

Business Interruption Claims

The BI claims on standard property damage and event cancellation policies are increasing in the U.S. as a result of the COVID19 economic shutdown. There are several groups that have organized the plaintiffs to mount serious challenges to the traditional definition of “property damage” and to the recent ISO “virus exclusion.”

The definition of property damage in the typical BI policy requires direct physical damage to the insured property to trigger the BI coverage. Most courts have historically defined physical damage as a change or alteration to insured property requiring repair or replacement of the insured property. However, some courts have begun to accept and apply the rule that physical damage could also be the “loss of essential function” of the insured property.

This newer theory of loss of essential function is based on cases where the intrusion of noxious gases or asbestos and other similar airborne substance closes down a commercial enterprise. These cases have evolved into the court holdings that the insured property is damaged without physical or structural alteration if the insured property is prevented from being used for its “essential function.” Thus, when ammonia gas was released into a manufacturing facility preventing the insured building from use for 5 days till elimination of the gas, the insured building lost its essential function constituting physical damage.

Relative to COVID, the challenges argue that contamination of insured property from a virus constitutes direct physical loss. The individual case facts and particular state law will contour the response to such claim. The most obvious concern in fighting these claims that germs are property damage are the state laws which support the loss of essential function interpretation.

Listed below are how certain states split on acceptance of the loss of essential function holding. Dependent on choice of law rules and jurisdiction, an insurer should press to have its cases heard in states which apply the change or alteration rules.

States which support rule that direct physical loss means physical change requiring repair or replacement of insured property. This is not a complete survey of the U.S.

New York
Michigan
Minnesota
Ohio
Oregon

States which interpret physical damage to include a change in essential function:

New Jersey
Louisiana
Pennsylvania
Massachusetts
Virginia

West Virginia

Relative to the ISO virus exclusion. The existence of the exclusion in a litigated policy assists in the denial of coverage even in a state which applies the loss of essential function rule. The ISO rule CP-01-75-07-06 arose from the avian flu about 10 years ago. There have not been reported cases challenging the exclusion. Currently the exclusion / endorsement is being challenged on the ground that it is ambiguous and inapplicable to the COVID because the property damage was the result of direction by civil authority.