International Franchise Association
53rd Annual Legal Symposium
May 4-6, 2021
Virtual

Managing Risks in Contracts and Relationships Due to COVID-19

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Introduction

Businesses around the globe continue to endure the devastating financial impact of COVID-19 and respond to the changes brought about by the ongoing pandemic. Franchised businesses in particular have been acutely impacted by the COVID-19 pandemic and continue to adapt to an increasingly complex mix of operational risks caused by prolonged government shutdown orders, supply chain disruptions, and expanded liability to customers, employees and other third parties. According to a recent report issued by the International Franchise Association (the "Economic Outlook Report"),[1] there were approximately 773,600 franchised businesses in operation throughout the United States as of 2019, which accounted for roughly 8.4 million jobs. The IFA further reports that through August of 2020, an estimated 32,700 franchised businesses were closed, and 1.4 million franchise jobs lost due to COVID-19. An additional 36,000 franchised businesses are projected to close through the first quarter of 2021. Finally, franchised businesses reported an average decrease in revenue of roughly 20%, totaling approximately $185.3 billion in lost revenue from franchised businesses. The financial impact and devastation franchise systems have experienced over the past year due to the COVID-19 pandemic cannot be overstated.

The COVID-19 pandemic, despite its widespread impact on global health and the economy, has put the franchising community on notice of certain unanticipated exposures and provided an opportunity for franchisors and franchisees to evaluate their operations and work to ensure that current insurance programs adequately address these exposures, including those related to COVID-19.This paper aims to provide guidance to franchisors and franchisees on how to effectively respond to emerging risks of COVID-19 through modifications to contractual risk transfer terms and enhancements to existing insurance programs.

1. Insurance Coverages Implicated by COVID-19

Franchise systems generally incorporate some form of insurance requirements in either the franchise agreement or operations manual. Although there can be wide disparity in the scope and type of insurance policies franchise systems require their franchisees to maintain, most include a standard mix of off-the-shelf first-party and third-party liability policies that fail to address risks that are unique to a system's operations. Thus, it is vital that franchisors and franchisees analyze current policies to ensure a clear understanding of the scope and limitations of coverage provided under their existing insurance programs, and if necessary, seek to enhance coverage terms and procure additional or alternative forms of insurance to adequately address emerging risks associated with COVID-19.

A. First-Party Coverage

[1] International Franchise Association, 2021 Economic Outlook for Franchising.

First-party insurance coverage typically indemnifies or reimburses a policyholder for its own losses, as opposed to affording protection against liability from claims asserted by a third-party. Business Interruption insurance is a form of first-party coverage that has been at the forefront of COVID-19 related litigation, with courts split on whether such policies afford coverage for losses resulting from the COVID-19 pandemic.

i. Business Interruption Coverage

As of September 15, 2020, over 1,000 business interruption insurance coverage lawsuits have been filed as a result of the COVID-19 pandemic.[2] Business Interruption (BI) insurance generally indemnifies an insured for loss of business income that arises from the suspension of business operations due to "direct physical loss" or "direct physical damage." Most BI coverage forms state that the insurer:

> [W]ill pay for direct physical loss of or damage to Covered Property at the premises described in the Declarations caused by or resulting from any Covered Cause of Loss.

In order to trigger BI coverage, policyholders typically must demonstrate that the coronavirus or COVID-19 has caused "direct physical loss of or damage to property." In the face of COVID-19-related insurance claims asserted to recover BI losses, insurers have uniformly and consistently taken the position that the virus and resulting losses are not covered under standard Commercial Property and Businessowners' Policy forms. The ensuing litigation has and will likely continue to hinge on whether the presence of coronavirus or COVID-19 can cause or constitute "direct physical loss of or damage to property" and whether the policy at issue includes some form of broadly construed Virus Exclusion.

Many businessowners rushed to the courthouse steps early on in the pandemic, based upon misguided advice of counsel unfamiliar with insurance coverage issues. This initially resulted in a steady stream of widely publicized decisions, which granted the dismissal of policyholder complaints and have been relied upon to reinforce the insurance carrier narrative that no coverage is available for such COVID-19 losses.[3] Indeed, a

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[2] Christopher C. French, *Forum Shopping COVID-19 Business Interruption Insurance Claims*, 2020 U. ILL. L. REV. ONLINE 187 (2020).

[3] *See* El Novillo Rest. v. Certain Underwriters at Lloyd's, London, No. 1:20-CV-21525-UU, 2020 WL 7251362, at *6 (S.D. Fla. Dec. 7, 2020) (conclusory allegations inadequately show direct physical loss under the policy); Promotional Headwear Int'l v. The Cincinnati Ins. Co., No. 20-CV-2211-JAR-GEB, 2020 WL 7078735, at *7-9 (D. Kan. Dec. 3, 2020) (alleging that COVID-19 was "likely" present on a property did not adequately show direct physical loss); Uncork & Create LLC v. Cincinnati Ins. Co., No. 2:20-CV-00401, 2020 WL 6436948, at *5 (S.D.W.V. Nov. 2, 2020) (plaintiff cannot show physical damage or loss because "the pandemic impacts human health and human behavior, not physical structures"); Turek Enterprises, Inc. v. State Farm Mut. Automobile Ins. Co., No. 20-11655, 2020 WL 5258484, at *6-8 (E.D. Mich. Sept. 3, 2020) (plaintiff must allege that property suffered "some tangible damage to the Covered Property" to recover); Malaube, LLC v. Greenwich Ins. Co., No. 20-22615-Civ-WILLIAMS/TORRES, 2020 WL 5051581, at *4-8 (S.D. Fla. Aug. 26, 2020) (plaintiff could not demonstrate physical loss when it alleged that the restaurant only suffered economic losses, and no tangible, actual, or physical loss); Rose's 1, LLC v. Erie

majority of courts have to date rejected policyholders' claims for business interruption coverage, holding that the presence of coronavirus particles or COVID-19 alone does not constitute direct physical loss or damage to property, as is required under such policies.

Of late, however, there have been a handful of decisions issued in favor of coverage that commonly involve a necessary mix of factual circumstances and relevant policy language, along with the prudent advice of experienced policyholder coverage counsel.[4] These courts have analogized the danger of COVID-19 to cases where asbestos, toxic air particles, or noxious gas has rendered a property uninhabitable or dangerous because of non-structural sources. For example, in *Studio 417, Inc. v. The Cincinnati Insurance Company*, a Missouri federal district court held that the presence of COVID-19 in and around physical structures qualified as "direct physical loss or damage" to covered property.[5] The plaintiffs alleged that since the pandemic arose, it was likely that customers, employees, and/or other visitors to the insured properties were infected with COVID-19, infecting the insured properties with the virus.[6] Plaintiffs further alleged that the virus "is a physical substance," that it "live[s] on" and is "active on inert physical surfaces," and is "emitted into the air," and it "renders physical property in their vicinity unsafe and unusable."[7] Consequently, COVID-19 attached to and deprived them of their property, "resulting in direct physical loss to the premises and property."[8] The plaintiffs sought coverage under their "all-risk" property policies, which included Business Income coverage.[9] The Business Income provision stated that the insurer would "pay for the actual loss of 'Business Income' ... you sustain due to the necessary 'suspension' of your 'operations' during the 'period of restoration.' The suspension must be caused by direct 'loss' to property at a 'premises' caused by or resulting from any Covered Cause of Loss."[10]

Ins. Exchange, 2020 CA 002424 B, 2020 D.C. Super. LEXIS 10, at *6 (D.C. Super. Ct. Aug. 6, 2020) (plaintiff must allege actual loss to show physical loss or damage).

[4] *See* Henderson Rd. Rest. Sys., Inc. v. Zurich Am. Ins. Co., No. 1:20 CV 1239, 2021 WL 168422 (N.D. Ohio Jan. 19, 2021) (policy susceptible to more than one interpretation and court agreed that the phrase "direct physical loss of" the real property could mean something different than "damage to" the property; therefore, court agreed that policyholders "lost their real property" under the policies' terms "when the state governments ordered that the properties could no longer be used for their intended purpose."); Lombardi's Inc. v. Indemnity Ins. Co. of North America, No. DC-20-05751-A (14 Dist. Ct., Dall. Cnty., Tex. Oct. 15, 2020) ("physical loss" can include disruptions to insureds ability to physically access and utilize portions of properties, in order to prevent the spread of COVID-19); North State Deli, LLC v. The Cincinnati Ins. Co., No. 20-CVS-02569, 2020 WL 6281507 (N.C.Super. Oct. 09, 2020) (plain and ordinary meaning of "direct physical loss" includes "the inability to utilize or possess something in the real, material, or bodily world" and therefore "describes the scenario where business owners…lose the full range of rights and advantages of using or accessing their business property."); Urogynecology Specialist of Fla. LLC v. Sentinel Ins. Co., Ltd., 489 F. Supp. 3d 1297 (M.D. Fla. 2020) (policy's virus exclusion did not unambiguously exclude COVID-19, therefore policy must be construed in insured's favor); Optical Services USA/JC1, et al. v. Franklin Mut. Ins. Co, No. BER-L-3681-20 (N.J. Super. Ct. Bergen Cnty. Aug. 13, 2020) (court rejected an insurer's motion to dismiss because argument that the "loss of physical functionality and use of [a] business" does not constitute "direct physical loss" is unsupported by New Jersey common law);

[5] 478 F. Supp. 3d 794 (W.D. Mo. 2020).

