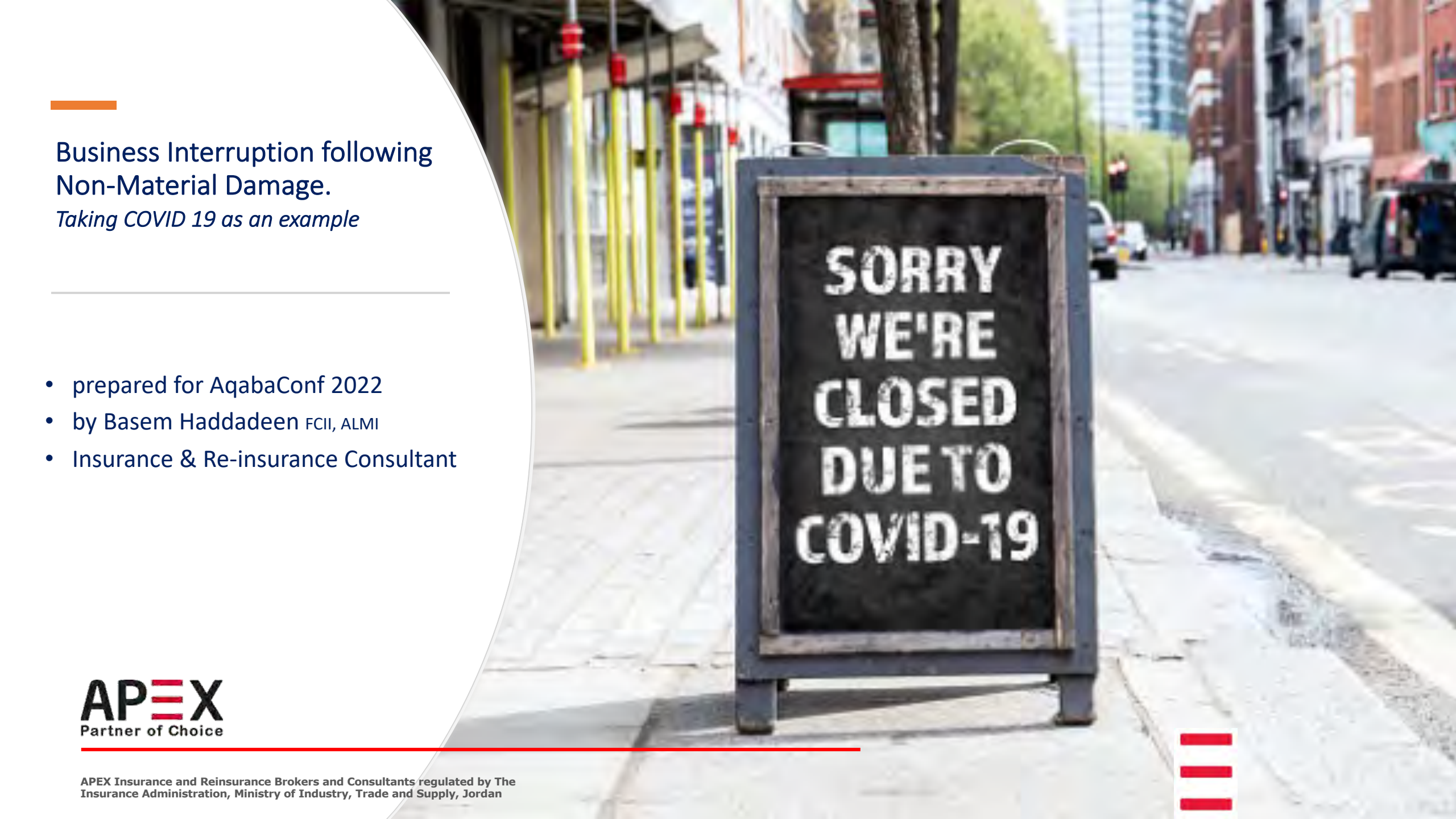
Business Interruption following Non-Material Damage.

Taking COVID 19 as an example



- prepared for AqabaConf 2022
- by Basem Haddadeen FCII, ALMI
- Insurance & Re-insurance Consultant

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It is not new!

