GFELLER LAURIE LLP
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December 1, 2022

COVID-19 Insurance Coverage and Liability Update

Business Interruption Coverage Decisions

There have been dozens of reported decisions since our September 8, 2022 Update. Most have favored Insurers. Overall, Insurers have prevailed at every Federal Circuit that has ruled: the Second, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, Tenth and Eleventh Circuits. Five State Supreme Courts – Iowa, Massachusetts, Oklahoma, South Carolina, Washington and Wisconsin also have ruled in favor of Insurers. The decisions have been based on lack of direct physical loss or damage, or virus exclusions, or both.

However, there has been a slight uptick in decisions, predominantly but not exclusively, in state courts, favoring Insureds and allowing cases to proceed past the pleading stage. Some of these are notable. The most significant was rendered by the Vermont Supreme Court. There also is a California Federal District Court decision under the unique Factory Mutual Insurance Company Policy form favoring the Insured.

In other developments, the United States Supreme Court denied certiorari on a Fourth Circuit case, thus allowing a holding of lack of coverage to stand. Further, the Louisiana Supreme Court has agreed to hear the appeal of the highly unusual State Appellate Court decision in favor an Insured.

Vermont Supreme Court Holds that Insurer Sufficiently Pleaded that the Virus Causes Direct Physical Damage.

Huntington Ingalls Industries, Inc, et al. v. Ace American Insurance Co., et al., 2022 VT 45 (2022) reversed a lower court, which granted judgment on the pleadings in favor or the Insurers. The Insured is a sympathetic one. It is the sole supplier of military warships to the United States Navy and Coast Guard. Although not stated in the decision, some of its executives describe its mission as "making sure no U.S. hero goes into battle with an inferior weapon."

In a 3-2 decision under Vermont law, the Supreme Court held that the Insured had sufficiently pleaded that the virus causes direct physical damage. The Insured is part of the Defense Industrial Base, part of the Essential Critical Infrastructure Sector. The Department of Defense indicated that the Insured "had a special responsibility to maintain [their] normal work schedule." The Insured kept its shipyards open but made changes to its operations in order to comply with CDC guidance and to protect employees. Over 6000 employees tested positive and the Court stated that "COVID-19 has been continuous present at the shipyards since March 2020."

The all-risk policies had the standard coverage requirement that there be "direct physical loss or damage to property." The Court analyzed existing caselaw and concluded that "direct physical loss" means "persistent destruction or deprivation, in whole or in part, with a causal nexus to a physical event or condition." The complaint alleged that the virus could adhere to surfaces, transforming the surface into a fomite. This causes "detrimental physical effects" that "altered and impaired the functioning of the tangible, material dimensions of the property." Because of this, the insured had to take "steps that involve physical alterations," such as installing barriers and devices and redesigning physical spaces. The Court wrote, "[W]e are inclined to allow experts and evidence to come in to evaluate the validity of the insured's novel legal arguments before dismissing this case based on a layperson's understanding of the physical and scientific properties of a novel virus." The Court stated that "remanding this case and allowing further factual development is consistent with the philosophy underlying notice pleading."

The Court only ruled that the pleading plausibly stated a claim of "direct physical damage," which was sufficient to reverse the dismissal. It stated that the Insured might also argue it suffered "direct physical loss," but that theory was best left to the trial court when a more complete record is developed. It twice stressed that this result was supported by Vermont's "extremely liberal pleading standards." (It bears emphasizing, however, that as alluded to in the dissent, Vermont's standards may not be notably more liberal than most other states with notice-pleading standards.)

Thus, the Court allowed the case to proceed.

California Federal Court Denies Motion to Dismiss Claims under a Policy Containing Communicable Disease and Contamination Provisions

Sacramento Downtown Arena LLC, et al. v. Factory Mutual Insurance Co., No. 2:21-CV-00441-KJM-DB, 2022 WL 16529547 (E.D. Cal. Oct. 28, 2022) interpreted the unique policy language of the Factory Mutual Insurance Company all risks property policy. The Insureds operate and manage the Golden I Center, the arena which is the home of the Sacramento Kings, as well as a nearby hotel and outdoor shopping center. Applying California law, the Court found the policy to be ambiguous and construed it in favor of the Insured. It denied Factory Mutual's motion to dismiss for failure to state a claim upon which relief can be granted and allowed the case to proceed.

