Coronavirus Triggers Arguments Over Insurance for Physical Damage

by Joshua Gold

In the debate over coverage for coronavirus business income losses, many insurers have asserted that the virus causes "no physical loss or damage" as their reason for denying claims. The argument is reminiscent of past coverage battles over just what constitutes "physical loss or damage" in the insurance realm. Indeed, until COVID-19 appeared, many of the recent battles over the issue of what constitutes "physical damage" for insurance purposes centered on technology losses—namely, losses of data, loss of computer system stability and damage to computer files. Others concerned various infusions or contaminations that rendered food or equipment or premises unusable.

The lesson learned from many of these court battles is that the insurance industry's restrictive interpretation of the phrase "physical loss or damage" may be legally untenable.

THE IMPACT OF PRIOR COURT DECISIONS

Court decisions have made clear that physical loss or damage may exist even in the absence of circumstances that better fit our conventional notions of property damage like bent steel or burnt factory facilities. As a result, coronavirus existing on property surfaces should constitute "physical loss and damage" under "all risk" property insurance coverage.

For example, computer system malfunctions or cyberattacks that cause the system to become unstable qualify as covered physical loss or damage. In *NMS Services Inc. v. The Hartford*, (4th Cir. Apr. 21, 2003) the U.S. appeals court found that the deliberate erasure of computer files and databases by a former employee was "damage to its property, specifically, damage to the computers it owned." In *American Guarantee & Liability Insurance Company v. Ingram Micro Inc.*, (D. Ariz. Apr. 18, 2000), a U.S. district court found property insurance coverage for loss of custom programming information stored in the computers' random access memory when the data center experienced a power outage. In *Southeast Mental Health Center Inc. v. Pacific Ins. Co. Ltd.* (W.D. Tenn. 2006), a U.S. district court found that the policyholder proved necessary direct physical loss where its pharmacy computer data was corrupted due to a power outage.

As for cyberattacks, in analyzing all risk property coverage for such an attack that rendered the policyholder's computer system slow and unreliable, a federal trial court found just this year in *National Ink and Stitch, LLC, v. State Auto Property and Casualty Insurance Co.* (D. Md. Jan. 23, 2020) "that loss of use...or impaired functionality demonstrate the required damage to a computer system, consistent with the 'physical loss or damage to' language in the policy."

Similarly, where property cannot be used due to coronavirus presence or governmental orders stemming from coronavirus, such scenarios should constitute physical loss or damage to property. In *Gen. Mills, Inc. v. Gold Medal Ins. Co.* (Minn. App. 2001), the appellate court found all risk property coverage for loss resulting from contaminated oats due to the presence of a pesticide. The court found that the loss was covered when the oats could not be used pursuant to FDA recommendations and the court further rejected application of a "contamination" exclusion due to ambiguity of the exclusion's language.

Loss of use of the property due to unsafe conditions where a

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dangerous physical condition exists should also qualify as "physical loss or damage" of property. In *TRAVCO Ins. Co. v. Ward* (E.D. Va. 2010), the federal trial court found that where a "home was rendered uninhabitable by the toxic gases" released by drywall, there was a "direct physical loss". Similarly, in *Mellin v. Northern Sec. Ins. Co.* (N.H. 2015), the court concluded that "physical loss may include not only tangible changes to the insured property, but also changes that...exist in the absence of structural damage." As such, coronavirus should qualify as physical loss or damage to property—whether the policyholder's or someone else's, such as that of a supplier or other third party. Similarly, in *Sullivan v. Standard Fire Ins. Co.* (Del. 2008), the court found that mold spores and bacteria present on the policyholder's personal property constituted a "physical loss." The court explained "the adjective 'physical' is defined as having 'material existence.' Mold spores and other bacteria associated with mold undoubtedly have a 'material existence,' even though they are not tangible or perceptible by the naked eye. Therefore, mold contamination constitutes a 'physical loss' within the meaning of the policy."

Similarly, in a case applying Iowa law to a commercial umbrella insurance policy, *National Union Fire Insurance Company of Pittsburgh v. Terra Industries, Inc.* (8th Cir. 2003), the federal appeals court found property damage coverage for the detection of benzene in trace amounts contained in beverages distributed through retailers to consumers. The trial court rejected the insurance company's arguments that the presence of benzene in the carbonated beverages did not constitute "property damage."

Finally, in *Phibro Animal Health Corp. v. National Union Fire Ins. Co. of Pittsburgh, Pa.* (N.J. App. Div. 2016), a New Jersey appellate court rejected a commercial general liability insurance company's argument that "property damage" must be permanent. Noting its ruling in a prior case that "physical" can mean more than "material alteration or damage," the court affirmed again that "any ambiguity on the point should be resolved in favor of coverage." (Note: Anderson Kill represented the policyholder in this case.)

In short, unduly restrictive arguments over the phrase "physical loss or damage" should not necessarily thwart an otherwise covered insurance claim. Coverage for losses stemming from the coronavirus and associated shutdowns and disruptions will hinge on specific policy language, and policyholders should not accept blanket assertions that losses do not stem from "physical loss or damage." ■

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