

# Client Alert

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## Incapacitation of Property Constitutes “Direct Physical Loss of or Damage” Under Property Policy

On November 25, 2014, a federal court in New Jersey held in *Gregory Packaging, Inc. v. Travelers Property Casualty Company of America*, No. 2:12-cv-04418 (D.N.J. Nov. 25, 2014), that contamination of a factory by ammonia gas constituted “direct physical loss of or damage to” property under a policy of commercial property insurance even though no structural damage or other alteration occurred to the insured property.

### Background

Gregory Packaging, Inc., makes and sells juice cups. While preparing a new factory to begin production of its product, a refrigeration system malfunction occurred, releasing ammonia gas into the facility. The release and continued presence of the gas rendered the facility “physically unfit for normal human occupancy and continued use until the ammonia was sufficiently dissipated.” A third party was engaged to remediate the contamination.

Gregory Packaging sought coverage under a property insurance policy issued by Travelers Property Casualty Company of America (Travelers) for loss arising from its inability to use the property, including recovery of business interruption and clean up expenses. The policy provided that Travelers “will pay for direct physical loss of or damage to Covered Property caused by or resulting from a Covered Cause of Loss.” Travelers denied coverage, contending that “‘physical loss or damage’ necessarily involves a ‘physical change or alteration to insured property requiring its repair or replacement.’” Travelers argued that the presence of ammonia gas in the facility, without any physical damage to the structure, did not constitute the requisite “physical loss of or damage to” covered property that was necessary to implicate coverage under the policy.

Gregory Packaging filed suit against Travelers, seeking a declaration of coverage. Gregory Packaging moved for partial summary judgment on the issue of whether the presence of gas in the facility sufficiently amounted to “direct physical loss of or damage to” a covered property.

### Holding

The United States District Court for New Jersey granted Gregory Packaging’s motion for partial summary judgment, finding that the presence of ammonia gas in the facility, which rendered the facility uninhabitable and inoperable for seven days, constituted “direct physical loss of or damage to Covered Property.” The court based its ruling on case law from New Jersey state and federal courts, as well as the law of other jurisdictions. (The court found no conflict between the law of New Jersey, the corporation’s home state, and that of Georgia, the location of the damaged property.) As the court explained, a property can sustain physical loss or damage for insurance purposes without experiencing structural alteration. Indeed, in one New Jersey appellate court case, “physical damage” was determined to have occurred for purposes of triggering insurance coverage where an electrical grid was not capable of functioning even though no structural damage to any individual piece of the grid was identified. Similarly, the court discussed how courts from other jurisdictions have found “direct physical loss” where the presence of vapors rendered a structure uninhabitable. The court went on to find that the temporary incapacitation of

the insured facility was neither expected nor intended by the insured, thereby satisfying the policy requirement that the loss arose from a fortuitous event. Accordingly, the court held that the temporary incapacitation of Gregory Packaging's facility constituted "direct physical loss of or damage to" that facility. In doing so, the court rejected Travelers' argument that the "direct physical loss of or damage to" language somehow required "a physical change or alteration to insured property requiring its repair or replacement."

### **Implications**

Property insurers have long argued for a narrow and restrictive definition of the direct physical loss and damage provisions typically used in commercial property policies such that coverage is afforded only after insured property has sustained some physical "alteration" or other form of physical damage requiring repair or replacement. The decision in *Gregory Packaging* rejected that narrow view in favor of an interpretation more consistent with the ordinary expectations of policyholders. The decision views the insurance contract as providing coverage when a physical event — release of harmful gas — causes damage and requires remediation, even though "structural alteration" did not occur. The decision therefore recognizes that the scope of coverage available under standard commercial property policies should include a fortuitous loss event that interrupts the ordinary use of covered property yet causes no structural harm requiring repair or replacement. Policyholders, therefore, should pursue recovery from property insurers for losses of income or increased operating expenses even where there may not appear to be any structural alteration or damage to insured property.

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Hunton & Williams LLP's insurance recovery lawyers assist policyholders to secure the full benefits to which they are entitled in the event of any type of loss, including amounts spent to defend or settle large-scale litigation. For more information, please contact the members of the firm's Insurance Coverage Counseling and Litigation team.

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