



PROGRAM MATERIALS

Program #30109

April 20, 2020

COVID-19: Contract Defaults and Insurance for Lost Income

**Copyright ©2020 by Donald A. Waltz, Esq., John R. Sigety, Esq. and Ashley Veitenheimer, Esq. - Kane Russell Coleman Logan. All Rights Reserved.
Licensed to Celesq®, Inc.**

Celesq® AttorneysEd Center
www.celesq.com

5301 North Federal Highway, Suite 180, Boca Raton, FL 33487
Phone 561-241-1919 Fax 561-241-1969

KANE RUSSELL 
COLEMAN LOGAN

**COVID-19:
CONTRACT DEFAULTS AND
INSURANCE FOR LOST INCOME**

**PRESENTED BY:
DON WALTZ, JOHN SIGETY, AND ASHLEY VEITENHEIMER**

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

TABLE OF CONTENTS

- Force Majeure
- Impracticability of Performance
- Frustration of Purpose
- Insurance Coverage for Business Interruption
- Actions of Civil Authorities

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

TABLE OF CONTENTS

- **Force Majeure**

Impracticability of Performance

Frustration of Purpose

Insurance Coverage for Business Interruption

Actions of Civil Authorities

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

- French translation: “superior force”
- Black’s Law (11th ed. 2019) definition: “an event or effect that can be neither anticipated nor controlled”

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

A force majeure clause relieves parties from their contractual obligations where performance is prevented due to causes beyond the parties' control.

Examples:

- Large-scale disasters
- Acts of God
- War

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

It is always advisable to include a force majeure provision in order to avoid uncertainty.

Without a force majeure provision, the parties will be forced to rely on narrowly-interpreted common law doctrines of impossibility of performance, impracticability and/or frustration of purpose.

However, force majeure provisions themselves are narrowly interpreted by courts. Generally, only events identified in the contract will excuse performance.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Force Majeure Provisions in Three States

- Texas
- New York
- Delaware

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Texas: Enforceable but Narrowly Construed

- “[A]n act of God does not relieve the parties of the obligations unless the parties expressly provided otherwise.” *GT & MC, Inc. v. Texas City Ref. Inc.*, 822 S.W.2d 252, 259 (Tex. App.—Houston [1st Dist.] 1991, writ denied)

Depends on the language of the contract

- “The scope and effect of a ‘force majeure’ clause depends on the specific contract language, on not on any traditional definition of the term.” *Virginia Power Energy Mktg., Inc. et al. v. Apache Corp.*, 297 S.W.3d 397, 402 (Tex. App.—Houston [14th Dist.] 2009, pet. denied)
- If the parties define the “contours” of force majeure in the contract, “those contours dictate the application, effect, and scope of force majeure.” *Allegiance Hillview, L.P. v. Range Texas, Prod. LLC*, 347 S.W.3d 855, 865 (Tex. App.—Fort Worth 2011, no pet.).

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Texas

Invoking a force majeure provision

- Burden is on the party seeking to excuse performance under the contract.
- Must be able to show that the force majeure event was unforeseeable when the contract was signed, and the parties lacked reasonable control over the occurrence of the event.
- However, the party seeking to excuse performance is not required to exercise reasonable diligence to avoid the effects of a force majeure event **UNLESS** the contract requires it.
- Also, performance not excuse just because cost of performance became greater than anticipated.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Texas: Is COVID-19 a force majeure event?

Answer: It depends on the contract

- Easy to argue that COVID-19 pandemic was unforeseeable, and parties leaked reasonable contract
- **BUT**, the question is whether the force majeure provision was intended to include events like an epidemic, pandemic, quarantine, regulations, or other disease-related event
- Note that subsequent government actions (e.g. restrictions on gatherings, travel restrictions, etc.) related to the COVID-19 pandemic could also constitute a force majeure if contemplated by the contract
- Otherwise, without an applicable provision, a Texas court would find that it is not at liberty to expand the scope of the contract to include COVID-19.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

New York: Similar to Texas

- Purpose: relieve a party of liability and/or limit its damages when the contracting parties' expectations are frustrated by unforeseeable circumstances not caused by their fault or negligence. *See Constellation Energy Servs. of N.Y. Inc. v. New Water St. Corp.*, 146 A.D.3d 557, 558, 46 N.Y.S.3d 25 (1st Dept. 2017).
- Narrowly construed: a party's performance will only be excused if the provision specifically identifies the event that prevents performance. *See Reade v. Stoneybrook Realty, LLC*, 63 A.D. 433, 434, 882 N.Y.S.2d 8 (1st Dept. 2009).

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

New York

Catchall language - New York law is clear that work constituting general catchall language in a force majeure provision should not be given the most expansive meaning possible.

