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Dependent Property Coverage for Essential Businesses

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Even if a business has not been shut down as a result of the coronavirus, it may still have suffered losses that are covered by its commercial property insurance policy. This is particularly true of essential businesses that provide products and services to other businesses that have been ordered closed due to the pandemic. Consider all the businesses that have lost sales as a result of government shutdowns of restaurants and bars in Oregon and in states where Oregon businesses export products. Wineries, distilleries, breweries, food processors, and farms all have lost important sources of income. Importantly, this loss of sales and other related expenses may be covered under property policies' "dependent property" coverage (which is sometimes also referred to as "contingent time element" coverage or "recipient property" coverage).

The Basics of Dependent Property Coverage

Many property policies provide that if the property of the insured business's customers, suppliers, or service providers suffers "physical loss or damage" of the type covered under the policy, then the insured business is entitled to coverage for related losses. This business interruption coverage can include loss of business income and increased expenses due to the insured business's attempts to mitigate its losses.

Importantly, the law in many jurisdictions, including Oregon, supports the argument that the presence of the coronavirus constitutes "physical loss or damage." Courts in Oregon have held that the presence of wildfire smoke, methamphetamine odors, mold spores, and lead constitute covered "physical loss or damage" because these events resulted in a loss of "essential functionality" of the property. See *Shakespeare Festival Ass'n v. Great American Insurance Co.*, 2016 WL 3267247 (D. Or. June 7, 2016) (wildfire smoke); *Farmers Insurance Co. of Oregon v. Trutanich*, 123 Or. App. 6 (1993) (pervasive odor from methamphetamine cooking); *Prudential Property & Casualty Ins. Co. v. Lillard-Roberts*, 2002 WL 31495830 (D. Or. June 18, 2002) (mold). Courts in other jurisdictions have found that the presence of ammonia, gasoline, carbon monoxide, E. Coli, fumes from Chinese drywall, odor from cat urine, among other things, can constitute covered "physical loss or damage." See *Gregory Packaging, Inc. v. Travelers Property Cas. Co.*, 2014 WL 6675934 (D.N.J. Nov. 25, 2014) (ammonia); *Western Fire Ins. Co. v. First Presbyterian Church*, 165 Colo. 34 (1968) (gasoline); *Matzner v. Seaco Ins. Co.*, 1998 WL 566658 (Mass. Super. Aug. 12, 1998) (carbon monoxide contamination); *Motorists Mut. Ins. Co. v. Hardinger*, 131 F. App'x 823, 826 (3d Cir. 2005) (E. Coli bacteria); *TRAVCO Ins. Co. v. Ward*, 715 F. Supp. 2d 699, 709 (E.D. Va. 2010), *aff'd*, 504 F. App'x 251 (4th Cir. 2013) (gases released by Chinese drywall); *Mellin v. N. Sec. Ins. Co., Inc.*, 167 N.H. 544, 550 (2015) (odor from cat urine).

The amount and scope of dependent property coverage varies widely. Some policies extend coverage to property of indirect customers and suppliers. Some policies expressly expand coverage to dependent properties shut down by government order as a result of “physical loss or damage” within a certain radius of that dependent property. The sublimits applicable to dependent property coverage are often less than the limits for standard business interruption coverage; nonetheless, this coverage may help affected businesses reduce losses they have incurred as a result of the pandemic.

Potentially Applicable Policy Exclusions

The insurance industry is generally taking the position that the presence of the coronavirus is not covered “physical loss or damage” and therefore does not fall with the coverage afforded by the typical property policy’s insuring agreement, but the industry will also rely on various policy exclusions to deny coverage. Insured businesses’ ability to avoid these exclusions will differ from policy to policy and from state to state. The overarching rule governing policy exclusions is that the insurer has the burden of drafting exclusions that are clear and that ambiguous exclusions should be construed against the insurer. Even if a policy expressly excludes viruses, there may be arguments that the exclusion does not apply to coronavirus-related losses because, among other reasons, exceptions apply, state endorsements limit the exclusion’s scope, and/or the exclusion applies to the standard property coverage but not the dependent property coverage. If insurers rely on exclusions that do not expressly use the word “virus,” as with some contamination exclusions and microorganism exclusions, there are good arguments that the exclusions do not apply to coronavirus-related loss. The application of more challenging virus exclusions may ultimately be eliminated or reduced by legislation. Legislation has been introduced in some states, like Pennsylvania, New Jersey, Louisiana, and Ohio) to eliminate the application of virus exclusions to the pandemic.

Preserving a Dependent Property Coverage Claim

Property policies contain several time-based conditions with which an insured business is well advised to comply.

The first time-based condition is the obligation to give notice of loss as soon as possible. If an insured business does not yet know the extent of loss that it has suffered, it still should give notice as soon as possible after that loss has occurred. Even those insured businesses that have more challenging virus exclusions in their policies should consider giving notice to preserve their coverage claim in the event a path to coverage is opened through legislation. While there are counter-arguments to a claimed forfeiture of coverage due to late notice, it is better if the insured business does not have to spend time and money advancing such arguments.

Property policies also require the insured business to submit a proof of loss within a certain time period after the loss or an insurer’s request for a proof of loss. The precise timing of such submission varies from policy to policy, and state law may further modify the timing requirement. Although the insurance industry is generally denying coverage for coronavirus-related coverage claims, the best practice would be for the insured business to request a delay of any proof of loss submission until after the insurer has accepted coverage.

Lastly, most property policies require an insured business to bring suit in a time period that is often shorter than the typical statute of limitations period. Many policies require any lawsuit to be brought within one year of the inception of loss. State law may modify this contractual limitations period. For example, Oregon law extends the period to two years—which is still much shorter than the six-year statute of limitations period that ordinarily applies to breach-of-contract actions. Failure to file suit or obtain a tolling agreement prior to the contractual limitations deadline likely will result in otherwise legitimate coverage claims being time-barred.

Conclusion

Dependent property coverage potentially can help essential businesses reduce losses arising from the closure and/or shutdown of important suppliers and customers. Every affected business should review its policy to determine whether it has such coverage and to understand the potential scope of its coverage. Thereafter, businesses should provide notice of loss, identify potentially covered losses, and track the deadline of the contractual limitations period.