The Policy language is dense. The first section of the Policy provides coverage for property damage, describing "additional other coverages" for "insured physical loss or damage." One such additional coverage was for "communicable disease response." If an insured location has the "actual not suspected presence" of a communicable disease and access is limited, restricted, or prohibited by "an order of an authorized governmental agency regulating the actual not suspected presence of a communicable disease" or the decision of an Officer of the Insured, the Policy covers the costs of cleanup, removal, and disposal of the communicable disease, as well as the actual cost of fees for public relations services or reputation management.

The Policy also provides TIME ELEMENT coverage applying to lost earnings or profits if the loss resulted "directly . . . from physical loss or damage of the type insured. . . to property described elsewhere in this Policy and not otherwise excluded by this policy or otherwise limited in the TIME ELEMENT COVERAGES." This coverage applies to Actual Loss and EXTRA EXPENSE "if an order of civil or military authority limits, restricts or prohibits partial or total action . . . provided such order is the direct result of physical damage of the type insured at the insured location or within five statute miles/eight kilometers of it."

The Policy has two relevant exclusions. The first is for "loss of market or loss of use." The second is for "contamination." It excludes, "unless directly resulting from other physical damage not excluded by this Policy," "contamination and any cost due to contamination including the inability to use or occupy property or any cost of making property safe or suitable for use or occupancy." It goes on to provide that if the contamination "directly results from other physical damage not excluded from this Policy, then only physical damage caused by such contamination may be insured..." "Contamination" is expressly defined to include virus, among other causes.

Parsing through the language, the Court concluded that the Policy "can reasonably be interpreted as defining the presence of a 'communicable disease' as 'physical loss or damage.'" The "Additional Coverages for insured physical loss or damage" includes governmental orders regulating the actual presence of a communicable disease, so the insured could reasonably expect that the presence of a communicable disease fits under the term "physical loss or damage." Also, the claims based on losses incurred as the result of civil and military orders tie back to the term "physical damage of the type insured." The Court concluded that "an insured could reasonably expect the term "physical damage" to have the same meaning throughout the policy." Factory Mutual argued that the presence of a communicable disease did not fall within the basic scope of coverage. The Court said that "[T]his reading may be a reasonable alternative… but that is not the question here." It said that "[U]nder California law, if the language in an insurance policy is capable of more than one reasonable interpretation, as in this case, the ambiguity is resolved in favor of coverage." It applied the same approach in ruling the contamination exclusion did not apply. Both parties had offered reasonable interpretations and the Court concluded that the ambiguity must be resolved in the Insured's favor. As for the loss-of-use exclusion, it does not apply if the policy states otherwise and using its prior analysis, the Court held that the communicable coverage and the TIME ELEMENT coverage did in fact state otherwise.

U.S. Supreme Court Declines to Hear Appeal from the Fourth Circuit

Bel Air Auto Auction Inc. v. Great Northern Insurance Co., No. 21-1493, 2022 WL 2128586 (4th Cir. June 14, 2022), *cert. denied*, No. 22-392, 2022 WL 17085221 (U.S. Nov. 21, 2022) is a case denying coverage on the grounds that COVID-19 did not physically alter property and that loss of intended use does not constitute property damage. In its Order List released on November 21, 2022, the United States Supreme Court included it in the cases in which certiorari was denied. The effect is to leave the Fourth Circuit ruling undisturbed.

Louisiana Supreme Court Accepts Appeal of Prominent Holding on Favor of the Insured

In our September 8, 2022 Update, we reported on ***Cajun Conti LLC v. Certain Underwriters at Lloyd's, London, et al.***, 2021-0343 (La. App. 4 Cir. 6/15/22), *on reh'g* (Aug. 8, 2022), *writ granted sub nom*, ***Cajun Conti LLC v. Certain Underwriter At Lloyd's***, 2022-01349 (La. 11/22/22). This case found coverage for business interruption from COVID-19 losses under an all-risk property policy. It was hailed by policyholders as a potentially breakthrough case. However, other courts have so far declined to follow it. On November 22, 2022, the Supreme Court of Louisiana agreed to hear an appeal. In the Louisiana Supreme Court, it is Case No. 2022-C-01349.

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:

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Sincerely,

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