COVID-19 AND BUSINESS-INCOME INSURANCE: THE HISTORY OF "PHYSICAL LOSS" AND WHAT INSURERS INTENDED IT TO MEAN

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I. INTRODUCTION

In thousands of cases filed throughout the United States, policyholders are seeking Business Income coverage for losses arising from the presence of SARS-CoV-2, the COVID-19 pandemic, or consequent orders of civil authority.[4] Typically, the Business Income clause is triggered by some variation of "direct physical loss of or damage to" the policyholder's property. Policyholders argue that the presence or suspected presence of SARS-CoV-2 on their property, or Civil Authority orders, prevent them from using their property as intended, causing a "loss of" that property.

To date, there have been several hundred decisions, mostly on the pleadings, on the meaning of "physical loss." These cases fall into five categories. In the first three, courts accept that there is a difference between "loss of" and

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[4] This Article will refer to SARS-CoV-2 as the virus and COVID-19 as the disease caused by infection with SARS-CoV-2.

"damage to" property, but reach different conclusions about what "loss of" property means:

> 1) Some courts have correctly found that "loss" and "damage" are distinct terms, separated by the disjunctive "or," and, as such, they must be given different meanings, and have further found that "loss" means (or can mean) the inability to use property for its intended purpose.[5]
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> 2) Other courts have found that "loss" can mean the inability to use property, but as used in property insurance policies, "loss" is limited to situations in which the policyholder suffers "permanent dispossession" of property.[6]
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> 3) Other courts have found that "loss" means total destruction of property, as compared to "damage," which means partial destruction of property.[7]

The last two categories ignore any difference between "loss" and "damage":

> 4) A number of courts have recognized that "loss" and "damage," in the abstract, have different meanings, but found that, because they are preceded by "direct" and "physical," the phrase "direct, physical loss of or damage to" must be given a unitary meaning, typically requiring physical "alteration" of property.[8]
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> 5) Other courts have simply disregarded any possible difference between the terms "loss" and "damage," often on the ground that the phrases like "direct physical loss of or damage to property" have already been judicially construed to require

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[5] *See, e.g.*, Kingray Inc. v. Farmers Group Inc., 523 F. Supp. 3d 1163, 1171-74 (C.D. Cal. 2021) (New York law).

[6] *See, e.g.*, Caribe Rest. & Nightclub, Inc. v. Topa Ins. Co., 533 F. Supp. 3d 938, 943-44 (C.D. Cal. 2021) (California law).

[7] *See, e.g.*, Dukes Clothing, LLC v. Cincinnati Ins. Co., No. 7:20-cv-860-GMB, 2021 WL 1791488, at *3-4 (N.D. Ala., May 5, 2021) (Alabama law).

[8] *See, e.g.*, Henry's La. Grill, Inc. v. Allied Ins. Co., 495 F. Supp. 3d 1289, 1293-94 (N.D. Ga. 2020) (Georgia law).

> some sort of "physical alteration" of property (most commonly, "distinct, demonstrable, physical alteration" of property).[9]

The only courts reaching the right result are those in category 1.

That rule is unfavorable to insurers, who have convinced most courts to adopt some version of the latter four tests in the COVID-19 litigation. Often, these insurer-side arguments champion the principle that insurance policies are "ordinary contracts" and that courts therefore must seek to ascertain and enforce the parties' "intent." This argument rests on a legal fiction—even the largest commercial entities rarely negotiate or consciously agree to the core terms of their insurance policies, which are standard forms drafted by insurance industry drafting organizations or use language drafted by such organizations.

But to the extent that general principle of contract law applies, it demands a finding that the category 1 cases are correct. The other meanings are not compelled by the plain language of the policies. For courts—and particularly state courts—seeking to accurately interpret insurance policies, a close look at history and insurance-industry intent is critical. Otherwise, insurers will receive a windfall: they will have charged premiums for broader coverage only to have the courts narrow it based on readings that insurers know are incorrect.

Until the mid-1980s, most policies employed a standard-form trigger for Business Income that required "damage" or "destruction" of property. The term "loss" was used only in reference to the amount owed by the insurance

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[9] *See, e.g.*, Graspa Consulting, Inc. v. United Nat'l Ins. Co., No. 20-23245-Civ-Williams/Torres, 2021 WL 1540907, at *5 (S.D. Fla., Apr. 16, 2021) (Florida law).

company. In the mid-1980s, however, the Insurance Services Office ("ISO"), the primary drafting organization for property insurers, changed the trigger on its standard-form policies to "direct physical loss of or damage to" property. ISO made this change to make clear that standard-form property insurance policy did not require tangible "damage or destruction" of property, and instead extended coverage to things like "theft" where a physical force interfered with a right of possession or use. This change was consistent with the case law in the United States, which had already construed "physical loss" this way under non-ISO forms.

The insurance industry thus intended "loss" to mean something different from "damage." It did not intend "loss" to mean complete "destruction" (the term "loss" replaced) or to require some sort of "alteration" of property (as stolen property is not, by necessity, altered by the thief). This intent was confirmed by the insurance industry's payments in relation to SARS-CoV-1 in 2002-2003, and the insurance industry's drafting of standard-form Virus or Bacteria exclusions to bar coverage for loss or damage caused by the presence of a virus.

Commentators have offered several reasons why the majority of COVID-19 courts have interpreted "loss" to mean the opposite of what insurers intended. One is that, around 1995, the third edition of *Couch on Insurance*—a veritable Bible for insurance lawyers—asserted that the "widely held" view was that "physical loss or damage" required some "distinct, demonstrable, physical alteration" to property.[10] That view was not "widely held"—in fact, it

[10] Richard P. Lewis, Lorelie S. Masters, Scott D. Greenspan, & Christopher E. Kozak, Couch*'s "Physical Alteration" Fallacy: Its Origins and Consequences*, 56 TORT, TRIAL & INS. PRAC. L.J. 621, 622-23 (2021) [hereinafter "Lewis, et al."].

was barely "held" at all—but courts, trusting *Couch*'s pedigree, assumed it was right and enshrined that misstatement in their precedent. Another is that the insurance industry responded to COVID-19 claims with a public-relations blitz, including the universal rejection of these claims.[11] Often citing *Couch*, insurers painted the policies as "clear," depriving plaintiffs of the chance to move past the pleadings and discover the industry's intent.

We would like to add a third point to the discussion, drawing on these initial comments. Insurance-policy drafting history in general, and this drafting history in particular, is not widely known. It exists, in print, in a small number of libraries—and is virtually nonexistent online, where most lawyers and judges do their research. Most drafting history never becomes important. But here, billions of dollars are at stake. It is critical that courts be fully informed of the industry's intent as the COVID-19 litigation winds its way through the state appellate courts.

II. THE EARLY HISTORY OF TIME-ELEMENT COVERAGE: 1902 TO 1970.

A. The Original Use and Occupancy Policy Forms Were Triggered by "Damage" or "Destruction" of Property.

Before ISO formed in 1971, insurance policies were drafted by and rates determined by a wide range of rating bureaus.[12] Thus, the pre-1980 policy forms discussed herein were written largely by rating bureaus.

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[11] Erik. S. Knutsen & Jeffrey W. Stempel, *Infected Judgment: Problematic Rush to Conventional Wisdom and Insurance Coverage Denial in a Pandemic*, 185 CONN. INS. L.J. 186, 244 (2020) [hereinafter "Knutsen & Stempel"].

[12] The Role of Advisory Organizations in Commercial Property Insurance: Insurance Services Office, Inc., at 2,

The first forms providing "time element" coverage in the United States were "use and occupancy" forms.[13] In the United States, decisions on such forms date to 1902.[14] The purpose of Use and Occupancy insurance was "to indemnify the owner for these interrupted earnings during the time necessary to restore the [manufacturing] plant to operating condition."[15]

The Per Diem Use & Occupancy form, which was the first such form used in the United States, provided coverage triggered by "damage to or destruction of" property":

> The Per Diem Policy form indemnifies the Insured at the rate of a specified sum per day for the loss of net profit and necessarily continuing business expense during the time the Insured's business is totally or partially prevented from operating because of **damage to or destruction of business property** by fire or other perils insured against.[16]

Accordingly, from the outset of Use and Occupancy coverage, and then for many more years thereafter, there was only coverage where there was "damage to or destruction of business property."[17] With only a few anomalous exceptions, the word "loss" was not used as a term defining the

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https://www.irmi.com/online/cpi/ch002/advisory-organizations/insurance-services-office.aspx (last accessed Mar. 9, 2021).

[13] *See, e.g.*, Omaha Paper Stock Co. v. Harbor Ins. Co., 596 F.2d 283, 288 (8th Cir. 1979).

