

# CORONA SHUTDOWN

## PROPERTY DAMAGE AND BUSINESS INTERRUPTION



### THE INVISIBLE MONSTER THAT WE ARE FACING

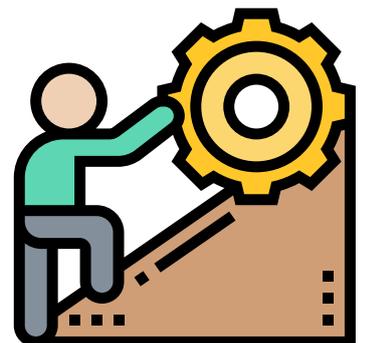
The novel coronavirus, officially named COVID-19 by the World Health Organisation, has become a global pandemic. Nearly all sectors of business across the world are significantly affected, ranging from manufacturing hospitality, entertainment, tourism, food and beverage to supply chain and logistics.

No modern disease has dominated the news and affected the worldwide economy on such scale as coronavirus (COVID-19). Coronavirus's impact is widespread across almost all business sectors. Governments are shutting down whole regions and cities to quarantine and contain the outbreak. Workers are being urged to stay home for weeks, rather than days, to avoid contagion or spread of the disease.

### WHY IT IS A CHALLENGE FOR THE INSURANCE SECTOR

Insurance is a mutual pool of funds that pay for the losses of the few, from the premiums of the many. Statistics on frequency and severity (cost) are used to maintain the pool, which is subject to regulation to maintain adequate solvency.

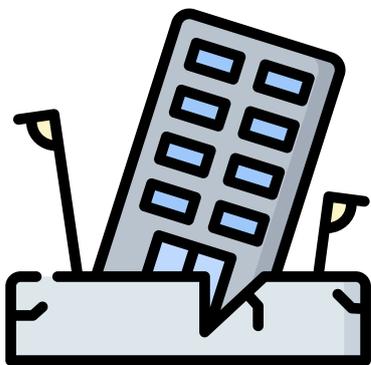
Pandemics, by their unpredictable, unforeseeable nature, cannot be modelled in the same way and do not follow the 'losses of the few'



principles. That is why they are not easily covered in a standard insurance market business interruption policy. The predicted cost of

COVID-19 is likely to exceed any possible insurance model and if at all covered universally by most property insurance policies under Business Interruption section, would have collapsed the insurance industry across countries, due to the sheer scale of losses and impossibility of insurers' capital to pay for those losses. COVID-19 is having drastic economic impacts on industry, including business interruption and supply disruptions. Liability risks also exist, especially in industries like health care, hospitality, transportation, and retail. Businesses are well-advised to assess their risks and determine whether existing insurance coverage may help meet such exposures.

Let us discuss two distinct areas of property insurance – (i) Property or material damage and (ii) Business Interruption as it is called all over the world and known as Loss of Profits or Consequential Loss insurance in India.



## PROPERTY OR MATERIAL DAMAGE DUE TO CORONA

The trigger for any property insurance policy and resulting time element coverage is physical damage to insured property by an insured peril. Insurers are likely to argue on two counts that ( a) that the mere introduction of a virus does not constitute direct physical loss or damage to insured property nor ( b) is it a covered peril.

While the introduction or contamination of 2019-nCoV to an insured property may be considered a fortuitous (unforeseen) event (similar to other triggers that are typically covered under property policies), it is most likely not covered due to standard policy exclusions.

The Industrial All Risks policy wording used by the Indian market does not contain Communicable disease or Infectious disease exclusion in the list of exclusions. Insurers may point to exclusions related to loss or damage arising from delay, loss or market, loss of use or indirect or remote loss or damage.

Globally, one may come across policy wordings that may contain a contamination exclusion that embeds virus, disease or illness causing agent in the definition of contaminant. Most property policies, including ISO, specific insurer forms and most manuscript policies, do not cover a loss resulting from a virus.

## HOW WOULD COURTS LOOK AT THIS ISSUE

If Property all Risks, Industrial All Risks or even a simple Fire Insurance policy wordings would require physical loss or damage as an ingredient to admit claims, there appears to be a split in court jurisdictions as to what actually constitutes “physical loss or damage.” Some courts restrict their analysis to require tangible changes resulting in material damage to property. Others more liberally find “physical loss” due to changes that cannot be seen or touched as long as there is a demonstrable alteration of the insured property.

One court analyzed whether property exposed to high humidity, mold, and mildew from wet air constituted direct physical loss or damage. The court determined there must be a distinct and demonstrable physical change to the property necessitating some remedial action to demonstrate physical loss or damage. “The recognition that physical damage or alteration of the property may occur at the microscopic level does not obviate the requirement that physical damage need be distinct and demonstrable. In the methamphetamine odor damage cases, the physical damage is demonstrated by the persistent, pervasive odor. In the absence of such odor, no physical damage could be found. The mere adherence of molecules to porous surfaces, without more, does not equate to physical loss or damage.



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## CORONA AND BUSINESS INTERRUPTION INSURANCE

Business interruption insurance covers businesses for a loss of income during periods when they cannot carry out business as usual due to an insured event (such as fire or flood). It aims to put you back in the same trading position it was in before the event occurred.

In most insurance programs where Business Interruption risk is covered, the loss of income should have happened based on physical loss of damage of insured property. Especially insurance markets who have based their policy forms based on British legacy in Insurance have this requirement – it is even specifically mentioned as “Material Damage proviso’ mentioned as part of BI coverage. Generally, most property policies that offer business interruption coverage require a causal connection between insured physical loss or damage and the loss of income.

This requirement of property damage is unlikely to be relevant in these circumstances where businesses are shut down due to actual contamination of the manufacturing block, one or more employees were identified as Corona infected and spent a whole shift of 8 hours in the shop floor, manufacturing section including clean rooms or temperature/dust/pollution control environment. In such a scenario you have an actual contaminated environment and one whole batch of finished product and a huge quantity of raw materials and semi-finished or Work in process kept inside that block.



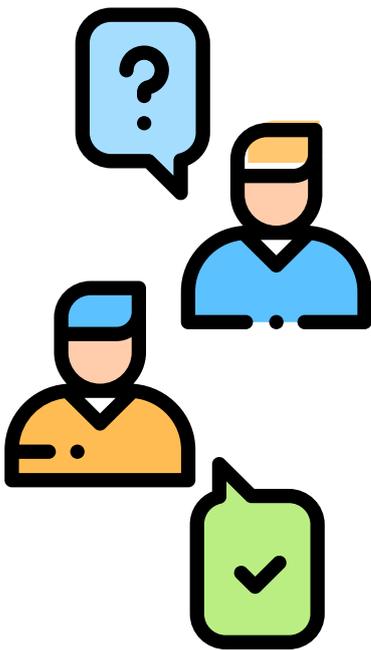
## CONTINGENT BUSINESS INTERRUPTION – SUPPLIES/CUSTOMERS PREMISES

The cover may be extended to BI losses as a consequence of damage to property anywhere else in the world of any supplier or customer. In these circumstances, such damage is treated as if it is damage to the insured property at the insured's defined premises and subject to the other terms and conditions of cover. This may in principle be relevant in the current scenario where global supply chains have been severely impacted.

The critical issue here is whether there has been physical damage at those suppliers' /customers' premises. Moreover, investigating those incidents, given their geographical location and in circumstances of reduced travel and accessibility, may prove to be extremely challenging.

There is also potential scope for consideration of non-damage BI triggers (noted above) being combined with contingent BI cover, to the effect that cover is provided for BI arising, for example, from the closure of a supplier's premises in China (or elsewhere), by order or action of a relevant authority as a result of a 'specified' or 'notifiable' disease.

Currently, many organisations- big and small will seek relief through their business insurance, specifically through policies that cover business interruptions. But while many policies do have business interruption coverage, a significant number of these policies exclude compensation for communicable disease outbreaks, a change many insurers made after the SARS outbreak of 2003.



## HAVE THERE BEEN EXCEPTIONS IN THE PAST

One rare case of how the client got indemnity for BI even without physical loss or damage to property was Mandarin Oriental in Hong Kong. Mandarin Oriental International Ltd. received \$16 million from its insurers to pay for business interruption losses due to SARS as they could not receive or book guests due to the outbreak, globally policies were quickly updated to exclude certain types of disasters - specifically communicable diseases.



