Business interruption update

27 July 2020

In the wake of the government lockdowns across the globe and as restrictions begin to be eased in some countries, RPC has accessed a number of pre-eminent insurance practices in the major claims centres to swap notes on some of the key legislative developments to date in their respective jurisdictions and any recent cases of interest.

Developments in Legislation

The COVID-19 pandemic has resulted in far-reaching government activity around the world on a scale usually only seen during wartime. In some countries, governments are even considering legislation which would allow the retrospective revision or rewriting of private sector contracts where the outcome of those contracts is deemed to be unfair or undesirable as a matter of public policy. One such area is insurance policies which provide cover for business interruption and property damage. We consider some of the recent developments in this area below.

In the days and weeks following the government quarantine/shut down orders executed in response to the COVID-19 pandemic, a flurry of bills was introduced in several U.S. states to retroactively create – by government fiat – business interruption coverage under property insurance policies where none had existed. Although some bills remain pending, they have not moved forward in the legislative process, and bills in Louisiana and Washington D.C., have been tabled. In California, however, a new bill was introduced that would shift the burden of proof from the policyholder to the insurer with regard to the requirements of direct physical loss or damage. The bill would impose a rebuttable presumption that "COVID-19 was present on the insured's property and caused physical damage to that property which was the direct cause of the business interruption." The presumption would apply only to claims under those commercial insurance policies that provide coverage for business interruption; and would also apply to the related coverages for extra expense, civil authority, and ingress and egress. The bill would not invalidate virus exclusions, but it would render pollution exclusions inapplicable to COVID-19. Like the problematic bills introduced in other states, the bill applies retroactively to commercial insurance policies with coverage for business interruption in effect on or after March 4, 2020.

Judith Selby, partner at **Hinshaw & Culbertson LLP**, considers that whilst cooler heads appear to be prevailing in some states, legislative overreach remains a looming threat for insurers.

CONTRIBUTORS

COLIN BIGGERS & PAISLEY LAWYERS

HMN • PARTNERS

MILLER THOMSON

On the federal level, the Pandemic Risk Insurance Act Of 2020 (H.R. 7011) (PRIA) was introduced in the U.S. House of Representatives. It would establish a federal backstop for business interruption and event cancellation losses resulting from a future pandemic or public health emergency declared on or after January 1, 2021. The current version of the bill expands the definition of insurer to include captives and self-insurance arrangements, and the aggregate annual coverage cap was increased from USD500bn to USD750bn. The bill's original language requiring the Department of Treasury to charge a premium to participating insurers was stricken, making it unclear now as to how the act would be funded. Finally, the federal pre-emption language was stricken. Insurer participation would still be voluntary.

The National Association of Mutual Insurance Companies (NAMIC), the American Property and Casualty Insurance Association (APCIA), and the Independent Insurance Agents & Brokers of America Inc. have come up with an alternative to the proposed federal PRIA legislation. The Business Continuity Protection Program (BCPP) would provide immediate revenue relief for payroll, employee benefits, and operating expenses, following a viral emergency declaration by the President. The program would be run by the Federal Emergency Management Agency (FEMA) and funded by taxpayer dollars. Businesses would purchase revenue replacement for three months' relief–for up to 80% of payroll and other expenses—through insurers that voluntarily participate in the BCPP. Protection must be purchased at least 90 days before the presidential declaration, according to the proposal. Businesses would be required to certify that they would use any funds received for retaining employees and paying necessary operating expenses and that they would follow federal pandemic guidelines. "Pandemics simply are not insurable risks; they are too widespread, too severe, and too unpredictable for the insurance industry to underwrite... Pandemics are a national problem, and we need a national solution," said Charles Chamness, President and CEO of the NAMIC.

On June 30, 2020, the Business Interruption Relief Act of 2020 was introduced in the U.S. House of Representatives. It would create a voluntary program where insurers purportedly could choose to pay out claims to businesses and be reimbursed by the federal government. Reportedly, eligible businesses would be limited to those with business interruption insurance that includes civil authority shutdowns but excludes virus-related damages.

