GFELLER LAURIE LLP
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COVID-19 Insurance Coverage and Liability Update

Business Interruption and Other Insurance Coverage Decisions

Since our last Update, two other federal Appellate Courts have handed down opinions on business interruption coverage. They are from the U.S. Courts of Appeals for the Sixth Circuit and the Eleventh Circuit, respectively. Like the Eighth Circuit before them (*Oral Surgeons, P.C. v. The Cincinnati Ins. Co.,* 2 F.4th 1141 (8th Cir. 2021), they too, affirmed a lower court decision finding there was no coverage. There have been many additional lower court decisions, the vast majority of which 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 those decisions. It will only address those with unusual aspects, with widespread effects. This Update includes a Third Circuit case on the standards for remanding COVID-19 cases to state court under the Declaratory Judgment Act, and the certification of a state-wide class action to pursue claims for coverage.

Sixth Circuit Court of Appeals Holds for Insurer Because of Lack of Direct Physical Loss or Damage

The Sixth Circuit is the third Appellate Court to address claims for business interruption caused by the COVID-19 pandemic. The Court in ***Santo's Italian Café v. Acuity Ins. Co.,*** No. 21-3068, 2021 WL 4304607 (6th Cir. Sept. 22, 2021) applied Ohio law to interpret a commercial property insurance policy issued to a restaurant. The Governor declared a state of emergency, and the Director of the Ohio Department of Health ordered restaurants to close their doors to in-person diners. In affirming the grant of the insurer's motion to dismiss, the Court focused with laser-like intensity on what it referred to as "the unrelenting imperative that the policy covers only 'physical' losses." It stated that "[A]t the outset, [the policy] says that '[w]e will pay for direct physical loss of or damage to Covered Property … caused by or resulting from any Covered Cause of Loss,'" and then says, "with respect to 'Covered Causes of Loss,' the policy applies to 'Risks of Direct Physical Loss." Then, in the Additional Coverage for Business Income and Extra Expense, the insurer must reimburse business income "due to the necessary suspension" if the "suspension" was "caused by direct physical loss of or damage to property."

No one argued that the virus physically and directly altered the property. The Court wrote that the imperative of direct physical loss or direct physical damage "is the North Star of this property insurance policy from start to finish." Later, it said that "These policies do not typically apply to losses caused by government regulation." The Court also held that "the loss of use is simply not the same as a physical loss." It distinguished cases that held that a loss of use sometime may constitute physical loss, by stating that they "involved property that became practically useless for anything."

Given its holding, the Court stated that it had no need to address the effect of two exclusions – the Virus Exclusion and the Ordinance or Law Exclusion.

The Court closed with interesting commentary. "That leaves a hard reality about insurance. It is not a general safety net for all dangers … Efforts to push coverage beyond its terms creates a mismatch, an insurance product that covers something no one paid for, and, worse, runs the risk of leaving insufficient funds to pay for perils that insureds did pay for."

This Opinion was marked "Recommended for Publication."

Eleventh Circuit Court of Appeals Holds for Insurer Because of Lack of Direct Physical Loss or Damage

The Eleventh Circuit became the second Appellate Court to address claims for business interruption caused by the COVID-19 pandemic. Like the Eighth Circuit before it, it held for the insurer, finding there was no "direct physical loss or damage." ***Gilbreath Family & Cosmetic Dentistry, Inc. v. The Cincinnati Ins. Co.,*** No. 21-CV-11046, 2021 WL 3870697 (11th Cir. Aug. 31, 2021) involved a dental practice that stopped performing nonessential procedures, in response to a "shelter in place" order from the Georgia Governor, and a Center for Disease Control guidance recommending that elective and non-urgent dental visits be postponed. The Court applied Georgia law and the federal pleading standards of *Ashcroft v. Iqbal,* 556 U.S. 662, 678 (2009). The policy provided Business Income and Extra Expense coverage only if there was "accidental physical loss" or "damage" to the dental practice's property. The Court found there was none, citing the holding of the Georgia Court of Appeals that "direct physical loss or damage" requires "an actual change in insured property" that either makes the property "unsatisfactory for future use" or requires "that repairs be made." *AFLAC Inc. v. Chubb & Sons, Inc.,* 260 Ga. App. 306 (2003). Plaintiffs also sought coverage under the Civil Authority provision, but the Court held that this required a Covered Cause of Loss, which was physical loss or damage to off-premises property, and the complaint made no such allegations.

Unlike the Sixth Circuit case above, this Opinion was marked "[DO NOT PUBLISH]." In the Eleventh Circuit, "[U]npublished opinions are not considered binding precedent, but they may be cited as persuasive authority."

Third Circuit Rules that Federal Courts Should Carefully Consider Retaining Jurisdiction Before Remanding Removed Cases

One recurring issue has been whether declaratory judgment actions removed from state to federal court based upon diversity of citizenship should be retained by the federal court. This is especially significant in COVID-19 business interruption cases, because surveys reflect there is a meaningfully greater chance of the insured prevailing in state court than in federal court. The Third Circuit addressed the standards for remand in its opinion in three consolidated cases involving restaurants: No. 20-2954, 20-2958, and 20-3122, each filed August 18, 2021. The underlying cases are ***DiAnoia's Eatery LLC v. Motorists Mutual Ins. Co.***, No. 20-CV-00787,

2020 WL 5051459 (W.D. Pa. Aug. 27, 2020), ***Umami Pittsburgh, LLC v. Motorists Commercial Mut. Ins. Co.,*** No. 20-CV-00999, 2020 WL 9209275 (W.D. Pa. Aug. 26, 2020), and ***Mark Daniel Hospitality LLC d/b/a INC v. AmGUARD Ins. Co.,*** 495 F. Supp.3d 328 (D.N.J. 2020).