- Wide area damage (WAD).
- Environmental (Global Warming etc..)
- Cyber BI.
- Following terrorist attack.
- Epidemics, Pandemics etc.
- Usually comes as an extension on the standard BI following Material Damage policy.

Hurricane Katrina, South Florida Aug 2005

Old news !!

On Dec. 31, 2019, the Chinese government reported a cluster of pneumonia cases in Wuhan, China.

Days later, it was determined that these cases were the result of a new virus named SARS-CoV-2.

This new virus began to spread to countries around the world, infecting more than 460 million confirmed individuals in at least 219 countries and resulting in more than 6 million deaths as of early May 2022*

https://www.worldometers.info/coronavirus

Insurers' initial reaction

Estimates indicate that small b…llion per month due to governments-ordered shutdowns.

While it is estimated that the g…40 billion*; that which would bankrupt the industry.

When businesses requeste…eir insurers denied the claims on the basis that that pandem…

By June 22, 2020, the insurance industry's denial of coverage for COVID-19 business interruption losses had generated as many as 30 million potential business interruption claims**

** Insurers are not required to report financial data for business interruption insurance on a separate line-item basis in their statutory filing.*

***Covid Coverage Litigation Tracker*, University of Pennsylvania Carey Law School (as of June 22, 2020).

Business Interruption Insurance:
Going back to the basics!

BI insurance protects a business' income stream when its operations are shut down by a *covered peril,* leading to decline in revenue and increase in expenses, or both.

The purpose of BI insurance is to return the policyholder to the position it would have occupied if the *covered peril* had not occurred.

Typically, BI insurance is purchased as part of an "all risk" insurance.

Wording issue

Unlike the policy language used in some other lines of insurance, the policy language in BI insurance policies can vary from insurer to insurer.

However, despite these variations, the language in BI policies, like other lines of insurance, is drafted by insurers and then sold on a take-it-or-leave-it basis.

Insurers have consistently asserted that BI claims stemming from COVID-19 were never intended to be covered under the BI policy, while policyholders and their lawyers argue that the language in the policy provides coverage.

The Insured's expectations regarding the scope of coverage is not based on the policy language itself, instead, it is based on the type of insurance being purchased (i.e., business interruption insurance) and the nature of their businesses.

THE MATERIAL DAMAGE PROVISO:

The origin of the problem!

*" The Company agrees that if during the period of insurance any building or property used by the insured at the Premises for the purpose of the business be interrupted or interfered with in consequence of Direct Physical Loss or Damage indemnifiable under section 1 ….. etc..**

Notably, the phrase "direct physical loss or damage" is not defined in the policy, so there is no basis in the policy language itself to conclude that tangible, physical damage is required in order to trigger coverage.

**LM7 BI Insurance Section. Wording can vary depending on the language used by Insurers.*

THE MATERIAL DAMAGE PROVISO:

The legal stand!

As it is not defined in the policy, many courts have interpreted the term physical damage" to mean a "distinct, demonstrable, physical alteration of the property".

Using this definition of "physical damage," it would appear that there is no cover to virus-related losses, as the loss did not result in the "physical alteration of the property."

As such, this created difficult problems of proof for many businesses, since coverage generally contemplates that the virus physically damaged the property of the insured.

Accordingly, a mere loss of use, or lost access to property would not trigger such coverage.*

However, this is potentially problematic for insurers as well, as it is often ruled by courts that when ambiguities in language exist in a policy, the court should find in favor of the insured.

**TKC London Ltd v Allianz Insurance plc [2020]). The Court held that the enforced closure and loss of use of the café did not constitute an insured "loss of property".*

THE MATERIAL DAMAGE PROVISO:

The legal stand cont'd…..!

To complicate things, some courts did rule that physical alteration of the property is not necessary to show physical damage occurred.

In the case of *Gregory Packaging, Inc. (GPI) v. Travelers Property Casualty Company of America*, 2014.

The court determent that covered property damage had occurred when ammonia was accidentally released into the insured facility, and the release of ammonia did constitute "direct physical loss of or damage to" the property.

