

COVID Coverage Cases Conflict With Insurer Documentation

By **Peter Kochenburger, Jeffrey Stempel and Erik Knutsen** (May 24, 2022, 6:25 PM EDT)

The recent federal court certification of COVID-19 coverage case Tapestry Inc. v. Factory Mutual Insurance Company to the Court of Appeals of Maryland provides not only a welcome respite from federal court resistance to obtaining authoritative state court decisions on a state law controlled issue of first impression, but also an opportunity to look beyond text of applicable insurance policies to determine the scope of business interruption coverage envisioned by insurers and their customers.[1]

To date, coverage decisions regarding this issue have been not only one-sided in terms of insurer victories but also surprisingly superficial in failing to appreciate the breadth and ambiguity of the policy text at issue.

At the outset of the COVID-19 pandemic, the widespread conventional wisdom in March 2020 was that resolution of the anticipated pipeline of COVID-19-related business interruption coverage litigation would produce considerable division in the courts, focusing both on whether COVID-19 contamination constitutes physical damage to property and the effect of virus exclusions when present.

Our focus in this article is on the crucial physical damage component in commercial property policies and the importance of comparing insurers' coverage arguments asserted now, with their understanding both at the onset of the COVID-19 pandemic and from 2004 to 2006 when drafting the virus exclusion currently in use.

Insurer documents considering whether virus contamination likely constituted physical damage reflect a broader notion of the term "physical loss or damage" than insurers have advanced in litigation. Dictionary definitions treating "deprivation" of property as "loss" and diminishment of value as "damage" suggested a world where insurers would be unlikely to obtain early dismissal of coverage actions by policyholders.[2]

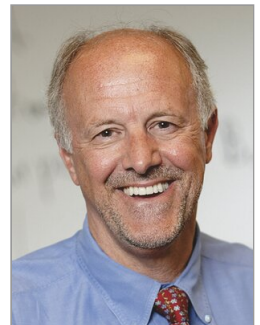
In addition, there is a long history of case law finding coverage in a wide variety of contexts involving property contaminated by various particles — like asbestos, chemicals, mold, bacteria, fumes, radioactive material and bugs — even when the property can eventually be remediated through some kind of sanitization.

To our surprise and that of many observers, insurers have largely prevailed in arguing for a narrow view of physical loss or damage, one that required permanent, structural alteration of property as a condition of coverage, even though this language is not found in most commercial property policies.

This is an odd result inconsistent with basic principles of insurance policy construction in which the policy is construed as a whole, with the presence or absence of specific exclusions playing a major role in determining the scope of coverage. The attention the insurance industry invested in the Insurance Services Office, or ISO, standard form virus exclusion crafted in response to the SARS epidemic of the early 21st century suggests that insurers certainly believed the presence or absence



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of a virus exclusion was important.

We are not evaluating the efficacy of ISO virus exclusions, but demonstrating that initially at least some insurers believed virus contamination by itself could constitute physical loss of or damage to property unless a more specific exclusion was added.

As insurance lawyers know, the ISO develops and files standard insurance forms with state insurance regulators that insurers can then use either as is or as the basis for the forms and endorsements in their policies.[3] ISO policy forms are utilized by much of the property casualty industry, particularly in the most common areas of commercial insurance, such as commercial property, commercial general liability and commercial auto.

Even large, nationwide insurers such as The Hartford rely extensively on ISO language. In these areas, ISO policy forms can be considered an industry standard and therefore ISO's drafting history is important in determining what the industry believed policy language might mean when they drafted it.

In the wake of the early 21st century SARS outbreak, the ISO developed a basic virus exclusion along with a rationale for its use. Despite concerns about coverage for disease-related losses, many insurers elected not to include the ISO virus exclusion in their policies or used their own or modified exclusion language.

Insurers — even those without a virus exclusion in their policies — have prevailed on motions in more than 90% of federal cases and roughly 75% of state cases.[4] The sweeping success to date of the no physical loss or damage COVID-19 business interruption defense has made for little discovery in these cases.

