'Physical Harm' v. 'Economic Loss': Past Precedent May Support 'Physical Loss' Trigger For Pandemic Business Interruption Claims

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Millions of dollars in fees have been spent, hundreds of lawsuits in as many venues have been filed, and barrels of ink have been spilled in the fight over the existence of “physical loss” arising out of the COVID-19 pandemic. Insurers have staunchly argued that loss of use and even exposure to the coronavirus do not constitute insured “physical loss or damage.” Corporate policyholders, who collectively have sustained billions of dollars in lost revenues from the COVID-19 pandemic, have maintained with equal fervor that viral contamination and civil authority orders suspending non-essential business operations trigger coverage for lost business income resulting from “direct physical loss or damage” to covered property.

What is missing, however, from this dialectic over insurance coverage is the broader context provided by decades of case law distinguishing between “economic loss” and “property damage.” With some notable exceptions, most jurisdictions determined years ago that tort liability for purely economic loss was too expansive, and as a matter of public policy, tort claims would be permitted only instances of “physical harm,” including property damage or bodily injury. *See, e.g., Seely v. White Motor Co*., 403 P.2d 145 (Cal. 1965) (holding that a truck manufacturer could be liable for physical injuries caused to person or property, but not for purely economic losses); *532 Madison Ave. Gourmet Foods, Inc. v. Finlandia Ctr., Inc*., 750 N.E.2d 1097, 1103 (N.Y. 2001) (“[L]imiting the scope of defendants’ duty to those who have, as a result of these events, suffered personal injury or property damage--as historically courts have done--affords a principled basis for reasonably apportioning liability. We therefore conclude that plaintiffs' negligence claims based on economic loss alone fall beyond the scope of the duty owed them by defendants and should be dismissed.”); *Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77, 79-80 (Tex. 1977) (holding that economic loss is not physical harm or property damage under strict liability).

It is no surprise, therefore, that commercial general liability insurance has “followed suit” in limiting coverage for exposure to tort liability for property damage (and bodily injury). But along the way, outside the context of first-party insurance claims and within the scope of adjudicating tort claims, courts have had occasion to distinguish between purely “economic loss” and the “physical harm” of “property damage”—including under circumstances roughly analogous to the current pandemic. These cases have repeatedly found that actual physical damage and structural alteration of property is not required. Contamination resulting in no visible impairment of property and even “loss of use” have been found to qualify as “physical harm” for purposes of establishing tort liability and avoiding the “economic loss rule.” *See, e.g., Good v. Am. Water Works Co*., 2016 U.S. Dist. LEXIS 138888, at *57-58 (S.D. W.Va. Oct. 6, 2016) (denying motion for summary judgment to bar claims arising out of contaminated water under the economic loss doctrine: “Put differently, the contamination of the water by an alien substance, Crude MCHM, was precisely what injured the water — the plaintiffs’ property acquired by contract - by rendering it unfit for its purpose. As to plaintiffs’ property generally, the mere fact that the contamination was temporary does not defeat an injury to property, if any there were, any more than the brevity of an illness defeats an injury to

person."); *In re Chinese Mfg. Drywall Prods. Liab. Litig*., 680 F. Supp. 2d 780, 798 (E.D. La. 2010) ("[T]he Chinese drywall is releasing contaminates, causing damage to the building and those occupying the buildings, just as the asbestos. Accordingly, there exist the same bases for allowing tort claims for economic losses in the instant matter, as there are in the in the asbestos cases."); *Messer Griesheim Indus. v. Cryotech of Kingsport, Inc*., 131 S.W.3d 457, 474 (Tenn. Ct. App. 2003) (reversing grant of summary judgment on economic loss grounds: "Guided by the Supreme Court's holding in *Saratoga*, we are compelled to conclude that the contaminated feedgas, as the product placed in the stream of commerce by Eastman, was 'the product itself' and the property of Messer and its customers which was injured as a result of contact with the contaminated carbon dioxide was 'other property.'"); *Northridge Co. v. W.R. Grace & Co.*, 471 N.W.2d 179, 184 (Wis. 1991) (reversing dismissal of asbestos contamination claims on economic loss grounds despite the absence of visible damage: "In this kind of case, no outwardly visible evidence of physical harm to the property exists. We infer from the complaint that the harm claimed is that the Monokote causes the air to contain particles of asbestos which are injurious to occupants of the buildings but invisible to the naked eye").

Of course, if the presence of a substance rendering property hazardous to health can qualify as "physical harm" and "property damage" sufficient to avoid the application of the economic loss doctrine, it is no great intellectual leap to find that the presence of a virus transforming productive business property to an unsafe and unusable condition also constitutes "physical harm" and even "property damage" for purposes of business interruption coverage in a commercial property policy. After all, "[w]hile economic loss is measured by repair costs, replacement costs, loss of profits, or diminution of value, the measure of damages does not determine whether the complaint is for physical harm or economic loss." *Northridge*, 471 N.W.2d at 931-32. To conclude otherwise would be contrary to established precedent and conceivably undermine tort claims by individuals or businesses otherwise entitled to recovery for property damage or bodily injury arising out of the COVID-19 pandemic.

Nearly a year has passed since the first losses associated with the COVID-19 pandemic began. Policyholders, who have not already pursued or preserved their business interruption claims will want to consider not only the impact of any statutory of contractual limitations periods applicable to these claims. Corporate policyholders should also consider and argue, where appropriate, how historical distinctions between "economic loss" and "physical harm," including property damage may support and facilitate the "physical loss" trigger in most commercial property policies.

If you have any questions about coverage for coronavirus-related business interruption loss or about insurance recovery in general, please contact one of Haynes Boone's Insurance Coverage Practice Group partners listed below.

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