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Alerts

COVID-19 Coverage Update: Insurers Prevail in First Two U.S. Appellate Court Decisions

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Insights for Insurers

The pace of new COVID-19 coverage actions has slowed down in recent months, but new cases continue to be filed. As of August 31, 2021, according to the Penn Law COVID Coverage Litigation Tracker, more than 1,980 COVID-19-related coverage cases have been filed through the end of July.

By the Numbers

State courts granted 73 motions to dismiss and denied 32. Meanwhile, federal courts granted 386 motions to dismiss and denied 21. The vast majority of dismissals were with prejudice and based on the absence of direct physical loss or damage or the presence of a virus or other exclusion. Most cases involve business interruption claims (1,791), extra expense (1,618), and civil authority coverage (1,542). Concerning class action allegations, 460 seek state or federal class action certification, while 1,543 did not involve class action claims. The tracker reports 686 cases contained bad faith allegations, while 1,317 did not.

There have been two appellate court decisions on the merits of coverage for COVID-19-related claims under first-party insurance policies as of September 2, 2021. Both of these decisions are from U.S. Circuit Courts and have upheld trial court rulings dismissing policyholder complaints based on the absence of direct physical loss or injury.

Eighth Circuit

In *Oral Surgeons, P.C. v. Cincinnati Ins. Co.*, the U.S. Court of Appeal for the Eighth Circuit found no coverage for COVID-19-related claims. Oral Surgeons sought coverage for losses sustained as a result of the suspension of non-emergency procedures. The policy insured Oral Surgeons against lost business income and specific extra expenses resulting from the suspension of operations "caused by direct 'loss' to property." The policy defines "loss" as "accidental physical loss or accidental physical damage." Cincinnati Insurance Company denied coverage on the basis that its policy did not provide coverage because there was no direct physical loss or physical damage to Oral Surgeons's property. The district court granted Cincinnati's motion to dismiss.

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The Eighth Circuit began its analysis by recognizing the policy requires direct "physical loss" or "physical damage" to implicate business interruption and extra expense coverage. "Accordingly, there must be some physicality to the loss or damage of property—*e.g.*, a physical alteration, physical contamination, or physical destruction."

The court further recognized that "the unambiguous requirement that the loss or damage be physical in nature accords with the policy's coverage of lost business income and incurred extra expense during the 'period of restoration.'" The court noted that the policy provides coverage until property "should be repaired, rebuilt or replaced" or until business resumes elsewhere assumes physical alteration of the property, not a mere loss of use. According to the court,

> Oral Surgeons did not allege any physical alteration of property. The complaint pleaded generally that Oral Surgeons suspended non-emergency procedures due to the COVID-19 pandemic and the related government-imposed restrictions. The complaint thus alleged no facts to show that it had suspended activities due to direct "accidental physical loss or accidental physical damage," regardless of the precise definitions of the terms "loss" or "damage." We reject Oral Surgeons's argument that the lost business income and the extra expense it sustained as a result of the suspension of non-emergency procedures were "caused by direct 'loss' to property. The policy clearly does not provide coverage for Oral Surgeons's partial loss of use of its offices, absent a showing of direct physical loss or physical damage. . . . this appeal presents only the question whether the COVID-19 pandemic and the related government-imposed restrictions constitute direct "accidental physical loss or accidental physical damage" under the policy. Iowa state and federal courts have uniformly determined that the COVID-19 pandemic and the related government-imposed restrictions do not constitute direct physical loss. Lisette Enters., Ltd. v. Regent Ins. Co., No. 4:20-cv-00299, 2021 WL 1804618, at *1–2 (S.D. Iowa May 6, 2021).

The court also cited to various trial court decisions under Iowa law in COVID-19-related coverage claims. The court rejected the policyholder's argument that the policy was ambiguous and rejected the notion that direct physical damage is different from direct physical loss—a key argument of policyholders in many of these cases.