POTENTIALLY APPLICABLE COVERAGES/EXTENSIONS

Under ***BI*** following ***Material Damage***

1- Denial of Access

2- Suppliers / Customers Extension

3- Contamination Provision

1- Denial of Access Clause

"Denial of Access resulting from interruption of or interference with the business in consequence of damage to property in the vicinity of the premises……".

Note that "damage" is undefined anywhere in the wording!

2- Suppliers / Customers Extension

"We will pay for the actual loss of Business Income you sustain due to physical loss or damage at the premises of a 'dependent property' caused by or resulting from any Covered Cause of Loss . . .

Still, "physical loss or damage" is undefined!

3- Contamination Provision

"If your 'operations' are suspended due to 'contamination,' [then] we will . . . pay for the actual loss of Business Income . . . you sustain caused by (a) 'Contamination' that results in an action by a public health or other governmental authority that prohibits access to the [policyholder's business]…..

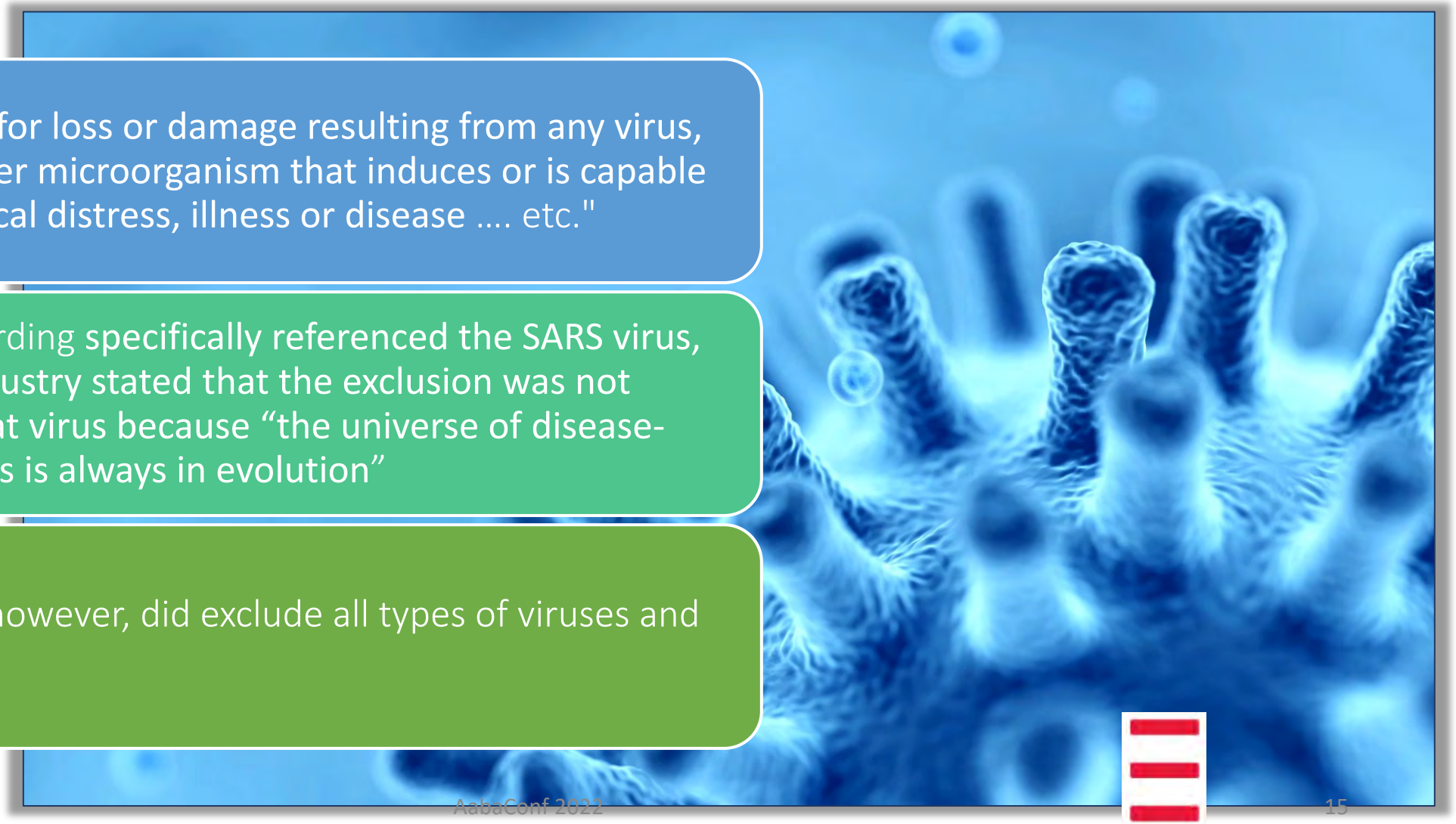
Unlike the other two BI coverage provisions that are based upon "physical loss or damage" to property, contamination coverage is triggered by a "dangerous condition" at the policyholder's premises.

