August 23, 2021

COVID-19 Insurance Coverage and Liability Update

In this Update we address some notable recent decisions on business interruption claims due to COVID-19, the majority of which continue to favor insurers, as well as a decision involving contamination coverage. Next, we provide a brief update on the latest development in multidistrict litigation on COVID-19 coverage claims. Finally, we discuss the current trend in decisions on *force majeure* defenses to contract performance due to COVID-19 in the context of lease agreements. For now, courts generally appear to be disinclined to allow such defenses, unless the defense is asserted to excuse performance for a specific time period, rather than invalidate the contract as a whole. However, the rise of COVID-19 variants may redirect that trend, as we discuss further below.

Business Interruption and Other Insurance Coverage Decisions

There is still only one known decision from an appellate court on business interruption coverage from the U.S. Court of Appeals for the Eighth Circuit, addressed in our July 19, 2021 Update. Since then, there have been many additional lower court decisions. The vast majority continue to favor insurers on the grounds of a lack of Direct Physical Loss or Damage, a Virus Exclusion, or both. This Update will not address all of the decisions. It will only address those with unusual aspects such as coverages or arguments that have not been repeatedly addressed, or those whose economic impact is especially notable. We also address a few decisions involving sports teams and a decision involving contamination coverage.

Business Interruption Decisions

New York Federal Court Dismisses Claims for $1.25 billion in Coverage Made by New York's Largest Health System. A highly-respected New York District Judge, Jed S. Rakoff, dismissed the claims in ***Northwell Health, Inc. v. Lexington Ins. Co. and Interstate Fire & Cas. Co.,*** No. 21-CV-1104 (JSR), 2021 WL 3139991 (S.D.N.Y. July 26, 2021). The insurers issued all-risks commercial property policies with standard Time Element coverage. They also provided four other coverages: Interruption by Communicable Disease; Civil or Military Authority; Decontamination Costs; and Ingress/Egress.

As an essential business, Northwell continued operating its 23 hospitals during the pandemic. It suffered losses including the costs of additional cleaning supplies, janitorial services, and the hiring of new employees and vendors to sanitize its properties. It also suffered losses from the forced cessation of elective surgeries, the closing of physicians' practices and fewer hospital admissions toother facilities. The Court found that there was no Time Element Coverage because those provisions require the cost or loss to be caused by direct physical loss or damage and there was none. There was no interruption by Communicable Disease Coverage because there was no plausible allegation that government orders declared uninhabitable and prohibited access to Northwell Facilities. There was no coverage for Civil or Military Authority, Decontamination

Costs and Ingress/Egress because they require direct physical loss or damage and Northwell failed to plead additional, independent requirements for coverage under them. One of the key factors was that COVID-19 does not persist and irreversibly change the physical condition of a property – the "physical integrity of objects" is not compromised. The claims were dismissed with prejudice.

Large Retail Chain Allowed to Pursue Claims Against Cargo and Property Policies. ***Ross Stores, Inc. et al v. Zurich American Ins. Co., et al.,*** Case. No RG20004158 (Super. Ct. Alameda Co. Cal June 13, 2021) involves claims for coverage under both Cargo Policies and Property Policies issued to a discount clothing chain with nearly 2,000 retail stores and nonretail locations, allegedly sustaining over $1 billion in damages from the pandemic. The Cargo Policies had endorsements extending coverage to interruption of business when ingress or egress is physically prevented. The Property Policy had a Time Element coverage extension for Interruption by Communicable Disease, as well as coverages for Communicable Disease Response and Decontamination Costs. The policies were entered into on March 1, 2020, when, as the Court noted, "entities in the business of managing risk would have been aware of the risks related to COVID and might have considered those risks when negotiating insurance policies." The Court speculated about numerous points and observed that "the status of COVID related knowledge on or about 3/1/20 strongly suggests that when interpreting the contract to give effect to the intent of the parties, that the negotiations leading to the contracts will be a more than usually useful tool in contract interpretation."

The Cargo Policies did not have a virus exclusion. The Court found that a reasonable reading of the policies might provide business interruption coverage but not Extra Expense coverage. It concluded that a reasonable reading of the Delay and Free of Capture and Seizure exclusions would not defeat coverage. As for the Property Policies, the Court found various coverages and exclusions ambiguous and ruled that their interpretation would need to be resolved at summary judgment or at trial.

