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COVID-19 Insurance Coverage and Liability Update

Business Interruption Coverage Decisions

Since our last Update, the United States Court of Appeals for the Seventh and Sixth Circuits handed down additional opinions on Business Interruption coverage. On December 9, 2021, the same three-Judge Panel of the Seventh Circuit issued four Opinions, collectively addressing a wide range of arguments. All cases were decided in favor of the insurers under Illinois law. Some of the issues had not been addressed in the District Court opinions. By taking this approach, the Court effectively may have shut down almost all COVID-19 Business Interruption litigation in Federal Courts in Illinois.

The Sixth Circuit's initial opinion was *Santo's Italian Café v. Acuity Ins. Co.*, 15 F.4th 398 (6th Cir. 2021), which held in favor of the insurer because of a lack of direct physical loss or damage. (*Santos Italian Café* was addressed in our Update dated September 28, 2021.) The first new decision, *Dakota Girls, LLC, et al. v. Philadelphia Indemnity Ins. Co.*,17 F.4th 645 (6th Cir. 2021), also held in favor of the insurer, but the grounds were that the communicable disease and water-borne-pathogen provision did not provide coverage. The second new decision, *Bridal Expressions LLC v. Owners Ins. Co.*, No. 21-3381, 2021 WL 5575753 (6th Cir. Nov. 30, 2021), applied *Santos Italian Café* on the direct physical loss or damage point and also addressed the sufficiency of the insured's pleadings.

Insurers also had victories in State intermediate Appellate Courts in California and Ohio.

There have been many additional decisions, the vast majority of which continue to favor insurers, on the grounds of lack of direct physical loss or damage, a Virus Exclusion, a pollution or contamination provision, or some combination of these. Our Updates do not address all decisions. We only address decisions with unusual aspects or widespread effects. This Update will address the first known case to proceed through a jury trial. It too, favored the insurer, which based its arguments around the absence of physical loss or damage.

Finally, we discuss a recent decision from the District Court for the Northern District of California concluding that ski pass holders' inability to access Vail Resorts due to COVID-19 government restrictions was not a covered loss under the Resorts' Policy affording coverage for "quarantine"-related losses.

New Seventh Circuit Opinions

Insurer Prevails for Lack of Direct Physical Loss

The first Opinion resolved three cases: ***Sandy Point Dental, P.C. v. The Cincinnati Ins. Co.***, No. 21-1186; 2021 WL 5833525 (7th Cir. Dec. 9, 2021); ***The Bend Hotel Development Co. LLC v. The Cincinnati Ins. Co.***, 515 F.Supp.3d 854 (N.D. Ill. 2021); and ***TJBC, Inc. v. The Cincinnati Ins. Co. Inc.***, No. 20-cv-815, 2021 WL 243583 (S.D. Ill. Jan. 25, 2021). Each of the policies provided coverage for income losses sustained on account of a suspension of operations caused by "direct physical loss" to covered property. They also provided coverage for income losses sustained as a result of an action of civil authority prohibiting access to covered property when such actions were taken in response to "direct physical loss" sustained by other property. The Governor issued an Executive Order mandating the temporary closure of restaurants, bars, and movie theaters, and a second order requiring all non-essential businesses to shut down partially and temporarily. The Court defined the phrase "direct physical loss." It said, "we need not wade into a debate about engineering or physical science." Instead, the Court examined the phrase in the context of the policy and related caselaw in Illinois and elsewhere and concluded that the phrase requires a "physical alteration to property." It rejected the insureds' arguments employing a loss-of-use theory. Thus, it found no coverage existed for the losses claimed.

