GFELLER LAURIE LLP
ATTORNEYS AT LAW

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COVID-19 Insurance Coverage and Liability Update

Business Interruption Coverage Decisions

Although there have been many reported decisions since our June 1, 2022 Update, there have been no significant changes in approach or results in federal appellate courts or state supreme courts. To recap the position broadly, Insurers have prevailed at every federal circuit that has ruled: the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth and Eleventh Circuits. The decisions have been based on lack of direct physical loss or damage, or virus exclusions, or both. Since our last Update, new state supreme court decisions in Wisconsin, South Carolina, and Washington have joined those in Massachusetts and Iowa. All have ruled in favor of Insurers, on the grounds of lack of direct physical loss or damage. These decisions will be reviewed below.

There are, however, a few state intermediate court decisions that present Insurers with potential exposure. They will be described below.

This potential exposure was demonstrated dramatically last week when a state court jury in Harris County, Texas returned a verdict in favor of Baylor College of Medicine against Lloyd's. The case had unusual features, set forth more fully below, but the key aspects were that the judge left to the jury the question of whether the presence of the virus caused direct physical loss or damage where the Insured's clinical and research hospital was required to continue operations.

Finally, one new decision from a federal district court is noteworthy because it is the first to rule on the number of occurrences when coverage exists for disease contamination.

Insurer Prevails under Wisconsin Law for Lack of Direct Physical Loss or Damage

Colectivo Coffee Roasters, Inc., et al. v. Society Insurance, 2022 WI 36 (Wis. June 1, 2022) reversed an intermediate Appellate Court and remanded with orders to grant the Insurer's motion for summary judgment. The Court unanimously held that the inability of bars and restaurants to use their dining space for in-person dining did not constitute direct physical loss or damage. The virus did not alter the appearance, shape, color, structure, or other material dimension of the property and did not necessitate structural repairs or remediation. The Court also held that the alleged presence of COVID-19 on the property did not implicate the policies' contamination provisions because the closures were not caused by the alleged contamination of their properties by virus, but rather, by governmental orders.

Insurer Prevails under South Carolina Law for Lack of Direct Physical Loss or Damage

Sullivan Management, LLC v. Fireman's Fund Ins. Co., et al., Case No. 2021-001209, 2022 WL 3221920 at *1 (S.C. Aug. 10, 2022) answered a certified question. The Court held that business interruption losses were not covered under an all-risks property policy. It said that "the presence of COVID-19 and corresponding government orders prohibiting indoor dining do not fall within the policy's trigger language of 'direct physical loss or damage.'"

Insurer Prevails Under Washington Law for Lack of Direct Physical Loss or Damage, with Additional Ruling Enforcing the Virus Exclusion

Hill and Stout, PLLC v. Mutual of Enumclaw Ins. Co., Case No. 100211-4, 2022 WL 3651805 (Wash. August 25, 2022) was a unanimous decision in favor of Insurers, from a jurisdiction that often favors Insureds. A dental practice sought business interruption coverage following the suspension of its practice pursuant to a proclamation of the Governor prohibiting nonemergency dental care. In a unanimous decision, the Supreme Court held that there was no direct physical loss or damage. The Court found it unreasonable to read that term to include the constructive loss of intended use of property. There had to be a physical loss. But here, the Insured was always able to physically use the property at issue. Even under a "loss of functionality test," there was no physical loss of functionality. The property continued to be functional. Although it was not necessary to go further, the Court examined the issue of efficient proximate cause "because it is fully briefed and this issue will likely repeat in other cases regarding the interpretation of similar insurance policies." The issue arose in the context of the Virus Exclusion. Under Washington law, where a peril specifically insured against sets other causes into motion which, in an unbroken sequence, produce the loss, the loss is covered, even though other events in the chain of causation are excluded. But here, the Court held that because COVID-19, which is an excluded peril, initiated the causal chain giving rise to the Governor's proclamation and the loss, the entire causal chain was excluded and the Virus Exclusion would be given effect.

State Intermediate Appellate Court Decisions in Favor of Insureds

There have been a few notable intermediate state court opinions in favor of Insureds, which present the possibility of exposure.

