

## Business Interruption Insurance and Rental Value Insurance: Issues Concerning Coverage for Rent Loss Due to COVID-19

April 27, 2020

### Client Advisory

The COVID-19 outbreak has created the possibility of a disruption in the collection and payment of rent among commercial landlords and tenants. Many businesses are unable to use and generate income from their leased premises due to the virus and related government orders, including the restrictions on non-essential businesses pursuant to New York Governor Cuomo's Executive Order No. 202.8 and subsequent executive orders.[1]

Commercial leases may include language requiring the tenant or the landlord, or both, to maintain some form of insurance coverage for rent interruption. As such, in addition to seeking financial relief that may be available under governmental programs, commercial landlords and tenants should review their property insurance policies and other insurance policies to determine whether those policies may provide coverage for coronavirus-related business interruption losses, including lost rent. As discussed below, coverage for such losses will depend on insurance policy language, lease language, the circumstances of the loss, and potentially even proposed legislation which, if enacted, would require some existing policies to cover such losses.

**Policy Language.** "Business income" insurance, also known as business interruption insurance, is usually part of a commercial property insurance policy. Business income insurance policy language typically includes an agreement by the insurer to pay for the actual loss of business income that the insured sustains due to the necessary suspension of the insured's operations during the period of restoration of the insured's property.[2] In order for the loss of business income to be covered, the suspension of the insured's operations generally must be caused by "direct physical loss of or damage" to insured property.[3] Business income includes net income that would have been earned but for the suspension of the insured's operations, as well as continuing normal operating expenses incurred during the restoration of the property.[4] In this context, "suspension" is typically defined as a slowdown or cessation of the insured's business activities, or that all or a part of the insured property is rendered untenable if "rental value" coverage applies.[5]

As part of its business income insurance, the insured may also elect to purchase coverage for "rental value," which is typically defined as net income that would have been earned or incurred as rental income from tenant occupancy of the damaged property, as well as continuing normal operating expenses incurred in connection with the damaged property.[6] An insured usually has three options with regard to coverage for "rental value": (1) coverage for business income including rental value; (2) coverage for business income other than rental value; and (3) coverage for rental value (in which case business income only includes rental value).[7] Landlords that rent to tenants and also operate out of an office in their building usually have coverage for business income including rental value, since the business income coverage would pay for the landlord's lost net income and continuing operating expenses from the suspension of its own operations, and the rental value coverage would pay for the lost rental income that the landlord would have received from its tenants.

Business income insurance policy language also often includes "civil authority" coverage in which the insurer generally agrees to pay for the loss of business income caused by action of civil authority that prohibits access to the insured's premises, but such coverage typically applies only if:

(1) civil authority has prohibited access to the area immediately surrounding damaged property and the insured's premises are within that area but not more than a specified distance (usually one mile) away from the damaged property; and (2) the civil authority's action is taken in response to dangerous physical conditions resulting from the damage or to enable the civil authority to have unimpeded access to the damaged property.[8]

Additionally, some policies contain endorsements which would exclude coverage for coronavirus-related losses, such as exclusions for damage caused by virus or disease.

Policy language typically varies from one insurer to the next, so it is important to carefully review the language of all policies that may provide coverage for coronavirus-related losses, including exclusions, limits, sublimits, waiting periods prior to coverage being triggered, and time restrictions limiting the period during which losses will be covered.

**Lease Language.** As noted above, commercial leases may contain language requiring the tenant or the landlord, or both, to maintain insurance coverage for rent loss. For example, the commercial office lease form on the New York City Bar Association's website contains provisions requiring the landlord to maintain "property insurance (including rent insurance)" and requiring the tenant to maintain "property insurance, including business interruption." [9] As one court recently stated:

Oftentimes ..., a commercial lease requires tenant to carry a policy of 'rent insurance'. However, there is no Rent Insurance policy, per se. Rather, it's available as part of Business Income Coverage, generally contained within a commercial property insurance policy with endorsement providing for 'rental value' on its Declaration Page. ... Basically, rental value coverage kicks in when the rent stops by reason of the casualty and ends when the rent begins again.[10]

