Disclosure Affects Enforceability Of Insurers' Virus Exclusions

By **Jordan Rand** (May 6, 2020)

Jordan Rand

The virus exclusion, which now requires not even cursory explanation, hasn't always been part of the common parlance. Many policyholders had never even heard this phrase until reading it in either a recent news article or in a just-received denial of coverage letter from an insurer.

This begs a critical question: Have insurers adequately publicized the incorporation of a virus exclusion in the context of annual renewals? The law generally requires insurers to give policyholders notice of changes to, or diminutions in, coverage at renewal time. The usual consequence for a carrier's failure to do so is invalidation of the new language for which insufficient or no notice was given.

Given the relative novelty of the virus exclusion, policyholders should consider whether an insurer's failure to communicate its incorporation for the first time in connection with a renewal transaction might render it wholly unenforceable.

The Etymology of the Virus Exclusion

In 2006, largely in response to the SARS outbreak, the Insurance Services Office adopted Form CP 01 40 07 06, an amendatory endorsement regarding exclusion of loss due to virus or bacteria. In connection with the adoption of the form exclusion, ISO issued an explanatory circular dated July 6, 2006.

Though ISO did not concede that the then-new form would affect a significant change in coverage, the circular does concede that the industry had, at a minimum, ascertained a need to materially change policy language. Inarguably, the new exclusion was a significant change to the form of the overwhelming majority of, in particular, property insurance policies that had never before contained a similar provision.

ISO attempted to contextualize the exclusion as simply a clarification of the impact of longstanding pollution exclusions. The circular states: Although the pollution exclusion addresses contaminants broadly, viral and bacterial contamination are specific types that appear to warrant particular attention.

Recognizing that when "disease-causing viral or bacterial contamination occurs, potential claims involve … business interruption losses," ISO explained that:
The specter of pandemic of hitherto unorthodox transmission of infectious materials raises concern that insurers employing [property] policies may face claims in which there are efforts to expand coverage and to create sources of recovery for such losses…In light of these concerns, we are presenting an exclusion relating to contamination by disease-causing viruses or bacteria or other disease-causing microorganisms.

While insurers and policyholders may debate whether the exclusion diminished coverage that was previously subject to only standard form pollution exclusions, it seems beyond argument that a carrier's decision to incorporate a virus exclusion for the first time rises to the level of materiality that triggers an insurer's duty to disclose the change at renewal time. Indeed, the change was significant enough to warrant a memorandum from ISO to the industry doing exactly that.

Notice Requirements Upon Renewal of an Insurance Policy

Insurance law recognizes that there is seldom such thing as an arm's-length transaction between an insurer and a policyholder. Even the largest and most sophisticated companies are not always on equal footing when buying even uniquely tailored manuscript policies to which most smaller businesses do not have access.

While most policyholders purchase insurance on a take-it-or-leave-it basis, the unequal playing field on which these transactions occur has led to the insurance industry being heavily regulated.

In many states, this regulation includes requirements about what an insurer must communicate to a policyholder at the time of policy renewal. Often, policyholders purchase an initial insurance policy, and then simply renew it year after year unless and until they are offered substantial cost savings by switching to a different carrier. In many instances, companies have been with the same insurers for years or even decades. Renewal transactions are therefore somewhat rote in nature.

Regulators recognize the opportunity for mischief that is exacerbated when an already inequitable transaction catches the party with lesser bargaining power asleep at the wheel. In many states, insurance regulations therefore require insurers to clearly and conspicuously disclose not only changes to premiums in connection with a renewal transaction, but also changes in coverage. For example, New York Insurance Law 3425(d) states:
Unless the insurer, at least forty-five but not more than sixty days in advance of the end of the policy period, mails or delivers to the named insured…a written notice of its intention …to condition its renewal upon change of limits or elimination of any coverages, the named insured shall be entitled to renew the policy upon timely payment of the premium billed to the insured for the renewal. The specific reason or reasons for nonrenewal or conditioned renewal shall be stated in or shall accompany the notice.

California Insurance Law 678(a) similarly requires "[a]t least 45 days prior to policy expiration," an insurer to identify "[a]ny reduction or elimination of coverage" upon which renewal is conditioned. The majority of states have similar regulatory requirements.

Changing coverage terms at renewal is often referred to as a conditional renewal, the notion being that the insurer will renew coverage on the condition that the policyholder agree to whatever changes in the policy are being introduced at the time of renewal. These rules are grounded in regulators' desire to protect policyholders from being surprised by new changes to policies that they may have had in place for many years.

The Reasonable Expectations Doctrine

Regulatory requirements intended to protect policyholders from unannounced changes to coverage are rooted in a common law doctrine of reasonable expectations. In my home state of Pennsylvania, for example, the doctrine dictates that "[w]hen an insurer creates a reasonable expectation of coverage that is not supported by the terms of a renewal policy, the reasonable expectations of the insured will prevail."[1]

In Reliance Insurance Company v. VE Corp., a policyholder sought coverage in connection with a products liability lawsuit filed against it by a man who alleged that he was injured by carbon monoxide emissions from one of the policyholder's products. The insurer denied

coverage on the grounds of a total pollution exclusion.

That exclusion, however, was not present in the policyholder's original policy. Rather, the carrier incorporated it in the first annual renewal policy purchased by the policyholder. The insurer, however, did not provide specific notice of the new provision to the policyholder.

The U.S. District Court for the Eastern District of Pennsylvania held that the total pollution exclusion was unenforceable as contrary to VE Corp.'s reasonable expectations. As the court explained, "[e]ven the most clearly written exclusion will not bind the insured where the insurer or its agent has created in the insured a reasonable expectation of coverage."

Accordingly, "[u]nder the reasonable expectations doctrine, an insurer may not make unilateral changes to an insurance policy unless it both notifies the policyholder of the changes and ensures that the policyholder understands their significance." Rather, "[t]he insurer will be equitably estopped from asserting an exclusionary clause in a renewal policy unless it meets its burden of proving that it both notified the insured and explained the significance of the change."

At least one court has relied upon the reasonable expectations doctrine to deny an insurer's request for summary judgment on the grounds of a clearly worded virus exclusion. In Parker's Farm Inc. v. Hartford Casualty Insurance Company,[2] the U.S. District Court for the District of Minnesota deemed adequate disclosure at the time of a 2006 coverage renewal a fact question requiring a trial. The matter settled in pretrial mediation.

Conclusion

Given that the ISO form virus exclusion was not adopted until 2006, some policyholders may not have had this type of exclusion in the property insurance policies until relatively recently. For policyholders that have been with the same insurer for many years, it should be determined when the exclusion was first added. If a virus exclusion was added at the time of an annual renewal, a lack of disclosure of that fact may be a basis to invalidate even the clearest of virus exclusions.

Jordan Rand is a partner at Klehr Harrison Harvey Branzburg LLP.

The opinions expressed herein are those of the author and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Reliance Ins. Co. v. VE Corp., 2000 WL 217511 (E.D. Pa. Feb. 10, 2000).

[2] 2012 WL 13027973 (D. Minn. June 21, 2012).