White and Williams LLP

# Why the Disconnect Between Perception and Reality for COVID-19 Business Interruption Coverage?

By: Randy J. Maniloff and Konrad R. Krebs
*Insurance Coverage and Bad Faith Alert*
3.23.20

"What's in a name?," the Bard asks in Romeo and Juliet. For some a lot, as focus turns to whether Business Interruption policies will cover the massive financial losses stemming from the coronavirus.

As has been widely discussed, on account of the policy requirement for "direct physical loss of or damage to" covered property, followed by the "Virus" exclusion, there are serious hurdles to the potential availability of coverage under such policies. Even some policyholder counsel have admitted as such. Yet, despite this, tremendous pressure is being placed on insurers – by the New Jersey Legislature, U.S. Congress, trade associations and probably others – to extend Business Interruption coverage. In addition, many policyholders are in disbelief when they learn that their Business Interruption policies will not respond. They take it as insurers skirting obligations that they clearly have.

How could there be such a wide disconnect between the perceived coverage available under a Business Interruption policy and its actual language? We believe that the answer is quite simple: the name "Business Interruption" policy. On its face, it sounds like the ideal tool to step in and cover the coronavirus-caused losses here. In essence, by its name, the policy has seemingly created a belief in insureds, and other stakeholders, that it affords coverage anytime a "business" is subject to an "interruption." [Ironically, a Business Interruption policy is usually not an actual stand-alone policy, but, rather, a coverage available under a Property policy. Moreover, its name is usually not "business interruption" at all but "business income."]

## REASONABLE EXPECTATIONS DOCTRINE

There is a name in insurance jurisprudence that explains a disconnect between coverage perception and reality: the Reasonable Expectations Doctrine. It finds its origin in a two-part 1970 Harvard Law Review article by Harvard Professor Robert Keeton (later a federal judge). The doctrine has been the subject of a substantial amount of commentary in insurance academic circles and it is well-beyond the scope to discuss it in detail here.

Briefly, Keeton examined decisions where a court's finding of coverage was at odds with the literal text of the insurance policy. He concluded that the decisions were not the result of judicial error or inability to read policies. But, instead, the professor reasoned that they represented an interpretative principle, specifically, in construing policies, courts will honor the "objectively reasonable expectations" of the policyholder even though "painstaking" examination of policy text would have negated those expectations. Keeton's article was the first to specifically identify the concept and give it a name. Those looking to Business Interruption policies to provide coverage for coronavirus-caused losses are attempting to put their expectations of coverage over the policy text.

## THE DOCTRINE IN USE

The manner of use of the Reasonable Expectations Doctrine has waxed and waned over the years. Today, just about all states apply it in some form for resolving unclear policy provisions. But that's the rub. The policy language must be ambiguous for a court to use the doctrine to conclude that coverage is owed.

The Alaska Supreme Court explained the operation of the Reasonable Expectations Doctrine this way:

The Bongens argue that application of the earth movement exclusion would defeat their reasonable expectations of coverage. We construe insurance contracts "so as to provide that coverage which a layperson would have reasonably expected from a lay interpretation of the policy terms." However, since most insureds develop an expectation that every loss will be covered, the reasonable expectation doctrine "must be limited by something more than the fervent hope usually engendered by loss."

*State Farm Fire & Casualty Company v. Bongen*, 925 P.2d 1042, 1047 (Alaska 1996) (citations omitted).

At the heart of the Reasonable Expectations Doctrine is its narrow application: "A rule of construction that considers the reasonable expectations of the parties is of no assistance where the policy terms are clear and unambiguous. We will not absolve the parties to an insurance policy from the duty to read the policy." *St. Paul Fire & Marine Insurance Company v. Albany County School District No. 1*, 763 P.2d 1255, 1263 (Wyo. 1988).

The Fifth Circuit's decision in *Vanderbrook v. Unitrin Preferred Insurance Company,* 495 F.3d 191 (5th Cir. 2007) is particularly instructive as it involved coverage for damages caused by flooding from Hurricane Katrina. Given Katrina's wide scope, some have compared its coverage litigation to what may be coming concerning losses for the coronavirus.

In *Vanderbrook,* flood victims asserted a host of reasons why they had a reasonable expectation of coverage for a flood, despite a "flood exclusion" in their policies. Among others, they argued that their policies were called "all-risk." However, the court noted the limitation of the Reasonable Expectations Doctrine – being inapplicable to recast policy language when such language is clear and unambiguous – and rejected any impact on coverage on account of the policy's "all-risk" label:

Although a few courts have stated that insureds with all-risk policies have "heightened expectations" of coverage, we are not aware of any Louisiana court that has so held. And although all-risk policies do generally extend to all fortuitous losses, this is true only to the extent that the policy does not expressly exclude the loss from coverage. . . . Given the generally prevailing use of the term "flood," we believe a reasonable policyholder would expect a massive inundation of water from a breached levee to be excluded, notwithstanding the all-risk nature of the policies.

*Id.* at 219-20 (citations omitted).

The limitation of the Reasonable Expectations Doctrine is demonstrated in *Cincinnati Specialty Underwriters Insurance Company v. Energy Wise Homes, Inc.*, 120 A.3d 1160 (Vt. 2015). The insured sought coverage for injury from inhalation of airborne chemicals on account of its installation of spray-foam insulation. The policy contained a total pollution exclusion, which excluded coverage for bodily injury caused by discharge of "pollutants," which included myriad toxins and fumes in its definition. The insured argued that his reasonable expectations were that the total pollution exclusion would not apply, because his actions were not consistent with traditional environmental liability. However, the Vermont Supreme Court rejected this argument, holding, "an insured's 'reasonable expectations' cannot trump 'unambiguous policy language.'" *Id.* at 1168.

Admittedly, examples can be found of courts applying the Reasonable Expectations Doctrine to find coverage. In *Auto Club Property-Casualty Insurance Company v. B.T.*, 596 Fed. Appx. 409 (6th Cir. 2015), the insured sought defense and indemnification, under a homeowner's policy, for injury to a child caused by a bottle rocket. The insurer claimed that the insured violated an applicable criminal law prohibiting the possession and ignition of fireworks without a license. The policy contained an exclusion for bodily injury resulting from a "criminal act or omission," regardless of whether charges were actually filed. However, the court concluded that the exclusion did not bar coverage, as the insured would reasonably expect that it was limited to crimes such as burglary, robbery or murder, and not the

bottle rocket offense at issue.

Like *Auto Club*, the cases applying the Reasonable Expectations Doctrine, to find coverage, usually do so because the policy language could have more than one meaning. That is hardly the case with a Business Interruption policy's requirement for "direct physical loss of or damage to" covered property and the "Virus" exclusion.

So what's in a name? When it comes to finding Business Interruption coverage for financial losses stemming from the coronavirus – nothing.

If you have any questions or need more information, contact Randy J. Maniloff (maniloffr@whiteandwilliams.com; 215.864.6311) or Konrad R. Krebs (krebsk@whiteandwilliams.com; 215.864.7018).

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates here.

This correspondence should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only and you are urged to consult a lawyer concerning your own situation and legal questions.