- Such language applies only to the same general kind or class of events or circumstances as those specifically mentioned. *See Team Mktg. USA Corp. v. Power Pact, LLC*, 41 A.D.3d 939, 942, 839 N.Y.S. 242 (3rd Dept. 2007).

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

New York

Invoking a force majeure provision

- Burden is on the party seeking to excuse performance under the contract.
- The party must demonstrate that it tried to perform its contractual duties despite the force majeure event. *See Phillips Puerto Rico Core, Inc. v. Tradax Petroleum*, 782 F.2d 314, 319 (2d Cir. 1985).
- Unanticipated difficulty in performing one's obligations and adverse economic conditions **DO NOT** constitute a force majeure event sufficient to excuse performance in New York.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

New York: Is COVID-19 a force majeure?

Answer: Again, it depends on the contract!

- Party will likely have to show that the clause specifically contemplated epidemics, pandemics, quarantine regulations, or other disease-related events.
 - Subsequent government actions (e.g. restrictions on gatherings, travel restrictions, etc.) related to the COVID-19 pandemic could also constitute a force majeure if contemplated by the contract
- Catchall language likely would not be sufficient.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Delaware

- In Delaware, a force majeure clause, “defines an area of events that might excuse nonperformance within the contract period.” *VICI Racing, LLC v. T-Mobile USA, Inc.*, 763 F.3d 273, 287 (3rd Cir. 2014)
- The court will look to the language of the contract to determine the intent of the parties.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Delaware

- There is much less case law on force majeure clauses in Delaware
- It is unclear if Delaware law required that a particular event be unforeseeable for it to constitute a force majeure.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Delaware: Is COVID-19 a force majeure?

Answer: Like I said before, it DEPENDS ON THE CONTRACT!

- The court will look to the language of the contract to determine whether a particular event was intended by the parties to excuse performance.
- However, the limited case law that exists suggests that Delaware courts may be willing to infer the meaning and scope of a force majeure clause based on outside factors, such as the parties' industry. *See VICI Racing*, 763 F.3d at 289.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

TABLE OF CONTENTS

Force Majeure

- **Impracticability of Performance**

Frustration of Purpose

Insurance Coverage for Business Interruption

Actions of Civil Authorities

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Impossibility of Performance

- Revolves around the concept of a “basic assumption”
- The “basic assumption” involves the non-occurrence of an event

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Classic Examples

- A key person remaining alive
- The existence of a “thing” necessary to perform the contract
- The legality of the transaction

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Market Conditions?

- The continuation of existing market conditions

or

- Financial condition of the parties

IS NOT a basic assumption

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Source of Supply

- The fact that a source is no longer available does not in and of itself relieve a party of performance
- That is true even when both parties intended a specific source of supply
- The Obligor must resort to other commercially reasonable substitutes

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Subjective v. Objective Impossibility

- Lack of funds caused by even unforeseeable factors does not make performance impossible
- Unprofitability caused by changes in circumstances does not make performance impossible

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Allocation of the Risk

- A party may, by appropriate language, agree to perform anyway despite the impracticality
- Allocation need not be express. It can arise from the circumstances.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Government Orders

- Government orders can cause impracticality
- However, mere financial hardship or inconvenience will not cause impracticality

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Temporary Impracticality

- Merely suspends performance

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

TABLE OF CONTENTS

Force Majeure

Impracticability of Performance

• **Frustration of Purpose**

Insurance Coverage for Business Interruption

Actions of Civil Authorities

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

- Arises where a change in circumstances makes performance under the contract by one party virtually worthless to the other party
- The party's principal purpose in entering into the contract is substantially frustrated by a supervening event that both parties assumed would not occur.
- Occurs when the supervening event makes performance no longer desirable (i.e. worthless) to the party asserting the defense.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Elements

1. The frustrated purpose was a principal purpose for which the asserting party entered into the contract.
2. Nonoccurrence of the intervening event was a basic assumption of the contract.
3. The frustration of the intervening event was so substantial that it cannot fairly be regarded as being within the risks the party assumed under the contract.
4. The frustrating event must not have been the fault of the asserting party.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Example

- The parade watcher

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

- Courts frequently view the asserting party's purpose for entering into the contract in broad terms
- Example: The Super Bowl travel package

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Leases

- Issue - does the intervening event actually substantially frustrate the purpose of the lease, or does it just make it less profitable for the tenant to continue operating under the lease?