Insurers Prevail Because of Virus Exclusions

The second Opinion is ***Mashallah, Inc. and Ranalli's Park Ridge LLC v. West Bend Mut. Ins. Co.***, No. 21-1507, 2021 WL 5833488 (7th Cir. Dec. 9, 2021). This case involved two underlying appeals. In one, the policy stated it would "not pay for loss or damage caused directly or indirectly" by "[a]ny virus … that induces or is capable of inducing physical distress, illness or disease." In the other, the policy said "[W]e will not pay for loss or damage caused by or resulting from any virus … that induces or is capable of inducing physical distress, illness, or disease." The Court enforced both Exclusions. It applied the efficient-or-dominant-proximate cause rule, predicting that if the Supreme Court of Illinois were to address this point, it would apply the rule because it has been adopted by lower courts in Illinois, and it is the common approach in most other jurisdictions. It found the virus was the cause of the losses. It further held that "[T]he only reasonable interpretation of the Virus Exclusion is that their applicability does not depend on whether a virus is actually detected on the insured's properties." The Court also affirmed the dismissal of claims under the Illinois Consumer Protection Act, and claims based on the theory of unjust enrichment.

Insurer Prevails Under the Loss of Use Exclusion and the Ordinance or Law Exclusion

The third Opinion is ***Bradley Hotel Corp. v. Aspen Specialty Ins. Co.,*** No. 21-1173, 2021 WL 5833486 (7th Cir. Dec. 9, 2021). The Court first summarily applied *Sandy Point Dental, supra*, to find there was no physical loss or damage. It then went on to address two exclusions that were not addressed by the district court, finding that they provided independent grounds for denying

coverage. The first Exclusion applied to "loss or damage caused or resulting from…[d]elay, loss of use or loss of market." The Court held that the insured's "loss of use fell squarely within the terms of the exclusion." The second Exclusion applied to "loss or damage caused directly or indirectly by … enforcement of or compliance with any ordinance or law … [r]egulating the construction, use or repair of any property." The Court enforced this exclusion as well, rejecting the argument that the Governor's Executive Orders did not quality as an "ordinance or law" within the meaning of the Exclusion. The insured argued that "law" should be understood to mean only a statute passed by a federal or state legislature, and "ordinance" should refer only to a municipal statute or regulation. The Court found these limitations would lead to "strange results," omitting things such as regulations issued by the Federal Occupational Safety and Health Administration, or a local fire marshal's order imposing occupancy limits.

Insurer Prevails Under Microorganism Exclusion

The final Opinion is ***Crescent Plaza Hotel Owner, L.P. v. Zurich Am. Ins. Co.***, No. 21-1316, 2021 WL 5833485 (7th Cir. Dec. 9, 2021). Here too, the Court summarily applied *Sandy Hook Dental, supra*, to rule against the insured under the "direct physical loss or damage" requirement. It then went on to hold that the Microorganism Exclusion independently barred coverage. Again, the Court ruled on this even though the district court did not address it. The Exclusion barred coverage or losses "directly or indirectly arising out of or relating to mold, mildew, fungus, spores or other microorganism of any type, nature, or description, including but not limited to any substance whose presence poses an actual or potential threat to human health." The Court held that the virus qualifies as a "microorganism" under this definition. It consulted dictionaries, most of which included viruses in their definitions of microorganism. Some did not, however, based on the view that viruses are not technically alive. The insured pointed to "considerable disagreement" among biologists as to whether viruses are appropriately categorized as microorganisms for various scientific purposes. To the Court, however, "[t]he question is how an ordinary reader or policyholder, not a scientist, would understand the term as used in the policy." It said that "[a]n ordinary reader, unversed in the nuances of classification debates in microbiology, would be unlikely to home in on viruses' lack of cellular structure to decide whether losses they cause fall under the exclusion." The Court looked to the context of the policy, including the definition of microorganism which included those "of any type, nature, or description," and described broadly as "any substance whose presence poses an actual or potential threat to human health."

The Court went on to find the provision was not surplus because of the biological or chemical materials exclusion, which referred to "the actual or threatened malicious use of pathogenic or poisonous biological or chemical materials." Finally, it rejected the argument that the insurer's addition of a Communicable-disease Exclusion in the 2020 policy did not amount to a tacit admission that the 2019 policy did not exclude losses caused by viruses.

