

Applying Commercial Property Insurance To COVID-19 Losses

By **David Kroeger and Elin Park** (March 12, 2020, 4:31 PM EDT)

Governments and health authorities worldwide are responding to an outbreak of respiratory disease caused by a novel coronavirus that was first detected in China and which has now been detected in almost 100 locations internationally, including in the United States.[1]

The virus has been named SARS-CoV-2, and the disease it causes has been named coronavirus disease 2019, which is commonly abbreviated as COVID-19.[2]

Information about the novel coronavirus, its continuing spread and its potential impact on the business world continues to dominate the news cycle and, increasingly, the attention of management and even boards of directors. As businesses continue to focus on how these developments are impacting or will impact them, one obvious question is the extent to which any of the anticipated business interruption and related losses might be covered by their insurance programs.

While policyholders in certain industries (such as travel and leisure) may have procured more specialized forms of insurance coverage that are specifically designed to address the impact of this type of public health crisis, most companies will need to seek cover for their business interruption losses, if at all, through their commercial all-risk property insurance programs.

As the name implies, these first-party insurance programs were generally designed to cover all risk of loss or damage to insured property, along with certain associated losses (including business interruption), except as specifically excluded. There are many different forms of business interruption coverage, but the general purpose of that coverage is to reimburse the policyholder for lost profits and fixed costs associated with operating the business during the period of restoration from that interruption.

This article discusses some of the most significant issues that may arise in connection with a potential commercial property insurance claim with respect to business interruption losses caused by the novel coronavirus. Each property insurance policy and program should be considered on its own merits, however, particularly as the language of commercial property insurance policies can differ, sometimes materially, from one insurer and/or one policyholder to the next.



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Is there covered property damage?

It is a surprisingly common misperception that property insurance policies provide standalone coverage for business interruption losses; they generally do not. Instead, property insurance policies more commonly provide coverage for business interruption losses solely to the extent that the interruption results from covered property damage.

In other words, a commercial policyholder can generally seek business interruption losses resulting from a fire that destroys its manufacturing facility but cannot generally seek business interruption losses that were not caused by covered property damage. As a general matter, a policyholder must therefore first demonstrate the existence of covered property damage and can only then seek insurance recovery for business interruption losses flowing from that property damage.

Commercial all-risk property insurance policies commonly require direct physical loss of or damage to covered property in order to trigger coverage. These terms are not commonly defined, so exactly what constitutes “direct physical loss or damage” has at times engendered litigation.

Insurance companies have argued that a loss of use, and not direct physical loss or damage, occurred where, for example, gasoline seeped into the basement of an insured church,[3] and where the policyholder removed its inventory from an insured building and sold it at a loss because the building appeared about to collapse.[4]

In both cases, however, the court ruled for the policyholder. In one of them, the court found that the threat of destruction caused by the accumulation of gasoline around and under the building constituted a direct physical loss. In the other case, the court held that the policy language requiring a direct physical loss was ambiguous and thus construed it against the insurer and in favor of the policyholder.

The likely question in a commercial property insurance context is thus whether the presence of the novel coronavirus in a commercial setting constitutes direct physical loss or damage. Knowledge about the novel coronavirus and the manner in which it might be transmitted continues to grow.

The Centers for Disease Control and Prevention has stated that the virus is thought to spread mainly from person-to-person contact but has also observed that a person can contract COVID-19 “by touching a surface or object that has the virus on it and then touching their own mouth, nose or possibly their eyes.”[5]

The University of California San Francisco has also stated that the principal mode of transmission is currently thought to be respiratory droplets, but close contact with an infectious person (“such as shaking hands, or touching a doorknob, tabletop or other surfaces touched by an infectious person”) can also transmit the virus.[6] The New York Times has reported that a study of other coronaviruses found they could remain on metal, glass and plastic for several days.[7]

Current scientific knowledge thus appears to support the conclusion that the presence of the novel coronavirus on desks and office equipment and in other commercial settings can constitute direct physical loss or damage. Nothing in these often undefined terms rules out the possibility of damage caused by the presence of microscopic organisms or requires that loss or damage be visible to the naked eye, or even visible at all.

For example, in *Motorists Mutual Insurance Co. v. Hardinger*, the U.S. Court of Appeals for the Third

Circuit explained that the presence of E.coli bacteria in the well of a house, which made the inhabitants of the house ill with respiratory, viral and skin conditions, could constitute physical loss or damage to a structure.[8]

The court explained that the key question turned on “whether the functionality of the [] property was nearly eliminated or destroyed, or whether th[e] property was made useless or uninhabitable.”[9]

Similarly, in Gregory Packaging Inc. v. Travelers Property Casualty Co. of America, the U.S. District Court for the District of New Jersey concluded that “courts considering non-structural property damage claims have found that buildings rendered uninhabitable by dangerous gases or bacteria suffered direct physical loss or damage.”[10]

The court then found that an ammonia discharge in a building inflicted direct physical loss of or damage to the insured’s facility because the release, which made the air unsafe, rendered the facility unfit for occupancy until the ammonia dissipated.[11]

The notion that direct physical loss or damage can be caused by the presence of microscopic organisms such as the novel coronavirus is further supported by the fact that at least one commercial property insurer now offers standard property insurance forms that expressly include coverage for communicable disease response and for business interruption caused by communicable disease.