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Leases

- *Gander Mount Co. v. Islip U-Slip LLC*, 923 F.Supp. 351 (N.D.N.Y. 2013)
 - A commercial tenant sued its landlord seeking a declaration that its lease was terminated due to a severe flooding event, and because the tenant had been unable to secure “all-risk insurance” to conduct business operation on the lease premises.
 - **HOLDING:** the tenant was not entitled to termination of the lease because the fact that it might be financially difficult or unprofitable to operate the store does not excuse performance pursuant to the doctrine of frustration purpose.
 - Also, the facts suggest that the flood and inability to obtain all-risk insurance were foreseeable, and therefore frustration of purpose did not excuse performance.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Summary

- Frustration of purpose will not apply in situations where an intervening event has merely made performance difficult and/or less profitable.
- A party seeking to excuse performance because of COVID-19 will need to show that the principal purpose of the contract has been substantially frustrated to the point that it is essentially worthless.
- The frustrating event must have been so severe that it would not have been fair to regard the event as within the risks assumed under the contract.
- Some states, like New York, may look to the foreseeability of the event and whether the party should have anticipated it and provided for its occurrence in the contract.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

TABLE OF CONTENTS

Force Majeure

Impracticability of Performance

Frustration of Purpose

• **Insurance Coverage for Business Interruption**

Actions of Civil Authorities

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Traditionally

- Business Interruption Insurance is a component of Property Damage Insurance

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Property Damage Requirement

- Given that Business Interruption is just a component of property damage insurance, requirement may be read into the policy
- *National Children's Exposition* case

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Modern Forms Require Some Damage to Property

- “Physical loss or damage to Property”
- Must be caused by a covered cause of Loss

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Ingress and Egress Insurance

- Intent is to provide coverage for damage to property other than the insured Property
- Must be caused by a covered cause of Loss

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Ingress and Egress Insurance

- Property damage requirement might not be read into the policy given that damage to insured risk is not required.
- *Fountain Power Boats* case

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

What is Physical Loss?

- Courts will require some form of compromise or invasion
- Courts are split whether damage to “brick and mortar” is actually required.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

COVID-19

- “Physical Loss” - Must at least be caused by some physical compromise or invasion
- Rare in COVID shutdown

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Cause of Shutdown

- Social distancing – that is separation of people. Nothing wrong with the Property.
- Buildings are functional, open usable.
- People are being told they cannot go there

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

There is “loss.” But no “physical” loss.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

TABLE OF CONTENTS

Force Majeure

Impracticability of Performance

Frustration of Purpose

Insurance Coverage for Business Interruption

- **Actions of Civil Authorities**

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Actions of Civil Authorities

- The civil authorities coverage contained in the standard ISO Commercial Property Coverage form also includes a property damage requirement.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Typical “civil authority” policy language:

5. Additional Coverages

a. Civil Authority

We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to *direct physical loss of or damage to property*, other than at the described premises, caused by or resulting from any Covered Cause of Loss.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Physical Damage to Property Typically Required

- Post-9/11 Terror Attacks
- Pre-Hurricane Landfall Evacuations

United Air Lines, Inc. v. Ins. Co. of State of Pa., 439 F.3d 128 (2d Cir. 2006)

HELD: The airport was not shutdown “as a direct result of damage” to the Pentagon but was “caused by fears of future attacks.”

In other words, there was no causal link between “prior [property] damage” and the action by the civil authority.

NO COVERAGE

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Physical Damage to Property Typically Required (*Cont'd*)

- Post-9/11 Terror Attacks

Southern Hospitality v. Zurich Am. Ins. Co., 393 F.3d 1137 (10th Cir. 2004)

FACTS: Hotels tried to claim lost rental income under their business interruption policies, claiming that the ground stop prevented access by guests.

HELD: “The FAA's order stopped airplanes from flying; it did not close hotels... the policy was intended to cover losses from an order *directly affecting* the hotels, not one tangentially affecting them as here. As we see it, the policy requires a *direct nexus* between the civil authority order and the suspension of the insured's business. That nexus is missing here.”

NO COVERAGE

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Physical Damage to Property Typically Required

- Pre-Hurricane Landfall Evacuations

Dickie Brennan & Co., Inc. v. Lexington Ins. Co., 636 F.3d 683 (5th Cir. 2011)

FACTS: A mandatory evacuation of New Orleans was ordered before Hurricane Gustav made landfall, resulting in the closure of an insured's restaurants. The plaintiff argued that the "property damage" requirement was satisfied based on the damage in the Caribbean.

HELD: "Nothing in the record, including the order itself, shows that the issuance of the order was 'due to' physical damage to property, either distant property in the Caribbean or property in Louisiana. We are therefore persuaded that the Brennans failed to demonstrate a nexus between any prior property damage and the evacuation order."