Under the Declaratory Judgment Act ("DJA"), 28 U.S.C. Sec. 2201-02, a federal court *may* abstain from hearing an action seeking declaratory relief, whether or not further relief is or could be sought. This is a limited exception to the otherwise strict rule that federal courts *must* exercise the jurisdiction conferred on them. As a preliminary matter, the Court rejected the insurers' argument that the complaints are for legal relief that is merely "masquerading" as declaratory relief. As noted, the DJA expressly provides that further, non-declaratory relief does not remove the discretion to abstain.

In the Third Circuit, most of the factors district courts should consider in deciding whether to retain or remand are set forth in *Reifer v. Westport Ins. Co.,* 751 F.3d 129 (3d Cir. 2014). *Reifer* identifies eight non-exclusive factors. The Court closely examined the specific factors in *Reifer* that were determinative in the three cases before it. The first is the "likelihood that a federal court declaration will resolve the uncertainty of obligation which gave rise to the controversy." Two of the lower courts concluded that this factor weighed in favor of remand. They reasoned that the cases would not resolve the "uncertainty of the obligation" because federal courts are limited to predicting state law and certain insurance issues that "have not been addressed by the Commonwealth's highest court." The Third Circuit ruled that this is a misreading of the meaning of the first factor. The question is not what the effect of a declaration would have on the development of state law. Rather, the inquiry is whether a declaration would bring about a "complete termination of the controversy between the parties" and thereby avoid piecemeal, duplicative litigation. The ***Umami*** court relied entirely on this factor in declining to exercise jurisdiction, so the Third Circuit vacated that court's remand order.

Another *Reifer* factor is the "general policy of restraint when the same issues are pending in a state court." The ***DiAnoia's*** and ***INC*** courts relied on this factor. But the Third Circuit ruled that it only applied when the "same issues" are in state court between the *same parties*, not merely when the *same legal questions* are pending in *any* state proceeding.

Another *Reifer* factor is "the public interest in settlement of the uncertainty of the obligation." The restaurants contended that the cases involve novel interpretations of state insurance law and the effect of unprecedented orders of New Jersey state officials. The Third Circuit found that ***DiAnoia's*** court did not identify what alleged "novel insurance coverage issues" were presented, but merely listed policy provisions without further explanation. The Third Circuit thus vacated the ***DiAnoia's*** court's order declining to exercise jurisdiction. The ***INC*** court did address the subject of novelty more squarely, but the Third Circuit found that no principles of insurance contract interpretation law that would need to be employed are unsettled. In fact, it summarized the New Jersey principles in four bullet points. The Third Circuit also concluded that determinations concerning the effect of the virus exclusion would not be exclusively for the state court systems, because the state courts do not have exclusive jurisdiction over public health, or insurance. Thus, the ***INC*** remand order was also vacated.

The Third Circuit concluded that "the courts either misinterpreted certain *Reifer* factors, failed to squarely address the alleged novelty of the state law issues, or did not create a record sufficient to enable us to effectively conduct abuse of discretion review. We will vacate the orders on appeal and remand for renewed consideration under the DJA and the *Reifer* factors as clarified in this opinion."

Federal Court in Virginia Grants First Class Certification in a COVID-19 Case

In late 2020, the federal court for the Eastern District of Virginia in ***Elegant Massage, LLC v. State Farm Mut. Auto. Ins. Co.,*** 506 F. Supp.3d 360 (E.D. Va. 2020) allowed a plaintiff to continue its claim for business interruption against an insurer. The Court found that "it is plausible that Plaintiffs experienced a direct physical loss when the property was deemed uninhabitable, inaccessible, and dangerous to use by the Executive Orders." In addition to declining to enforce the Virus Exclusion, it declined to enforce the Ordinance and Law Exclusion, the Acts or Decisions Exclusion, and the Consequential Loss Exclusion (except for the period between voluntary closing and the Executive Orders).

The plaintiff then moved for class certification, and the decision was granted in part. In a new opinion filed August 19, 2021, the Court certified a class comprising at least 111 Virginia businesses whose claims under all-risk policies were denied by two State Farm companies. However, the Court did not certify a larger class consisting of all 19,300 Virginia businesses holding State Farm all-risk policies. Plaintiffs had failed to provide evidence that all the policyholders were impacted by COVID-19 closures or that they filed claims with State Farm which were denied.

Settlement of Liability Case of Note

There are press reports that in August 2021, a **McDonald's franchise** in Oakland California settled a lawsuit in which its employees alleged that, during the height of the pandemic, they were given masks made from dog diapers and coffee filters. It is alleged that one of the employees and her 10-month-old son contracted COVID-19, and that at least 25 people were infected from an outbreak at the restaurant.

UK Insurers Hit Hard By COVID-19

Readers will recall that in the United Kingdom, many issues of business interruption coverage were addresses through a "Test Case" mechanism established by the Financial Conduct Authority. (This is described in our previous Updates dated June 26 and September 30, 2020.) In short, the Test Case did not go well for the insurers. On September 15, 2021, Reuters reported that small companies have received more than one billion pounds ($1.4 billion) in full and interim business interruptions to date.

Note

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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