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Catastrophic Loss

Commercial Property Policies Are Hardly A Panacea For COVID-19 Business Interruption Losses

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A commentary article reprinted from the September 2020 issue of Mealey's Litigation Report: Catastrophic Loss

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Commentary

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I. An Introduction To COVID-19 Claims Under Commercial Property Policies

Commercial property insurance covers businesses and organizations for damage to their physical structures and contents due to a covered loss. The two major categories of such policies are "named peril" and "all risk." Policyholders will face numerous challenges in obtaining business interruption coverage for COVID-19 claims because property policies are not designed to cover pandemic losses and such losses often will be excluded in the policy or otherwise not fall within the terms of coverage. Some policies may provide limited coverage by special extension or endorsement usually with relatively low sub-limits. As with most claims, the subject policy must be reviewed to make determinations regarding coverage as applied to the claim-specific facts.

Several types of COVID-19 related claims are being noticed or subject to coverage litigation, including first-party business interruption claims, ingress/egress claims where the policyholder claims that access to insured property is impacted by government restrictions, interruption claims predicated on loss of use and business interruption claims based upon state or local governmental orders requiring businesses to shut down entirely or to limit operations (*e.g.*, restaurants allowed only to be opened by drive-through or carry-out orders), and contingent business interruption coverage claims where a policyholder's supply chain was cut-off or limited where a supplier closed due to a COVID-19 incident or ordinance and the policyholder can no longer obtain all the supplies or materials it needs to continue operations and supply its customers or clients.

Although policyholders from many industries have filed the more than a thousand business interruption/business loss claims arising out of COVID-19 as of August 5, 2020, the food service and health care services industries are leading the charge in this first round of litigation. Lawsuits has been filed in state and federal courts across the country, with many seeking class action certification or involving multiple parties. Many complaints have asserted claims of bad faith in addition to asserted breach of contract and declaratory relief claims.

II. Tracking Legislative And Regulatory Developments

It is always important for insurers and policyholders to ascertain legislative and regulatory developments that may impact claims presentation, claims handling, and coverage determinations. However, in view of the scope of the pandemic, the extent of its impact, and unique

challenges presented, the regulatory rules and advisories, and the legislative proposals have preceded at a fast and furious pace.

At the federal level, the Pandemic Risk Insurance Act of 2020 (H.R. 7011) was introduced in the summer of 2020 in the U.S. House of Representatives. The proposed legislation would establish a federal backstop for business interruption and event cancellation losses resulting from a future pandemic or public health emergency declared on or after January 1, 2021. It would not apply retroactively to the instant COVID-19 pandemic. To trigger the act, a covered public health emergency would be certified by the Secretary of Health and Human Services. The proposed legislation, as currently constructed, would establish a federal backstop for pandemic insurance industry losses. The bill would have similar features to the Terrorism Risk Insurance Act and losses in excess of an individual insurer's deductible would be shared between the federal government and the individual insurer, with the government paying 95%. The program would be triggered when industry losses exceed the $250 million threshold and aggregate losses would be capped at $750 billion in a calendar year for both insurers and the government. In return for a federal backstop on pandemic losses, insurers would agree to make available business interruption insurance coverage for insured losses.

Additionally, the Business Interruption Relief Act of 2020 was introduced to create a "Business Interruption Relief Program" to reimburse insurers that voluntarily paid COVID-19 business interruption claims under policies that include coverage for civil authority shutdowns, but exclude virus-related loss.

More problematic are the legislative proposals in several states. Some of these proposals would, by legislative fiat, retroactively require insurers provide business interruption insurance under policies that expressly exclude coverage for virus claims and/or that do not apply due to lack of direct physical loss or other policy requirements not being satisfied. *See generally* Seaman, S.M. and Selby, J.A., "Tracking The Flurry Of COVID-19 Related Legislative & Regulatory Activity Impacting Insurers" *Mealey's Litigation Report: Catastrophic Loss*, Vol. 15, No. 7 (April 2020).

There has also been considerable regulatory activity that should be consulted with respect to COVID-19 related claims under various lines of coverage. *See, e.g.*, Hinshaw & Culbertson LLP, *On the Law Series*, Vol V: *Workers' Compensation Law Exclusive Remedy, Exceptions, Third-Party Action Over Claims & Covid-19 Developments: A Fifty-State Survey* (1st Ed. 2020).

III. An Overview Of Fundamental Coverages And Policy Requirements

The starting point for analysis of coverage for business income loss is the policy language. Some commercial first-party policies are form policies, while others are manuscript policies. Even form policies may contain manuscript or customized coverage extensions, exclusions, and endorsements. Accordingly, it is important to review the entire policy.

The ISO commercial property business income form, for example, generally states:

> 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 premises which are described in the Declarations and for which a Business Income Limit Of Insurance is shown in the Declarations. . ..

A. The Requirement Of Direct Physical Loss Or Damage

The requirement of direct physical loss or damage will be a significant hurdle for a policyholder to clear when seeking coverage for any alleged business interruption loss under a commercial property policy. COVID-19-related losses experienced by businesses are typically due to causes other than physical property damage – namely, businesses not producing goods and services voluntarily attributable to a variety of factors, most notably government stay at home orders or directives. Such losses are not physical damage to insured property.

Direct physical loss or damage generally requires a material change or alteration of the insured property which degrades or impairs its function. The party claiming a loss must demonstrate that the property was physically damaged in order to trigger coverage. One example of this comes from the Third Circuit Court of Appeals' decision in *Port Authority of N.Y.*

& N.J. v. Affiliated FM Ins. Co., 311 F.3d 226, 233 (3rd Cir. 2002). There, the policyholder contended that the mere presence of asbestos in commercial structures accessible to the public constituted physical loss or damage. In rejecting that argument, the Third Circuit found that, if an otherwise undesirable element present in or on property does not impair the utility of the property, there exists no physical loss or damage. 311 F.3d at 235-36. The court held that physical damage to property requires "a distinct, demonstratable and physical alteration of its structure," and then set the requirement that the level of the asbestos fibers had to exceed governmental regulations or standards. Because testing did not reveal asbestos fibers in the air above set standards, the asbestos did not cause any degradation or impairment to the property. The Third Circuit found that no physical damage had been established, baring coverage.

