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COVID-19 Insurance Coverage Litigation

Since our August 26, 2020 Update, many courts have rendered decisions on motions to dismiss business interruption claims. By a vast margin, the majority have ruled in favor of the insurers, based on the absence of direct physical loss or analogous coverage terms. A few have based their decision on virus exclusions. In late September, however, three decisions denied motions to dismiss, including one in which there was a virus exclusion.

It bears emphasis that these are decisions on motions to dismiss on the pleadings and in some of the jurisdictions involved, plaintiffs have the option of filing amended pleadings. Thus, we recount the courts' rulings or discussions on amendment, if any, in each case. In some cases, there has been an unusual willingness to allow amendment. The explanation is some variation of "the law concerning business interruption coverage linked to the COVID-19 pandemic is very much in development."

In the meantime, efforts to establish multidistrict litigation ("MDL") continue, notwithstanding the August 2020 decision by the Judicial Panel on Multidistrict Litigation rejecting arguments for a single MDL venue. We outline the current status of the debate further below.

Outside of the US, the UK Financial Conduct Authority Test Case, described in our June 26, 2020 Update, has resulted in a decision largely favoring the insureds.

And finally, in follow up to our prior piece about the role of the force majeure contract defense in the COVID-19 era, we briefly summarize a recent Federal court (California) complaint invoking that defense.

Decisions Granting Motions to Dismiss Business Interruption Claims Based on Lack of Direct Physical Loss

Malaube, LLC v. Greenwich Ins. Co., 20:22615-KMW, 2020 WL 5051581 (S.D. Fla. Aug. 26, 2020). A restaurant's claim was dismissed because "direct physical loss or damage" was construed to mean an "actual change in insured property" that would require repair. The court also noted there was no allegation that COVID-19 was physically present in the premises. It granted leave to amend. However, the court noted that it had not ruled on the policy's Virus Exclusion.

10E, LLC v. Travelers Ind. Co. of Connecticut, et al., 2:20-cv-04418-SVW-AS, 2020 WL 5359653 (C.D. Cal. Sept. 2, 2020). A restaurant's claim was dismissed because "direct physical loss of or damage to property" requires a "distinct, demonstrable, physical alteration." The court allowed plaintiff leave to amend.

Turek Enterprises, Inc., d/b/a Alcona Chiropractic v. State Farm Mut. Auto. Ins. Co., et al., 1:20-cv-11655-TLL-PTM, 2020 WL 5258484 (E.D. Mich. Sept. 3, 2020). A chiropractor's claim was dismissed because "physical loss to Covered Property" does not include the inability to use the property. As noted below, the court also dismissed based upon a Virus Exclusion. The court dismissed the complaint with prejudice.

Pappy's Barber Shops, Inc., et al., v. Farmers Group, Inc., et al., 20-cv-907-CAB-BLM, 2020 WL 5500221 (S.D. Cal. Sept. 11, 2020). The claims of two barbershops were dismissed because there was "no direct physical loss." The court rejected the argument that the loss of ability to continue operating the businesses due to a government order qualified as a covered cause of loss. Nor was there civil authority coverage because plaintiffs did "not plausibly allege" any direct physical loss to property at a location other than plaintiffs' places of business. The court noted that any amendment to the complaint is likely to be futile, so if plaintiffs seek to amend, they must file a motion seeking leave and a redlined version of the proposed amended complaint.

Mudpie, Inc. v. Travelers Cas. Ins. Co. of America, 20-cv-03213-JST, 2020 WL 5525171 (D.N.C. Cal. Sept. 14, 2020). The court dismissed a retailer's claims because "direct physical loss of property" required an "intervening physical force" beyond the government closure orders. Plaintiff failed to allege direct physical loss to its own or anyone else's property. The court also noted that the Policy stated that it "will not pay for loss or damage resulting from . . . loss of use or loss of market." The Policy also contained a Virus Exclusion, which the court said it need not consider because of its other ruling. As to amendment, the court said, "it seems doubtful" plaintiff could establish direct physical loss, but it also "recognize[d]…that the law concerning business interruption coverage linked to the COVID-19 pandemic is very much in development." It granted leave to amend solely to correct the deficiencies identified in the Order.

Sandy Point Dental, PC v. The Cincinnati Ins. Co., Case No. 20 CV 2160, (N.D. Ill. Sept. 21, 2020). The claims of a dental practice were denied because the Policy requirement of "direct physical loss" unambiguously requires some form of actual, physical damage to the insured premises. The court held that "the coronavirus does not physically alter the appearance, shape, color, structure, or other material dimension of the property." Similarly, there was no allegation (and there "likely could not" be) of physical damage to other property. The decision did not address amendment.

