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INSIGHT

Business Interruption Insurance and COVID-19

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The economic disruption from the COVID-19 pandemic has led businesses and policymakers to ask whether insurance should cover associated losses. The loss of income from mandatory or voluntary closures, supply chain disruptions, and reduced demand due to social distancing measures may induce businesses of all sizes to seek compensation from insurers.

Commercial Property Insurance

Most businesses carry commercial property insurance, including coverage for damage to their building and contents due to a covered cause, such as a fire or windstorm. Such insurance may also cover loss of income resulting from property damage (see "Business Interruption Insurance" below). Viruses and infectious diseases are generally not designated perils in a standard policy, although all-risks coverage might include COVID-19.

Following previous health crises, many policies now contain explicit exclusions for virus or bacterial losses. In 2006, the Insurance Services Office (ISO) introduced an exclusion for loss due to virus or bacteria that applies to property damage to buildings or personal property and endorsements that cover business income, extra expense, or action of civil authority. This language excludes coverage for loss or damage resulting from any virus or microorganism that induces physical distress, illness, or disease.

Physical Loss or Damage Requirement

Property insurance policies typically require direct physical loss or damage to tangible property. For policies without an exclusion for viruses, the determination of coverage related to the coronavirus may turn on the definition of physical damage. When a business remains habitable but has been closed as part of a mandatory or voluntary closure to protect against contamination, it has probably not suffered a direct physical loss. If a property has become physically contaminated and uninhabitable due to coronavirus, there may be a basis to claim that a direct physical loss has occurred. Some orders shutting businesses, such as that issued by the Mayor of New York, have specifically cited property damage from COVID-19 as one of the underlying reasons for shutdowns. In addition, there is some case law that supports an

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interpretation of direct physical loss to include damage that is not structural but could make the premises unfit for occupancy. Several lawsuits challenging the physical damage requirement have been filed, arguing that the virus physically infects and stays on the surface of materials for days and contamination of the insured premises by the coronavirus is a direct physical loss needing remediation.

Business Interruption Insurance

Business interruption (BI) insurance can be an add-on to a property insurance policy, or a stand-alone policy, covering loss of income, contingent BI, and possibly losses due to actions by civil authorities. It typically covers business losses directly or indirectly caused by a covered peril—loss of profits, fixed costs (operating expenses and other costs still being incurred), cost of actions taken to mitigate the loss, and reasonable expenses to allow the business to continue operating.

Business Income Coverage

Business income coverage provides coverage for sustained loss of income due to the necessary suspension of the policyholder's operations. For example, if fire damage shuts down a factory, the business income coverage usually pays for lost income until the damage can be repaired and production can be restored. The suspension, however, must be caused by a covered cause that results in direct physical loss or damage to the property.

Contingent Business Interruption

Contingent business interruption coverage covers a policyholder's business losses resulting from loss, damage, or destruction of property owned by others, as long as the underlying cause of damage to the supplier or customer is of the type covered by the insured's own property policy. For example, if a windstorm were to damage a supplier's factory and prevent it from producing component parts essential to an insured business's operation, the business would be able to claim under contingent BI coverage.

Civil Authority Coverage

Civil authority coverage provides coverage for BI losses when a civil authority prohibits or impairs access to the policyholder's premises. Depending on specific wording, a policy's civil authority coverage may require that the access restriction results from physical loss. Some courts have rejected coverage for losses sustained as a result of civil authority orders that were designed to prevent future damage rather than address existing property damage, such as evacuation in advance of a hurricane. A Louisiana lawsuit is seeking a judicial determination that the state's public gathering restrictions related to COVID-19 trigger the civil authority provision in their all-risks policy.

Legislative Actions Related to Business Interruption Insurance

Insurers are reluctant to cover BI losses in a pandemic, both because of the scale and the extreme correlation of the losses. In response, some legislators are considering actions to shift some economic losses to the insurance industry, particularly with respect to BI losses. A bipartisan group of 18 House members wrote to four insurance industry trade groups, asking them to make financial losses related to COVID-19 part of their BI coverage retroactively, particularly for small businesses. In response, the industry representatives said that, although they are working to assist their customers, BI policies do not, and were not designed to, provide coverage against communicable diseases such as COVID-19. Industry sources suggest that the cost of covering BI claims for small businesses could be $110 billion to $290 billion monthly.

The response of insurance trade groups includes consideration of an option where businesses submit claims to their insurers as if BI resulting from coronavirus were covered. Insurers would then adjust those claims as normal and determine the appropriate claims payment, which would be funded by the government. This approach would resemble the existing mechanism used for the National Flood Insurance Program.

A state bill in New Jersey would require insurers retroactively to include virus transmission as a covered peril in BI policies. The bill also includes a provision that would allow liable insurers to petition the state for partial reimbursement collected from other insurers in New Jersey that do not offer BI coverage. This would potentially shift business losses attributable to COVID-19 to all insurers in the state. Massachusetts, New York, and Ohio have also introduced bills on BI coverage.

Author Information

Diane P. Horn
Analyst in Flood Insurance and Emergency Management

Baird Webel
Acting Section Research Manager

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