Most jurisdictions hold that absent that distinct, demonstratable, and physical alteration, direct physical loss or damage does not exist as a matter of law. *See, e.g., Source Food Technology, Inc v. United States Fidelity & Guar. Co.*, 465 F.3d 834, 836 (8th Cir. 2006) (applying Minnesota law) (holding that a USDA prohibition on importing beef product did not constitute physical loss or damage absent evidence the beef product itself incurred physical damage); *Leafland Group-II v. Insurance Co. of North America*, 881 P.2d 26, 28 (N.M. 1994) (holding that a loss of building value does not constitute physical loss or damage); *Great Northern Ins Co. v. Benjamin Franklin Sav. & Loan Ass'n*, 793 F.Supp. 259, 264 (D. Or. 1990) *aff'd* 953 F.2d 1387 (9th Cir. 1992) (applying Oregon law) (same).

When addressing whether the presence of a contaminant amounts to direct physical loss or damage, the policyholder must show that contamination of the property is such that its function is nearly eliminated, destroyed, or rendered useless or uninhabitable. In most instances, however, policyholders will not be able to prove that the virus actually existed on any surface of the building, even if they are able to show when, where, and for how long any infected person was in the building. Further, even if the virus was shown to exist on a building's surface, the presence of COVID-19 does not materially change or alter its structure. *See, e.g., Universal Image Prod. Inc. v. Chubb Corp.*, 703 F.Supp.2d 705, 710 (E.D. Mich. 2010) (applying Michigan law) (holding odor caused by bacterial contamination in building duct work did not constitute direct physical loss or damage where insured failed to show that it suffered any structural or any other tangible damage to the insured property; "even physical damage that occurs at the molecular or microscopic level must be 'distinct and demonstrable.'"). *See also Mastellone v. Lightning Rod Mut. Ins. Co.*, 884 N.E.2d 1130, 1139-1140 (Ohio App. Ct. 2008) (affirming lower court's ruling that dark staining from mold did not constitute physical loss where removed could be removed from wood surface by chemical treatment); *Great Northern Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan Ass'n*, 1992 U.S. App. Lexis 1593, *3-4 (9th Cir. 1992) (applying Oregon law) (asbestos contamination did not constitute direct physical loss since it did not physically alter the building).

Even if a policyholder could prove that COVID-19 was present on its property, the function of the building surface has not been degraded or impaired, and within hours, the virus is no longer viable. Further, it can be readily eradicated within those hours by wiping or spraying the surface with a disinfecting agent or soap. Where the surface of property can be cleaned such that the property was never altered, then a strong argument exists that it has suffered no direct physical damage. *See, e.g., Mama Jo's Inc. v. Sparta Ins. Co.,* No. 18-12887, D.C. Docket No. 1:17-cv-23362-KMM (11th Cir. Aug. 18, 2020) ("We conclude that the district court correctly granted summary judgment on [the insured's] cleaning claim because, under Florida law, an item or structure that merely needs to be cleaned has not suffered a 'loss' which is both 'direct' and 'physical'"). Policyholder arguments regarding the impact of air conditioning and heating systems on airborne virus particles does little to advance their quest to establish direct physical damage.

In order to constitute "direct physical" damage, there must be some permanency and not just a temporary impairment. Policyholders may rely upon cases involving intangible losses to property, such as smoke, odors, and gases, to support their claim that property potentially affected by the virus is physically damaged. However, courts appear to universally require the policyholder's property to be physically affected in some way. The facts will vary from claim to claim, and policyholders will undoubtedly advance creative arguments in support of their claims, supported by some prior decision. *See, e.g., Western Fire Ins. Co. v. First Presbyterian Church*,

437 P.2d 52 (Colo. 1968) (holding that a church building sustained direct physical loss or damage when it was rendered uninhabitable because of the accumulation of gasoline under and around the church; *Hughes v. Potomac Ins. Co.*, 18 Cal. Rptr. 650 (Cal. Ct. App. 1962) (ruling that coverage applied where a landslide resulted in the loss to plaintiffs of a block of earth 30 feet wide and 100 feet long, and deprived them of subjacent and lateral support essential to the stability of their otherwise undamaged house); *Motorists Mut. Ins. Co.* v. *Hardinger*, 131 F. App'x 823, 826-27 (3rd Cir. 2005) (applying Pennsylvania law) (holding that there were issues of fact as to whether direct physical damage existed and the functionality of a home was nearly eliminated or destroyed because *E. coli* was present in a homeowner's well, but had not yet caused damage); *Mellin v. Northern Security Insurance Co.*, 115 A.3d 799, 805 (N.H. 2015) (remanding and noting that cat urine odor could constitute direct physical loss); *Farmers Ins. Co. v. Trutanich*, 858 P.2d 1332, 1335 (Or. Ct. App. 1993) (denying insurer's summary judgment motion as issue of fact exists as to whether odors from a neighboring methamphetamine laboratory constitutes physical loss); *Gregory Packaging, Inc. v. Travelers Prop. & Cas. Co. of America*, 2014 U.S. Dist. Lexis 165232, *17 (D.N.J. 2014) (applying New Jersey law) (holding release of ammonia refrigerant constitutes direct physical loss because it rendered the refrigeration facility physically unfit for occupancy); *Columbiaknit, Inc. v. Affiliated FM Ins. Co.*, 1999 U.S. Dist. Lexis 11873, *18-19 (D.Or. 1999) (finding an issue of fact as to whether a pervasive, persistent odor from mold damage constitutes direct physical loss); *Matzner v. Seaco Ins. Co.*, 1998 Mass. Super. Lexis 407, *12-13 (Mass. Super. Ct. 1998) (holding carbon monoxide contamination constitutes direct physical loss even though it did not produce tangible damage to the structure of insured property).

As discussed further below, some policies contain endorsements or provisions that cover non-physical damage for limited purposes such as crisis management coverage, coverage for interruption by communicable disease, or cancellation of events or bookings coverage. Any such provisions must be reviewed carefully to determine their breadth, including whether they may be extended to cover upstream or downstream losses due to closure of supplier or customer locations due to fear of infectious diseases. These provisions often apply only where there is actual – not suspected – presence of communicable diseases at the policyholder's location, and they may require the issuance of a governmental order, specific to the location, after the actual presence of communicable disease is discovered. Further, such provisions will likely contain sub-limits and other limitations.