[14] *See* Chatfield v. Aetna Ins. Co., 75 N.Y.S. 620, 620 (N.Y. App. Div. 1902).

[15] W.S. FOSTER, REMOVING THE MYSTERY FROM U & O INSURANCE 3 (NAT'L UNDERWRITER CO. 1927) [hereinafter "FOSTER"].

[16] HENRY C. KLEIN & WALLACE L. CLAPP, JR., BUSINESS INTERRUPTION INSURANCE AND EXTRA EXPENSE INSURANCE AS WRITTEN BY FIRE INSURANCE COMPANIES IN THE UNITED STATES AND CANADA, (THE ROUGH NOTES CO., 1ST ED. 1964) (emphasis added) [hereinafter "KLEIN"].

[17] *See, e.g.*, Hudson Mfg. Co. v. N.Y. Underwriters' Ins. Co., 33 F.2d 460, 460-61 (7th Cir. 1929) ("The conditions of this contract are that if

trigger or cause of a claim; rather, it generally referred to the amount of damages that might be owed under a policy.

Following the initial development of Use and Occupancy coverage, four standardized Use and Occupancy Policies came into use.[18] These forms, some of which continued in use into the 1970s, provided coverage only where there was "damage to or destruction of covered property," in promises such as the following:

> The conditions of this contract are that if the building [Insert]_____ described above, and/or machinery and/or equipment _____ (insert "and/or stock" if covering liability for suspension of business **due to damage to, or destruction** of stock, otherwise policy shall not cover) contained therein, be **destroyed or damaged by fire** occurring during the term of this policy so as to necessitate a total or partial suspension of business, this company shall be liable under this policy for the actual loss sustained consisting of net profits on the business which is thereby prevented….[19]

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the building … be **destroyed or damaged** by fire occurring during the term of this policy so as to necessitate a total or partial suspension of business….") (emphasis added); Brecher Furniture Co. v. Firemen's Ins. Co. of Newark, 191 N.W. 912, 912 (Minn. 1923) (noting that Use and Occupancy form obligated insurance company to pay "for not exceeding such length of time as should be required with the exercise of due diligence and dispatch to rebuild, repair or replace such part of said building as might be **destroyed or damaged** commencing with the date of the fire") (emphasis added); Chatfield v. Aetna Ins. Co., 75 N.Y.S. 620, 620 (N.Y. App. Div. 1902) ("It is a condition of this contract that if said building, or any part thereof, shall be **destroyed or so damaged** by fire….") (emphasis added).

[18] These forms are set forth in L.E., AGENTS MANUAL—USE AND OCCUPANCY INSURANCE OF BUSINESS INTERRUPTION INDEMNITY INCLUDING RENTS, PROFITS AND LEASEHOLD INSURANCE 8-28 (AM. INS. CO. 1929) [hereinafter "AGENTS MANUAL"]; *see also* KLEIN, *supra* note 16, at 28-29.

[19] AGENTS MANUAL, *supra* note 18, at 8-9 (emphasis added). For a further presentation of and discussion regarding Forms 1, 2, 3, and 4, as well as related forms, see K.W. WITHERS, BUSINESS INTERRUPTION

In the late 1950s, the standardized business interruption loss forms were changed, but **the essential features remain "unchanged"**:[20] coverage was only provided where there was "damage" to or "destruction" of covered property.

In relation to these early "use and occupancy" forms, four things are relevant here. First, all the insurance policies provided coverage where the property was "damaged" or "destroyed." Second, the word "loss" was used only to refer to the amount to be paid in the event of damage or destruction, and not in reference to the event itself. Third, these forms either covered only fire or limited named perils; they were not all risk forms. Fourth, and relatedly, non-damage losses, such as theft, were not covered—and in many cases, they were expressly excluded.

III. ISO Refines the Business-Income Coverage and Incorporates It Into Commercial Property Coverages

A. ISO's Standalone Business-Interruption and Business-Income Policy Forms.

1. *The Formation of ISO*

In 1971, "the Insurance Rating Board, the Multi-Line Insurance Rating Bureau, and the Inland Marine Insurance

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Insurance Coverage and Adjustment, 24-57 (The Howell-North Press 1973); *see also* Frank S. Glendening, Business Interruption Insurance: What Is Covered 16 (Nat'l Underwriter Co., 1st Ed. 1980) [hereinafter "Glendening"].

[20] Roy McCormick, Business Interruption and Extra Expense Insurance, *Presentation Before the Proceedings of the Transportation Insurance Rating Bureau Sessions Mutual Technical Conference* (Chicago, Ill., Nov. 9-12, 1959) (reprinted by the Transportation Insurance Rating Bureau, 1959, at 19-20); *see also* Robert L. Shifrin, *Risk Management*, American Agent & Broker, at 12 (May 1980).

Bureaus became the Insurance Services Office (ISO). Nine fire bureaus (now referred to as property bureaus) also merged into ISO that year."[21] Since 1971, ISO has drafted most of the insurance policy forms used by property insurers, and this is critical to the modern insurance market:

> A very important part of ISO's service to its customers is the development of standardized coverage forms and endorsements. These forms and endorsements are copyrighted by ISO and are licensed for use by its insurer customers. ISO's standardized forms and endorsements serve as benchmarks. Without them, it would be very difficult for consumers and [government] to make meaningful price and coverage comparisons among insurers. Standardized forms provide a base from which insures can depart, tailoring endorsements to insure unique risks or target markets.
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> ISO's staff drafts language to express the intent of the new or revised coverage concept in a way that addresses such matters as new laws, court interpretations of forms, or changed market conditions. Once the new forms are developed [it] is reviewed by the appropriate working committee. Once approved by the committee, ISO files the proposed forms, where necessary, with state insurance regulators for their approval.[22]

As relevant here, ISO has historically closely monitored the common law, and decided whether or not to draft changes in policy language, or endorsements, to address "court interpretations."

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[21] Tim Wagner, Insurance Rating Bureau, 19 J. INS. REG. 189, 199 (Winter 2000); *see also* Douglas Talley, *Stock and Mutual Insurer Contract Wordings*, at 4 (June 2011), at https://www.irmi.com/articles/expert-commentary/proving-standard-policy-language-of-missing-insurance-policies (last accessed Feb. 13, 2021) [hereinafter, "TALLEY"].

[22] TALLEY, *supra* note 21, at 4; Hartford Fire Ins. Co. v. California, 509 U.S. 764, 772 (1993) (explaining more about what ISO does).

2. *The Early ISO Business Interruption Forms Continued to Provide Coverage for Only "Damage to or Destruction of" Covered Property.*

The original ISO Business Interruption forms were similar in important ways to the Use and Occupancy forms. For example, the ISO 1977 Business Interruption (Gross Earnings Form for Mercantile or Non-Manufacturing Risks), Form CF 15 03 (Ed. 05.77), provided in pertinent part:

> 1.This policy insures against loss resulting directly from necessary interruption of business caused by **damage to or destruction of real or personal property** by the peril(s) insured against during the term of the policy, on premises occupied by the Insured and situated as herein described.[23]

The 1977 ISO Form, now referred to as a "Business Interruption" form, replaced Use & Occupancy Forms, was written on a named peril basis,[24] and is sometimes referred to as the "standard policy."[25] The ISO named peril form continued to provide time element coverage only when property was "damaged or destroyed." As with the Use and Occupancy policies, the word "loss" was used to describe the amount the insurer may have to pay, and did not refer to the event which resulted in that payment.

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[23] GLENDENING, *supra* note 16, at Appendix A (emphasis added, all capitalization in original).

[24] The named perils were "fire, lightning, the extended coverage perils, vandalism or malicious mischief, and sprinkler leakage." *See* RICHARD D. TURNER, ET AL., MULTIPLE-LINES INSURANCE PRODUCTION 553 (INS. INSTITUTE OF AM., 1ST ED. 1981) [hereinafter "TURNER"].

[25] *Id.* at 550. At the same time, ISO issued an "all risk" policy, sometimes referred to as the "Special policy." *Id.*

3. *ISO Develops the Businessowners Policy, Including Business Income Coverage and Expanding Coverage to Include Loss of or Damage to Covered Property.*

The Businessowners policy, sometimes referred to as the "BOP," was first introduced in the early 1980s.[26] Two versions of the policy were introduced: an all risk form and a named peril form. The all risk form automatically included coverage for burglary and robbery, without the need for endorsement.[27] This was the first commercial businessowners form that combined both property and business income loss coverages.

