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March 14, 2020

ISO Excluded
Coronavirus Coverage 15
Years Ago

*Randy Maniloff
Ed Koch
Margo Meta
White and Williams, LLP*



The coronavirus is contagious. The same can be said of articles, penned by coverage lawyers, addressing the potential availability of insurance for losses tied to the pandemic. We've lost track of how many we've seen. Understandably, as the situation is so novel, and rapidly developing, these articles generally speak in terms of "it could be this" or "it could be that" when discussing which policies may be in the mix and whether they may apply.

So far, business interruption policies have taken center stage in the coronavirus-insurance dialogue. That makes sense. We believe that two issues may grab the spotlight.

First, those looking into the coronavirus crystal ball have made the point that, to trigger business interruption coverage, there must be "direct physical loss of or damage to property at premises which are described in the Declarations." This property damage requirement does not appear to be satisfied on the basis that coronavirus-tied losses will be on account of a general decline in economic activity.

But policyholder advocates have been saying "hold the phone," with several pointing to one case in particular that they believe supports an argument that the presence of the coronavirus in a structure satisfies the "direct physical loss of or damage to" requirement.

Jenner & Block, a policyholder-side firm, put it this way: "Nothing in these often undefined terms rules out the possibility of damage caused by the presence of microscopic organisms or requires that loss or damage be visible to the naked eye, or even visible at all." Don Henley was right: Lawyers dwell on small details. That may be where this is headed for businesses that had the virus on hand.

But despite all the talk about whether there has been "direct physical loss of or damage to" the covered property, it could be muffled out. Many business interruption policies contain an exclusion for "Loss Due To Virus Or Bacteria." And, in fact, ISO's 2006 circular, prepared as part of its filing of this exclusion with state regulators, had COV-19 in mind.

Direct Physical Loss Of Or Damage To Covered Property

The case that we've seen most cited by policyholders, in support of an argument that the presence of the coronavirus in a structure satisfies the "direct physical loss of or damage to" requirement is *Gregory Packaging, Inc. v. Travelers Property and Casualty*

Gregory Packaging sought coverage under a property insurance policy issued by Travelers for business interruption following the release of an unsafe amount of ammonia from a refrigeration system contained inside one of its facilities. Travelers denied coverage for the loss on the basis that Gregory Packaging did not suffer "direct physical loss of or damage to Covered Property," as required by the Travelers policy.

The New Jersey federal court, relying upon New Jersey courts and the Third Circuit, defined "physical damage" as "a distinct, demonstrable, and physical alteration" of a property's structure. The court determined that, while structural alteration provides the most obvious sign of physical damage, a property can sustain physical loss or damage without experiencing structural alteration. The court concluded that ammonia, a dangerous gas, which rendered Gregory Packaging's buildings uninhabitable, constituted a "direct physical loss," sufficient to trigger coverage under the Travelers' policy.

But the issue is not so cut and dry. See *Mama Jo's, Inc. v. Sparta Ins. Co.*, 2018 U.S. Dist. LEXIS 201852 (S.D. Fla. Jun 11, 2018) (holding that restaurant did not sustain direct physical loss when dust and debris from nearby roadwork could be remediated by cleaning); *Mastellone v. Lightning Rod Mut. Ins. Co.*, 884 N.E.2d 1130 (Ohio Ct. App. 2008) (finding that mold which could be removed by cleaning was not physical damage, as it did not alter or otherwise affect the structural integrity of the building's siding); *Universal Image Prods. v. Chubb Corp.*, 703 F. Supp. 2d 705 (E.D. Mich. 2010) (holding that intangible harms such as odors or the presence of mold and bacteria in an HVAC system did not constitute physical damage to property); *Great N. Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan Ass'n*, 793 F. Supp. 259 (D. Or. 1990) (opining that asbestos contamination was not a physical loss, as the building remained unchanged), aff'd, 953 F.2d 1387 (9th Cir. 1992).

There will be plenty of cases examined and dissected when addressing the "direct physical loss of or damage to" issue.

Exclusion For Loss Due To Virus Or Bacteria

ISO form CP 01 40 07 06 is titled "Exclusion for Loss Due To Virus Or Bacteria" and provides, in relevant part:

"We 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."

The exclusion goes on to specifically state that it applies, among other things, to "business income," i.e., business interruption.

ISO's July 6, 2006 circular [LI-CF-2006-175], prepared as part of its filing of the exclusion with state regulators, makes specific reference to such viral and bacterial contaminants as rotavirus, SARS, influenza (such as avian flu), legionella and anthrax.

The policy form scribes go on to set out their then-Current Concerns:

*"Although building and personal property could arguably become contaminated (often temporarily) by such viruses and bacteria, the nature of the property itself would have a bearing on whether there is actual property damage. An allegation of property damage may be a point of disagreement in a particular case. In addition, pollution exclusions are at times narrowly applied by certain courts. ***"*

While property policies have not been a source of recovery for losses involving contamination by disease-causing agents, the specter of pandemic or hitherto unorthodox transmission of infectious material raises the concern that insurers employing such policies may face claims in which there are efforts to expand coverage and to create sources of recovery for such losses, contrary to policy intent.

In light of these concerns, we are presenting an exclusion relating to contamination by disease-causing viruses or bacteria or other disease-causing microorganisms."

The exclusion for virus-caused business interruption, even if the presence of the coronavirus in a structure satisfies the "direct physical loss of or damage to" requirement, is clear. And so is ISO's back-story on its purpose.

But we can expect to see policyholder counsel subject the "Loss Due To Virus Or Bacteria" exclusion to a CSI-like investigation looking for ways around it. There will just be too much at stake.

The disputes over coverage for Hurricane Katrina damages provide a good example of where all of this may be going. The flood exclusion in commercial property and homeowners policies looked water-tight. But policyholders challenged it aggressively. What choice did they have given the scope of damages? And they won some early victories, despite insurers prevailing in important cases on appeal.

History shows that necessity is the mother of creative insurance coverage arguments.