

# Coronavirus: Factors for the Insurance Industry to Consider – Part 1 Business Interruption



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Wednesday, February 26, 2020

Coronavirus, recently named “COVID-19” by the World Health Organization, presents like a Hollywood disaster movie:

- It appears to be a mutated virus
- There is no available vaccination
- More than 50 million people in China have been quarantined, more than 60,000 people are infected and more than 1,700 people are dead
- Global businesses operating in affected zones in China have shut down or significantly restricted operations
- Health experts project this outbreak may not peak until April 2020.

Given the risk to life and the economic impact of coronavirus, policyholders and the insurance industry alike are watching and considering whether business interruption or event cancellation insurance benefits may be available while similarly assessing liability risks. **This three-part series will cover specific aspects of insurance that all stakeholders - insured, insurers and brokers - should consider.**

## **Coronavirus: Status and Impact**

Coronavirus is believed to have originated at a market in Wuhan, China, that sold animals for human consumption. Reports from China tell us that since its discovery in late December 2019, more than 70,000 people have been infected with the coronavirus, resulting in more than 2,400 deaths. Outside of China, there have been some 1,700 cases in 28 nations according to the World Health Organization, which has declared coronavirus a global health emergency. In the United States, the Centers for Disease Control and Prevention report at least 35 confirmed cases.

International travel has been curtailed, national borders have been closed and millions have been quarantined. Americans evacuated from Wuhan, the epicenter of the virus, are being isolated on military bases as a precautionary measure. Americans boarded two flights chartered by the State Department and headed to the United States after the number of coronavirus cases aboard the Diamond Princess cruise ship docked in Japan grew to 690. Of those Americans, 36 have so far tested positive for the virus and are in quarantine. Global businesses such as Intercontinental Hotels Group, Hilton, Starbucks and McDonald's have shuttered many locations. Disney may face a \$280 million loss. The cessation of business operations is likely to affect China's role in the global manufacturing supply chain. For example, iPhone manufacturer Foxconn has stopped nearly all of its Chinese production and Apple has said it will not meet its quarterly guidance based on supply chain disruptions.

**In this first part of the three-part series, we will review Business Interruption factors that insurance stakeholders should consider when claims under these policies are brought forward.**

## **Business Interruption Insurance**

### *Designated Peril Requirement*

Commercial businesses often procure business interruption coverage as part of their commercial property coverage. Business interruption coverage is designed to assist policyholders that suffer financial losses in their operations, generally arising from a designated cause such as fire or earthquake. If the insurance policy requires a designated cause of loss, but the loss does not qualify, coverage for business interruption will generally not be available.

### *Direct Physical Loss*

Commercial property policies also typically require "direct physical loss" to the property and proof of causation. In the event of a claim for coronavirus-related business interruption, questions may arise as to whether this "physical loss" requirement has been met. In particular, in circumstances where a business has been closed as part of a mandatory or voluntary closure – but is otherwise still habitable and uncontaminated – it has probably not suffered a direct physical loss since infectious diseases arising from human-to-human transmission generally will not qualify as property damage.

Broadly, "direct physical loss" does not include consequential or resulting economic loss.

In contrast, if a property has become physically contaminated and uninhabitable due to coronavirus, there may be a basis for a policyholder to claim that a direct physical loss has occurred. For example, if a person is infected via contact with tangible property (such as while on board a cruise ship, visiting a doctor's office or flying on an airplane), the contamination of physical property may qualify as direct physical loss to property. However, prophylactic measures to protect against future contamination, or shutdown due to fear of contamination, generally will not qualify as direct physical loss to property.

A decision from the Eighth Circuit Court of Appeals explains the "direct physical loss" requirement. In *Source Food Tech., Inc. v. U.S. Fidelity & Guar. Co.*, No. 06-1166 (8th Cir. Oct. 13, 2006), the insured argued that the closure of the U.S. / Canada border to its imported beef product due to "mad cow" disease concerns qualified as "direct physical loss" since it was unable to transport its product. The Eighth Circuit disagreed, finding that Source Food's inability to transport its beef product across the border did not constitute product that was physically contaminated or damaged, and to hold otherwise would render the word "physical" meaningless.

