INSURANCE ISSUES IN
AN AVIAN FLU PANDEMIC

David W. Gordon, Esq.
KENNEY & MARKOWITZ L.L.P.
255 California Street, Suite 1300
San Francisco, CA 94111
Telephone: (415) 397-3100
Fax: (415) 397-3170
Email: dgordon@kennmark.com

Robert Hill
Assistant Vice President
Technology Claims Team Leader
ABD INSURANCE & FINANCIAL SERVICES
305 Walnut Street
Redwood City, CA 94063
Telephone: (650) 839-6338
Email: rob@abdi.com
INSURANCE ISSUES IN AN AVIAN FLU PANDEMIC

If the H5N1 avian influenza mutates into a strain which is transmissible among humans, the likely result would be a world-wide pandemic on a par with the Spanish Influenza of 1918-1919, the Asian Flu of 1957-1958 and the Hong Kong Flu of 1968-1969. The impact would be severe and would require the proactive risk management, HR and business continuity measures addressed in the other segments of this presentation.

The focus of this aspect of the seminar is the insurance resources which could respond in the event of a pandemic. The insurance issues will be encountered in three distinct phases: initial impact, intermediate effect and a long term third-party liability process. Each phase will present different challenges for the Human Resources, Risk Management and General Counsel departments. It should be noted that the flu outbreaks could occur more than once so the insurance phases could also recur. Lastly, it should be emphasized that the insurance industry will be affected by building closures, employee absences, etc., and that the claims process will slow down as a result.

A. Initial Impact

1. Federal Immunity and Compensation Systems

The threat of an avian flu pandemic will lead to increased administration of vaccines with the attendant risk of adverse reactions such as anaphylaxis, thrombocytopenia and encephalopathy. At present, there are two parallel federal systems within the U.S. Department of Health and Human Services, which deal with these conditions.

(a) National Vaccine Injury Compensation Program (NVICP)

This program had its origins in the National Childhood Vaccine Injury Act of 1986, 42 U.S.C. §§300aa-1 to 300aa-34. The legislation reflected concerns that vaccine injury liabilities were mounting and that pharmaceutical companies would cease manufacturing in the absence of relief.

In effect, vaccine administrators and manufacturers are granted immunity from civil suits (in the absence of willful misconduct) and, in exchange an affected individual is given access to a federal no-fault system which responds to injuries or deaths caused by vaccines. The claims process is within the jurisdiction of the U.S. Court of Federal Claims.

The NVICP was originally directed to conventional childhood immunization such as those for diphtheria, tetanus, measles, mumps, hepatitis, etc. As of July 1, 2005, the program was extended to cover claims for injuries or deaths from trivalent influenza vaccines. The term “trivalent” refers to the conventional flu vaccine routinely administered each year to deal with the three strains of virus deemed most likely to occur.
(b) Public Readiness and Emergency Preparedness Act (PREPA)

If an avian flu pandemic materializes, vaccines currently under development will be rushed into production and use. Such unconventional or experimental vaccines may carry a greater risk of adverse results and might not be subject to the NVICP if they did not come within the definition of a trivalent vaccine. The PREPA was designed specifically to deal with an avian flu outbreak, similarly grants immunity for the pharmaceutical industry and similarly provides compensation for injured individuals. This legislation was signed into law on December 30, 2005, and is found at 42 U.S.C. §§319F-3 to 319F-4.

These provisions are triggered by a specific finding of the Secretary of Health and Human Services which declares the existence of a public health emergency. The declaration must list disease(s), populations and geographic areas which are implicated. In that event, “covered countermeasures” such as vaccines cannot be the basis of a civil action and the injured individual is remanded to a recovery from the Covered Countermeasures Process Fund.

The procedures and recoverable amounts are those established by earlier legislation to deal with countermeasures against smallpox. By statute, recovery is limited to medical benefits, lost income and death benefits. There is no recovery for pain and suffering.

Human resource departments will want to be familiar with these two programs in the event of a threatened pandemic. Further information and descriptions of the claims processes appear in the websites maintained by the Department of Health and Human Services and the Health Resources and Services Administration.

2. Health Insurance

There are no significant coverage limitations on this class of insurance and it should respond conveniently with the outbreak of a pandemic. However, practical problems will arise when an overburdened health care system is unable to respond to a massive increase in patient load. The major question is whether coverage written on a preferred provider basis will honor “out-of-network” claims when employees are forced to seek any available treatment and not simply the treatment available from approved providers. These considerations involve employee communication issues for Human Resources and negotiations for in place out-of-network coverage, in the event of an emergency.

There are also longer term financial planning issues for those health care plans written on a loss experience rating system or a self-insured/stop-loss basis.

3. Disability

An individual who contracts avian influenza would be incapacitated for 10 days to two weeks which would be within the waiting period for conventional disability insurance. Prior experience with influenza epidemics indicate that long term disability is unlikely to occur as a result of the flu itself; people will either recover or die. In the latter case, however, some disability policies provide death benefits which would be triggered in the absence of a communicable disease exclusion.
Note however that long term disability could occur with an adverse reaction to vaccination.

4. **Life Insurance/Keyman Coverage**

The effect depends upon whether the policy is written to benefit individual survivors or to provide a business with a financial cushion should key personnel be lost. At the moment, there are no flu-specific limitations, but this could change if a pandemic appears imminent.

5. **Business Travel**

This would provide coverage for the repatriation of employees who contract flu while off site on a business trip. Some Asian and Pacific markets are considering specific avian flu exclusions, but this is not as yet widespread.

6. **Workers’ Compensation**

For the most part, an individual’s medical and financial losses incurred in a 10 day to two week absence will be absorbed by conventional employee benefits and this would moot the need for a workers’ compensation claim. Such claims could be presented, however, in the event of long term disability or death.

Workers’ compensation insurance applies on a no-fault basis to those injuries which are sustained by an employee in the course and scope of his employment. The main question then is one of fact: whether an employee could prove that he contracted flu on the job. This will be easier for those employees who are in close contact with the sources of infection: health care workers, fire and police personnel, airline employees, poultry workers, business travelers, etc. An office worker may be unable to distinguish between an on-the-job exposure and an infection acquired from a family member.

Workers’ compensation policies also provide a type of employer’s liability coverage which responds when an employee is not subject to the sole remedy defense and is instead allowed to pursue a civil action against his employer. (This rarely occurs and is limited to situations where the employer has acted outrageously or fraudulently.) This coverage is usually limited to $100,000, but excess coverage is available under conventional umbrella liability policies.

B. **Intermediate**

1. **Property Insurance**

This insurance covers a policyholder’s interests in its own physical property on either an “all risk” or a “named peril” basis. All risk coverage would encompass viral infestation following a pandemic, but carriers could be expected to argue that there is no physical loss and that the contamination exclusion eliminates coverage in any event. The insuring agreement in a named peril policy extends coverage to losses caused by certain causes of loss such as fire, explosion, impact by aircraft, riot, hail, etc., which do not include infectious events. However, if the flu virus is introduced by a third party’s malicious act, coverage could result.
2. **Business Interruption**

The terms of these policies vary considerably, but they generally cover lost profits and extra expense caused by a covered form of loss during a necessary suspension or interruption of operations. For example, if a factory burns down, lost profits would be covered for a reasonable period required for rebuilding and resumption of operations. Some policies also cover “dependent premises” and provide coverage where the operations of a key supplier are disrupted. (This is significant for industries which operate with “just in time” inventories.) A related coverage is Contingent Business Interruption (CBI), which covers business interruption due to loss or damage to properties “not operated by the Insured.” CBI insures against events that prevent entities from supplying goods to or receiving goods from the insured. CBI protects the insured against the consequences of a supplier’s problems. CBI could potentially apply where there is damage to property of the insured’s customers.

These coverages usually require that the loss “must be caused by or result from direct physical damage to property.” Thus, the main issue will be whether the bare presence of a virus constitutes a form of direct physical harm. There is very little case law and the insurance industry can be expected to contest most claims.¹

Some policies do not require physical harm if operations are suspended at the direction of a civil or military authority. Such coverage would be triggered by a quarantine order and is subject to a four to eight week limitation. Coverage would not apply to a voluntary suspension of operations.

Loss of market share is generally not covered under business interruption policies, which usually state that only “actual loss sustained” will be covered.²

Leader property provisions cover losses to property not owned or operated by the insured, located in the same vicinity as the insured, which attracts business to the insured.

3. **Event Cancellation**

This is a specialty form of insurance which is usually found in the entertainment industry, but can also apply to risks such as business conventions. The essential concept is that it covers losses on an all risk basis when a scheduled event such as a concert cannot be held due to site closure.

---

¹ See, e.g., *Source Food Technology, Inc. v. United States Fidelity and Guaranty Company*, 2005 WL 3334592 (D. Minn.) (company that removed cholesterol in beef lost its best customer due to border closing prompted by mad cow disease in Canada; court held that there was no “direct physical loss” where insured’s beef products were not contaminated).

C. **Long Term**

The variety of third-party liability claims is difficult to anticipate, but an active plaintiff’s bar will be inventive in crafting theories. Some operations such as poultry processors, the hospitality industry and airlines will have apparent exposures in harboring and spreading the virus. More conventional risks like shopping malls and office buildings will be charged with negligence in failing to keep their premises free from infection. This could involve “sick building” claims or theories that air conditioning/circulation systems were improperly maintained. Claimants will nonetheless have a difficult burden of proof to show that their particular case of flu was caused by the condition of a particular location in context of a universal pandemic. Put simply, the issue will be whether they were infected at the mall or at home.

1. **General Liability**

These policies insure liability for bodily injury and property damage caused by an occurrence. Coverage would exist if an individual could establish that he contracted flu through the negligence of a policyholder. The standard pollution exclusion is unlikely to eliminate coverage since it is directed to environmental claims arising out of the dispersal of industrial toxins. The insurance industry does have a “communicable disease” exclusion, but it is not in widespread use and is usually attached only to homeowner’s policies.

Most states do not recognize a claim based on the unrealized fear of contracting a disease. If such a claim were allowed, it would not be subject to coverage in the absence of an actual physical impact. Simple distress or concern would not rise to the level of an actual physical injury and would thus be uninsured.

Property damage claims would be less likely to be covered. The basic theory would be that a policyholder negligently caused the claimant’s premises to become infected and that it was closed as a consequence. In the absence of an actual physical impact, a general liability carrier would decline coverage. The standard definition of “property damage” does include a “loss of use” of property, but this also requires a threshold physical impact. However, there could be covered property damage in the agricultural or food service arenas where contamination to property is claimed.

A major point to emphasize is that a general liability policy obligates the carrier to defend bodily injury and property damage claims against the insured even if they are groundless, false or fraudulent. This is a valuable form of protection and will be a major expense for the insurance industry in the event of a pandemic.

---


4 See *Pig Improvement Co., Inc. v. Middle States Holding Co.*, 943 F.Supp. 392 (D. Del. 1996) (non-coverage case where seller of pig breeding stock was sued for alleged introduction of Porcine Reproductive and Respiratory Syndrome (PRRS) into buyer’s herd.)
General liability policies exclude claims asserted by the insured’s employer and coverage for these would have to be sought under the workers’ compensation and umbrella coverages noted above.

General liability policies often provide medical payments coverage which will respond on a no-fault basis for first aid and treatment incurred by a claimant because of the condition of the insured’s premises. This coverage is often subject to a small sub-limit.

Finally, most general liability policies also provide “personal injury” coverage which insures liability for torts grouped under false arrest, malicious prosecution, wrongful eviction, defamation and privacy headings. Wrongful eviction could be implicated if an apartment building is closed due to quarantine orders following an outbreak.

2. **Umbrella/Excess**

These policies will provide an excess layer of coverage over the general liability policies and are subject to the same analytical considerations. The chief distinction, noted above, is that these policies often provide the excess layer for the employer’s liability coverage afforded by standard workers’ compensation policies.

3. **Directors and Officers**

This type of policy generally insures corporate management for its alleged dereliction of duty in conducting the operations of a business. It is customarily written on a claims made basis and requires the insured to conduct his own defense subject to reimbursement by the carrier.

One scenario which implicates this coverage would be a shareholder suit against the management of a poultry producing company which alleges that the directors and officers failed to take proactive steps to minimize the impact of a pandemic, and that the equity values were diluted as a consequence. Another scenario would be a shareholder suit alleging misrepresentation about the company’s performance where a pandemic (or avian flu scare) affected performance.5

Note that a failure to procure adequate insurance is excluded under D&O policies as are claims for conventional bodily injury or property damage.

4. **Infringement Insurance**

There are IP insurance products that provide defense costs reimbursement insurance to offset some of the costs of defending against a patent infringement claim and “infringement enforcement insurance” when an insured elects to enforce its patents. These coverages may assist an insured who owns a patent for developing an avian flu vaccine.

---

5 See *Selbst v. McDonald’s Corp.*, 432 F.Supp.2d 777 (N.D. Ill. 2006) (shareholder class action alleging that McDonald’s misrepresented performance of certain overseas restaurants due in part to mad cow and Severe Acute Respiratory Syndrome (SARS) scares.