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## Economic Issues in Calculating Damages in COVID-19 Business Interruption Insurance Lawsuits

As the COVID-19 pandemic continues to affect economy activity across the US<sup>1</sup>, a wave of litigation has emerged. Hundreds of lawsuits in federal and state courts across the country are pitting businesses against insurance companies in business interruption insurance coverage cases.<sup>2</sup> Although the specific allegations in these cases vary, in general plaintiffs claim that their insurance policies provide coverage for business income losses due to coronavirus-related interruptions and aim to recover lost profits among other damages.<sup>3</sup> These proceedings include a large number of class actions, with the Judicial Panel on Multidistrict Litigation considering petitions to centralize federal suits.<sup>4</sup> Economic analysis provides a framework that can help courts both estimate the relevant damages at issue and consider the appropriateness of plaintiffs' claims for collective action.

### Economic Analysis to Estimate Lost Profits Due to Business Interruptions

Lost profits due to business interruptions are estimated by comparing the actual world to a world *but for* the business interruption. Profits in the actual world can be observed and measured, for example, by using ordinary course documents such as income statements. The counterfactual but-for profits, on the other hand, are not observed and must therefore be modeled through economic analysis.

When economists model these but-for outcomes, they must first consider whether the insurance coverage at issue is dependent on why business operations were interrupted. For example:

- some businesses may have closed or interrupted operations voluntarily during the pandemic, as a preventive measure for example;
- others may have closed in response to COVID-19 infections among their clientele or their workforce;
- others may have closed or reduced operations due to government directives or civil authority orders to do so; and
- other businesses may have experienced reductions in operations due to lowered consumer activity or difficulties in procuring supplies and inputs through strained supply chains.

A but-for world that assumes a combination of no voluntary closings, no COVID-19 pandemic or infections, no civil regulatory action, and no aggregate reduction in economic activity may not be adequate to estimate damages in these cases. Instead, to the extent the insurance coverage differs based on the reason for the business interruption—due for example to the specific language contained in the insurance contracts—the calculation of economic damages may have to be limited to lost profits causally tied and attributable to only the specific factor or factors covered.

Moreover, the coronavirus pandemic has had and continues to have wide-ranging effects that affect not only the operations of plaintiffs in these cases, but also the behavior of their customers, suppliers, and competitors. Consider for example a dine-in restaurant in Washington, DC that closed on March 16, 2020, due to a government order and reopened on June 22.<sup>5</sup> The restaurant may argue that, but for the government order, it would have remained open during that three-plus-month window and earned profits. However, concurrently to the restaurant closure, there was also a stay-at-home order in place starting on March 30 that could have affected the number of patrons that would have dined at the restaurant had it remained open.<sup>6</sup> Conversely, consider a grocery store in the same city that closed because some of its employees tested positive for COVID-19. Had these employees not fallen ill from the coronavirus and had this grocery store remained open, it would potentially have experienced “windfall” revenues and profits compared to its business-as-usual experience because of increased grocery shopping to eat at home.<sup>7</sup> The business-as-usual performance of the restaurant and the grocery store prior to the pandemic may therefore not be a reliable measure for their performance but for the business interruption.

Whether these windfall profits to the grocery store or the reduced profits to the restaurant—compared to their business-as-usual performance—should be accounted for in the damages calculation may depend on the case-specific fact pattern, including the insurance policy language, or on the application of relevant case law. Previous cases involving business interruptions due to large-scale natural disasters have sometimes awarded policyholders windfall profits that they would have earned had they operated under the specific economic conditions caused by the natural disaster, while in other cases courts have preferred to reject them.<sup>8</sup>

Once the but-for world to be modeled is determined, the next question is *how* to do so. In some cases, the performance of comparable businesses that did not suffer a business interruption could provide a good yardstick to proxy plaintiffs' but-for performance. However, the broad effects of the COVID-19 pandemic may make this type of yardstick comparison more difficult: many businesses have been affected since the start of the pandemic and their experience may not be representative of an appropriate but-for world.

Another approach uses plaintiffs' past performance as a proxy for their performance but for the business interruption. However, projections based solely on past performance may be speculative without an extensive track record to establish a consistent and reliable benchmark, which may not be available for recently opened businesses. In addition, using past performance as a proxy for business-as-usual profits assumes that the economic demand and supply conditions experienced by the policyholder in the past are the same as those that would prevail in the but-for world, absent the business interruption. However, this assumption may not be reliable if economic and competitive conditions have changed over time. For example, a retail clothing store may be facing increased competition and decreased demand due to the opening of competing clothing stores on the same block. In that case, the store's performance before its competitors' entry may not be a reliable benchmark for its but-for performance after their entry.