The ISO Businessowners Standard Property Coverage Forms in the 1980s were some of the first business property forms to provide coverage for "direct physical loss of or damage to Covered Property."[28] The Policy provided:

> We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration." The suspension must be caused by **direct physical loss of or damage** to property at the described premises.[29]

Unlike preceding business income and commercial property forms, which insured for "damage or destruction" to property, the 1985 ISO policy deleted the word "destruction," and replaced it with the word "loss." The use of loss, in this context, was not to reference the amount that the insurer owed; rather, it referred to the cause of that amount.

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[26] *See* PHILIP GORDIS & EDWARD A. CHILANDA, PROPERTY AND CASUALTY INSURANCE 709 (ROUGH NOTES CO., 27th ed. 1982).

[27] *Id.* at 710.

[28] *See, e.g.,* ISO Form BP 00 01 06 89, at 1 of 17.

[29] *Id.* at 4 of 17 (emphasis added).

A close examination of this BOP Form reveals why this change had to be made.[30]

ISO's BOP named peril form contained a number of coverages that cover only the loss of property and not its damage or destruction. For example, the named peril version provided coverage for "[l]ooting occurring at the time and place of a riot or civil commotion."[31] Loot or looting is defined as "to seize and carry away."[32] Accordingly, looting can occur without damage to property, as it can result just from the removal of property. Similarly, coverage was provided for "loss or damage" resulting from "Burglary and Robbery."[33] Significantly, ISO's BOP defined Burglary as:

> (1) Burglary, meaning the taking of property from inside the described premises by a person unlawfully entering or leaving the premises as evidenced by marks of forcible entry or exit; or
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> (2) Robbery, meaning the taking of property from the care and custody of a person by one who has:
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> > (a) Caused or threatened to cause that person bodily harm; or
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> > (b) Committed an obviously unlawful act witnessed by the person from whom the property was taken.[34]

Again, there was no requirement that property be "damaged." The only requirement was that the property be taken

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[30] Here, we propose to follow the rule of insurance policy interpretation that insurance policies must be interpreted in context and with regard to its intended function and the structure of the policy as a whole. *See, e.g.*, Bay Cities Paving & Grading, Inc. v. Lawyers' Mut. Ins. Co., 855 P.2d 1263, 1271 (Cal. 1993).

[31] ISO Form BP 00 01 06 89, at 2 of 17.

[32] *Loot*, MERRIAM-WEBSTER ONLINE DICTIONARY (last visited Dec. 19, 2021), *available at* www.merriam-webster.com/dictionary/loot.

[33] ISO Form BP 00 01 06 89, at 13 of 17.

[34] *Id.*

—in other words, that the insured lost the use of the property.

Likewise, ISO's BOP provided coverage for "employee Dishonesty":

> a. We will pay for direct loss of or damage to Business Personal property, including money and securities, resulting from a dishonest act committed by any of your employees acting alone or in collusion with other persons (except you or your partner) with the manifest intent to:
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> (1) Cause you to sustain loss or damage, and also
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> (2) Obtain financial benefit (other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment.[35]

The foregoing actually sets forth the extent of coverage for dishonest or criminal acts, including theft, by establishing the category of persons whose dishonest or criminal acts, including theft, are not covered. This means that there is coverage for the dishonest or criminal acts (including theft) of those persons who commit such acts that are outside this category.

Accordingly, coverage is provided for certain criminal and dishonest acts, including theft, which again do not require that any property be damaged, but, rather, only lost.

Further, the "Loss Payment" section of the BOP provided that "[i]n the event of loss or damage covered by this policy" the insurer had the option to "[p]ay the value of lost or damaged property."[36] In other words, the BOP contemplated that coverage would extend to property not damaged, but simply lost. This coverage (further expanded in the all risk form) would require that the insuring agreement

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[35] *Id.* at 14 of 17.

[36] *Id.* at 9 of 17.

be changed to cover both "loss" and "damage." As explained in one insurance industry text:

> Physical loss is not synonymous with damage or physical damage. Too often, when reference is made to this insuring agreement, physical loss is not mentioned as if it does not exist. It does exist, and it is different from physical damages.[37]

If loss were interpreted as damage or destruction, there would be no (or extremely limited) coverage under the BOP provisions that did not require damage to property. Accordingly, loss must be interpreted as the loss of use or function of property in order for the BOP to provide the full scope of its express coverages.[38]

The foregoing would most certainly be the case for the all risk Businessowners' policy, drafted around the same time, and which provided even broader coverage for losses, such as from theft. As one insurance industry author has noted, "[a]n 'all risks' insurance coverage is broader basically than specified perils coverage."[39] There is another critical difference between the two types of policies. Under "an 'all-risks' type of policy there is a presumption of coverage unless the insurance company can show that the exclusions in the policy apply to the loss. In case of doubt as to the exact cause of a loss, the insured is in a better position with

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[37] DONALD S. MALECKI, COMMERCIAL PROPERTY COVERAGE GUIDE 8 (NAT'L UNDERWRITER CO., 5TH ED. 2013).

[38] It has been noted in the insurance industry text, Property Coverages, that "[s]ome causes of loss do not alter the property itself but do affect the person's ability to possess or use the property. For example, property lost or stolen may still be used, but not by its rightful owner." MARY ANN COOK & ARTHUR L. FLITNER, PROPERTY COVERAGES, §3.5 (THE INSTITUTES, 1ST ED. 2011).

[39] WILLIAM H. RODDA, PROPERTY AND LIABILITY INSURANCE, 185 (PRENTICE-HALL, INC. 1986) (hereinafter, "RODDA").

an 'all risk' type of coverage than he is with a specified perils type."[40] Indeed, pursuant to insurance industry standards, the insurer must resolve doubts in coverage in favor of insured.[41]

B. The 1986 ISO Revisions to the Business Income Form.

In 1986, there was a "major overhaul" of the Business Income policy.[42] This included the introduction of Form CP 00 30, which is a "combination form that provides both business income and extra expense coverage."[43] As IRMI noted, the form "was first introduced in 1986, as part of an entirely new ISO simplified language forms portfolio."[44] The form has been revised several times since then, but the insuring agreements have not changed.[45] All ISO Business Income forms, from 1986 to date, still provide coverage for "loss of or damage to" covered property.[46] Likewise, the Building and Personal Property Coverage Form CP 00 10 was first introduced in 1986, again "as part of an entirely new ISO simplified language forms portfolio."[47] This form

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[40] *Id.*

[41] *See* DONNA J. POPOW, PROPERTY CLAIM PRACTICES §5.34 (THE INSTITUTES, 1ST ED. 2011).

[42] BUSINESS INCOME INSURANCE: HOW IT WORKS 2 (BJ PUBLICATIONS, 2ND ED. 1989).

[43] "Introduction—Business Income and Extra Expense Coverage Form Annotated Discussion," at 1 (IRMI), at https://www.irmi.com/online/cpl/ch005/1I05m000.aspx (last accessed Apr. 17, 2021).

[44] *Id.*

[45] *Id.*

[46] *See* ISO Form CP 00 30 10 12, at 1 of 9.

[47] *Annotation of Building and Personal Property Coverage Form (CP 00 10)*, at 1 (IRMI), https://www.irmi.com/online/cpl/ch005/1I05e000.aspx (last accessed Apr. 17, 2021).

as well has been modified many times since 1986; however, the insuring agreement has not changed, and it still provides coverage for "loss of or damage to" covered property.

C. Judicial Interpretation of Policies Requiring "Damage," "Destruction," and "Physical Loss"

Courts have frequently been asked to interpret the core terms of first-party insurance policies. In addition to the classic perils (*e.g.*, fire, wind, lightning), courts universally construed the policies to reach unusual perils over insurer objections until the 1990s.

For example, courts in the 1950s and 1960s construed both "damage or destruction"[48] and "loss of or damage to"[49] policies to encompass property rendered unsafe by the presence of radon, smoke, and gasoline vapors, even though any alteration of the property occurred, if at all, on a molecular level. In *Murray Oil Products, Inc. v. Royal Exchange Assurance Company*, the New York Court of Appeals construed a "physical loss" term in a specialty policy to include loss by theft or conversion.[50] Another case found "physical loss of" a house when it was not altered at all—just temporarily destabilized by nearby erosion and unsafe to live in.[51] These cases were well known to the insurance industry, as they were cited again and again in the coming

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[48] Am. Alliance Ins. Co. v. Keleket X-Ray Corp., 248 F.2d 920, 925 (6th Cir. 1957) (radioactive dust).

[49] W. Fire Ins. Co. v. First Presbyterian Church, 437 P.2d 52, 54 (Colo. 1968) (en banc) (gasoline fumes); Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co., 98 N.W.2d 280, 295, 300 (Minn. 1959) (smoke).

