

# Case Summary: MDS Inc. v. Factory Mutual Insurance Company

## Defence + Indemnity

April 2020

An Ontario court held that under an all-risk policy the “physical damage” requirement for coverage may be met by a loss of use, which may have some application for COVID-19 business interruption claims.

*MDS Inc. v. Factory Mutual Insurance Company (FM Global)*, 2020 ONSC 1924, per J. Wilson, J.

### Facts + Issues

The Plaintiffs MDS Inc. et al (MDS) purchased radioisotopes from Atomic Energy of Canada Limited’s Nuclear Research Universal Reactor (NRU), which MDS then processed and sold for use in medical products. In 2009, the Plaintiff’s nuclear facility experienced a leak of heavy water containing radioactive material. The facility was proactively shut down, without a government order, but was later ordered to be shut down by the regulator. The shut-down, originally estimated to last 36 hours, ended up lasting 15 months and the Plaintiff incurred loss of profits in the amount of \$121,248,000.

At the time of the shutdown, Factory Mutual Insurance Company (Insurer) had issued a worldwide all-risks policy (the “Policy”) to MDS. Section B of the Policy covered Property Damage which the Court summarized in the following terms:

180 Sections B and C outline the totality of property that is covered under the Policy. Section B of the Policy covers Property Damage. According to Section B(1), the Policy insures Real Property, Personal Property (to the extent of the Insured’s interest in such property), and the interests of contractors and subcontractors in insured property, unless otherwise excluded, located at an Insured Location or within 1,000 feet thereof. Insured Location is defined as “a location 1) listed on a Schedule of Locations attached to this Policy. 2) covered as a Miscellaneous Unnamed Location. 3) covered under the terms and conditions of the Automatic Coverage or Errors and Omissions Provisions.” [footnotes omitted]

The Section engaged in this case, Section C, covered Time Element losses, including loss of profits to the insured MDS “flowing from physical damage to a supplier ‘directly resulting from physical loss or damage of the type insured by this Policy’ to a maximum of US\$25,000,000.00” (subject to exclusions) (para. 182). Section C(3) extended Time element coverage “to situations, such as losses incurred when a civil authority has prohibited access to property, service interruption loss under certain conditions, and losses incurred for reasonable delays to the start-up of business operations” (para 182). The insurer Factory Mutual acknowledged that there was coverage for MDS’s loss of profits unless it could prove that the exclusions for corrosion or nuclear radiation exclusions applied.

The corrosion exclusion provided as follows:

C. This Policy excludes the following, but, if physical damage not excluded by this Policy results, then only that resulting damage is insured: ...

### Industries

[Insurance](#)

### People

[Connor Malone](#) Lawyer  
[cmalone@fieldlaw.com](mailto:cmalone@fieldlaw.com)

3) deterioration, depletion, rust, corrosion or erosion, wear and tear, inherent vice or latent defect.

[Emphasis added by the Court, at para. 437]

The term “physical damage” was not defined in the Policy.

The Nuclear Radiation Exclusion provided as follows:

## 5. Exclusions

The following exclusions apply unless specifically stated elsewhere in this Policy:

...

B. This Policy excludes loss or damage directly or indirectly caused by or resulting from any of the following regardless of any other cause or event, whether or not insured under this Policy, contributing concurrently or in any other sequence to the loss:

1) nuclear reaction or nuclear radiation or radioactive contamination. However:

a) if physical damage by fire or sprinkler leakage results, then only that resulting damage is insured; but not including any loss or damage due to nuclear reaction, radiation or radioactive contamination.

b) this Policy does insure physical damage directly caused by sudden and accidental radioactive contamination, including resultant radiation damage, from material used or stored or from processes conducted on the Insured Location, provided that on the date of loss, there is neither a nuclear reactor nor any new or used nuclear fuel on the Insured Location. This coverage does not apply to any act, loss or damage excluded in item B2f of this EXCLUSIONS clause.

This exclusion B1 and the exceptions in B1a and B1b do not apply to any act, loss or damage which also comes within the terms of exclusions B2b of this EXCLUSIONS clause.

2)

a) hostile or warlike action in time of peace or war including action in hindering, combating or defending against an actual, impending or expected attack by any:

(i) government or sovereign power (de jure or de facto);

(ii) military, naval or air force; or

(iii) agent or authority of any party specified in (i) or (ii) above.

b) discharge, explosion or use of any nuclear device, weapon or material employing or involving nuclear fission, fusion or radioactive force, whether in time of peace or war and regardless of who commits the act.

c) insurrection, rebellion, revolution, civil war, usurped power, or action taken by governmental authority in hindering, combating or defending against such an event.

d) seizure or destruction under quarantine or custom regulation, or confiscation by order of any governmental or public authority.

e) risks of contraband, or illegal transportation or trade.

f) Terrorism, including action taken to prevent, defend against, respond to or retaliate against Terrorism or suspected Terrorism, except to the extent provided in the TERRORISM coverage in this section of the Policy. However, if direct loss or damage by fire results from any of these acts (unless committed by or on behalf of the Insured), then this Policy covers only to the extent of the Actual Cash Value of the resulting direct loss or damage by fire to property insured. This coverage exception for such resulting fire loss or damage does not apply to:

(i) direct loss or damage by fire which results from any other applicable exclusion in the Policy, including the discharge, explosion or use of any nuclear device, weapon or material employing or involving nuclear fission, fusion or radioactive force, whether in time of peace or war and regardless of who commits the act.

(ii) any coverage provided in the TIME ELEMENT section of this Policy or any other coverages provided in this Policy.

Any act which satisfies the definition of Terrorism as provided herein shall not be considered to be vandalism, malicious mischief, riot, civil commotion, or any other risk of physical loss or damage covered elsewhere in this Policy.

Any act which satisfies the definition of Terrorism as provided herein shall not be considered to be vandalism, malicious mischief, riot, civil commotion, or any other risk of physical loss or damage covered elsewhere in this Policy.

If any act which satisfies the definition of Terrorism as provided herein also comes within the terms of item B2a of this EXCLUSIONS clause then item B2a applies in place of this item B2f exclusion.

If any act which satisfies the definition of Terrorism as provided herein also comes within the terms of item B2b of this EXCLUSIONS clause then item B2b applies in place of this item B2f exclusion.

If any act which satisfies the definition of Terrorism as provided herein also comes within the terms of item B2c of this EXCLUSIONS clause then item B2c applies in place of this item B2f exclusion.

If any act excluded herein involves nuclear reaction, nuclear radiation or radioactive contamination, this item B2f exclusion applies in place of item B1 of this EXCLUSIONS clause.

References and Application. With the exception of PROVISIONS APPLICABLE TO SPECIFIC JURISDICTIONS clause in the GENERAL PROVISIONS section, the following term wherever used in this Policy means:

Terrorism:

Any act, involving the use or threat of: force, violence, dangerous conduct, interference with the operations of any business, government or other organization or institution, or any similar act,

When the effect or apparent purpose is:

- (i) To influence or instill fear in any government (de jure or de facto) or the public, or any segment of either; or
- (ii) To further or to express support for, or opposition to, any political, religious, social, ideological or similar type of objective or position.

[Emphasis added the Court]

MDS argued that even if the corrosion exclusion applied, “resulting physical damage” caused by corrosion was exempt from that exclusion, and its business loss was covered. The Insurer argued, in response, that the loss of use of one’s premises was not resulting physical damage.

MDS sued for breach of the Policy.

**HELD: For the insured; claim covered.**

1. The court held that the insurer had not discharged its burden of proving that the Corrosion Exclusion was applicable:

415 I conclude considering the reasonable objective expectation of the parties in light of the factual context of this case that coverage should be available for losses caused by the leak of heavy water at J-41 resulting in a shutdown of the NRU. The cause of the fortuitous corrosion was triggered by an unanticipated and unpredicted microscopic attack of the Calandra wall due to the presence of an aggressive agent, or contaminant, probably chlorine, that caused a through wall leak. I refer to my findings of fact and conclusions as to the quality of the water leaking from the reflector to the J-rod annulus confirming the probable presence of chlorine as well as other contaminants [para 150 to 162].

416 I have defined corrosion in the Policy as “the anticipated and predictable process of corroding, esp. of a rusting metal.” “Corrode” is defined as “wear away, esp. by chemical action.”

417 Applying this definition to the facts of this case, I conclude that the Insurer has not met the burden of proof that the corrosion exclusion applies to this fortuitous, unanticipated and unpredictable corrosion found at J-41. Hence, I conclude that the corrosion exclusion does not apply.

2. The Court also concluded that if the corrosion exclusion did apply, the exception to that exclusion for resulting “physical damage” applied to exempt the insured’s loss of use of the isotopes from that exclusion.

- a. The Court held that the onus of proving that an exception to an exclusion clause applies is on the insured and that exceptions to exclusions are to be interpreted broadly. (para. 439 – 441)
- b. Wilson, J. identified the issue:

445 The question is:

To qualify as resulting physical damage under the Policy does there have to be actual tangible damage to the J-rod annulus caused by the leak of heavy water? (the Insurer's position) or

Does resulting physical damage in this Policy include loss of use of the NRU as a consequence of the leak of heavy water? (the Plaintiffs' position)

- c. There is conflicting case law on the interpretation of "physical damage" in an all-risk policy. One line of cases interprets physical damage as requiring actual physical damage; the other interprets physical damage more broadly to include damage other than actual physical damage to property. In this case, "physical damage" was not a defined term in the Policy. Considering the conflicting common law definitions, the Court held that Section C of the Policy was ambiguous.
- d. The Court held that an "all-risks" policy like this one often provided coverage for risks not usually covered under other types of insurance policy:

498 The Supreme Court of Canada's discussion of the intended purpose of all-risks policies in *Ledcor* is directly on point. The court considered a particular type of all-risks policy, "builders' risk" insurance. However, the court cited a general passage from E.A. Dolden as to the purpose of all-risks policies applicable to this case:

"Urbanization and industrialization in the past 100 years have made the concept of an insurance policy covering all conceivable risks advantageous to both insureds and their insurers. The insured benefits from the extensive nature and scope of the coverage, and insurers benefit from the economies of managing and marketing a policy which, in terms of its scope, has certainty. For these reasons, the "all risk policy," which creates a special type of coverage extending to many risks not customarily covered under other types of insurance policies, is attractive to both the insurance industry and consumers."

[Emphasis added by the Court; footnotes deleted]

- e. The Court held that in the circumstances of this case, completely shutting down the NRU in response to the leak was required to avoid a catastrophe. The Court concluded that a broad definition of property damage should be applied, which included the loss of using physical property. Consequently, Section C of the Policy applied to MDS's loss of profits that resulted from the NRU's shut down:

515 A broad interpretation of resulting physical damage to include impairment of use confirms the principle that exceptions to exclusions should be interpreted broadly.<sup>140</sup>

516 The Policy must be considered as a whole. The other provisions of the Policy including the loss of use exceptions, and the Contingent Time Coverage provisions, with specific regard to the period of liability when read with the resulting physical damage exception, all appear to confirm that loss of use of the NRU caused by the leak of heavy water would constitute resulting physical damage. The effect of the leak of heavy water rendered the NRU inoperable until the safety concerns and protocol imposed by the CNSC had been met.

517 In assessing the objective reasonable expectation of the parties as to the meaning of physical damage, it makes common sense that if the unanticipated leak of heavy water from the Calandra precipitates the shutdown of the NRU ordered by the CNSC to study and rectify the problem causing the leak, that this circumstance rendering the NRU inoperable would constitute resulting physical damage.

518 Applying the principles of *Ledcor* to interpret the meaning of resulting physical damage, I conclude that a broad definition of resulting physical damage is appropriate in the factual context of this case to interpret the words in the Policy to include impairment of function or use of tangible property caused by the unexpected leak of heavy water.

519 This interpretation is in accordance with the purpose of all-risks property insurance, which is to provide broad coverage. To interpret physical damage as suggested by the Insurer would deprive the Insured of a significant aspect of the coverage for which they contracted, leading to an unfair result contrary to the commercial purpose of broad all-risks coverage.

520 For these reasons, I conclude in the facts of this case that the Plaintiffs have met their onus of proving that the leak of heavy water from the Calandra to the J-rod annulus was resulting physical damage and that if the corrosion exclusion applies then the exception provisions of resulting physical damage apply allowing coverage for the Plaintiffs losses.

3. In particular, the Court held that the profit loss flowing from the disruption of the supply of the Plaintiff MDS's isotopes was included in the resulting physical loss from the leak and covered:

460 The wording of the Period of Liability for the Time Element Coverage "starting at the time of physical loss or damage causing the disruption of the normal movement of materials" supports the argument of the Plaintiffs that the disruption in the flow of isotopes from loss of use of the NRU is intended to be included in the resulting physical loss.

461 When the leak of heavy water with Tritium emissions was detected, the NRU was shut down until the source of the leak was identified and repaired. As the location of the leak was unexpected, the complex process to repair the leak and meet the safety protocol of the CNSC took 15 months. The physical loss or damage of the leak of heavy water triggered the shutdown, and caused "the disruption of the normal movement" of the supply of isotopes to MDS until the NRU was reopened in August 2010 as approved by the CNSC.

462 When the resulting physical damage exception is considered in light of other provisions in the Policy, including Period of Liability for the Time Element Coverage, it appears clear that the meaning of resulting physical damage contemplates loss of use of the NRU. Therefore the Policy is not ambiguous. This would end the analysis on the applicability of the resulting physical damage exemption. The Plaintiffs' loss flowing from the disruption of the normal supply of isotopes would be covered under the Policy.

4. The Court held that the Nuclear Radiation Exclusion was unambiguous and did not apply to this case. The purpose of the Nuclear Radiation Exclusion was to exclude damage from large nuclear events, not the day-to-day operational activities. It was consistent with the wording of the exclusion and the parties' expectations that the Nuclear Radiation Exclusion would not apply in the circumstances of this case.

### Commentary

What we see from Justice Wilson's analysis, the interpretation of a "physical damage" component will depend on the type of insurance policy in question, the specific provisions of that policy and that the principles of interpreting an insurance policy (including the doctrine of reasonable expectations) in any given case.

In this case, coverage was assessed in the context of a global all-risk policy, not a comprehensive property policy or a CGL policy. Although the Court interpreted the term "property damage" broadly, it was done in the context of a loss that stemmed from a physical event that effectively stopped production of a product. The Policy held by MDS specifically contemplated a loss of business income due to the failure of a third-party supplier to produce a product.

However, a key takeaway from this case is a court's willingness to classify non-tangible losses as "physical damage," which will be relevant to both businesses and insurers. While the words "resulting physical damage" do not appear in the Policy, the Court's view that such wording includes "loss of use" may influence a later Court to take the additional step of finding that an all-risks commercial property policy provides coverage resulting from "physical damage" caused by a government-ordered shutdown.

For business interruption claims, most policies require that some actual, physical loss to tangible property is required for there to be coverage for resulting loss of use of the premises.

This decision may have relevance to business interruption claims due to the COVID-19 pandemic, where businesses may be forced to shut down by government order or even where government orders falling short of requiring shut down make it impractical for a business to continue to operate. For example, a government order prohibiting gatherings of more than 15 people may render the operation of a bar to be impractical. Perhaps a government order need not be involved if leaving the business open creates an unacceptable risk to patrons and staff.

Even if a term is defined, coverage will still be determined based on the meaning of particular words within the definition when considered in the context of case law and, specifically, the factual context of a particular COVID-19 claim.

If, on the other hand, a term is not defined and/or is a term that may be applicable due to the common law, such terms will need to be determined in accordance with, amongst other things, the factual context of the particular COVID-19 claim. For instance, words such as "property damage" and "physical damage," and what these words entail, will need to be examined closely. The physical damage component might arguably be met in some circumstances by temporarily contaminated surfaces on the premises, for example.

At the same time, however, it is clear that securing business interruption coverage without actual, tangible physical damage under a policy remains an "uphill battle". Now more than ever, businesses and insurers are well-advised to review their respective policies and coverages.

