

## **COVID-19 AND COMMERCIAL PROPERTY INSURANCE: COVERAGE CONSIDERATIONS REVISITED**

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As expected, the financial impact of COVID-19, or the “coronavirus”, has been far-reaching and will likely to continue to grow as travel restrictions, mandatory closures, and “stay-at-home” orders persist and continue to be extended in the United States and across global markets. This paper addresses insurance coverage issues that have begun to arise due to the COVID-19 pandemic.

Insurance claims stemming from COVID-19 under commercial property insurance policies can take many forms, from cleaning a contaminated structure to mere inability to access a business that has been otherwise unaffected by the virus. Each type of claim warrants individual consideration and treatment. This paper focuses on common issues in claims for business interruption.

### **BUSINESS INCOME LOSS / EXTRA EXPENSE - REQUIREMENTS**

Merely experiencing financial loss does not automatically equate to a covered claim. Under a typical commercial property policy, two (2) requirements must be met in order to recover for a loss of business income. First, the insured property must sustain direct physical loss or damage. Second, the damage must be caused by a peril insured under the policy that is not otherwise excluded. Business Income (And Extra Expense) Coverage Form CP 00 30 10 00 reads:

We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit Of Insurance is shown in the Declarations.

Under this language, business income coverage is triggered only if the property first sustains direct physical loss or damage to the insured premises as a result of a covered cause of loss.<sup>1</sup> In Pennsylvania, for example, courts have interpreted the term “physical loss or damage” to include a loss of utility resulting from a structure being made useless or uninhabitable due to contamination.<sup>2</sup> While a preemptive business suspension or closure due to absent/sick employees is unlikely to constitute “direct physical loss or damage”, insurers may be faced with issues concerning the cost of mitigation and loss prevention efforts if the policy affords such coverage.<sup>3</sup>

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<sup>1</sup> See *Roundabout Theatre Co. v. Cont'l Cas. Co.*, 302 A.D.2d 1 (N.Y. App. Div. 2002) (ruling direct physical loss requirement not met where access to the policyholder’s theatre was denied due to street closure); see also *Southeast Mental Health Ctr. Inc. v. Pac. Ins. Co.*, 439 F. Supp. 2d 831 (W.D. Tenn. 2006) (power outage not considered direct physical loss).

<sup>2</sup> See *Motorists Mut. Ins. Co. v. Hardinger*, 131 Fed.Appx. 823 (3d Cir. 2005).

<sup>3</sup> Ultimately, it will be the policyholder’s burden to prove the existence of a loss within the policy’s initial grant of coverage. See *Doherty v. Allstate Indem. Co.*, 2017 U.S. Dist. LEXIS 52795 (E.D.Pa. April 6, 2017).

Further, while courts vary in their approach, a different result might be reached if an infected employee/patron brings COVID-19 onto the insured premises. If the insured premises is deemed unusable due to the physical presence of the virus, an argument for business interruption could exist for the period of restoration (the period of time to de-contaminate the premises).<sup>4</sup> Following prior epidemics such as SARS in 2003, Ebola in 2014, and Zika in 2015, coverage was often limited by operation of specific exclusions relating to viruses and biological contaminants. Under traditional property policy forms, losses related to COVID-19 may well be barred or limited. However, businesses could potentially obtain broader coverage through specific endorsements or manuscript policies.

## **CIVIL AUTHORITY – BUSINESS CLOSURES**

Countless government orders have been put into effect prohibiting operation of “non-essential” businesses and directing citizens to stay at home unless absolutely necessary. With regard to these closures, commercial policies may contain the following provision concerning Civil Authority Coverage:

We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss.<sup>5</sup>

Civil Authority Coverage is intended to apply where access to a policyholder’s property is prevented or prohibited due to an order issued by a civil authority.<sup>6</sup> Policyholders may be entitled to recover a loss of business income under this provision if the loss: (1) is caused by an action of civil authority; (2) involves prohibited access to the policyholder’s property; (3) is caused by direct physical loss of or damage to property other than the policyholder’s property; and, (4) the loss or damage to property is caused by a loss covered under the policy.

When analyzing Civil Authority claims, it is important to quantify and understand the nature of the physical damage (e.g. property damage vs. exposure to the virus), whether the policy contains temporal or geographic limitations, whether the order completely bars access or merely limits it, and whether the event triggers coverage. Historically, determining whether an action of a civil authority is due to “property damage” has led some courts to engage in intellectual gymnastics.<sup>7</sup> For example, in the context of hurricane evacuations, courts have generally been reluctant to find direct physical loss where evacuation orders were issued due to fear of property damage, as

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<sup>4</sup> See *Travco Ins. Co. v. Ward*, F. Supp. 2d 699 (E.D. Va. 2010), aff’d, 504 F. App’x 251 (4th Cir. 2013)(finding coverage where sulfuric gas rendered the building unusable); see also *Motorists Mutual Ins. Co. v. Hardinger*, 131 Fed. Appx. 823 (3d Cir. 2005)(water contamination of a well constituted direct physical loss where occupants of the house became ill and house was rendered unusable).

