

STONE MAGNANINI

COMPLEX LITIGATION

COVID-19 ALERT

TO: Friends of the Firm

FROM: Stone & Magnanini LLP

DATE: April 17, 2020

SUBJECT: COVID-19: What Claims Could Arise out of COVID-19 and What Actions Should Companies be Taking in these Difficult Times?

Many of you have been inundated over the last few weeks with e-mail blasts regarding the legal consequences of COVID-19, which while helpful to frame the issue, are mostly devoid of substantive content. Much of this analysis was done in real-time, with little more than a top level summary. In contrast, our aim is to provide our clients with a more comprehensive discussion of the various legal issues raised by the pandemic that they are likely to face.

We are sending three separate alerts over the coming days. Each focuses a particular issue of concern: Commercial Contracts, Insurance Coverage, and Employment Issues. If you would like to discuss any of these concerns further or if our firm can be of help to you in any way, do not hesitate to call us at 973-218-1111, or email our managing partners at dstone@stonemagnalaw.com or rmagnanini@stonemagnalaw.com.

Please note that this alert is not intended to constitute legal advice, and is not a substitute for having a licensed attorney analyze your company's particular contract and/or situation.

I. Insurance Coverage Concerns

A. Business Interruption Insurance

The first step a business should take in these unique times is to review its insurance policy to see if it contains business interruption coverage, and if so what exclusions apply. Whether your business is covered may depend on the specific language of that exclusion as we discuss below.

One of the major questions circulating amongst the small business and insurance communities is to what extent business interruption insurance will cover lost income suffered as a result of COVID-19. This question has incredible financial significance for business owners and the insurance industry, as one estimate found that small business' potential continuity losses could total

\$220 billion to \$383 billion *per month*, which would quickly consume the estimated \$800 billion surplus that U.S. insurers have for payouts.¹

Due to certain exclusions now present in many commercial policies, the general presumption is that coverage for business losses suffered due to coronavirus will be, in many cases, nonexistent. Business interruption coverage requires physical damage, and property and liability policies often exclude contamination by viruses and bacteria, through such exclusions as comprehensive Communicable Disease Exclusions, Contamination Exclusions, Organic Pathogen Exclusions, Exclusions for Loss Due to Virus or Bacteria, and even some Absolute Mold Exclusions which include the term “virus” within their language.²

This was not always the case. In 2003, Mandarin Oriental hotels in Asia suffered significant economic loss due to cancellations and reduced restaurant sales stemming from the SARS outbreak. Mandarin Oriental International Ltd. recovered \$16 million from its insurers to pay for such business interruption losses.³ Following the SARS outbreak, insurers took greater pains to build into business interruption policies exclusions that would specifically prevent this type of loss in the future. For example, many policies currently contain a Communicable Disease Exclusion. A frequently used definition for communicable diseases is quite broad – enough to cover COVID-19:

a contagious disease or illness arising out of or in any manner related to an infectious or biological virus or agent or its toxic products which is transmitted or spread, directly or indirectly, to a person from an infected person, plant, animal or anthropoid, or through the agency of an intermediate animal, host or vector of the inanimate environment or transmitted or spread by instrument or any other method of transmission. “Communicable disease” shall include, but not be limited to Acquired Immune Deficiency Syndrome (AIDS) or Human Immunodeficiency Syndrome (HIV), Severe Acute Respiratory Syndrome (SARS), West Nile Disease, chicken pox, any type of strain of influenza (including but not limited to avian flu), legionella, hepatitis, measles, meningitis, mononucleosis, whooping cough, cholera, bubonic plagues and anthrax.⁴

(Emphasis added). Some policies also include an Organic Pathogen Exclusion, which defines an organic pathogen as “any type of bacteria, *virus*, fungi, mold, mushroom, or mycotoxin, or their spores, scent, or byproducts, or any reproductive body they produce.”⁵ (Emphasis added). Again, this definition is broad enough to presumably include COVID-19. Many exclusions have subtle differences in their language that will require a review by insurance counsel.