POTENTIALLY APPLICABLE EXCLUSIONS INSURERS RELY UPON:

1- COMMUNICABLE DISEASE EXCLUSION (VIRUS EXCLUSION)

2- POLLUTION EXCLUSION

1) Communicable Disease Exclusion

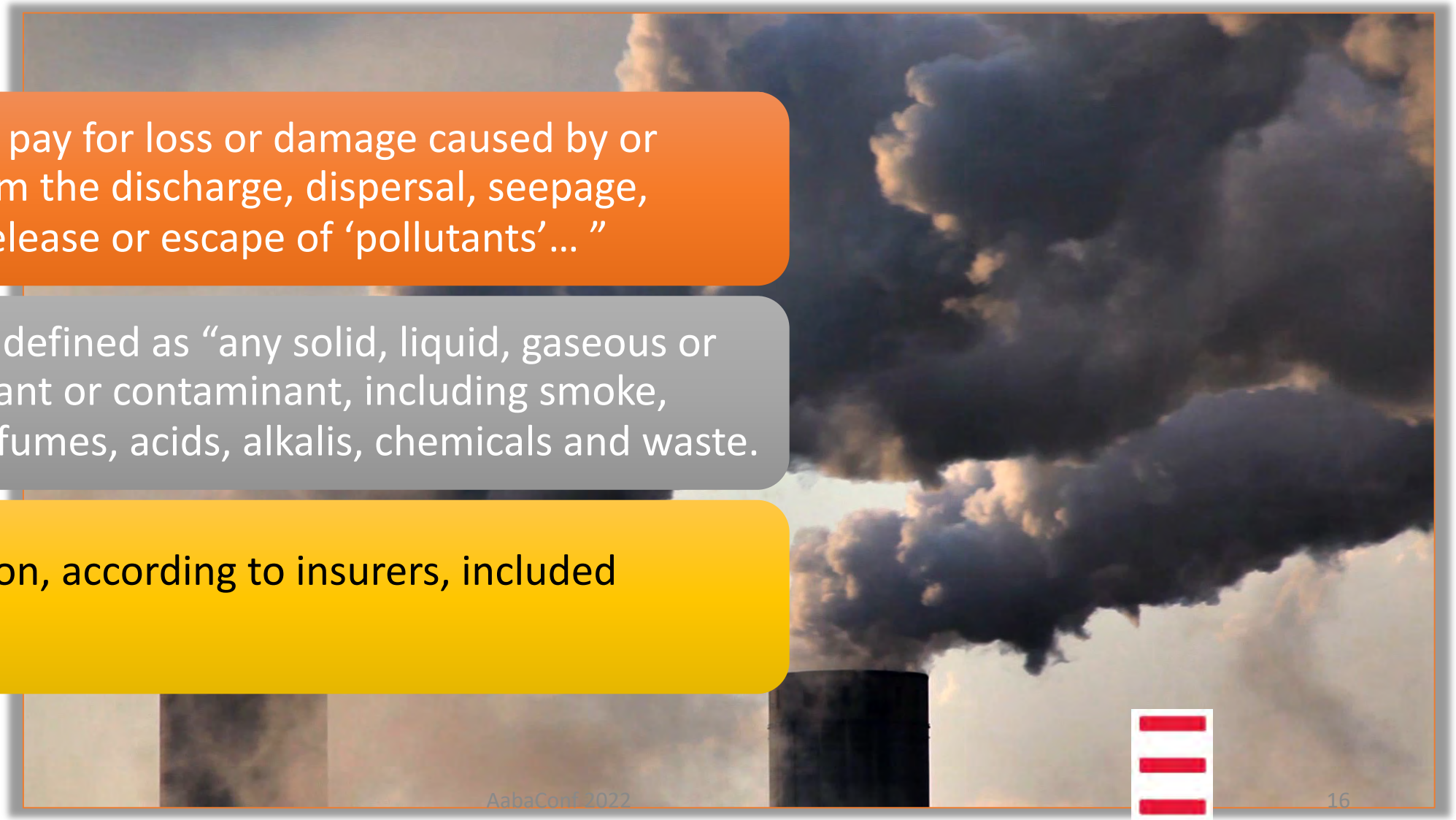


"We will not pay for loss or damage resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease …. etc."

Although this wording specifically referenced the SARS virus, the insurance industry stated that the exclusion was not limited to just that virus because "the universe of disease-causing organisms is always in evolution"

Newer versions, however, did exclude all types of viruses and their mutations.

2) The Pollution Exclusion



"We will not pay for loss or damage caused by or resulting from the discharge, dispersal, seepage, migration, release or escape of 'pollutants'… "

Pollutants is defined as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.

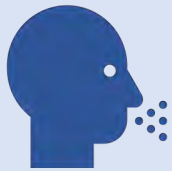
That definition, according to insurers, included Viruses!!

Defenses against Coverage

A range of defenses may allow insurers to avoid, or limit, payment for losses stemming from the Coronavirus:

First: some policies contain broad explicit exclusions of damage caused by biological agents. Those exclusions may be found either in standalone provisions or be incorporated into exclusions for pollution or contamination.

Second: most policies contain sub limits for some of the coverages and/or have waiting periods before the coverage is triggered, or both.