[50] Murray Oil Prods., Inc. v. Royal Exch. Assur. Co., 235 N.E.2d 762, 764 (N.Y. 1968) ("physical loss, physical damage or expense" arising from failure to deliver oil covered conversion of the oil by a thief).

[51] Hughes v. Potomac Ins. Co., 18 Cal. Rptr. 650, 655 (Cal. Ct. App. 1962).

decades by courts reaching similar conclusions.[52] An ISO employee reading about one case in this area would quickly discover the rest.

In the 1970s and 1980s, courts, for the first time, started to draw lines between "physical" and "nonphysical" loss and damage. On the "physical" side of the spectrum were cases where some physical force or substance was involved, such as smoke,[53] vibrations,[54] theft,[55] and unstable buildings.[56] The "physical" requirement was minimal—the smoke and vibrations did not actually injure the property, merely making it unacceptable to the customer (smoke) and forcing the machine to shut down for inspection (vibrations).[57] The property was removed from the unstable building before any damage occurred.[58]

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[52] For example, *First Presbyterian* was subsequently cited by a host of other similar decisions. Prudential Prop. & Cas. Ins. Co. v. Lillard-Roberts, No. CV-01-1362-ST, 2002 WL 31495830, at *8-9 (D. Or., June 18, 2002) (mold); Matzner v. Seaco Ins. Co., 1998 WL 566658, at *4 (Mass. Super., Aug. 12, 1998) (carbon monoxide); Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1335 (Or. App. 1993) (methamphetamine fumes); Hetrick v. Valley Mut. Ins Co., 1992 WL 524309, at *3 (Pa. Comm. Pl. May 28, 1992) (oil fumes).

[53] Blaine Richards & Co. v. Marine Indem. Ins. Co., 635 F.2d 1051, 1055-56 (2d Cir. 1980) ("physical loss of or damage to"); Pillsbury Co. v. Underwriters at Lloyd's, London, 705 F. Supp. 1396, 1399-401 (D. Minn. 1989) ("all risks of physical loss or damage" covered loss due to health-threatening organisms).

[54] Cyclops Corp. v. Home Ins. Co., 352 F. Supp. 931, 937 (W.D. Pa. 1973) ("sudden and accidental damage").

[55] Intermetal Mexicana, S.A. v. Ins. Co. of N. Am., 866 F.2d 71, 72 (3d Cir. 1989) ("all risks of direct physical loss or damage").

[56] Hampton Foods, Inc. v. Aetna Cas. & Sur. Co., 787 F.2d 349, 352 (8th Cir. 1986) ("direct physical loss").

[57] *Blaine Richards*, 635 F.2d at 1055-56; *Cyclops Corp.*, 352 F. Supp. at 937.

[58] *Hampton Foods*, 787 F.2d at 352.

In 1989, the Third Circuit, borrowing from a line of cases spawned by *Murray Oil*, confirmed that "physical loss" policies covered theft.[59] "The evidence is undisputed that [the policyholder] lost possession and control over the insured equipment" when it was seized, and it "has not had possession or control of the equipment since that date."[60] "We find that such an absence of possession and control falls within the plain meaning of 'loss.'"[61]

On the "non-physical" end of the spectrum were legal and economic injuries to the property or rights attaching to the property. Those cases principally involved title defects,[62] but at least one case came to the same conclusion in a case involving a voided product warranty.[63]

In 1990, a federal district court in Oregon rejected a claim that mitigation of nonfriable asbestos was covered under a "physical loss" policy.[64] Drawing on a (now discredited) reading of "property damage" in liability insurance, the court concluded that there was no "*physical* loss, direct or otherwise," because the property was "intact and undamaged."[65] With the assistance of *Couch on Insurance 3d*,

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[59] *Intermetal Mexicana*, 866 F.2d at 76, 78 (citing Buckeye Cellulose Corp. v. Atl. Mut. Ins. Co., 643 F. Supp. 1030, 1036 (S.D.N.Y. 1986); Great N. Ins. Co. v. Dayco Corp., 620 F. Supp. 346, 350-51 (S.D.N.Y. 1985)).

[60] *Id.* at 76.

[61] *Id.*

[62] Comm. Union Ins. Co. v. Spoonholz, 866 F.2d 1162, 1162 (9th Cir. 1989); HRG Dev. Co. v. Graphic Arts Mut. Ins. Co. 527 N.E.2d 1179, 1181 (Mass. Ct. App. 1988).

[63] Glens Falls Ins. Co. v. Covert, 526 S.W.2d 222, 223 (Tex. Ct. App. 1975).

[64] Great N. Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 793, F. Supp. 259, 263 (D. Or. 1990), *disapproved by* Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1335 (Or. App. 1993).

[65] *Id.*

that lone case ballooned into a test requiring "distinct, demonstrable, physical alteration" of property before coverage attaches under a "physical loss" policy.[66] As we have written elsewhere, that rule is seriously flawed, inconsistent with the case law existing in 1990, and infects the vast majority of cases denying coverage in the modern era.[67]

Nevertheless, the majority of cases from 1990 until 2007 (when the industry developed the virus-or-bacteria exclusion) continued to follow the distinction between "physical" and "nonphysical" losses reflected in the earlier cases. Coverage existed when there was physical contamination[68]

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[66] Lewis, et al., *supra* note 10, at 625-28, 634-35.

[67] *Id.*

[68] Hetrick v. Valley Mut. Ins Co., 1992 WL 524309, at *3 (Pa. Comm. Pl., May 28, 1992) (oil spill rendering home dangerous); Largent v. State Farm Fire & Cas. Co., 842 P.2d 445, 446 (Or. Ct. App. 1992) (methamphetamine fumes); *Trutanich*, 858 P.2d at 1335 (same); Azalea, Ltd. v. Am. States Ins. Co., 656 So.2d 600, 602 (Fla. Ct. App. 1995) (death of bacteria colony essential to operation of sewage plant); Arbeiter v. Cambridge Mut. Fire Ins. Co., No. 9400837, 1996 WL 1250616, at *2 (Mass. Super. Mar. 15, 1996) (oil fumes); Sentinel Mgmt. Co. v. N.H. Ins. Co., 563 N.W.2d 296, 300 (Minn. Ct. App. 1997) (friable asbestos); Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc., 78 Cal. App. 4th 847, 865 (2000) (wood shavings in shipment of almonds); Matzner v. Seaco Ins. Co., 1998 WL 566658, at *4 (Mass. Super., Aug. 12, 1998) (carbon monoxide); Columbiaknit, Inc. v. Affiliated FM Ins. Co., No. 98-434-HU, 1999 WL 619100, at *7-8 (D. Or., Aug. 4, 1999) (mold); Bd. of Educ. v. Int'l Ins. Co., 720 N.E.2d 622, 625-26 (Ill. Ct. App. 1999) (friable asbestos); Sentinel Mgmt. Co. v. Aetna Cas. & Sur. Co., 615 N.W.2d 819, 825-26 (Minn. 2000) (same); Gen. Mills, Inc. v. Gold Medal Ins. Co., 622 N.W.2d 147, 152 (Minn. Ct. App. 2001) (pesticides); Prudential Prop. & Cas. Ins. Co. v. Lillard-Roberts, No. CV-01-1362-ST, 2002 WL 31495830, at *8-*9 (D. Or., June 18, 2002) (mold); Cooper v. Travelers Indem. Co. of Ill., No. 01-cv-2400, 2002 WL 32775680, at *1 (N.D. Cal., Nov. 4, 2002) (e coli bacteria); Graff v. Allstate Ins. Co., 54 P.3d 1266, 1269 (Wash. Ct. App. 2002) (methamphetamine vapor and residue); Yale Univ. v. CIGNA Ins. Co., 224 F. Supp. 2d 402, 413 (D. Conn. 2002) (friable asbestos); Motorists Mut. Ins. Co. v. Hardinger, 131 F. App'x 823, 824, 826–27,

or when the property was unsafe or unusable due to a physical peril.[69]

IV. Loss, Damage, and Coronaviruses

As the above discussion should make clear, there were many decisions finding that physical substances could cause "physical loss" by contaminating or being present on the property, if they made it unsafe or unusable. To the authors' knowledge, there were no cases to the contrary. ISO and the insurance industry therefore knew, and expected, that their Commercial Property, Businessowners, and Business-Income coverages would respond if a policyholder's property was unsafe or contaminated by a harmful foreign substance.