Still, an insured could find coverage in certain circumstances, particularly if the government or the courts step in to fill the gap and order or declare the exclusions waived; however, if such declarations or rulings do not also address the usual physical damage requirement, coverage may still be disclaimed. Past court rulings could be construed to aid the COVID-19 insured. For example, in *Gregory Packing, Inc. v. Travelers Prop. Cas. Co. of America*,⁶ a New Jersey federal court held that an ammonia discharge which did not physically damage a plant but rendered it unusable for a time was covered under business interruption insurance. While COVID-19 does not render a property permanently damaged, it may render it temporarily uninhabitable both due to its danger and the social distancing mandates and orders that necessarily come with it.⁷ Similar rulings, essentially finding coverage when there has been a loss of use as opposed to a physical loss, have occurred in other states.⁸ As a result, it is highly likely that different courts sitting in different states will view

this same pandemic through different lenses. *Lyle Enterprises, Inc. v. Hartford Steam Boiler Inspection and Ins. Co.*, 399 F. Supp. 2d 821 (W.D. Mich. 2005)(blackout in 2003 was not caused by direct physical damage to Detroit Edison's equipment); *Contra, Wakefern Food Corp v. Liberty Mut. Fire Ins. Co.*, 406 N.J. Super. 524 (App. Div. 2009)(court analyzing same 2003 blackout concluded it was caused by direct physical damage and found coverage).

A creative and well-prepared insured may also rely on different coverages beyond business interruption. For example, event cancellation policies commonly indemnify the insured for losses arising from the unavoidable cancellation, curtailment, postponement, removal to alternative premises, or abandonment of an event, and for any enforced reduced attendance. The loss must generally be caused by factors beyond the control of the insured or the attendees, such as a lawful order which prohibits attendance by some (or all) attendees. Exclusions in such a policy should be thoroughly reviewed, but for events that were to be held in states subject to mandatory quarantine and social distancing-related executive orders, such as New York, New Jersey, California or Washington, among others, event cancellation policies may be a fertile ground for coverage.⁹

Government orders that interfere with a company's ability to conduct business could result in coverage in other scenarios. For example, an insured may be experiencing a disruption as a result of its manufacturing facility being shut down due to a COVID-19 quarantine ordered by the local, state, or federal government. The absence of property damage at the facility would ordinarily be a barrier to business interruption coverage. However, coverage might be available under a civil authority coverage extension, if part of the applicable policy. Civil authority coverage reimburses lost profits and other economic losses when a government entity has issued a legal order resulting in the denial of access to the policyholder's insured premises. While some civil authority provisions expressly require physical property damage, others do not.

Coverage might also be available via ingress/egress coverage, which is designed to pay for a loss of profits and other economic losses due to the suspension of access to the insured's business. In some policies, the prevention of ingress and egress must be caused by a physical impediment, such as a blocked road, a flood or downed power lines. In other policies, however, the ingress/egress coverage is not tied to the facility's inaccessibility being caused by direct physical damage. In other words, depending on the policy language, a COVID-19 quarantine order imposed on a particular location that prevents access to an insured's premises might trigger this coverage, even in the absence of virus contamination or other physical damage to the insured property itself. And where the ingress/egress coverage does require physical damage, that may be satisfied by the presence of coronavirus near the insured property.¹⁰

While it may be an uphill battle, we can expect that thousands of companies will go to court to test the boundaries of these exclusions and coverages. For example, Thomas Keller, the famous chef associated with such restaurants as The French Laundry and Per Se, has already brought suit to require his insurance company, Hartford Fire Insurance Company, to cover his restaurants' coronavirus-related business losses.¹¹ New Orleans seafood restaurant Oceana Grill made a similar move earlier this month in asking a Louisiana court to make a declaratory judgment that its insurance policy with Lloyd's of London covered civil authority-ordered closures.¹² We can expect many similar cases throughout the country in the weeks and months ahead.

B. State Laws Mandating Coverage

Some of the foregoing provisions may end up moot if as has recently been discussed, states enact laws requiring insurance companies to provide coverage for COVID-19 related losses. If you are an insurance company, such laws could be catastrophic. If you are an insured they could be a godsend. However, depending on how such laws are written they may be subject to serious state and federal constitutional challenges and may ultimately be unenforceable.