[6] *Id.* at 798.

[7] *Id.* at 798.

[8] *Id.* at 798.

[9] *Id.* at 797.

[10] *Id.* at 797.

The Court in *Studio 417* noted that the "or" signified that either a "loss" or "damage" is required, and that "loss" is distinct from "damage."[11] Since the "all-risk" insurance policies, which contained Business Income coverage, failed to define "physical loss," the Court relied on the phrase's "plain and ordinary meaning" to determine whether the plaintiffs' claim was covered.[12] "Given that "physical" is defined as "having material existence: perceptible especially through the senses and subject to the laws of nature," the court held that the plaintiffs had adequately demonstrated that they suffered a "direct physical loss."[13] The court supported the contention that COVID-19 allegedly attached to and deprived the plaintiffs of their property, making it "unsafe and unusable, resulting in direct physical loss to the premises and property."[14]

A Virginia federal district court, in *Elegant Massage, LLC v. State Farm Mutual Automobile Insurance Company*, has also recently held that the meaning of "physical loss" was ambiguous, construing the term in favor of the insured, as required by state law where insurance policy terms are ambiguous.[15] In that case, the insured were also covered by an "all-risk" property policy. [16] The policy provided Loss of Income and Extra Expense Coverage, which covered the loss of business income sustained as a result of the suspension of business operations, including action by a civil authority that prohibits access to the insured business property.[17] After analyzing Virginia case law, the court determined that "direct physical loss" had been interpreted in several different ways.[18] Due to Virginia's "spectrum of interpretations"[19] the insurer was "fully aware of cases that interpreted intangible damage as a 'direct physical loss'" before issuing its policy.[20] Since the insurer failed to explicitly include "structural damage" in the language, the policy could be construed in favor of more coverage based on prior cases that allowed coverage without "structural damage."[21] Moreover, the court refused to apply the virus exclusion in the policy, because the governmental orders, not the virus itself, caused the loss.[22]

If the "direct physical loss" requirement is satisfied, the next hurdle will likely be a virus exclusion, if contained within the BI policy. An example of such an exclusion is "Exclusion of Loss Due to Virus or Bacteria," which states that the insurer:

> [W]ill not pay for loss or damage caused by or resulting from any virus, bacterium or other micro-organism that induces or is capable of inducing physical distress, illness or disease …. [23]

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[11] *Studio 417*, 478 F. Supp. 3d at 800.
[12] *Id.* at 800.
[13] *Id.* at 800.
[14] *Id.* at 800.
[15] No. 2:20-CV-265, 2020 WL 7249624 (E.D. Va. Dec. 9, 2020).
[16] *Id.* at *1.
[17] *Id.* at *1.
[18] *Id.* at *8-9.
[19] *Id.* at *8.
[20] *Id.* at *9.
[21] *Id.* at *9.
[22] *Id.* at *13.
[23] Commercial Property Endorsement CP 01 40 07 06.

Based on the specific endorsement in the policy, certain other exclusions may be far broader than the above example, excluding coverage if a virus plays ***any part*** in causing the loss, even if there is some other covered cause of loss. It is critical that policyholders take note of any exclusions that may be implicated. For example, pollution exclusions, depending on their wording, could be used by insurers to deny coverage for business losses related to COVID-19. Historically, these exclusions have been limited to traditional pollutants, but some jurisdictions have expanded the definition to apply to anything that could be considered an "irritant" or "contaminant." The application of this type of exclusion would depend on whether COVID-19 can be characterized as a "contaminant."

More recent decisions out of the Northern District of Ohio demonstrate the difficulties courts have experienced in determining whether COVID-19 related claims can satisfy the requirement of "direct physical loss or damage." This Ohio court has released a handful of decisions interpreting the same set of facts, the same policy language, and applied Ohio law, yet has reached different conclusions.

The Northern District of Ohio's COVID-19 decision in *Henderson Road Restaurant Systems, Inc. v. Zurich American Insurance Company* granted summary judgment in favor of the policyholder, finding availability of coverage for BI losses.[24] In *Henderson*, the plaintiffs argued that "direct physical loss of" included an inability to possess something in the "real, material or bodily world, and that the government orders caused [p]laintiffs to lose their property in th[at] manner."[25] The plaintiffs stressed, among other things, that the insurance policy did not state that "direct physical loss of or damage to property" required "physical alteration or structural damage to any property at the Insured Premises."[26] The court held that "direct physical loss of or damage to property" was ambiguous and susceptible to two different meanings.[27] Specifically, the plaintiffs' inability to have dine-in customers, could be characterized as a "loss *of*" their real property.[28] The standard definitions of the word "loss," a word the policy did not define, could not reasonably be limited to "permanent dispossession" as the insurer tried to argue.[29] Further, the court held that the Microorganism exclusion did not apply.[30] The court interpreted the language very literally and stated that the plaintiffs' restaurants were not closed because there was an outbreak of COVID-19 at their properties; they were closed as a result of governmental orders.[31]

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[24] No. 1:20 CV 1239, 2021 WL 168422 (N.D. Ohio Jan. 19, 2021).
[25] *Id.* at *5.
[26] *Id.*
[27] *Id.* at *10.
[28] *Id.* at *11 (emphasis in original)
[29] *Id.* at *12.
[30] *Id.* at *14. The exclusion in relevant part states that:

> We will not pay for loss or damage consisting of, directly or indirectly caused by, contributed to, or aggravated by the presence, growth, proliferation, spread, or any activity of "microorganisms" ….

[31] *Id.*

Alternatively, in *Brunswick Panini's, LLC v. Zurich American Insurance Company*, the same Ohio District Court granted the insurer's motion to dismiss because "[n]either the COVID-19 virus nor the state government orders caused 'direct physical loss of or damage to' Plaintiffs' Insured Property."[32] The court once again relied on the plain and ordinary definition of the phrase "direct physical loss of or damage to property" but in this instance, it held that plaintiffs had not and could allege tangible damage or permanent alteration of property, and physical deprivation of possession, enjoyment, or use of their premises. [33] Moreover, the court held that the policy's Microorganism exclusion, which was identical to the one in *Henderson*, applied because the governmental order prohibiting onsite dining was prompted by COVID-19, and therefore indirectly resulted from a microorganism, necessitating denial under the exclusion.[34] [35]

The Supreme Court of Ohio may finally provide some clarity and reconcile these seemingly divergent opinions by way of its forthcoming decision in *Neuro-Communication Services, Inc. v. Cincinnati Insurance Company*.[36] The following question was certified to the court: "Does the general presence in the community, or on surfaces at a premises, of the novel coronavirus known as SARS-CoV-2, constitute direct physical loss or damage to property; or does the presence on a premises of a person infected with COVID-19 constitute direct physical loss or damage to property at that premises?" In the meantime, insureds bringing BI claims should note that their claims may be more favorable on a motion for summary judgment, like in *Henderson*, as opposed to a motion to dismiss, which resulted in a decision in favor of the insurers in all relevant Ohio cases.

ii. Contingent Business Interruption Coverage

Contingent business interruption insurance expressly covers lost profits and other economic losses that result from loss or damage to the property of a supplier, customer, or client. This type of coverage usually requires physical damage to customers' or suppliers' property. Such coverage is important for any insured that may experience a loss arising from a disruption to their supply chain. Like Business Interruption coverage, Contingent Business Interruption (CBI) coverage requires a "direct physical loss or damage" by a covered peril to property, resulting in actual loss of income to the insured. The difference between CBI and BI coverage is the location of the property. BI policies cover the insured's own premises, while CBI covers property that is owned by a third party

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[32] No. 1:20CV1895, 2021 WL 663675, at *8 (N.D. Ohio Feb. 19, 2021).
[33] *Id.* at *7-*9.
[34] *Id.* at *9.
[35] This Ohio court has also rendered another decision in conflict with *Henderson*, specifically stating it was not persuaded by *Henderson*'s reasoning. *See* Santo's Italian Cafe LLC v. Acuity Ins. Co., No. 1:20-CV-01192, 2020 WL 7490095 (N.D. Ohio Dec. 21, 2020) (financial losses did not constitute direct physical loss or damage to insured's premises, and therefore public health closure orders did not meet coverage threshold, therefore financial losses insured experienced from closure orders were not covered under civil authority provision and virus exclusion applied); Ceres Enterprises, LLC v. Travelers Ins. Co., No. 1:20-CV-1925, 2021 WL 634982 (N.D. Ohio Feb. 18, 2021) (decision on appeal now) ("direct physical loss of or damage to property" is not ambiguous and in order for coverage to be required, plaintiffs need to prove either 1) tangible damage, or 2) permanent alteration of property as well as physical deprivation of possession, enjoyment, or use).
[36] *Order of Certification to the Supreme Court of Ohio*, Case No. 4:20-CV-1275 (N.D. Ohio Jan. 19, 2021).

in the insured's supply chain. For example, under these policies, if a COVID-19 contamination constitutes physical damage under the policy, then the presence of the virus at a supplier's plant resulting in a shutdown could trigger this coverage.

The primary issue policyholders encounter in pursuit of CBI claims is difficulties in quantifying and demonstrating that a CBI loss has actually been incurred. In order to ensure that insureds can track this kind of damage, they should document all losses throughout the pandemic and then review those losses to determine what part, if any, are due to supply chain disruptions or other covered causes of loss. These reviews often require the assistance of forensic accountants and other consultants, who review financial statements, sales forecasts, inventory reports, invoices or purchase orders, receipts, and tax returns. Many Commercial Property and Businessowner policies provide coverage to an insured for the costs incurred for such consultants. It is important to note that policyholders must consider and satisfy any relevant notice conditions and requirement of prior approval before incurring costs to retain such a consultant.

iii. Civil Authority Coverage

Civil Authority coverage covers loss of business income that results when access to the insured property is prohibited by order of civil authority due to "direct physical loss" or "direct physical damage" to properties adjacent to or within a certain proximity to the insured property. Such prohibitions prevent the insured from accessing its property, giving rise to the business income loss. This coverage usually mandates that the other property be a certain distance from the insured property and restricts coverage to a limited period of time (e.g., 12 months). Most courts considering civil authority coverage have dismissed policyholder claims, holding that the presence of COVID-19 or an order of civil authority alone, does not constitute physical loss or damage within the meaning of Civil Authority coverage.[37]

The *Studio 417* court, which held that the presence of COVID-19 could give rise to "direct physical loss," also considered the claim in the context of Civil Authority coverage.[38] In that case, the plaintiffs' "all-risk" policy included Civil Authority coverage.[39] In response to the pandemic, the Governors of Missouri and Kansas issued orders requiring the suspension of business at various establishments, including the plaintiffs'

[37] *See* Kessler Dental Assocs., P.C. v. Dentists Ins. Co., No. 2:20-CV-03376-JDW, 2020 WL 7181057, at *4 (E.D. Pa. Dec. 7, 2020) (holding that Civil Authority coverage only applies if there is direct physical loss or physical damage to other property, in conjunction to prohibited access to the covered property); Water Sports Kauai, Inc. v. Fireman's Fund Ins. Co., No. 20-CV-03750-WHO, 2020 WL 6562332, at *8 (N.D. Cal. Nov. 9, 2020) (holding that civil authority coverage is not triggered if the neighboring property to plaintiff's property had no actual coronavirus exposure); Henry's Louisiana Grill, Inc. v. Allied Ins. Co. of Am., No. 1:20-CV-2939-TWT, 2020 WL 5938755, at *5-6 (N.D. Ga. Oct. 6, 2020) (holding that civil authority order did not constitute physical damage to property, therefore, coverage was not triggered); Mudpie, Inc. v. Travelers Cas. Ins. Co. of Am., 487 F. Supp. 3d 834, 839-40 (N.D. Cal. 2020) (holding that COVID-19 did not constitute a direct physical loss to property under civil authority coverage).

[38] 478 F. Supp. 3d 794, 803 (W.D. Mo. 2020).

[39] *Id.* at 798.

businesses.[40] Seeking Civil Authority coverage, the plaintiffs argued that they have been required to cease and/or significantly reduce operations, and have been prohibited from accessing their premises.[41] The Civil Authority coverage portion of the "all-risk" policies stated that the insurer would "pay for the actual loss of 'Business Income' you sustain and necessary Extra Expense you sustain caused by the prevention of existing ingress or egress at a 'premises' … due to direct 'loss' by a Covered Cause of Loss at a location contiguous to such 'premises.'"[42] Relying on its determination that plaintiffs were able to allege a "direct physical loss" under the BI coverage, the court found that the Civil Authority coverage was also triggered.[43] Since the plaintiffs adequately alleged that they suffered a physical loss, this loss was also applicable to other properties in the vicinity.[44] State and local government officials issued closures and stay at home orders throughout Missouri and Kansas, which included properties other than the plaintiffs' premises.[45]

The specific policy language utilized in the Civil Authority coverage grant will dictate how causally connected the government order and property damage to adjacent or nearby property must be. For example, in *United Air Lines, Inc. v. Insurance Company of State of Pennsylvania*, the court held that the insured was not entitled to Civil Authority coverage because the business shutdown was not a "direct physical result" of the damage to the adjacent property.[46] In that case, United Airlines sought indemnity for economic losses relating to the government closure of Ronald Reagan Washington National Airport in connection with the terrorist attacks on the World Trade Center and the Pentagon.[47] The policy insured:

> [A]gainst loss resulting directly from the necessary interruption of business caused by damage to or destruction of the Insured Locations resulting from Terrorism, Sabotage, Insurrection, Rebellion, or Coup d'Etat. This section is specifically 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.[48]

The court held that United Airlines was not entitled to Civil Authority coverage because the airport was shut down before the attack on the Pentagon and was therefore not "a direct result of damage" to adjacent property.[49] The evidence showed that the shutdown was based on the fear of future attacks.

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[40] *Id.* at 798.
[41] *Studio 417*, 478 F. Supp. 3d at 798.
[42] *Id.* at 797-98.
[43] *Id.* at 803.
[44] *Id.* at 803.
[45] *Id.* at 803.
[46] 439 F.3d 128 (2d Cir. 2006).
[47] *Id.* at 129.
[48] *Id.* at 131.
[49] *Id.* at 134.

Furthermore, only government orders causing a business to close will constitute a "civil authority order." If a business closes because of government action that does not rise to the level of an order, like an advisory, then there will be no Civil Authority coverage.[50] To guarantee proof of such an order, insureds should obtain copies of any formal order off their government websites.

iv. Ingress/Egress Coverage

Ingress/egress coverage is designed to pay for a loss of profits and other economic losses due to the suspension of access to the insured's business. In some policies the prevention of ingress and egress must be caused by a physical impediment, however, not all ingress/egress coverage conditions coverage upon the insured premises being inaccessible due to direct physical damage.

The policies in *Studio 417* also contained Ingress/Egress coverage. The coverage stated that the insurer will "pay for the actual loss of 'Business Income' [insured] sustain and necessary Extra Expense [insured] sustain caused by the prevention of existing ingress or egress at a 'premises' … due to direct 'loss' by a Covered Cause of Loss at a location contiguous to such 'premises.'"[51] Much like the BI and Civil Authority coverage, the court held that the plaintiffs were successfully able to allege coverage under the Ingress/Egress coverage.[52] The plaintiffs' ability to successfully show that COVID-19 and the civil authority closure orders rendered their and other's premises unsafe for ingress and egress.[53]

- *First-Party Coverage Considerations*

Generally, recovery under any form of business interruption or first-party insurance coverage is based upon the express language of the policy at issue, including whether there are specific exclusions or extensions for viruses. Broadly stated coverage grants are advantageous to policyholders and may afford courts and judges the necessary latitude to construe the meaning of "direct physical loss or damage" broadly and in favor of coverage for COVID-19 related losses. Under these fortunate circumstances, policyholders must then overcome any potentially applicable exclusions to coverage contained in their policy. Franchisees are urged to identify and familiarize themselves with all relevant exclusions, particularly the scope of any "virus" or "pollution" exclusion and take steps to have any overly broad endorsements removed. Although these exclusions can effectively eliminate coverage in many cases, it is important that policyholders review and understand the implications of any nuances in the express terms of their own policies as coverage may still be available. For example, if your policy contains an exclusion that

[50] *See* Penton Media, Inc. v. Affiliated FM Ins. Co., Case No. 3cv2111, 2006 WL 2504907 (N.D. Ohio Aug. 29, 2006), aff'd, 245 Fed. Appx. 495 (6th Cir. 2007) (holding that FEMA's take-over of the Javits Center following the September 11, 2001, attacks did not constitute an "order of civil authority").
[51] Studio 417, 478 F. Supp. 3d at 798-99.
[52] *Id.* at 804.
[53] *Id.*

applies to the "presence, growth, proliferation, spread, or any activity" of a virus, coverage may still be afforded if COVID-19 is not physically present on your property.[54]

Endorsements can also help safeguard coverage. In early February 2020, the Insurance Services Office developed two new endorsement forms: "Business Interruption: Limited Coverage for Certain Civil Authority Orders Relating to Coronavirus" and "Business Interruption: Limited Coverage for Certain Civil Authority Orders Relating to Coronavirus."[55] These forms are designed to add limited business income or extra expense coverage for loss suffered when the insured's business is ordered closed or placed under quarantine by a civil authority to avoid or limit the spread of the virus. If dependent properties are included in the coverage, such as a supplier's or customer's premises, then the coverage applies to the dependent property as well. Unfortunately, these endorsements have not been approved for use by the insurance regulators in a number of states and ultimately remain commercially unavailable to policyholders. Despite these circumstances, further inquiry and discussion with your insurance broker and insurers may prove beneficial overtime.