## WHAT DOES OUR POLICY FORM SAY

In India there are three types of policies cover physical assets – Standard Fire and Special Perils policy along with a Fire Loss of Profit Insurance policy is taken for BI cover, the market standard wordings of Industrial All Risks Insurance Policy and the Mega Insurance policy issued by reinsurance companies and followed by Direct insurers.

In the IAR policy the wording mentions Business Interruption cover as follows:

The Company agrees that if during the Period of Insurance the business carried on by the Insured at all the premises specified & listed in the Schedule is interrupted or interfered with in consequence of loss destruction or damage indemnifiable under Section I, then the Company shall indemnify the Insured for the amount of loss as hereinafter defined resulting from such interruption or interference

The issue both insurers and insureds will face, therefore, is whether the insured's lost business income was the direct result of physical loss or damage. This will be a key issue in considering coverage for coronavirus-related claims.



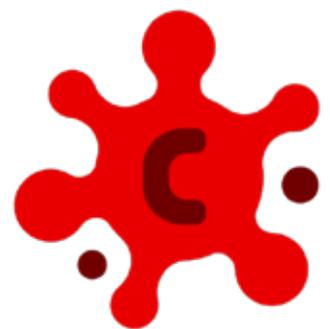
Coronavirus-related losses that businesses are experiencing to date are typically due to causes other than physical property damage – e.g., people are staying home from work – they are not producing necessary goods and services for other businesses, they are not traveling, and they are not purchasing goods and services to the same degree. None of these causes of economic loss are related to physical damage to the insured property.

A restaurant in the heart of New Orleans, US tourism district filed a lawsuit during March 2020 asking a state judge for a declaratory judgment that its business-interruption policy will cover its damages if it is ordered to close by civil authorities in response to the coronavirus. The lawsuit maintains that the virus physically infects and stays on surfaces for up to 28 days and that contamination of the insured premises by the virus would be a “direct physical loss needing remediation to clean the surfaces of the establishment.” It likens the coronavirus infection to cases where the intrusion of lead or gaseous fumes has been found to constitute a direct physical loss.

The complaint formally has asked the judge to affirm that because the policy does not contain an exclusion for a viral pandemic, there is business income coverage for any future civil shutdowns of restaurants due to physical loss from coronavirus contamination.

## NON-DAMAGE BI EXTENSION

Some insurers outside India who have given a Non-damage Business Interruption cover under the Property All Risks policy. In practice, BI cover is more likely to be triggered as a result of COVID-19 where the policy contains a relevant non-damage BI extension for infectious diseases. Such extensions can take various forms. One common form sets out a list of ‘specified’ diseases and covers BI arising from the occurrence of such disease at the insured premises that causes restrictions on the use of the defined premises on the order or advice of a competent authority. However, given the timing of the outbreak, currently active policies written on this basis are unlikely to expressly include cover for COVID-19.





## BUSINESS INTERRUPTION DUE TO GOVERNMENT ORDER

Another common format provides cover for closure of part or whole of the insured's premises by an order of a competent/public authority as a result of an outbreak of a 'notifiable' human infectious disease. The key issue here being that there must be a legal obligation to notify the presence to the relevant authority. In certain jurisdictions this will take the form of a specific order. In these circumstances BI occurring prior to the disease becoming legally notifiable is not generally covered.

## CURRENT SCENARIO IN INDIA

In the Indian market, the national reinsurer GIC RE have introduced a specific exclusion in their treaties covering property insurer, to exclude losses arising out of Communicable diseases. Following this insurers also would introduce this exclusion in all their insurance policies.

Much unlike the health insurance policies that would admit a corona related hospitalisation claim, the property insurance policies issued to business clients in India would not cover the loss attributable to communicable diseases both for property damage and It is to be seen how the Commercial line insurers respond both locally and globally to this clamour to cover losses under this risk for property damage claims arising out of contamination and also indemnify for Corona related business interruption arising out of shutdown of business operations either on their own or due to a Government order to close down temporarily.