B. Timing Issues

Timing issues may be important in assessing coverage for some COVID-19-related claims for purposes beyond determining whether a policy is triggered or whether claims-made requirements are satisfied.

Even if the presence of the virus constitutes damage to property, any such damage likely would be limited and fleeting. On March 17, 2020, the NIH published a study of the COVID-19 virus that concluded that the virus may remain viable on surfaces from two hours to 72 hours (usually less) depending upon the type of surface. Further, the virus cannot penetrate the skin of a person who touches a surface containing a droplet of the viable virus. The droplet of viable COVID-19 must enter the mouth, nose, or eyes to infect an individual. The limited viability period often would mean that there is no coverage whatsoever under policies that provide that the period of coverage or restoration does not begin for 72 hours after the time of direct physical loss or damage for business interruption coverage.

In any event, coverage usually ends when the property could reasonably be repaired or remediated, which presumably would be no later than (and usually considerable sooner than) the end of the 72-hour virus viability period, and likely much earlier – possibly within minutes or hours – bearing in mind that most policies require the insured to act with "reasonable speed" during the restoration period. Even where there is remediation, it would appear to be generally limited to cleaning surfaces and perhaps testing. It is important to note that studies are ongoing with respect to COVID-19 and the science is evolving.

Additionally, civil authority coverage for business income, under many policies, will not begin until 72 hours (or some other period) after the time of the first action of civil authority that prohibits access to the described premises, and only apply for a period of up to two or four consecutive weeks from the date on which such coverage began. Courts routinely enforce

the terms of waiting periods as written. *See BY Dev., Inc. v. United Fire & Cas. Co.*, 2006 U.S. Dist. LEXIS 14703 (D.S.D. Mar. 14, 2006) (applying South Dakota law) (holding that policyholder was not entitled to recover business income and extra expenses under policy's civil authority coverage because access to the insured property was not prohibited for the 72 hours necessary before coverage would have been triggered); *Abner, Herrman & Brock, Inc. v. Great N. Ins. Co.*, 308 F. Supp. 2d 331 (S.D.N.Y. 2004) (applying New York law) (ruling civil authority coverage applied only to the four-day period when access to the insured property was prohibited); *54th St. Ltd. Partners, L.P., v. Fid. and Guar. Ins. Co.,* 306 A.D.2d 67, 763 N.Y.S.2d 243, 244 (N.Y. App. Div. 2003) (holding that a civil authority provision applied only to the two days when access to the premises was denied and did not apply to the days thereafter because, although vehicle and pedestrian traffic to the premises was diverted, access was not denied to the public, employees, or vendors).

C. Causal Connection

To establish a time element claim either for business interruption, civil authority, or ingress/egress, a policyholder must establish a causal nexus between covered physical damage and the loss of income. The civil authority order or lack of ingress/egress must have been due to physical damage of type insured in the policy, which prevents access to the business and which often times must have happened within a specified distance of the business. *Dictiomatic, Inc. v. United States Fidelity & Guaranty Co.*, 958 F. Supp. 594, 602 (S.D. Fla. 1997) (applying Florida law) (ruling to recover for business interruption policyholder must sustain damage to covered property); *Gregory v. Continental Ins. Co.*, 575 So. 2d 534, 539 (Miss. 1990) (stating to recover for business interruption, policyholder's premises must have suffered covered physical damage); *Thriftmart, Inc. v. State Farm Fire & Casualty Co.*, 558 N.W.2d 531, 537 (Neb. 1997) (ruling expenses not related to interruption of business caused by damage to covered property are not covered under policy's extra expense provision); *730 Bienville Ptnrs Ltd. v. Assurance Co. of Am.*, 2002 U.S. Dist. LEXIS 18780, 2002 WL 31996014 (E.D. La. 2002) (applying Louisiana law) (ruling civil authority provision did not apply to a Louisiana hotel whose business was affected by the FAA 9/11 airport closure order because access to the hotel was not "prohibited" by any order).

Similarly, for income loss or gross earnings coverage, the interruption of business operations must have been necessarily caused by the covered physical damage. *The Port Authority of New York & New Jersey v. Affiliated FM Ins. Co.*, 245 F. Supp.2d 563, 579 (2001) (applying New Jersey law). *See also National Children's Expositions Corp. v. Anchor Ins. Co.*, 279 F.2d 428, 431 (2d Cir. 1960) (applying New York law) (determining no coverage for business interruption claim related to reduced attendance at an exhibition due to an unprecedented snowstorm because there was no direct physical damage to the insured property); *Witcher Const. Co. v. St. Paul Fire & Marine Ins. Co.*, 550 N.W. 2d 1, 6-7 (Minn. Ct. App. 1996) (holding where an explosion that happened four blocks from the policyholder's construction project did not damage construction project, policyholder was not entitled to coverage for losses attributable to construction delays so that experts could inspect the project to determine whether there had been any structural damage); *Howard Stores Corp v. Foresmost Ins. Co.*, 453 N.Y.S.2d 682 (N.Y. 1982) (ruling no coverage for business interruption loss for two stores where no damage occurred); *Harry's Cadillac-Pontiac-GMC Truck Co. v. Motors Ins. Corp.*, 126 N.C.App. 698, 702 (N.C. Ct. App. 1997) (holding no business interruption loss where alleged losses were caused not by physical loss or damage but by inability to access dealership after snowstorm); *Bros., Inc. v. Liberty Mut. Fire Ins. Co.*, 268 A.2d 611 (D.C. 1970 (ruling no coverage for business interruption losses that allegedly resulted from a curfew imposed by city ordinance during the civil disturbances in the 1960s where the policyholders failed to allege and prove damage or destruction to the insured property); *Two Caesars Corp v. Jefferson Ins. Co.*, 280 A.2d 305 (D.C. 1971) (same); *United Airlines, Inc. v. Ins. Co. of the State of Penn.*, 385 F. Supp. 2d 343, 349 (S.D.N.Y. 2005) (ruling no coverage for system wide shut down because no physical loss or damage); *Roundabout Theatre Co. v. Continental Casualty*, 751 N.Y.S.3d 4, 13 (N.Y. 2002) (holding off-site property damage in which theater became inaccessible to the public precluded coverage for business interruption loss since there was no damage to insured property); *St. Paul Mercury Ins. Co. v. Magnolia Lady, Inc.*, 1999 U.S. Dist. Lexis (N.D. Miss. 1999), *7 (applying Mississippi law) (holding no business interruption coverage resulting from structural damage to a bridge that provided only access to the insured hotel); *Source Food Technology, Inc. v. United States Fid. & Guar. Co.*, 465 F.3d 834 (8th Cir. 2006) (applying