If the rent under a commercial lease does not abate upon the occurrence of property damage which disrupts the tenant's operation of its business at the leased premises, then the landlord's insurer would not have to pay for lost "rental value" since the tenant would be required to keep paying rent, which may be covered by the tenant's insurer.[11] Conversely, if the rent under a commercial lease does abate upon the occurrence of such property damage, then the tenant's insurer would not have to pay for such lost "rental value,"[12] which may be covered by the landlord's insurance. In the event that the lease provides for a partial rent abatement rather than a total abatement, the tenant's insurer may pay for the portion of the rent that the tenant has to pay, and the landlord's insurer may pay for the abated portion of the rent that the tenant does not have to pay.

**Circumstances of the Loss.** As noted above, in most commercial property insurance policies, business interruption coverage is triggered when the insured property sustains "direct physical loss or damage." That said, several courts have held that structural damage to the insured property is not required for coverage, and that proof of relatively intangible conditions like bacteria, gases and odors that render the property unusable may constitute a physical loss or damage to insured property.[13]

For example, in the case of *Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*, the U.S. District Court for the District of New Jersey ruled that "property can sustain physical damage without experiencing structural alteration" and held that an accidental ammonia discharge into the insured's facility caused a covered "direct physical loss of or damage to" the facility, since the ammonia discharge "physically transformed the air" in the facility and rendered the facility "unfit for occupancy until the ammonia could be dissipated." [14] Likewise, in the case of *Newman Myers Kreines Gross P.C. v. Great Northern Ins. Co.*, the U.S. District Court for the Southern District of New York stated that the policy term "requiring 'physical loss or damage,' does not require that the physical loss or damage be tangible, structural or even visible." [15]

These cases support the position that proof of a relatively intangible condition at an insured property that renders the property unusable, such as the presence of coronavirus, may constitute physical loss or damage to property sufficient to trigger business interruption coverage. Because the coronavirus is reportedly transmitted through the air or from contact with infected surfaces, coronavirus contamination at insured property

may potentially be proven through documentation concerning the times when infected individuals were present at the property and testing of the property. It bears noting, however, that these are very unique circumstances, and potentially complicating the argument that a property is unusable is that the same premises that are unusable by a non-essential business might well be usable by an essential business. That is, absent an inability to use space because of the presence of the coronavirus, the determining factor as to whether a space is usable is the nature of the business being conducted in the space.

As for governmental orders, such as Executive Order 202.8, that prevent the use of insured property, such governmental orders alone are unlikely to trigger business interruption coverage in policies that require “direct physical loss or damage” to insured property. In that regard, in the case of *Roundabout Theatre Co. v. Cont'l Cas. Co.*, the New York Appellate Division, First Department, ruled that the business interruption clause of an insurance policy issued to the plaintiff, a theater company, did not cover losses resulting from an order of the City of New York closing the street and denying access to the theater due to a construction accident in the area in the “absence of any physical damage to the theater premises.”[16] In doing so, the court stated that because the language of the business interruption clause in the policy provided coverage only when there was “direct physical loss or damage” to the insured’s property, the plaintiff’s losses were not covered under the policy.[17] Of note, the policy did not include “civil authority” coverage and included a governmental authority exclusion; however, the court determined that it was unnecessary to decide whether that exclusion applied since the insured’s loss was not covered because it was not caused by “direct physical loss or damage” to the insured’s property.[18]

