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HOTELS: NEWS

## How does biz interruption insurance work in a pandemic?

By [Guest Contributor](#) on 6/30/2020

The COVID-19 pandemic has significantly impacted the hospitality sector. In this article, we explain how owners who have purchased business interruption insurance may look to insurance coverage for relief against the financial effects of the pandemic.

### All risks policies

Many hotel owners have purchased industrial, operational or property all risks policies, which usually comprise two parts: Section 1, which provides an indemnity for the cost of repairing or reinstating damage to insured property; and Section 2, which provides an indemnity for the financial consequences of business interruption resulting from that damage. The policies may also include extensions and endorsements that cover the financial consequences of the outbreak of an infectious disease, closure by a public authority or denial of access.

### What is damage?

At the moment, our knowledge about the COVID-19 virus is limited. This lack of knowledge means that there is much debate on the impact of the virus on insurance policies. What we do know is this:

- The insurance industry accepts that damage is a change in the physical condition of the insured property that reduces its utility, purpose or value
- That damage extends to microscopic changes in the condition of insured property
- That damage can be temporary or permanent

What we do not know is whether COVID-19 in fact changes the condition of insured property adversely or to the extent that such change can be described as damage.



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### **Policy extensions**

Given the resistance that insurers are likely to raise against claims proceeding on the basis of property damage, what are other options for hotel owners? They will have to look to the extensions to the policy to determine whether they have purchased cover for situations where financial loss has been suffered in the absence of property damage. The extensions, and the cover provided by the extensions, may vary among policies but there are two particular extensions that the hotel owner should look for.

**The infectious (or contagious) disease extension** provides an indemnity for financial loss resulting from the outbreak of a notifiable infectious disease. Over the years, and particularly since the SARS outbreak, the ambit of this cover has been narrowed by reducing the geographical scope: from an outbreak within 25 kms of the insured property to an outbreak within 2.5 kms or to manifestation within a person at the insured property. To benefit from this extension, the cover holder does not have to establish damage. Instead, it simply has to establish that a notifiable infectious disease has occurred at or within the geographical limits stipulated by the extension and that, as a result, it has incurred financial loss.

**The public authority extension** provides an indemnity for financial loss resulting from the actions of a public, civil or governmental authority, particularly in closing premises or denying access. For example, in New Orleans, following Hurricanes Rita and Katrina in 2005, the city authorities imposed a curfew, cutting off access and visitor numbers to the hotels in the central business district. To benefit from this extension, the cover holder must establish that the action by a relevant authority resulted in financial loss to its business.

### **Concurrent causes**

More likely than not, multiple causes will have interrupted the hotel's business: the outbreak of the virus at multiple locations, the authorities' response and the impact on hotel guests. What if the cover holder has infectious disease or public authorities cover, but not both? What if the insurer argues that while the cover holder may have an infectious disease extension, the real cause of financial loss was action by public authorities, or vice versa?

When two perils – that acting individually would not result in a loss – combine to cause the loss in such a way that it is impossible to identify the dominant peril, we need to look at the legal doctrine of concurrent causes of loss in the respective jurisdiction. Under English law, we look at whether the concurrent causes are insured, excluded or simply not mentioned in the policy. The English Courts have held that if one concurrent cause is insured and the other is uninsured, then cover is triggered and insurers are obliged to indemnify the loss. But if one concurrent cause is insured and the other is expressly excluded, then cover is not triggered.

### Amount of the indemnity

Establishing that the insurer is liable to indemnify the cover holder is one half of the equation; establishing the amount of the indemnity is the other. Here, cover holders will have to look to the basis of loss settlement clause within Section 2 of their policies. That will set out the basis for calculating the amount payable for the loss (of revenue, gross profit or debt financing costs) incurred during the indemnity period as well as for increased costs of working (mitigation costs) and additional increased costs of working (remarketing costs).

This is a complex calculation that will require the assistance of forensic accountants. It is made even more complex by the trends clause, which requires the amount of the indemnity to be calculated on a hypothetical basis – for example, against the revenue that would have been earned during the indemnity period if the hotel had not been closed/inaccessible but all other factors stayed the same, rather than against the previous year's revenue or the revenue budgeted for the current financial year.

Insurance and insurance policy wordings are complex matters. This is evidenced by the fact that the Financial Conduct Authority regulating the insurance industry in the U.K., with the co-operation and agreement of leading insurers, is expediting 16 test cases through the English Courts to provide clarity as to the nature and extent of business interruption cover provided to businesses primarily in the hospitality industry. The judgment, which should provide some guidance, is due to be received within the next three months.

Given those complexities, owners should consult their insurers brokers and legal counsel to understand the nature and extent of the insurance cover that they have provided.

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## Hotel business interruption insurance

It would be helpful to know more on this subject

TUESDAY, JUNE 30, 2020 | HARRY TUCKER

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