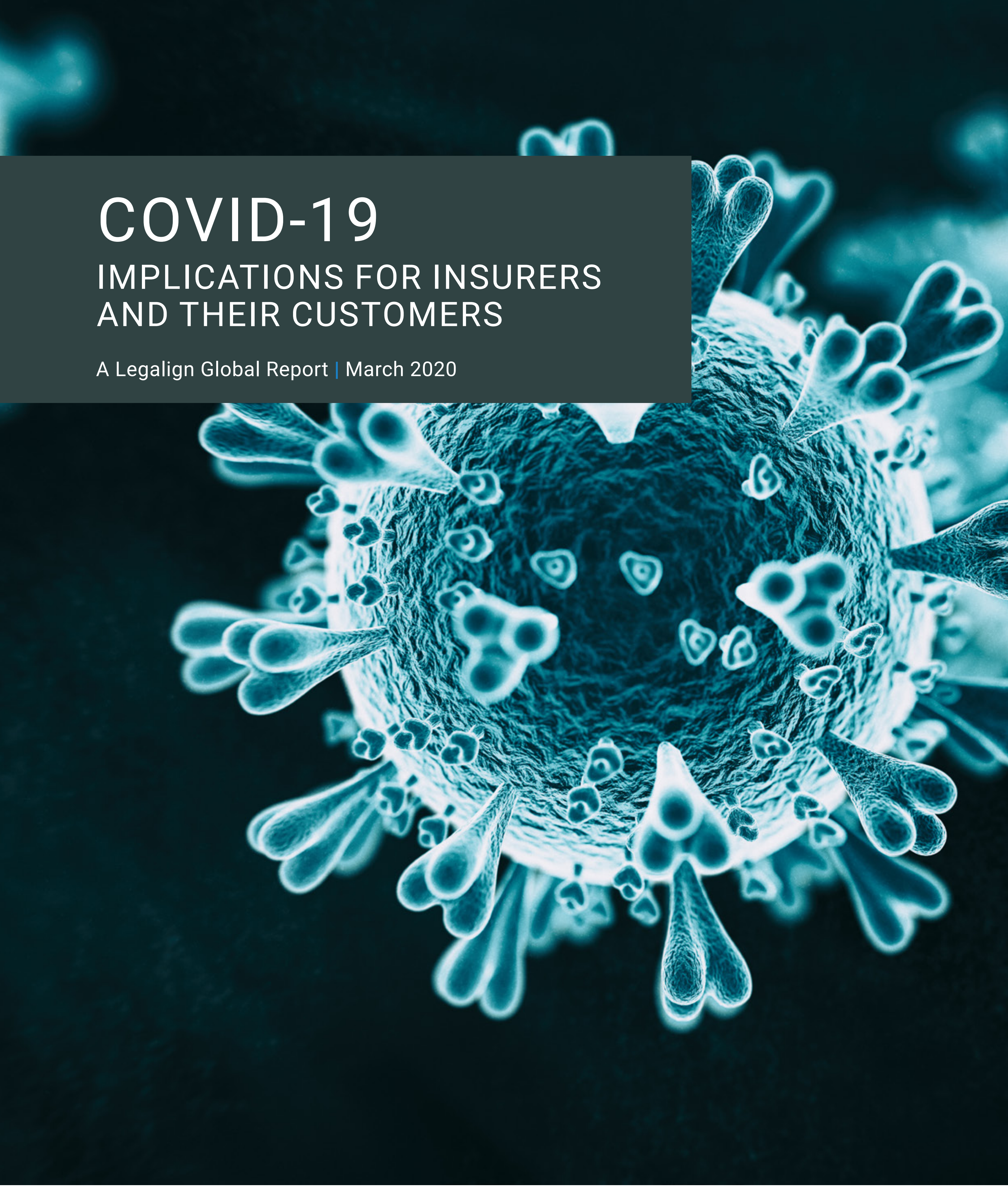
COVID-19

IMPLICATIONS FOR INSURERS AND THEIR CUSTOMERS

A Legalign Global Report | March 2020



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CONTENTS

INTRODUCTION

With COVID-19 being declared a pandemic by the World Health Organisation on 11 March 2020, the significant impact of the coronavirus is being felt worldwide. Stock markets have fallen reflecting concerns about the virus's impact on global and local economies. Many industries have been hard hit, including transport, tourism, events, hospitality and education.

The ripple effects from China's disrupted economy and manufacturing powerhouse have also been sorely felt across the wide range of industries with supply chain exposures. Supply chains across other countries are also likely to be disrupted due to failure to deliver materials or parts essential to production.

For the insurance sector, the exposures created by the coronavirus are significant as an international event of this size and complexity carries a range of insurance risks, including first party and supply chain business interruption, event cancellation insurance benefits, travel and liability claims.

Legalign Global is an integrated alliance of world-class insurance law specialists operating across all major markets. We are assessing the rapidly evolving insurance implications of COVID-19 on the European, US and Australasian markets.

This publication brings together commentary from each of the four Legalign Global firms on key insurance issues that are likely to arise. It should be noted that relevant law does vary from country to country and between common law and civil jurisdictions, and the intention of this publication is to provide a general commentary on some of the key issues.

Legalign Global's team of insurance law specialists will continue to monitor developments and are available to assist insurers and their customers in responding to financial losses associated with the virus in relevant jurisdictions.

Legalign Global is a closely integrated alliance of the world's leading insurance law firms. The alliance was founded on the principle of offering clients uniform and unrivalled levels of legal excellence and service across all major commercial insurance lines. Each member firm has built a significant reputation for delivering high-quality legal services through decades of investment in the global insurance industry. Legalign Global offers the distinct advantage of independent advice from established lawyers in more than 60 offices worldwide throughout Europe, Latin America, Australasia, Asia Pacific and the United States. It is the largest team of specialists of its kind, understanding the risks and complexities of the global market, responding with world class service quality and efficiency.

BLD Bach Langheid Dallmayr, a German firm with close associations throughout Europe.
DAC Beachcroft, an international firm with coverage across the UK, Ireland, Spain, Latin America and Asia Pacific.
Wilson Elser, a US firm with offices across the United States and another in London.
Wotton + Kearney, an Australian firm operating in the Asia Pacific region with a focus on Australasia.

Discovery in late 2019

167,000+ people infected

152+ nations reporting infections

Major event cancellation

Global markets at record lows

Cyber criminal threat increasing

CORONAVIRUS STATUS & IMPACT

The world has been watching the iterative development of the complex domestic, and increasingly international, issues associated with the identification and spread of the 2019 Novel Coronavirus (coronavirus), which originated in Wuhan City, Hubei Province in China.

The stakes were raised again on 30 January 2020 when the World Health Organisation (WHO) officially declared the coronavirus to be a Public Health Emergency of International Concern (PHEIC). On 11 February 2020, the WHO announced a name for the new coronavirus disease COVID-19, and on 11 March 2020, the WHO declared COVID-19 a pandemic.

Since its discovery in late December 2019, the coronavirus has swept the globe with 152 nations reporting infections by 16 March. According to the WHO situation report on 16 March, more than 167,511 people have been infected with the virus. Outside of China, the virus spread in the Republic of Korea, Italy, Iran and Japan are WHO's greatest concern.

The spread of the virus caused global markets to tumble to record lows, governments to launch multi-billion dollar stimulus programs, and reserve banks to plunge interest rates to close to zero. Recession looms large as a possibility acknowledged by heads of state around the world.

Major events and industry conferences have been cancelled due to fears of spreading the virus. The Geneva International Motor Show was effectively cancelled when Switzerland banned all gatherings of more than 1,000 people until mid-March. Facebook cancelled one of its most anticipated annual events, the annual F8 conference in California, and in Barcelona the Mobile World Congress, the world's biggest mobile phone trade show, also was cancelled. The NBA season and European football leagues have been suspended, the Australian Formula 1 Grand Prix cancelled, and there are suggestions that the Tokyo Olympic Games, scheduled for July, may be cancelled if the virus is not contained by the spring.

This is only the tip of the iceberg. The WHO is warning of cybercriminals cashing in on topical news stories like this to send emails asking for sensitive information or including malware. Employers, directors and officers and the hospitality industry may also face liability claims for exposing others to the coronavirus. Other complexities will also arise, such as the need to consider whether, and the extent to which, there are other reasons for any financial loss, such as political instability and Chinese New Year.

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BUSINESS INTERRUPTION

As with many earlier viral events, insureds and brokers are likely to quickly discover the coverage restrictions in standard commercial or industrial special risks policies, which may lead to significant limitations on – or denial of – their financial recovery.

However, the insurance market has matured through a number of global health-related cycles, and policy wordings have evolved to specifically deal with the tricky areas around policy trigger. For example, many of the wordings in play around the SARS-era have been increasingly refined. This has regularised the link between material damage and business interruption coverage and identified appropriate ways to write bespoke coverage. This evolution should give insureds and insurers dealing with the current pandemic far greater certainty around what is or isn't going to be covered.

Coverage for both business interruption and contingent business interruption is most commonly consequent on there being damage to property (in contingent business interruption, the property belonging to someone other than the insured, such as the supplier), for example a fire at a factory, which is clearly not the case with the coronavirus. Beyond any questions over the indemnifying provision, there may also be pollution or contamination exclusions, which may include viruses, bacteria or diseases.

Policyholders may have more specialised supply chain insurance or extensions that may meet the needs of this situation, providing contingent business interruption cover triggered by non-physical damage events, such as infectious diseases or denial of access, although post-Ebola, exclusions are more commonplace.

Designated peril requirement

Commercial businesses often procure business interruption coverage as part of their commercial property coverage. Business interruption coverage is designed to assist policyholders that suffer financial losses in their operations, generally arising from a designated cause such as fire or earthquake. If the insurance policy requires a designated cause of loss, but the loss does not qualify, coverage for business interruption will generally not be available.

Direct physical loss

Commercial property policies also typically require "direct physical loss" to the property and proof of causation. In the event of a claim for coronavirus-related business interruption, questions may arise as to whether this "physical loss" requirement has been met. In particular, in circumstances where a business has been closed as part of a mandatory or voluntary closure – but is otherwise still habitable and uncontaminated – it has probably not suffered a direct physical loss since infectious diseases arising from human-to-human transmission generally will not qualify as property damage. Broadly, "direct physical loss" does not include consequential or resulting economic loss.

In contrast, if property has been adversely physically changed by coronavirus there may be a basis for a policyholder to claim that a direct physical loss has occurred. For example, if coronavirus has physically "infected" walls and furniture or equipment and must be cleaned or removed it might qualify as direct physical damage to such property. However, prophylactic measures to protect against such an effect, or shutdown due to fear of such an effect, will not generally qualify as direct physical damage to property. Even if the policyholder can argue for physical damage caused by "infection" with coronavirus many policies will exclude cover by the use of standard "contamination and pollution" exclusions.

By way of example, decision from the Eighth Circuit Court of Appeals in the US explains the "direct physical loss" requirement. In Source Food Tech., Inc. v. U.S. Fidelity & Guar. Co., No. 06-1166 (8th Cir. Oct. 13, 2006), the insured argued that the closure of the U.S. / Canada border to its imported beef product due to "mad cow" disease concerns qualified as "direct physical loss" since it was unable to transport its product. The Eighth Circuit disagreed, finding that Source Food's inability to transport its beef product across the border did not constitute product that was physically contaminated or damaged, and to hold otherwise would render the word "physical" meaningless.

Given numerous health crises over the past few decades, insurers have added various exclusions designed to preclude coverage. Some are virus-specific – such as exclusions for Ebola or Bird Flu – while others may apply generally to property damage arising from bacteria or viruses. It is unlikely that the coronavirus will allow for a one-rule-fits-all conclusion when it comes to a determination of whether an insured has suffered a direct physical loss. Rather, it is more likely that each claim will be investigated and evaluated based on the specific facts.

Even where the policy is triggered, it will also be necessary to consider if other circumstances would have caused the business to suffer a downturn in business in any event (commonly known as the "wide area damage" issue). For example, could it be said that the business would have suffered losses anyway due to a lack of customer appetite or loss of critical services or transport infrastructure?

