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PRIVATE EQUITY LOOKS TO INSURERS TO COVER COVID-19 LOSSES

BUSINESS INTERRUPTION LAWSUITS BEGIN TO MATERIALIZE IN RESPONSE TO CARRIER COVERAGE DENIALS

One of the most intensely studied and scrutinized coverage questions arising from the COVID-19 crisis has been whether typical property insurance policies provide coverage for the economic losses, known in insurance parlance as "business interruption" losses, suffered by insureds in the wake of the novel coronavirus pandemic. "Business Interruption" coverage is intended to compensate business owners, including Private Equity portfolio companies, for lost profits that result from covered losses that impact their businesses. Naturally, Private Equity firms, like other insureds, are looking to this provision of their insurance policies for relief in the wake of significant income losses that have resulted from COVID-19 and the government's efforts to contain it.

While insureds have looked to this coverage with hope, insurance companies have taken the position that Business Interruption coverage found in most policies is simply not designed to indemnify insureds in the current situation. They argue that the coverage typically contains specific elements that make COVID-19-related claims ineligible for coverage.

There are typically several prongs to the insurance companies' reasoning:

1. Insurers point out that Business Interruption coverage is generally trigged by "direct physical loss or damage" to the insured's property that results in the closure of the business and therefore, directly relates to the lost income. Insurers contend that COVID-19 does not cause "direct physical loss or damage" for purposes of coverage.

2. Insurers further argue that, even if the presence of COVID-19 does constitute "direct physical loss or damage," it is not the type of damage that the policy intends to cover because:

    a. The businesses of most insureds are not closed because of the presence of the virus, but rather, they have been closed to prevent the further spread of the virus.

    b. The damage caused by the virus is a temporary condition that self-corrects in a matter of days, whereas the business closures have persisted even after the virus is no longer present. Insurers argue that the type of damage that is intended to be covered is damage that has a permanent impact and must be remedied through active remediation and repair. Further complicating the issue, it is very difficult for an insured to actually prove the presence of the virus at or on their property.

3. Insurers state that most typical property policies contain a specific virus exclusion, which precludes coverage for losses stemming from viruses like COVID-19.

However, insureds are unconvinced and undeterred by this reasoning. Recently, several lawsuits have been filed that challenge the insurers' interpretation. To be sure, the resolution of these lawsuits will depend on the specific

policy language in the insured's policy, making any generalizations meaningless. But these lawsuits give insight into the issues that will have to be resolved by the courts in the coming months and years.

Direct Physical Loss or Damage

With respect to the first two prongs of the insurers' arguments, insureds argue that the presence of the virus at an insured's properties does constitute physical damage because the virus remains on, and therefore "damages," surfaces in the insured's premises. While insurers do not necessarily accept the reasoning that the physical presence of the virus constitutes damage, they further argue that it is irrelevant since the type of physical damage that the policy is designed to cover is a different type of damage. Insurers contend that the policies are designed to cover for losses in the case of permanent physical damage – in other words, structural damage that requires the insured to repair the property , not to simply clean and sanitize it. Put another way; the coverage does not apply to this type of damage since the purported "damage" remedies itself with time. While many courts have agreed with the insurers' reasoning, there is some case law that provides support for the insureds' position, including cases where contaminants such as noxious vapors and smoke have been held to be physical damage that triggers Business Interruption coverage. Like COVID-19, this type of physical damage also only lasts a short period of time before resolving itself. These cases rest their decision on the fact that the physical damage in these cases, whether temporary or permanent, causes the insured's economic loss because it renders the insured's property unusable for the insured's business purposes.

Insurers counter that claims arising under COVID-19 are different in that the businesses are closed because of government intervention, not physical damage. To answer the insurers, insureds assert that the reason given for the governments' actions is often the physical nature of the virus and that it is spread through physical contact. Indeed, insureds point out that many of the governmental shutdown orders specifically mention the physical nature of the virus.

Virus Exclusion

As for the remaining prong of the argument (the argument that many policies contain a specific exclusion for losses caused by viruses), commentators acknowledge that this is difficult to refute. Nevertheless, many of the cases that have been filed specifically state that the relevant policies do not have such an exclusion. Many commentators have questioned how common these exclusions actually are.

Further, insureds point out the exclusionary language, where present, is often more nuanced than a specific "virus" exclusion. Often the exclusions do not specifically allude to "viruses." Instead, the exclusions often use broader and more ambiguous language like "disease" or "microorganisms." Policyholder attorneys argue this broad language creates an ambiguity that should be read in favor of coverage.

Wild Card

Finally, there is the "wild card," – whether states or the federal government will take action to modify the terms and conditions of insurance policies through legislation that will cause business interruption claims to be covered, regardless of the policy language. Indeed, several states have already proposed bills that would void virus exclusions. So far, none of these bills have passed, and many pundits have questioned the constitutionality of any such proposed law. Although unlikely, the possibility that such laws will be passed remains.

In the end, myriad factors will go into the resolution of these cases. But one thing is certain - businesses and organizations across the country and indeed around the globe will be watching how these cases are resolved and, like the pandemic itself, the economic and societal impact of them will be far-reaching and long-lasting.

What to Do

While it is impossible to know how all these issues will be resolved, it is prudent for insureds to be prepared. Private Equity portfolio companies should track and record income loss and extra expenses they incur as a result of the crisis and the shutdowns. Taking early action will position these insureds to recover more quickly if it is determined that coverage is afforded under their policies. Further, even if the policy does not respond, qualification for government assistance programs may require the same or substantially similar information and documentation demonstrating the impact of the crisis on its business.

A more difficult question is whether Private Equity firms should file a claim for Business Interruption for its portfolio companies, given that insurers are stating the Business Interruption losses are not covered. We strongly recommend a detailed conversation with your insurance broker to address specific, individual circumstances. In some situations, advisors are warning against putting in claims reasoning that it will not be paid anyway. From that perspective, it is suggested, there is no upside to putting in a claim and only downside. The portfolio company's claim will not get paid, but the loss will become part of the insured's loss history. Given that insurers focus on claims experience when determining whether to offer insurance to a particular insured and at what premium, some advise against filing a claim that is likely to be denied.

On the other hand, some risk professionals argue that there is no downside in placing an insurance company on notice of a claim. It is clear that many Private Equity portfolio companies, like so many businesses, are suffering significant Business Interruption losses and many are seeking recovery from insurers – or have begun filing lawsuits to force payment of these claims. From that perspective, submitting a claim preserves the insured's rights to recovery in the event that these claims are covered. In fact, some policies require notice of a loss "as soon as practicable" and therefore some policyholders are taking a conservative approach to ensure they comply with that condition. For many portfolio companies, payment of their Business Interruption claim is their last hope for survival.