Once an insured gets past the hurdle of demonstrating the availability and trigger of coverage, it must establish a loss of profits to a "reasonable certainty."[56] This can be a complicated process that usually involves forensic accountants. For efficiency, you must properly document the reason for a particular action or cost. This is particularly important when insureds continue to operate, but at a reduced degree. Depending on the type of business, it may be worthwhile to examine whether procedures need to be put into place to ensure full documentation of all business decisions.

Policyholders must sufficiently allege that their properties have suffered "direct physical loss or damage," as required by their particular jurisdictions. For example, under California law, "direct physical loss of or damage to property" occurs only when the property undergoes a "distinct, demonstrable physical alteration."[57] In such a situation, the insured may have to show that the virus "infects and stays on surfaces"[58] of the property. Arguing that COVID-19 simply keeps patrons from visiting the business will not be enough.[59] This means that the insured has to allege that COVID-19 creates a tangible alteration to the property and is the root of operation suspension.

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[54] Urogynecology Specialist of Florida LLC v. Sentinel Ins. Co. Ltd., Case No. 6:20-CV-1174-Orl-22EJK (M.D.Fla. Sept. 24, 2020) (holding that "Fungi, Wet Rot, Dry Rot and Virus exclusion was ambiguous because the exclusion "does not logically align with the grouping of the virus exclusion with other pollutants such that the Policy necessarily anticipated and intended to deny coverage for these kinds of business losses.").

[55] Linda G. Robinson, Coronavirus (COVID-19) Business Income Losses—Are They Covered? (March 2020), https://www.irmi.com/articles/expert-commentary/coronavirus-COVID-19-business-income-losses-are-they-covered.

[56] Polytech, Inc. v. Affiliated FM Ins. Co., 21 F.3d 271, 276 (8th Cir. 1994).

[57] *See* 10e, LLC v. Travelers Indemnity Co. of Connecticut, Case No. 2:20-cv-04418-SVW-AS, 2020 WL 5359653 (C.D. Cal. Aug. 28, 2020).

[58] *Id.* at *5.

[59] *Id.*

Policyholders can also argue that the policy language itself is ambiguous, and should as a consequence be interpreted in favor of coverage. As mentioned above, a policyholder in Ohio successfully argued that the phrase "direct physical loss of or damage to property" is ambiguous.[60] The BI coverage in that case provided:

> The actual loss of "business income" you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by *direct physical loss of or damage to property* at a "premises" at which a Limit of Insurance is shown on the Declarations for Business Income. The loss or damage must be directly caused by a "covered cause of loss."[61]

The policyholder contended that physical loss of the property means something different than damage to the property, based on the "or" in the clause, and the court agreed.[62] The policyholder also successfully argued that the policy's "Loss of Market or Delay" exclusion was inapplicable.[63] The exclusion stated in relevant part that the insurer would "not pay for loss or damage caused by or resulting from loss of market, loss of use, or delay."[64] The court held that if the exclusion applied it would functionally void the business income coverage in its entirety.[65] Since the exclusion could be read to bar coverage the policy explicitly provided, it would be inapplicable.[66]

B. Third Party Coverage

Unlike first-party coverage, a third-party insurance policy is one that defends and indemnifies the policyholder for claims by third parties. A third-party claim is filed with the insurance carrier by the policyholder, seeking defense and indemnity for the policyholder's alleged liability to the third party.

i. Commercial General Liability Coverage

Commercial general liability insurance (CGL) protects businesses from a variety of claims including bodily injury, property damage, personal injury, and others that may arise from their business operations. Businesses open to the public may face liability for inadequate measures to prevent the transmission of COVID-19, and claimants may

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[60] Henderson Rd. Rest. Sys., Inc. v. Zurich Am. INS. Co., No. 1:20 CV 1239, 2021 WL 168422 (N.D. Ohio Jan. 19, 2021).
[61] *Id.* at *12.
[62] *Id.* at *10 (emphasis added).
[63] *Id.* at *16; see also Neuro-Commc'n Servs., Inc. v. Cincinnati Ins. Co., No. 4:20-CV-1275, 2021 WL 274318, at *2 (N.D. Ohio Jan. 19, 2021) (the ambiguity of coverage language has led to the following question being certified to the Ohio Supreme Court: "Does the general presence in the community, or on surfaces at a premises, of the novel coronavirus known as SARS-CoV-2, constitute direct physical loss or damage to property; or does the presence on a premises of a person infected with COVID-19 constitute direct physical loss or damage to property at that premises?").
[64] *Henderson*, 2021 WL 168422, at *16.
[65] *Id.*
[66] *Id.*

attempt to link their infections directly to employees' infections. CGL policies characteristically cover "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies."[67] To be within the scope, an underlying claim or suit against the insured must allege damages because of "bodily injury" or "property damage" caused by an "occurrence." "Bodily injury" is typically defined to include "bodily injury, sickness, or disease sustained by a person, including death resulting from any of these at any time."[68] "Property damage" is defined as:

> a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
> b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.[69]

The standard definition of an "Occurrence" is "an accident, including continuous or repeated exposure to the same general harmful conditions."[70] A key aspect of whether there is CGL coverage will be if the lawsuit alleges that bodily injury and/or property damage arose because of an "occurrence." Contracting the virus at a business could be an "occurrence" if the claimant alleges the business accidentally caused him or her to contract it.

At first glance it seems that CGL policies would be triggered for COVID-19 related losses, but a full review of the particular policy may make clear that attaining coverage is not that straightforward. For example, CGL policies often contain Employers Liability exclusions, which would negate coverage for most workplace safety related claims. This exclusion excludes coverage for bodily injury to employees of the insured "arising out of and in the course of: Employment by the insured; or; Performing duties related to the conduct of the insured's business."[71] Such an exclusion would likely eliminate coverage for claims where employees seek damages for COVID-19 infections while in the workplace.[72] Insureds should also be aware of exclusions for "expected or intended" injuries. The types of allegations that support a claim for spreading COVID-19 may inherently allege that the business could have "expected" or "intended" the resulting harm. Insurers could argue that insureds could "expect or intend" that reopening a business or not implementing stringent enough safety measures could cause virus-related harm, and deny coverage on that basis.

Another prominent exclusion in CGL policies is the Communicable Disease Exclusion endorsement. This broad endorsement, states that coverage does not exist for

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[67] ISO, CGL Coverage Form - CG 00 01 04 13, § I, Coverage A.1.a. (2012).
[68] *Id.* at § V.3.
[69] *Id.* at § V.17.
[70] *Id.* at § V.13.
[71] *Id.* at § I.A.2.e.
[72] However, if an employee contracts COVID-19 at work and then passes it to family members, if those individuals bring claims against the business those will still be covered.

damages "arising out of the actual or alleged transmission of a communicable disease."[73] Although the endorsement does not define communicable diseases it covers, it applies to actual and alleged transmission. It has functioned to eliminate coverage for diseases such as the avian flu, SARS, and rotavirus. While litigation analyzing whether coverage is generally available under traditional CGL policies is still pending, it will likely be difficult for an insured to argue that this exclusion does not include COVID-19 within the exclusionary wording. Similarly, another typical endorsement titled "Exclusion for Loss Due To Virus Or Bacteria" also provides, in relevant part that the insurer "will not pay 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."[74] This broad language will also likely function to bar coverage for COVID-19 related claims.

Most CGL policies also contain some form of pollution exclusion. Some states have expanded the definition of pollutant to include various substances not traditionally considered environmental pollutants. For example, a court has interpreted a pollution exclusion to specifically include viruses.[75] Depending on how a state interprets what a "pollutant" is these provisions could also function to exclude COVID-19 related claims.

- *CGL Coverage Considerations*

Whether your CGL policy applies to a particular suit arising out of a COVID-19 related event is a fact-specific inquiry. To maximize the chances of being covered, all "virus" and "pollution" exclusions should be reviewed. Insureds should try and get overly broad exclusions amended or removed altogether. Even if a policy does not have these exclusions, other standard provisions in the policies like Employers Liability exclusions or "expected or intended" acts clauses may make coverage under CGLs tricky.