That insurer now offers express coverage for “costs to clean up, remove and dispose of a communicable disease at your location, plus public relations expenses” as well as “business interruption coverage for loss resulting from the temporary shutdown.”[12] This coverage applies to the “actual not suspected presence of communicable disease” and may also be subject to sublimits that significantly restrict the potential benefit of the coverage to policyholders.

Damage to uninsured property can potentially trigger coverage.

A policyholder may, in certain circumstances, be able to seek coverage even if direct physical loss or damage occurs to uninsured property. For example, commercial property insurance policies commonly provide coverage for “civil or military authority.” This extension can provide coverage “if an order of civil or military authority limits, restricts or prohibits partial or total access to an insured location provided such order is the direct result of physical damage of the type insured at the insured location or within [a specified distance of the insured location]” and may even apply in situations in which no property has been lost or damaged.

Similarly, commercial property insurance policies also commonly provide coverage for “contingent business interruption,” which is generally understood as interruption to the policyholder’s business that is triggered by “direct physical loss or damage” that occurs at, inter alia, a direct customer, supplier, contract manufacturer and/or contract service provider to the policyholder.

Contingent business interruption coverage may become particularly important to businesses that depend upon parts manufactured in China and other areas heavily impacted by the novel coronavirus.

Is there an applicable exclusion?

Once a policyholder establishes that direct physical loss or damage to insured or other relevant property has resulted from the presence of the novel coronavirus, as well as other components necessary to bring

a novel coronavirus-related loss within a policy's insuring agreement, the next significant question is whether any policy exclusion applies.

Commercial all-risk property insurance policies commonly include exclusions for pollution and/or contamination. The terms "contaminant" or "contamination" may or may not be defined and may or may not be defined to expressly include a virus. Further, while the term "pollutant" or "pollution" commonly will be defined, that definition may or may not specifically reference a virus.

Depending upon the nature of the policy language at issue: (1) whether it excludes pollutants and/or contaminants; (2) whether it defines those terms to the extent they are excluded; and (3) whether any such definitions expressly include (or do not include) a "virus," a commercial policyholder should assess the laws of potentially relevant jurisdictions to assess whether the policy or program should properly be construed to exclude losses resulting from the novel coronavirus.

Some courts have reasoned that viruses and comparable microscopic substances are not pollutants,[13] but at least one court has held that a virus can be considered a pollutant — even if the policy definition does not expressly reference the term "virus." [14]

However, given the range of judicial guidance concerning the scope of pollution exclusions, and particularly if an insurer chooses not to define terms or to define them without including viruses, careful analysis will be important.

So what do you do?

As coverage of and concerns about the novel coronavirus have continued to grow, those practicing in this field have no doubt heard strong initial opinions both in favor of and against coverage. Oftentimes, those opinions have been provided with little or only superficial analysis. The true answer likely lies in the middle.

Policyholders may be able to establish (at least some) coverage for novel coronavirus-related business interruption losses, but determining the extent to which they have that coverage will require careful analysis of the specific policy language at issue as applied to the specific facts as they develop. That analysis should begin now, to the extent it has not already started.

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[1] <https://www.cdc.gov/coronavirus/2019-ncov/summary.html> (last visited March 10, 2020).

[2] Id.

[3] *Western Fire Insurance Co. v. First Presbyterian Church*, 165 Colo. 34, 437 P.2d 52 (Colo. 1968).

[4] *Hampton Foods, Inc. v. Aetna Casualty & Surety Co.*, 787 F.2d 349 (8th Cir. 1986) (applying Missouri law).

[5] <https://www.cdc.gov/coronavirus/2019-ncov/about/transmission.html> (last visited March 10, 2020).

[6] <https://www.ucsf.edu/news/2020/02/416671/how-new-coronavirus-spreads-and-progresses-and-why-one-test-may-not-be-enough>.

[7] <https://www.nytimes.com/2020/03/02/health/coronavirus-how-it-spreads.html>.

[8] 131 F. App'x 823, 824-26 (3d Cir. 2005).

[9] *Id.* at 826-27.

[10] No. 2:12-cv-04418, 2014 WL 667 5934, at *6 (D.N.J. Nov. 25, 2014).

[11] *Id.*

[12] <https://www.fmglobal.com/products-and-services/products/the-fm-global-advantage-all-risk-policy> (last visited March 10, 2020).

[13] *Westport Insurance Corp. v. VN Hotel Group, LLC*, 761 F. Supp. 2d 1337, 1343-44 (M.D. Fla. 2010) (Legionella bacteria are not pollutants, and thus pollution exclusion did not apply); *Johnson v. Clarendon National Insurance Co.*, No. G039659, 2009 WL 252619, at **2, 13 (Cal. Ct. App. Feb. 4, 2009) (pollution exclusion did not apply to mold and likely would not apply to viral infections; court reasoned that the language of the pollution exclusion was unclear, and thus the exclusion must be interpreted in favor of coverage).

[14] *First Specialty Insurance Corp. v. GRS Management Associates, Inc.*, No. 08-81356, 2009 WL 2524613, at **3, 5 (S.D. Fla. Aug. 17, 2009).