

MDS Inc. v. Factory Mutual Insurance Company: Implications for COVID-19 Business Interruption Litigation

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By Raj Datt

A recent Ontario Court of Appeal decision provides guidance for businesses and insurers involved in litigation about the inability to use machinery due to COVID-19 lockdowns.

[MDS Inc. v. Factory Mutual Insurance Company, 2021 ONCA 594](#), is an appeal about whether the insurer appellant, Factory Mutual Insurance Company (“FM Global”), is required to provide insurance coverage for losses arising from an unplanned shutdown of the Atomic Energy of Canada Limited (“AECL”) Nuclear Research Universal (“NRU”) reactor located in Chalk River, Ontario on May 14, 2009. The respondents, “MDS”, operate a global health science company.

On February 21, 2006, MDS agreed to buy radioisotopes from AECL to be produced at the NRU reactor. The radioisotopes were to be sold worldwide for cardiac imaging, cancer treatments, and sterilization of medical products. On May 14, 2009, heavy water containing radioactive tritium was discovered leaking through the calandria wall of the NRU reactor. The reactor was shut down for 15 months to repair the leak caused by corrosion. As a result of the shutdown, MDS lost its supplier of radioisotopes and lost profits of approximately \$121,248,000.

FM Global issued MDS an all-risk insurance policy which covers all risks of physical loss or damage to property and contingent time element coverage resulting from a supplier’s business interruption (the “Policy”). The Policy excluded coverage for losses caused by “corrosion”, but the term “corrosion” was not defined. The Policy included an exception from this exclusion for resulting “physical damage not excluded by this Policy” at specified locations. MDS submitted a claim for loss of profits, and FM Global denied coverage. MDS succeeded at trial and was awarded \$56,406,911.

Court of Appeal’s Decision

The Court of Appeal reversed the trial judgment and found that the claim was not covered by the Policy. The Policy excluded coverage for losses caused by corrosion. There was an exception from this exclusion for resulting “physical damage not excluded by this Policy”. The Court found that the word “corrosion” was clear and hence excluded coverage.

Further, the term “physical damage” in the exception to the exclusion clause was also clear. The Court held that it did not apply to economic losses caused by the inability to use the equipment during the shutdown. The Court disagreed with the trial judge that “loss of use” should be considered physical damage. The Court stated that Canadian authorities, including those that pertain to all-risk policies, have long held that exclusions for physical damage do not include loss of use or pure economic loss, unless otherwise specifically provided for in a policy. Further, appellate courts in both the United States and the United Kingdom have also concluded that physical damage exceptions to exclusions do not include loss of use.

Takeaways

The analysis concerning the exception for “physical damage” may have some relevance to COVID-19-related insurance litigation. A multitude of class actions and lawsuits have been commenced by policy holders to compel insurers to cover business interruption losses arising from the pandemic. Generally, insurers have denied these claims on the basis that COVID-19 does not cause any physical damage.

One of the arguments relied upon by policy holders is that “loss of use” should be considered physical damage. The *MDS* decision weighs against these arguments. As always, it will be important to carefully review the wording of the policy. The Court in *MDS* relied upon various components of the Policy to ultimately conclude that loss of use was not “physical damage”. Of course, different policy wordings or the factual matrix surrounding the inception of a policy may lead to a different result.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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