Even where a business income insurance policy includes “civil authority” coverage, as noted above, such coverage typically requires proof that access to the insured’s property is prevented by a government order prohibiting access to the area surrounding nearby damaged property. For instance, in the case of *United Air Lines, Inc. v. Insurance Co. of State of Pennsylvania*, the plaintiff sought coverage under its insurance policy for losses relating to the government shutdown of Ronald Reagan Washington National Airport after the September 11th terrorist attacks, which prevented access to the plaintiff’s facilities at the airport.[19] The insured’s policy stated that it insured “against loss resulting directly from the necessary interruption of business caused by damage to or destruction of the Insured Locations resulting from Terrorism, Sabotage, Mutiny, Insurrection, Rebellion, or Coup d’Etat” and that it was “extended to cover a situation when access to the Insured Locations is prohibited by order of civil authority as a direct result of damage to adjacent premises, not exceeding, however, two (2) consecutive weeks.”[20] Based on this policy language, the Second Circuit Court of Appeals ruled that there was no civil authority coverage for the plaintiff’s losses since the government shutdown of the airport was not “as a result of damage to” property adjacent to plaintiff’s facilities at the airport (i.e., the Pentagon) but was instead due to concern about future attacks.[21]

**Proposed Legislation.** On March 27, 2020, a bill was introduced in the New York State Assembly which would require certain property insurance policies that include business interruption coverage to be construed as including business interruption losses relating to the COVID-19 outbreak.[22] The bill states in relevant part as follows:

Section 1. (a) Notwithstanding any provisions of law, rule or regulation to the contrary, every policy of insurance insuring against loss or damage to property, which includes, but is not limited to, the loss of use and occupancy and business interruption, shall be construed to include among the covered perils under that policy, coverage for business interruption during a period of a declared state emergency due to the coronavirus disease 2019 (COVID-19) pandemic.[23]

The bill applies to policies in effect as of March 7, 2020 that were issued to insureds with less than 250 full-time employees.[24]

This bill, if enacted, would likely be challenged on constitutional grounds by the insurance industry.

**Conclusion.** As the COVID-19 pandemic continues to create the possibility of disrupting commercial landlords and tenants in collecting and paying rent due to tenants’ inability to operate and produce income from their leased premises, commercial landlords and tenants should consider whether their property insurance and other insurance policies cover lost rent and other coronavirus-related business interruption

losses. Additionally, commercial landlords and tenants should document coronavirus-related conditions at their premises, promptly notify insurers whose policies may provide coverage, and prepare to pursue coverage for their losses.

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[1] Executive Order No. 202.8 (March 20, 2020) (available at <https://www.governor.ny.gov/news/no-2028-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency>) provides in relevant part that:

The provisions of Executive Order 202.6 are hereby modified to read as follows: Effective on March 22 at 8 p.m.: All businesses and not-for-profit entities in the state shall utilize, to the maximum extent possible, any telecommuting or work from home procedures that they can safely utilize. *Each employer shall reduce the in-person workforce at any work locations by 100% no later than March 22 at 8 p.m. Any essential business or entity providing essential services or functions shall not be subject to the in-person restrictions.* An entity providing essential services or functions whether to an essential business or a non-essential business shall not be subjected to the in-person work restriction, but may operate at the level necessary to provide such service or function. Any business violating the above order shall be subject to enforcement as if this were a violation of an order pursuant to section 12 of the Public Health Law. (emphasis added).

The above provision in Executive Order No. 202.8 was in effect through April 19, 2020, was extended by subsequent Executive Orders, and is currently effective through May 15, 2020 pursuant to Executive Order No. 202.18 (available at <https://www.governor.ny.gov/news/no-20218-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency>).

Of note, Executive Order 202.8 also provides that “[t]here shall be no enforcement of either an eviction of any tenant residential or commercial, or a foreclosure of any residential or commercial property for a period of ninety days.” Although a bill (N.Y. State Senate Bill S8125A) was introduced that would provide relief for any “small business commercial tenant in the state that has lost income or has been forced to close their place of business as a result of government ordered restrictions in response to the outbreak of coronavirus disease 2019 (COVID-19)” to “have all rent payments suspended for ninety days” – and provides that any person or entity “who faces a financial hardship as a result of being deprived rent payments for property pursuant to this section shall receive forgiveness on any mortgage payments for such property for ninety days” – that bill is still in committee. See <https://www.nysenate.gov/legislation/bills/2019/s8125>.

