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Business Interruption Insurance and the COVID-19 pandemic

This paper supports a webinar delivered by Rory Cochrane and John Platts-Mills on 7th May 2020.

This paper considers a number of issues that are likely to arise in the context of the COVID-19 pandemic. It does not, of course, constitute legal advice and should not be construed as such.

The paper is structured as follows:

A. business interruption insurance and damage to property;
B. contamination exclusions;
C. causation; and
D. issues arising from various policy extension wordings.[1]

A) What constitutes "property damage" for the purpose of business interruption insurance policies?

Business interruption policies are generally purchased as extensions to property damage policies. The core cover under the BI policy can be tied to the cover provided under the property damage policy by a 'material damage proviso' though this feature is perhaps less common now than it was in the past.

If the underlying property damage policy has been triggered, business interruption losses arising as a result of the property damage are covered (subject to the policy terms); if the property damage policy is not triggered, there is no cover under the business interruption policy, subject to the existence of broader cover by way of extensions (addressede below).

The first question under the BI core cover is, has there been property damage and, if so, in what form?

Close attention must be paid to the policy wording, though many definitions require physical damage. Some definitions may respond to "damage" in the form of loss of use and is a very important distinction. However, focusing on the main form of cover for "physical damage", what might qualify as physical damage in this context?

A number of insurance cases have clarified what does and does not constitute physical damage, when such damage is barely perceptible:

- ***Quorum v Schramm*** [2002] 1 Lloyd's Rep 2492, the issue was whether there was '*direct physical damage'* to Degas' La Danse Grecque following its exposure to smoke from a fire. Thomas J accepted the underwriters' contention that there was no indemnity in respect of any stigma attaching to the picture as a result of it having been in the fire at the warehouse. However, the Judge accepted evidence that there had been '*sub-molecular change [giving] rise to the shortening of the life of the pastel and the risk of deterioration'* (at [91]). This amounted to direct physical damage, 'even though it might not be visible and its extent

[1] On 11 June 2020 the FCA issued the Covid-19 test claim, the focus of which is upon such extensions: FCA Website

could not be determined without testing which could not be carried out because of its effects on the pastel.' (at [90])

- ***Tioxide Europe Ltd v CGU International Insurance Plc*** [2004] EWHC 2116 (Comm) [2005] Lloyd's Rep. I.R. 114, Langley J: accepted that '*"physical injury" to tangible property would normally extend to an* ***unwanted physical change in the relevant subject matter*** *even if the change was not permanent or irreparable, provided it did impair the value or usefulness of the subject.*' (at [43]). Accordingly, change to pigment which caused discoloration of PVC doors and window frames was physical damage.

These decisions might be contrasted with ***Pilkington United Kingdom Ltd v CGU Insurance plc*** [2004] 1 Lloyd's Rep IR 891. This claim arose out of the installation of heat-soaked toughened glass panels manufactured by Pilkington and installed in the roof of the Eurostar Terminal at Waterloo, a small number of which (at most 13 out of some 3000 panels) proved defective in that they fractured in situ. However, the policy did not cover liability for damage to the panels themselves, it required damage to surrounding property. Importantly, there wasn't '*any damage to the fabric of the terminal other than the fractures in the panels themselves'*. Eurostar had installed safety features, to prevent damage that might otherwise have been caused by further fractures or failures of the panels. Potter LJ, observed that '*generally speaking,* ***damage requires some altered state****, the relevant alteration being harmful in the commercial context*'. Since there was no physical harm caused to the surrounding property the policy did not respond.

There are several cases in which property adversely affected by a dangerous or deleterious substance has been held to be physically damaged (the extent to which this may be regarded as 'contamination' we will come back to), in the absence of an '*altered state'* even, at a sub-molecular level.

In ***Jan de Nul (UK) Ltd v AXA Royale Belge SA*** [2002] 1 Lloyd's Rep 583 the defendant appellant caused silt to be deposited on land occupied by the third-party claimant. The defendant was insured by AXA against third-party liabilities in tort, but not contract. The court held that the deposit of silt was a form of physical interference with the third parties' land, sufficient to give rise to liability in tort. The cost involved in removing the silt was accordingly recoverable.