Reasonable Expectation Doctrine Should Not Be Applied When a Broker Is Involved. ***Vinart Management Co., Inc. v. Employers Mut. Cas. Co.,*** No. CV 20-2954, 2021 WL 3033819 (E.D. Pa. July 19, 2021) is a straightforward case enforcing a Virus Exclusion to dismiss a claim. There was one interesting feature, however: the plaintiff argued that its reasonable expectations should prevail and coverage should exist. The Court cited to other Pennsylvania cases to reject this and concluded, "Plaintiffs are commercial insureds who used an insurance broker to obtain the Policy in question ... As such, they simply cannot defeat the plain and unambiguous terms of the Policy and their reasonable expectations argument fails."

Sports Report

Sports teams split a doubleheader in early August.

Chubb 1, Lakers 0

In ***The Los Angeles Lakers, Inc. v. Federal Ins. Co.,*** No. 2:21-cv-0228 (U.S.D.C. C.D.Ca. Aug. 11, 2021), the Lakers alleged that the mere presence of the COVID-19 virus at Staples Center, as evidenced by athletes who contracted it after playing there, constituted direct physical loss or damage. The Judge held that the claims were "merely legal conclusions couched as factual allegations." California law requires an actual change in the insured property and that "loss" requires damage "within the common understanding of that term." The Court granted the motion to dismiss without prejudice.

Yankees 1, CNA 0

In ***SWB Yankees LLC v. CNA Financial Corp., et al,*** No. 2020-CV-2155 (Ct. Common Pleas, Lackawanna Co. Pa. Aug. 4, 2021), the Court permitted the claims of New York Yankees Triple-A Team, the Scranton Wilkes/Barre Rail Raiders, to continue. The Team specifically pled that the coronavirus was present at its property. The Court relied upon what it referred to as the "better-reasoned decisions" which applied a "physical contamination theory" to find business interruption coverage could apply. These include a Third Circuit decision holding that allegations of e-coli contamination created a factual issue concerning physical loss. The Court also noted that the policy contained thirty exclusions for business income and extra expense coverage, including exclusions for contaminants, pollutants, fungi and microbes, but there was no exclusion for viruses. The Court declined to find civil authority coverage, however, because the team's season was cancelled by Minor League Baseball, not governmental authorities.

Other Coverage Decision of Note

Louisiana Federal Court Finds No Coverage Under Accidental Contamination Provisions of Restaurant Recovery Policy. ***New Orleans Equity LLC v. U.S. Specialty Ins. Co.,*** No. CV 20-1935, 2021 WL 3362943 (E.D. La. Aug. 3, 2021) involved two famous adjoining New Orleans restaurants, Galatoire's Restaurant and Galatoire's 33 Bar & Steak. They sought coverage under the accidental contamination provision of their restaurant recovery policy. In a motion for summary judgement, the restaurants argued that one of the restaurants' staffers, unaware that he had COVID-19, continued to work and accidentally contaminated various products. In addition to food and ingestible items, the restaurants argued that the term "insured product" in the policy should include the restaurants themselves, the "service" provided by the restaurants, and non-ingestible products such as plates, tablecloths and saltshakers. The Court rejected these attempts to extend the definitions, which it noted would transform the policies into property policies. The restaurants' expert witness only was able to demonstrate that the infected employee served a number of meals over a four-day period. But there was no proof that any customer got sick from exposure to these items. Thus, the Court concluded that the restaurants failed to meet their burden of proof that their claim was covered and granted summary judgment for the insurer.

Other Developments of Interest

The Late British Festival Season Gets a Boost. There is good news for music lovers and other festival goers and live gatherers in Britain. According to the Reuters article *Festivals for Britain as events get $1 billion COVID reinsurance cover,* Aug. 5, 2021, the British government is working with Lloyd's of London to develop a plan to provide extra insurance against cancellations due to COVID-19. The insurance is reportedly being underwritten by Beazley, Hiscox, and Munich Re, with the government acting as a reinsurer and will be available in September. The plan also applies to other types of gatherings, which is good news for devotees of insurance conferences.

Multidistrict Litigation Update

As previously reported, substantial portions of COVID-19 business interruption coverage claims are being adjudicated through multidistrict litigation ("MDL") in several different Federal Court venues. In the Pittsburgh-based MDL (*In Re: Erie COVID-19 Business Interruption Protection Insurance Litigation*, No. 1:21-mc-00001; W.D.PA) the Court recently ruled that the plaintiffs should file a consolidated complaint against Erie Insurance or potentially lose the ability to amend their individual complaints if their cases are dismissed. The Court explained that all of the cases before it in that MDL hinge on questions of whether policy language requiring "physical loss or damage to" an insured property requires actual or tangible alterations to that property; whether the policy requires that the property have been rendered useless or uninhabitable to be covered; and whether any virus exclusions barred coverage. Thus, it said, it "believes the various legal theories that would likely be relied upon by both plaintiffs and defendants have now been sufficiently ventilated so as to permit their assertion now in the context of a definitive consolidated amended complaint such that these matters may proceed with a degree of confidence." Filing a consolidated complaint would moot Erie's pending motions to dismiss the individual complaints, the Court specified, but if the plaintiffs didn't agree to a consolidated amended complaint, the Court would address the motions to dismiss. In that case, the Court cautioned, it would be less inclined to allow the plaintiffs to amend their individual complaints.