[2] See, e.g., Insurance Services Office (ISO) “Business Income (And Extra Expense)” Coverage Form CP 00 30 and “Business Income (Without Extra Expense)” Coverage Form CP 00 32.

[3] See *id.*

[4] See *id.*

[5] See *id.*

[6] See *id.*

[7] *See id.*

[8] *See id.*

[9] *See NYC Bar Association Commercial Office Lease Form*, Sections 13.1 and 13.3 (available at <https://www2.nycbar.org/RealEstate/Forms/lease.pdf>).

[10] *819 Realty Group LLC v. Beast Fitness Evolved LLC*, 63 Misc.3d 1237(A), 115 N.Y.S.2d 831, 2019 N.Y. Misc. LEXIS 2976 at \*1 n.1 (Civ. Ct. N.Y. Co. 2019) (citing *What Would Rent Insurance Be If There Were Such A Thing?*, By Ira Meislik, May 12, 2013).

[11] *See id.*

[12] *See id.*

[13] *See, e.g., Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2014 U.S. Dist. LEXIS 165232, at \*13-17 (D.N.J. Nov. 25, 2014) (citations omitted); *Mellin v. Northern Sec. Ins. Co.*, 115 A.3d 799, 804-805 (N.H. 2015) (citations omitted).

[14] *See, Gregory Packaging, Inc.*, 2014 U.S. Dist. LEXIS 165232, at \*16-17. The court also held that the ammonia discharge caused a covered physical loss or damage to the insured's facility under Georgia law because it "physically changed the facility's condition to an unsatisfactory state needing repair." *Id.* at \*19.

[15] 17 F. Supp. 3d 323, 330 (SDNY 2014).

[16] 302 AD2d 1, 2-3 (1st Dep't 2002) (further stating that "the theater sustained only minor damage to its roof and an air conditioning system, which was repaired within one day").

[17] *Id.* Similarly, in *Newman Myers Kreines Gross P.C.*, the court, relying on the *Roundabout* decision, ruled that an insured's claim for business interruption losses resulting from its inability to access its office due to a decision by Con Edison to shut off electricity during and after Hurricane Sandy was not covered under the insured's policy which required "direct physical loss of or damage to property." 17 F. Supp. 3d at 331. In doing so, the court stated that "[t]he words 'direct' and 'physical,' which modify the phrase 'loss or damage,' ordinarily connote actual, demonstrable harm of some form to the premises itself, rather than forced closure of the premises for reasons exogenous to the premises themselves, or the adverse business consequences that flow from such closure." *Id.* 332-333.

[18] 302 AD2d at 5-9.

[19] 439 F.3d 128, 129 (2d Cir. 2006).

[20] *Id.* at 131.

[21] *Id.* at 134-135.

[22] N.Y. State Assembly Bill A10226A.

[23] *Id.*

[24] *Id.*

Carter Ledyard has created a COVID-19 Response Group to monitor the evolving legal landscape, address client questions and ensure client compliance with the laws and regulations issued in response to the COVID-19 pandemic. The Carter Ledyard COVID-19 Response Group consists of **Jeffery S. Boxer** (212-238-8626, [boxer@clm.com](mailto:boxer@clm.com)), **Judith A. Lockhart** (212-238-8603, [lockhart@clm.com](mailto:lockhart@clm.com)), **Bryan J. Hall** (212-238-8894, [hall@clm.com](mailto:hall@clm.com)), **Alexander G. Malyshev** (212-238-8618, [malyshev@clm.com](mailto:malyshev@clm.com)), **Melissa J. Erwin** (212-238-8622, [erwin@clm.com](mailto:erwin@clm.com)), and **Leonardo Trivigno** (212-238-8724, [trivigno@clm.com](mailto:trivigno@clm.com)). Clients should contact the attorneys listed above or their regular CLM attorney for any questions concerning legal obligations arising from the COVID-19 pandemic.

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