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Insurance coverage for coronavirus claims: 'Loss of use' does not require physical injury in liability policies

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In our strange new world, leaders of shuttered businesses are sitting in their kitchens, reading insurance policies with sudden interest. Insurance company executives are doing the same. Several COVID-19 coverage lawsuits have already been filed, and many more are expected to follow.

One of the first battlegrounds will be whether the shutdowns arise from "physical injury" — often required in property and liability policies to trigger coverage.

But in some cases, the answer to this question will not matter. Drafting history shows that liability policies provide coverage for loss of use, even without physical injury to property, in certain circumstances. Businesses should keep this fact in mind.[1]

THE 1966 CGL POLICY

CGL insurance policies — originally "comprehensive general liability" and later "commercial general liability" — are the backbone of most insurance programs. They provide defense and indemnification against claims by third parties.

When these policies were created in 1966, the standard-form definition of "property damage" was simply "injury to or destruction of tangible property." There was no reference to loss of use. The drafting history, however, shows that loss of use was intended to be included. The only reason the definition does not so state is that the drafters thought its inclusion of loss of use was clearly implied.

An early draft of this definition made physical injury a requirement of property damage.

In 1961, the Joint Forms Committee to the Rating Committees of the National and Mutual Bureaus, which was a committee of policy drafters, proposed defining property damage as "physical injury to or destruction of tangible property."[2]

The Joint Forms Committee abandoned this proposal precisely to incorporate loss of use. In approving this deletion, the committee explained:

Thus the intent is clarified that the injury or destruction must be to "tangible" property but such property need not be physically damaged, e.g. the damages sustained by the closing down of a building would be within the definition.[3]

In 1966, William J. Obrist, of the General Accident Group, wrote an article analyzing the new policy form. With regard to "property damage," he stated:

The new definition omits any requirement of physical injury as a prerequisite for coverage. The National Bureau states that the policy will cover the insured's legal liability if no specific exclusion applies even though the tangible property is not physically damaged but is made useless by the act of an insured. An example would be the breaking down of a large piece of contractor's equipment on a public street in such a manner that the street must be closed off for a period of time and the public has limited or no access to the stores located in the block affected.[4]

Drafting history shows that liability policies provide coverage for loss of use, even without physical injury to property, in certain circumstances.

But the drafters created an opportunity for confusion by failing to specify that property damage includes loss of use.

This opportunity became a guarantee when they made an unrelated change — including "loss of use" in the definition of damages. The 1966 standard form insurance policy defines damages as follows:

"Damages" includes … damages for loss of use of property resulting from property damage.

Thus, the drafters used "loss of use" in two ways:

(1) as a form of property damage that can trigger coverage in the absence of physical injury.

(2) as a form of damages that may be collected when there is insurance coverage.[5]

Confusion ensued because the drafters failed to include "loss of use" in the definition of property damage as they did in the definition of damages.

Many courts and commentators interpreted "property damage" correctly even though it did not include this term.[6]

But some concluded the opposite.[7] The result was a split in decisions regarding the term.

THE 1973 CGL POLICY

The insurance industry tried to fix the confusion when it revised the standard-form CGL policy in 1973.

That revision changed the definition of property damage to:

(1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or

(2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

Under subsection (1), coverage would attach when property was physically injured or destroyed. Under subsection (2), coverage would attach when there was loss of use of property *even without physical injury or destruction*. This definition added the specificity that was missing in 1966.

The Defense Research Institute, in a 1974 analysis of the 1973 revisions, provided two illustrations of loss of use coverage under subsection (2):

(1) The insured contractor, engaged in road repairs, damages a gas main, requiring that the gas be shut off. As a result of the interruption of the gas service, a plant served by the lateral from the gas main must temporarily shut down. The "loss of use" claim would be covered even though none of the "tangible property" of the plant has been damaged.

(2) The insured's crane buckles and blocks the entrance to a building. The claim for "loss of use" of the building would be covered.[8]

These examples are substantially similar to the examples chosen by the 1966 drafters to illustrate the intent of the 1966 policy.

The similarity confirms that the 1973 revisions merely clarified the original meaning.

Also, the 1973 revisions eliminated the definition of "damages" entirely. According to the Fire, Casualty & Surety Bulletins, the definition was no longer needed because its terms had been incorporated elsewhere.

For example, the reference in the former definition of damages to "loss of use of property resulting from property damage" was incorporated into subsection (1) of the revised property damage definition.

That subsection now included "the loss of use thereof resulting therefrom."[9]

This revision makes clear that "loss of use" in subsection (1) actually refers to the consequential damages that may result from physical injury to or destruction of tangible property.[10]

An interesting argument can be made about why the reference to loss of use in the damages definition was transferred to the property damage definition.