The effect of WHO's declaration

According to the New York Times, this is only the sixth time the WHO has declared a PHEIC since it was established in 2005. It did so for the Swine Flu pandemic in 2009, a polio outbreak in 2014, an Ebola outbreak in 2014, the Zika virus outbreak in 2016 and an Ebola outbreak in 2019.

PHEIC DECLARATIONS

This is only the sixth time the WHO has declared a PHEIC since it was established in 2005.

2020

Coronavirus

2018–20

Ebola

2016

Zika virus

2014

Ebola

2014

Polio

2009

Swine Flu

> “The market challenge with all events of this complexity is the lack of an obvious answer within the CBI coverage extensions to a “standard” set of facts.

While the PHEIC has been declared, and member states are obliged to comply with the Regulations, the focus is around coordinating an international response from countries to address matters like travel, trade, quarantine, screening and treatment.

The WHO’s PHEIC declaration alone is unlikely to have a direct “triggering” impact on property policies that contain conventional Contingent Business Interruption clauses. While each clause will need to be considered on its own merits, the relevant public authority order is usually domestic, not the WHO. Local governments and authorities are likely to exercise their own discretion on whether or not to close down a business and are not bound to strictly follow the WHO’s declaration.

Contingent Business Interruption Extensions

Most financial loss claims will be directed into the complex series of coverage extensions that are loosely captured under the term Contingent Business Interruption (CBI). CBI coverage is catalysed by something that is “deemed” by the policy to be damage not by actual damage to insured property. The deeming nature of each of the extension clauses is deliberately different.

For businesses dependent on supply chain production, CBI coverage often provides coverage when a supplier suffers a direct physical loss to its property that impairs its ability to provide delivery of goods or materials. Insureds in the manufacturing, hospitality and health care businesses are some of the more common policyholders for this product line.

The problem in trying to address the facts of a pandemic in standard market offerings is that there is superficial attraction to finding the “peril”, rather than the deemed damage. In most cases, the actual “peril” giving rise to the incident may be excluded under material damage and might only be written back on a limited basis into a CBI coverage extension. Integrating the “damage” and the “peril” under a CBI extension is never as clean as applying a standard material damage trigger.

There are no standard clauses in the market, and many bespoke clauses have restrictions knitted into them, such as radius and the level of formality of the civil authority intervention. CBI extensions that mix these triggers up can often, unintentionally, upset the fabric of the policy. Many contingent business interruption insurers require that affected suppliers be identified or scheduled in the insured's policy for coverage to exist.

There have been many attempts to widen CBI coverage extensions, often with the reverse effect. Most CBI covers clearly work on a single peril trigger and combining two perils into one clause can often have a qualifying effect. Additionally, the underlying vice that each extension looks to address is generally very different, which should lead to CBI extensions and any applicable policy sub-limits not being "stacked" (or at least stackable).

The market challenge with all events of this complexity is the lack of an obvious answer within the CBI coverage extensions to a "standard" set of facts. In many events of this type, the vast majority of claims are unlikely to fall neatly within the four walls of a CBI extension.

Specialised Business Interruption

While traditional policies may not cover economic losses arising from the suspension of operations due to a health crisis or pandemic, the insurance industry has made various specialised products available.

Hospitality and Health Care – for Communicable and Infectious Diseases

The insurance industry offers specialised coverage arising from the shutdown of operations, in some circumstances without requiring physical loss to property. These policies or policy endorsements primarily focus on insureds in the business of health care and hospitality and typically extend insurance coverage for business interruption losses caused by "communicable or infectious diseases."

Pandemic-specific coverage or exclusions

Pandemic "scares" have prompted the insurance industry to offer specialised coverage and exclusions for pandemic events. In May 2018, for example, it was reported that Marsh, in collaboration with Munich Re and epidemic risk modeler Metabiota, had launched PathogenRX, a fully integrated pandemic coverage product:

> *"Using triggers like Metabiota's new Pathogen Sentiment Index, which provides extensive analytics into infectious disease outbreaks, businesses can model their potential financial loss from an outbreak and protect against the threat through an insurance policy underwritten by Munich Re. The policy is customisable and can be tailored to provide coverage for specific expenses, geographies, types of disease, or portions of a calendar year."* – Insurance Journal (May 22, 2018)

In response to the Ebola crisis, several insurers expressly excluded coverage for Ebola-related claims. Other insurers, however, offered specific business interruption coverage to facilities such as hospitals, hotels, airports, shopping centres, restaurants, theatres and gyms or any other business that might be forced to shut its doors because of an Ebola outbreak.

