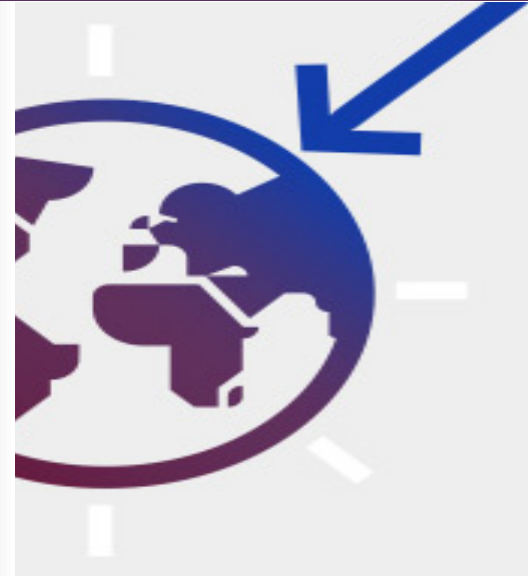


Business Interruption insurance and COVID-19: are businesses covered?

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The COVID-19 pandemic, and the ensuing lockdowns and restrictions on movement, have caused unplanned business closures and supply chain disruptions world over. Businesses face cashflow constraints due to unsold inventories and mounting receivables, imperilling their ability to continue operations.

Though insurance penetration is low in Pakistan relative to comparable economies, many businesses routinely obtain insurance for coverage against losses caused by unforeseen events. The present unprecedented global crisis, in which further rounds of lockdowns or similar restrictions are expected, may seem like exactly the sort of event such businesses consider themselves covered against. This paper will explore whether insurance policies commonly taken by businesses in Pakistan are likely to cover losses suffered on account of the pandemic.

I. Policy terms

In order to illustrate the main issues involved, we have examined the provisions of an industrial all risks policy (the “Policy”) issued to a business by an insurer in Pakistan, having terms typically found in other such policies. The insuring clause of the Policy has two main sections, namely: property damage and business interruption (“BI”). The most important factor in determining whether coverage extends to a particular loss in any policy is whether the occurrence causing the interruption (and the resulting loss) is the result of a peril insured against. As the Policy is an all-risks policy, the property damage section insures against all risks of physical loss or damage to covered property while on described premises except as is excluded. The BI section

insures against loss of revenue (gross profit) due to loss of capacity directly resulting from an occurrence covered by the all risks policy. Notably, the Policy does not define the term “physical loss” or “physical damage.”

The Policy lists several excluded perils, including “micro-organisms, toxic moulds and fungi.” An insurer may look to rely on these exclusions to decline a claim by contending that a virus, having attributes similar to the exclusions, should also be excluded. Unusually for policies issued after the SARS outbreak in 2003, the Policy does not list virus or pandemics in the excluded perils. Given that the Policy did not expressly list virus as an excluded peril, viral contamination is unlikely to fall within the scope of the exclusion. However, whether viruses will be treated as excluded perils will depend on the language of the specific policy issued to the policyholder.

II. Physical loss

Many businesses will have had to evacuate manufacturing plants and suspend operations if viral contamination of the premises is suspected, for instance, after an employee tests positive. In such a case, the question of whether a property insurance policy will cover any losses that may arise will depend on whether viral contamination is held to constitute physical loss or damage to property. The conventional view has been that permanent and tangible alteration in the physical state of a property must exist for coverage under a property damage insurance policy to attach. Mere loss of function or usefulness to the property has not been treated to amount to physical damage. Like the Policy, most policies do not define the term “physical loss” or “physical damage.” It often falls to lawyers to interpret whether a

particular occurrence constitutes physical damage, by attempting to determine the intention of the parties from the language of the policy as a whole and the surrounding circumstances when the policy was issued and examining that against the facts of the occurrence causing the loss.

A survey of case law from foreign jurisdictions indicates that the jurisprudence is evolving. In *Quorum AS v Schramm*¹ it was held that sub-molecular change, which was not visible, constituted physical damage to a painting as it could quicken deterioration and shorten the life of the pastel. Even intangible physical damage can therefore meet the threshold in appropriate circumstances. In the case of *Losinjaska Plovidba v Transco Overseas Ltd (The Orjula)*², the Commercial Court in London found that spillage of hydrochloric acid onto a vessel requiring decontamination constituted “damage”, even though there was no apparent physical damage to the deck. A relevant consideration in that case was whether there had been “injury impairing value and usefulness” and whether expense would need to be incurred to restore the property to its former useful condition. The decisions in *Quorum* and *The Orjula* may provide basis in English law to contend that an intangible physical occurrence, whose effect on a property is reversible, can constitute physical damage in appropriate cases. Some courts in the US have interpreted the term physical damage even more expansively, by holding that it also entailed the effect of any intangible phenomena, such as odour or noxious gases, that diminished a property’s suitability for use. A case in point is *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am*³, in which the District Court for New Jersey decided that “property can sustain physical loss or damage without experiencing structural damage.” Recently the Ontario Superior Court of Justice in the case of *MDS Inc. v Factory Mutual Insurance Company (FM Global)*⁴, held that the term ‘physical damage’ in an all-risk insurance policy included “impairment of function or use of tangible property”. A decisive factor was the court’s conclusion that the commercial purpose of an all risk policy was to provide broad coverage to the policy holder. Based on the Court’s expansive interpretation, the policy holder was able to claim business interruption losses arising from its supplier’s production facility being shut down due to a leak.