However, when cases have proceeded to discovery and the insurance industry has been required to produce documents, these documents have conflicted with the insurance industry's litigation position that the presence of COVID-19 does not constitute physical loss or damage under the terms of the policies.

A look at three illustrative cases reflects a large gap between insurer arguments made in litigation about policy text and the insurance industry's own understanding of the potential for property damage/business interruption coverage of virus- and disease-related claims both when drafting the ISO virus exclusion and again when considering the applicability of their policies to COVID-19 coverage claims.

In these three matters, documents filed on the public record contradict the prevailing insurer narrative and raise concerning questions regarding other documents that might have emerged had more cases proceeded to discovery.

Hartford Fire Insurance Company v. Moda LLC

In *Moda* in 2021 in Connecticut Appellate Court, the policyholder, Marc Fisher, who is in the business of designing and selling footwear, obtained discovery from ISO. These documents demonstrated that in the mid-2000s, ISO and the members of its Commercial Property Panel, which included The Hartford, The Cincinnati Insurance Company and St. Paul Travelers among others, were aware that commercial property policies could potentially cover coronavirus contamination, such as SARS.[5]

In late 2004, the Commercial Property Panel was working on a new biological contamination exclusion to address, among other things, "contamination of property [which] include[d] ... c]ontamination of office equipment and/or products by anthrax or by a virus such as SARS." [6]

The ISO documents described the emerging issue of contamination as follows: "The anthrax attacks and SARS epidemics bring up issues of contamination and cleanup" and explained that "ISO staff developed preliminary drafts of a biological contamination exclusion" that was discussed at the Commercial Property Panel on Dec. 9, 2004.[7] Internal handwritten notes stated that "contam[ination] implies the intrusion of or contact with an external force as the cause of the contam[ination]; there need not be a change in the product's form or substance (damage is sufficient)."[8]

Perhaps most significantly, the ISO documents produced in Moda also show that ISO and the Commercial Property Panel understood that the "new exclusion" they were working on "to specifically address the risk of loss due to contamination" would be "a reduction in coverage," which implies that the policies without this exclusion — at least as written in the mid-2000s — covered contamination with a coronavirus such as SARS.[9]

In 2006, when ISO submitted its new endorsement to state insurance regulators, it represented instead that

While property policies have not been a source of recovery for losses involving contamination by disease-causing agents, the specter of pandemic ... raises the concern [of] ... efforts to expand coverage.[10]

These representations reflect insurer concern that their standard form policy could reasonably be read to provide coverage for virus-related losses — an understanding that contradicts today's insurer arguments in court.

Despite the production of these documents and in the face of two pending motions to compel documents from Hartford, the Moda trial court granted Hartford's motion for summary judgment, and only briefly addressed Moda's request for a continuance of the motion to allow for the completion of discovery.[11] Moda's appeal is currently pending before the Connecticut Supreme Court.[12]

Treasure Island LLC v. Affiliated FM Insurance Company

Similarly, documents produced in a March U.S. District Court for the District of Nevada case brought against Affiliated FM Insurance Company by Las Vegas casino and resort Treasure Island contained admissions by FM that COVID-19 can cause physical loss or damage as defined by their policies.[13] For example, an internal FM email stated that "communicable disease" loss code 60 is "physical loss or damage which results from the actual presence of a communicable disease and the associated business interruption as defined in the policy." [14]

In addition, an internal voicemail between two FM adjusters discussed whether FM should change language in a denial letter that a claimed loss from COVID-19 "would not" constitute physical loss or damage to "may not" constitute physical loss or damage, suggesting internal disagreement on the clarity of the policy language.[15]

K.C. Hopps Ltd. v. Cincinnati Insurance Company Inc.