Even if your CGL policy does not indemnify your losses related to COVID-19, you can likely still demonstrate that the insurer owes you a duty to defend. CGL policies give the insurer "the right and duty to defend the insured against any suit seeking…damages 'bodily injury' or 'property damage.'"[76] The insurer's duty to defend is often determined by the allegations in the underlying complaint and the language of the policy. The duty to defend is far broader than the duty to indemnify, therefore the insurer must defend suit if the allegations bring the claim within the possibility of coverage.

ii. Commercial Auto Liability Coverage

As many businesses move to delivery options in light of COVID-19, franchisors and franchisees must reconsider if their Commercial Auto Liability insurance policies adequately cover their employees. Overall, food delivery revenue has increased by more

[73] ISO - CG 21 32 05 09.
[74] ISO - CP 01 40 07 06.
[75] *See* First Specialty Insurance Corporation v. GRS Management Associates, Inc., 2009 WL 2524613 (S.D.Fla. 2009).
[76] ISO - CG 00 01 04 13, § I, Coverage A.1.a. (2012).

than 20% in 2020 compared to 2019.[77] If businesses require their delivery employees to utilize their own vehicles, the employees' personal auto policies will likely not provide coverage, because personal car insurance policies have a list of exclusions that often include "driving-for-hire."

Businesses that have adopted a delivery model need to ensure that their Commercial Auto policies provide coverage on an "any auto" basis. "Any auto" liability coverage provides primary auto liability coverage for the vehicles the business owns, vehicles that are hired, and other non-owned vehicles. If the policy is not on an "any auto" basis, the insured must confirm that the policy covers "Symbol 9" autos, which are defined as, "'autos' you do not own, lease, hire, rent or borrow that are used in connection with your business. This includes 'autos' owned by your 'employees' … while used in your business …."[78] Non-owned auto insurance can also provide coverage to a franchisee owner for liability arising out of an accident involving a vehicle owned by an employee, which is being used for commercial or business purposes. Employers can also expand the scope of coverage available by adding policy endorsements that cover drivers for bodily injury and property damage if they cause an accident while on an "active delivery."[79]

- Commercial Auto Coverage Considerations

As you review your Commercial Auto coverage be sure to also review your employees' personal auto policies. There is often a coverage gap between a businessowner or franchisee's policies and their employees' policies. For example, a businessowner's policy would typically provide coverage to an employee while they are delivering takeout to a customer, but not while driving to the restaurant to pick up the order. There are a number of potential solutions businessowners can utilize to limit and even eliminate this gap, including requiring all employees that use personal vehicles for business purposes to obtain "Business-Use" endorsements, which provide liability coverage in connection with the use of such vehicles. Unfortunately, this approach is not always feasible in many cases. Under these circumstances, it is strongly recommended that franchise owners which face such auto-related exposures maintain excess non-owned auto liability coverage with sufficient limits.

iii. Employment Practices Liability Coverage

Employment Practices Liability (EPL) coverage generally provides coverage for claims made by employees alleging a violation of their legal rights. These claims are usually for discrimination, harassment, wrongful termination, defamation, and invasion of privacy. During COVID-19 these claims could take on new forms. For example, if an employee that voluntarily self-quarantines during the pandemic is terminated for violating an existing HR attendance policy, such an employee could attempt to allege wrongful

[77] Jason Metz, *Navigating Auto Insurance For Delivery Driver*, FORBES ADVISOR (Apr. 8, 2020), https://www.forbes.com/advisor/car-insurance/delivery-drivers/.
[78] Commercial Auto Coverage form CA 00 01 10 13.
[79] *Id.*

termination. Likewise, EPL policies could be triggered for claims made by employees that are laid off or lose their jobs due to government mandated shutdowns or company shutdowns.

EPL coverage has been sought in relation to violations of various federal and state laws. At least one case has arisen due to an alleged violation of the Families First Coronavirus Response Act or Act (FFCRA).[80] The FFCRA requires employers with less than 500 employees to provide their employees with paid sick leave or expanded family and medical leave for specified reasons related to COVID-19. Employers may be sued for failure to provide the required time off, and for a failure to provide pay for or retaliation towards an employee for exercising this right. Likewise, there has been recent COVID-19 related litigation due to alleged violations of the Americans with Disabilities Act (ADA). The ADA prohibits discrimination based on disability and requires an employer to provide reasonable accommodation to qualified individuals with disabilities who are employees or applicants for employment, unless doing so would cause undue hardship. The ADA also prohibits disparate treatment on the basis of disability or being regarded as disabled. In *Peeples v. Clinical Support Options, Inc.*, the Massachusetts federal district court granted a preliminary injunction allowing an employee to work remotely after his employer had refused to allow the employee to work remotely during the pandemic, despite having asthma, and being able to perform the essential functions of his job remotely.[81] The court found that the employee was likely to prevail on the contention that asthma was a disability during the pandemic.[82] Based on this, the employer's action violated the ADA because working remotely was deemed a reasonable accommodation under the circumstances.[83] Moreover, several employees are filing claims with their state Equal Employment Opportunity Commissions based on illegal terminations and retaliation.

- *EPL Coverage Considerations*

As you lean on your EPL insurers for coverage, you must be mindful of several exclusions that could bar coverage for claims arising out of COVID-19 related events. Claims for certain workplace statutes are typically excluded under EPL policies. These exclusions include OSHA, WARN, COBRA, NLRA, FLSA, and FMLA. Insureds should review these exclusions to see if the provisions provide any carveouts for some related covered claims. For example, even though EPL policies bar coverage for FMLA claims, most insurers will include a carveout for "retaliation" claims. Furthermore, most EPL policies contain exclusions for losses related to "bodily injury." Since many COVID-19 related claims may allege some form of bodily injury, policyholders must be conscious of whether their policy excludes claims for the actual bodily injury or all claims arising out of bodily injury. Also, much like several other coverages, EPL policies also can contain pollution exclusions.

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[80] *See* Jones v. Eastern Airlines, No. 2:20-cv-01927 (E.D. Pa. April 16, 2020) (the case is still pending and thus far Eastern Airlines has filed a Motion to Dismiss).
[81] 487 F. Supp. 3d 56 (D. Mass. 2020).
[82] *Id.* at 62.
[83] *Id.* at 63.

Another often overlooked portion to pay attention to is any "Wage and Hour" exclusions. Some EPL policies contain a small defense cost sublimit specifically addressing issues arising out of wage-and-hour disputes. In the absence of that sublimit, wage-and-hour claims are largely excluded from EPL policies unless you purchase special wage-and-hour insurance products. To the extent that COVID-19 claims arise from certain leave or quarantine measures that impact pay, this exclusion may become relevant.

Lastly, insureds need to be mindful of the potential influx of claims sparked by mandatory COVID-19 vaccines in the workplace. The Equal Employment Opportunities Commission ("EEOC") recently provided updated guidelines for employers who want to proceed with vaccine requirements.[84] The EEOC has indicated that employers may require employees to get the vaccine but must do so within the legal confines of the Americans with Disabilities Act (ADA) and Title VII of the Civil Rights Act. This means that if there are any disability or religious related objections to the vaccine, the employer must engage in the interactive process and try to find reasonable accommodations. If an employee cannot get vaccinated and there is no reasonable accommodation, then it would be lawful to exclude the employee from the workplace. However, before terminating the employee, the employer needs to confirm that no other EEOC, federal, state, or local laws are being violated. Mandatory vaccination requirements will likely see a rise in ADA and/or Title VII claims, as well as retaliation claims. There is also a possibility of disparate impact claims if accommodations and exceptions are not applied in a consistent manner. As long as these claims allege employment practices violations, EPL policies should be triggered. Insured should keep in mind that written communications from employees regarding the vaccine and/or COVID-19 may be deemed a "claim" so it is important to provide insurers notice of anything that could be construed as a claim or become one.

C. Worker's Compensation Coverage

Worker's Compensation ("WC") Coverage covers medical expenses, lost wages, and rehabilitation costs for employees who are injured or become ill "in the course and scope" of employment. WC generally also pays death benefits to the families of employees who die "in the course and scope of" employment. Every state has a unique WC policy in place, and states apply differing coverage requirements and standards based on industry, occupation, and the size and structure of a business. WC is designed to benefit both employers and employees by providing reliable insurance coverage with predictable payments and reduced legal costs.

- *WC Coverage Considerations*

Whether WC policies will provide coverage for COVID-19 related claims is complicated. While WC policies usually cover "occupational diseases" that arise out of and in the course of employment, many state statutes exclude "ordinary diseases of life"

[84] EEOC, *What You Should Know About COVID-19 and the ADA, the Rehabilitation Act, and Other EEO Laws* (2020), https://www.eeoc.gov/wysk/what-you-should-know-about-covid-19-and-ada-rehabilitation-act-and-other-eeo-laws.

from coverage, for illnesses like the common cold or flu. The National Council on Compensation Insurance records that prior to COVID-19 at least 19 states had policies stating that if firefighters and other first responders develop lung and respiratory illnesses, those conditions are presumed to be work-related and covered under WC, but it is unclear if those existing policies would cover COVID-19 illnesses. The COVID-19 pandemic also presents a distinct circumstance in which many jobs that are not traditionally considered hazardous have suddenly become very dangerous. Workers deemed essential including health care workers, mass transit operators, and grocery store workers are at a high risk of exposure.