The argument is that the reference was transferred to show that when loss of use results from physical injury, it cannot trigger coverage under subsection (2) even if it continues in later periods.

The drafting history of the 1973 definition of property damage supports this argument. Specifically, the Joint Conference Subcommittee originally proposed amending the 1966 definition to read:

property damage means physical injury to or destruction of or loss of use of tangible property.[11]

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Another committee approved this proposed definition on the basis that the proposal would clarify the 1966 intent to include loss of use as property damage.[12]

The Joint Forms Committee, however, refined the proposed definition further, ending up with the two-part definition that ultimately was adopted.

The committee explained that the refinement was needed to prevent confusion about which policy period was in effect when loss of use from physical injury extends over multiple periods:

If a building is physically injured in Policy A and has resultant loss of use extending over Policy A and later Policy B, all of the damages would be covered under Policy A.[13] As explained by Robert P. Cook, assistant general attorney at Liberty Mutual Insurance Company:

In the new property damage definition, we divide the concept into two parts: the first, physical injury along with all resulting loss of use: the second, pure loss of use of tangible property which has not been physically injured. ... Then, as to the first category — where there is physical injury — we telescope all resulting loss of use back to the time of the physical injury.[14] The same result is achieved in subsection (2) due to the requirement that the loss of use must be caused by an occurrence during the policy period, unless the physical injury or the occurrence itself was continuous.

In such case, each policy in force during the continuous physical injury or occurrence should pay for loss of use.[15]

THE 1986 CGL POLICY

In 1986, the standard-form CGL was revised yet again.

The new form defines property damage as follows:

(1) Physical injury to tangible property, including all resulting loss of use of that property; or

(2) Loss of use of tangible property that is not physically injured.

This revision eliminates from both subsections any reference to occurrences or damage that occurred during the policy period. These provisions have not been eliminated from the policy, however; they have been moved to the insuring agreement.

It now reads as follows:

(1) This insurance applies only to … "property damage" which occurs during the policy period. The … "property damage" must be caused by an "occurrence."

(2) "Property damage" that is loss of use of tangible property that is not physically injured shall be deemed to occur at the time of the "occurrence" that caused it.

The drafting history indicates that this change was made, at least in part, to eliminate circular language in the 1973 form.

There, subsection (2) of the property damage definition addressed loss of use "resulting from an occurrence." The occurrence definition, however, stated that an occurrence "results in … property damage."

To eliminate this circularity, the Ad Hoc Committee on Special Comprehensive Rules and Forms recommended in 1978 that all references to occurrence be deleted from the property damage definition.[16]

But the 1986 definition of property damage was intended to have the same meaning as the prior ones.

THE LOSS-OF-USE EXCLUSION

Although a discussion of the standard exclusions is beyond the scope of this commentary, attention should be paid to one exclusion in the standard form 1973 policy: the loss-of-use exclusion.

This exclusion tracks subsection (2) of the 1973 definition of property damage, barring coverage for loss of use of tangible property that has not been physically injured or destroyed resulting from:

(1) a delay in or lack of performance by or on behalf of the named insured of any contract or agreement.

(2) the failure of the named insured's products or work performed by or on behalf of the named insured to meet the level of performance quality, fitness or durability warranted or represented by the named insured.

But this exclusion does not apply to loss of use of other tangible property resulting from the sudden and accidental physical injury to or destruction of the named insured's products or work performed by or on behalf of the named insured after such products or work have been put to work by any person or organization other than an insured.

The exclusion applies only when coverage is based on loss of use under subsection (2) of the definition. It is restricted to loss of use of non-damaged property due to: (1) delayed performance or non-performance of a contract; or (2) unsatisfactory products or work.

The drafters offered the following example of how to apply it:

(1) The insured fuel dealer fails to deliver oil to an apartment building. As a result, the occupants must be evacuated. Neither the loss of rent nor the cost of relocating the tenants would be covered. … However, if due to the non-delivery of oil, the water pipes freeze and burst, the cost of repair as well as the loss of use would be covered.

(2) A boiler sold and installed by the insured in a manufacturing plant fails to heat a quantity of water to the specified temperature, and the plant's capacity is thereby reduced. There would be no coverage for the resulting loss. However, if the boiler suddenly and accidentally breaks down, or explodes, without causing physical damage to other property, the loss of use of the plant would be covered.[17]

In practical terms, the exclusion proved difficult to apply. Accordingly, it was revised in 1986 to exclude:

"Property damage" to "impaired property" or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work;" or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use.

CONCLUSION

In the years that followed these standard forms, insurance companies have written new policies and different definitions of "loss of use," "property damage" and other key terms.

But while the words have changed, other things have not — like the intent of these critical words, as shown by the drafting history summarized here, and the importance of reading every policy in full, in accordance with its plain language and, where appropriate, its drafting history.