Regression analysis is one tool that is available to economists which, when carried out reliably, can be used to account for the differences between the benchmark or comparator outcomes and the modeled but-for outcomes. That is, regressions can potentially be used to isolate the effects of the business interruption on outcomes such as profits by controlling for other differences in relevant demand and supply factors. In our retail clothing store example, a properly specified regression could use the store's historical performance to estimate its but-for profits by appropriately accounting and controlling for the effects of increased competition. However, the economic expert using regression analysis to model the but-for world must ensure that all relevant demand and supply factors are properly accounted for. Otherwise, the resulting regression estimates may be biased and unreliable.<sup>9</sup>

## Mitigation

Although but-for outcomes need to be estimated, outcomes such as profits in the actual world are typically observed. However, economic damages in business interruption cases may also depend on the extent to which the policyholder followed appropriate damages mitigation strategies.<sup>10</sup> These can include reductions in operating costs, exploring alternative operating strategies, and seeking and requesting assistance from government programs. In calculating business interruption damages, the economic expert may be asked to assess the plaintiffs' observed mitigation efforts and to determine whether they were optimal or whether superior and more effective strategies were in fact available to plaintiffs.

Faced with lasting reductions in sales or interruptions to their operations, businesses can undertake actions to reduce their operating costs. These efforts may include reducing operating expenses by shutting down machinery and equipment, taking advantage of the interruption of operations to conduct relevant maintenance, decreasing or stopping the purchase of non-storable supplies, furloughing or laying off staff, or renegotiating property rental costs. For example, a restaurant that closed during the pandemic could furlough its staff and/or seek to reach an agreement with its landlord or property owner to reduce the monthly rent due for the expected duration of the closure. Because profits equal revenues minus costs, a decrease in costs can help increase profits—or decrease losses.

Businesses experiencing business interruptions can also explore alternative strategies to operate and thus reduce any losses they may be experiencing. For example, dine-in restaurants can update their menus to tailor them for take-out and carry out focused marketing campaigns accordingly. Wholesalers and distributors that usually cater to restaurants, stores, or other businesses can supply final consumers and residential addresses instead.<sup>11</sup> Other types of businesses may be able to encourage work from home—by providing their employees with the necessary IT support—and foster online operations.

In addition to cost-cutting measures, businesses can seek government assistance whenever available. For example, the federal Coronavirus Aid, Relief, and Economic Security (CARES) Act included a Paycheck Protection Program intended to provide American small businesses with federally guaranteed loans. These loans, with advantageous conditions, could be used to fund payroll and employee benefits costs, mortgage interest payments, rent and lease, and utilities payments. Moreover, the loans can be forgiven under certain conditions, provided the funds are used to cover allowed expenses.<sup>12</sup>

## Predominance

In the case of class actions involving claims related to insurance coverage for business interruptions, the considerations outlined above also need to be analyzed from the point of view of predominance. Under Rule 23(b)(3) of the Federal Rules of Civil Procedure, a class action “may be maintained if [...] the court finds that the questions of law or fact common to class members *predominate* over any questions affecting only individual members.”<sup>13</sup> One of the key issues that economists are asked to opine on is the feasibility of assessing impact and damages using a methodology common to a proposed class. That is, can different class members use the same economic analysis to establish harm and calculate damages?

In the case of damages calculation, this may prove to be difficult. To understand why, let us consider the following example: a putative class action is composed of many different types of retail businesses—including bars, restaurants, grocery stores, and wine and liquor stores—that claim they incurred losses because they had to close during the COVID-19 pandemic.<sup>14</sup> Bars and restaurants likely started seeing losses due to reduced socialization by patrons even before their closure.<sup>15</sup> Because of that, they may prefer to put forward a legal strategy that argues that the relevant but-for world for their damages estimation should be one absent the COVID-19 pandemic. On the other hand, grocery stores and wine and liquor stores may have experienced increased windfall revenues had they stayed open during the pandemic and may as a result prefer to argue for a relevant but-for world in which the pandemic still existed, but plaintiffs did not interrupt operations.<sup>16</sup>