COVID-19 As Force Majeure Excusing Contract Obligations

Since our last update, more courts have rendered decisions on the availability of the Impossibility of Performance, Impracticability of Performance and the Frustration of Purpose doctrines as defenses to non-performance of contractual obligations due to COVID-19. We address some of these cases here specifically in the context of lease agreements. A majority of courts have rejected the defenses in that context as a means of invalidating the entire contract. However, some courts have excused nonperformance for the limited time that government shutdowns precluded operation of the contracted-for business, reasoning that the shutdowns made performance temporarily impracticable or impossible. In reaching their decisions, courts focused on the explicit contract language and the canons of contract interpretation to determine the parties' respective obligations and the stated purpose of the contract, also taking into account allocation of risk provisions.

It appears the spread of the Delta COVID-19 variant likely will start a new phase of court decisions involving these defenses that are informed by the *continued* state of pandemic, rather than the immediate crisis of the initial stages of the pandemic.

AGW Sono Partners, LLC v. Downtown Soho, LLC, No. NWHCV206005853S, 2021 WL 2775075 (Conn. Super. Ct. Mar. 8, 2021), *appeal pending*. A restaurant tenant's defenses of Impossibility of Performance and Frustration of Purpose for the non-payment of rents were rejected and are currently awaiting argument on appeal. The court relied on the explicit language of the lease: the restaurant assumed the risk of compliance with governmental orders, the purpose of the lease did not include operating a *profitable* restaurant and none of the governor's executive orders made restaurant operations impossible. The Court concluded, "[t]he purpose of the lease was not frustrated, the defendant's profitability for continuing that purpose was frustrated. It is a key distinction that causes this defense to fail."

PNC Equip. Fin., LLC v. Flash Limousine, Inc., No. 20 C 6773, 2021 WL 3142124 (N.D. Ill. July 25, 2021). The Court ruled in favor of a commercial lender on its motion for summary judgment for the borrower's failure to resume payments after a 90-day deferral period (the lender granted from April 2020 to June 2020). The court relied on the language contained in the loan that explicitly assigned the risk of Impossibility of Performance to the borrower: "payments are an absolute obligation of Borrower."

267 Dev., LLC v. Brooklyn Babies & Toddlers, LLC, 2021 N.Y. Slip Op. 30796 (N.Y. Sup. Ct. 2021). The Court entered summary judgment for the commercial tenant on its defenses of Impossibility of Performance and Frustration of Purpose in seeking to excuse its nonpayment of rents for *the limited time that the government shutdown stayed in effect*, forcing the tenant's business to close and precluding the tenant from performing its contractual obligations. The Court reasoned that the shutdown was not foreseeable and therefore, could not have been a part of the bargained-for agreement.

Martorella v. Rapp, No. 20-P-1042, 2021 WL 3234312 (Mass. App. Ct. July 30, 2021). This case involved a cancelled Purchase & Sale Agreement that did not contain a financing contingency (i.e. effectively making the purchaser's nearly $200,000 deposit nonrefundable). On the closing date, the purchaser had not obtained financing, yet was required to quarantine because his wife was hospitalized with COVID-19. The Appellate Court affirmed the trial decision rejecting the purchaser's defense of Impracticability of Performance after first acknowledging its potential success: (i) had the contract allocated the risk to excuse the purchaser's continued non-performance following the cessation of the event that originally made performance impractical; or (ii) had the breaching party indicated its intention to proceed with the contract once the event rendering performance impossible ceased. Thus, once the wife's condition improved, no longer necessitating quarantine, the purchaser was no longer excused from performance.

Svanaco, Inc. v. Brand, No. 15-CV-11639, 2021 WL 2526234 (N.D. Ill. June 21, 2021). In ruling to enforce a settlement agreement that involved the repayment of services in exchange for a release of rights, the Court rejected the payor's defenses of Impracticability of Performance and

Frustration of Purpose because: (1) the payor did not present evidence that it was unable to make the payments to plaintiff; (2) the payor's reduced sales and revenue were foreseeable economic changes of its business; and (3) the government shutdown did not affect the value of the agreement for the payor, i.e. payee's release in exchange for repayment. Therefore, the Court ruled it was not impracticable for the payor to make the promised payments (without evidence of financial inability) and there was no frustration of purpose where voiding the settlement agreement would allow the payee to pursue its claims in court.

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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