COVID-19: Ins. Cvg. for the Energy and Manufacturing Industries

HOW CONTINGENT BUSINESS INTERRUPTION WILL AFFECT ENERGY AND MANUFACTURING COMPANIES IN THE WAKE OF COVID-19.

BY PAMELA D. HANS
AND NICHOLAS R. MAXWELL

AS CORONAVIRUS (COVID-19) continues its march across the globe, it has become a significant potential problem for many industries, especially those reliant on suppliers, transporters, distributors, or ultimate customers in countries affected by the virus. While COVID-19 could implicate many different lines of commercial insurance, one of the most important will be business interruption. Here, we focus on the coverage perhaps most important for energy and manufacturing companies right now: contingent business interruption (often referred to as "contingent BI"). Contingent BI is the subset of business interruption coverage designed to apply when companies in the policyholder's supply chain or distribution network, rather than the policyholder itself, suffer property damage and a resulting disruption of business.

COVID-19 has made the importance of contingent business interruption coverage particularly clear because supply chains, distribution networks, and customer bases for so many American and multinational companies are in China and other countries affected by the virus. Indeed, COVID-19's genesis in China has already meant the shutdown of dozens of factories, shipyards, LNG terminals, and others. The effect on U.S. businesses continues to grow.

CONTINGENT BUSINESS INTERRUPTION: UNDERSTANDING THE BASICS

Contingent business interruption coverage has become an increasingly important subset of commercial property coverage. In general, business interruption coverage is designed to cover lost profits due to interruptions to business operations. It is usually triggered when the policyholder suffers direct physical loss or damage to insured property due to a covered cause of loss, and that damage disrupts the policyholder's business.

Contingent business interruption coverage insures losses suffered at a policyholder's supplier, transporter, distributor or customer (often called a "contingent location"), so long as the contingent location is damaged by a covered peril. In other words, insurance coverage may be available for losses upstream in a policyholder's supply chain or downstream in its distribution network and ultimate customer base.

POTENTIAL AREAS OF DISPUTE FOR COVID-19 CONTINGENT BI CLAIMS

Policyholders can anticipate several areas of dispute for COVID-19 claims. One key question might be whether COVID-19, a microscopic virus, causes "physical damage" as that term is used in property policies. Various court decisions have determined that viral contamination can constitute physical damage if it renders a facility unusable or uninhabitable. Even if COVID-19 is invisible to the naked eye and does not visibly disfigure property, the entire point of business interruption coverage is to provide coverage when the policyholder's (or its supplier's or distributor's) property becomes unusable.

A second key question may be whether COVID-19 is a covered cause of loss under a given policy. Some property policies include specific viral contamination exclusions that likely encompass COVID-19. Others contain vague pollution exclusions that could potentially apply to viral outbreaks. Courts have gone both directions in cases where insurance companies attempt to use their pollution exclusions to cover something not typically considered a "pollutant"—such as a viral outbreak. Some policies even contain exclusions that explicitly encompass bacterial outbreaks but not viral outbreaks like COVID-19.

Policyholders should remember that insurance companies have the burden to prove that an exclusion applies. Since insurance companies often author the forms on which policies are written, courts impose a high burden on insurance companies to be crystal clear about what they are and are not covering. In any event, policyholders can expect disputes over whether COVID-19 is a covered cause of loss under their property policies.

MITIGATION, CLAIM VALUATION,

AND THE LIKELY RESULTING DISPUTES

From both a business perspective and an insurance perspective, policyholders facing a contingent business interruption loss should consider alternate suppliers (upstream) or ultimate customers (downstream) to mitigate losses. Assume a manufacturer normally buys raw material for $100/ton and sells its final product for $150/ton, making a $50 profit: If the supplier has a fire—or a viral outbreak—but the policyholder can get its raw material elsewhere for $125/ton, the policyholder's contingent BI claim could decrease from $50/ton to $25/ton. The expense of purchasing alternative raw material, often called an "expense to avert BI," should be part of a covered contingent business interruption claim. The same analysis applies looking downstream to a transporter or distributor that suffers a loss, if the policyholder can find alternate distribution methods.

In addition to the positive business impacts of mitigation, many property policies require the policyholder to take reasonable mitigation measures. Unfortunately, however, these mitigation measures can ultimately make a contingent BI claim more contentious if valuation issues arise. Suppose a contingent location only takes six months to rebuild, but in order to mitigate its loss during that time period, a policyholder must sign a one-year contract with the alternative supplier. Is the whole contracted amount covered, even if the policyholder did not make some payments until after the contingent location was restored to service? Suppose an LNG plant normally sells to Japanese energy producers but its Asian network of distribution hubs is shut down due to a COVID-19 outbreak. Must the LNG company turn its ships around and search for alternate distributors?

These are complex questions inherent to contingent business interruption. Policyholders should be well equipped to address not just the threshold question of whether a COVID-19 loss is covered, but also the claim valuation issues that might arise during the claim adjustment.

THE IMPORTANCE OF CLAIM PREPARATION

In any sophisticated commercial property loss, valuing the claim can be just as important as establishing coverage. If an insurance company admits coverage but substantially undervalues the loss, the policyholder's victory could be in name only. Accordingly, policyholders should retain an experienced claims preparer with expertise in contingent business interruption, ideally with specific expertise in the policyholder's industry.

NEW COVERAGE SPECIFIC TO COVID-19?

There are various arguments for covering COVID-19 claims under existing standard property insurance policies. In addition, the insurance industry recently unveiled limited optional "civil authority" coverage for COVID-19. Civil authority is a common supplemental coverage triggered when a governmental entity issues orders restricting access to a policyholder's property (by way of example, property owners in New York City used civil authority coverage when the city temporarily barred access to certain areas after Superstorm Sandy). It is unclear whether the COVID-19 coverage described above would apply to contingent locations—a key question for U.S. companies since at present the majority of supplier facilities shut down by government order are in China. In any event, a key question for policyholders considering these new coverages is whether they are sub-limited. Tailored supplemental coverages are frequently subject to quite low sub-limits.

It may turn out that the business impact of COVID-19 is limited for many companies. For those that suffer losses of the type discussed herein, however, contingent business interruption coverage could limit the financial burden, especially for businesses whose supply chains or distribution networks touch any of the growing number of substantially affected countries. Policyholders should review their policies, speak with their insurance brokers, and contact an insurance professional if questions arise concerning the scope of coverage for potential COVID-19-related losses.

Pamela D. Hans is the managing shareholder of Anderson Kill's Philadelphia office. Her practice concentrates in the area of insurance coverage exclusively on behalf of policyholders. Her clients include utilities, businesses in the oil and gas sector, manufacturing companies, educational institutions and religious organizations whom she has represented in disputes with their insurance companies. She can be reached at phans@andersonkill.com

Nicholas R. Maxwell is an attorney in Anderson Kill's Philadelphia and New York offices. He represents corporate policyholders in courts throughout the country seeking to recover under all major lines of commercial insurance, including property, cyber, D&O, E&O, and general liability.