For example, the New York State Assembly introduced a bill “requiring certain perils be covered under business interruption insurance during the coronavirus disease 2019 (COVID-19) pandemic.” Like New Jersey’s own COVID-19 bill (A-3844),¹³ the New York bill (A-10226) – which is currently being considered by an Assembly Committee – would require every property policy providing business interruption and loss of use coverage to include among the policy’s covered perils coverage for business interruption during the COVID-19 declared state emergency.¹⁴ Coverage required by the New York bill would include any loss of business or business interruption for the duration of the declared state of emergency, subject to the applicable policy limits. Massachusetts, Louisiana, and Ohio are considering similar laws.¹⁵ Whether such state laws could survive a Contracts Clause analysis under the federal constitution remains an open question.¹⁶

Specifically, the United States has recognized a three-part test for “harmonizing the command of the [Contracts] Clause with the ‘necessarily reserved’ sovereign power of the states to provide for the welfare of their citizens.”¹⁷ To determine whether legislation violates the Contracts Clause, the court must (1) analyze whether the law has operated as a substantial impairment of a contractual relationship; (2) whether the government entity, in justification, had a significant and legitimate public purpose behind the regulation; and (3) whether the impairment is reasonable and necessary to serve this important public purpose.¹⁸ Even if a government entity can establish a legitimate purpose, the statute can be declared invalid if it is not limited to reasonable and necessary steps to serve the purpose.¹⁹

Assuming these statutes pass, there will undoubtedly be a clear and substantial impairment of insurance companies’ contractual relationships with their insureds. So the question becomes, is this impairment bolstered by a legitimate public purpose? A legitimate public purpose is one aimed at remedying a broad and general social or economic problem.²⁰ Saving Main Street USA from economic ruin would likely pass that prong. Once a legitimate public purpose has been identified, courts must then decide whether the impairment is both necessary and reasonable to meet the purpose advanced by the Government in justification.²¹ The courts do not accord legislatures “complete deference,”²² when assessing the necessity of a given impairment. But the Contracts Clause also “does not require the courts ... to sit as superlegislatures,” choosing among various options proposed by plaintiffs, as they are “ill- equipped even to consider the evidence that would be relevant to such conflicting policy alternatives.”²³ This is where the battle lines surely will be drawn.

In 2018, the Supreme Court issued its first Contracts Clause decision in many years: *Sveen v. Melin*, 138 S.Ct. 1815 (2018). In *Sveen*, the Court considered a Minnesota statute providing that the dissolution of a marriage automatically revokes a life-insurance beneficiary designation made by a person in favor of the person’s former spouse. Sveen married in 1997 and one year later purchased a life insurance policy, designating his then spouse as the primary beneficiary. In 2002, Minnesota

enacted a statute that automatically revoked life insurance beneficiary designations of a spouse upon divorce. Five years later Sveen divorced. Sveen took no action to revoke or modify his life insurance beneficiary designation and died in 2011. Relying on the revocation statute, Sveen's children argued that they were the beneficiaries of the policy proceeds. His former spouse disagreed, arguing that the statute retroactively impaired the obligations of Sveen's life insurance contract and could not be constitutionally applied to revoke his beneficiary designation.

The Supreme Court upheld the statute as an unsubstantial impairment of the life insurance contract. In an opinion authored by Justice Kagan, the Court considered the extent to which the law undermined the contractual bargain, interfered with a party's reasonable expectations, and prevented the party from safeguarding or reinstating his rights. The majority of the Court agreed that three aspects of the Minnesota law, taken together, demonstrate that the law does not operate as a substantial impairment to the contract.

We expect that these statutes, if passed, will receive significant appellate level review in both state and federal courts.

C. Cyber Liability Coverage: Remote Work?

In addition to business interruption coverage, insureds should check to see if their insurance provides cyber coverage. Cyber liability coverage has become increasingly popular in recent years as a result of the high-profile losses suffered by various major corporations from hacking incidents, ransomware attacks, and the like. With the vast majority of the nation's professionals and corporate employees currently working from home due to COVID-19, the security of each individual employee's home WiFi and related systems is a clear and present concern.²⁴ Whether cyber liability coverage will extend to a security incident that occurs as a result of remote work is a policy by policy question.

While each individual policy should be reviewed to determine what, if any, exclusions apply for remote work, a company would likely be protected for cyber-related remote-work exposures by a stand-alone cyberinsurance policy.²⁵ The costs and payments necessary to end a ransomware event would likely be covered under the policy's cyber extortion section. A cyberattack could undoubtedly cause a plethora of incident response costs covered by the policy, such as those incurred for forensic investigations, legal advice, complying with each state's data breach notification laws, public relations and restoring or recreating data. There would also be possible coverage for the loss of business income and extra expenses resulting from either a business or network interruption due to a cyberattack, a voluntary shutdown of a network to mitigate the impact of an attack or a system failure, which would not require an actual cyberattack.