Decisions Granting Motions to Dismiss Based on Virus Exclusions

Martinez v. Allied Ins. Co. of America, 2:20-cv-00401-JLB-NPM (M.D. Fla. Sept. 2, 2020). The claims of a dental practice were denied because of the existence of a Virus Exclusion, the plain language of which excluded coverage. The Exclusion applied to loss or damage caused "directly or indirectly," by "[a]ny virus, bacterium, or other microorganism that induces or is capable of inducing physical distress, illness, or disease." Finding that "any amendment would be futile," the court dismissed with prejudice.

Franklin EWC Inc., et al. v. The Hartford Financial Services Group Inc., et al., Case No. 20-cv-04434 JSC (N.D. Cal. Sept. 22, 2020). The claims of a European Wax Center were dismissed by a Magistrate Judge based on a "Fungi", Wet Rot, Dry Rot, Bacteria And Virus Exclusion. It provided that "[w]e will not pay for loss or damage caused directly or indirectly by any of the following … regardless of any other cause or event that contributes concurrently or in any sequence to the loss: (1) Presence, growth, proliferation, spread or any activity of "fungi", wet rot, dry rot, bacteria or virus." However, the Magistrate did not prohibit amendment, "[i]n light of the rapidly evolving legal landscape involving COVID-19 business interruption coverage."

The Virus Exclusion was an alternative basis for dismissal in ***Turek Enterprises, Inc., supra***. The Exclusion applied to losses that would not have occurred but for some "virus, bacteria or other microorganism that induces or is capable of inducing physical distress, illness, or disease." The court rejected the argument that it was a state Executive Order that caused the suspension of the operations, not COVID-19 itself. It held that "Plaintiff is wrong to suggest that whether the reason for the [Order] was preventing the spread of a virus or an asteroid spreading magic dust is irrelevant," because "[i]f it were the latter, the Virus Exclusion would not apply."

Decisions Denying Motions to Dismiss Based on Potential Physical Loss or Damage

Blue Springs Dental Care, LLC, et al. v. Owners Ins. Co., Case No. 20-CV-00383-SRB (W.D. Mo. Sept. 21, 2020). This case was decided by the same judge who ruled for the insured in ***Studio 417, Inc. v. The Cincinnati Ins. Co.***, Case No. 20-cv-03127-SRB, 2020 WL 4692385 (W.D. Mo. Aug. 12, 2020), reported in our August 26, 2020 Update, and its companion case, ***K.C. Hopps, Ltd. v. The Cincinnati Ins. Co.***, Case No. 4:20-cv-00437-SRB (W.D. Mo. Aug. 12, 2020), Judge Stephen Bough. This case is a putative class action brought by dental practices. The Judge focused on the term "direct physical loss," which the Policy did not define. Plaintiffs alleged that it is likely people who were in the insured property in recent months were infected with COVID-19, and they suspended or limited operations "to prevent physical damage to the premises by the presence and proliferation of the virus and the physical harm it could cause to persons present." The court found this adequately stated a claim for a direct physical loss. It also determined it was premature to reach conclusions on whether the dentists' offices "suspended" operations, even though some remained open for emergency procedures. The court also found unresolved factual questions as to the scope, effect, applicability, and impact of the Stay Home Orders, which were relevant to the Civil Authority Coverage.

Optical Services USA/JCI v. Franklin Mut. Ins. Co., Case No. BER-L-3681-20 (N.J. Super. Ct. Bergen Cty. Aug. 12, 2020). Analysis of this case is challenging because, as of this writing, there has not yet been a formal written decision or order. There is only a transcript of the hearing on the motion and the ruling from the bench. In essence, the court found that under New Jersey law, there were unsettled questions about whether the loss of a property's functional use can constitute "direct physical loss." The plaintiffs relied an earlier case in New Jersey holding a property can sustain a physical loss without a structural alteration (***Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co.***,

406 N.J. Super. 524 (App. Div. 2009)). As the court put it, "there is an interesting argument made before this court that physical damage occurs where a policy holder loses functionality of their property and by operation of civil authority such as the entry of an executive order results in a change to their property." The court allowed the parties to proceed to "issue-oriented" discovery and to amend their complaint accordingly.

Decision Denying Motion to Dismiss Based on Ambiguous Virus Exclusion

Urogynecology Specialist of Florida, LLC v. Sentinel Ins. Co. Ltd, Case No. 6:20-cv-1174-Orl-22EJK (M.D. Fla. Sept. 24, 2020). A gynecologist survived a motion to dismiss despite the presence of an exclusion for "fungi," wet rot, dry rot, bacteria, or virus. The court concluded that several aspects of the Policy language, allegations, and context made the exclusion ambiguous: (1) The "Limited Fungi, Bacteria or Virus Coverage" section of the Policy starts by stating that it modifies certain coverage forms. The forms are not in the Policy itself, nor were they provided to the court; (2) The Exclusion states that it is added to an Exclusions Form which was not provided to the court; (3) Denying coverage for COVID-19 "does not logically align with the grouping of the virus exclusion with the other pollutants [identified];" and (4) The precedents did not deal with "the unique circumstances of the effect COVID-19 has had on our society – a distinction this Court considers significant." In light of these factors, the court concluded that plaintiff had stated a plausible claim at this juncture.