Civil Authority Coverage/Denial of Access

Other policies extend business interruption coverage for losses arising from "civil authority" orders that impair or prohibit access to an insured's property. The scope and limitations of business interruption coverage under such endorsements vary and can be issued under an insurer's standard form endorsement, and they can vary based on whether a "direct physical loss" will be required. Insurers also may issue such cover on a manuscript basis (custom designed for a particular insured), addressing specific needs based on expenses, geography, disease, calendar year, voluntary or mandatory orders, direct physical loss, a designated risk or other criteria.

EVENT CANCELLATION & CONTINGENCY NON-APPEARANCE INSURANCE

Beyond travel, the coronavirus has resulted in a number of cultural, music and sporting events being cancelled. Event cancellation and disruption insurance will need to be considered in light of government travel restrictions, any closure of event spaces and the need for the cancellation. Careful review of exclusions or extensions relating to infectious diseases will be necessary.

Businesses considering buying cover now are likely to see the coronavirus specifically excluded, but that doesn't mean that an infectious diseases extension is not valuable against other diseases.

Not surprisingly, coronavirus is already impacting scheduled events. For example, the Dalai Lama cancelled all current public engagements; some ports have rejected cruise ships altogether; some airlines have stopped flights to parts or all of China; and many countries have imposed travel restrictions and entry bans for citizens or visitors of the most affected areas of the pandemic. Major events have been cancelled or curtailed, including all sport in Italy suspended until at least 3 April, the suspension of the NBA season and European football leagues, and the decision to cancel the Australian Formula 1 Grand Prix.

Insurance products specific to event cancellations or non-appearance of a key person generally provide coverage due to perils beyond the control of the insured, the organiser of an event and the attendees when such perils result in cancellation, abandonment, postponement or enforced reduced attendance.

Insureds, insurers and brokers now may find themselves evaluating such products to determine whether coverage under such policies may have been triggered. Under most policies, an insured has an obligation to mitigate its losses by reasonably seeking to postpone or reschedule an event to a different time or location. Terms and conditions of each policy may vary. An event cancellation policy can protect an insured from financial losses such as lost ticket sales, out-of-pocket expenses, contractual guarantees to others and sometimes even reimbursement to attendees for their purchased tickets.

Covered perils and losses

Covered perils in a typical event cancellation policy may include death, accident or illness; unavoidable travel delay; venue damage; and inclement weather.

A covered claim may appear to be a claim for unavoidable travel delay in which event attendees could not make it to their destination due to travel arrangements that were delayed or cancelled, making it impossible to reach the event. A common misconception made by insureds, however, is that a claim for an event cancellation would be covered if the cancellation is due to the attendees' or event organisers' fear of travelling, or spreading or catching the coronavirus, in circumstances where travel restrictions do not exist and the event is ready to go forward.

The cancellation of an event, while possibly in the best interest of the business, may not be covered under such policies because the cancellation was not beyond the control of the event organisers or attendees.

Exclusions

A typical event cancellation policy may contain exclusions for lack of interest or support for an event, a pre-existing condition, terrorism, breach of contract, financial failure of a venture and even communicable diseases.

One issue to be aware of is the Communicable Disease exclusion that excludes coverage where a loss arises out of fear of any world epidemic determined by the WHO. While this exclusion may exist in some event cancellation policies, coverage still may be provided in some circumstances, such as if the venue where the event was to take place was closed under the order of a government or public or local authority due solely to a communicable disease that manifested within the venue.

TRAVEL CLAIMS

In light of governments' foreign travel advice, a clear distinction needs to be drawn between travel to destinations where there is advice not to travel and a more general reluctance to travel due to the situation as a whole.