In short, now is the time for business owners to review their cyber liability policies to ensure that they cover remote work.

The purpose of this client alert is to put companies on notice regarding steps they can take to protect themselves from COVID-19 related incidents and to inform insurance companies about claims they may be facing as this the pandemic draws down. If our firm can be helpful in any way, we stand ready to provide advice in this difficult time.

FOR FURTHER DISCUSSION PLEASE TELEPHONE US AT 973-218-1111 OR EMAIL US AT DSTONE@STONEMAGNALAW.COM OR RMAGNANINI@STONEMAGNALAW.COM

¹ Alicia Wallace, *French Laundry restaurateur Thomas Keller sues for coronavirus insurance coverage*, CNN Business (Mar. 28, 2020), available at <https://www.msn.com/en-us/money/companies/french-laundry-restaurateur-thomas-keller-sues-for-coronavirus-insurance-coverage/ar-BB11OQ5B?li=BBbnfcl> (last visited Mar. 29, 2020).

² See, e.g., Jing Yang, *Why Many Businesses Will Be on the Hook for Coronavirus Losses: Burned by SARS, insurers across the board now exclude epidemics in standard business-interruption policies*, The Wall Street Journal (Feb. 21, 2020), available at <https://www.wsj.com/articles/why-many-businesses-will-be-on-the-hook-for-coronavirus-losses-11582282802> (last visited Mar. 29, 2020).

³ See Gavin Souter, *Hotel chain to get payout for SARS-related losses*, Business Insurance (Nov. 2, 2003), available at <https://www.businessinsurance.com/article/20031102/ISSUE0101/100013638/hotel-chain-to-get-payout-for-sars-related-losses> (last visited Mar. 29, 2020).

⁴ J. Wylie Donald, *Climate Change, Pathogens, and Business Insurance: Some Thoughts on Viruses, Virulence, and Variation*, available at <https://www.slideshare.net/NationalUnderwriter/climate-change-pathogens-and-business-insurance-some-tou> (last visited Mar. 29, 2020). Additionally, ISO Form CP 01 40 07 06 is titled "Exclusion for Loss Due To Virus Or Bacteria" and provides, in relevant part: We will not pay for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease." (Emphasis added). The exclusion goes on to specifically state that it applies, among other things, to "business income," i.e., business interruption.

⁵ *Ibid.* Also note that "Absolute Mold Exclusions" may have very similar language, even including the term "virus" specifically within the definition. That is why an in-depth review of the subject policy is necessary, as a simple review of an exclusion's title could be deceiving.

⁶ Civ. No. 2:12-CV-04418 (D.N.J. Nov. 25, 2014).

⁷ See also *Western Fire Ins. Co. v. First Presbyterian Church*, 165 Colo. 34, 437 P.2d 52 (Colo. 1968) (the Colorado Supreme Court concluded that "coverage was triggered when authorities ordered a building closed after gasoline fumes seeped into a building structure and made its use unsafe. Although neither the building nor its elements were demonstrably altered, its function was eliminated.")

⁸ See, e.g., *Murray v. State Farm*, 203 W.Va. 477, 509 S.E.2d 1 (W. Va. 1998) (a covered loss included situations that rendered the insured property unsafe or uninhabitable that may exist in the absence of structural damage to the insured property); *American Guar. & Liab. Ins. v. Ingram Micro*, 2000 WL 726789 (D. Ariz. 2000) (finding that physical damage is not restricted to the physical destruction or harm of computer circuitry, but included loss of access, use and functionality); *Farmers Ins. Co. of Oregon v. Trutanich*, 858 P.2d 1332 (Or. App. 1993) (methamphetamine odor created a loss of use that was covered).

⁹ Suzan Charlton, Justin Howell, Benedict Lenhart and Bert Wells, *8 Possible Paths To Insurance Coverage For COVID-19 Losses*, Law360 (Mar. 26, 2020), available at <https://www.cov.com/-/media/files/corporate/publications/2020/03/8-possible-paths-to-insurance-coverage-for-covid-19-losses.pdf> (last visited Mar. 29, 2020).

¹⁰ *Ibid.*

¹¹ Wallace, *supra*.

