New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 264—NO. 98
THURSDAY, NOVEMBER 19, 2020

Outside Counsel

Look to 'Optical' in Deciding COVID-19 Business Interruption Cases

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Most business owners in New York have been faithfully paying significant premiums to insurance companies for years or even decades for business interruption insurance only to see carriers unfairly deny coverage across the board based on the ethereal, undefined "direct physical loss" requirement contained in their business owner's property polices.

While some courts have sided with carriers in dismissing lawsuits stemming from COVID-19 related shutdowns, New York courts need not look further than across the George Washington Bridge for an analysis that falls within the bounds of New York jurisprudence and leaves the door open for coverage that so many business owners desperately need.

In *Optical Services USA/JCI v. Franklin Mutual Insurance Co.*, No. BER-L-3681-20, currently pending in the Superior Court of New Jersey, Law Division, Bergen County, a New Jersey state court correctly denied an insurer's motion to dismiss a business owner's complaint alleging that the shutdown of the business premises by executive order deeming the premises unsafe constituted a direct physical loss for which there was coverage under the subject insurance policy. New York courts would be right to adopt this New Jersey court's reasoning in similar business interruption cases.

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In *Optical*, the defendant insurer argued that a closure of the premises for business purposes, by its self, was not a covered cause of loss under the policy. See *Transcript of Motion*, at page 10. According to the defendant, the policy's definition of "covered cause of loss" required a "physical impact" to the premises, i.e. structural, physical damage. Id. at page 11. Thus, defendant concluded that the closure and resultant loss of functionality of the premises was not a covered loss under the policy as there was no physical damage or destruction that precipitated the closure. See id.

The court rejected this argument for two reasons. First, the court stated defendant's argument that the closure of the business pursuant to executive order cannot constitute a direct physical loss is a "blanket statement unsupported by any common law in the State of New Jersey or by a blank review of the policy language." In fact, the court pointed out that the controlling case law directly contradicted defendant's argument. The court cited *Wakefern Food v. Liberty Mutual Fire Insurance Company*, 406 N.J.Super. 524 (App. Div. 2019), where it was found that a grocery store suffered covered physical damage when its generators and transmission equipment were incapable of supplying power after problems with the electrical grid activated safety features that

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shut down the store's electrical equipment. *Wakfern,* 406 N.J. Super, at 541-42.

Even though there was no material damage, the court in *Wakfern* held that the complete loss of the system's functionality in delivering electricity could constitute physical damage within the meaning of the policy. Id. at 541. Further, the *Wakefern* court found the term "physical damage" ambiguous because "physical" can mean more than material alteration or damage. Id. at 541-42.

Accordingly, the court in *Optical* rejected defendant insurer's argument because the controlling precedent in New Jersey indicates that a loss of use of a premises for its intended business purposes can constitute a "direct physical loss" because the premises lose all functionality when shut down.

Secondly, the *Optical* court found that plaintiff's allegation that the premises were shut down by executive order deeming the premises unsafe due to the risk of COVID-19 transmission successfully countered defendant's argument that the loss of use theory lacked a physical nexus to a condition on the property to satisfy the "direct physical loss" requirement for coverage. See *Transcript of Motion*, at page 27.

Interestingly, the defendant insurer began its oral argument by pointing out that plaintiff's complaint alleged that there was no known presence of the COVID-19 virus, such presence defendant argued would be sufficiently related to a physical condition on the property for coverage had there been no virus exclusion in the policy. See id. at 8-9. Accordingly, the *Optical* court astutely made an important distinction between the risk to person and property posed by COVID-19 virus transmission and the presence of the COVID-19 virus within a premises as separate and distinct causes for the closure of the premises.

This distinction also opens the door for plaintiffs with policies containing a virus exclusion to plead a sufficient nexus to a physical condition within the premises related to COVID-19 but avoid the direct application of the virus exclusion to exclude coverage.

New York, unlike New Jersey, lacks strong precedent to support a pure loss of use theory where there is no nexus to a physical condition within the premises. However, Judge Paul Englemayer of Southern District of New York suggested that there can be a direct physical loss of property where a premises is "rendered unusable or unsatisfactory for its intended purpose" as long as there exists some connection between the loss of use and a physical condition within the premises. See *Newman Myers Kreines Gross, P.C. v. Great Northern Ins. Co.*, 17 F. Supp. 3d 323, 329 (S.D.N.Y 2014).

Accordingly, insofar as a connection or nexus to a physical condition within the premises is required for the closure of a business to constitute a direct physical loss under New York common law, New York courts should look to the reasoning in Optical for guidance.

Indeed, the *Myers* court cited to several out of state of cases where a loss of use of the premises for its intended purposes constituted a direct physical loss as long as it related to some physical condition or risk even though there was no structural damage to the premises. See id. at 329-30; citing, e.g., *TRAVCO Ins. Co. v. Ward,* 715 F. Supp. 2d 699 (E.D. Va. 2010), aff'd, 504 F. App'x 251 (4th Cir. 2013) (holding "physical damage to property is not necessary" and that invisible sulfuric gas was sufficient to cause direct physical loss where a building was rendered unusable for its intended purpose); *Essex v. BloomSouth Flooring*, 562 F.3d 399, 406 (1st Cir. 2009) (unpleasant odor rendering property unusable constituted physical injury to property); *Murray v. State Farm Fire & Cas. Co.*, 203 W.Va. 477, 509 S.E.2d 1 (Supreme Court of Appeals West Virginia 1998) (risk of damage to home from rockfall constitutes a direct physical loss even where there is no structural damage because the threat alone makes the home untenable for living).

Accordingly, insofar as a connection or nexus to a physical condition within the premises is required for the closure of a business to constitute a direct physical loss under New York common law, New York courts should look to the reasoning in *Optical* for guidance. Specifically, New York court's should take note of the *Optical* court's finding that the closure of the premises by executive order deeming the premises unsafe "given the risk of transmission of COVID-19" was sufficiently related to specific condition within the premises to constitute a direct physical loss because this reasoning accords with Judge Englemayer's decision in the *Meyers* case.

Accordingly, in order to save thousands of New York business from closing their doors permanently, New York courts should look to *Optical* for a decision and rationale that is consistent with New York jurisprudence.