Valuing COVID-19 Business Interruption Loss: Considering Post-Event Economic Activity

If a business can show physical damage to property and avoid any virus exclusion how should profits be calculated?

By **J. Wylie Donald** | August 03, 2020

Coronavirus has turned the world topsy-turvy. Lockdowns compel the citizenry to stay home, require stores to close, prohibit gyms from opening, and so forth. The world we live in today is unlike any in our experience.

American businesses have suffered enormous losses. The governmental orders that shut down or drastically curtailed the operations of all sorts of businesses necessarily affected their profits. Casinos, construction companies and concert halls (and many others) found themselves designated as non-essential businesses and saw their bottom lines turn negative. Fortunately, some had purchased business interruption insurance, and, if able to show physical loss or damage to their own property, or that of others, and to avoid any virus exclusion, should be recovering their lost profits. But how are those profits to be calculated?

Business interruption insurance is intended to put a business back into the position it would have been in had it not suffered the loss. *See National Union Fire Ins. Co. v. Anderson-Prichard Oil Corp*., 141 F.2d 443, 445 (10th Cir. 1944). In a far-reaching catastrophe like a flood, a hurricane or a pandemic, the losses of a business will arise from the direct effect of the catastrophe on that business, but may be increased or reduced by the area-wide effects of the catastrophe on the local economy. On the one hand, a closed casino would like to recover its usual and customary profit, but might also consider itself entitled to the larger profits that would have been earned if it were the only casino in operation. *See Catlin Syndicate Ltd. v. Imperial Palace of Mississippi, Inc.*, 600 F.3d 511, 512 (5th Cir. 2010). On the other hand, an insurer might argue that a closed concert hall would have no lost profit because no sane person in a coronavirus pandemic would attend an indoor concert. *Accord Consolidated Co. v. Lexington Ins. Co*., 616 F.3d 422, 432 (5th Cir. 2010) ("The [insurer's] premise is that because economic conditions affecting [the insured's] customers post-Katrina were poor, [the insured's] profits would have been reduced from their usual level even had there been no damage to [the insured]."). What is the required result?

This article examines these two scenarios with decisions supporting each outcome. The positions of insurer and insured will not always be the same; they will depend very much on the particular circumstances of the particular claim, including the specific policy language at issue. The article concludes that, consistent with their policy language, insureds should argue the position that maximizes their recovery for two reasons. First, there is no settled rule among state courts whether valuation of a business loss following a catastrophe should consider only the narrow impact of the event on the insured, or, instead, the full scope of

the catastrophe and its impact on the economy in which the business would have operated. Second, the approach is consistent with the established rule throughout the country that ambiguities are to be construed against the insurer and in favor of the policyholder.

The judges of the Fourth Circuit Court of Appeals set forth both sides of the dispute in *Prudential LMI Commercial Ins. Co. v. Colleton Enterprises, Inc.*, 976 F.2d 727, 1992 WL 252507 (4th Cir. Oct. 5, 1992) (non-precedential table case). In the case, the insured motel suffered damage from Hurricane Hugo and could not operate until the damage was repaired. While it was shut down, the motel business boomed because of the demand for rooms by temporary workers involved in the recovery from the storm. The motel, which had not made any money for an extended period before the storm, sought to use the post-storm boom as the basis for its damages calculation. The trial court, considering South Carolina law, granted the motel summary judgment on its theory. The insurer appealed.

As is generally the case in insurance disputes, the court of appeals began with the terms of the contract, which provided: "in determining loss …, due consideration shall be given to: a. the earnings of the business before the date of damage or destruction and to the probable earnings thereafter, had no loss occurred." *Id.* at *3. The court homed in on the "had no loss occurred" language. The court recognized the probative value of pre-loss business activity, but it agreed that post-loss activity could also be used by the insured to prove its projected business interruption loss, provided such activity did not create a windfall.

Unfortunately for the motel, the court perceived a windfall:

For had the hurricane not occurred (the policy's built-in premise for assessing profit expectancies during a business interruption), neither would the specifically claimed earnings source have come into being. To allow the claim therefore would be to confer a windfall upon the insured rather than merely to put it in the earnings position it would have been in had the insured peril not occurred. *Id.* at *4.

The Fourth Circuit explained that it was applying "a special application of the general no-windfall principle," which was that an insured "may not claim as a probable source of expected earnings (or operational expenses) a source that would not itself have come into being but for the interrupting peril's occurrence." *Id.* Accordingly, because the increased occupancy of the hotel was due to the hurricane that caused the business interruption in the first place, post-loss business activity could not serve to inform the extent of the motel's loss.