Further guidance can be derived from decisions in the field of tort. In ***Rothwell v Chemical & Insulating Co. Ltd*** [2008] 1 AC 281, Lord Hoffmann, when reviewing the property damage authorities raised in the course of argument in that appeal, captured the essence of physical damage for the purpose of a claim for negligence:

> **"Damage in this sense is an abstract concept of being worse off, physically or economically, so that compensation is an appropriate remedy."**

The focus on "being worse off, physically", rather than a need for an "altered physical state" can be seen in a line of tort cases concerning property damage:

- ***Losinjska Plovidba v Transco Overseas Ltd (The Orjula)*** [1995] 2 Lloyd's Rep 395 per Mance J at 398 – 399: in which a layer of hydrochloric acid lying on part of a vessel's deck, which was not in any way altering the physical integrity of the deck, was held to have caused property damage. The leaked acid required cleaning to remove it before the vessel could be unloaded. Mance J found that this was an "***injury impairing value and usefulness"*** of the vessel, sufficient to amount to physical damage – there was a "***need for work and the expenditure of money to restore the property to its former usable condition***".
- In ***Skandia Property (UK) Ltd v Thames Water Utilities Ltd*** [1999] BLR 338, the court expressed the view, obiter, that the cost of reinstating property in the absence of evidence of actual damage caused by a flood might be allowed where it would be impractical to obtain the necessary evidence to establish damage and it would be "*reasonable to assume that physical damage had been incurred*". It is arguable that this goes beyond a simple finding of damage on the evidence, it may provide a basis for arguing that in the case of coronavirus, inferences can be drawn as to the presence of the virus within premises, particularly if those premises were frequented by numerous people.
- ***Network Rail Infrastructure Limited v Simon Handy*** [2015] EWHC 1175 concerned a number of issues in negligence including the leaving of vehicles on the rail network, Mr Justice Akenhead observed:

> *" In my judgment and following from the above, property can be damaged for the purposes of negligence where the breach of duty* ***results in substances or physical things being deposited on the property in question in more than a de minimis manner such that the property cannot be used or enjoyed as it otherwise would or could be if the substances or physical things had not been so deposited****. "*

What these property damage cases show is that property can be damaged where it is rendered less useful or valuable by some physical effect. A reduction in the value or usefulness of property and/or the need for expenditure to remedy adverse physical changes are relevant factors when assessing whether an insured is "*worse off*" as a result of physical changes affecting his property.

Application to the Coronavirus

The evidence to date suggests that COVID-19 can be spread by transfer, with suggestions that the virus may endure for a number of days depending on the particular material.

Take the following scenario, a number of employees working on the production line at a factory packaging food report symptoms or are reported to be exhibiting symptoms by their co-workers. The company responds by shutting down the factory to undertake a deep-clean. We assume for current purposes that the lockdown does not directly affect this factory, since it is an essential business manufacturing food.

What issues are likely to arise as to the extent of cover that may be available under a BI policy which responds to business interruption caused by "*physical damage*"?

First, can the policyholder prove that the insured premises was physically effected by corona virus? In cases where insured premises are shut as a result of diagnosed cases of Covid-19, it may be relatively straightforward to prove the presence of coronavirus on the premises requiring cleaning.

In cases where there are merely reports of symptoms, the court may fairly readily draw the same conclusions.

However, other cases, involving more precautionary closures may be more difficult to prove.

A more extreme case might involve a policyholder seeking to prove physical damage in premises that were closed in response to the lockdown. For example, a restaurant in a shopping centre might seek to infer the presence of the virus from the fact that a certain proportion of its customers or workers were likely to have been infected. Expert evidence might support such a conclusion.

It might be that as things develop it becomes apparent that the risk of transmission by transfer, particularly in relation to particular materials is de minimis, which might lead to an argument by insurers that the principle of *de minimis non curat lex* applies so as to preclude a finding of property damage. This is an interesting and developing area of law.[2]

B) Contamination Exclusions

In the context of potential claims caused by the presence of virus on insured premises, a further issue likely to arise is the effect of pollution and contamination exclusions. When describing property as being adversely affected by a dangerous or deleterious substance, it might be challenging to avoid the conclusion that the property has been "*contaminated*", depending on policy definition/context

That was the word considered (in other contexts) by the High Court in ***D Pride & Partners (A Firm) v Institute for Animal Health*** [2009] EWHC 685 (QB) in the context of claims flowing from the foot and mouth outbreak in 2009 and by the Court of Appeal in ***Wood v TUI Travel Plc (t/a First Choice)*** [2017] EWCA Civ 11 when addressing the presence of bacteria.

However, we can expect these decisions will come under closer scrutiny in the context of pandemic claims, depending on the precise wording of such exclusions. In the case of exclusions which appear to be directed towards excluding environment pollution the position may well be debatable. This applies with special force if the exclusion would deprive a disease extension of all material effect if it was construed as applying to contamination in a more general sense.

[2] It remains to be seen whether a policyholder's claim emerges to test the limits of what qualifies as physical damage.

C) Causation Issues

Causation may be a challenging issue for policyholders. Even if property damage can be established, or liability can be established under a clause that covers losses other than from physical damage, complexities arise where losses are suffered over a wide geographical area affecting a large number of businesses, or indeed businesses and the economy generally. There are other incidents that fall into this category, typically natural disasters such as hurricanes or earthquakes, but a similar point of principle applies to a pandemic. These issues arises in at least two contexts.

First, business interruption policies are drafted to provide cover for losses arising out of "damage" following an "incident" which causes business interruption with consequent decline in turnover and therefore loss. Even assuming that it is accepted that the presence of the SARS 2 coronavirus has caused "damage" to property, can it be said that the losses suffered by an insured are losses caused by the damage to property itself, or are they instead losses caused by the consequences of the wider incident?

For example, assume a restaurant makes a claim on a BI policy alleging that the presence of coronavirus has caused "damage" to property, which required the restaurant to close. Assume that at the same time, authorities have implemented restrictions preventing the general population from leaving home. Is the downturn suffered by the restaurant attributable to the presence of coronavirus in the restaurant, or to the wider actions of the authorities in preventing customers from patronising it?

Second, issues also arise in the application of formulae that provide for the calculation of losses. The approach required by business interruption policies is typically to calculate the standard turnover of a business (being the "reference" turnover earned in the same calendar period of the prior year), and then to subtract the actual turnover in the indemnity period to calculate the loss. This calculation of the standard turnover however is typically subject to a "*trend clause*" - a clause which operates to adjust the standard or reference turnover that it is assumed the business would have earned but for the business interruption.

The decision in ***Orient-Express Hotels Limited v Assicurazioni Generali Spa*** **(UK)** [2010] EWHC 1186 (Comm), illustrates the point in the context of Hurricanes Rita and Katrina in the United States. The English High Court determined that the profits of a severely damaged New Orleans hotel would have fallen in any event due to hurricane damage to the wider area, and not as a result of physical damage to the insured property. Even had the hotels been unaffected by the hurricanes, turnover would have decreased in any event due to the fact that the demand for hotels was depressed by the aftermath of the hurricanes.

One often overlooked feature of the decision in ***Orient Express*** is that insurers agreed to pay - and had paid - the hotel operator's losses under extensions of the policy for denial of access and loss of attraction. The payment of these claims (which were subject to lower limits) arguably involved a logical inconsistency with the outcome and reasoning adopted by the Court when considering the disputed claim. This aspect of the case is sure to come under scrutiny in the context of pandemic claims.

In any event, there was some dissatisfaction with the result in ***Orient Express*** in the market. This resulted in more astute policyholders and brokers seeking cover for loss "*resulting from the Incident*" rather than loss "*resulting from the Damage*" to the insured property.

The decision in ***Orient-Express*** is sure to come under pressure in the current climate and attempts can be expected to distinguish any policy wording which arguably covers the wider effects of an incident. Its effect, whilst strictly logical in terms of the literal wording of the policies, runs contrary to a more "*common sense*" view of losses intended to be covered by such policies, as would be understood by the average policyholder and, perhaps, by the courts. We consider that this issue is likely to trouble the Supreme Court sooner or later. It is arguable that the effect of the decision is something that should be made clear by an appropriate exclusion, rather than being buried in obscure loss adjustment provisions.

It is also the case that in some policies a reduced limit applies to extensions of cover, such as those applying to denial of access, loss of attraction or disease. On proper construction it may be that the "*trend clause*" in a policy does not apply to the lower limit provided by such extensions. Given the expense of instructing accountants to examine the complex multitude of trends involved in assessing business interruption losses (which can easily run into significant five figure sums, or more), there is a clear commercial sense in the parties choosing not to apply a trends clause to the lower limits typically applied to such extensions.