New Sixth Circuit Opinions

Insurer Prevails Because Coverage Is Not Provided by the Communicable Disease or Water-Borne Pathogen Provision

Dakota Girls, LLC, et al. v. Philadelphia Indemnity Ins. Co., 17 F.4th 645 (6th Cir. 2021) involved seventeen private preschools that were among the child-care programs ordered to be shut down for approximately two months by the Ohio government to combat the spread of COVID-19. The provision at issue covered losses that result when a government orders a shutdown of business operations "due directly to an outbreak of a communicable disease or a water-borne pathogen that causes an actual illness at the described premises[.]" There was no dispute that COVID-19 is a communicable disease.

The insureds argued that the Court should read the phrase "that causes an actual illness at the described premises" to apply only to "water-borne pathogens." In effect, they were arguing for the application of the "last antecedent rule," which presumes that qualifying words and phrases refer solely to the last antecedent. The Court declined to apply this presumption for two reasons. First, the presumption does not apply where the modifying phrase follows a concise and integrated clause – here, "communicable disease or a water-borne pathogen," which lists two examples of disease. It distinguished this from a phrase such as "a tornado, armed uprising, or water-borne pathogen that causes actual illness." Second, the presumption does not apply when the surrounding context suggests a "contrary intent." Here, the policy's period of restoration was set at 24 hours after "[the insured's] premises are evacuated due to illness caused by an outbreak of a 'communicable disease' or a 'water-based pathogen.'" The Court held that this reflected the intent that an actual illness from a communicable disease (as well as a water-borne pathogen) must be at the insured's premises if coverage is to exist.

That requirement also made the insureds' complaint deficient. The complaint never alleged that someone at the preschools in fact had COVID-19. It only alleged that "each school had individuals on their premises with symptoms consistent with COVID-19." The Court found that this did not meet the test for pleading in *Ashcroft v. Iqbal*, 556 U.S. 662 (2009). It also held that the complaint did not and could not have alleged that the statewide shutdown order arose from an illness at the premises. The shutdown order was framed in general terms to all childcare providers, and "to avoid an imminent threat," *i.e.*, it was a prophylactic measure not directed to a specific illness discovered *anywhere*.

For all these reasons, the Court affirmed dismissal of the Complaint. The Opinion was marked "RECOMMENDED FOR PUBLICATION."

Insurer Prevails because Loss of Use Is Not Covered and the Complaint Failed to Allege the Presence of COVID-19 in the Insured's Premises and that it Materially Altered Specific Property

Bridal Expressions LLC v. Owners Ins. Co., Case No. 21-3381, 2021 WL 5575753 (6th Cir. Nov. 30, 2021) involved a claim under a Business Owners Insurance Policy with a "Special Property Coverage Form" that covered "direct physical loss of or damage to Covered Property." The Court summarily applied *Santos Italian Café* as controlling authority in the Sixth Circuit for the rule that the mere loss of use is insufficient for coverage. The Court went on to address the argument made in this case that "the presence of COVID-19 altered the structure of the air, the physical space, and the property surfaces at" the insured's premises. Reviewing the complaint, the Court found that the closest operative paragraph did little more than repeat the language of the policy, alleging that the presence of the virus "impaired and damaged" the covered property and "caused" a disruption of operations. The Court held that this "did not put the insurance company on notice of a distinct theory of coverage by explaining how the virus physically altered property in the store … For this theory to have traction, the complaint would need to allege at a minimum that the coronavirus was present in the store and materially altered specific property at the time." The Court affirmed dismissal of the claim. The Opinion was marked "NOT RECOMMENDED FOR PUBLICATION."

State Intermediate Appellate Court Decisions

There are still no State Supreme Court rulings on COVID-19 coverage issues. There have been two recent intermediate appellate court decisions.

Inns by the Sea v. California Mut. Ins. Co., 4th Cir. No. D079036, 2021 WL 5298480 (Nov. 15, 2021) denied coverage under the Business Income and Civil Authority provisions of an all-risk policy. The Court held that the operative government shelter-in-place orders were issued to stop the spread of the virus, and not in response to physical damage or loss to any property. This decision is broadly consistent with the Ninth Circuit opinion in *Mudpie Inc. v. Travelers Cas. Ins. Co. of Am.,* 15 F.4th 885 (9th Cir. 2021) (addressed in our Update dated October 21, 2021).