A. In the Early 2000s, the Insurance Industry Paid Claims of Loss from SARS-CoV-1.

Consistent with this discussion, the insurance industry paid a number of claims for loss caused by the original novel coronavirus, SARS-CoV-1, which led to an epidemic in 2002-2004. As noted in an article in the Washington Post

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824-26 (3d Cir. 2005) (e coli bacteria); de Laurentis v. United Servs. Auto. Ass'n, 162 S.W.3d 714, 722-23 (Tex. Ct. App. 2005) (mold); Schlamm Stone & Dolan, LLP v. Seneca Insurance Co., No. 603009/2002, 2005 WL 600021 (N.Y. Supr., Mar. 16, 2005) (noxious dust particles); Brand Mgt., Inc. v. Md. Cas. Co., No. 05-cv-02293, 2007 WL 1772063, at *2 (D. Colo., June 18, 2007) (listeria bacteria); Stack Metallurgical Servs., Inc. v. Travelers Indem. Co., No. 05-1315, 2007 WL 464715, at *8 (D. Or., Feb. 7, 2007) (lead).

[69] Murray v. State Farm Fire & Cas. Co., 509 S.E.2d 1, 17 (W. Va. 1998) (house rendered unsafe due to potential for falling rocks); Cook v. Allstate Ins. Co., No. 48D02-0611-PL-01156, 2007 Ind. Super. LEXIS 32, at *6-10 (Madison Cnty., Nov. 30, 2007) (brown recluse spider infestation).

titled "Insurers knew the damage a viral pandemic could wreak on businesses. So they excluded coverage":

> The forced closure of businesses nationwide because of the novel coronavirus would seem to be the perfect scenario for filing a "business interruption" insurance claim.
>
> But most companies will probably find it difficult to get an insurance payout because of policy changes made after the 2002-2003 SARS outbreak, according to insurance experts and regulators.
>
> SARS, which infected 8,000 people mostly in Asia and is now seen as foreshadowing the current pandemic, led to millions of dollars in business-interruption insurance claims. Among the claims was a $16 million payout to one hotel chain, Mandarin Oriental International.[70]

The insurance industry, through its ratings organizations, its claims handlers, its coverage counsel, and its employees reading trade journals, was well aware of the case law, set out above, concluding that disease-causing agents could cause "loss" or "damage" to property.

To the extent there is any doubt of this, ISO and the American Association of Insurance Services ("AAIS") have admitted that it was part of their responsibility to their member companies to monitor the common law on standard-form property insurance policies, and that such review prompted them to draft changes to the standard forms to eliminate ambiguities:

> In addition, pollution exclusions are at times narrowly applied by certain courts. In recent years, ISO has filed exclusions to address specific exposures relating to contaminating or harmful substances. Examples are the mold exclusion in property and liability policies and the liability exclusion addressing sil-

[70] Todd C. Frankel, *Insurers knew the damage a viral pandemic could wreak on businesses. So they excluded coverage*, WASH. POST (April 2, 2020).

> ica dust. Such exclusions enable elaboration of the specific exposure and thereby can reduce the likelihood of claim disputes and litigation.[71]

Further, it has been noted that ISO "conducts ongoing research and review of state insurance laws and insured-related case law in order to be responsive to necessary changes in prospective loss costs, policy forms, endorsements, factors, classifications or manuals, as applicable."[72] In addition, the ISO Advisory organization "has processes in place to identify and provide subscribers with necessary changes (by virtue of changes in state laws or case law) to advisory forms, rules and loss costs."[73]

B. As a Result of Their Close Review of the Common Law, and the Insurance Industry's Payments for Loss from SARS-CoV-1, ISO and AAIS Drafted the Virus or Bacteria Exclusion.

Despite ISO's monitoring of case law, ISO has not changed the insuring agreement in either the Businessowners or Business Income Forms since at least 1985. More specifically, ISO has not removed the word "loss" from the insuring agreements, in apparent recognition that policy forms covered loss of use and function. On the other hand, the trend in the common law, and insurance company payments in relation to SARS-CoV-1,[74] motivated the insur-

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[71] Amendatory Endorsement—Exclusion of Loss Due to Virus or Bacteria (2006), at 2 (attached to ISO 2006 Circular) (emphasis added).

[72] Government of the District of Columbia, Aug. 28, 2013, Report on Examination—Insurance Services Office, at 12.

[73] *Id.* at 45.

[74] The SARS outbreak was recognized and discussed in detail in one ISO document. *See* Hartford Fire Ins. Co. v. Moda, No. HHD-CV-20-6217638-S (Conn. Super. Ct. at Hartford) [hereinafter "Hartford Action"] (Aff. of Christine A. Montenegro, Bates Nos. ISO_4709–4710).

ance-industry drafting organizations, on behalf of its members, to draft the Exclusion for Loss Due to Virus or Bacteria (the "Virus Exclusion") in 2006.[75]

At that time, ISO acknowledged that viruses can cause physical damage. Internally, after the SARS outbreak in 2003, the insurance industry realized that claims for pandemics could be deemed covered under the standard ISO Special Causes of Loss Coverage form, due to the extremely broad protection it provides.[76] This is certainly consistent with the history of the form, and the case law regarding the legal meaning of "loss" and "damage."

Initially ISO considered the adoption of a new contamination exclusion that would address viruses. A draft of this endorsement was set forth in a 2005 ISO document.[77] The Draft Contamination Exclusion, in pertinent parts, states:

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[75] Lucca de Paoli, *et al.*, *Insurance Unlikely to Cushion Coronavirus Losses – But There Are Exceptions*," INS. J. (Mar. 4, 2020).

[76] The Fire, Casualty & Surety Bulletin ("FC&S"), an insurance industry resource for policy interpretation, received the following question:

> Our insured accidentally threw away some digital x-ray sensors in the trash. Now, they want to be compensated for them. The BOP policy, Section I Property, Coverage agreement states, "we will pay for direct physical loss…." I believe the coverage agreement precludes coverage as this is not "direct physical loss." Nothing happened to them—they were simply thrown away. Do you believe coverage exists?

Direct Physical Loss under BOP, NU FC&S Expert Coverage Interpretation (July 2, 2011), at https://www.nuco.com/fcs/2011/07/12/direct-physical-loss-under-bop-422-12966/ (last accessed July 15, 2021). FC&S responded. "There is no exclusion that applies to this loss. There does not need to be any impact on or damage to the items themselves for there to be a direct physical loss—just like when items are stolen. But, **there is a loss in that they are no longer available to the insured**." *Id.* (emphasis added).

[77] Hartford Action, Bates No. ISO_4700.

> Introduction
>
> This filing introduces a new exclusion specific to naturally occurring or manmade contamination.
>
> Some examples of contamination of property include:
>
> . . .
>
> • Contamination of office equipment and/or products by anthrax or by a virus such as Severe Acute Respiratory (SARS) or Avian Influenza.
>
> Background
>
> The pollution exclusion is constructed as an extremely broad exclusion intended to encompass contamination. In recent years, however, there has been a trend to treat various subjects ("hot" topics, emerging exposures or frequently encountered types of loss) with more focused exclusions. Examples are the mold exclusion in Property and Liability policies and a General Liability exclusion (recently filed) addressing silica dust. The "laser" treatment may enhance an insured's understanding of the policy and avert claims disputes and litigation.
>
> . . .
>
> Explanation of Changes
>
> We are adding a new exclusion to specifically address the risk of loss due to contamination.
>
> Impact
>
> This change is a reduction in coverage.[78]

As the foregoing indicates, ISO, in 2005, recognized that a virus could contaminate physical objects, such as office equipment or products. Indeed, at least initially, ISO concluded that the proposed Contamination Exclusion would be a reduction in coverage.[79] ISO noted that an insured's understanding of the scope of such an exclusion

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[78] *Id.* (emphasis added).

[79] ISO later changed this position, apparently because "[s]ince the existing Pollution exclusion is intended to encompass contamination, I believe we should state, 'There is no change in coverage.'" *Id.*

would be "enhanced" by expressly including a contamination exclusion in the property policy with specific reference to viruses.[80] This also indicates that ISO had concern that then current property policies and their exclusions (*i.e.*, for mold, etc.) may not put an insured clearly on notice that damage from a virus is excluded. The apparent failure to property put an insured on notice that a particular peril is not covered would be contrary to insurance industry standards.[81]

In a document entitled "CPP-2005-008 Biological Contamination and Errors in Production,"[82] created in 2005, ISO's Commercial Property Panel again recognized that viruses could contaminate physical property.

