FRIED FRANK

To Our Clients and Friends

Memorandum

March 25, 2020

COVID-19 Pandemic: Business Interruption Insurance Issues

The COVID-19 pandemic has already caused a major disruption of business activity both in the United States and abroad. With workers and consumers alike directed to "stay at home" and "shelter in place," many businesses have either shuttered completely or are experiencing significant reductions in revenue as a result. Stakeholders and policymakers are naturally asking whether existing "business interruption" insurance policies could help mitigate the economic fallout. The answer for any business will depend on the specific language of the policy at issue as well as the governing law and the facts and circumstances applicable to the particular company. Perhaps unsurprisingly, insurance companies have already taken the position that business interruption claims based on the COVID-19 pandemic are *not* covered.

Business Interruption Insurance Generally

Business interruption insurance is typically offered as part of a broader property insurance policy. In a standard business interruption insurance provision, the insurer agrees to cover losses resulting from an interruption in normal business operations caused by "direct physical loss or damage" to the insured's covered property resulting from a "covered peril," such as a fire, earthquake or theft. Of course, the terms and conditions of insurance coverage can vary widely, and a claimant's entitlement to relief will depend on the specific facts, the language of the policy and the governing law.

The Physical Damage Requirement

While courts interpreting the physical damage requirement do not necessarily require structural damage to the building, they have been more likely to find "physical damage" if there has been some presence—whether tangible or intangible—of the peril *on the premises*. For example, actual contamination by harmful chemicals, odors or bacteria *may* be sufficient to show "physical damage" in the context of business interruption insurance. Thus, absent specific exclusions in the insurance policy for infectious diseases or other contaminants or pollutants (discussed further below), businesses that can provide evidence of *actual exposure* to the COVID-19 virus on the premises may be able to recover for certain losses, such as net income lost during the time required to sanitize or otherwise make the premises safe to resume normal business operations.

At the same time, purely economic losses in the absence of physical damage typically are not covered. The Southern District of New York has held in cases following the 9/11 terrorist attacks that "physical" damage is required even where the policy itself only used the word "damage." It remains to be determined whether, in the context of the current COVID-19 pandemic, where the vast majority of businesses shut down or altered or decreased operations *preemptively* (either on their own or as a result

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of government mandates) so as to avoid exposing their employees and customers to the virus, such businesses might obtain reimbursement for resulting losses.

In most cases, these issues likely will not be resolved without litigation. Of note, in a joint response to a letter from a bipartisan group of members of the U.S. House of Representatives, four leading insurance industry trade organizations stated explicitly that business interruption policies "do not, and were not designed to, provide coverage against communicable diseases such as COVID-19."

Businesses should also note that, while physical damage is a prerequisite for business interruption claims, such claims are *not* dependent on businesses also having filed claims for property damage.

Damage to Nearby Properties

Where actual exposure to COVID-19 occurs at a nearby property that is not otherwise covered under the insured's policy, the availability of coverage for a resulting business interruption will depend on the language of the policy and the governing law. Some insurance policies expressly require that the physical damage causing the business interruption be to property that is "covered" under the property section of the policy. Where the policy is silent, courts may consider whether the interrupted business and the damaged property are "mutually dependent." For example, losses attributable to decreased patronage at a hotel as a result of damage to a restaurant on the premises that was not covered under the insured's policy was found *not* to be compensable whereas damage to an uninsured structure that caused a decrease in the business's production capacity *and* earnings was found to be covered. Additional exclusions and limitations may apply.

Policy Exclusions

Following the outbreak of severe acute respiratory syndrome ("SARS") in 2003, many insurers began to specifically exclude infectious diseases from coverage. Similar exclusions for "pollutants" or "contaminants" may also be broadly applied to bar recovery for COVID-19-related losses. Businesses should closely examine the terms of their policy to determine whether these or other exclusions may apply. Notably, some policy riders exclude "bacterial" infection but not necessarily "viral" infection.

The Cessation of the Business Requirement

Another issue for any potential claim under a business interruption clause relates to the scope and duration of the "necessary suspension of operations." The modern trend in business interruption policies is to cover both slowdowns and the complete cessation of business, although courts in some jurisdictions (including New York) have held that, in the absence clear defined terms, claimants must show a total interruption of the business. Businesses should note, however, that mere diminished production capacity in the absence of a demonstrable loss of earnings may not be compensable.

Damage by Order of Civil Authority

There is also a question of whether a policy holder may recover for losses due to a business interruption caused by a governmental order, such as the mandatory shutdown and quarantine orders as well as limitations on group gatherings implemented by many states in response to COVID-19. So-called "civil authority" coverage may be available where expressly stated in a separate provision from or as an extension of the standard business interruption clause, but may still be subject to a physical damage requirement (as described above).

Potential Legislative Action

It has been reported that lawmakers in New Jersey were in discussions with insurance carriers regarding a bill to retroactively expand business interruption insurance to cover losses attributable to the COVID-19 pandemic for New Jersey businesses with fewer than 100 full-time employees. It is too soon to know whether New Jersey or other state or federal lawmakers will actually enact this or other legislative solutions, whether larger businesses would be included, or whether such laws will be able to withstand judicial scrutiny.

Conclusion

As discussed, there are many factors affecting the likelihood that damages attributable to the COVID-19 pandemic would be covered by existing business interruption insurance policies. Businesses should consult counsel, carefully review the specific terms of their policy as well as the law in the relevant jurisdiction to determine whether they have a valid insurance claim, and expect that such claims will face staunch opposition from insurance companies.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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