Finally, there are also difficult questions that may arise with respect to the length of the indemnity period. For example, might the fact that coronavirus can only live on surfaces for a matter of days mean that any damage to property will only persist for a few days. even absent decontamination measures? A further issue might arise where restrictions are lifted, such that employees are able to return to work, but trading conditions remain depressed due to other restrictions or downturn caused by the ongoing economic effects of the virus.

Given the issues highlighted above with respect to damage to property, policyholders are looking carefully at policy extensions that do not require damage to property. These come in a number of guises. Set out below is a consideration of some typical examples, but the criteria vary, sometimes considerably. Paying attention to the particular policy wording is vital. Not all will be described as extensions – they may be a more integral part of cover.

Extension: Notifiable Diseases

First, perhaps the most obviously relevant extensions will be those that offer cover for business interruption caused by the occurrence of "*notifiable disease*" on or in the vicinity of insured premises[3]. Such extensions may or may not also extend to (or require) actions to be taken by civil authorities regarding such disease.

[3] In England, COVID-19 is as of 5 March 2020 a "notifiable disease", by virtue of the Public Health (Control of Disease) Act 1984 with other provision made for Wales, Scotland and Northern Ireland - Public Health (Scotland) Act 2008 on 22 February 2020; the Public Health Act (Northern Ireland) Act 1967 on 29 February 2020; and Health Protection (Notification) (Wales) Regulations 2010 as of 6 March 2020.

Coverage for business interruption due to notifiable disease was traditionally sought by hospitality businesses. However, these extensions have become a relatively common feature of policies. Note also that notifiable diseases cover tends to be sub-limited, typically for an amount of up to 10% of the total insured amount.

An example of a more widely drawn extension wording offers coverage for business interruption "*due to restrictions imposed by a public authority during the period of insurance following an occurrence of a notifiable human disease*".

However, there is a great deal of variation between wordings. Many extensions require the occurrence to be on the insured premises, or within a relatively wide radius of the premises (e.g. 25 miles); some include the discovery of causative agents (i.e. the mere presence of the virus) and not merely the resulting disease.

Narrow triggers (e.g. cover triggered by an occurrence of notifiable disease on insured premises only) will face difficult causation issues. However, wider triggers (e.g. cover triggered by an outbreak within a 25 mile radius) are more readily engaged.

Extensions triggered by the restrictions imposed by civil authorities also vary. They might relate either to the use of the insured's business premises, to supplier premises (including utilities), or in the case of cover resulting in "loss of attraction", to the closure of premises within a certain vicinity.

The "Coronavirus Disease 2019" or COVID-19 as it become commonly known has been a notifiable disease in England since 5 March 2020. Restrictions controlling access to premises have been imposed since 26 March[4].

The policy definition of "notifiable disease" is often a key issue.

Many extensions state that they apply to specified diseases only (for example, Legionnaire's Disease or Norovirus) or to lists of diseases. Given that COVID-19 is a new disease caused by the SARS-CoV-2 coronavirus, policies that operate in this way may not provide cover.

[4] The main provisions of the CV Act concerning the use of premises are set out in Schedule 22. The power to force closure of premises, including retail shops, is provided by paragraph 6 of Schedule 22, which provides that the relevant power is "for the purpose of preventing, protecting against, delaying or otherwise controlling the incidence or transmission of coronavirus". The general lockdown was imposed by the CV Regulations, which came into force at 1pm on 26 March 2020, when the Lockdown became legally effective in respect of, inter alia, retail premises (closure required by Regulation 5) and the general public (the general Lockdown had been announced earlier, on 24 March 2020, initially as a request made to the public). Regulation 6 requires members of the public to stay in their homes and only to leave with "*reasonable excuse*". More limited/advisory measures were in place prior to this.

However, on analysis, some lists may appear to be intended to be comprehensive lists of statutorily notifiable diseases. If so, the intended scope of cover may be open to argument. Careful attention is required, as some policies include notifiable diseases using terminology of superseded legislation – i.e. they are simply out of date. Others mix statutory notifiable diseases with statutory causative agents (e.g. viral agents).