These principles will be of paramount importance during this astounding pandemic, where insurance may prove essential to avoiding economic collapse. Those business leaders, with piles of policies on their kitchen tables, should be reading very carefully.

FOOTNOTES

1 The article is adapted from a 1990 article in the Insurance Litigation Reporter. See Rhonda D. Orin, "The Meaning of Loss of Use in the Definition of Property Damage," Insurance Litigation Reporter (October 1990, cited e.g., at Craig F. Stanovich, "Loss of Use as Property Damage" (June 2016), available at https://www.irmi.com/articles/expert-commentary/loss-of-use-as-property-damage; Peter J. Kalis, Thomas M. Reiter, James R. Segerdahl, "Policyholder's Guide to the Law of Insurance Coverage (1997), at § 2.02[D] n.116.

2 *See* Explanatory Memorandum of the Joint Forms Committee, May 4, 1961.

3 *See id*. (emphasis supplied).

4 Obrist, New Comprehensive General Liability Insurance Policy (1966), reprinted as Appendix C to Defense Research Institute, General Liability Insurance-1973 Revisions (Vol. 1974, No. 1, Jan. 1974) (emphasis supplied). See also Nachman, The New Policy Provisions for General Liability Insurance, The CPCU Annals 197, 200 (1965) (since definition does not require physical injury, "if the insured's crane buckles and the street must be closed off, loss of use claims from business owners on the street would be covered"). See also Brain, Changes and Possible Problems In The New Liability Policy, Mid-America Insurance (July 1966).

5 *See Continental Casualty Co. v. Gilbane Bldg. Co.*, 391 Mass. 143, 461 N.E.2d 209 (1984) (finding coverage for losses incurred by a restaurant that is forced to shut down (loss of use as damages) because falling glass from windows above the restaurant required the street to be closed (loss of use as property damage)).

6 *See, e.g., American Motorists Ins. Co. v. Trane Co.*, 544 F. Supp. 669, 682-83 (W.D. Wis. 1982) (plant's decreased operating capacity is "property damage"), aff'd, 718 F.2d 842 (7th Cir. 1983); *Cute'-Togs of New Orleans Inc. v. Louisiana Health Serv. & Indem. Co.*, 376 So. 2d 999 (La. Ct. App. 1979), *rev'd on other grounds,* 386 So. 2d 87 (1980) (machinery's lost use is "property damage"); 3 R. Long, Law of Liability Insurance § 6 at 38 app. (rev. ed. 1974).

7 *See, e.g., Dreis & Krump Mfg. Co. v. Phoenix Ins. Co.*, 548 F.2d 681, 687 (7th Cir. 1977) (uselessness of housing structure resulting from brake's defectiveness not "property damage"; "actual" injury required); Tarpey, *The New Comprehensive Policy: Some of the Changes*, 33 Ins. Corns. J. 223, 227 (1966).

8 *See* Defense Research Institute, General Liability Insurance-1973 Revisions (Vol. 1974 No. 1 January 1974).

9 *See* F.C.& S. Bulletins, *General Liability Changes* (1973); Comments of Richard H. Elliott, of the Insurance Services Offices, on the 1973 General Liability Policy Revision, attached to letter to WAIB-IBA (Committee on Revised Liability Forms, September 22, 1972) ("The reference to 'loss of use' of property present in the definition of damages is transferred to the new definition of 'property damage.'").

10 *See, e.g.*, Letter from David B. Edwards, Counsel to Aetna Fire & Casualty Co., to Robert F. Bauer, vice president of Johnson & Higgins, (Dec. 18, 1972) (confirming Bauer's belief that loss of use under subsection (1) "should fall within consequential loss covered by the policy"); Annotated Copy of Umbrella Excess Liability Policy released by Liberty Mutual Insurance Co. in July 1973 (interpreting subsection (1) as meaning that "the policy in force at the time of the physical injury also covers consequential damage including subsequent loss of use arising from this incident").

11 *See* Joint Conference Subcommittee Meeting, Minutes (February 18, 1970).

12 *See* General Liability Governing Committee Meeting, Minutes (March 17, 1970).

13 Joint Forms Committee Meeting, Minutes (August 4-5, 1970).

14 *See* Address by Cook, *Contemplated Changes In General Liability Coverage*, Mutual Insurance Technical Conference in Philadelphia, Pa. (November 18, 1970).

15 *See id.*

16 Ad Hoc Committee on Special Comprehensive Rules And Forms, Minutes (August 22-24, 1978).

17 *See* Defense Research Institute, General Liability Insurance - 1973 Revisions (Vol. 1974, No. 1, Jan. 1974).

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  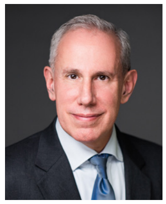

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