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NJ Cos. May Have Insurance Coverage For COVID-19 Losses

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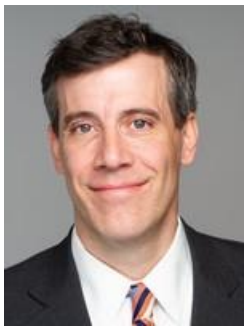

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Many commentators are analyzing whether insurance coverage will exist for business interruption and supply chain disruption caused by the coronavirus crisis. Most conclude that the physical injury requirement under a property policy will be a major roadblock to coverage.

However, two New Jersey cases indicate courts can interpret physical injury broadly to find coverage for business closures and loss of functionality resulting from events that don't involve physical alteration to tangible property.

Wakefern Food Corp. v. Liberty Mutual Fire Insurance Co.[1] involved the power blackout of 2003. Wakefern, a retailer-owned cooperative group of supermarkets, purchased insurance coverage for damage caused by an interruption of electric power. The policy stated that the interruption had to be the result of physical damage, which the policy did not define.

Liberty Mutual argued that the blackout did not result from physical damage, but from "the de-energizing of transmission lines by the proper operation of protective relay devices."[2] The trial court agreed, and the New Jersey Appellate Division reversed.

The Appellate Division found that "based on the highly technical analysis" in the utility's report, "one could certainly argue that the system was not physically damaged."[3]

The court found that from the point of view of the consumers, however, "the system certainly suffered physical damage, because it was incapable of providing electricity."[4] The court held that the term "physical damage" was ambiguous and had to be construed in favor of coverage. The court discussed several cases from other jurisdictions in which courts construed physical damage broadly as loss of functionality.[5]

The Wakefern court prefaced its discussion of the case with a recitation of New Jersey's fundamental rules of insurance policy construction: courts will construe ambiguities to promote coverage; "coverage clauses are interpreted liberally, whereas exclusionary are strictly construed"; and, most importantly, "insurance policies are to be interpreted so as to effectuate the reasonable expectations of the insured."[6]

The court also stressed that the insurance company was the sole drafter of the insurance policy. These rules were central to the court's analysis. Essentially, the court found that a reasonable policyholder would expect coverage for food spoiled by an electric power outage, regardless of scientific technicalities as to whether physical damage had taken place.

Gregory Packaging v. Travelers Property Casualty Co. of America[7] concerned an ammonia release that caused the evacuation of a building for several days because it was unsafe. The U.S. District Court for the District of New Jersey held that the ammonia discharge inflicted direct physical loss or damage to the facility "because the ammonia physically rendered the facility unusable for a period of time."[8]

In addition to Wakefern and cases from other jurisdictions, the Gregory court also relied on Port Authority of N.Y. and N.J. v. Affiliated FM Insurance Co.[9] That case found that if "'the presence of large quantities of asbestos in the air of a building is such as to make the structure uninhabitable and unusable, then there has been a distinct loss to its owner' which would constitute 'physical loss.'"[10]

These cases are directly apposite to business interruption and disruption caused by the coronavirus. To be sure, the COVID-19 virus will impact businesses in many different ways, some of which may be covered and some not. However, if the release of ammonia or asbestos in a building is physical damage, the same should apply to a release of the virus. If a building is closed because of the presence of the virus, coverage should also exist.

Moreover, coverages such as ingress/egress and civil authority are also triggered by physical loss. Parties litigated civil authority coverage after 9/11, when parts of New York were temporarily closed to business. If the government orders a building closed because of the presence of the virus in the neighborhood, the insured should look at coverage.

Further, this also applies to contingent business interruption. This is essentially supply chain insurance, and provides coverage if a supplier of the insured is unable to deliver a component that disrupts the insured's operation, or if a key customer cannot accept goods of the insured.

If the peril that disabled the supplier or customer is covered by the insured's policy, the insured has coverage. If a company's operations are disrupted because of the closure of a facility, contingent business interruption coverage may apply.

As set forth in Wakefern, New Jersey has strong pro-policyholder rules of insurance policy construction. As stated in Wakefern, it is well settled that those purchasing insurance "should not be subjected to technical encumbrances or to hidden pitfalls and their policies should be construed liberally in their favor to the end that coverage is afforded 'to the full extent that any fair interpretation will allow.'"[11] In the past year, the Appellate Division has strongly affirmed these principles.

First-party property policies are not as standardized as are general liability policies. The exact wording of the policy needs to be precisely plotted against the facts of the company's disruption. However, every company that suffers interruption or disruption because of COVID-19 needs to review its insurance policies to determine if coverage exists.

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[1] Wakefern Food Corp. v. Liberty Mutual Fire Insurance Co., 406 N.J. Super. 524 (App. Div.), certif. denied, 200 N.J. 209 (2009).

[2] Id. at 535.

[3] Id. at 541.

[4] Id.

[5] See also, Customized Distribution Services v. Zurich Insurance Co., 373 N.J. Super. 480, 487-8 (App. Div. 2004), certif. denied, 183 N.J. 214 (2005) (finding 'direct physical loss' ambiguous, stating that "'physical' can mean more than material alteration or damage…").

[6] 406 N.J. Super. at 539.

[7] Gregory Packaging, Inc. v. Travelers Property Casualty Co. of America,Civ. No. 2:12-CV-04418 (WHW) (CLW), 2014 U.S. Dist. Lexis 165232 (D.N.J. Nov. 25, 2014) directly followed Wakefern.

[8] Id. at *17.

[9] 311 F.3d 226, 235 (3d Cir. 2002) (applying New York and New Jersey law).

[10] Gregory Packaging, 2014 U.S. Dist. Lexis 165232 at *15, quoting Port Authority,311 F.3d at 236.

[11] Wakefern at 539, citing Kievit v. Loyal Protective Life Ins. Co.,34 N.J. 475 (1961), citing Danek v. Hommer, 28 N.J. Super. 68, 76 (App. Div. 1953), aff'd o.b. 15 N.J. 573 (1954).