Louisiana Intermediate Appellate Court Holds that Coverage Exists under an All-Risks Policy Based on Ambiguity and "Prior Precedent"

Cajun Conti, LLC v. Certain Underwriters at Lloyd's, London, et al., Case No. 2021-CA-0343, 2022 WL 2154863 (La. Ct. App.4 Cir, June 15, 2022). This was the first business interruption suit seeking insurance coverage for COVID-19 losses. It was also the first to go to a bench trial, resulting in a ruling against the Insured. But it now has been reversed, with the holding that coverage exists under an all-risks policy because contamination by COVID-19 constitutes "direct physical loss or damage." The case was decided by a 3-2 majority, which issued two separate

opinions supporting the decision. Two of the judges held, most significantly, that the policy is ambiguous on lost business income coverage and therefore, the applicable provisions should be liberally construed in favor of coverage. The policyholder's interpretation was reasonable and the Court held it was reasonable that a suspension due to physical loss or damage would include a loss of the property's full use. The third Judge in the majority concurred, reasoning that the Court was bound by its prior decision in *Wider v. Louisiana Citizens Prop. Ins. Corp.*, 82 So.3d 294 (La. Ct. App. 4 Cir, 2011), in which it held that physical damage was not needed to trigger homeowner's policy coverage in a residential lead contamination case, where the property was made unusable or unlivable.

California Intermediate Appellate Court Holds Pleadings of Direct Physical Loss or Damage Sufficient and Allows Business Interruption Claim to Continue

Marina Pacific Hotel and Suites, LLC, et al. v. Fireman's Fund Ins. Co., Case No. B316501, 81 Cal. App. 5th 96 (Second Dist., Div. Seven, July 13, 2022) reversed a trial court's ruling that COVID-19 cannot, as a matter of law, cause direct physical loss or damage sufficient to trigger business interruption coverage under a commercial property policy. The trial court had dismissed the case at the pleading stage. The Insured had pled that COVID-19 had been physically present at its insured hotel and had bonded and/or adhered to various surfaces and objects involving "physico-chemical" reactions involving cells and surface proteins. The Appellate Court found these allegations sufficient to plead coverage. The policy also included express coverage for communicable disease, which also required direct physical loss or damage. To the Appellate Court, this reinforced the conclusion that a communicable disease such as COVID-19 could, in fact, cause direct physical loss or damage. The Appellate Court recognized that its ruling was inconsistent with previous California Appellate Courts' decisions, but distinguished them because of the "well-pleaded allegations of direct physical loss or damage" in the case before it. As a result of the ruling, the Insured is entitled to proceed and present evidence. The opinion is marked "CERTIFIED FOR PUBLICATION."

California Appellate Court Holds that the Term "Evacuation" Gives Rise to Coverage under a Civil Authority Endorsement Not Requiring Physical Loss or Damage and that a Mold Exclusion Does Not Apply Where There is No Allegation the Virus was Present on the Premises

Butter Nails and Waxing, Inc., v. Underwriters at Lloyd's, London, Case No. B311455, 2022 WL 3653866 (Cal. Ct. App. Second Dist., Div. Five, Aug. 5, 2022), a case not involving physical loss or damage, held that a civil authority endorsement covered business interruption coverage and that the mold exclusion mentioning virus did not apply. In addition to the policy's civil authority coverage provisions, which required physical damage to adjoining property, the policy contained a separate "Civil Authority Endorsement." That Endorsement contained no requirement of physical damage, affording coverage merely upon "a mandatory action from a government authority requiring evacuation." It did not, however, define "evacuation." The Court construed the government order as requiring "evacuation" to be broad enough to encompass the public health

orders that required the Insured to close its doors to prevent the spread of a dangerous virus, reasoning this would be the Insured's reasonable expectation.

The policy also included a "Mold Exclusion" stating it would not cover loss "caused by… exposure to …organic pathogens (a term defined to include viruses)." The Court reasoned that the Mold Exclusion was not "applicable to *every* claim stemming directly or indirectly from a virus." Rather, "an insured would reasonably understand the exclusion to apply only where the claimed losses were related in some way to the presence of the organic pathogen on the business premises." The Insured did not allege that the virus was present on the business premises.