As of the date of this writing, 17 states and Puerto Rico have taken action to extend WC coverage to include COVID-19 as a work-related illness[85]. Minnesota, Utah, and Wisconsin have limited the coverage to first responders and health care workers. Illinois, New Jersey, and Vermont have covered all essential workers, and California and Wyoming have covered all workers.[86]

The National Council on Compensation Insurance ("NCCI") has also proposed some changes to help employers dealing with this new wave of WC claims. In April 2020, NCCI created a new class code 0012 for furloughed employees.[87] Under the proposal, payments to these employees do not need to be included in payroll information for purposes of calculating WC premiums. In May 2020, NCCI also proposed excluding COVID-19 claims from experience rating calculations. NCCI reasoned that "[t]he presence or absence of a pandemic in a recent historical period is not believed to be a reliable good predictor of whether one will return in a given future year, after the current one runs its course. These newly adopted frameworks were set to expire on December 31, 2020, but in light of the pandemic remaining ongoing, NCCI submitted a new filing to state regulators removing the expiration date. If approved in your state, the code will remain in place until circumstances warrant, which in all likelihood means after the pandemic ends."[88]

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[85] These states are: Alaska, Arkansas, California, Connecticut, Florida, Illinois, Kentucky, Michigan, Minnesota, New Hampshire, New Jersey, New Mexico, North Dakota, Utah, Vermont, Wisconsin, and Wyoming. For further details on each of these states' actions and other states' pending actions see NAT'L COUNCIL ON COMP. INS., COVID-19 AND WORKERS COMPENSATION: WHAT YOU NEED TO KNOW - FREQUENTLY ASKED QUESTIONS - UPDATE (Oct. 9, 2020).

[86] *See* Josh Cunningham, *COVID-19: Workers' Compensation*, NAT'L CONF. OF STATE LEGISLATURES (Dec. 9, 2020), https://www.ncsl.org/research/labor-and-employment/covid-19-workers-compensation.aspx (providing a full list of legislation each state is considering in the scope of WC coverage).

[87] NAT'L COUNCIL ON COMP. INS., COVID-19 AND WORKERS COMPENSATION: WHAT YOU NEED TO KNOW - FREQUENTLY ASKED QUESTIONS - UPDATE (Oct. 9, 2020). "Currently, the expiration date of the changes established in Item Filing B-1441 is December 31, 2020. Since the COVID-19 pandemic is ongoing and the end date is unknown, NCCI submitted a new filing to state regulators (Item Filing B-1443) that removes the expiration date. Once approved, the changes in Item Filing B-1441 will continue to remain in effect and will not expire until further amended as circumstances warrant in consultation with state regulatory authorities. A future filing will be made to establish an expiration date to this rule as determined and approved by the regulator."

[88] NAT'L COUNCIL ON COMP. INS., ITEM E-1407—EXCLUSION OF COVID-19 CLAIMS FROM EXPERIENCE RATING AND MERIT RATING (July 10, 2020).

2. Legislative Responses with Implications for Coverage[89]

Litigation over insurance coverage for COVID-19 related claims remains in its infancy. In the meantime, several states are trying to step in by enacting legislation that would help insureds access coverage. These states are considering legislation that will require property insurers to provide coverage for business interruption losses stemming from the pandemic. These states include: Louisiana – H.B. 858, Massachusetts – SD.2888; New Jersey – N.J. Draft Bill A-3844; New York – Draft A.B. A10226, 498, 1937 and S.B. 847 and 4711; Ohio – H.B. 589; Oregon – H.B. 2730; Pennsylvania – H.B. 2372 and 42; Rhode Island – H.B. 5052; South Carolina – S.B. 1188; Texas – S.B. 249; and Washington – S.B. 5351.

The scope and effect of the proposed legislation varies by state, but by way of example, let us consider New York's Draft Assembly Bill A10226. If enacted, New York's proposed bill would have immediate retroactive effect applying to property policies containing business interruption and loss of use and occupancy coverage, in force as of March 7, 2020. The bill would apply to policyholders under such policies with less than 100 full-time employees who work a normal week of 25 hours or more in the State of New York. The proposed bill would effectively avoid disputes as to whether the presence of COVID-19 on property triggers the direct physical loss of or damage to property condition requirement contained in most BI coverages. Though not explicitly addressed, New York's proposed bill would also effectively result in any "virus" exclusions in such policies being unenforceable. A further example is South Carolina's S.B. 1188, which explicitly prohibits property insurers from denying coverage for BI claims resulting from COVID-19 on the basis of any virus exclusion, a lack of direct physical loss or damage to property, or based on any civil authority order or decision of a governmental entity.

The pandemic has also resulted in proposed legislation at the federal level. The Pandemic Risk Insurance Act of 2020 ("PRIA") would have established a Pandemic Risk Reinsurance Program ("PRRP") that "provides compensation to insurers if they incur losses as a result of coverage related to pandemics and outbreaks of disease."[90] Insurers who elected to participate in the program would have had to meet certain criteria. Specifically, insurers participating in the program would have been required to offer, in all BI policies, coverage for public health emergencies related to an outbreak of infectious disease or a pandemic declared on or after January 1, 2021 and certified by the Department of Health and Human Services. Any exclusions that explicitly excluded loss covered under the PRRP would have been void, but state-approved exclusions would have been preempted by PRIA. Functionally, if PRIA were enacted, PRRP would be triggered after aggregate industry losses for participating insurers exceed $250 million, and the federal funds would be capped at $750 million within a calendar year. The bill's sponsor, Representative Carolyn B. Maloney of New York, has stated she intends to reintroduce PRIA during the current term.

[89] The proposed COVID-19 related state bills described in this section remain pending as of the date of publication of this paper.
[90] Pandemic Risk Insurance Act of 2020, H.R.7011, 116th Cong. (2019-2020).

Another piece of proposed legislation is the Business Interruption Insurance Coverage Act of 2020 ("BIICA").[91] If implemented, the BIICA would have been applicable to all companies with BI coverage without restrictions based on the number of employees or size of the company. The BIICA would have applied retroactively to the beginning of the pandemic. It would have voided any existing exclusions in BI policies of a participating insurer, but if enacted would have permitted reinstatement of these preexisting provisions if certain requirements are met. The BIICA would have required that BI policies cover losses resulting from (1) future viral pandemics; (2) any forced closure of business, or mandatory evacuation; and (3) any power shut-off conducted for public safety purposes.

The Never Again Small Business Protection Act of 2020 ("NASMPA") was another proposed act.[92] NASMPA would have required BI policies to provide coverage to policyholders during any presidentially declared national emergency or disaster. Under NASMPA, a BI policy would have been permitted to exclude coverage for business interruptions resulting from such a national emergency only if the insured agrees in writing or if the insured fails to pay its premiums.

3. Indemnity Provisions in Franchising Agreements

Indemnification clauses are ubiquitous throughout the business world and serve as a principle means of managing and transferring risk. Due to the unique nature of franchise, there is no doubt that franchisors should include indemnification clauses to protect themselves from third party claims based on the franchisees' operation of their independent businesses. Such indemnification clause is consistent with the established vicarious liability doctrine. Vicarious liability doctrine ordinarily makes principals or employers vicariously liable for the acts of their agents or employees in the scope of their authority or employment.[93] If there is no agency relationship, there is no vicarious liability. Based on this established principle, a franchisor is not liable for its franchisee's conduct unless the principal/agent relationship exists.[94]

An example of a typical indemnification clause is as follows:

> You will protect, defend, hold harmless and indemnify us, the Franchisor Entities and each of our and their respective affiliates, directors, officers, interest holders, shareholders, owners, members, managers, partners, employees, accountants, agents, attorneys, representatives, heirs, successors and assigns, from and against any and all costs and expenses (including attorneys' fees, arbitration and court costs, investigation costs

[91] Business Interruption Insurance Coverage Act of 2020, H.R.6494, 116th Cong. (2019-2020). It is currently unknown whether this will be reintroduced.
[92] Never Again Small Business Protection Act of 2020, H.R.6497, 116th Cong. (2019-2020). It is currently unknown whether this will be reintroduced.
[93] Meyer v. Holley, 537 U.S. 280, 285-86 (2003).
[94] Kids R Kids Int'l, Inc. v. Cope, 769 S.E.2d 616, 617–18 (Ga. Ct. App. 2015) ("In order to impose liability on the franchisor for the obligations of the franchisee, it must be shown that: (a) the franchisor has by some act or conduct obligated itself to pay the debts of the franchisee; or (b) the franchisee is not a franchisee in fact but a mere agent or 'alter ego' of the franchisor.").

and costs of collection), losses, liabilities, damages, claims and demands of every kind or nature, arising in any way out of or relating to your actions or omissions to act, whether under this Agreement, in the operation of the Business or otherwise.

