, the policyholder sought coverage for its Covid-19 business interruption loss. The insurance company moved to dismiss, arguing that there was no 'direct physical loss or damage' alleged in the complaint. The policyholder countered the insurance company's motion by arguing that pursuant to New Jersey law, and particularly the Wakefern decision, 'direct physical loss or damage' does not require a tangible change to property but just the loss of functionality. The court found the policyholder's argument 'compelling' in the context of a motion to dismiss, and denied the motion.

This decision follows the policyholder-favorable decision by the federal court for the Western District of Missouri in Studio 417, Inc. v. Cincinnati Insurance Co. There, too, the insurance company moved to dismiss, arguing "direct physical loss requires actual, tangible, permanent, physical alteration of property." The court disagreed. It found the policyholders' complaint alleged a direct physical loss because it alleged "a causal relationship between COVID-19 and their alleged losses."

Undeniably, several courts around the country have granted insurance companies' motions to dismiss Covid-19 business interruption complaints. However, such cases are distinguishable for at least two reasons.

First, courts dismissed many of these complaints because they failed to actually allege, or even attempt to allege, any physical loss or damage. These complaints were brought, by and large, by attorneys unfamiliar with insurance coverage litigation and simply failed to meet the pleading requirement. To avoid dismissal, it is essential that every complaint allege in detail the physical impact of Covid-19.

The second issue is that some states have different law than New Jersey. Those states require a physical impact to property to trigger business interruption coverage. Under New Jersey case law to date, however, there is no requirement of a physical impact but only a loss of functionality.

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New Jersey courts have not yet addressed the applicability of the virus exclusion, and this will certainly be a major coverage battle. Some of the complaints filed in New Jersey rely on the regulatory estoppel doctrine to counter the virus exclusion; this doctrine holds that if the insurance industry has misrepresented the impact of the exclusion to regulators, insurance companies are estopped from relying on the exclusion. Certain insurance industry documents suggest the insurance industry represented that the virus exclusion did not reduce coverage but only clarified it, which policyholders claim was false.

Not every property policy contains a virus exclusion. Other policies do not have a standard virus exclusion but try to include viruses within a pollution or contamination exclusion, which may not be effective under New Jersey law. It is essential to review each policy carefully to determine if it contains a virus exclusion and if so, whether that exclusion is applicable to losses stemming directly or indirectly from the pandemic.

We are in the opening stages of what will undoubtedly be a protracted war over coverage for Covid-19 business interruption losses. Companies should review their property policies now, if they have not already done so, and consult with insurance professionals concerning the possibility of coverage and next steps. Companies with losses should make claims, even if they serve only as placeholders while the company waits for the law to develop. Finally, most property policies contain contractual limitations periods for bringing suit, usually two years in commercial policies. Companies therefore have time to evaluate their claims and see how the law develops, but must act – or obtain tolling agreements -- before the limitations period lapses.

The case is *Optical Services USA et al. v. Franklin Mutual Insurance Company*, BER-L-3681-20, Superior Court of New Jersey, Aug. 13, 2020.

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