Minnesota law) (ruling no coverage for losses arising out of embargo preventing the importation of beef from Canada due to "mad cow" disease); *National Union Fire Ins. Co. v. Texpak Group*, 906 So.2d 300 (Fla. Ct. App. 2005) (determining no coverage for business interruption losses that did not result from the damage or destruction of covered property caused by a covered peril); *Fresh Express Inc. v. Beazley Syndicate 2623/623 at Lloyd's,* 199 Cal.App.4th 1038, 1056 (Cal. App. Ct. 2011) (rejecting policyholder's claim for business income loss due to FDA's advisory regarding E. coli in spinach because there was no nexus between the business loss and an event covered under the policy); *Commonwealth Enterprises v. Liberty Mut. Ins. Co.,* 1996 U.S. App. LEXIS 29664, *6-7 (9th Cir. 1996) (applying California law) (rejecting policyholder's claim for business interruption as even though fire initially caused interruption, the interruption was primarily caused by the discovery of asbestos contamination and not fire damage); *City of Chicago v. Factory Mut. Ins. Co.*, 2004 U.S. Dist. Lexis 4266 (N.D. Ill. 2004) (applying Illinois law) (barring business interruption claim where no direct physical loss or damage to O'Hare Airport caused the City's income losses stemming from the September 11, 2001 terrorist attacks); *Jones v. Chubb Corp.*, No. 09-6057, 2010 U.S. Dist. LEXIS 109055 (E.D. La. Oct. 11, 2010) (applying Louisiana law) (no coverage where civil authority order prohibiting access to insured property was issued in anticipation of Hurricane Gustav; coverage was not triggered by second civil authority order because the order was rescinded during the policy's waiting period).

D. Named Perils

Some commercial property policies provide coverage only for specifically identified covered perils. Under such policies, the policyholder must establish that the loss resulted from one of those covered perils. Viruses and communicable diseases typically are not covered perils. *See generally* 5 New Appleman on Insurance Law Library Edition § 41.02 (2020) ("For purposes of first-party insurance, the term "perils" thus refers to the particular fortuitous causes of physical damage to property against which first-party property insurance protects. The Insurance Services Office 'basic' 'named perils' insurance form lists 11 perils: (1) fire, (2) lightning, (3) explosion, (4) windstorm or hail, (5) smoke, (6) aircraft or vehicles, (7) riot or civil commotion, (8) vandalism, (9) sprinkler leakage, (10) sinkhole collapse, and (11) volcanic action. The ISO 'broad form' lists the following additional named perils: (12) glass breakage, (13) falling objects, (14) weight of snow, ice, or sleet, (15) water damage, and (16) collapse.").

Care should be taken to determine whether communicable disease coverage has been added by endorsement. Such coverages are usually limited and, for example, may contain sub-limits, apply only to scheduled premises and diseases defined with specificity, and/or require an order from a designated governmental health agency. *See Catholic Med. Ctr. v. Fireman's Fund Ins. Co.,* 2015 U.S. Dist. LEXIS 70450 (D.N.H. 2015) (applying New Hampshire law) (ruling communicable disease coverage that applied to decontamination of premises described in the declarations did not cover decontamination of surgical instruments); *SCGM, Inc. v. Certain Underwriters at Lloyd's, Case 4:20-cv-01199*, filed April 2, 2020 (U.S. Dist. Ct. S.D. Tex.)

E. Civil Authority Orders

Some property insurance policies provide business interruption coverage where income loss results from an order of a civil authority prohibiting access to an area or property. Policyholders may argue that various government stay-at-home orders implicate such coverage where they are unable to conduct normal business operations at their premises due to such orders. The first requirement for such coverage is that there must be damage to property other than the subject property (this usually requires the other property to be within a mile of the subject property). *See, e.g., Kelaher, Connell & Conner P.C. v. Auto-Owners Ins. Co.*, No. 4:19-cv-00693-SAL, 2020 U.S. Dist. LEXIS 31081 (D.S.C. Feb. 24, 2020) (holding civil authority coverage was not triggered because there was no evidence the civil authority order was issued "because of damage or destruction" to property other than the insured property); *United Air Lines, Inc. v. Ins. Co. of State of Pennsylvania*, 439 F.3d 128 (2nd Cir. 2006) (holding civil authority coverage was not triggered because the FAA airport closure order was issued before the 9/11 attack on the Pentagon and not "as a direct result of damage" to adjacent property).

As noted above, if there is damage, the resulting loss to the subject insured property must be "caused by" an order of the civil authority that prohibits access to the described premises. If, for example, the governmental

order allows restaurants to continue operations with a drive-through, delivery, or carry-out, then there is no access prohibition. Additionally, the access to the area immediately surrounding the damaged property must be prohibited by civil authority as a result of such damage.

The civil authority prohibition of access to the "area" where the damage exists must be the result of physical damage itself, and not for the purpose of minimizing the transmission of a communicable disease. Coverage is not triggered by orders that prohibit access to specific businesses, but to the general area where those businesses are located. This does not appear to be the case with the COVID-19 governmental orders that have been issued thus far – even such orders that include a reference to "damage," most likely at the insistence of an attorney familiar with property coverage. Moreover, many of the COVID-19-related orders do not preclude operation of essential businesses. Policyholders within the category of "essential businesses" are not precluded from operating their businesses.