The Nail Nook, Inc. v. Hiscox Ins. Co., et al., Case No. 110341, 2021 WL 5709971 (Ohio Ct. App. Dec. 2, 2021) also denied coverage under a Businessowners Policy. The Court found that there was no "direct physical loss or damage" and cited the Sixth Circuit decision in *Santos Italian Café, supra.* It also applied the Policy's Virus Exclusion.

First Jury Trial

In a Case Involving the Issue of Physical Loss or Damage, Federal Jury in Missouri Returns Verdict in Favor of Insurer

K.C. Hopps, Ltd. v. The Cincinnati Ins. Co., No. 20-cv-00437, 2021 WL 4302834 (W.D. Mo. Sept. 21, 2021) was addressed in our Update dated October 21, 2021. There, the Court denied an insurer's motion for summary judgment, setting up a jury trial and battle of experts on whether the there was a possibility that COVID-19 was present on the insureds' property, and if so whether there was physical loss or damage. The trial took three days. The jury deliberated for one hour and 45 minutes and returned a verdict in favor of the insurer. There is no information on the jury's reasoning.

Ski Pass Insurance Does Not Extend to COVID-19 Shutdown Orders

In ***In Re: United States Specialty Insurance Company Ski Pass Insurance Litigation***, Case No. 20-md-02975-YGR (N.D. Cal. October 26, 2021), the District Court for the Northern District of California recently found no coverage under a ski pass insurance policy for losses Vail Resorts incurred as a result of COVID-19 restrictions. The case involved a pending motion to dismiss the plaintiffs' Second Amended Consolidated Class Action Complaint ("SAC") filed by the defendant, United Specialty Insurance Company ("USIC"), in multidistrict litigation. The plaintiffs purchased ski passes, known as Epic Passes, for access to the mountain resorts owned and/or operated by Vail Resorts for the 2019/2020 ski season. The plaintiffs also purchased Ski Season Ski Pass Insurance (the "Policy") from USIC.

At issue was the definition of the term "quarantined" as used in the Policy. Specifically, peril (e) of the Policy provided coverage against loss of use of the season ski pass if caused by one of the following unforeseen perils occurring after the effective date of coverage: "[y]ou are subpoenaed, required to serve on a jury, hijacked, quarantined or your travel visa is denied[.]"

The plaintiffs claimed that because of Vail Resorts' decision to close its North American mountain resorts for the entirety of the 2019/2020 season due to COVID-19, they were prevented from entering upon and using any Vail Resorts' facilities or properties and deprived of the use of their Epic Passes. The plaintiffs argued that Vail Resorts' decision to shut down its resort locations and exclude its passholders was a "quarantine," given the commonly understood meaning of the term, as it was a measure aimed at restricting access of Epic Pass holders from publicly gathering at resort locations to prevent further spread of COVID-19. The plaintiffs asserted that this quarantine was a peril insured against by USIC under the Policy and as such, the plaintiffs and other purchasers of the Policy were entitled to coverage for their losses attributable to being excluded from Vail Resorts.

USIC argued that the phrase "you are . . . quarantined . . . means that the insured is detained or isolated from others because he or she has been potentially exposed to a communicable disease." USIC moved to dismiss the action on the grounds that the SAC failed to plead coverage under the Policy and SAC failed to plead the claimed loss occurred while coverage was in effect.

The Court noted that the term "quarantined" was not defined in the Policy and interpreted the Policy's use of the term in its ordinary and popular sense, relying upon the dictionary definition of the term and considering the term in the context of the Policy. Interpreting the Policy with the assistance of dictionary definitions, surrounding terms and common sense, the Court concluded that the plaintiffs' expansive definition of "quarantined" to include any measure excluding individuals from a particular area to prevent the spread of disease, without any other restriction, is "patently unreasonable" and "while creative, defies common sense." The Court found instead that, at a minimum, the meaning of quarantine encompasses a limitation of movement to a particular area, a meaning which is clear and unambiguous. Under California law, the Court concluded that the plaintiffs failed to allege plausible coverage under the Policy and could not state a claim upon which relief could be granted. Thus, the Court granted USIC's motion to dismiss with prejudice and ordered that judgment enter for USIC.

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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