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An Important Early COVID-19 Business Interruption Coverage Win for Policyholders in New Jersey

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New Jersey courts have long blazed the trail to shape the landscape nationally on important insurance coverage issues. Many years ago, our Supreme Court found that insurers actually have to deliver on the coverage that they promise in their policies by applying regulatory estoppel to the interpretation of the pollution exclusion and requiring insurers to pay for environmental liabilities. Our Supreme Court has also led the way on allocation issues for long-tail claims by looking for ways to maximize coverage for significant liabilities despite insurer arguments trying to ring-fence their coverage responsibilities. For that reason, policyholders should have confidence and hope that New Jersey courts will get it right with respect to the availability of business interruption coverage for the catastrophic losses so many businesses have incurred as a result of COVID-19 and the related shutdown orders.

Recently, a New Jersey state court stayed true to our state's strong reputation of protecting policyholder rights by denying an insurer's motion to dismiss a COVID-19 business interruption lawsuit, giving policyholders a significant win. See Transcript of Oral Argument and Decision, *Optical Servs. USA v. Franklin Mut. Ins. Co.*, Case No. BER-L-3681-20 (N.J. Sup. Ct. Law Div. Aug. 13, 2020) ("Transcript"). Insurers have been engaged in a full-court press across the country to secure early dismissals of business interruption claims and have had some success. *Optical Services* is an important exception to that nationwide trend. This case highlights the extremely high importance of coverage counsel (1) adequately alleging the factual record, (2) thoroughly understanding and arguing state-specific law and binding precedent, (3) properly analyzing the language of the particular policy in light of applicable facts and law, and (4) selecting the appropriate forum for coverage disputes.

Adequately Allege the Factual Record

To date, there have been approximately a dozen decisions regarding lawsuits against insurers for denying business interruption claims as a result of COVID-19 and related civil authority orders. Of the reported decisions, prior to *Optical Services*, only one had ruled in the policyholder's favor, and only one complaint alleged the presence of COVID-19 on the policyholder's property. See *Studio 417, Inc. v. Cincinnati Ins. Co.*, Case No. 20-cv-03127-SRB, 2020 WL 4692385 (W.D. Mo. Aug. 12, 2020). Since most property policies cover insured perils for "direct physical loss or damage," policyholders asserting a loss as a result of COVID-19 must carefully consider how they will establish that COVID-19 caused physical loss or damage to the insured premises. See, e.g., *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co.*, 2014 WL 6675934, at *6 (D.N.J. 2014) (finding that the release of ammonia "physically transformed the air within [the insured's] facility" and "inflicted 'direct physical loss of or damage to' [the insured's] facility, as that phrase would be construed under New Jersey law by the New Jersey Supreme Court, because the ammonia physically rendered the facility unusable for a period of time"); see also *Port Authority of N.Y. and N.J. v. Affiliated FM Ins.*, 311 F.3d 226, 236 (3d Cir. 2002) ("When the presence of large quantities of asbestos in the air of a building is such as to make the structure uninhabitable and unusable, then there has been a distinct

loss to its owner."). Interestingly, in *Optical Services*, even counsel for the insurer admitted that "[i]f the complaint had alleged that there was contamination on the premises, then there probably would be direct physical loss. . . ." Transcript at 9. The plaintiffs in *Optical Services* did not allege the presence of COVID-19 on their premises. Instead, they argued that the New Jersey governor's civil authority orders closing down nonessential businesses constituted physical loss that is covered under their policy.

The court responded by noting that the standard governing dismissal motions in New Jersey is "[w]hether a cause of action is 'suggested' by the facts." Transcript at 19 (quotin *Green v. Morgan Properties*, 215 N.J. 431, 451 (N.J. 2013)) (citations omitted). On the basis of this standard, an insufficient record before the court, and the absence of any discovery, the court denied the insurer's motion to dismiss and invited the plaintiffs to amend their complaint if necessary.

Thoroughly Understand and Argue State-Specific Law and Binding Precedent

The *Optical Services* court also denied the insurer's motion to dismiss because it was laser-focused on New Jersey precedent and was not interested in insurer counsel's pleas to blindly follow decisions made by courts in other states. Transcript at 26 ("The defendant argues that there is a plain meaning of 'direct physical loss[,]' and the closure of the plaintiffs' business does not qualify for . . . purposes of coverage. This is a blanket statement unsupported by any common law in the State of New Jersey . . . ."). In the absence of conclusive legal authority, the court found an analogous argument in *Wakefern Food Corporation v. Liberty Mutual Fire Insurance Company,* 406 N.J. Super. 524 (App. Div. 2009) compelling. In *Wakefern*, the grocery store policyholder suffered losses as a result of a four-day power outage. The court found 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." 406 N.J. Super. at 541-42. Thus, the *Optical Services* court concluded that "[t]here is an interesting argument made before this Court that ***physical damage occurs where a policyholder loses functionality of their property*** . . . by operation of civil authority such as the entry of an executive order [that] results in a change to the property." Transcript at 29 (emphasis added).

Properly Analyze the Language of the Particular Policy in Light of Applicable Facts and Law

In addition to rightly focusing on New Jersey precedent, the court rightly focused on the specific language of the parties' policy. Transcript at 24-25 ("The pivotal issue before this Court is the parties' interpretation of the subject policy language and [the insurer's] claim denial premised on a narrow interpretation of the terms of the subject policies."). Since policies have different terms, the language of each individual policy is paramount in determining whether or not a policyholder has coverage for a specific event. Under New Jersey law, "[w]hen the terms of a policy are clear and unambiguous, the court must enforce the contract as it finds it. . . . However, where an ambiguity exists, it must be resolved against the insurer. [Further, coverage] clauses should be interpreted liberally, whereas those of exclusion should be strictly construed." *Stone v. Royal Ins. Co.*, 211 N.J. Super. 246, 248-49 (App. Div. 1986) (citations omitted).

Though the policy at issue in *Optical Services* has a virus exclusion, that exclusion does not apply to the policy's civil authority order coverage. Transcript at 12 (counsel for insurer stating that the policy "does not have an exclusion for a closure of business based on the risk of virus proliferation"). During the hearing, the court specifically asked the insurer, "Why didn't the policy then have specific exclusions for an event such as this?" Transcript at 11. That is, the court indicated that it would interpret coverage grants broadly and exclusions narrowly.

Because of the absence of conclusive legal precedent in New Jersey and the parties' distinct and opposite interpretations of the policy language, the court reached the "inevitable conclusion" that the plaintiffs should be afforded the opportunity to prove that a COVID-19 closure may be a covered loss under the policy. Transcript at 29. Specifically, the court granted the policyholders the opportunity to prove that a business's loss of functionality as a result of civil authority orders relating to COVID-19 satisfies the policy's physical damage requirement.

Select the Appropriate Forum for Coverage Disputes

Optical Services is a significant win for policyholders who are litigating or may litigate their COVID-19 business interruption claims in New Jersey, because the court stayed true

to the Garden State's strong trailblazing roots and refused to simply "follow the crowd" of other jurisdictions that have prematurely denied COVID-19 business interruption claims. Policyholders should consult with experienced coverage counsel to determine whether they have a strong claim that is worthy of pursuit in a jurisdiction where the court will consider issues carefully and fairly.

To see our prior alerts and other material related to the pandemic, please visit the Coronavirus/ COVID-19: Facts, Insights & Resources page of our website by clicking here.

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