<sup>5</sup> Business Income (And Extra Expense) Coverage Form, CP 00 30 10 00, p. 2 of 8

<sup>6</sup> See Clark Schirle, *Time Element Coverages in Business Interruption Insurance*, 37 *The Brief* 32, 38 (2007).

<sup>7</sup> Compare *S. Tex. Med. Clinics, P.A. v. CNA Fin. Corp.*, 2008 U.S. Dist. LEXIS 11460 (S.D.Tex. Feb. 15, 2008) with *Assurance Co. of Am. v. BBB Serv. Co.*, 593 S.E.2d 7 (Ga.Ct.App. 2003).

opposed to actual property damage.<sup>8</sup> While it is an open question, by comparison to hurricane evacuations, an argument can be made that Civil Authority Coverage does not apply where a business is forced to close solely as a result of the fear of spreading COVID-19.

Similarly, Civil Authority Coverage may be inapplicable where travel or restrictions on imports results in a loss. *Source Food Tech., Inc. v. United States Fid. & Guar. Co.* involved a civil authority order prohibiting importation of ruminant products from Canada to protect against the spread of Mad Cow Disease. The policyholder was unable to fill its orders and presented a claim for business income loss based, in part, on the Civil Authority Coverage. The Court ruled that the policyholder's inability to transport its product did not constitute direct physical loss.<sup>9</sup>

While traditional policies may not afford Civil Authority Coverage for orders relating to a pandemic response, ISO has already released optional endorsements for business interruption due to civil authority orders relating to COVID-19.

### **SUPPLY CHAIN ISSUES – CONTINGENT BUSINESS INTERRUPTION**

Financial losses due to supply chain interruptions, shortages in raw materials or decreases in labor and production impacting other businesses that supply, or purchase products from, the a policyholder may be compensable.

While the requirement of direct physical loss still exists, Contingent Business Interruption (“CBI”) Coverage is intended to cover these types of supply chain disruptions.<sup>10</sup> This coverage is triggered by physical loss or damage from an insured peril sustained by a customer or supplier, which results in a loss of a dependent customer or inability to obtain materials needed to produce the insured's product.<sup>11</sup> A related (but important) issue involves the extra expense associated with sourcing products from alternative suppliers and the increased cost of delivery – particularly in light of port restrictions and shipping delays.

In the event of a supplier's shut down, investigation into whether the shutdown was due to fear of the spread of the virus or the actual physical presence of the virus should be conducted. Coverage will also depend on how closely connected the supplier is to the insured's business, as many CBI endorsements require a direct relationship between the insured and the supplier.<sup>12</sup> Others will specifically define what constitutes a “dependent property.”<sup>13</sup> Finally, the direct physical loss required in the CBI endorsement will likely have to be caused by a covered peril.<sup>14</sup>

As with all claims stemming from the COVID-19 pandemic, detailed review of the policy will be necessary, including whether the policy is a named peril versus an all risk policy, and whether any applicable exclusions, sublimits, or deductibles apply.

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<sup>8</sup> *S. Tex. Med. Clinics, P.A. v. CNA Fin. Corp.*, 2008 U.S. Dist. LEXIS 11460, \*31 (S.D.Tex. Feb. 15, 2008).

<sup>9</sup> 465 F.3d 834 (8th Cir. 2006).

<sup>10</sup> See *Source Food Tech*, 465 F.3d 834 at 838.

<sup>11</sup> See *Penton Media, Inc. v. Affiliated FM Ins. Co.*, 245 Fed. Appx. 495 (6th Cir. 2007).

<sup>12</sup> See *Millennium Inorganic Chems. Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburg*, 744 F.3d 279 (4th Cir. 2014).

<sup>13</sup> See e.g., *S. Hospitality, Inc. v. Zurich Am. Ins. Co.*, 2003 U.S. Dist. LEXIS 18325 (W.D.Okla. Sept. 30, 2003).

<sup>14</sup> *Id.*

## COMMUNICABLE DISEASE ENDORSEMENTS

Insurance policies may contain additional coverage for communicable diseases. Additional coverage for loss of business income during the period of restoration can include the costs incurred to test, disinfect, and cleanup property. The terms of the additional coverage must be read closely, as the coverage may only apply in limited circumstances. For example, in *Catholic Med. Ctr. v. Fireman's Fund Ins. Co.*, the additional coverage for communicable disease required direct physical loss or damage at the insured premises.<sup>15</sup>

## CONCLUSION

COVID-19, and other “pandemics,” present novel coverage questions. Understanding the mechanics of the loss, the specific nature of the damage, and state-specific legal interpretations of various policy provisions that may afford coverage are essential steps when navigating a business interruption claim relating to coronavirus.

Timone Knox’s Insurance Industry Group prides itself on being at the forefront of developing issues in the insurance industry. If you would like additional information concerning this or any other issue, please do not hesitate to contact us.

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<sup>15</sup> 2015 U.S. Dist. LEXIS 70450 (D.N.H. 2015).