An email produced in the U.S. District Court for the Western District of Missouri case K.C. Hopps Ltd. v. Cincinnati Insurance Company Inc. in January contained an admission by Cincinnati Insurance that the presence of a person infected with COVID-19 on the policyholder's premises would constitute property damage.[16]

Specifically, a Cincinnati employee stated,

Once someone who is a carrier is on our premises, then I think, and Tore agreed, that constitutes some type of property damage and Tore thought we would at least pay for clean-up/disinfectant costs (e.g., a student is diagnosed with the disease, and we pay to disinfect dorm room.) [17]

The plaintiffs cited this admission in their unsuccessful motion for a new trial arguing that the email "directly contradicts Cincinnati's arguments at trial that the presence of the virus lacks the physicality necessary to constitute physical contamination." [18]

Implications for Future Adjudication

Our point here is not that these documents conclusively demonstrate the insurers' true coverage understanding, but that they are highly relevant in many of the cases being litigated today.

Documents produced in these three cases show that while insurers have argued with astounding

success in the COVID-19 coverage litigation that the presence of COVID-19 at the insured's premises does not constitute physical loss of or damage to property, the industry's own internal documents often paint a different picture. A good definition of ambiguity is when multiple insurers have internally inconsistent interpretations of similar policy language.

Courts hearing pending and future COVID-19 business interruption coverage disputes should be concerned about this disjunction between the construction given to words like "loss" and "damage" by most courts, as a matter of law, and the insurance industry's own documentation.

At the very least, the documents produced to date, which may be a tip of the iceberg, counsel in favor of more discovery and more scrutiny of insurer understanding of terms such as "loss," "physical" and "damage," as well as the drafting history of virus exclusions and the insurance industry's understanding of its exposure to coverage for disease-related claims impacting policyholders who paid additional premium dollars for the protection of business income/business interruption coverage.

This aspect of the COVID-19 coverage wars also cautions that courts should be reluctant to seize upon any individual judge's disjunctive understanding of an insurance policy term in the face of competing dictionary definitions and reasonable constructions of the terms.

In addition to the perils of overconfidence regarding word meaning and the dangers of reading policy text in isolation without the benefit of contextual material,^[19] the discovery allowed to date, although not extensive, is enough to cast serious doubt on the policy text construction that has been advocated by insurers.

Ironically, judicial refusal to examine drafting history, documents and the intent/purpose of virus exclusions has to date largely resulted in decisions in which insurers that specifically added virus exclusions in the wake of SARS are treated no better by courts than insurers that failed to add virus exclusions to their policies. This is not just illogical but unfair.

Insurers without a virus exclusion may well have used this as a marketing pitch to prospective policyholders or charged a higher premium than their counterparts using virus exclusions. They appear to be getting an undeserved windfall when courts treat their exclusionless policies the same as the policies of competitors that contain a virus exclusion, which may have reduced premiums charged or sales made.

To be sure, insurers of course have and will now argue — 15 years after the SARS-related virus exclusions were added — that virus exclusions were merely clarifying some perceived lack of coverage and were not strictly necessary to curtail otherwise existing coverage. Policyholders will of course counter that adding a virus exclusion suggests that the policy would indeed provide coverage in the absence of such an exclusion.

Determining which argument is more persuasive — and whether a particular virus exclusion bars a particular, fact-specific claim — demands a sufficient look at the background, context, history and underlying documents surrounding virus and related exclusions.

Without adequate discovery and examination of the larger context of policy language, courts unwisely operate in a relative vacuum that fails to appreciate the insuring and risk management objectives and expectations underlying the purchase of insurance. Instead, decisions reflect mere definitional dictionary bingo.

The conflict between the insurers' assertions in their motions and the insurers' understandings that are reflected in documents produced in discovery also underscores the dangers of a rush to judgment, and the inaccuracy and error that can result when federal courts mistakenly forge ahead, on an impoverished record, to decide cases rapidly out of a perceived urgency.