F. Ingress/Egress

Some policies have extensions of coverage for ingress/egress. Such extensions typically cover losses due to the necessary interruption of the policyholder's business on account of the prevention of ingress to or egress from the policyholder's property, whether or not the policyholder's property was damaged. Policyholders must establish that their property cannot be accessed due to actual physical loss or damage. *See e.g. City of Chi. v. Factory Mut. Ins. Co.*, No. 02 C 7023, 2004 U.S. Dist. LEXIS 4266, *10, (N.D. Ill. Mar. 11, 2004) *(applying Illinois_ law)* (stating "upon careful interpretation of each clause of the Ingress/Egress policy within the context of the contract as a whole, it becomes clear that the provision insures against business interruptions due to the prevention of ingress to or egress from the City's airports, provided that the prevention is the result of direct physical damage to property that is at or within 1,000 feet of the airport premises."); *County of Clark v. Factory Mut. Ins. Co.*, No. CV-S-02-1258-KJD-RJJ, 2005 U.S. Dist. LEXIS 47574 (D. Nev. Mar. 25, 2005) (applying Nevada law) (prevention of ingress to and egress from insured locations was caused by FAA stop orders, not as the direct result of physical damage as required by the policy). Policyholders will have a difficult time demonstrating that any ingress/egress is prevented due to physical damage from COVID-19.

G. Exclusions

Most commercial property policies contain exclusions that may bar or limit coverage for COVID-19-related claims. Here are some typical exclusions that should be reviewed and considered.

Exclusion Of Loss Due To Virus Or Bacteria

> **A.** The exclusion set forth in Paragraph **B.** applies to all coverage under all forms and endorsements that comprise this Coverage Part or Policy, including but not limited to forms or endorsements that cover property damage to buildings or personal property and forms or endorsements that cover business income, extra expense or action of civil authority.
>
> **B.** We will not pay for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease.
>
> However, this exclusion does not apply to loss or damage caused by or resulting from "fungus", wet rot or dry rot. Such loss or damage is addressed in a separate exclusion in this Coverage Part or Policy.
>
> **C.** With respect to any loss or damage subject to the exclusion in Paragraph **B.**, such exclusion supersedes any exclusion relating to "pollutants".
>
> **D.** The following provisions in this Coverage Part or Policy are hereby amended to remove reference to bacteria:
>
> > **1.** Exclusion of "Fungus", Wet Rot, Dry Rot And Bacteria; and
> >
> > **2.** Additional Coverage - Limited Coverage for "Fungus", Wet Rot, Dry Rot And Bacteria, including any endorsement increasing the scope or amount of coverage.
>
> **E.** The terms of the exclusion in Paragraph **B.**, or the inapplicability of this exclusion to a particular loss, do not serve to create coverage for any loss that would otherwise be excluded under this Coverage Part or Policy.

Fungi or Bacteria Exclusion

A. The following exclusion is added to Paragraph 2. Exclusions of Section I . Coverage A.

Bodily Injury And Property Damage Liability:

2. Exclusions

This insurance does not apply to:

Fungi Or Bacteria

> a. "Bodily injury" or "property damage" which would not have occurred, in whole or in part, but for the actual, alleged or threatened inhalation of, ingestion of, contact with, exposure to, existence of, or presence of, any "fungi" or bacteria on or within a building or structure, including its contents, regardless of whether any other cause, event, material or product contributed concurrently or in any sequence to such injury or damage.
>
> b. Any loss, cost or expenses arising out of the abating, testing for, monitoring, cleaning up, removing, containing, treating, detoxifying, neutralizing, remediating or disposing of, or in any way responding to, or assessing the effects of, "fungi" or bacteria, by any insured or by any other person or entity.

This exclusion does not apply to any "fungi" or bacteria that are, are on, or are contained in, a good or product intended for bodily consumption.

* * *

C. The following definition is added to the Definitions Section:

"Fungi" means any type or form of fungus, including mold or mildew and any mycotoxins, spores, scents or byproducts produced or released by fungi.

Communicable Disease Exclusion

A. The following exclusion is added to Paragraph 2. Exclusions of Section I – Coverage A – Bodily Injury And Property Damage Liability:

> 2. Exclusions This insurance does not apply to: Communicable Disease "Bodily injury" or "property damage" arising out of the actual or alleged transmission of a communicable disease. This exclusion applies even if the claims against any insured allege negligence or other wrongdoing in the:
>
> a. Supervising, hiring, employing, training or monitoring of others that may be infected with and spread a communicable disease;
>
> b. Testing for a communicable disease;
>
> c. Failure to prevent the spread of the disease; or
>
> d. Failure to report the disease to authorities.

Pathogen Exclusion

(1) This Insurance does not apply to "bodily injury", "property damage", "personal and advertising injury" or medical expenses arising out of:

> a. Any "organic pathogen";
>
> b. Any substance, vapor, or gas produced by or arising out of any "organic pathogen";
>
> c. Any material, product, building component, building or structure that contains, harbors, nurtures or acts as a medium for any "organic pathogen"; or

(2) The costs of testing for, monitoring, abatement, mitigation, removal, remediation, or disposal of "organic pathogen(s).

This exclusion also applies to:

> a. Any supervision, instructions, recommendations, warnings or advise given or which should have been given in connection with the above; and
>
> b. Any obligation to share damages with or repay someone else who must pay damages because of such injury or damage. The above applies regardless of any other direct or indirect cause, including material, product, or building components that contributed concurrently or in any sequence to such injury or damage.

For the purpose of this endorsement, the following definition is added: "Organic pathogen(s)" means

> any type of bacteria, virus, fungi, mold, mushroom, or mycotoxin, or their spores, scent, by products, or any reproductive body they produce.

Additionally, many policies contain various forms of pollution or contamination exclusions. The applicability of a pollution exclusion often will depend upon whether a virus will be considered a pollutant. This analysis will depend on how "pollutant" is defined in the policy and also how the relevant jurisdiction has interpreted the scope of "pollutant." Jurisdictions vary as to how narrow or broadly a pollution exclusion is interpreted. *Compare First Specialty Ins. Corp. v. GRS Mgmt. Assocs.*, No. 08-81356-CIV-MARRA, 2009 U.S. Dist. LEXIS 72708, *12-14 (S.D. Fla. Aug. 17, 2009) (applying Florida law) (holding insurer had no duty to defend or indemnify insured homeowners association for claim arising out of child's contraction of the Coxsackie virus from community pool; coverage was barred by the pollution exclusion, which defined pollutant as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. . .;" "substance in the pool was a viral contaminant and a harmful microbe."); *with Paternostro v. Choice Hotel Int'l Servs. Corp.*, No. 13-0662, 2014 U.S. Dist. LEXIS 161157, *78-9 (E.D. La. Nov. 14, 2014) (applying Louisiana law) (holding, based on same definition of pollutant as in *GRS Mgmt. Assocs*., bacteria legionella and pseudomonas aeruginosa do not qualify as pollutants; "these microbial agents are bacteria, not pollutants as is generally understood").

