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How Property Insurance Coverage Shrank After The Pandemic

By **Richard Lewis and Nicholas Insua** (November 7, 2024, 10:31 AM EST)

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When the COVID-19 pandemic began, and issues arose regarding whether affected policyholders could seek business income and civil authority coverage from the presence or suspected presence of the virus, and consequent civil authority orders, many lawyers specializing in representing policyholders, including us, thought the easiest question to answer was whether such policyholders had suffered physical loss or damage to their property.

However, instead of a clear "yes," courts largely have accepted insurance company arguments that COVID-19 did not cause physical loss or damage. Insurance companies are now leveraging those decisions to reverse the former majority rule on physical loss or damage in all contexts.

Prior to COVID-19, there was a majority consensus on "physical loss or damage" in unusual circumstances.

We write and annually update a book that discusses every business income, or business interruption, case decided in the U.S.

Many issues arising under policies providing time-element coverage have but a handful of decisions discussing them, but whether unusual circumstances — i.e., events other than fire, windstorm, etc. — cause physical loss or damage to property had been the subject of more than 40 decisions by March 2020.

In about three quarters of those cases, courts held that such unusual circumstances — falling rocks that threatened but had not yet hit a property, a temporary infusion of ammonia or gas fumes, the risk of collapse caused by the collapse of a neighboring building — caused physical loss or damage if the property could not be safely used as it had been used previously.

Indeed, this interpretation of "physical loss or damage" was so well established that, in response to SARS-CoV-1, the virus responsible for the 2002-2003 SARS outbreak, the insurance industry drafted and received regulatory approval for a virus exclusion,[1] such that coverage for losses arising from a virus might be barred. This, of course, assumed that the coverage was triggered in the first place; otherwise, there would be no need for an exclusion.

For instance, in Oregon Shakespeare Festival Association v. Great American Insurance Co.,[2] the policyholder canceled several performances at its outdoor theater because of dangerous levels of smoke and ash caused by numerous nearby fires. The policyholder made an insurance claim for lost business income, which was denied on a number of grounds, but primarily because the loss was not caused by "physical loss or damage to the theatre."[3]

In the coverage case, the policyholder argued that "the wildfire smoke caused injury or harm to the interior of the theatre, which includes the air within the theatre."[4]

In its June 2016 **decision**, the U.S. District Court for the District of Oregon first rejected the insurance company's argument that "air is not 'property.'"[5] Next the court rejected the insurance company's argument that "the loss or damage must be physical" finding it did "not give a sufficient

explanation for why air is not physical. Certainly, air is not mental or emotional, nor is it theoretical." [6]

The insurance company argued that the smoke from the fires did not require any structural repairs to the theater, and thus there was no "period of restoration."[7] The court rejected this, finding that dissipation of the smoke took several days, and that it was not a plausible reading of the policy to add the word "structural."[8]

In support, the court cited similar cases.[9]

Note that this decision was vacated in March 2017 as a condition of the payment of a settlement,[10] which should have indicated to policyholders the strategic approach the insurance industry would take in COVID-19 cases.

We thought the majority rule of Oregon Shakespeare Festival would continue to be applied in COVID-19 cases.

Courts accepted insurers' physical loss arguments in the COVID-19 context.

Unfortunately for policyholders, this prediction was incorrect. Courts largely have accepted insurance company arguments that SARS-CoV-2, the virus that causes COVID-19, and consequent civil authority orders do not cause physical loss or damage. In the wake of these decisions, there have been two interesting, if wholly predictable, developments.

Courts continued to apply the majority physical loss rule in other contexts.

Initially, in the first few non-COVID-19 coverage cases decided after March 2020, courts continued to interpret "physical loss or damage" as including covered loss from events rendering property unfit for its intended use.

For instance, in James W. Fowler Co. v. QBE Insurance Corp.,[11] at issue was coverage for a microtunnel boring machine, or MTMB, that was being used to bore a tunnel deep underground when it became immobilized, with no potentially cost-effective way to recover it, although it had not been physically damaged in any way.[12]

The policyholder sought to recover the cost of the MTBM under a policy providing coverage for "direct physical loss caused by a covered peril."[13] The insurer argued that "direct physical loss" required "physical damage."[14]

The Oregon District Court found, in its July 2020 decision, that the policyholder's "alleged loss is not intangible or incorporeal, nor a mere detrimental economic effect. ... The MTBM, while intact and undamaged, is rendered useless to [the policyholder] if it is stuck underground."[15]

In Fowler and other cases,[16] there was not tangible damage or alteration of property; what was lost instead was the use of property for its intended purpose. What was inexplicable was the difference between the results in these cases and the result in COVID-19 cases.

Insurers are successfully leveraging physical loss rulings in the COVID-19 context to win in all similar contexts.

The insurance industry is using results in COVID-19 cases to affect a major restriction in the coverage they provide without securing regulatory approval — and incurring a cut in rates.