> Some examples of contamination of property include:
>
> • Aforementioned growth of listeria bacteria in milk;
>
> • Bacterial contamination of meat processing equipment;
>
> • Contamination of office equipment and /or products by anthrax or by a virus such as SARS.[83]

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[80] *Id.*

[81] ROBIN K. OLSON & RICHARD J. SCISLOWSKI, FUNDAMENTALS OF INSURANCE LAW (INT'L RISK MGMT. INST. 2010) ("Rules of Policy Construction"), at https://www.irmi.com/online/bkinslaw/07-policy-construction-rules.aspx (last accessed July 8, 2021) ("Courts in many states have held that exclusions in an insurance policy must be conspicuous. They cannot be buried in the fine print. They must be somehow set apart from the rest of the policy in a format that would call attention to them. Courts have held that setting off exclusions in their own sections or identifying them with bold type makes them sufficiently conspicuous.").

[82] Hartford Action, Bates No. ISO_4931 (emphasis in original). The Commercial Property Panel consisted of nine members, all of whom were from insurance companies, such as The Hartford, CNA, St. Paul Travelers, and Safeco. *Id.*

[83] Hartford Action, Bates No. ISO_4716. Likewise, in an ISO document entitled "Draft of Contamination Exclusion (difference between

The notes from the same meeting, under "**PANEL DISCUSSION**," contain the following observation: "The contamination exclusion is intended to encompass contamination of any Covered Property, including premises and products."[84] It is difficult to understand why any "Covered Property" would be subject to a contamination exclusion, which expressly included viruses, unless it was recognized that viruses could damage physical property, as ISO had recognized elsewhere.

The ISO documents from this period also contain the following significant handwritten entry:

> 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).[85]

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original draft and the draft shown in bold," the following policy exclusion language was proposed: "We will not pay for loss or damage caused by or resulting from any of the following: Contamination by any pathogenic or poisonous biological agent, including but not limited to viruses and bacteria." Hartford Action, Bates No. ISO_4719. Further, in another copy of the same document, just opposite the three bullet points, appears the following handwritten notion: "bacteria + viruses." Hartford Action, Bates No. ISO_4938.

[84] Hartford Action, Bates No. ISO_4720 (emphasis in original).

[85] Hartford Action, Bates No. ISO_5433. Indeed, this statement appears to be contrary to ISO's Ann Casillo's October 2, 2006, statement to Sheri Cullen, of the Massachusetts Division of Insurance, in which she wrote: "Various other known substances (such as rotovirus) are not mold, do not become visible, do not alter the physical appearance of property and typically cause no property damage. But their mere presence may be alleged to be property damage (for example alleged on of (sic) property). Our objective is to convey that, even if there were property damage (or alleged property damage) by disease-causing microorganisms, there is no coverage." Hartford Action, Bates No. ISO_4237. This is, at the least, an implicit recognition that viruses may cause property damage, consistent with ISO's earlier internal recognitions that viruses can cause property damage.

ISO therefore recognized that the mere presence of a substance (*e.g.*, a virus) can cause contamination, without any need for a change in the form or substance of the object where the virus appears. This is consistent with ISO's other statements recognizing that viruses can damage physical property.

ISO subsequently decided not to go forward with the contamination exclusion.[86] Rather, ISO proceeded with a similarly worded Virus Exclusion. ISO submitted the Virus Exclusion to many state departments of insurance for approval. Specifically, on July 6, 2006, ISO submitted an ISO Circular announcing "the submission of form filings to address exclusion of loss due to disease-causing agents such as viruses and bacteria."[87] In relevant part, the ISO Circular states that property policies had not historically been a source of coverage for loss from "disease-causing agents,"[88] which, as shown above, was not true.[89] ISO further stated that it aimed to prevent efforts to "expan[d]" coverage under standard-form wordings, contrary to policy intent; *i.e.*, to remove what it recognized was at least an ambiguity:

> Although building and personal property could arguably become contaminated (often temporarily) by such viruses and bacteria, the nature of the property itself would have a bearing

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[86] *See* Hartford Action, Bates No. ISO_4703.

[87] ISO 2006 Circular, New Endorsements Filed To Address Exclusion of Loss Due to Virus or Bacteria (July 6, 2006), at 1 of 3 [hereinafter "ISO 2006 Circular"].

[88] Amendatory Endorsement—Exclusion of Loss Due to Virus or Bacteria (2006), at 2 (attached to ISO 2006 Circular).

[89] *Supra*, nn.48-49, 53, 68 & accompanying text (citing cases finding coverage for bacteria, radioactive dust, noxious air particles, lead, asbestos, mold, mildew, "health-threatening organisms," smoke, gasoline vapors, and pesticides); *see also* Henri's Food Prods. Co. v. Home Ins. Co., 474 F. Supp. 889, 892 (E.D. Wis. 1979) (finding coverage for contamination by vaporized agricultural chemicals under standard fire policy).

> on whether there is actual property damage. An allegation of property damage may be a point of disagreement in a particular case. In addition, pollution exclusions are at times narrowly applied by certain courts. In recent years, ISO has filed exclusions to address specific exposures relating to contaminating or harmful substances. Examples are the mold exclusion in property and liability policies and the liability exclusion addressing silica dust. Such exclusions enable elaboration of the specific exposure and thereby can reduce the likelihood of claim disputes and litigation.
>
> **While property policies have not been a source of recovery for losses involving contamination by disease-causing agents, the specter of pandemic or hitherto unorthodox transmission of infectious material raises the concern that insurers employing such policies may face claims in which there are efforts to expand coverage and to create sources of recovery for such losses, contrary to policy intent.**
>
> In light of these concerns, we are presenting an exclusion relating to contamination by disease-causing viruses or bacteria or other disease-causing microorganisms.[90]

In the same time period, AAIS's Filing Memorandum sent to state regulators likewise stated, incorrectly, that property policies had not been a source of recovery for loss or damage caused by disease-causing agents. As relevant here, however, AAIS stated that the new exclusion was intended to "clarify policy intent"; *i.e.*, to remove ambiguity:

> Virus Or Bacteria Exclusion - Filing Memorandum
>
> AAIS has developed and is filing a mandatory endorsement for use with the Commercial Properties Program. This new mandatory Virus Or Bacteria Exclusion, CL 0700, is described below.
>
> Property policies have not been, nor were they intended to be, a source of recovery for loss, cost, or expense caused by disease causing agents. With the possibility of a pandemic, there is concern that claims may result in efforts to expand coverage to

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[90] Amendatory Endorsement—Exclusion of Loss Due to Virus or Bacteria (2006), at 2 (attached to ISO 2006 Circular) (emphasis added).

> create recovery for loss where no coverage was originally intended. In light of this possibility, AAIS is filing a Virus Or Bacteria Exclusion that will specifically address virus and bacteria exposures and clarify policy intent.
>
> This endorsement clarifies that loss, cost, or expense caused by, resulting from, or relating to any virus, bacterium, or other microorganism that causes disease, illness, or physical distress or that is capable of causing disease, illness, or physical distress is excluded. Avian Flu, SARS, rotavirus, listeria, legionella, or anthrax are examples of disease or illness causing agents addressed by this exclusion but are by no means an exhaustive list.[91]

The regulatory submissions filed by drafting organizations included a July 18, 2006, submission to the Massachusetts Division of Insurance (hereinafter, "MDI").[92] In response to the submission, on August 17, 2006, Sheri Cullen, an MDI Policy Form reviewer, requested the following from Anne Casillo of ISO:

> 1.Provide examples of virus, bacterium, or microorganism that damages property but would not be considered mold, Fungus, mildew, or any mycotoxins, spores, scents, or byproduct produced by the mold.[93]

On November 7, 2006, Casillo responded:

> For business income coverage to apply, the loss of business income must be caused by direct physical loss or damage to property and must be caused by or result from a Covered Cause of Loss. Loss or damage caused by viral or bacterial contaminants are not intended to be covered under the current property policies. . . . The new Exclusion of Loss Due to Virus or Bac-

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[91] Property Lines - PA 10/06, Copyright, American Association of Insurance Services, Inc., 2006, filed in reference to CL 0700 10 06 (emphasis added).

[92] Hartford Action, Bates No. ISO_4199.

[93] Hartford Action, Bates No. ISO_4203.

> teria endorsement reinforces this by specifically excluding contamination by disease-causing viruses or bacteria or other disease-causing mircroorganisms.[94]

This response is contrary to ISO's internal recognition that viruses can cause property damage. Indeed, it is difficult to understand why ISO would want to include a virus exclusion if, as ISO represented, the policy in the first instance does not cover damage from viruses.[95] ISO's attempt to justify such an exclusion is simply that the exclusion "reinforces" the policy intent. The policy intent to not cover viruses, however, is nowhere clearly expressed. Indeed, that purported intent would be contrary to the historic development of the BOP. Further, when ISO submitted the Virus Exclusion for approval to departments of insurance across the country, ISO conceded that a virus could cause Business Income losses:

> Disease-causing agents may render a product impure (change its quality or substance), or enable the spread of disease by their presence on interior buildings surfaces or the surfaces of personal property. When disease-causing viral or bacterial contamination occurs, potential claims involve the cost of replacement of property (for example, the milk), cost of decontamination (for example, interior building surfaces), and business interruption (time element) losses.[96]

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[94] Hartford Action, Bates No. ISO_4206; *see also* Bates Nos. ISO_4208–4209, Bates No. ISO_4977.