Policies also may contain a government action exclusion, whichtypically is limited to the government's seizure and destruction of property. Whether exclusions of this type may apply will depend on close scrutiny of factual circumstances and policy language. Some policies contain an ordinance or law exclusion. *State Farm Fire & Cas. Co. v. Metro. Dade Cnty.*, 639 So. 2d 63 (Fla. Dist. Ct. App. 1994) (holding policy exclusions for loss caused by the enforcement of ordinances or laws regulating home construction were clear and unambiguous and precluded coverage for costs of post-hurricane building code upgrades and home elevation alterations); *Kao v. Markel Ins. Co*., 708 F.Supp. 2d 472 (E.D. Pa. 2010) (applying Pennsylvania law) (ruling government acts exclusion did not apply where a warrant was not lawfully executed); *Brandywine Flowers, Inc. v. W. Am. Ins. Co.*, Civil Action No. 92C-04-196, 1993 Del. Super. LEXIS 103 (Super. Ct. Apr. 19, 1993) (ruling no business interruption coverage for losses attributable to zoning and land use laws).

H. Sue And Labor

Some policies may contain coverage for sue and labor, which applies to expenses incurred by the policyholder in the event of eminent physical loss or damage covered by the policy. Policyholders generally must establish that the physical damage was of the type insured by the policy and caused by a covered peril. Policyholders will likely have a difficult time demonstrating they were attempting to prevent covered physical damage.

I. Other Issues

The above discussion provides an overview of some of the coverage issues expected to be presented with respect to COVID-19 related business loss claims. It is not intended to be an exhaustive discussion of all issues or cases. Indeed, several other issues may be presented such as issues of concurrent/anti-concurrent causation. *See*, *e.g*., Seaman, S., Selby, J., and Ferlazzo, M., "Property Coverage for Riot-Related Claims Is Not Automatic Law 360 (*Portfolio Media* June 18, 2020). In addition, policyholders will face considerable challenges and limitations in attempting to establishing covered business loss damages.

IV. Early Pronouncements On COVID-19 Coverage Claims

Insurance commissioners of multiple jurisdictions, including Georgia, Kansas, Louisiana, Maryland, Mississippi, North Carolina, West Virginia and the District of Columbia have expressed in writing various degrees of doubt as to whether business interruption coverage is owed for losses caused by coronavirus shutdowns. *See* "Several Insurance Commissioners Wary of Business Interruption COVID-19 Claims" *Carrier Management Journal (*April 30, 2020).

On August 12, 2020, the United States Judicial Panel on Multidistrict Litigation denied motions to centralize nearly 300 COVID-19 related business interruption coverage actions filed against over 100 insurers various district courts across the country in the Northern District of Illinois and in the Eastern District of Pennsylvania. The panel concluded that an industry-wide MDL in this instance will not promote a quick resolution of these matters as the substantial convenience and

efficiency challenges posed by managing a litigation involving the entire insurance industry outweighs the limited number of common questions. The Panel also declined to create regional and state-based MDLs, but suggested cases against insurers facing a large number of suits might be suitable for MDL. It ordered briefing on the issue from the Hartford Financial Services Group Inc., Cincinnati Insurance Co., Underwriters at Lloyd's, London, and Society Insurance Co.

As of August 5, 2020, more than a thousand COVID-19 related coverage actions have been filed with numerous others expected. Motions to dismiss are pending in many of the actions. We briefly summarize some of the early trial court rulings in COVID-19 coverage actions below. However, in view of the volume of cases and the pace of the litigation, numerous decisions are likely to be rendered in the near future. Insurance professionals and practitioners must keep abreast of developments and conduct their own research.

The first substantive business interruption decision on COVID-19 related claim was a ruling in *Social Life Magazine, Inc. v. Sentinel Ins. Co. Ltd.,* No. 20-cv-3311 (S.D.N.Y.). The magazine sought a preliminary injunction requiring the insurer to immediately pay its claim. During a telephonic show-cause hearing on May 14, Judge Caproni denied the policyholder's emergency application and stated: "I feel bad for your client. I feel bad for every small business that is having difficulties during this period of time. But New York law is clear that this kind of business interruption needs some damage to the property to prohibit you from going. You get an A for effort, you a gold star for creativity, but this is not what's covered under these insurance policies." The policyholder voluntarily dismissed the case and its interlocutory appeal to the U.S. Court of Appeals for the Second Circuit.

On June 10, 2020, a federal district court in Texas granted a joint motion to dismiss filed by the policyholders and the insurer. *SCGM, Inc. v. Certain Underwriters at Lloyd's, London,* No. 4:20-CV-01199 (S.D.Tex. June 12, 2020). The policyholder sought coverage under a Pandemic Event Endorsement, which is triggered by the occurrence of certain enumerated diseases. Although the insurer did not deny the policyholder's claim, the policyholder filed suit and asserted a claim for "Breach of Contract-Anticipatory Breach/Repudiation" based on a statement by an alleged "agent" of the insurer to the policyholder's broker, stating that COVID-19 is not a named disease on the endorsement. The policyholder also asserted a common law bad faith claim based on an alleged "internal, high-level directive to automatically deny all pandemic-related business interruption claims," as well as a claim for "Gross Negligence and/or Malice." The order to dismiss was issued with prejudice.