The COVID-19 pandemic has raised additional uncertainty as consumers and workers have brought negligence claims after contracting COVID-19 at business premises due to inadequate safety measures. Claimants have to show they were infected at the business and their damages and injuries were caused by the infection, making these types of claims harder to prove in some franchise models, such as restaurants. Alternatively, risks are higher for hotel and health care franchises where claimants can normally show they have been in an owner-controlled environment controlled for a relatively longer period of time.

Generally speaking, in response to such claims, franchisees can argue that they followed the relevant guidance at the federal, state, or local level. However, the "relevant guidance" is a moving target and it is not always easy to implement for franchisees with limited resources. Under such situations, franchisors must provide guidance and assistance to their franchisees. It is in franchisors' best interest to communicate and guide their franchisees through this difficult time. The fear of third-party lawsuits should not become a deterrent because indemnification clauses typically cover these types of claims. However, to protect themselves, franchisors should clarify in writing that any guidance provided to the franchisees are recommendations instead of mandates, and that it is ultimately each franchisee's responsibility to follow all appliable rules.

While the indemnification clauses are typically sufficient to protect the franchisors from COVID-19 contraction claims, they are also generally one-sided. If franchisees struggle to survive the economic stress, franchisors should revisit indemnification clauses and thrive to achieve a more balanced result. The success of a franchise system depends on the franchisees and franchisors working hand in hand, which prompts a deeper look into how risk is transferred between the parties.

Indemnification clauses in franchise agreements often require franchisees to reimburse the franchisors for legal fees and other expenses incurred in defending the third-party claims. These agreements do not specifically require such reimbursement to be "reasonable," which could leave a franchisee in a very difficult position. This is especially true when a franchisor retains the right to choose its own attorney to defend third-party claims. Burdening franchisees in financial distress with large legal fees is not a good practice, especially since the flow of liability to the franchisor is limited by the vicarious liability rules.

Franchisors in the product sales industries should even consider whether they should be indemnifying their franchisees. While the indemnification clauses in franchise agreements generally require the franchisees to indemnify the franchisors of all claims and liabilities arising out of the franchisee's operations, they typically do not require the franchisors to indemnify the franchisees. For franchisees in the service industries, such

one-sided indemnification clauses are less concerning since the core value provided by the franchisors typically lies in the trademarks and confidential know-how, which are less likely to be subjected to third-party liabilities. However, in a model where the franchisees sell the franchisor's product, like a branded nutritional supplement or fitness equipment, the franchisees are exposed to more significant risks if the indemnification clause is one-sided. Even if a distributor does not participate in the designing or production of a product that allegedly causes the harm, the law may still impose liability on the distributor based on the doctrine of strict liability. The basis of strict liability is that each member of the distribution chain benefits from the sale of the product, so each member should share in the liability and burden when something goes awry. In a relationship where the parties have equal bargaining powers, a manufacturer would typically agree to indemnify the distributor. However, that is not the norm in franchise relationships.

More often, franchisors provide a carve out that franchisees are not required to indemnify the franchisors for the franchisors' fault. This is largely due to state statutes governing anti-indemnity provisions. Most states have some form of anti-indemnity law that bars contract provisions that require another party to indemnify a party for their own negligence or fault. An example of an indemnification clause containing such a carve out is as follows:

> Franchisee shall indemnify and hold harmless Franchisor, its Affiliates, and their respective shareholders, officers, directors, employees, agents, successors and assignees (the "Indemnified Parties") against any and all claims, obligations, lawsuits, demands, investigations, damages, losses and liabilities arising directly or indirectly from, as a result of, or in connection with Franchisee's ownership or operation of the Franchised Business or breach of this Agreement, as well as the costs, including attorneys' fees and court costs, of defending against them. However, Franchisee shall not be required to indemnify Franchisor for any claims to the extent arising out of the gross negligence or intentional misconduct of the Franchisor or defects in goods manufactured by Franchisor's Affiliate present on delivery thereof to Franchisee. Franchisor has the exclusive right to defend any such claim. Under no circumstances will Franchisor or any other Indemnified Party be required to seek recovery from any insurer or other third party, or otherwise mitigate its or their losses and expenses, in order to maintain and recover fully a claim against Franchisee.

This type of indemnification clause should be revised to include the franchisors' indemnification of the franchisees for liabilities caused by the products designed or manufactured by the franchisors. In practice, the franchisors would want to retain control of the defense of their own products.

4. Force Majeure Clauses in Franchise Agreement

"Force Majeure" is French for "superior force." Force Majeure clauses contractually excuse the parties from performing their contractual obligations when an unforeseeable

circumstance arises that making performance impracticable, illegal, or impossible. When interpreting a Force Majeure clause, two components are the most important: a list of triggering events and the performance to be excused.

The list of triggering events is crucial because the interpretation of a Force Majeure clause follows the basic rules of contract interpretation. When determining whether a specific situation is covered by the clause, the wording of the clause will govern. Different industries may have different relevant triggering events, so the clause should be tailored to meet specific needs. Whether the COVID-19 pandemic is an "Act of God" or otherwise within the scope of a standard force majeure provision is still a grey area, but some courts have upheld their application in this scope.[95]

In franchise settings, Force Majeure clauses typically do not excuse performance to the extent of cancelling the franchise agreement. In some cases, the agreement will excuse franchisee's delay in paying royalties. Similarly, development schedule delay may be excused. Many Force Majeure clauses limit the duration of the emergency, meaning that if the condition causing the inability to satisfy the contractual obligations continues for more than a specified time period, then the ability to claim Force Majeure may end.

The COVID-19 pandemic exposed the problem in one form of Force Majeure clauses common in leases and franchise agreements the contain them. Below is an example:

> Whenever a period of time is provided in this Agreement for either party to perform any act, except the payment of monies, neither party shall be liable nor responsible for any delays due to strikes, lockouts, casualties, acts of God, war, governmental regulation or control or other causes beyond the reasonable control of the parties, and the time period for the performance of such act shall be extended for the amount of time of the delay.

This type of Force Majeure clause provides "extension" as a relief for the performance of obligations, "except the payment of monies." As a result, franchisors and landlords are excused from providing much needed support or maintenance of the premise, while franchisees must continue to pay royalties and rent.

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[95] *See* In re Hitz Rest. Grp., 616 B.R. 374 (Bankr. N.D. Ill. 2020) (stay-at-home order issued during pandemic, which prevented Chapter 11 debtor from providing on-premises dining at its restaurant and limited it to takeout and curbside service, partially relieved debtor of obligation to pay rent pursuant to force majeure clause in lease, which was triggered by both "governmental action" and issuance of "order"); JN Contemp. Art LLC v. Phillips Auctioneers LLC, No. 20CV4370 (DLC), 2020 WL 7405262 (S.D.N.Y. Dec. 16, 2020) (COVID-19 pandemic and government restrictions fell squarely within force majeure clause in contract between art seller and auction house, which was triggered when auction was postponed for circumstances beyond parties' reasonable control).

Even when the Force Majeure clause does not exclude "the payment of monies," the party obligated to make payment may gain no protection from Force Majeure. This is due to the basic structure of a Force Majeure clause, which requires a triggering event to present to an extent that the performance of an obligation is "prevented." For example, a governmental mandate that all restaurants must remain closed would prevent a franchised restaurant from operating, but does not prevent the franchisee from making a payment. Unless the payment obligation is entirely contingent on a franchisee's income, the government mandate would not trigger such a Force Majeure clause. During the COVID-19 pandemic many franchisees found themselves in this exact situation with franchisors and landlords.

A one-sided Force Majeure clause that provides unsatisfactory relief to a franchisee, in some situations, could be more harmful than no Force Majeure clause at all. When a contract contains a Force Majeure clause, courts focus on the language of the clause without resorting to general common law doctrines. On the other hand, if a contract is silent on Force Majeure, parties may be able to argue that common law doctrines of commercial impracticability/impossibility, frustration of purpose, etc., apply.

Apart from the stand-alone Force Majeure clauses, some franchise agreements incorporate Force Majeure clauses into other provisions such as opening requirements, relocation provision, and default provisions. Often franchisors will extend the required opening period when a franchisee is unable to obtain a necessary license or permit to open, at no fault of the franchisee. Under these types of situations, franchisees may be given the right to terminate the franchise agreements. Some franchise agreements incorporate Force Majeure language into these provisions, like the following:

> Extension of Opening Period. If, due to circumstances beyond Franchisee's control, Franchisee is unable to begin operations and service of customer contracts by the expiration of the Opening Period, Franchisee may request in writing that Franchisor extend the Opening Period … If Franchisee is unable to open the Franchised Business by the expiration of the extended Opening Period, Franchisee may request in writing that Franchisor grant a further extension. The final determination as to any extension will be in Franchisor's sole discretion.