For example, in the December 2022 decision in EMOI Services LLC v. Owners Insurance Co., the Ohio Supreme Court **reversed** an Ohio Court of Appeals ruling, which had concluded that a hacker's encryption of computers, which in turn resulted in the computers not being able to be used normally, had caused the computers physical loss or damage.[17]

In so ruling, the Ohio Supreme Court cited a COVID-19 case. Insurers have made similar arguments, citing COVID-19 cases in other contexts as well for the proposition that claims had not resulted from physical loss or damage.

For instance, in NMA Investments LLC v. Fidelity & Guaranty Insurance Co., the policyholder was a laundromat that made a business interruption claim for when its operation were affected by government and nongovernment barricades erected on streets in the wake of riots caused by the murder of George Floyd.[18]

In **rejecting** the policyholder's claim, in its September 2022 ruling, the U.S. District Court for the District of Minnesota cited a COVID-19 decision and held there was no coverage because barricades did not cause physical loss or damage to policyholder's property.

Likewise, in 87 Uptown Road LLC v. Country Mutual Insurance Co., the New York Appellate Division, Third Department, cited a COVID-19 case and concluded that the loss at the policyholder's apartment complex was attributable to tenants moving, not because their apartments had been damaged by fire.[19]

Specifically, the court found, in its March 14, 2024, decision, the policyholder's loss was caused by "various inconveniences" accompanying rebuilding of damaged units, and not by physical loss or damage because "inconvenience alone, absent direct damage, is not enough to afford coverage."

Similarly, in Meridian Park Radiation Oncology Center Inc. v. Allied Insurance Co., the court found on Feb. 13 that a facility administering radiation treatment, which had to take its linear accelerator offline when its third-party cloud-network service provider went offline due to cyberattack, had not suffered physical loss or damage to its linear accelerator.[20]

Instead, and citing COVID-19 cases in support, the Oregon district court held that "physical loss or damage" requires "physical alteration or dispossession of the covered property," and that the policyholder had not carried its burden under that standard.

In yet another example, in Century Aluminum Co. v. Certain Underwriters at Lloyd's, the policyholder brought a claim for loss from physical loss or damage to its alumina ore when the closure of inland waterways prevented it from timely receiving ore.[21]

The U.S. Court of Appeals for the Sixth Circuit, again citing cases addressing the alleged effect of COVID-19, found, on April 4, "[t]he temporary delay never threatened to deprive [the policyholder] of its ownership or control of the alumina," and thus the policyholder did not suffer physical loss or damage. Accordingly, coverage was not triggered.[22]

How will and should rates be affected with this drastic reduction in available coverage?

Inevitably, and as shown above, insurance companies will leverage cases giving them relief in the COVID-19 context to reverse the former majority rule on physical loss or damage in all contexts.

This will dramatically restrict coverage for thousands of policyholders, given that the vast majority of property insurance claims are resolved by negotiation, not litigation, on the basis of the law set forth by courts. But with this dramatic restriction of historic coverage should come a commensurate reduction in insurance rates.

Yet, just as coverage is seemingly shrinking, rates are rising. It would seem, then, that state regulators will need to intervene as the industry's unilateral reduction in coverage coupled with an increase in rates is not sustainable and in need of attention.

If courts continue to adopt insurance company arguments on the meaning of physical loss or damage, it is the regulators that can impose the necessary correction to offer at least some protection for insurance purchasers.

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[1] Todd C. Frankel, "Insurers knew the damage a viral pandemic could wreak on businesses. So, they excluded coverage," WASHINGTON POST (Apr. 2, 2020), https://www.washingtonpost.com/business/2020/04/02/insurers-knew-damage-viral-pandemic-could-wreak-businesses-so-they-excluded-coverage.

[2] Oregon Shakespeare Festival Association v. Great American Insurance Co., No. 1:15-cv-01932-CL, 2016 WL 3267247 (D. Or. June 7, 2016), vacated by joint stipulation, 2017 WL 1034203 (Mar. 6, 2017).

[3] 2016 WL 3267247, at *5.

[4] 2016 WL 3267247, at *5.

[5] 2016 WL 3267247, at *5.

[6] 2016 WL 3267247, at *5.

[7] 2016 WL 3267247, at *5-6.

[8] 2016 WL 3267247, at *6.

[9] Gregory Packaging Inc. v. Travelers Prop. Cas. Co., No. 2:12-cv-04418, 2014 WL 6675934, at *5-6 (D.N.J. Nov. 25, 2014) (ammonia discharge); W. Fire Ins. Co. v. First Presbyterian Church, 437 P.2d 52, 54 (Colo. 1968) (gasoline vapors); Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1335 (Or. Ct. App. 1993) (methamphetamine odor).