Miller Thomson partner, Mark Frederick, has explained that the Canadian regulators appear to have little interest in forcing insurers to take any steps that would in any way mandate coverage not bargained to be provided in the insurance contract. Mindful of the relatively small size of the domestic market and its small potential for domestic capitalisation, Canadian regulators generally leave the market alone in the face of widespread and immediate change. Whether in the case of terrorism, as seen after 9/11, or the recent COVID-19 pandemic and its devastating impact upon Canadian commerce and society, regulators are reluctant to introduce any law to make insurers pay for something they have not agreed to cover or to force parties into lawsuits or test cases in order to have the courts determine remedy on broad issues.

Meanwhile, in France, **HMN & Partners** reports that a working group composed of the French Insurance Federation (FFA), brokers, the MEDEF (national confederation of French employers) and Parliament members was formed by the Finance Ministry to think about the creation of a specific "extraordinary catastrophe" regime to compensate business interruption losses. Multiple issues were raised including what type of losses would be covered, whether the regime will be optional or compulsory and whether the costs will be shared with the State or exclusively be borne by the private sector. The first reflections are expected in the next few weeks. In parallel, 11 legislative proposals were filed before the French Parliament.

Following the lockdown in the United Kingdom on 23 March 2020, the Government ruled out introducing legislation requiring insurers to pay for COVID-19 related BI losses that completely fall outside the scope of cover. In answering questions from the Budget Select Committee on the issue, the Chancellor clarified that insurers had written and rated risks on the basis of an agreed scope of cover and that requiring insurers to pay claims that were not within the scope of that cover could result in solvency issues for insurers.

Shortly after, on 31 March 2020, Lloyd's of London issued guidance to the market on the payment of COVID-19 related claims and at the same time confirmed that all valid claims would be paid as quickly as possible. Lloyd's urged insurers not to automatically cancel policies due to missed payments of premium, but rather to have regard to the suitability and fairness when applying such a provision in light of the economic climate. The theme of 'flexibility' echoed the sentiment of earlier guidance issued by the FCA on 19 March which also emphasised the importance of operational resilience and the need for firms to have in place business continuity plans to manage and mitigate the impact of the crisis.

The overarching theme of the guidance from the FCA and Lloyd's was for firms to show flexibility, including when considering claims, offering renewals and suspending or terminating products. That flexibility has in large part been achieved despite the unprecedented circumstances, with the insurance market showing operational resilience and continuing to renew, transact and deal with claims. Following the April 2020 renewals, one major broking house commented on the "unbroken service" despite the disruption caused by the sector working-from-home.

The Government has subsequently followed its counterparts in Germany and France in announcing that it will provide reinsurance support to the UK trade credit insurance sector by way of a backstop in the amount of £10bn (USD12.4bn). The scheme will be backdated to cover losses from 1 April 2020 and will be available to UK insurers on a temporary basis until 31 December 2020. The scheme is aimed to support supply chains and help businesses trade during the pandemic with the knowledge that it will be protected if a customer defaults or delays on payment.

In addition to legislative reform, various stakeholders across the UK (re)insurance industry are working together with the Government to find solutions to the gap in cover for many policyholders through the creation of insurance vehicle "Pandemic Re". On 17 April 2020, a steering group chaired by Stephen Catlin of Convex was convened to consider the idea of creating a public-private risk financing solution for future pandemics. The so called "Pandemic Re" would follow the template of the UK government backed terrorism mutual, Pool Re. The group has since gained widespread support from across the industry and has formed a project committee with six working groups.