[95] *See* Knutsen & Stempel, *supra* note 11, at 191 (pointing out that "[i]f the insuring agreement or other exclusions in those policies had sufficiently precluded coverage, there logically would have been no need for a specific virus exclusion").

[96] Amendatory Endorsement—Exclusion of Loss Due to Virus or Bacteria (2006), at 1 (attached to ISO 2006 Circular) (emphasis added) It appears that ISO misrepresented the reason for the exclusion to the regulators. *See, e.g.*, ISO's June 29, 2006, submission for approval to the Ohio Director of Insurance, for approval of the Virus Exclusion; *see also* Knutsen & Stempel, *supra* note 11, at 241-22 (discussing pre-2006 court

These statements are further evidence that ISO *subjectively believed* that disease-causing viruses may result in a wide range of insurance claims, including business income claims.

C. Courts and Insurers Continue to Find Coverage for these losses Under Policies That Lacked a Clear Exclusion.

After the insurance industry drafted the Virus Exclusion, courts continued to rule for policyholders in cases involving loss or damage from non-traditional events. These cases include recognitions that a "physical loss" could occur when property was "physically incapable of performing [its] essential function,"[97] as well as other instances of contamination by physical substances[98] or were property was rendered unsafe or unusable by a physical force.[99]

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decisions finding "direct physical loss or use" where there was no actual physical or structural damage).

[97] Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co., 968 A.2d 724, 734 (N.J. App. Div. 2009).

[98] Ass'n of Apartment Owners of Imperial Plaza v. Fireman's Fund Ins. Co., 939 F. Supp. 2d 1059, 1068 (D. Haw. Apr. 9, 2013) (intrusion of arsenic into roof); Mellin v. N. Sec. Ins. Co., 115 A.3d 799, 806 (N.H. 2015) (pervasive cat urine odor); Gregory Packaging, Inc. v. Travelers Prop. & Cas. Co. of Am., No. 2:12-cv-04418, 2014 WL 6675934 (D.N.J. 2014) (ammonia contamination).

[99] Manpower Inc. v. Ins. Co. of Pa., No. 08C0085, 2009 WL 3738099, at *1 (E.D. Wis., Nov. 3, 2009) (unstable, though undamaged, office space); Travco Ins. Co. v. Ward, 715 F. Supp. 2d 699, 708 (E.D. Va. 2010) (finding coverage "at least where the building in question has been rendered unusable by physical forces," in that case noxious gas emitted by defective drywall); *In re* Chinese Mfr'd Drywall Prods. Liab. Litig., 759 F. Supp. 2d 822, 831 (E.D. La. 2010) (same); Oregon Shakespeare Festival Ass'n v. Great Am. Ins. Co., No. 1:15-cv-01932-CL, 2016 WL 3267247, at *5-6 (D. Or., June 7, 2016) (smoke from wildfires making venue unsafe).

Beyond this, insurance companies had confirmed the status of the law discussed above. For instance, three months before the pandemic, Factory Mutual Insurance Company—perhaps the most sophisticated property insurance company in the United States—admitted that "physical loss or damage" to property exists when the presence of a physical substance renders property unfit for its intended use, despite it causing **no** structural alteration to property.[100] That case, *Factory Mutual Insurance Co. v. Federal Insurance Co.*, involved a mold infestation in a "clean room" at a drug manufacturing plant.[101] In its effort to recover a share of the losses from another insurer, FM's position was that there was a "physical loss" because the contamination "physically rendered the facility unusable for a period of time."[102]

Indeed, since the inception of the COVID-19 pandemic, insurance companies have drafted a number of exclusions to bar coverage for loss arising from infusion of property with a virus or other communicable disease, such as the following:

> COMMUNICABLE DISEASE EXCLUSION
>
> This policy, subject to all applicable terms, conditions and exclusions, covers losses attributable to direct physical loss or physical damage occurring during the period of insurance. Consequently and notwithstanding any other provision of this policy to the contrary, this policy does not insure any loss, damage, claim, cost, expense or other sum, directly or indirectly arising out of, attributable to, or occurring concurrently or in any sequence with a Communicable Disease or the fear

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100 Lewis, et al., *supra* note 10, at 629-30 (discussing this case).

101 *Id.*

102 *Id.*

> or threat (whether actual or perceived) of a Communicable Disease.[103]

As we discuss below, some insurers added this highly specific language days after they were sued for pandemic losses. Those actions simply reinforce that policies *without* such exclusions must be construed to cover virus- and pandemic-based losses.

V. ANALYSIS: HONORING INSURANCE-INDUSTRY INTENT

The National Association of Insurance Commissioners estimate that 80-83% of property policies in effect when the pandemic struck incorporated the ISO Virus or Bacteria exclusion.[104] Yet, despite their knowledge of the risk of viral contamination or pandemics, some insurance companies did not exclude those perils.

That was a conscious underwriting choice. Insurers have always been well aware that the words "physical loss" includes situations where a physical force interferes with possession and control of the insured property. It was added specifically to provide coverage for property stolen, but undamaged. And decade after decade, courts construed it to cover a wide variety of other losses, even where the property was not damaged or altered. Those losses included contamination by disease-causing agents, insurers paid those losses, and they developed industry-standard language to exclude certain classes of them (*i.e.*, from virus or bacteria).

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[103] Cherokee Nation v. Lexington Ins. Co., 2021 WL 506271, *6 (Okla. Dist. Ct., Cherokee Cnty., Jan. 28, 2021).

[104] *See NAIC Covid-19 Report for 2020: Year in Review*, p.23, NAT'L ASS'N OF INS. COMM'RS (last accessed Dec. 20, 2021), *available at* https://content.naic.org/sites/default/files/naic-covid-19-report-update3-eoy-2020.pdf.

For the 20% of insurers who refused to use this widely-available language, there must be consequences. This has always been the law. When carriers fail to use clear and distinct language to exclude a cause of loss known in the market, they "act at their own peril."[105] As with the definition of *direct physical loss*, the insurance companies could have included language that would have clarified any ambiguity regarding pandemic coverage, but they chose not to do so. Indeed, some insurers' choice to add the "Communicable Disease Exclusion" (discussed above) underscores the conclusion that standard-form policies not clearly and distinctly exclude pandemics.[106]

A. The Inclusion of Coverage for Loss of or Damage to Covered Property in The ISO Business Income Policy Form Expanded Coverage to Include Loss of Use or Function.

"Loss" in the Business Income section must also be construed as providing coverage for the loss of the property, or in the case of real and personal property, its loss of use or function. The foregoing accords with the insurance industry standard for the interpretation and application of insurance policies, as well as judicial decisions from 1957 to 2018. Significantly, the words "loss" and "damage," are separated by the disjunctive "or." In the insurance industry, "or" stands "for the disjunctive or alternative."[107] Accordingly, in order to interpret "loss of or damage to," the words

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[105] Pan Am. World Airways, Inc. v. Aetna Cas. & Sur. Co., 505 F.2d 989, 1001 (2d Cir. 1974).

[106] *Id.*

[107] KENNETH S. WOLLNER, HOW TO DRAFT AND INTERPRET INSURANCE POLICIES 94 (CAS. RISK PUB., LLC 1999).

"loss" and "damage" must be considered and defined separately, as they are set forth as alternative scopes of coverage.[108]

The words loss and damage are not defined in the Policy. In the insurance industry, phrases and words in an insurance policy are "to be given their plain, ordinary meaning."[109] Accordingly, it is presumed that the "parties [to the contract] meant to use the common, ordinary dictionary definition of the words they employ in their written contracts."[110] Pursuant to insurance industry standards, we must turn to the common dictionary definitions for these words.[111]

> Direct is defined as "stemming immediately from a source," or as "characterized by close logical causal, or consequential relationship."[112]

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[108] Knutsen & Stempel, *supra* note 11, at 247 ("Some courts have held that the disjunctive 'or' between 'physical loss of or damage to' property must mean that 'loss' must mean that 'loss' must mean something different than 'damage' (typically it is held to mean an absence of property, as in theft). In that regard, 'loss' could mean 'loss of use' or 'Loss of function' such that it renders the property useless to the policyholder (i.e., if you lost the useful use of the property, it is as if you lost it, even though it did not physically go away).").

