



## Property Insurance Law Committee

### NEW JERSEY EXPANDS TRADITIONAL NOTIONS OF PHYSICAL LOSS OR DAMAGE

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New Jersey courts continue to expand traditional notions of physical loss or damage in a recent decision of the New Jersey Federal District Court, [\*Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of America\*](#), Civ. No. 2:12-cv-04418 WHW, 2014 WL 6675934 (D.N.J. Nov. 25, 2014) (J. Walls). The court held that a building suffered physical loss or damage after an ammonia release, even though there was no structural change or alteration to the property that required some degree of repair or replacement.

The [\*Gregory Packaging, Inc.\*](#) case arose out of the accidental release of ammonia during the installation of refrigeration system in a manufacturing and packaging plant in Newnan, Georgia. The ammonia burned a refrigerator installer upon release, but there were no tangible alterations or change to any of the property therein. The plant was evacuated after the release because of unsafe conditions, and government authorities arrived at the scene. Gregory Packaging hired a remediation company to dissipate the ammonia to reach a safe level for occupancy. It took approximately five (5) days for the ammonia to be dissipated to a safe level.

The plant was insured under a commercial property insurance policy issued by Travelers that provided coverage for “direct physical loss of or damage to Covered Property caused by or resulting from a covered

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Cause of Loss.” Travelers denied coverage in part because Gregory Packaging did not suffer the “direct physical loss of or damage” to property required to trigger coverage.

Gregory Packaging, headquartered in New Jersey, filed a declaratory judgment action asking the district court to find coverage, and moved for partial summary judgment on the issue of whether the ammonia release constituted “direct physical loss of or damage”. In opposition, Travelers asserted that “physical loss of or damage” involves a “physical change or alteration to insured property requiring its repair or replacement,” and not the inability to use the manufacturing and packaging plant.

In granting partial summary judgment in Gregory Packaging’s favor and rejecting Travelers’ arguments, the district court found that under both New Jersey and Georgia law, substantial evidence had been presented showing that the ammonia discharge “rendered Gregory Packaging’s facility physically unfit for normal human occupancy and continued use until the ammonia was sufficiently dissipated.” The following facts were undisputed and critical to the holding: 1) Government authorities evacuated the area for a one mile radius after the incident; 2) The responding fire department would not allow anyone in the building on the date of the release and the following day; 3) The refrigeration contractor issued a work order summary the day after the incident that the ammonia level was too high for human occupancy; and 4) The remediation company washed down the plant with water and used fans to dissipate the ammonia levels as part of its clean-up efforts.

The district court relied on the finding in *Wakefern Food Corp v. Liberty Mut. Fire Ins. Co.*, 968 A.2d 724, 727 (N.J. Super Ct. App. Div. 2009) that an electrical grid and its component parts were “physically damaged” when rendered physically incapable of performing its essential function of providing electricity. It should be noted that individual pieces of the grid experienced structural damage in *Wakefern*, but the *Gregory*

*Packaging, Inc.* court found that the *Wakefern* decision rested on the “loss of function of the system as a whole.” The opinion also cited to dicta in the Third Circuit Court of Appeal’s decision in *Port Authority of N.Y. and N.J. v. Affiliated FM Ins. Co.* that if the presence of large quantities of asbestos in the air of a building made it uninhabitable and unusable, there has been a distinct loss to the building owner that would constitute “physical loss.” 311 F.3d 226 (3d Cir. 2002). The district court found that the *Wakefern* and *Port Authority* decisions were rooted in the idea that property can be physically damaged, without undergoing structural alteration requiring repair or replacement, when it “loses its essential functionality.” The opinion also cited to cases in other jurisdictions that found buildings rendered uninhabitable by dangerous gases or by bacteria in the water supply experienced direct physical loss or damage.

The district court did not stop its analysis at stating that a building being rendered unsafe for occupancy constitutes direct physical loss or damage. The court also concluded that the ammonia release “physically transformed the air” within the plant so that it contained an unsafe amount of ammonia as an alternate ground for finding coverage to be triggered.

The opinion did not elaborate further on whether a change in the content of the air constituted “direct physical loss of or damage to” property or whether air constituted property of the type insured by the insurance policy.

In granting partial summary judgment on the issue of “physical loss of or damage to” property, the opinion cautioned that the insured still had to prove that the damage was caused by or resulted from a “Covered Cause of Loss.” That question of whether the ammonia release qualifies as a covered cause of loss is currently under review by the district court after briefing by the parties.

The *Gregory Packaging* decision represents a continued evolution of courts finding that a property can experience physical loss where rendered unfit for habitation or occupancy without accompanying physical or structural alteration even where the incapacitation is temporary. There are numerous questions that remain from this decision. For example, what chemicals or substances

“...courts in New York and New Jersey are beginning to wrestle with how best to handle the voluminous docket of insurance-related lawsuits that have been generated. This is a problem of unprecedented magnitude for the courts in these states, and steps are being taken to ensure efficient management and to provide for prompt resolution of as many cases as possible...”

would render a building unfit for occupancy? In *Universal Image Productions, LLC v. The Chubb Corp.*, by contrast, a federal district court in Michigan found that strong odors from water seepage and the presence of mold and/or bacteria in the air that caused the insured to abandon its production facility did not constitute “direct physical loss.” [703 F.Supp.2d 705, 709-10 \(E.D. Mich. 2010\)](#). Also, what testing needs to be done for a court to determine whether the air has been transformed? The *Gregory Packaging, Inc.* court did not identify a minimal time period that the property under review needs to be rendered unfit for its intended use

in order to trigger coverage. Is it one hour, one day, or more? Moreover, who makes the determination as to whether a building is rendered unfit? In *Gregory Packaging*, a fire department prohibited entry into the building on the day of the ammonia release and the following day. Would a court reach a different determination if a government authority had not prohibited entry? All these questions will continue to be pondered by courts as the scope of “direct physical loss of or damage to” property continues to be evaluated by courts in a wide variety of changing circumstances. ⚖️