While the latter concerns are fully understandable, cancelling a holiday outside restricted countries, such as China, Iran and Italy, is unlikely to be covered. Where there is advice not to travel, a key factor is the date on which the warning against travel was made. In reviewing any policy, care should be taken to consider any extensions that cover epidemics.

Risk of infection with the coronavirus is often not covered by travel cancellation or travel interruption insurance, though. The fear of something that might happen is usually not covered. If, however, the insured actually falls ill with the virus before the trip, the travel cancellation insurance usually takes effect. As the virus has been classified as a pandemic, this might be excluded, depending on the wording.

LIABILITY INSURANCE

If the coronavirus continues to spread worldwide, insurers are likely to confront liability claims that span the spectrum of their insurance product lines.

General Liability Insurance

Businesses, particularly those that open their doors to the general public, may find themselves targets of claims that their negligence led to the exposure and infection of clients including:

- exposure resulting in bodily injury or property damage
- negligence related to visitors to businesses or locations such as offices, day care centres, retail shops, hotels and places of worship
- product liability related to air filtration and recirculation, particularly in situations involving airplanes and hospitals
- personal injury involving occurrences such as wrongful eviction or imprisonment
- constitutional claims involving the quarantine or restriction of infected or exposed persons, and
- negligence or other liability suits against a company or organisation that fails to implement a pandemic contingency plan.

Of course, the target of such claims will be not only the business but also the business's general liability insurance and its coverage for "bodily injury." Policy exclusions may exist for claims arising from a pandemic, virus or bacteria. Many insurers also include broadly worded pollution exclusions that could serve to preclude or limit coverage.

Errors & Omissions (E&O) Insurance

There is an adage that the most likely place to get sick is in a hospital. Medical care and managed care providers purchase errors and omissions (E&O) insurance that provides coverage for bodily injury arising out of their providing or failing to provide medical care.

While such policies generally preclude coverage for bodily injury to employees during the course of their employment (i.e. an employee being exposed to an infectious or contagious disease), such policies may respond to claims that a health care professional acted or failed to act in a manner that led to a patient (non-employee) contracting a coronavirus bodily injury.

Directors & Officers (D&O) Insurance

The coronavirus has roiled stock markets worldwide, resulting in ups and down depending on whether the market perceives that the crisis is being managed appropriately and whether global supply chains will be impacted. Ultimately, how a company responds to the coronavirus may subject its directors and officers to the scrutiny of the company's shareholders.

Shareholder claims have become commonplace when market valuations are purported to have unreasonably dipped. In response to a coronavirus-based loss in value, shareholders may argue that the directors and officers committed acts or omissions responsible for the loss in valuation and, in turn, the loss befalling the individual shareholder.

Claims may also arise by and among companies and their directors or officers. Such claims could include whether the company was sufficiently prepared for the risks associated with a pandemic illness, or whether appropriate steps were taken in response to the crisis.

Most D&O insurers include absolute bodily injury exclusions that expressly preclude coverage for any claim or loss "based on, directly or indirectly arising out of, or relating to actual or alleged bodily injury." While there are different versions of the exclusion, the insurer's intent is generally to preclude coverage for any claim, even one for economic loss, if it is based on, arising out of or related to bodily injury. Of note, such exclusions continue to be challenged in the courts.

Workers' Compensation Insurance

Workers' compensation policies generally extend insurance benefits to employees for injuries "arising out of or in the course of employment." Workers' compensation actions addressing the language often address whether the claimed injury is truly work-related, focusing on such factors related to the loss as its nature, the injured employee's activity, the time and the location. Consequently, employees and employers whose work is related to coronavirus should maintain records identifying potential exposures.

PREPARING FOR IMPACT

To prepare for the potentially catastrophic impact of a global pandemic or similar health crisis, policyholders and insurers should review insurance policies to determine:

- if they are sufficient
- what new exposures and risks are present given the unique nature of the coronavirus
- which current policyholders are likely impacted most
- the size, scope and nature of earlier claims and what they may indicate, and
- the process to triage claims to ensure they are handled in the best interest of all stakeholders.

To prepare for the catastrophic impact of a potential global pandemic, insureds, insurers and brokers must understand what is and is not covered under relevant policies. They should work together to minimise potential losses by evaluating potential claims as early as possible.

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