Importantly, the dissent in *Colleton Enterprises* approached the critical policy language differently. It pointed out that the majority had equated "had no loss occurred" with the larger statement: "had no hurricane occurred." The dissent explained: "'Had no loss occurred' does not refer to the overall loss in the surrounding area." The correct interpretation was plain: "['loss'] clearly refers only to the loss incurred by the insured." *Id.*

Although not acknowledged, the same conclusion as the *Colleton Enterprises* dissent was also reached in *Stamen v. Cigna Property & Casualty Insurance Co.*, 1994 U.S. Dist. LEXIS 21905 (S.D. Fla. June 13, 1994), a Hurricane Andrew business interruption case. There, convenience store operators brought suit against their insurer, which had refused to value their loss based on "the profits the stores would have made had they stayed open immediately after the hurricane." The language at issue paralleled – but was not the same as – that in *Colleton Enterprises*: "In calculating your lost income, we will consider your situation before the loss and what your situation would probably have been *if the loss had not occurred*." *Id.* at *5 (emphasis added). "[This] policy language dictate[d] the result." *Id.*

The meaning of "loss" was critical, and it was undefined in the policy, although "covered loss" was defined (and meant "loss or damage for which [the insurer] provided insurance."). Accordingly, the court limited "loss" to the damage at each individual convenience store and rejected the insurer's invitation to equate

"loss" (the convenience stores' damages) with "occurrence" (Hurricane Andrew). *Id.* at *7. If the insurer had meant for the terms to mean the same thing, it should have "substituted the word 'occurrence' for the word 'loss' in the clause describing how business interruption losses would be calculated." *Id.*

In reaching this conclusion the court rejected the Fourth Circuit's non-precedential decision in *Colleton Enterprises.* Significantly, the *Stamen* court expressly stated that the convenience stores' recovery of "greater profits in the aftermath of Hurricane Andrew" was "not accurately described as a windfall." *Id.* Rather, the convenience stores were "seeking to recover [their] actual losses, which is exactly what the insurance policy require[d the insurer] to pay." *Id.* The court concluded that the insureds' lost profits "should be measured, at least in part, by the increased profits that would have resulted had the stores been open immediately after the hurricane." *Id.* at *5.

Another decision approving consideration of area-wide post-catastrophe economic activity eschewed reliance on either the *Colleton Enterprises* dissent, or the Southern District of Florida's decision in *Stamen*; instead it focused on the precise policy language at issue. In *Levitz Furniture Corp. v. Houston Casualty Co*., the insured, a furniture store, was closed for over two months as a result of flooding. 1997 U.S. Dist. LEXIS 5883, at *2 (E.D. La. Apr. 28, 1997) (considering Louisiana law). Upon re-opening and as a result of the flood, the store experienced an increase in customer demand, which the store wished to use in its loss calculation. *Id*. at *6. The insurer, relying on the majority opinion in *Colleton Enterprises*, argued that its coverage was "designed to place [the insured] in the position it would have been in had no loss occurred, i.e., had there been no flood, there would have been neither damage to [the insured] nor increased consumer demand." *Id*.

The argument the insurer presented incorporated the language "had no loss occurred" as seen in common policy language (e.g., *Colleton Enterprises*). However, the argument was inapposite because the store's policy used different language:

In determining the indemnity payable under this Endorsement, due consideration shall be given to the experience of the business before the Period of Interruption and the probable experience thereafter and to the continuation of only those normal charges and expenses that would have existed *had no interruption of production or suspension of business operations or services occurred*. *Id*. at *7 (emphasis added).

Accordingly, the court "flatly rejected" the insurer's argument, pointing out that the store's policy's language – "no interruption" – "clearly and unambiguously" referred to no business stoppage. Thus, this language did "not exclude profit opportunities due to increased customer demand created by the flood" and the court ruled that "business interruption loss earnings may include sales [the store] would have made in the aftermath of the flood had it been open for business during that period." *Id.*

Opposed to the decisions in *Stamen* and *Levitz* and the dissent in *Colleton Enterprises* is a triumvirate of cases out of the Fifth Circuit construing again the "had no loss occurred" language.

In *Finger Furniture Co. v. Commonwealth Insurance Co*., the floods of Tropical Storm Allison precluded a furniture company from opening its Houston stores over a two-day period. 404 F.3d 312, 313 (5th Cir. 2005). When the stores reopened, "sales soared after [the insured] slashed its prices and customers purchased furniture at discounted prices." *Id.* The insurer sought to offset the loss from the two days of closure with the profits from the two days of sales. The insured, however, contended that consideration of post-storm sales was not permitted by the policy language and the insurer's position would be "expand[ing] the policy language." *Id*.

