Insurance Coverage Law Center

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The Insurance Industry's COVID Sin

"More evidence now available to the public shows insurers did not actually believe the central theme to the sermon they've preached when defending pandemic-related business interruption claims," said Gotwald and Levine.

By **Greg Gotwald and Michael S. Levine** | December 14, 2022

(L-R) Greg Gotwald, Managing Partner, Plews Shadley Racher & Braun LLP and Michael Levine, Partner, Hunton Andrews Kurth LLP. Courtesy photos.

One of the Ten Commandments (https://www.bible.com/bible/114/EXO.20.16.NKJV) is "*You shall not bear false witness against thy neighbor.*" Basically, don't lie. That's not only a key tenet of religious traditions around the world, it's also a simple principle we teach children. It's becoming evident, however, that insurers haven't followed it with regard to COVID-19 insurance claims. More evidence now available to the public shows insurers did not actually believe the central theme to the sermon they've preached when defending pandemic-related business interruption claims.

The meaning of "physical loss or damage" is the centerpiece of virtually every such case. Insurers have consistently argued that a loss of function due to the presence of a dangerous substance does not satisfy this language or that a virus can never cause damage. The insurers often cite Section 148:46 of the Couch on Insurance, 3d treatise as gospel, claiming it is a "widely held" rule that there must be some physical or structural alteration to property. When shown its flaws, as discussed in Richard P. Lewis's article *Couch's 'Physical Alteration' Fallacy: Its Origins and Consequences* (//www.huntonak.com/images/content/7/9/v2/79632/couchs-physical-alteration-fallacy-its-origins-and-consequences.pdf) (2021), insurers exclaim: "Heresy! It's Couch."

Now the truth is coming to light. Evidence is surfacing that insurers did not believe what they've been arguing. They knew the state of the law when the pandemic started and recognized what many policyholders have been advocating: The presence of the virus (a dangerous substance) satisfies their own understood meaning of "physical loss or damage." But even if there were some doubt, this evidence at least proves the ambiguity in the language. As the Indiana Supreme Court stated in *Am. States Ins. Co. v. Kiger* (https://www.law.com/insurance-coverage-law-center/2022/12/14/american-states-ins-co-v-kiger/):

That [an] interpretation was advanced simply demonstrates the presence of the ambiguity that requires this Court to construe the insurance policy in favor of the insured and against the insurer who drafted it. When the insurance industry itself has offered differing interpretations of the same language, we must assume that the insured understood the coverage in the more expansive way.

Below we highlight evidence from many of the largest property insurers in the country (and the world). Many will attempt to scorn us for our motives here. Admittedly, we are policyholder evangelists, but the facts below are objective statements and positions insurers have made and taken. Although final judgment of these positions is a matter for state courts of last resort, we wish to spread the good news of this emerging evidence to policyholders.

AIG

At the start of the pandemic, internal emails—not marked confidential—produced during discovery in *The Trustees of Purdue University v. American Home Assurance Co.*, No. 02D02-2108-PL-327 (Ind. Commercial Ct. Allen Cty.) show AIG understood that a loss in functionality satisfies the "physical loss or damage" trigger. Upon learning of the first business income lawsuit in March 2020, AIG's Head of Retail Property, North America General Insurance, stated in an email exchange with top AIG officers and executives:

[It's a] very thorny question as to whether or not the threat or presence of COVID-19 contamination is considered physical damage.

AIG's Head of Property and Energy Claims responded to the group that he "[a]greed" and then stated to the Head of Retail Property and the Chief Underwriting Officer of North America Property:

"It's well-accepted that physical damage or loss is a 'material change' which 'degrades' or '**impairs the function of the property'**." (Emphasis added).

The Retail Property Chief Underwriting Officer repeated this maxim to the Regional Property Underwriting Manager and the South Zone Property Executive:

"What is physical loss or damage — It's well-accepted that physical damage or loss is a 'material change' which 'degrades' or **'impairs the function of the property'**." (Emphasis added).

These statements are not the standard insurers have preached as the gospel truth of property insurance. It was the standard for decades before COVID-19 that policyholders have advocated and that should continue to be the law.