¹² *Ibid.*

¹³ See Suzette Parmley, *COVID-19 and Business Insurance: NJ Legislation Still in Play*, New Jersey Law Journal (Mar. 23, 2020), available at <https://www.law.com/njlawjournal/2020/03/23/covid-19-and-business-insurance-nj-legislation-still-in-play/> (last visited April 6, 2020). A copy of the New Jersey bill is available at: https://www.njleg.state.nj.us/2020/Bills/A4000/3844_11.HTM (last visited April 6, 2020).

¹⁴ The New York Assembly bill is available at: <https://legislation.nysenate.gov/pdf/bills/2019/A10226> (last visited April 6, 2020).

¹⁵ Linda Hsu and Savannah Montanez, *Should States Force Property Insurers To Cover Virus Losses?*, Law360 (April 3, 2020), available at https://www.law360.com/newjersey/articles/1258611/should-states-force-property-insurers-to-cover-virus-losses-?nl_pk=338efd08-9cf8-4432-abdf-fd0dbddb9e95&utm_source=newsletter&utm_medium=email&utm_campaign=newjersey (last visited April 6, 2020).

¹⁶ See, e.g., *General Motors Corp. v. Romein*, 503 U.S. 181, 191 (1992) (while the U.S. Constitution generally prohibits states from retroactively interfering with vested contractual rights without due process, such an interference may be upheld if it is rationally related to a legitimate state interest); see also Tyler Clifford, *Chubb CEO: Forcing insurers to pay pandemic loss*

claims is 'plainly unconstitutional', CNBC.com (Apr. 16, 2020), available at <https://www.cnbc.com/2020/04/16/chubb-ceo-making-insurers-cover-pandemic-losses-is-unconstitutional.html> (last visited Apr. 17, 2020).

¹⁷ *Baltimore Teachers Union v. Mayor & City Council of Baltimore*, 6 F. 3d 1012, 1015 (4th Cir. 1993) (quoting *U.S. Trust Co. v. New Jersey*, 431 U.S. 1 (1977)).

¹⁸ See *Energy Reserves Grp., Inc. v. Kan. Power & Light Co.*, 459 U.S. 400, 411-13 (1983); *Nieves v. Hess Oil V.I. Corp.*, 819 F.2d 1237, 1243 (3d Cir. 1987); *Farmers Mut. Fire Ins. Co. of Salem v. N.J. Prop.-Liab. Ins. Guar. Ass'n*, 215 N.J. 522, 546-47 (2013) (alterations in original)(quoting *State Farm Mut. Auto. Ins. Co. v. State*, 124 N.J.32, 64 (1991)).

¹⁹ *Id.*

²⁰ See *Energy Reserves Grp.*, 459 U.S. at 411-12; *Allied Structural Steel Co.*, 438 U.S. at 247 (finding that there was “no showing in the record before us that this severe disruption of contractual expectations was necessary to meet an important general social problem. The presumption favoring ‘legislative judgment as to the necessity and reasonableness of a particular measure’ simply cannot stand in this case.”) (citation omitted).

²¹ See *U.S. Trust Co. v. New Jersey*, 431 U.S. 1, 22 (1977) (“Legislation adjusting the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption.”); *N.J. Retail Merchs. Ass’n v. Sidamon-Eristoff*, 669 F.3d 374, 386 (3d Cir. 2012) (“[T]he court must ascertain ‘whether the adjustment of the rights of the parties to the contractual relationship was reasonable and appropriate in light of that purpose.’” (citation omitted)).

²² *U.S. Trust*, 431 U.S. at 26.

²³ *Balt. Teachers Union*, 6 F.3d at 1021-22.

²⁴ COVID-19: CERT-In says spurt in cyberattacks on personal comps since 'work from home' protocol began, *The Economic Times* (Mar. 27, 2020), available at <https://economictimes.indiatimes.com/tech/internet/covid-19-cert-in-says-spurt-in-cyberattacks-on-personal-comps-since-work-from-home-protocol-began/articleshow/74849119.cms?from=mdr> (last visited Mar. 29, 2020).

²⁵ Jason Krauss, *Client Alert: Cyber risk, coronavirus and insurance coverage*, Willis Towers Watson (Mar. 12, 2020), available at <https://www.willistowerswatson.com/en-US/Insights/2020/03/client-alert-cyber-risk-coronavirus-and-insurance-coverage> (last visited Mar. 29, 2020).