Let's say an employee was diagnosed with coronavirus comes to work and exposes others. Employees are quarantined. The entire office or plant might have to be shut down, resulting in lost income.

In this scenario, "interruption by communicable disease" coverage would pay de-contamination costs, and business downtime. However, claims triggered under this coverage are usually very narrow, with sub-limits that would really make it not very helpful

Defense against Coverage

A range of defenses may allow insurers to avoid, or limit, payment for losses stemming from the coronavirus:

Third: Even if the presence of coronavirus is considered property damage, most *time-element* coverages insure only the period needed to repair the damaged property.

Insurers argue that the virus exists for only a very short period in the air or on surfaces, and that a quick cleaning is all that is needed to eliminate it and thereby restore the property, allowing a very limited period of recovery.

Enter: The Non-Damage BI (NDBI)
What is it?

This is a solution to cover non-core BI risks resulting from events that may not produce Physical Damage to the insured property.

These are “black swan” events (Low frequency, high severity) that can lead to a serious disruption to earnings to the Insured.

So, is the problem solved!

Unfortunately, no.

- The coverage position is even less clear in relation to businesses that have purchased these ‘non-damage’ extensions in their BI cover.

- Solutions are often tailored to specific risks and not usually “all risk” covers.

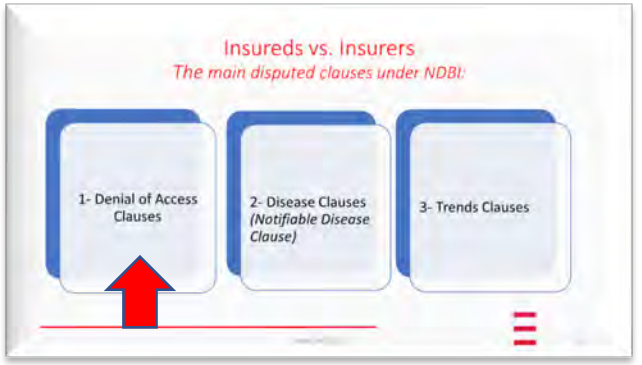
Insureds vs. Insurers
The main disputed clauses under NDBI:

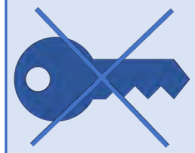
1- Denial of Access Clauses

2- Disease Clauses *(Notifiable Disease Clause)*

3- Trends Clauses

(1) Denial (Prevention) of Access Clauses





The clause provides cover for interruption to a business where there has been an order by a public authority that prevents the use of the insured premises.

Such clauses contain a series of elements that must all be satisfied to trigger the indemnity:

(1) Denial (prevention) of Access Clauses

i- Force of Law

The important issue of whether the various government advisory statements constituted “restrictions imposed”?

i.e does government *advisory* restrictions carry Force of Law?

(1) Denial (prevention) of Access Clauses

ii. Inability to use

A Complete or Partial inability to use the premises?

e.g A hotel is allowed to remain open but with its restaurants closed!!

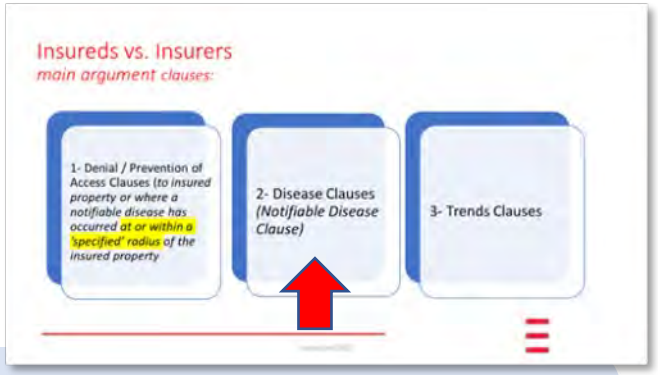
(1) Denial (prevention) of Access Clauses

iii. Interruption?

Complete cessation vs. disruption of business

Insurers argue that this should mean a complete stop and is different from "interference".

(2) Notifiable Disease Clause



"Notifiable Disease" is defined as "illness sustained by any person resulting from… any human infectious or human contagious disease… an outbreak of which the competent local authority has stipulated shall be notified to them."

The general nature of these clauses is to provide insurance cover for business interruption loss caused by occurrence of a notifiable disease at or within a specified distance (or in the 'vicinity')* of the policyholder's business premises.

**Most wordings use…."in the vicinity" however they do not specify it!!*

(2) Notifiable Disease Clause

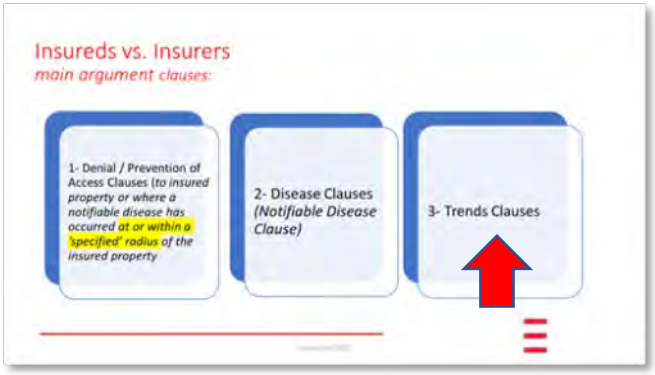
The arguments

Insurers argue that this only covered cases that occurred within the specified radius and any cases outside this area were not part of the insured peril.

This would severely limit the cover available as it would be extremely difficult (if not impossible) for policyholders to pinpoint the location of the exact cause of the loss such that they could prove that it is within this radius.

Insureds argue that the clause should be read as covering the business interruption wherever the case occurred, provided there was at least one case within the radius.

(3) Trends Clause



"Trend's" clauses are relevant to the calculation of the insured loss because they take account of the circumstances/trends of the insured business.

This type of clause appears in most business interruption policies and allows insurers to reduce the amounts payable under the policy where other wider factors have influenced its ability to trade.

