Vermont High Court: COVID Virus, Like Cat Urine, Can Cause Physical Loss

Claims Journal

Citing decisions that found insurance coverage was owed for contamination caused by cat urine and gasoline vapors, the Vermont Supreme Court broke from courts across the nation and found that SARS-CoV-2 can cause a direct physical loss to property.

The 3-2 decision released Friday revived a lawsuit filed by Huntington Ingalls Industries — which the opinion described as the nation's largest military shipbuilder — that sought coverage under reinsurance policies issued to its captive insurer. The high court reversed a ruling by the Franklin County Superior Court that dismissed HII's request for a declaratory judgment that coverage was owed because the virus had not caused a direct physical loss.

The Supreme Court majority said that a direct physical loss "need not necessarily be visible; alterations at the microscopic level may meet this threshold." Because HII's reinsurers did not include the standard virus exclusion in their policies, coverage may be owed, the opinion says.

"It is necessarily true that property perfectly intact cannot be used if it is stolen," the opinion says. "As various courts have recognized over the years, deprivation may also occur when property is unusable due to a health hazard."

State high courts in Iowa, Massachusetts, Oklahoma, South Carolina, Washington and Wisconsin and all but one of the federal Circuit Courts of Appeal have ruled against policyholders that sought coverage for business-interruption costs caused by COVID-19. In a statement, the Association of Property Casualty Insurance said the decision turned on what the court described as Vermont's "extremely liberal" notice-pleading standards.

"APCIA is, however, encouraged by the court's findings that direct physical damage requires a distinct,

demonstrable, physical change to property and precludes coverage for purely economic harm, and these bedrock tenets of property insurance jurisprudence should ultimately result in a finding of no coverage," the association said in a statement.

Unlike many businesses that were forced to close at the outset of the COVID-19 pandemic in March 2020, HII kept its shipyards operating as part of the nation's "essential critical infrastructure." Nevertheless, the virus disrupted operations of the company. More than 6,000 of its 40,000 employees were infected, the company said in its civil complaint. HII also incurred expenses by taking mitigation measures, such as installing barriers between workers and improving information technology systems.

Multiple reinsurers shared equal portions of the risk under a global policy issued by HII's captive insurer, which was domiciled in Vermont. The policy did not include the standard virus exclusion that was created in 2006, after an outbreak of the original coronavirus, SARS-CoV-1.

HII filed a lawsuit in Franklin County seeking a declaratory judgment that coverage was one owed under its reinsurance policies for disruption and mitigation costs caused by COVID-19. The reinsurers, led by Chubb's Ace American Insurance Co., filed a motion to dismiss the lawsuit.

The trial court granted the motion, finding like the majority of jurisdictions that have heard similar cases that the virus did not cause a direct physical loss. Two dissenters said in a separate opinion issued on Friday that the trial court made the right call.

The Supreme Court majority, however, cited numerous decisions over the past 60 years where courts found that something intangible had caused a direct physical loss. For example, the New Hampshire Supreme Court ruled in 2015 that the oder of cat urine from a downstairs neighbor hadcaused a physical loss to the owner of a condominium unit. In 1968, the Colorado Supreme Court sided with a church that sought insurance coverage because of gasoline vapors that wafted from contaminated groundwater below its sanctuary, rendering the structure uninhabitable.

HII alleged that the virus that causes COVID-19 lingers in the air and adheres to surfaces, disrupting the orderly construction and repair of vessels and causing the company to incur mediation costs. The Vermont high court said a jury should be allowed to hear the insured's "novel legal argument."

"Although the science when fully presented may not support the conclusion that the presence of the

virus on a surface physically alters that surface in a distinct and demonstrable way, it is not the court's role at this stage in the proceedings to test the facts or evidence," the opinion said.

James T. Busenlener, a partner with the Matthisen, Wickert &. Lehrer law firm in New Orleans, said the Vermont decision may influence other courts to "think twice" before dismissing COVID-19 business-interruption claims in initial pleadings. Busenlener wrote a column, republished in the Claims Journal last month, that said appellate court decisions in New York and Louisiana in favor of policyholders who made COVID-related business-interruption claims may have opened "a hole in the dam" for insurers.

"The longer the case survives, the more pressure on the insurer defendants to resolve," Busenlener said in an email Friday.

The Anderson Kill law firm filed an amicus curie brief in favor of HII on behalf of United Policyholders.

"United Policyholders is pleased to see a careful analysis from a state supreme court that recognizes what the insurance industry and policyholders have long known: that all risks insurance policies protect against a broad range of perils, including deadly contamination by an invisible virus," Executive Director Amy Bach said in a statement. "Companies that purchase business-interruption insurance pay high premiums to cover disruptions to their operations due to unforeseen events. That's exactly what happened during the COVID-19 pandemic, but insurance companies across the board summarily denied all COVID-19 related claims and were one of the few industry groups to profit during the pandemic."