Likewise, a reliable estimation of business income damages for different putative class members may involve the use of different benchmark periods, different yardsticks, or even different regression models. Indeed, members of a proposed class that spans across county or state lines were likely subject to different government orders that may have resulted in business interruptions on different dates, subject to different local economic conditions, and subject to varied pandemic conditions—including testing availability or COVID-19 case counts and growth rates. Estimating damages for a restaurant in New Jersey may therefore require a different economic analysis than estimating damages for a liquor store in Oregon, even if both businesses held policies from the same insurance company. In addition, the determination of whether businesses took advantage of the mitigation strategies that were available to them may require an individualized inquiry into the specific situation of each business. Because the calculation of economic damages stemming from business interruption during the COVID-19 pandemic would need to rely not only on individualized evidence but also on individualized methodologies, class actions brought forward on behalf of policyholders aiming to recover lost profits due to coronavirus-related business interruptions face an uphill battle at the class certification stage. ■

## Notes

1. See <https://edgeworthanalytics.com/state-by-state-continuing-unemployment-insurance-weekly-update/>, <https://www.bea.gov/news/2020/gross-domestic-product-2nd-quarter-2020-advance-estimate-and-annual-update>.
2. See <https://leftcoastlaw.com/cvclassaction-2/>, <https://www.alston.com/en/-/media/files/insights/publications/2020/05/20200526covid19state-and-federal-insurance-litig-r.pdf>, <https://www.law360.com/articles/1297345/6-key-moments-from-the-covid-19-insurance-mdl-hearing>.
3. See e.g., *Bauer Family Enterprises, Inc. v. Ohio Security Insurance Company* (M.D. Fla.); *Billy Goat Tavern I, Inc. et al. v. Society Insurance* (N.D. Ill.); *Mudpie, Inc. v. Travelers Casualty Insurance Company of America* (N.D. Cal.); *Beniak Enterprises, Inc. v. Chubb Ltd et al.* (D. N.J.); *Blue Springs Dental Care et al. v. Owners Insurance Company* (W.D. Mo.); *Glow Medispa v. Sentinel Insurance Company* (W.D. Wash.); *Troy Stacy Enterprises Inc. v. The Cincinnati Insurance Company* (S.D. Ohio).
4. See <https://www.law360.com/articles/1295746/jpml-questions-if-one-size-fits-all-for-virus-cases>, <https://www.law360.com/articles/1297345/6-key-moments-from-the-covid-19-insurance-mdl-hearing>.
5. <https://www.cnn.com/2020/03/16/politics/coronavirus-washington-dc-closures/index.html>; <https://mayor.dc.gov/release/mayor-bowser-announces-phase-two-begins-monday-june-22>.
6. <https://coronavirus.dc.gov/release/mayor-bowser-issues-stay-home-order>
7. See <https://www.uschamber.com/co/start/strategy/coronavirus-successful-businesses>.
8. See <https://www.law360.com/articles/966260/economy-conditions-complicate-business-interruption-claims> for a summary of existing caselaw involving contested insurance claims for business interruption due to natural disasters.
9. See e.g., American Bar Association Antitrust Section, “Econometrics: Legal, Practical and Technical Issues,” 2<sup>nd</sup> Edition, 2014, Section 5.C.
10. See Mark A. Allen, Robert E. Hall, and Victoria A. Lazear, “Reference Guide on Estimation of Economic Damages,” Section VII, in Reference Manual on Scientific Evidence, Third Edition, Federal Judicial Center, 2011. Available at <https://www.fjc.gov/sites/default/files/2012/SciMan3D10.pdf>.
11. <https://www.nytimes.com/2020/03/18/dining/baldor-specialty-foods.html>; <https://wtop.com/business-finance/2020/04/food-distributor-baldor-opens-online-delivery-to-homes-in-dc-suburban-maryland/>.
12. See <https://www.sba.gov/funding-programs/loans/coronavirus-relief-options/paycheck-protection-program>.
13. [https://www.law.cornell.edu/rules/frcp/rule\\_23](https://www.law.cornell.edu/rules/frcp/rule_23), emphasis added.
14. Putative class actions alleging insurance coverage for business interruption often involve nationwide classes composed of many different types of businesses that allegedly held similar insurance policies. See e.g., *Beniak Enterprises, Inc. v. Chubb Ltd et al.* (D. N.J.); *Blue Springs Dental Care et al. v. Owners Insurance Company* (W.D. Mo.); *Glow Medispa v. Sentinel Insurance Company* (W.D. Wash.); *Troy Stacy Enterprises Inc. v. The Cincinnati Insurance Company* (S.D. Ohio).
15. <https://edgeworthanalytics.com/the-economic-consequences-of-coronavirus-the-restaurant-industry/>
16. <https://www.uschamber.com/co/start/strategy/coronavirus-successful-businesses>

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