There is no reported case law in Pakistan on the question of what constitutes physical loss or damage to property in

the context of insurance. Having said that, in order to raise a tenable claim, a policy holder will have to prove that the virus was in fact present. While some business closures are caused by the actual presence of the virus in the premises, others will be the result of government orders for lockdowns. Losses suffered due to measures taken to quell the spread of the virus are unlikely to be covered, unless it can be established that these were in response to an actual outbreak.

III. Coverage under BI

The BI coverage under the Policy covers losses caused by a whole or partial interruption resulting from an occurrence covered under the property damage section of the Policy, to any property, insured under the Policy. BI Loss is defined in the Policy as the reduction in production or turnover caused by an interruption or interference. The necessary elements that must be satisfied for the coverage to be triggered are: (a) the loss must result from a whole or partial interruption of business; (b) caused by an occurrence covered under the all-risk property damage section of the Policy and (c) to any property insured under the Policy.

In general, business interruption insurance is intended to return to the insured’s business the amount of profit it would have earned, had there been no interruption of the business or suspension of its operations. However, business interruption coverage ought not be used to put the insured in a better position than it would have occupied without the interruption. As with most policies, the Policy therefore excludes coverage for any consequential (or remote) losses or loss of market.

IV. Conclusion

While the world battles through the pandemic, businesses will make claims in the hope of recovering at least some of their losses. As discussed above, the success of every claim will depend on the particular wording of the policy, the circumstances of the occurrence causing the loss and the policy holder’s compliance with other policy requirements, such as warranties and notice provisions.

In the US, there has been a spate of lawsuits in which policy holders have sought to recover BI losses on account of the pandemic. A threshold issue in the pending lawsuits is whether a policyholder has experienced “direct

¹ [2001] All ER (D) 35 (Aug)

² 14 June 1995

³ [No. 2:12-cv-04418]

⁴ [2020 ONSC 1924]

physical loss or damage,” which is typically a requirement in order to recover business interruption losses flowing from that property damage. Another issue is the effect of virus exclusions, which are present in some policies, and which vary in language and form. The government of China has directed domestic insurers to cover Chinese enterprises against disruption from COVID-19 outbreak. In the United Kingdom, the government declared COVID-19 a ‘notifiable disease’ in order to extend coverage under insurance policies for losses caused by such diseases. One of the UK’s insurance regulators, the Financial Conduct Authority, announced that it will seek a declaratory judgment from the High Court in London on sample policy wordings commonly used in business interruption in order to obtain an authoritative ruling as to whether such policies respond to losses caused by the pandemic. The FCA named eight insurers to be the Defendants to the test case, and is asking for rulings on seventeen of those insurers’ policy wordings which are typical of wordings used in the UK. The hearing will take place in an eight-day period at the end of July. The judgment should address the meaning of various expressions which are commonly used in BI policies, and also principles of causation and quantification of loss.

There is no indication at the moment that Pakistan will enact any policy holder friendly legislation to ensure that insurers cover losses arising from COVID-19 on existing insurance policies. Courts generally tend to be lenient with policy holders after unforeseen events, as they were in the aftermath of 9/11 and Hurricane Katrina. In this regard, the outcome of litigation in foreign jurisdictions is certain to impact disputes that have or will inevitably arise between policy holders and insurers in Pakistan. The traditional view that losses caused by a virus will not, under any circumstances, be covered by a physical loss policy, is unlikely to hold good.

In the short term, businesses are likely to require an in-depth review of their insurance policies to determine the possible coverages available for losses caused by COVID-19. In the medium and long term, the experience of many businesses in Pakistan during the pandemic may lead them to consider obtaining insurance with coverage for similar events in the future, such as non-damage business interruption (which provides coverage for loss caused by events disrupting business operation which are not caused by physical damage to property, such as cyber-attacks, governmental or regulatory actions and pandemics).

Note: This article is not intended to provide legal advice and no legal or business decision should be based on its content. It is intended to provide information of general interest about current legal issues.

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