[109] Robin K. Olson & Richard J. Scisiowski, *Rules of Policy Construction*, at 5, *in* FUNDAMENTALS OF INSURANCE LAW (INT'L RISK MGMT. INST. 2010).

[110] *Id.*

[111] *See* Knutsen & Stempel, *supra* note 11, at 253 n.161 ("[T]here is ample evidence in dictionaries and thesauruses suggesting the plain and ordinary meaning approach augers in favor of finding loss when a policyholder's use of property is restricted by viral infection or government order.").

[112] *Direct*, MERRIAM-WEBSTER ONLINE DICTIONARY (last accessed Dec. 20, 2021), *available at* www.merriam-webster.com/dictionary/direct.

> Loss is defined as the "act of losing possession: DEPRIVATION."[113]
>
> Damage is defined as a "loss or harm resulting from injury to person, property, or reputation."[114]

The foregoing definitions correspond to the insurance industry's subjective understanding of their meaning.[115]

Applying the foregoing definitions and understandings to the words "loss" and "damage" leads to the following conclusion: Whereas damage refers to physical damage, the word "loss" clearly does not and cannot.[116] Indeed, "loss" broadly refers to the loss of use of a property and does not require any physical damage to be present.[117] Ac-

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[113] *Loss*, MERRIAM-WEBSTER ONLINE DICTIONARY (last accessed Dec. 20, 2021), *available at* www.merriam-webster.com/dictionary/loss.

[114] *Damage*, MERRIAM-WEBSTER ONLINE DICTIONARY (last accessed Dec. 20, 2021), www.merriam-webster.com/dictionary/damage.

[115] *See* Kuntsen & Stempel, *supra* note 11, at 234-37. Knutsen and Stempel discuss the various definitions of loss, damage and physical, and conclude that "[a]pplying this mix of Merriam-Webster definitions [among other dictionary definitions] suggests that one might reasonably find a "physical loss" when a policyholder is deprived of something material—such as use of one's business, especially if the loss takes place in an unanticipated manner through something like a pandemic that spurs government-ordered use of the business property." *Id.*

[116] *See id.* at 237 ("Regarding the distinction between the words "loss" and "damage", it should be noted that courts typically subscribe to the "surplusage" canon of construction, which posits that each word in a document (statute, contract, regulation) should be given its own meaning and not treated as a mere repetition by synonym.").

[117] *Id.* ("[T]he word "loss" should be viewed as meaning something different than "damage.").

cordingly, and consistent with the history of business income policies,[118] coverage is provided for the loss of use or function of the property.

B. The Failure of the Insurance Industry to Use Specific, Widely Available Language to Exclude a Known Peril Must Have Consequences.

Decisions addressing claims for loss or damage from SARS-CoV-2 and COVID-19 have noted that courts, in wrestling with the issue since 1957, had essentially begged the insurance industry to make their language more specific. For instance, in *Cherokee Nation v. Lexington Insurance Co.*, the policyholder, in response to the COVID-19 pandemic, temporarily closed its business operations to implement mitigation protocols and modifications, such as acrylic barriers and sanitation stations, staggering seating and gaming machines, and replacing air filters, to allow its businesses to operate safely.[119] The policyholder sought coverage for its losses of income under a policy triggered by "all risk of direct physical loss or damage," which "important phrase" was not defined.[120]

The insurance companies argued that "direct physical loss or damage" was a "phrase-of-art" which means "distinct, demonstrable, physical alteration to the property."[121]

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[118] As Knutsen & Stempel point out, "the words should be construed in accord with party intent and overall purpose rather than through textual assessment alone." *Id.* at 233 n.90. The history and development of business income coverage provides that "purpose." It is evident from the history that the purpose of the modern ISO business interruption and income loss coverages was to discard the limitation on coverage to only "damage or destruction" to property and to expand that coverage to include not only damage but also loss.

[119] No. CV-20-150, 2021 WL 506271, *1-2 (Okla. Dist. Jan. 28, 2021).

[120] *Id.* at *3.

[121] *Id.*

The court first noted that the interpretation of this phrase "could have been preempted if [the insurance companies] would have simply defined the phrase within the [insurance] Policy," noting that "[c]arriers have utilized the phrase *direct physical loss* for over fifty (50) years and courts have begged carriers to define the phrase to avoid the precise issue before the Court now."[122] Later in the opinion, the court noted "[i]t is also notable that since at least 1968, several courts have rejected [the insurance companies'] interpretation and instructed carriers to clearly limit *direct physical loss or damage* within their policies for it to have the meaning [the insurance companies] advance here," but the insurance companies "failed to do so."[123]

"Despite these pleas and the known confusion surrounding the phrase 'direct physical loss,' Defendant Insurers made no attempt to clarify or define that phrase within the [insurance] policy to avoid the [policyholder's] that losses such as the closure of a business in response to the Pandemic would be covered—at least, not until it was too late."[124] Specifically, the insurance companies added a Communicable Disease exclusion, which the court construed against them:

> The day after the [policyholders] filed this same action under this same policy, Defendant Insurers added a new Communicable Disease exclusion to the [insurance] Policy that preempted coverage due to the fear or threat of viruses. This action on the part of the Defendant Insurers can mean one of two things. Either the exclusion was added to provide clarity for [the insurance companies'] interpretation—i.e., that Pandemic-related closures like the one at issue here are not covered—which underscores the confusion surrounding the existing policy language and the conclusion that the [insurance policy] is ambiguous. Or the exclusion was added because the

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122 *Id.*

123 *Id.* at *7 n.16.

124 *Id.* at *3.

> [policyholders'] interpretation is correct—i.e., that Pandemic-related closures like the one at issue here are covered—and Defendant Insurers needed to create a truly new exclusion in order to avoid liability for such claims. In either event—even assuming the Defendant Insurer[s'] interpretation of the existing language is reasonable—Oklahoma law would require the Court to adopt the [policyholders'] interpretation.[125]

This reasoning makes perfect sense for anyone who understands how insurance is structured and regulated. Contrary to the recent suggestions of some federal judges, insurance policies generally do not "rejoic[e] in overlapping terms and concepts."[126] Although it might be true that ordinary legal boilerplate is generally not complete "if it d[oes] not come with some surplusage,"[127] insurance policies are not typical boilerplate.

Policies are meticulously drafted and heavily regulated instruments for shifting risk. Insurers make money by levying premiums that match both the language of a policy and the risk existing in the real world. Because of that complexity and the lack of consumer bargaining power, state regulators scrutinize almost every piece of text developed by insurers before it can legally be sold in each state. They have the power to veto language they deem too confusing, too complicated, or too narrow, and to enforce rate reductions where appropriate.

For that reason, surplusage is an underwriter's worst enemy. Too much of it in a coverage grant, and the policy accepts too much risk for the company to make money. Too much of it in an exclusion, and regulators will deny approval (or enforce a rate reduction), both of which negatively influence the company's balance sheet. Insurance-

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125 *Id.* at *4.

126 Santo's Italian Café v. Acuity Ins. Co., 15 F.4th 398, 404 (6th Cir. 2021).

127 *Id.*

policy drafters strive for *precision*, not to cover as many bases as possible or to employ a "belt and suspenders" approach.

Thus, it is a mistake for courts to brush off variances across policies, as many of them have been doing. This is particularly true in this context, where some insurers chose to use virus exclusions, and others did not. Those variances are either competitive choices (which the courts should respect) or they are underwriting failures (which the courts lack authority to cure). Either way, policies that lack a virus or pandemic exclusion must be construed to provide coverage.

VI. CONCLUSION

Insurers have always intended the words "physical loss" to cover deprivations, dispossessions, and other injuries to possession and control—so long as they are caused by a physical force. Pandemics and viruses (and the government edits responding to them) are undeniably physical. Where an insurer has included a clear exclusion in its policy, that insurer's rights ought to be respected. But by the same token, where insurers have *not* included such language, the policyholder's right to broader coverage must also be respected.

Currently, most courts are not doing this when it comes to loss caused by the SARS-CoV-2 virus and the COVID-19 pandemic. They are treating policies with (and without) virus exclusions as providing identical coverage. This violates not only basic principles of insurance law, but also fundamental tenets of contract law—that using terms in one contract, but not in another, is significant.

There is still time to reverse course and return to these basic principles. Most state appellate courts (the ultimate arbiters of insurance law) have not weighed in on this issue.

The authors' sincere hope is that, when they do, they give due respect to not only the text of the term "physical loss," but also to what the insurance industry plainly intended that term to mean.