NO COVERAGE

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Physical Damage to Property Typically Required

- Pre-Hurricane Landfall Evacuations

S. Tex. Med. Clinics, PA v. CNA Fin. Corp., 2008 WL 450012 (S.D. Tex. Feb. 15, 2008)

FACTS: A civil authority order required evacuation of Wharton County because Hurricane Rita was projected to land in the area. The insured owned and operated several medical clinics that closed pursuant to the order. However, the storm took a different path, and Wharton County suffered no storm damage.

HELD: “When, as here, the only relevance of prior damage to other property in deciding whether to issue a civil authority order that would preclude access to the insured’s property is to provide a basis for fearing future damage to the area where the insured property is located, the causal link between the prior damage and the civil authority order is missing. Requiring such a causal link between the prior damage and the action by a civil authority does not rewrite the parties’ policy, but rather gives effect to the language it contains.”

NO COVERAGE

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Actual Structural Damage versus Physical Compromise

Universal Image Prod., Inc. v. Chubb Corp., 703 F. Supp. 2d 705 (E.D. Mich. 2010) *aff'd* 475 Fed. Appx. 569 (6th Cir. 2012)

FACTS: Insured argued that a pervasive odor, mold, and bacterial contamination caused direct physical loss.

HELD: “[D]irect” signaled intermediate or proximate cause and “physical” is defined by Merriam-Webster’s Dictionary as having a “material existence; perceptible especially through the senses and subject to the laws of nature.”

Odors, mold, and bacterial contamination were not “direct, physical loss” because there was no “*structural or tangible damage* to the insured’s property.”

NO COVERAGE

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Mellin v. Northern Sec. Ins. Co., Inc., 115 A.3d 799 (N.H. 2015)

FACTS: Insured argued that cat urine emanating from a neighboring condominium unit caused “physical loss” of property.

HELD: Cat urine smell caused physical loss to the premises.

The Court relied upon a line of cases holding that exposure to adverse conditions that render the premises unusable is sufficient to be “physical damage,” concluding that “these cases stand for the proposition that an insured may suffer 'physical loss' from a contaminant or condition that causes changes to the property that cannot be seen or touched.”

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

U.S. Metals, Inc. v. Liberty Mutual Group, Inc., 490 S.W.3d 20 (Tex. 2015)

ISSUE: Whether “[a] thing whose use or function is diminished by the incorporation of a faulty component can fairly be said to be injured, even if the injury is intangible, latent, or inchoate.”

HELD: Agreed "with most courts to have considered the matter that the best reading of the standard-form CGL policy text is that **physical injury requires tangible, manifest harm** and does not result merely upon the installation of a defective component in a product or system.”

QUERY: The problem with applying *U.S. Metals* to COVID-19 contamination is that the Court was not dealing with something as ethereal as a virus. The general *theory* employed by the Court, that some change in form is required, could be argued to encompass a change in "condition," even though that is not specifically mentioned in the *U.S. Metals* opinion.

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Even if it is physical loss, what is the claim?

- Most shutdowns not caused by potential contamination by a given person
- True reason: social distancing
- NOT physical loss

And even if a shutdown was caused by exposure to a given person, the period of restoration would only be:

- the time it takes to disinfect the premises
- or, at the most, the time it takes for the virus to die

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Example of recently-filed case and attempts to circumvent
“physical loss” requirement:

LH Dining, LLC d/b/a River Twice Restaurant v. Admiral Ind. Co., No. 2:20-cv-01869, 2020 WL 1817073 (E.D. Penn. Apr. 10, 2020)

- Insured seeks declaratory relief **ONLY**:
 - Asserts that restaurants are more susceptible “to *being or becoming*” contaminated because respiratory droplets and fomites are more likely to be retained on the Insured Property and remain viable for far longer as compared to a facility with open-air ventilation
 - Claims any effort by defendant to “deny the reality that the virus causes physical loss and damage would constitute a false and potentially fraudulent misrepresentation that could endanger Plaintiff and the public.”
- Interestingly, the plaintiff specifically pleads that it is **NOT** seeking any determination of whether COVID is “physically in or at the Insured Property...”

COVID-19: CONTRACT DEFAULTS AND INSURANCE FOR LOST INCOME

Recent State Legislation

- Louisiana, Massachusetts, New Jersey, New York, Ohio, Pennsylvania, South Carolina
- Requiring policies to cover COVID-related claims
- Prohibiting insurers from denying coverage due to lack of physical damage to insured property

Kane Russell Coleman Logan PC

Questions?



John R. Sigety

Phone: (214) 777-4277

E-Mail: jsigety@krcl.com



Ashley Veitenheimer

Phone: (214) 777-4225

E-Mail: aveitenheimer@krcl.com

Don Waltz

Phone: (214) 777-4247

E-Mail: dwaltz@krcl.com