[10] This practice of insurance companies making vacatur of unfavorable decisions a condition of settlements, first identified by Eugene R. Anderson in the 1990s, is an increasingly common practice of the insurance industry in property insurance litigation. Eugene R. Anderson, et al., "Out of the Frying Pan and Into the Fire: the Emergence of Depublication in the Wake of Vacatur," J. of App. Prac. & Proc. (2002). For instance, Lion Oil Co. v. National Union Fire Insurance Co., No. 13-CV-1071, 2016 WL 4275963 (W.D. Ark. May 25, 2016), vacated Lion Oil Co. v. National Union Fire Insurance Co., No. 1:13-cv-01071, 2015 WL 6680900 (W.D. Ark. Nov. 2, 2015), a good decision for policyholders and one of five total cases then on Contingent Extra Expense, and Lion Oil Co. v. National Union Fire Insurance Co., No. 13-CV-1071, 2015 WL 6680899 (W.D. Ark. Nov. 2, 2015), a good decision for policyholders and one of thirteen total cases on the Service Interruption. The comparatively small numbers of property insurance cases makes the practice of vacatur especially problematic.

[11] James W. Fowler Co. v. QBE Insurance Corp., No. 3:18-cv-1705-S1, 2020 WL 4291272 (D. Or. July 24, 2020).

[12] Id. at *2.

[13] Id. at *3.

[14] Id. at *4.

[15] Id. at *6; see also James W. Fowler Co. v. QBE Ins. Corp., No. 20-35926, 2021 U.S. App. LEXIS 31714, at *2 (9th Cir. Oct. 21, 2021) (unpublished) (agreeing on appeal that MTBM would suffer "direct physical loss" "if the MTBM is either impossible or unreasonably expensive to recover," but reversing grant of summary judgment to policyholder because parties' experts disagreed about "whether the MTBM is impossible to recover and (assuming it is recoverable whether recovery costs would be unreasonably expensive").

[16] See Crisco v. Foremost Ins. Co., No. C 19-07320 WHA, 2020 WL 7122476, at *4-5 (N.D. Cal. Dec. 4, 2020) (finding mobile homes suffered PLOD when fire destroyed electric, gas, sewer, and potable water infrastructure, which serviced them but did not damage mobile homes themselves);

National Ink & Stitch LLC v. State Auto Prop. & Cas. Ins. Co., No. SAG-18-2138, 2020 WL 374460, at *5 (D. Md. Jan. 23, 2020) (finding policyholder that suffered ransomware attack on its computer server causing permanently lost access to its art files and other data had suffered loss of "functionality" and thus PLOD); and EMOI Servs. LLC v. Owners Ins. Co., 2021-Ohio-3942, P5-7 (Ohio App. 2021) (rejecting insurer's argument that PLOD "does not occur when the insured merely loses access or use," concluding that "[a]s a result of the encryption, [the policyholder] and its clients were unable to access [the policyholder's computer] system for a significant period of time").

[17] EMOI Services, L.L.C. v. Owners Insurance Co., 208 N.E.3d 818 (Ohio 2022) (applying Ohio law).

[18] NMA Investments L.L.C. v. Fidelity & Guaranty Insurance Co., No. 22-cv-1618, 2022 U.S. Dist. LEXIS 164606, at *8-10 (D. Minn. Sept. 13, 2022).

[19] 87 Uptown Road, LLC v. Country Mutual Insurance Co., 207 N.Y.S.3d 241, 244-45 (N.Y. App. Div. 2024) (applying New York law).

[20] Meridian Park Radiation Oncology Center, Inc. v. Allied Insurance Co., No. 3:21-cv-1471-AR, 2024 U.S. Dist. LEXIS 53178, at *10-14 (D. Or. Feb. 13, 2024) (applying Oregon law).

[21] Century Aluminum Co. v. Certain Underwriters at Lloyd's, 97 F.4th 1019, 1023 (6th Cir. 2024) (applying Kentucky law).

[22] See also Cup Foods Inc. v. Travelers Cas. Ins. Co., No. 22-cv-1620, 2023 U.S. Dist. LEXIS 10711 (D. Minn. Jan. 23, 2023) (rejecting Business Income claim for loss from barriers set up by government and private citizens citing COVID-19 case); Garland Connect, LLC v. Travelers Cas. Ins. Co., No. CV-20-09252, 2022 U.S. Dist. LEXIS 33960, at *9-11 (C.D. Cal. Feb. 3, 2022) (applying California law) (citing COVID-19 case and finding that policyholder who was unable to access its former business premises when landlord refused to extend its contract to perform operations there did not suffer PLOD); Archer Western-De Moya J.V. v. Ace Am. Ins. Co. 87 Uptown Road, No. 1:22-CV-21160, 2024 U.S. Dist. LEXIS 51943, at *36-40 (S.D. Fla. Jan. 12, 2024) (applying Florida law) (noting insurance company's reliance on COVID-19 cases concluding that PLOD "requires a tangible alteration to the covered property" in arguing that policyholder's bridge components did not suffer PLOD from defective concrete); but see Tiffany & Co. v. Lloyd's of London Syndicates 33, 510, 609, 780, 1084, 1225, 1414, 1686, 1861, 1969, 2001, 2012, 2232, 2488, 2987, 3000, 3623, 4444, 4472, & 4711, No. 651544/2023, 2024 N.Y. Misc. LEXIS 2433, at *66-67 (N.Y. Supr. May 3, 2024)(applying New York law) (finding "loss" of ore not controlled by COVID-19 case).