Multidistrict Litigation Update

As we reported in our August alert, on August 12, 2020, the Judicial Panel on Multidistrict Litigation ("JPLM") refused to create one MDL for all the federal COVID-19 coverage cases, which involve more than 100 insurers. But most recently, the JPML heard arguments on whether to establish five separate "single-insurer" MDLs to centralize COVID-19 business interruption coverage actions pending in Federal District Courts against five insurers: The Hartford, Cincinnati Insurance Co., Society Insurance Co., Travelers and a slew of Lloyd's underwriters. The JPML's decision will determine whether nearly 300 suits against those insurers will move forward individually or on some form of a consolidated basis.

A number of policyholder attorneys reportedly strongly endorsed the concept as a "sensible middle ground." However, Senior U.S. District Judge Ellen Huvelle appears to remain skeptical about the value and practicality of centralization based on her questioning of the attorneys presenting argument in support of creation of the five dockets. She noted that the motions to dismiss already filed by Cincinnati in several dozen cases, for example, appear to focus on purely legal issues and noted that generally, centralization is not appropriate for matters involving purely legal issues.

In contrast, U.S. District Judge Matthew F. Kennelly asked why it would not make sense for a single judge to resolve the arguments raised in Cincinnati's motions to dismiss, rather than "20, 30 or 40 judges all ruling on essentially the same motion, and probably not all coming up with the same result," especially given that a number of Cincinnati policyholders have taken the position

that common issues of fact exist in the coverage disputes. In contrast, counsel for the other insurance carriers expressed concerns over a *lack* of common factual issues in the cases against them, including the facts of the specific government shutdown orders affecting each policyholder and the degree to which each policyholder was required to close or reduce its operations.

Ruling in the UK Test Case

As reported in our June 26, 2020 Update, the UK regulatory authority known as the Financial Conduct Authority commenced a "Test Case" before the High Court in London. It invited numerous policyholders and insurers to present arguments on a representative sample of policy wordings with respect to business interruption. After many days of oral argument this summer, the High Court handed down its judgment in favor of policyholders on September 15, 2020. We thought it would be best to present a detailed analysis of the decision by our long-time friends in London, the Solicitors Carter Perry Bailey. Their analysis can be found here.

COVID-19 As Force Majeure Excusing Contract Obligations

On September 21, 2019, the National Hot Rod Association ("NHRA") filed suit in the Federal District Court for the Central District of California against The Coca Cola Company asserting claims for breach of contract and for a declaratory judgment as a result of Coca Cola allegedly reneging on its sponsorship obligations to the NHRA due to COVID-19. NHRA claims that in January 2018, it and Coca Cola entered into a six-year extension of Coca Cola's sponsorship of NHRA's professional drag racing series, but that Coca Cola has "seized on a global tragedy, the COVID-19 pandemic" to claim that NHRA breached that agreement and to terminate it early. NHRA alleges that as a result of the COVID-19 outbreak, it was forced to cancel and postpone many of its events, but continued some of the in-person events and otherwise continued to provide Coca Cola the benefits of the sponsorship agreement outside of the live event context.

NHRA alleges that nonetheless, Coca Cola took the position that NHRA had breached the sponsorship agreement and in May 2020, failed to make a payment due under the agreement. The parties then began negotiating compromised figures for the payments Coca Cola still owed under the agreement due to the cancelled and postponed events, but by September 2020, Coca Cola allegedly unilaterally declared the agreement "terminated."

NHRA claims that Coca Cola asserted three grounds for termination, one of which was force majeure. The agreement includes a force majeure clause which provides that force majeure is a viable defense to performance in the event that "failure, inability or delay in performance continues for a contiguous period of 180 calendar days" in which case, both parties are released of their obligations. However, NHRA alleges that it did, in fact, partially perform under the agreement in that it held several in person Mello Yellow events in July, August and early September and continued to promote Coca Cola and provide benefits to it outside of live event forums. Thus, among other relief, NHRA seeks a court declaration that Coca Cola's performance under the agreement is not excused and the agreement remains in effect.

As of the date of this COVID-19 alert, Coca Cola had not yet answered NHRA's complaint. We will continue to monitor the case and report on any significant developments coming from it in the force majeure context.

The guidance provided in this Update is a basic overview, with high-level advice, and it should not be applied in the drafting of documentation without further consideration of the specific state laws and factual circumstances involved therewith. For more information on this topic or advice on specific questions related to managing risk for your business in the pandemic, please contact one of our COVID-19 Coordinators, identified below.

For more information, please contact the Gfeller Laurie LLP attorney with whom you regularly communicate or one of our COVID-19 Coordinators:

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Sincerely,

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