New Jersey Court Refuses to Dismiss Policyholders' COVID-Related Business Interruption Claims, Dealing a Blow to Insurer's Arguments That Such Claims Cannot Constitute Covered Loss Under a Property Policy

Insurance Recovery, Litigation & Counseling Alert

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A New Jersey state court recently rejected an insurer's claim that COVID-related losses cannot qualify as covered losses. In *Optical Services USA/JCI v. Franklin Mutual Insurance Co.*, No. BER-L-3681-20, pending in the Superior Court of New Jersey, Law Division, Bergen County, the policyholders assert they purchased business interruption insurance coverage to protect their businesses from an "unanticipated crisis." They contend such a crisis struck in March 2020, when the novel coronavirus spread across the globe, causing governments – including the State of New Jersey – to take dramatic action. Specifically, Governor Murphy issued Executive Orders requiring nonessential businesses to close and ordering residents to stay home. Plaintiffs allege they closed their businesses in compliance with Governor Murphy's orders and, as a result, suffered significant financial loss covered by their insurance policies.

The insurer denied coverage and moved to dismiss the Complaint for its alleged failure to state a legal claim. Relying on policy language that defined covered loss as "fortuitous direct physical damage to or destruction of covered property by a covered cause of loss," the insurer's counsel argued the policy defines loss as requiring "physical impact." Op. at 11. Because "[t]here is no known instance of COVID-19 transmission or contamination within the premises of plaintiffs' businesses," the insurer argued there was no "direct physical loss." *Id.* at 8-9.

The court challenged the insurer, questioning why the policy did not have "specific exclusions for an event such as this." *Id.* at 11. The insurer conceded that there was no specifically applicable exclusion and that the policies' contamination exclusions did not apply to this situation. Instead, the insurer resorted to arguing the coverage definition had not been satisfied. *Id.* at 12.

The policyholders responded they "were forced to close their businesses because the executive order issued by the State … [and] across the country in emergency response to the pandemic found that there is a dangerous condition on plaintiffs' property." *Id.* at 13. Plaintiffs asserted two main bases for coverage being triggered under their policies. First, plaintiffs argued a dangerous condition on property can constitute physical loss, citing *Gregory Packaging Inc. v. Travelers Property Casualty Co. of America*, 2014 U.S. Dist. LEXIS 165232 (D.N.J. Nov. 25, 2014), in which the court found "physical loss or damage" when ammonia

gas discharged into the facility's air rendered the facility "temporarily unfit for occupancy." Second, plaintiffs argued the closure orders "not only affected plaintiffs' businesses, but they affected . . . all properties around plaintiffs" thereby triggering civil authority coverage. Slip. op.at 15.

The court denied the insurer's motion to dismiss, noting the "pivotal issue" of the "interpretation of a direct covered loss under the policy and whether or not there was physical damage to the plaintiffs' business." *Id.* at 24-25. The plaintiffs argued the loss of physical functionality and use of their business constituted a covered loss, while the insurer argued the opposite. The court found the insurer did not provide the it with any controlling legal authority to support its interpretation. The court, conversely, found the plaintiffs' argument was supported by *Wakefern Food Corp. v. Liberty Mutual Fire Insurance Co.*, 406 N.J. Super. 524 (App. Div. 2009) — a lawsuit handled by McCarter & English. The *Wakefern* court found a grocery chain was covered for loss of power because the electrical grid and transmission lines were not physically capable of performing their essential function of providing electricity. Relying on that ruling, the *Optical Services* court held that "[s]ince the term 'physical' can mean more than material alteration or damage, it is incumbent on the insurer to clearly and specifically rule out coverage in the circumstances where it was not to be provided." *Id.* at 28 (citing *Wakefern*, 406 N.J. Super. at 542). This precedent required rejection of the insurer's motion to dismiss in the absence of a complete record. *Id.*

The court concluded the policyholders "should be afforded the opportunity to develop their case and prove the event of the COVID-19 closure may be a covered event under the Coverage C, Loss of Income, when occupancy of the described premises is prohibited by civil authorities." *Id.* at 29. The court further noted: "There is an interesting argument made before this Court that physical damage occurs where a policyholder loses functionality of their property and by operation of civil authority such as the entry of an executive order results in a change to the property." *Id.* The court found this coverage theory warranted a denial of the insurer's motion to dismiss at that early stage of the litigation. *Id.*

The *Optical Services* decision accords with numerous decisions (in New Jersey and elsewhere), finding coverage for the loss of use or function of property, even when there exists little or no tangible damage to the property. It also rebuts the noncoverage narrative the insurance industry has tried to perpetuate to dissuade policyholders from seeking coverage for their pandemic-related losses.