

## **Mitigation of Losses in the Time of Covid-19: An Overview for New York Businesses and Consumers**



On March 22, 2020, Governor Cuomo’s “New York State on PAUSE” Executive Order (E.O. #202.8) became effective.<sup>1</sup> The measure requires all “non-essential” businesses to “reduce the in-person workforce at any work locations by 100%.” This applies to most New York businesses—only certain enterprises enjoy “essential” status, such as qualifying

healthcare providers, infrastructural institutions (airports, utilities, etc.), some critical manufacturing and professional sectors (pharmaceuticals, sanitary products, food products, etc.), and “essential retail,” which includes purveyors of basic necessities such as groceries, medicine, fuel, hardware and the like.<sup>2</sup> Restaurants are allowed only to offer take-out or delivery service. All other businesses are, as the name of the Order suggests, paused. Employees are required to stay home indefinitely, working remotely when they can. Disobedience of the Order is punishable by civil penalties of up to \$2,000 per violation (and more for serial violators).<sup>3</sup> It is perhaps the most dramatic episode of acute state intervention in commercial affairs in New York’s history.

As businesses and consumers alike grapple with these restrictions, questions that many may have regarded as academic a week ago are critical today.

### **Is my business insured for lost income from the shut down?**

Many “business owner” insurance policies include coverage for lost income or “business interruption.” But whether or not that coverage will apply to losses occasioned by a state-ordered shut down depends greatly on the particular language of your policy.

Most commonly, business interruption coverage applies to lost income caused by “direct physical loss or damage”<sup>4</sup> to the property where you do business, or to the equipment you use in your business. In these policies, the definitions of “loss” and “damage” are usually restrictive to physical or mechanical impairment. For example, if the roof in your boutique collapses, or if the kitchen in your diner is sidelined by fire damage, you may be indemnified for the income you lose during the restoration period. Ordinarily this coverage would not relieve a business that is suspended for a reason unrelated to the damage or destruction of its own property (such as a government order to cease operations during a health crisis).

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<sup>1</sup> See <https://www.governor.ny.gov/news/no-2028-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency>

<sup>2</sup> For a complete list of “essential” businesses, see: <https://www.governor.ny.gov/news/governor-cuomo-issues-guidance-essential-services-under-new-york-state-pause-executive-order>

<sup>3</sup> See Executive Order 202.8, *citing* N.Y. Public Health Law §12.

<sup>4</sup> See ISO Form CP 00 30 04 02, Coverage “A1.”

There are some versions of business interruption coverage that do apply to intervention by the government. But here again, the language of the policy is crucial. For example, one of the more inclusive (and less common) policy forms covers “[income] loss sustained during the period of time when ... access to real or personal property is prohibited by order of civil or military authority.”<sup>5</sup> It has been held that this policy does not require physical damage to trigger coverage<sup>6</sup>—coverage may lie, for instance, when the government bars access to the property as a protective measure in the face of an oncoming hurricane. A policy formulation like this is perhaps promising for coverage of income lost to government-ordered Covid-19 lockdowns.

On the other hand, many other “civil authority” coverage types still require some connection to physical property damage or loss. A common form covers “loss of Business Income you sustain ... caused by action of Civil Authority that prohibits access to the described premises due the direct physical loss or damage to property other than [your property].”<sup>7</sup> This version, in other words, more narrowly targets situations in which the government blocks access or entry to your property because of hazardous damage at a neighbor’s property. A carrier is less likely to apply this coverage to a lockdown-related business interruption, in the absence of physical property damage.

Other considerations may govern the analysis if your business is interrupted more directly by actual Coronavirus exposure than it is by the PAUSE Executive Order. For example, if you were forced to dispose of inventory or critical equipment because it was exposed to a Coronavirus-positive employee, your business interruption might be prolonged beyond the (eventual) sunset of Executive Order 202.8. As noted, many of the common policy forms require that the business interruption stem from some form of physical “damage” or “loss” to property or equipment—but there is some debate as to whether a *contamination* may qualify as “damage” or “loss.” Many courts appear to equate damage or loss with a physical structural change, but there is some authority for the proposition that a non-structural, chemical infiltration, for instance, is a sufficient physical property loss to trigger business interruption coverage.<sup>8</sup>

Another critical piece of the puzzle is what coverage *exclusions* are in your policy. Regardless of whether your policy requires physical damage or not as a coverage trigger, a specific exclusion may disqualify you. The most pertinent is the relatively common exclusion that bars coverage 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.”<sup>9</sup> Therefore, a threshold consideration of your coverage prospects is to determine whether this or a similar exclusion is tucked into your policy.

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<sup>5</sup> See *Fountain Powerboat Indus., Inc. v. Reliance Ins. Co.*, 119 F. Supp. 2d 552, 557 (E.D.N.C. 2000); see also *Sloan v. Phoenix of Hartford Ins. Co.*, 207 N.W.2d 434 (Mich. 1973).

<sup>6</sup> *Id.*

<sup>7</sup> See ISO Form CP 00 30 04 02, Coverage “A5.”