Litigation Update

In the United States, business interruption, travel insurance and event cancellation lawsuits, including class actions, continue to be filed. However, Judith Selby at **Hinshaw & Culbertson** notes that early developments have been favourable for insurers. Firstly, a Michigan state court judge issued what appears to be the first substantive ruling on COVID-19 business interruption claims brought by two restaurants. The court noted that the policy covers direct physical loss of or damage to property, which means something that alters the physical integrity of the property, Since the insured alleged only loss of use of the restaurants, the court ruled that the policy did not apply. The court further ruled that the policy's virus exclusion would apply even if physical loss or damage had been alleged. In a tactic utilized by many policyholders in recently filed business interruption lawsuits, the insured had tried to avoid application of the exclusion by arguing that government orders, not the coronavirus, caused the loss of use of the restaurants. The judge said that argument was "just nonsense." Second, the Pennsylvania Supreme Court denied an emergency application made by an insured restaurant, asking the court to assume extraordinary jurisdiction over its business interruption coverage suit on the basis of immediate public importance. The petition also sought to establish a coordinated system to resolve all similar business interruption cases in the state. Next, an insured magazine business filed a notice of dismissal of its business interruption coverage suit in a New York federal court. The magazine had sought an injunction requiring the insurer to immediately pay its claim. During a telephonic show-case hearing, the federal judge denied the insured's emergency application and stated: "I feel bad for your client. I feel bad for every small business that is having difficulties during this period of time. But New York law is clear that this kind of business interruption needs some damage to the property to prohibit you from going. You get an A for effort, you a gold star for creativity, but this is not what's covered under these insurance policies." Finally, at least two policyholders, a legal services company and a Pennsylvania restaurant, have voluntarily dropped their coverage lawsuits.

A number of policyholders, however, have launched efforts to centralise business interruption coverage disputes in multidistrict litigation (MDL), a federal procedure by which cases from around the country are transferred to one court. Proponents of MDL treatment assert that consolidation would expedite discovery and provide uniform answers on coverage issues. Insurers, joined by NAMIC, APCIA, a number of policyholders, and United Policyholders, a non-profit policyholder advocacy group, have opposed MDL treatment on numerous grounds, including differences in policy language, applicable law, and procedural difficulties.

Judith Selby anticipates that legislative efforts will continue to play out in the coming months, but if cooler heads do indeed prevail, the extreme state legislative proposals will not become law. She also hopes that courts will apply the policies as written in coverage litigation and reject improvident efforts to circumvent traditional coverage litigation through emergency applications, class actions, and other mass joinder attempts. Although insurers have scored some early wins, the COVID-19 insurance coverage wars have only just begun.

RPC

COLIN BIGGERS & PAISLEY LAWYERS

HMN • PARTNERS

MILLER THOMSON AVOCATS | LAWYERS

Mark Frederick at **Miller Thomson** reports that Canada has yet to see a flurry of COVID-19 related issues involving insurance or personal injury suits, although wrongful death cases arising out of operation of seniors' homes are now coming on track. There have been a small handful of cases on issues about whether claims could proceed, and there are several proposed and issued class actions seeking to get rulings against all insurers for putative denials of coverage, but few actual claims have made it to any judicial determination. This may in part be explained by the fact that the majority of property policies with business interruption cover expressly restrict the extent of the cover provided. Exclusions first put out during the SARS pandemic of several years ago were common place in policies issued by Canadian insurers, as were other exclusions or business interruption provisions that required property to suffer physical injury or damage to trigger payment. It remains to be seen whether there will be cases where coverage is sought for losses that arose because of the pandemic and where there is no exclusion in place. Looking ahead, Mark Frederick expects that most Canadian insurers will be mandating COVID-19 and other pandemic exclusions for all renewals post April 1, 2020. He also expects that over the next year we will see a number of rulings that speak to obvious coverage language in policies where cover can be found.