Seldom, if ever, should speed or perceived efficiency be favored over accuracy in decision making or justice, particularly in areas of law committed to the states rather than the federal government.^[20]

Conclusion

Insurance — like contract, tort, and property law — is primarily a matter of state law, which has produced numerous calls, largely unheeded to date, for federal court certification of COVID-19 coverage questions to state high courts.[21]




In view of the novelty and importance of COVID-19 coverage questions, federal courts would be wise to seek guidance from state supreme courts. And all courts addressing these cases would be wise to recognize the limitations of textual analysis alone. They should permit adequate discovery regarding the history, background, intent, purpose and understanding of policy terms.

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[1] See <https://www.law360.com/articles/1487363/md-high-court-to-hear-fashion-co-s-virus-coverage-suit> (discussing [Tapestry, Inc. v. Factory Mut. Ins. Co.](#) , 2022 U.S. Dist. LEXIS 75665 at *5-*6 (D. Md. April 25, 2022)(granting motion to certify to Md. Ct. of Appeals the following question: 'When a first-party, all-risk property insurance policy covers 'all risks of physical loss or damage' to insured property from any cause unless excluded, is coverage triggered when a toxic, noxious, or hazardous substance—such as Coronavirus or COVID-19—that is physically present in the indoor air of that property damages the property or causes loss, either in whole or in part, of the functional use of the property?'). See also [Neuro-Communication Servs. v. Cincinnati Ins. Co.](#) , 2021 U.S. Dist. LEXIS 20069 at *3 (N.D. Ohio Jan. 19, 2021)(certifying question to Ohio Supreme Court); [Neuro-Communication Servs. v. Cincinnati Ins., Co.](#) , 2021 Ohio LEXIS 733 at *1 (April 14, 2021)(accepting certification and agreeing to answer question: "Does the general presence in the community, or on surfaces at a premises, of the novel coronavirus known as SARS-CoV-2, constitute direct physical loss or damage to property; or does the presence on a premises of a person infected with COVID-19 constitute direct physical loss or damage to property at that premises?").

[2] Dictionaries defining "loss" or "damage" routinely use terms such as "deprivation" that do not require total destruction, structural change, or tangible alteration of property for it to be considered lost or damaged. Consequently, one would have thought at the dawn of the COVID-19 coverage litigation, that traditional application of a "plain meaning" rule would warrant denial of a Rule 12(b) (6) motion to dismiss and permit discovery and consideration of policy purpose, drafting history, and context to attempt to resolve ambiguity of policy text standing alone.

[3] See [Hartford Fire Ins. Co. v. California](#) , 509 U.S. 764, 772 (1993) ("ISO develops standard policy forms and files or lodges them with each State's insurance regulators. ... For each of its standard policy forms, ISO also supplies actuarial and rating information: it collects, aggregates, interprets, and distributes data on the premiums charged, claims filed and paid, and defense costs expended with respect to each form ... and on the basis of this data it predicts future loss trends and calculates advisory premium rates.") (citations omitted); Marianne Bonner, Business Insurance Glossary, Insurance Services Offices (ISO), The Balance Small Business, <https://www.thebalancesmb.com/insurance-services-office-iso-462706>.

[4] See University of Pennsylvania Covid Coverage Litigation Tracker, <https://www.cclt.law.upenn.edu/judicial-rulings> (visited May 16, 2022). This track record is perhaps the best insurers have ever done in major coverage litigation, even if the product of error in applying prior case law that had found the presence of asbestos fibers or other contaminants to satisfy the loss-or-damage requirement. See Erik S. Knutsen & Jeffrey W. Stempel, Infected Judgment: Creating Conventional Wisdom and Insurance Coverage Denial in a Pandemic, 27 Conn. Ins. L.J. 185 (2020).