Other extensions cover "notifiable diseases" generally, subject to specific carve outs. Disputes are likely to emerge (and indeed have already emerged) between insureds and insurers as to the scope of those carve outs. There are a number of carve outs that may prove particularly relevant.

Some policies expressly carve out certain viruses (i.e. SARS 1, swine flu and avian flu – though note that avian flu has never been notifiable in the UK). Some of those carve outs are also accompanied by wording such as "any variant thereof". It is possible therefore that arguments might arise as to whether SARS-2 is a "variant" of the SARS 1 virus (or, indeed, a variant of other covered diseases).

Other policies have an even more general carve out for "*any pandemic influenza or strain identified by the World Health Organisation*" or (particularly for more recent policies "*any pandemic coronavirus or strain identified by the World Health Organisation*"). The WHO declared the COVID-19 disease a pandemic on 11 March, and so policies with these carve outs may not provide cover.

There is one particularly prominent and useful decision on business interruption insurance arising out of notifiable disease from ***Hong Kong in New World Harbourview Hotel Co Ltd And Others V. Ace Insurance Ltd***, a 2012 decision of the Hong Kong Court of Final Appeal [2012] HKCFA 21; (2012) 15 HKCFAR 120; FACV 12/2011 (23 February 2012). The decision provides some guidance for claims arising from the current pandemic. It concerned business interruption arising out of the SARS-1 pandemic.

The relevant policies provided coverage "*to insure actual loss, as a result of … notifiable human infectious or contagious disease occurring within 25 miles of the Premises*."

The judgment, delivered by former Australian High Court Chief Justice, Sir Anthony Mason, contains two particularly relevant points:

- First "*Notifiable disease*" means "*an infectious or contagious disease which is required by law to be notified to an authority*", and not simply a disease which is "*so serious as to warrant notification*" as the insured had argued.
- The second point, which follows from the first, is that coverage was found not to extend to losses suffered prior to the disease becoming notifiable, because "*…the cause of the loss must be a notifiable disease and a disease does not become notifiable until it is required to be notified*." Therefore, that particular wording provided no coverage for losses incurred prior to the date of the disease becoming legally notifiable.

This result may depend on the particular statute concerned – the relevant UK statute includes provisions for rendering **new** diseases notifiable, which may lead to arguments about when COVID-19 first fell within the scope of the statute. If the same approach is followed as was adopted by the Hong Kong Court of Appeal then losses suffered prior to 5 March will likely not be covered. However, there may be arguments that the disease was notifiable once it qualified for inclusion as such under the UK statutes, despite not being formally declared until 5 March 2020.

Another point to note from the first instance judgment in ***Harbourview*** is that it held that the standard revenue (i.e. the reference revenue by which the losses were to be calculated) would include the depressing effect on business of SARS in the period leading up to SARS being declared notifiable in Hong Kong on 27 March 2003 – which also reduced the potentially recoverable losses.

Extension: loss of attraction

In relation to loss of attraction extensions (which have been touched upon above), these typically cover losses arising out of damage to property other than the insured's property in a defined vicinity (which may range from 1 to 25 miles) which leads to a reduction in turnover.

Where the policy wording contains a requirement for the loss of attraction to result from "damage" to another property, obviously the difficulties discussed earlier in relation to whether "damage" can be said to have occurred arise.

However, there are also "non damage" loss of attraction extensions, which cover loss of attraction as a result of closure of businesses within a defined vicinity due to the actions of authorities in response to notifiable disease.

Extension: denial of access

Pure denial of access extensions provide cover for incidents resulting in the insured being unable to access the insured property for business purposes. These extensions frequently also require "damage" to the insured property. While there are some policies which cover denial of access for reasons including action by the authorities as a result of notifiable disease, this coverage is frequently excluded from pure denial of access extensions, and is instead [5]dealt with by specific notifiable diseases extensions.

Subject to the causation issues discussed above, denial of access extensions may provide one of the more promising bases for claims by policyholders, particularly for businesses primarily affected by the closure of their premises as opposed to the loss of custom caused by the lockdown of the general public.

[5] This may be arguable, depending on the particular wording.

Conclusion

The issues we have discussed today are likely to provide fertile grounds for disputes in the months and years ahead. We hope you found this high-level overview illuminating, but if you have any further questions we would be pleased to assist. Please contact our clerks for further assistance.

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