

# Memorandum

## COVID-19 and Insurance Coverage: “Physical Damage” By a Covered Peril

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As the respiratory illness known as coronavirus disease 2019 (“COVID-19”) spreads across the globe, so too are its major impacts on businesses, financial markets, and international trade and commerce. Business are confronting a range of losses related to the World Health Organization-declared pandemic and will look to insurance to cover those losses. While insurers’ coverage decisions will be fact-specific and based on the terms and conditions of the relevant policy, whether there has been physical damage caused by a covered peril is likely to be at the forefront of early disputes.

### Business Interruption Coverage

Policyholders will reflexively look to business interruption coverage when normal business operations are interrupted. Commercial property insurance policies often insure against a loss of business income caused by covered physical damage to the insured’s own property. In the context of COVID-19-related losses, disputes may arise as to whether the loss of use of property that has become uninhabitable or unusable because of COVID-19 contamination sustained a “physical loss” for purposes of business interruption coverage. In instances where a facility is quarantined or closed down in an attempt to minimize the spread of COVID-19, policyholders are likely to argue that the “physical loss or damage” requirement has been satisfied for business interruption coverage purposes.

In other contexts, courts have ruled that property contamination caused by harmful airborne particles are sufficient to constitute direct physical loss. *See, e.g., Sullivan v. Standard Fire Ins. Co.*, 956 A.2d 643 (De. 2008) (mold contamination constitutes a physical loss under property policy); *Farmers Ins. Co. of Oregon v. Trutanich*, 858 P.2d 1332 (Or. Ct. App. 1993) (pervasive odors from amphetamine laboratory are a direct physical loss); *Matzner v. Seaco Ins. Co.*, 9 Mass. L. Rptr. 41 (Mass. Super. Ct. 1998) (direct physical loss or damage encompasses carbon monoxide contamination); *Motorists Mut. Ins. Co. v. Hardinger*, 2005 WL 1163426 (2d Cir. 2005) (presence of E. coli in water well of residence, which caused physical illness to inhabitants, could constitute physical loss or damage to property); *Gregory Packaging Inc. v. Travelers Prop. Cas. Co. of Am.*, 2014 WL 6675934 (D.N.J. Nov. 25, 2014) (release of ammonia in building constituted direct physical loss because it “physically transformed” the air and rendered the property unusable). These courts have reasoned that “physical loss or damage” may include changes or alterations to property that are intangible and/or invisible to the naked eye.

However, this body of case law is not necessarily controlling in the context of COVID-19-related closures. The question of whether the presence of COVID-19 in insured property is deemed to constitute “physical loss or damage” will ultimately depend several factors, including most significantly, the particular facts related to the property at issue, applicable policy language, and governing law. Additionally, the question of whether COVID-19 contamination can be classified as “physical” will turn on the scientific consensus that develops around the virus and its transmission. To the extent that contamination has occurred through accumulation of microscopic viral particles on surfaces, such as floors, desks and equipment, or through ventilation systems, a policyholder will make a case for “physical loss or damage.” Conversely, where business closures have occurred preventatively prior to any actual contamination, or where policies limit the scope of insured property in important respects, coverage may be unavailable. See *Universal Image Productions, Inc. v. Federal Ins. Co.*, 475 F. App’x 569 (6th Cir. 2012) (insured did not suffer “direct physical loss or damage” as a result of mold and bacterial contamination in ventilation system because premises were not rendered completely uninhabitable and because policy defined “building” and “personal property” to exclude “air, either inside or outside of a structure”).

In addition to the physical loss condition, most policies will require the damage to be caused by a “peril not otherwise excluded” in order to trigger business interruption coverage. Therefore, policy exclusions may preclude coverage for business interruption losses, even where such losses arise from physical loss. Moreover, if losses are arguably caused by a combination of multiple factors, coverage decisions will become significantly more complicated, likely involving application of ensuing loss and concurrent causation provisions. Finally, regardless of causation, valuation issues relating to proof and extent of business interruption loss are likely to create complicated litigation issues.

### **Contingent Business Interruption Coverage**

Property insurance policies also typically include provisions that insure against a loss resulting from interruption to a policyholder’s supply chain or network because of damage to the supplier’s property. Contingent business interruption coverage insures against losses sustained by an insured’s supplier, distributor or customer, rather than the policyholder itself. Given the reality of today’s global economy, contingent business interruption provisions are likely to be implicated in losses stemming from COVID-19-related closures. All of the same issues that are likely to arise in the context of business interruption coverage are similarly present in the contingent business interruption coverage context.

The outcome of any such COVID-19 litigation will undoubtedly be fact-dependent, based on an evaluation of applicable policy language as applied to the record presented, and in accordance with governing jurisdictional law. Overall, early on industry observers do not foresee a major effect on the property insurance market from insured claims. According to Moody’s, “global P&C commercial lines exposure is limited with modest insured losses relative to economic losses.” With respect to the domestic market, Fitch Ratings predicts that COVID-19 is unlikely to have an “adverse impact on financial results reported by U.S. P&C companies, nor their ratings,”

explaining that “the nature of insured commercial exposures, along with restrictive language embedded in policy contracts, will likely limit U.S. P&C companies from a material level of claims.” See <https://www.propertycasualty360.com/2020/03/13/u-s-pc-insurers-face-limited-exposures-from-coronavirus/?slreturn=20200214150727>.

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