The FM Global Group

Years before the pandemic, FM instructed its claim adjusters and clients (policyholders) through policy workshop slide decks that "physical damage" means an "actual substantive change" that "reduces worth or usefulness" of property or "prevents [it] from being used as designed or intended." FM also knew that a virus could meet that meaning and that its broad all-risk/all-peril insurance products specifically included such damage. In fact, the company included "communicable disease," defined in FM's insurance policies as "one that is transmissible from one person to another," as one many covered perils, defining the peril as "physical loss or damage resulting from … communicable disease and the associated business interruption as defined

in the policy." It should come as no surprise, therefore, that FM's corporate representative admitted in a federal court deposition that a virus *can* cause physical loss or damage to property. [*See, e.g., Cinemark Holdings, Inc. v. Factory Mut. Ins. Co. (https://www.law.com/insurance-coverage-law-center/2022/12/14/cinemark-holdings-inc-v-factory-mut-ins-co/)*, 2021 U.S. Dist. LEXIS 140292 (E.D. Tex. 2021).]

These statements show FM Global knew, well before the pandemic, that a loss of functional use caused by the presence of a dangerous substance meets both the insurer's and the commonly understood meaning of "physical damage." Even more, the fact that FM specifically defined both the types of diseases that its policies would cover and the peril to which the resulting loss would be assigned for internal coding reveals a level of knowledge and expectation that certain diseases and, necessarily, their causative virus or disease-causing agent, could trigger multiple coverages.

The Cincinnati Insurance Companies

Internal communications from The Cincinnati Insurance Companies used in the *K.C. Hopps, Ltd. v. The Cincinnati Ins. Co. (https://www.law.com/insurance-coverage-law-center/2022/12/14/k-c-hopps-ltd-v-cincinnati-ins-co/),* 2021 U.S. Dist. LEXIS 203904 (W.D. Mo. 2021) trial refute another position insurers advocate, that the presence of the virus does not satisfy "physical loss or damage." Cincinnati's Commercial Lines Product Director emailed its VP for Commercial Property on March 10, 2020, stating:

Once someone who is a carrier [of COVID-19] is on premises, then I think, and Tore [Swanson, Cincinnati's Assistance Vice President and Property Claims Manager] 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 the dorm room).

This admission shows that Cincinnati believed the presence of the virus on the property constitutes damages triggering coverage.

Strathmore

The evidence doesn't stop with internal communications or legal arguments. Strathmore Insurance Company (a/k/a GNY) once asked regulators for an exemption from a requirement that their policies include a virus exclusion (//www.huntonak.com/images/content/7/9/v2/79632/couchs-physical-alteration-fallacy-its-origins-and-consequences.pdf) because it would reduce coverage.

In New York, the insurance industry trade group and policy-drafting organization Insurance Services Office, Inc. (ISO) sought to make its virus exclusion mandatory in property policies. Strathmore objected, asking regulators if it could omit the virus exclusion, making it "optional" rather than "mandatory", in order to offer their customers broader coverage, as it did in *Legal Sea Foods, LLC v. Strathmore Ins. Co. (https://www.law.com/insurance-coverage-law-center/2022/12/14/legal-sea-foods-llc-v-strathmore-ins-co/)*

In its memorandum to New York regulators, Strathmore acknowledged that coverage exists for "this type of loss ('pandemic')" in the absence of a virus exclusion. It told regulators that viruses and pandemics could result in potential covered losses in "Business Interruption/Time Element coverage segments." It gave specific examples of diseases spreading in indoor, highly trafficked spaces, like restaurants or doctors' offices, that may create a covered loss. It acknowledged that a "pandemic" loss from "contagious disease" could involve a wide variety of vectors, including losses "transmitted to third parties via ingestion," "direct contact to an insured's products," or "spread through the HVAC system" in a building—the last of which has, unfortunately, been proven true during the COVID-19 pandemic.

Strathmore specifically downplayed the possibility that a virus "would spread throughout a vast proportion of the apartments and condominiums across NYC that we insure," but it nonetheless admitted that it was deliberately insuring that kind of risk. Crucially, Strathmore admitted what all standard-form property insurers knew: policyholders reasonably expect this coverage and would never willingly part with it. Strathmore said:

[W]e do not anticipate that any of our insureds will voluntarily request this [virus] exclusion; some (habitational risks) because **it would never enter their minds as a problem for which they would voluntarily reduce coverage**; others (restaurants) because they feel that **such an event is well within the realm of possible fortuitous occurrences and should be covered** should such an event arise. (Emphasis added).

Looking for Additional Proof

This evidence is a sampling. Insurers should be nervous that policyholders will discover additional proof that the insurers' understanding of "physical loss or damage" contradicts their claims in courts. Courts are likely to hesitate now, before dismissing well-pled complaints. And as these cases progress, insurers will have to atone for the sins of their arguments.

These views are the authors' own.

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