On July 1, 2020, a Michigan state trial court dismissed COVID-19 business interruption claims brought by two restaurants in *Gavrilides Management Company v. Michigan Insurance Company,* 20-000258-CB, Michigan Cir. Ct., Ingham Cnty. (filed May 4, 2020). The court noted that the policy covers direct physical loss of or damage to property, which means something that alters the physical integrity of the property. Because the policyholder alleged only loss of use of the restaurants, the court ruled that the policy did not apply. The court further ruled that the policy's virus exclusion would apply even if physical loss or damage had been alleged. In a tactic utilized by many policyholders in recently filed business interruption lawsuits, the policyholder attempted to avoid application of the exclusion by arguing that government orders, not the coronavirus, caused the loss of use of the restaurants for dine-in services. The court stated that argument was "just simply nonsense, and it comes nowhere close to meeting the requirement that there has to be some physical alteration to or physical damage or tangible damage to the integrity of the building."

On August 6, 2020, a Washington D.C. Superior Court judge granted an insurer's motion for summary judgment while denying the insured restaurants' motion, ruling that the D.C. mayor's government closure orders did not constitute direct physical loss. *Rose's 1 LLC, et al. v. Erie Insurance Exchange*, Civ. Case No. 2020 CA 002424 B. The policyholders asserted that "the loss of use of their restaurant properties was 'direct' because the closures were the direct result of the mayor's orders without intervening action." Rejecting that argument, the court stated that the "orders were governmental edicts that commanded individuals and businesses to take certain actions. Standing alone and absent inventing actions by individuals and businesses, the orders did not effect any direct changes to the properties."

Next, the insureds argued that their losses were "physical" because the COVID-19 virus is "material" and

"tangible," and because the harm they experienced was caused by the mayor's orders rather than "some abstract mental phenomenon such as irrational fear causing diners to refrain from eating out." The court noted, however, that the policyholders offered no evidence that COVID-19 was actually present on their insured properties at the time they were forced to close, and that the mayor's orders did not have any effect on the material or tangible structure of the insured properties.

The policyholders also argued that "loss" incorporates "loss of use," which only requires that the insured be deprived of the use of their properties, not that the properties suffer physical damage. The court rejected that position, stating: "[U]nder a natural reading of the term 'direct physical loss,' the words 'direct' and 'physical' modify the word 'loss.' As such, pursuant to [the insureds'] dictionary definitions, any 'loss of use' must be caused, without the intervention of other persons or conditions, by something pertaining to matter—in other words, a direct physical intrusion on to the insured property. Mayor Bowser's orders were not such a direct physical intrusion." Finally, the court cited a number of decisions, including *Roundabout Theatre Co. v. Continental Casualty Co.*, 302 A.D.2d 1 (N.Y. App. Div. 2002), for the proposition that "courts have rejected coverage when a business's closure was not due to direct physical harm to the insured premises."

In *The Inns by the Sea v. California Mutual Ins. Co.,* 20CV001274, Cal. Superior Ct. (Aug. 6, 2020), a California superior court sustained the insurer's demurrer to the insured hotel's "entire Complaint . . .without leave to amend on the grounds that the allegations fail to state facts sufficient to constitute a cause of action." (emphasis in original). The policyholder sought business income, extra expense, and civil authority coverage for losses sustained following the issuance of various governmental orders, as well as damages for bad faith denial of coverage. At an August 4, 2020 hearing on the insurer's motion, counsel for the insurer argued, "the Court need not turn a blind eye to the realities of the pandemic and the business situation where businesses are open while this pandemic is still ongoing, and that's a result of the fact that [the government orders are] designed to keep people socially distanced and reduce the spread of the pandemic, and that is why the shelter in place is in place . . . ." Citing *MRI Healthcare Center v. State Farm General Ins. Co.,* 187 Cal. App. 4th 766, 779-80 (2010) ("A direct physical loss contemplates an actual change in the insured property then a satisfactory state, occasioned by accident or other fortuitous event directly upon the property causing it to become unsatisfactory for future use or requiring repairs to be made."), counsel further noted that the policyholder had not alleged that its business income loss was caused by direct physical damage to property, stating "at most, they've alleged a physical presence on the property of the virus and not that that has caused the business income loss."

A federal district court judge on August 13, 2020 granted an insurer's motion to dismiss a complaint filed by six barbershops in Texas. *Diesel Barbershop, LLC v. State Farm Lloyds,* No. 5:20-CV-461-DAE, 2020 U.S. Dist. LEXIS 147276 (D.C. Tex. August 13, 2020) (applying Texas law). The policyholders asserted that their inability to use insured properties because of governmental orders constituted direct physical loss under their policies. Rejecting that argument, the court stated that "[w]ithin our circuit, the loss needs to have been a distinct, demonstrable physical alteration of the property." But even if a direct physical loss had been demonstrated, the court ruled, the policies' virus exclusion would preclude coverage. Citing the exclusion's anti-concurrent causation language, the court also rebuffed the policyholders' attempt to circumvent the exclusion by arguing that governmental orders, not the virus, caused their losses. The court also ruled that the policies' civil authority coverage was not triggered, noting that such coverage "is intended to apply to situations where access to an insured's property is prevented or prohibited by an order of civil authority issued as a direct result of physical damage to other premises in the proximity of the insured's property." In conclusion, the court stated:

> While there is no doubt that the COVID-19 crisis severely affected [the policyholders'] businesses, [the insurer] cannot be held liable to pay business interruption insurance on these claims as there was no direct physical loss, and even if there were direct physical loss, the Virus Exclusion applies to bar [the policyholders'] claims. Given the plain language of the insurance contract between the parties, the Court cannot deviate from this finding without in effect re-writing the Policies in question. That this Court may not do.

On August 12, 2020, based solely on the allegations in the complaint, a Missouri federal district court denied an insurer's motion to dismiss a COVID-19 coverage lawsuit. *Studio 417, Inc. v. The Cincinnati Ins. Co.*, Case No. 20-cv-03127-SRB, (W.D.Mo. Aug. 12, 2020) (applying Missouri law). The insured hair salons and restaurants in that case are looking to recover under various policy coverages, including business income, dependent property, ingress/egress, civil authority, and sue and labor. The insurer moved to dismiss on the ground that those coverages apply "only for income losses tied to physical damage to property, not for economic loss caused by governmental or other efforts to protect the public from disease."

