



# COVID-19: Business Interruption for Private Equity Companies

Private Equity looks to COVID-19-related business interruptions as lawsuits begin to materialize.

One of the most intensely studied and scrutinized coverage questions to arise out of the COVID-19 crisis is whether typical property insurance policies provide coverage for the economic losses suffered by insureds in the wake of the novel coronavirus pandemic. In insurance parlance, these are known as “business interruption” losses.

“Business Interruption” coverage is intended to compensate business owners, including private equity portfolio companies, for lost profits that result from having their businesses closed. Naturally, private equity firms, like other insureds, are looking to this provision of their insurance policies for relief in the wake of the loss of business that has 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 triggered 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.
3. Insurers claim 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 impossible. But these lawsuits give insight into the issues that will be resolved by the courts in the coming months and years.

## DIRECT PHYSICAL LOSS OR DAMAGE

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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 since 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, damage that requires the insured to repair, not simply clean and sanitize the property. Put another way; the coverage does not apply to this type of damage since the "damage" remedies itself with time. They point out that the virus only survives for a few days on surfaces and then dies without any outside intervention.

While many courts have agreed with the insurers' reasoning, there is some case law that provides support for the insureds' position, including cases where 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 since it renders the insured's property unusable for the insured's business purposes.

Insurers point out that the case of COVID-19 is different in that the businesses are closed because of government intervention, not physical damage. To answer the

insurers, insureds call attention to the fact that the reason given for the governments' actions is often the physical nature of the virus and the fact 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

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As for the last 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. Indeed, 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." Lawyers for insureds feel that this provides more room for argument about the policy intent and, thus, more opportunity for courts to find the exclusions inapplicable in the case of COVID-19.

## WILD CARD

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Finally, there is the "wild card," where 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 and Congress have already proposed bills that would do just that. So far, none of these laws have been passed, and many pundits have questioned the constitutionality of any such law. Nevertheless, the possibility that such laws will be passed remains.

In the end, a lot of factors will go into the resolution of these cases. But one thing is certain, a lot of companies 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

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While it is impossible to know how all these issues will be resolved, it is prudent for insureds to be prepared. We are advising our insureds to keep records of their economic loss and the extra expenses that they incur as a result of the crisis and the shutdowns. This will allow an insured to be prepared to act quickly if it is determined that coverage is afforded under its policy. Further, even if the policy does not respond, qualification for government assistance programs may require the same or substantially similar information about the effects of the crisis on its business.

A more difficult question to answer is whether or not private equity firms should put in a claim for business interruption for its portfolio companies, even in light of the fact that insurers are stating the business interruption losses are not covered. For this question, we recommend a conversation with your insurance broker. In some situations, advisors are warning against putting in claims reasoning that it will not be paid anyway. From that perspective, they argue, there is no upside to putting in a claim. 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, they argue that this is a bad thing.

On the other hand, some advisors argue that there is no downside. It is well known that portfolio companies, like other businesses, are suffering significant business interruption losses and that many are seeking recovery from insurers – and that many have begun filing lawsuits seeking court interventions 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. For many portfolio companies, payment of their business interruption claim is their last hope for survival.



The Hays team is continually monitoring COVID-19, its influence on your business and how you can be prepared for the implications of COVID-19. Reach out to your Hays service team with any questions.

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