The franchisee's right to extend the opening period or terminate the franchise agreement could become an industry norm in light of COVID-19. Franchisees should also note that the franchisor may also require them to comply with the post-termination non-compete clauses after such early termination.

Force Majeure language is also often incorporated in other default clauses. Often, they can be found in clauses as an exception for termination, or typically, as an exception for abandonment. A clause like this may state that the:

> Franchisor may terminate you effective immediately upon receipt of written notice by you … If you cease to operate your Business, unless: (i) operations are suspended for no more than sixty (60) days; and (ii) the

> suspension was caused by fire, earthquake, hurricane, condemnation, or act of God.

When there is no catch-all language and the list of events is limited, as here, a franchisee would likely have a difficult time persuading a court that additional events could be included. Likewise, some franchise agreements allow a franchisee to relocate if an "act of God" makes operation impractical. The triggering events are typically limited to those affecting the physical location of the franchise and state:

> If Franchisee is unable to continue operation of its Business at the Approved Location due to an act of God (including but not limited to fire, flood, or earthquake) or due to extreme hardship or due to other circumstances approved by Franchisor in its sole discretion, Franchisee may request in writing permission to relocate its Business, provided that Franchisor may reduce, alter, or eliminate the Protected Territory in connection with any such relocation.

In all scenarios, the party invoking a contractual Force Majeure provision should strictly follow any procedural requirements set forth in the provision, like providing written notice detailing the provision, its expected duration, and the impact on the party's ability to perform. In addition, if a franchisee invokes a Force Majeure clause in an effort to excuse its non-performance of some provision under the franchise agreement, the franchisor should acknowledge the matter in writing so to (1) avoid a waiver claim and (2) establish the cause and timing of the force majeure event (if the parties agree the provision was properly triggered) or document the franchisor's position if the franchisor believes the provision was not implicated or does not excuse the performance at issue.

5. Emerging Business Risks & Associated Recommendations

While franchisors and franchisees are facing insurance-based issues, there are several other emerging business risks within the franchise system. Specifically, both parties have to consider how franchise agreements and contracts need to be amended in light of COVID-19.

A. Non-Waiver Provisions Contained in Franchise Agreements

Generally, a non-waiver provision prevents the waiver of contractual rights unless the waiver is agreed to in writing between the parties. A comprehensive franchise agreement will contain a non-waiver clause. Courts, however, have been inconsistent in their enforcement of non-wavier clauses. Therefore, even with a non-waiver provision present in the franchise agreement, when granting COVID-19 related contractual relief, franchisors should communicate details of the relief provided in writing. Failure to do so risks a later claim that the franchisor somehow waived the franchisee's obligation.

A signed deferral agreement with the individual franchisee setting forth the terms of the relief is preferrable. However, during the COVID-19 crisis many franchisors could

not afford the time and effort involved in securing signed agreements with each franchisee. Instead, many franchisors simply communicated to the entire franchise system the terms of relief to be offered. The advantage of the system-wide relief is both ease of operations, as well as transparency in the system of uniform treatment of the franchisees. The disadvantages are that such an approach prevents any sort of individual negotiations between the parties. If a franchisor opts to use system-wide communication, the relief should be carefully written to precisely describe the relief offered, any prerequisites (including whether the franchisor is requiring the franchisee to execute a release in exchange for the offered relief), the timing of the relief, any conditions under which the relief is forfeited, and the consequences of such forfeiture.

B. Non-Discrimination Obligations

Even with system-wide relief policies, the COVID-19 crisis created many situations in which the franchisor provided additional, individually tailored relief to differently impacted franchisees. Examples are royalty relief, advertising requirement relief, delay in re-opening following mandated shut down, and delay in development timing. The benefit of such individually crafted relief agreements is that it has the most impact on the neediest cases. On the other hand, however, franchisors should carefully consider their obligation under certain state laws—like in Indiana, Illinois, Hawaii, and Arkansas—to not discriminate against a franchisee. A written statement setting out the standards under which such individual relief will be offered is a mechanism to mitigate the risk of a claim of discrimination.

C. COVID-19 Specific Situations

i. Requests for Relief from Royalty and Other Fees

During the COVID-19 pandemic, many franchisees struggled to pay normal expenses given the closing of the economy. Franchisees sought assistance from franchisors in many forms, with royalty and advertising fund relief being primary. Franchisors responded to the need with system-wide programs that allowed for deferring the payment of monthly royalty fees and advertising fees. Also, many franchisors waived required minimum royalty fees, which meant those franchisees who collected no revenue during the crisis, paid no royalty fee.

While deferring these fees or waiving minimum fees helped franchisees to manage cashflow during the pandemic, many franchisees sought abatement rather than mere deferral. In weighing the pros and cons of such abatement relief programs, the franchisor should consider its obligations under its franchise agreements to provide services to all franchisees. The resiliency of the franchise system will depend greatly on the ability of the franchisor to emerge from the crisis with programs and promotions to jump start the system sales. It is also important to note that without royalty or advertising fees, franchisors inherently risk finding themselves in a cash-crunch. Without these funds, a franchisor may be forced to furlough support staff and marketing promotions, to the potential detriment of the entire system. A franchisor must weigh its desire and need to

assist franchisees impacted by the crisis with the franchisor's obligation to remain healthy enough to support the surviving franchisees as the system emerges from the crisis.

ii. Delayed Openings: Economic Restraints, Permitting & More

Even where the parties' franchise agreements did not contain Force Majeure provisions, during the pandemic many franchisors granted relief to franchisees who were impacted by the crisis by extending construction deadlines, opening timelines, and renovation schedules. Many franchisees could not obtain financing to commence construction, could not obtain the necessary permits to start, and could not open to the public due to governmental stay-at-home orders. Even in the heat of the crisis, most believed the situation was temporary and believed that eventually the restrictions or shortages which created the delay would come to an end. Believing the crisis was temporary, franchisors were reluctant to terminate the franchise agreement as a whole based solely on the pandemic alone when a simple deferral agreement would suffice.

iii. Landlord-Tenant Relationships

Commercial lease expense is often one of the largest expenses on the franchisee's Profit and Loss Statement. Commercial leases often contain a Force Majeure provision that expressly exclude a tenant's duty to stop paying rent. This exclusion meant that, during the crisis when governmental stay-at-home orders required the franchisee to close its operations, the commercial lease's Force Majeure clause did not excuse the franchisee's obligation to continue to pay rent to the landlord. Many landlords expressly took the position that the tenant was required to pay rent despite governmental stay-at-home orders. In some cases, entire malls or shopping centers were closed to the public, but the landlord continued to require rent payments.

Ultimately, most landlords agreed to some sort of limited rent deferral with one or two months of base rent being deferred for a few months. In very few cases, landlords agreed to a rent waiver or abatement. Often these deferral or abatement agreements came with many other concessions that the landlord required of the tenant, including, in some cases, a tenant warranty that it would apply for, secure, and remit to the landlord any governmental grants or loans made available to the tenant due to the crisis. In defending their tactics, landlords have claimed that their lenders or banks prohibit them from extending more relief. They have made these contentions despite the federal reserve and other banking regulators instructing its regulated institutions to show leniency toward tenants who may not be able to pay. Moreover, many landlords argued that the structure of the federal Payroll Protection Program ("PPP") encouraged rent deferral rather than forgiveness. This was largely based on the fact that PPP was, in general, not available to landlords. However, a certain amount of PPP loan forgiveness was achieved through payment of commercial rent. Therefore, landlords saw deferral as the mechanism to force their tenants to apply for PPP and remit the PPP funds to landlords as rent.

Furthermore, during the crisis, state and local governments placed occupancy and hours restrictions on many indoor malls and some higher density outdoor shopping

centers. Landlords responded by closing common areas or forbidding tenants from accessing the common areas during certain times. Most commercial leases contain provisions that allow the landlord to control the common areas, revise common area rules and, via the Force Majeure provision, excuse landlords' obligation under the lease to open the common areas during business hours. Tenants have argued that such prohibitions frustrate the purpose of the lease and abrogate the tenant's obligation to pay rent and even negate the lease entirely. Given that most tenants do not want to terminate the lease and lose their space, the closure of the common area was generally part of a larger rent deferral negotiation between the parties.

Conclusion

The COVID-19 pandemic and resulting impact on franchised businesses has been nothing short of devastating, and it illustrates the current need for franchise systems to undertake an exhaustive evaluation of their operations and existing insurance and risk management programs. The standard insurance products and policy forms traditionally relied upon and contractually required by most franchisors are no longer sufficient to address the complex mix of risks franchisors and franchisees currently face. Given these complexities, it is recommended that franchisors and franchisees seek further guidance from their insurance brokers or coverage counsel to determine the type and scope of insurance necessary to address their operational risks and create or update standard insurance requirements that will provide a strategic advantage and ensure the continued success of a franchise system.