After the insured prevailed on summary judgment at the trial court, an appeal ensued. The Fifth Circuit applied Texas law and interpreted the clause "had no loss occurred" in the business interruption valuation provision to mean: had the catastrophe not occurred. *Id*. Construing the language in this manner, the court reasoned that had the flooding never occurred, then the business would have been operating per usual; thus, the best source of information to value damages would be based on its prior business. *Id*. The court

stated that the prior sales not only reflected the business "before the date of the damage," but they were also sufficient to reflect "the business's probable experience had the loss not occurred"; therefore, the court did not consider the post-damage sales. *Id*. at 314. *See also Alley Theatre v. Hanover Ins. Co*., 2020 U.S. Dist. LEXIS 52393, at *10-11 (S.D. Tex. Mar. 26, 2020) (finding that because the policy language mirrored that in *Finger Furniture*, "the parties must follow *Finger Furniture*'s instruction for business-interruption calculations, limiting the inquiry to historical revenue and not actual post-storm revenue.").

The *Finger Furniture* analysis was adopted by the court in another hurricane-loss case under Mississippi law. *Catlin Syndicate Ltd. v. Imperial Palace of Mississippi, Inc*., 600 F.3d 511 (5th Cir. 2010). There, the insured, Imperial Palace, closed because of Hurricane Katrina, was one of the first casinos to re-open after the storm. As a result of the lack of competition, it experienced revenues millions of dollars higher than it did before the hurricane and sought to apply that as the basis for its loss. *Id*. at 512. The parties could not reach agreement, the insurer sued, and then prevailed on summary judgment. Imperial Palace appealed.

The Fifth Circuit turned once again to the "had no loss occurred" provision of the policy in order to determine how to value the damages and relied on its decision in *Finger Furniture*. *Id*. at 515. Imperial Palace argued the court had improperly conflated the concepts of loss and occurrence and that post-event circumstances mattered. The court rejected the conclusions in *Stamen* and the *Colleton Enterprises* dissent and ruled against Imperial Palace: "While we agree with Imperial Palace that the loss is distinct from the occurrence … we also believe that the two are inextricably intertwined under the language of the business-interruption provision." *Id.* at 595 and n.3. Accordingly, only pre-event information was relevant to calculating the loss.

The Fifth Circuit's third business interruption valuation decision, *Consolidated Co. v. Lexington Insurance Co*., considered Louisiana law and evaluated loss incurred by a warehouse as a result of Hurricane Katrina. 616 F.3d 422 (5th Cir. 2010). The insurer sought to diminish the insured's recoverable loss by ascribing some of the loss to "the generally poor post-Katrina business conditions." *Id.* at 430. Following suit by the insured and a jury verdict in its favor, the insurer appealed. Unsurprisingly, the court found its prior decisions in *Finger Furniture* and *Catlin Syndicate* sufficient because Texas, Mississippi and Louisiana law had, according to the court, no material differences in their contract interpretation law. The court rejected the insurer's position and concluded: "The jury was not to look at the real-world opportunities for profit post-Katrina, but instead was to decide the amount of money required to place [the insured] 'in the same position in which [it] would have been had [Katrina not] occurred.'"

Insureds should take at least three lessons from the above. First, the language of the policy matters. In determining whether to consider actual post-loss circumstances, the *Stamen* and *Levitz* courts reached different conclusions from *Colleton Enterprises* because they considered different language. It should be added that a recent ISO form permits the insurer to offset an insured's loss with post-event profits and also to exclude profits that "would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses." *See Rimkus Consulting Group v. Hartford Casualty Ins.*, 552 F. Supp. 2d 637, 640 (S.D. Tex. 2007). Policyholders should examine their policies closely.

Second, the case law is thin and consists of federal courts construing state substantive law. State courts are not bound by any of these interpretations.

Third, although never discussed in any meaningful way in any of the cases, ambiguity may be a central issue in these disputes. Ambiguity matters because ambiguous terms generally are strictly construed against the insurer and in favor of coverage. 2 L. Russ & T. Segalla, *Couch on Insurance* § 21.11 (3d ed. 1995). As evidenced by the contrary positions of the majority and the dissent in *Colleton Enterprises*, the meaning of "loss" under one common policy provision is critical: does it mean the damage to the insured, or does it mean the event causing the damage (the "occurrence"). *See* 1992 WL 252507, at *4 (dissent); *see also Stamen*, at *7. The two different meanings ascribed to the word "loss" by the majority and the dissent in

Colleton Enterprises certainly suggest the word "loss," as used in that policy, is subject to more than one reasonable interpretation and, therefore, is ambiguous. The Fifth Circuit's conclusion in *Catlin Syndicate* that "loss" and "occurrence" are "inextricably intertwined" is unlikely to be the last word. Indeed, that insurance companies take positions on both sides is further evidence of ambiguity.

One of the most notable features of the valuation of business interruption loss is how dependent it is on the circumstances of the loss. Insurers or insureds may wish to take advantage of the post-event area-wide economy, or not, depending on their interests. For the moment at least, outcomes are not assured and policyholders seeking to maximize their recovery should press the theory that provides the most advantage.

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