<sup>8</sup> See *Gregory Packaging, Inc. v. Travelers Property and Casualty Company of America*, No. 12-cv-04418, 2014 WL 6675934 (D.N.J. Nov. 25, 2014); see also *Trupo v. Preferred Mut. Ins. Co.*, 59 A.D.3d 1044 (4th Dep’t 2009)(chemical infiltration of home constituted “direct physical loss” under home owner’s policy).

<sup>9</sup> See ISO Form CP 01 40 07 06.

The short answer, therefore, is that the devil is in the details. Whether you may have coverage for Covid-19 related business interruption depends entirely on the particular combination of coverage formulations and exclusions in your insurance policy. It is important to study the policy carefully to make an educated determination.

**I can't fulfill my contractual obligations because of the lockdown. Am I liable for breach of contract? My suppliers are offline and my tenants aren't paying the rent. Are they liable to me?**

The first place to look is in the contract itself. The pandemic has cast a bright spotlight on a type of provision that is often regarded as an afterthought, relegated to the bottom pages of the contract: the "force majeure" clause. A force majeure clause (French for "superior force") is a contract provision that expressly defines the parties' rights and obligations in the event of an unforeseen misfortune. A typical version might read as follows:

Neither Party shall be liable for any failure or delay in performance under this Agreement to the extent said failures or delays are proximately caused by causes beyond that Party's reasonable control and occurring without its fault or negligence, provided that, as a condition to the claim that a party is not liable, the party experiencing the difficulty shall give the other prompt written notice, with full details following the occurrence of the cause relied upon.<sup>10</sup>

Some versions are more specific, limiting the clemency to a particular list of disasters, such as inability to perform because of fire loss, storms, "war," flood, or the oft-debated "Acts of God." The Covid-19 measures may spawn a healthy crop of litigation about whether the shutdown did or did not "proximately cause" an individual party's non-performance. In many cases there will be little doubt that an Executive Order prohibiting everyone from going to work is a circumstance beyond the parties' control (except for cases with narrowly drawn clauses), but there may be triable questions about whether a particular company could have or should have serviced a particular agreement, working remotely or through some other permissible work-around. At one end of the spectrum, a banquet hall clearly cannot honor a wedding reception reservation for Saturday March 28, 2020. At the other end, a web design firm with technicians working remotely from home, may be able to complete client's website redesign by the target date. There are numerous businesses that fall somewhere in the middle, in which the defendant's ability or inability to perform may, itself, be the issue in controversy.

If the shutdown has disabled your business, it is important that you review your contracts for force majeure clauses. Don't assume that you are protected, and don't be passive. If you do have such a clause, it may contain specific requirements in which you must give notice to the other party that you are invoking it, and why (like the example above). Make sure you preserve your defense by complying strictly with these requirements.

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<sup>10</sup> See 6B New York Forms Legal & Bus. § 11A:37 (West).

Note that if you have already accepted payment to provide a good or service and you rightfully invoke the force majeure clause as an excuse for non-delivery, the law nevertheless requires you to refund the payment you have accepted.<sup>11</sup>

### **What if my contract doesn't have a force majeure clause?**

In the absence of a force majeure clause, common law doctrine will excuse a party's performance for unforeseen circumstances that render his or her performance impossible. The case law stresses that the changed circumstances must make performance literally impossible, not merely more difficult or costly.<sup>12</sup>

Unforeseeable governmental action that effectively prohibits performance may constitute a valid impossibility defense. However, *temporary* governmental interference does not necessarily excuse performance indefinitely.<sup>13</sup> Therefore, for example, the Covid-19 restrictions may legitimately make it impossible for parties to close on a property sale while law firms are in isolation, but will not necessarily excuse either party from closing after the restrictions are relaxed. The impossibility doctrine is most apt to excuse contractual obligations that are due in the short term, which cannot be met while employees are barred from the workplace. It will be less apt to longer term contractual undertakings that can resume when the workplace is up and running again.

Special mention should be made regarding contractual obligations to make rent and mortgage payments. The Governor's Executive Order prohibits the enforcement of tenant evictions and mortgage foreclosures for a period of ninety days.<sup>14</sup> The Order does not excuse tenants or mortgagees from financial liability for missed payments, but does spare them from the remedy of dispossession during the specified time frame. It remains to be seen whether the relief period will be extended by further Order.

If you have any questions, please contact Ben Neidl at [bneidl@joneshacker.com](mailto:bneidl@joneshacker.com) or call 518-270-1253.

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<sup>11</sup> *Cintron v. Tony Royal Quality Used Cars, Inc.*, 132 Misc.2d 75 (Civ. Ct. Kings Co. 1986); *Toledano & Pinto, Inc. v. Anasae Corp.*, 83 N.Y.S.2d 612 (S. Ct. N.Y. Co. 1948).

<sup>12</sup> *Di Scipio v. Sullivan*, 30 A.D.3d 660 (3d Dep't 2006).

<sup>13</sup> *Green Island Contracting Co. v. State*, 117 Misc.2d 435 (Ct. Claims 1983); *Schoelkopf v. Morlbach Brewing Co.*, 184 N.Y.S. 267 (S. Ct. Erie Co. 1920).

<sup>14</sup> <https://www.governor.ny.gov/news/no-2028-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency>