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CAN INSURERS DENY COVERAGE FOR LOSS OF BUSINESS INCOME OR BUSINESS INTERRUPTION ARISING FROM THE COVID-19 PANDEMIC?

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Implications of the Decision in MDS Inc. v. Factory Mutual Insurance Company (FM Global), 2020 ONSC 1924 on Business Interruption Claims Arising from the COVID-19 Pandemic

by Ian P. Katchin

Many businesses in Ontario have been forced to shut their doors by operation of Orders made under the *Emergency Management and Civil Protection Act*, R.S.O. 1990, c. E.9, as amended (the "**Act**").

On March 17, 2020, and as a result of the COVID-19 pandemic, the government of Ontario made an Order declaring an emergency under section 7.0.1(1) of the *Act*. On March 23, 2020, the government of Ontario announced the mandatory closure of non-essential businesses starting March 24, 2020 for a 14-day period under section 7.02(4) of the *Act*. As of March 24, 2020, the list of essential businesses fell into 74 categories.

A subsequent order was made on April 3, 2020 that narrowed the list of essential businesses (to 44 categories) and required non-exempt businesses to close commencing on April 4, 2020 for a 14-day period.

The effect of these closures has been devastating to those non-exempt businesses, including their owners and employees, and their respective families.

In response, there has been a fair amount of head-scratching in the insurance industry over the past few weeks on whether claims for loss of business income (or business interruption) resulting from the COVID-19 pandemic are covered under all-risks property insurance policies.

These types of policies are understood to protect against fortuitous losses, unless such losses are otherwise excluded. In *Progressive Homes v. Lombard General Insurance Co. of Canada,* 2010 SCC 33, [2010] 2 S.C.R. 245, the Supreme Court of Canada defined fortuity: "When an event is unlooked for, unexpected or not intended by the insured, it is fortuitous. This is a requirement of coverage."

All-risks insurance is not all loss insurance. It is intended to cover only fortuitous or accidental losses subject to express conditions or exclusions.

The insureds' argument is, quite simply, that they should have coverage for loss of business income as a result of the COVID-19 pandemic.

But what most insureds may not appreciate is that coverage for loss of business

income or business interruption usually requires a set of conditions to be satisfied in the insuring agreement before coverage for this type of claim will be granted.

Typically, the insuring agreement for loss of business income will extend coverage when there has been a loss of "business income" due the "suspension" of "operations" during the "indemnity period" caused by "**direct physical loss of or damage to property**" at the insured's premises. (emphasis added)

In certain commercial property policies, the terms "business income", "suspension", "operations" and "indemnity period" are defined terms. As such, it is a relatively straightforward analysis as to whether these terms have been met in the circumstances of any particular case.

The issue lies is in the meaning of the terms "direct physical loss of or damage to property". Ordinarily, those terms are **not** defined in the policy and are left open to interpretation based upon the facts of the case, applicable caselaw and contractual interpretation principles as they apply to insurance policies (discussed below).

Insurers may very well take the position that loss of business income or business interruption is property coverage that is triggered by a physical and/or tangible insured peril at an insured's premise. They may also take the position that the COVID-19 pandemic is not, or has not caused, a physical loss of or damage to an insured's property so as to trigger coverage.

Relatively recent caselaw from Ontario illustrates the Court's willingness to find coverage for loss of business income in certain circumstances (unrelated to the COVID-19 pandemic).

In *Leo Deluca Enterprises Inc. v. Lombard General Insurance Company of Canada*, 2008 CanLII 13790 (ON SC) a restaurant closed as a result of a power blackout. The Court accepted the tenant's argument that the business interruption or loss of business due to the closing of the restaurant as a result of the blackout fell within the scope of "damage to the property" under the insurance covenant. The actual physical damage in that case related to a downed power/transmission line that occurred with the coverage radius for that type of loss.

In *224981 Ontario Inc. v. Intact Insurance Co.*, [2016] O.J. No. 1416, 2016 ONSC 642, Justice Faieta determined whether Zurich was correct in denying coverage for the owner's claim for loss of rental income on the basis that the tenant should have continued to pay rent after a fire destroyed the premises.

The Court concluded that the tenant had a month to month lease and was under no obligation under its monthly lease to pay rent to the owner after the fire when its manufacturing operation stopped due to the fire. The Court concluded that the owner's loss of rent was caused by the fire and, as such, the owner was entitled to recover those amounts from its insurer. In that case; however, there was a patent direct physical loss of or damage to property – caused by the fire.

The *224981* decision is also relevant because it summarizes certain principles for interpreting insurance policies, which are equally applicable when ascertaining coverage resulting from the COVID-19 pandemic:

1. A court should give effect to a policy's clear language, reading it like a contract as a whole;

2. Words in an insurance policy should be construed as they would be understood by the average person applying for insurance, not as they might be perceived by a person experienced in insurance law;

3. A court should be reluctant to depart from authoritative judicial precedent interpreting the policy in a particular way where the issue arises subsequently in a similar context and where the policies are similarly framed;

4. If the language of an insurance policy is ambiguous, a Court should prefer interpretations that are consistent with the reasonable expectations of the parties so long as such interpretation can be supported by the text of the policy; and

5. If the application of the rules of construction cannot resolve an ambiguity, then the policy should be construed in favour of the insured by interpreting coverage provisions broadly and exclusion clauses narrowly.

In both the *Leo Deluca* and *224981* decisions there was a component of a direct and tangible physical loss, which triggered coverage under the applicable policies.

But what about circumstances where there is no actual physical or tangible loss or damage?

Can insurers deny coverage for loss of business income or business interruption arising from the COVID-19 pandemic, because there may not have been an actual physical and/or tangible loss or damage to an insured's property?

At the time of publication of this article, this specific issue has not been determined by the Courts in Ontario.

However, the 113 page decision of Justice Wilson in *MDS Inc. v. Factory Mutual Insurance Company (FM Global)*, 2020 ONSC 1924 ("**MDS**"), released on March 30, 2020, may very well provide insureds with the arguments they need to make the case for coverage for loss of business income or business interruption in circumstances where there has not been an actual physical or tangible loss or damage to their property.

In *MDS*, Justice Wilson determined, among other things, the extent of coverage for "resulting physical damage" under an "all risks insurance policy" in relation to an unanticipated leak of heavy water containing radioactive Tritium from a nuclear reactor. This, in turn, shut down a nuclear reactor that produced radioisotopes for use in cardiac imaging, cancer treatment and sterilization of medical products.

The plaintiff had historically purchased radioisotopes produced at the reactor and processed them for sale for profit worldwide. Due to the shutdown of the reactor, the plaintiff was unable to purchase and sell radioisotopes. This, in turn, caused it to suffer a loss of business income.

At the time of the shutdown, the defendant insurer had issued a worldwide all-risks policy to the plaintiff covering property described in the policy against losses from all risks of physical loss or damage except as excluded.

As a result of the shutdown, the plaintiff submitted a claim for loss of profits under its insurance policy. The insurer denied coverage and the plaintiff commenced an action for breach of contract.

In canvassing the scope of coverage under an all risks policy, Justice Wilson noted that they are understood to protect against fortuitous losses, unless such losses are excluded, and should be consistent with the reasonable expectation of the parties.

This analysis was undertaken with a view to determining whether resulting physical damage should be defined narrowly to require actual physical or tangible damage (as preferred by insurers), or broadly to include impairment or loss of use or function (as preferred by insureds).

The purpose of the policy in *MDS* was to insure the plaintiffs for loss of profits in their business operations, which is likely similar to the purpose of the policies of many readers of this article.

As part of its analysis, the Court in *MDS* noted that there were few Canadian cases that specifically discussed the interpretation of physical loss or physical damage in the context of an all-risks policy.

Based upon a review of those cases, including caselaw in other jurisdictions, the Court noted two approaches to the interpretation of physical damage: 1) a narrow view that limits damage to corporeal, tangible damage; and 2) a broader view that encompasses not only tangible damage but also impairment of use or function.

In considering the purpose of all-risks coverage in the context of coverage for loss of profits in the *MDS* case, the Court cited the U.S. decision in *Western Fire Ins. Co. v. First Presbyterian Church*, 437 P.2d 52 (Col. Sup. Ct. 1968) where a property was rendered uninhabitable due to the infiltration and saturation of gasoline vapours from an adjacent property. These circumstances, combined with a government declaration of uninhabitability, amounted to a direct physical loss allowing coverage in that case.

The government of Ontario's Order for the shut-down of non-essential businesses pending further notice could, by analogy, be equivalent to the declaration of uninhabitability in *Western Fire* until the safety conditions imposed by the public body for the building had been satisfied.

In *MDS*, the Court noted that “a broad interpretation of resulting physical damage to include impairment of use confirms the principle that exceptions to exclusions should be interpreted broadly.”

The Court went on to note that that a broad definition of resulting physical damage was appropriate in that case to interpret the words in the policy to include impairment of function or use of tangible property caused by the unexpected leak of heavy water. In the Court's own words, to “interpret physical damage as suggested by the Insurer would deprive the Insured of a significant aspect of the coverage for which they contracted, leading to an unfair result contrary to the commercial purpose of broad all-risks coverage.”

In the *MDS* decision, the Court accepted the plaintiff's argument, based upon the facts of that case, that a broad definition of resulting physical damage was appropriate to interpret the words in the policy to include impairment of function or use of tangible property caused by the unexpected leak of heavy water.

The Court expressly rejected the defendant insurer's argument that a narrow definition of resulting physical damage should be favoured, as it would deprive the insured of a significant aspect of insurance for which they contracted.

In so doing, the Court clarified that physical or tangible loss of use or damage to property may not be necessary to advance a claim for loss of business income or business interruption under an all-risks policy. The implications of this case for the COVID-19 pandemic are significant.

It is recommended that insureds carefully consider the wording of their all-risks policies in light of the *MDS* decision and to meet with their legal representatives prior to submitting any type of claim for loss of business income or business interruption arising from the COVID-19 pandemic.

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