Given numerous health crises over the past few decades, insurers have added various exclusions designed to preclude coverage. Some are virus-specific – such as exclusions for Ebola or Bird Flu – while others may apply generally to property damage arising from bacteria or viruses.

It is unlikely that the coronavirus will allow for a one-rule-fits-all conclusion when it comes to a determination of whether an insured has suffered a direct physical loss. Rather, it is more likely that each claim will be investigated and evaluated based on the specific facts.

#### *Contingent Business Interruption*

Other policies may provide *contingent* business interruption coverage arising from disruptions with a supplier or customer, while still requiring that the underlying cause fall within a designated cause of loss and arise from direct physical loss to property – similar to the policyholder's own coverage for a first-party loss. For businesses dependent on supply chain production, contingent business interruption coverage often provides coverage when a supplier suffers a direct physical loss to its property that impairs its ability to provide delivery of goods or materials. Insureds in the manufacturing, hospitality and health care businesses are some of the more common policyholders for this product line.

Of note, many contingent business interruption insurers require that affected suppliers be identified or scheduled in the insured's policy in order for coverage to exist. Contingent business interruption policies are also likely to include the same exclusions found in a standard form first-party policy.

### **Specialized Business Interruption**

While traditional policies may not cover economic losses arising from the suspension of operations due to a health crisis or pandemic, the insurance industry has made various specialized products available.

*Hospitality and Health Care – for Communicable and Infectious Diseases*

The insurance industry offers specialized coverage arising from the shutdown of operations, in some circumstances without requiring physical loss to property. These policies or policy endorsements primarily focus on insureds in the business of health care and hospitality and typically extend insurance coverage for business interruption losses caused by “communicable or infectious diseases.”

#### *Pandemic-Specific Coverage or Exclusions*

Pandemic “scars” have prompted the insurance industry to offer specialized coverage and exclusions for pandemic events.

In May 2018, for example, it was reported that Marsh, in collaboration with Munich Re and epidemic risk modeler Metabiota, had launched PathogenRX, a fully integrated pandemic coverage product:

“Using triggers like Metabiota’s new Pathogen Sentiment Index, which provides extensive analytics into infectious disease outbreaks, businesses can model their potential financial loss from an outbreak and protect against the threat through an insurance policy underwritten by Munich Re. The policy is customizable and can be tailored to provide coverage for specific expenses, geographies, types of disease, or portions of a calendar year.” *Insurance Journal* (May 22, 2018).

In response to the Ebola crisis, several insurers expressly excluded coverage for Ebola-related claims. Other insurers, however, offered specific business interruption coverage to facilities such as hospitals, hotels, airports, shopping centers, restaurants, theaters and gyms or any other business that might be forced to shut its doors because of an Ebola outbreak.

#### *Civil Authority Coverage*

Other policies extend business interruption coverage for losses arising from “civil authority” orders that impair or prohibit access to an insured’s property. The scope and limitations of business interruption coverage under such endorsements vary and can be issued pursuant to an insurer’s standard form endorsement, and they can vary based on whether a “direct physical loss” will be required. Insurers also may issue Civil Authority Coverage on a manuscript basis (custom designed for a particular insured), addressing specific needs based on expenses, geography, disease, calendar year, voluntary or mandatory orders, direct physical loss, a designated risk or other criteria.

## **Conclusion**

To prepare for the potentially catastrophic impact of a global pandemic or similar health crisis, policyholders and insurers should review Business Interruption and Specialized Business Interruption policies to determine:

- If they are sufficient
- What new exposures and risks are present given the unique nature of the coronavirus
- Which current policyholders are likely impacted most

- The size, scope and nature of earlier claims and what they may indicate
- The process to triage claims to ensure they are handled in the best interest of all stakeholders.

The risk of a global pandemic with catastrophic consequences seems to grow more prevalent every few years. To prepare for the catastrophic impact of a global pandemic, insureds, insurers and brokers must understand what is and is not covered under such policies, and should work together to minimize *potential* losses by evaluating *potential* claims as early as possible.

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**Source URL:** <https://www.natlawreview.com/article/coronavirus-factors-insurance-industry-to-consider-part-1-business-interruption>