Unlike *Marina Pacific Hotels, supra,* this opinion was marked "NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS"

New York Appellate Court Allows Claims to Continue under a Pollution Legal Liability Policy that Does Not Require Direct Physical Loss or Damage

New York Botanical Gardens v. Allied World Assur. Co., Case No. 2021-04319, 206 A.D.3d 474 (N.Y. App. Div., 1st Dep't June 14, 2022) arose under a Pollution Legal Liability policy and did not implicate direct physical loss or damage issues. The parties agreed that the pandemic qualified as a "pollution incident" under the policy. When such an event on, at or under an independent location, gives rise to a governmental order denying access to the Insured's premises, the policy affords contingent business interruption coverage. The issue was whether that coverage applied during periods when the Insured had temporary access to the property, including periods involving potential partial resumption of operations to mitigate damages. The Insurer contended there was only coverage for a complete denial of access. The Appellate Division held that policy language, which it did not quote, contemplates coverage for periods of temporary and partial access. It also allowed the Insured's claims for breach of the implied covenant of good faith and fair dealing to continue. The complaint alleged the Insurer did not conduct a complete or fair investigation of the claim, had no meritorious basis for denying the claim and simply applied a business policy of denying COVID-19-related business interruption claims.

Texas State Court Jury Returns Verdict in Favor of Insured

Texas Jury Returns Verdict in Favor of Hospital that Suffered Losses while Continuing to Operate

Baylor College of Medicine v. XL Ins. America Inc., et al., Case No 2020-53316, (Dist. Ct Tex., Harris County, verdict returned Aug. 31, 2022). In what is believed to be the first jury verdict in favor of an insured in a COVID-19 business interruption suit, after a three-day trial, a jury in a state court in Texas returned a verdict in favor of the Insured. According to published reports, there were several notable and unusual features in the case. First, in most cases, the plaintiffs have been required to suspend operations. Here, however, the Insured plaintiff was a University clinical and research hospital that was required to remain open to admit and treat patients and to continue its

COVID-related research projects. It alleged that the governmental orders to slow the pandemic's spread forced it to dramatically reduce operations at its clinics, implement telehealth services, significantly curtail its laboratory research and teaching programs and purchase additional equipment.

The judge left the question of whether the presence of COVID-19 caused direct physical loss or damage to the jury. There was continuous exposure because patients with the virus were always on the premises. The jury found that the Insured suffered about $42.8 million in lost profits, about $3.3 million in extra expenses for items such as plexiglass barriers and personal protective equipment and about $2.3 million in damages to its research projects. Lloyd's provided 25% of the insurance, so if the verdict survives appeal, they will be responsible for 25% of the damages, about $12 million. The rest of the insurance was provided by ACE American Insurance Company and XL Insurance America, Inc. Their policies contained virus exclusions and the claims against them were dismissed last year.

Ruling on Number of Occurrences

Illinois Federal Court Finds Separate Occurrences for Governmental Orders in Different States under Disease Contamination Provision

Dental Experts, LLC v. Massachusetts Bay Ins. Co., Case No. 20 C 5887, 2022 WL 2528104 (N.D. Ill. July 7, 2022) involved a Disease Contamination provision that provided coverage up to $25,000 per occurrence. The policy defined "occurrence" as "[a]n act, event, cause or series of similar, related acts, events, or causes." The case concerned a total of twenty governmental orders issued during the pandemic in a total of ten different jurisdictions in which the Insured had operations. The Court applied Illinois law, which uses a cause-based rule to determine the number of occurrences, so the focus was on proximate cause. From a proximate cause standpoint, it was the governmental orders that forced the Insureds to close its offices, not the pandemic itself. The Court found that within jurisdictions, the multiple orders were causally related to each other, so they could not be separate occurrences. Across states, however, the orders were not causally related to one another, because orders issued in one state were not caused by those entered by officials in another state. Rather, a separate and intervening human act in each of the ten jurisdictions was the proximate cause of the respective losses. Thus, there were ten separate occurrences with ten separate limits.

A Note on Future Updates

Starting with this Update, we will no longer address or identify every appellate-level decision on COVID-19 business interruption. For the most part, new decisions have become repetitive and rote, reaching the same conclusions for the same reasons as earlier decisions. To address them all would disrespect our readers' time and attention. Instead, as in this current Update, we will identify

and address only those decisions with unusual holdings or other singularly noteworthy features. Thus, the Updates are likely to become less frequent, but more valuable.

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 these topics or advice on specific questions related to coverage and/or 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:

Robert Laurie (rlaurie@gllawgroup.com), 860-760-8405)
Melicent Thompson (mthompson@gllawgroup.com), 860-760-8446)
Vince Vitkowsky (vvitkowsky@gllawgroup.com), 212-653-8870)
Kendra McGuire (kmcguire@gllawgroup.com), 860-760-8445)

Sincerely,

Gfeller Laurie LLP