France entered a phase of increased litigation almost as soon as the lockdown lifted, reports **HMN & Partners**. The most widely reported case involved a restaurant owner who initiated summary proceedings before the Commercial court of Paris in order to request condemnation of its insurer to make a provisional payment corresponding to a portion of the business interruption suffered as a result of an administrative closure of his restaurants due to the pandemic and the subsequent governmental decisions. The summary judge rejected the insurer's argument alleging the uninsurable character of the risk and focused on the strict application of the policy that did not expressly exclude the pandemic. Following the initial decision of the summary judge and the appointment of an expert, a settlement was reached by the parties. Similar demands have recently been presented before the Commercial court of Lyon. By order dated 10 June 2020, the summary judge in that instance considered that he did not have jurisdiction to address the discussion regarding the validity and application of the exclusion clause and rejected the claim, noting that such discussion should be addressed in a proceeding on the merits. On 23 June 2020, the summary judge before the Commercial court of Bordeaux rejected the claim of a restaurant requesting a provisional condemnation of its insurer and appointed an expert to assess the amount of the BI suffered.

Each of the above cases were concerned with the application of policy conditions and the extent to which the exclusion clauses apply. No principled stand has been established to date and it is clear that the decisions will depend on the wording of each specific policy. It is possible that in the next few months, collective actions from insureds could arise following denial of coverage from the insurers.

Colin Biggers and Paisley partner Jonathan Newby commented that in Australia, the potential for dispute over pandemic exclusions and COVID-19 has become so apparent that the main financial ombudsman's service, Australian Financial Complaints Authority (AFCA), is now looking for a business interruption test case with the intent to help resolve impending disputes and provide an authoritative decision over how insurance policies should respond to the shutdowns. AFCA has confirmed that the issues in dispute for the test case are still under discussion and that they will be 'dealt with by a court with requisite jurisdiction to make a binding decision' i.e. not AFCA and more likely the Federal Court of Australia. This is in contrast to determinations made by AFCA itself which have no precedent force. Whether this initiative gets off the ground remains to be seen as the variation in wordings and exclusions is vast. However, the alternative is that AFCA itself deals with what is expected to be a deluge of claims and with a jurisdictional limit of AUD1m for claims pursued by small businesses, insurers could find themselves having the issues tested in a very consumer friendly jurisdiction.

Meanwhile, in the United Kingdom, the recent industry headlines have been dominated by the Financial Conduct Authority's (FCA) own test case and various class actions that have been initiated by claimant groups from various industries. On 9 June 2020, the FCA issued proceedings in the High Court of England and Wales to commence a test case in respect of a range of BI policies that provide cover in certain circumstances where there had been no physical damage to the insured property. The stated intention of the FCA's test case was to resolve contractual uncertainty around the validity of business interruption claims arising from the coronavirus pandemic.

The test case seeks the determination of 25 key questions concerning cover under 17 specimen non-damage business interruption policies. The questions have been identified as representative of the coverage issues raised by claims for losses which policyholders have sustained as a result of the COVID-19 pandemic, whilst the assumed facts make it clear that the test case is specific to the actions taken by the UK government in response to the pandemic. As such, the outcome of the test case will be legally binding on the insurers that are parties to the case in respect of the specific wordings in question and may provide some guidance for the interpretation of similar policy wordings and claims.

The FCA issued finalised guidance to insurers, managing agents and insurance intermediaries outside the test case requiring them to review and determine whether their non-damage business interruption policies are affected by the outcome of the issues to be considered and determined in the test case and to communicate that decision to its policyholders no later than 15 July 2020.

In the final case management conference prior to the hearing, various directions were given by Lord Justice Flaux and Mr Justice Butcher as to how the test case is to proceed, with two consumer action groups permitted to intervene and the FCA given the right to reserve dealing with the determination of issues relating to the under-recording of prevalence of COVID-19 in the UK until a further hearing in September.

The hearing continues this week and is being keenly watched by both insurers and policyholders in the hope that it will bring some clarity on some of the issues and questions that continue to arise on claims resulting from the COVID-19 pandemic. However, given the importance of the decision and the fact that the parties retain the right under the Framework Agreement to seek an expedited "leapfrog" appeal to the Supreme Court, we may have to wait a little longer before any such clarity is achieved.

Concluding Remarks

The above article is intended to provide the reader with an update on some of the different types of legislative and regulatory responses to the COVID-19 pandemic that have been seen around the world, as well as snapshot of some of the litigation that has arisen (and continues) to arise from it.