- [5] Appendix to the Brief of the Defendants-Appellants Vol.1, at A1441 (Agenda, Commercial Property Panel, Teleconference of December 9, 2004) (listing members of the Commercial Property Panel), *Hartford Fire Ins. Co. v. Moda LLC, et al.*, No. SC20678 (Conn. Feb. 10, 2022).
- [6] *Id.* at A1448 (Teleconference of December 9, 2004, Commercial Property Panel, Agenda CPP-2004-001), A1428-29 (Meeting of September 28, 2005, Commercial Property Panel, Agenda CPP-2005-008).
- [7] *Id.* at A1435 (EIP-2005-002B, Attachment, Minutes, June 21, 2005).
- [8] *Id.* at A1493.
- [9] *Id.* at A1412–13 ("Contamination Exclusion").
- [10] Amendatory Endorsement – Exclusion of Loss Due to Virus or Bacteria (Endorsement CP 01 40 07 06), at 2 in ISO Circular, Commercial Property, New Endorsements Filed to Address Exclusion of Loss Due to Virus or Bacteria, LI-CF-2006-175 (July 6, 2006).
- [11] See *Hartford Fire Ins. Co. v. Moda LLC*, 2021 WL 2474216, at *9 n.10 (Conn. Super. Ct. June 15, 2021); Brief of Defendants-Appellants, at 34-35, *Hartford Fire Ins. Co. v. Moda, LLC*, No. SC20678 (Conn. Feb. 10, 2022).
- [12] See *Hartford Fire Ins. Co. v. Moda, LLC*, No. SC 20678, <https://appellateinquiry.jud.ct.gov/CaseDetail.aspx?CRN=76579&Type=CaseName>.
- [13] Eli Flesch, *Vegas Hotel Says Insurer Admits Virus Can Physically Damage*, Law360 (March 17, 2022), <https://www.law360.com/insurance-authority/articles/1474519/vegas-hotel-says-insurer-admits-virus-can-physically-damage>.
- [14] *Treasure Island LLC's Notice of Supplemental Evidence, Ex. A, Treasure Island, LLC v. Affiliated FM Insurance Co.*, No. 2:20-cv-00965-JCM-EJY (D. Nev. March 15, 2022) (ECF No. 243-1).
- [15] *Id.* Ex. E.
- [16] Ben Zigterman, *New Evidence OK in Ohio High Court COVID Suit, Biz Argues*, Law360 (Jan. 21, 2022), <https://www.law360.com/articles/1457690/new-evidence-ok-in-ohio-high-court-covid-suit-biz-argues>.
- [17] Plaintiff's Motion for a New Trial and Suggestions in Support, Ex. C, at 26, *K.C. Hopps Ltd. v. Cincinnati Ins. Co.*, No. 4:20 CV-437-SRB (W.D. Mo. Nov. 24, 2021) (ECF No. 257-3).
- [18] Plaintiff's Motion for a New Trial and Suggestions in Support, at 25, *K.C. Hopps Ltd. v. Cincinnati Ins. Co.*, No. 4:20 CV-437-SRB (W.D. Mo. Nov. 24, 2021) (ECF No. 257).
- [19] See Jeffrey W. Stempel & Erik S. Knutsen, *Rejecting Word Worship: An Integrative Approach to Judicial Construction of Insurance Policies*, 90 U. Cinn. L. Rev. 259 (2021); Lawrence Solan, et al., *False Consensus Bias in Contract Interpretation*, 108 Colum. L. Rev. 1268 (2008).
- [20] Efficiency may be perceived rather than real when initial federal court decisions are later rejected by authoritative state court decisions. Unfortunately, by the time this occurs, it is often too late to undo prior federal decisions later found to be erroneous. Application of claim preclusion/res judicata will then saddle the earlier losing litigant with a clearly incorrect (and hence unfair) result – the exact opposite of the goal of the preclusion doctrine.
- [21] See Christopher C. French, *Federal Courts' Recalcitrance in Refusing to Certify State Law COVID-19 Business Interruption Insurance Issues*, 100 Tex. L. Rev. Online 152 (2022).