The court ruled that the policyholders' allegations that COVID-19 is a physical substance that lives and is active on inert physical surfaces and is emitted into the air were sufficient to allege direct physical loss. While recognizing that the relevant government orders did not completely shut down the insured restaurants or prohibit access to the insured hair salon, the court ruled that at the pleading stage, the complaint "plausibly allege[s] that access was prohibited to such a degree as to trigger the civil authority coverage," noting that the civil authority coverage provision did not specify "all access" or "any access" to the premises. Based on its reasoning in support of the direct physical loss and civil authority coverage rulings, the court also ruled that the insureds stated a claim for ingress/egress coverage. That same reasoning, along with the policyholders' allegations that they suffered a loss of materials, services, and lack of customers because of COVID-19, provided the basis for the court's further ruling that the insureds had adequately stated a claim for dependent property coverage. Finally, the court ruled the policyholders' adequately stated a claim for sue and labor coverage, based on their allegations that they incurred expenses to protect covered property by complying with government orders and suspending operations.

Importantly, the court "emphasized" that the policyholders had "merely pled enough facts to proceed with discovery" and that "all rulings herein are subject to further review following discovery." The court also stated that "[s]ubsequent case law in the COVID-19 context, construing similar provisions, under similar facts, may be persuasive" and that "[i]f warranted, [the insurer] may reassert its arguments at the summary judgment stage."

A federal magistrate judge in Florida issued a report on August 26, 2020 recommending dismissal of a restaurant's COVID-19 complaint against its insurer on the ground that government orders impacting the insured's business did not cause "direct physical loss or damage" to the property. *Malaube, LLC v. Greenwich Insurance Co.,* 20-22616-Civ-Williams/Torres (S.D. Fla. Aug. 26, 2020) (applying Florida law). The magistrate stated that the insured "only alleges that two Florida Emergency Orders forced the closure of its restaurant. . . . [C]ourts have found this to be insufficient to state a claim because there must be some allegation of actual harm." The magistrate further noted that that the insured's "allegations are insufficient to state a claim for an entirely separate reason because, when we examine the language of the insurance policy, 'direct physical' modifies both 'loss' and 'damage.' That means that any 'interruption in business must be caused by some *physical problem* with the covered property . . . which must be caused by a 'covered cause of loss.'"

On August 28, 2020, a federal district court in California granted an insurer's motion to dismiss a lawsuit brought by a Los Angeles restaurant seeking compensation for lost business and other costs related to the pandemic. *10E, LLC v. Travelers Indemnity Co.,* 2:20-cv-04418-SVW-AS (C.D. Cal. Aug. 28, 2020) (applying California law). The insured alleged that public health restrictions prohibiting access to the restaurant caused "physical damage" by "labeling of the insured property as non-essential" and "preventing the ordinary intended use of the property. Relying on *MRI Healthcare Ctr. of Glendale, Inc. v. State Farm Gen. Ins. Co.*, 187 Cal. App. 4th 766, 779 (2010), the court stated: "Under California law, losses from inability to use property do not amount to 'direct physical loss of or damage to property' within the ordinary and popular meaning of that phrase. Physical loss or damage occurs only when property undergoes a 'distinct, demonstrable, physical alteration.' . . . 'Detrimental economic impact' does not suffice." The court further noted that "[a]n insured cannot recover by attempting to artfully plead impairment to economically valuable use of property as physical loss or damage to property."

On September 2, 2020, a federal district court in Florida dismissed a dentist's COVID-19 complaint seeking coverage for decontamination costs and lost business income because of government orders. *Martinez v. Allied Insurance Co.,* 2:20-cv-00401-FtM-66NPM

(M.D. Fla. Sept. 2, 2020). The Court stated: "[The insurer asserts] that there has been: (1) no action of civil authority prohibiting access to [the insured'] dental practice premises, and (2) no damage to property within one mile of the premises from a covered cause of loss. Most importantly, [the insurer] also argues that the policy contains an exclusion for loss or damage caused 'directly or indirectly,' by '[a]ny virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease.'" The further court stated that the insured's claims for coverage under the policy's business income and civil authority provides must fail "because the loss or damage asserted was not due to a 'Covered Cause of Loss.' In fact, the policy expressly excludes insurer liability for loss or damage caused 'directly or indirectly' by any virus."

Relying on *Gavrilides* and *Diesel Barber Shop, supra*, a Michigan federal court ruled on September 3, 2020 that a chiropractor's COVID-19 complaint should be dismissed for failure to state a claim. The insured sought coverage under the policy's Loss of Income, Extra Expense, and Civil Authority provisions. In an attempt to avoid application of the policy's virus exclusion, the insured alleged that a civil authority order was the sole cause of its losses, stating that the order was issued "to ensure the absence of the virus, or persons carrying the virus, for the [insured's] premises" and "there is no evidence at all that the virus did enter [the premises] or that it had to be de-contaminated." Rejecting the insured's argument that "direct physical loss" includes "loss of use," the court ruled that the insured did not stated an "accidental direct physical loss to Covered Property," and that the Virus Exclusion would otherwise bar recovery. The insured argued that the Virus Exclusion was inapplicable because it was meant to exclude only losses related to viral, bacterial, or fungal contamination. The insured cited the 2006 ISO circular, which allegedly shows that "the [Virus Exclusion] was meant to preclude coverage for 'recovery for losses involving contamination by disease-causing agents,' and that the exclusion related only 'to contamination by disease-causing viruses." In response, the court stated that "the ISO circular is extrinsic evidence that may not be used as an aid in the construction of the unambiguous contract. Therefore, even if [the insurers] misrepresented the purpose and extent of the Virus Exclusion in 2006, the plain, unambiguous meaning of the Virus Exclusion today negates coverage." (*internal citations omitted*). The court further noted that there was no need to address Loss of Income, Extra Expense, and Civil Authority provisions because the insured failed to state a Covered Cause of Loss, a prerequisite to the application of each of those provisions.

V. Conclusion

COVID-19 is the pandemic of the Century. The enormous human and economic toll exacted by the pandemic continues to mount. The legislative and regulatory activities associated with COVID-19 have been extensive. The volume of claims and number of insurance coverage actions already is large and continuing to grow. The amounts involved are nothing short of staggering. Although the early trial court decisions are instructive, it is safe to say that the COVID-19 related coverage wars have only just begun. ■

MEALEY'S LITIGATION REPORT: CATASTROPHIC LOSS
edited by Jennifer Hans
The Report is produced monthly by

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Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
ISSN 1559-9221