(3) Trends Clause
The arguments

Insurers argument:

The trends clauses meant that Insurers were not liable to indemnify policyholders for losses that would have arisen as a result of the wider consequences of the pandemic.

Orient Express Hotels v Generali Spa (UK), 2010

Insured argument:

Silver Cloud (P and C Insurance Limited v Silversea Cruises Limited [2004].

The Orient Express case referred to property damage loss only and cannot be relied upon in this case it was held that that there was an inseparable connection between two concurrent causes of loss (FCA test case).

The UK BI insurance test case.

Financial Conduct Authority (FCA) vs Arch et al

On 15 January 2021, the UK Supreme Court handed down its judgment on the case that the FCA intended to resolve on the uncertainty as to how BI insurance policies should respond to Covid-19 related claims by obtaining a judgment in relation to the meaning and effect of a representative sample of multiple policy wordings (21 in total), underwritten by eight insurers*.

**The eight Defendant insurers who agreed to participate in the test case are:*

(1) Arch Insurance UK Ltd.
(2) Argenta Syndicate Management Ltd.
(3) Ecclesiastical Insurance Office Plc.
(4) Hiscox Insurance Company Ltd.
(5) MS Amlin Underwriting Ltd.
(6) QBE UK Ltd
(7) Royal & Sun Alliance Insurance Plc.
(8) Zurich Insurance Plc.

The court also allowed intervening claims by policyholder representatives (1) the Hiscox Action Group and (2) the Hospitality Insurance Group.

The UK BI insurance test case.

Financial Conduct Authority (FCA) vs Arch et al

The Supreme Court broadly accepted the FCA appeals (with some qualifications). Although it accepted some of the arguments made by Insurers, they ultimately concluded they did not affect the outcome of the appeal. Insurers' appeals were all dismissed.

The outcome of this decision meant that all insuring clauses that were being considered in the appeal will provide cover for losses caused by Covid-19 and these losses will not be reduced by reference to any Covid-19 related losses that occurred prior to policies being triggered.

The impact:

- ✓ The losses are likely to be substantial. Premiums have already increased, capacity is reduced, and businesses now find it more difficult to obtain cover.
- ✓ Insurers that continue to offer insurance against epidemic or pandemic BI will likely want to provide precise wording about coverages and to consider an appropriate premium for this coverage.

In circumstances where policyholders find that they are not covered as they expected, they will still be looking to recover those losses from elsewhere. In this regard, the Impact is largely felt in the D&O & PI policies.

Reinsurance Implications

- ✓ It is very likely that the risk of a pandemic will be systematically excluded during future renewals, particularly in the treaties covering disasters.
- ✓ Currently in the EU there are proposals to create a private–public partnership or pools for protection against future pandemics and NDBI.

- ✓ Non-proportional reinsurance, XOL and per event, will still be the first solution for the coverage of pandemic risks.
- ✓ The interpretation of the “inability to use/prevention of access” clauses in situations where businesses are still able to use part of their premises, have a significant impact on how claims are adjusted.
- ✓ Aggregation Provisions that are defined by reference to an *Event*, *Occurrence, or Catastrophic Event (in CAT XOL treaties)* need to be re-clarified.

What need to be done?

More emphasis on the importance of clear and comprehensive policy wording.

Cedants and reinsurers will need to consider the extent to which losses can be recovered under reinsurance contracts, a subject on which they may disagree.

e.g., “Follow the Settlements” disputes?
Covid 19 overlapped more than one year, and in circumstances where an applicable exclusion clause may have been inserted in the renewed reinsurance?

A final remark:

"…only the government can cover the cost of the economic impact of such a major crisis, through redistribution mechanisms that spread the cost over all economic agents, and even over several generations. It's not surprising then that to date no country has managed to develop a system whereby insurance covers this cost. It's not about bad faith on the part of insurers, rather it's a question of technical and economic impossibility."

Denis Kessler, Chairman and CEO of SCOR, in an article published on 15 Jan 2021 entitled " Why pandemic risk is uninsurable".

Thank you for your time!

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