Eleventh Circuit

More recently, the Eleventh Circuit addressed coverage for COVID-19-related claims in *Gilreath Family & Cosmetic Dentistry Inc. v. The Cincinnati Insurance Co.* The policyholder, Gilreath Family & Cosmetic Dentistry, sued Cincinnati Insurance Company after it denied coverage for losses Gilreath sustained as a result of the COVID-19 pandemic. The subject policy provided coverage for Covered Cause of Loss, which required direct accidental physical loss or damage. The policy did not contain a virus exclusion. Gilreath alleged that the presence of virus or disease can constitute physical damage to property and claimed the virus physically impacted its property because its business is "highly susceptible to rapid person-to-property transmission of the virus." As such, the virus "render[ed] [its property] unsafe, uninhabitable, or otherwise unfit for its intended use, which constitute[d] direct physical loss." According to Gilreath, even if the virus did not impact its business, the various orders and recommendations made it impossible to operate. Gilreath contended that the Policy does not define what constitutes a direct physical loss and is ambiguous. It further contended that physical loss does not require a visible or physical alteration to the property, and that the mere presence of COVID-19 constitutes physical damage to the property sufficient to require coverage under the Policy. It further argued that it was entitled to civil authority coverage because the COVID-19 pandemic and the accompanying orders and recommendations prevented it and numerous businesses in the area from operating and accessing their premises.

The court found the decision in *Mama Jo's Inc. v. Sparta Insurance Company*, a non-COVID-19 case decided under Florida law, persuasive. In that matter, the court looked to the plain meaning of the phrase to find that the words "direct" and "physical" modify "loss" and 'impose the requirement that the damage be actual.'" It also relied upon *Johnson v. The Hartford Financial Services Group, Inc*., which dismissed an action brought by a group of dentists because the plaintiffs failed to allege that the COVID-19 virus caused any physical damage to their properties or that it caused any tangible alteration to a single physical edifice or piece of equipment. The court was not persuaded by the plaintiffs' argument that the damage was caused by "the omnipresent specter of COVID-19." It concluded that such "conjecture and speculation" could not defeat a motion to dismiss. It also cited to numerous other district courts in Georgia and around the country that have applied a similar analysis and dismissed COVID-19-related claims.

The Eleventh Circuit concluded that, although the phrase "direct physical loss" is not defined in the policy, its plain and literal meaning requires actual, physical damage to the covered premises. The court found Gilreath's reliance on the opinions in *Studio 417, Inc. v. Cincinnati Insurance Company* and *Blue Springs Dental Care, LLC v. Owners Insurance Company* to be misplaced. In fact, the court found those cases to be contrary to Georgia law. Further, it disagreed with their reasoning that the potential attachment of a virus with a limited life cycle to the walls of a building equals physical damage or loss. It found Gilreath's interpretation "would stretch the terms of the Policy beyond what was intended, render meaningless the word 'physical' and lead to an absurd result." It was asserted that because the COVID-19 virus is airborne, easily transmissible, and may be found within Gilreath's premises, Gilreath was forced to suspend non-emergency procedures due to the various orders and recommendations entered as a result of the pandemic—as were other businesses in Gilreath's area. This argument was insufficient. Further, to the court, it was notable that there is no allegation of a confirmed case of the virus in Gilreath's offices.

Looking Ahead

Additional trial court decisions are expected going forward. Many appeals are pending in state and federal appellate courts across the country, and new decisions will be rendered in the coming weeks. As with the trial court decisions, insurers have received early favorable decisions from courts of appeal, but the ultimate direction of COVID-19 insurance coverage litigation remains to be seen.

See, e.g., Milligan v. Grinnell Mut. Reinsurance Co., No. 00-1452, 2001 WL 427642, at *2 (Iowa Ct. App. Apr. 27, 2001) (concluding that "direct physical loss or damage" "unambiguously referred to injury to or destruction of" insureds' property and finding support for the conclusion "in the fact that the loss or destruction must be physical in nature"); *The Phx. Ins. Co. v. Infogroup, Inc*., 147 F. Supp. 3d 815, 823 (S.D. Iowa 2015) ("The common usage of physical in the context of a loss therefore means the loss of something material or perceptible on some level."). The policy cannot reasonably be interpreted to cover mere loss of use when the insured's property has suffered no physical loss or damage. *See Pentair, Inc. v. Am. Guar. & Liab. Ins. Co*., 400 F.3d 613, 616 (8th Cir. 2005) ("Once physical loss or damage is established, loss of use or function is certainly relevant in determining the amount of loss, particularly a business interruption loss."); *Infogroup*, 147 F. Supp. 3d at 825 ("While a loss of use may, in some cases, entail a physical loss, the Court does not find 'loss of use' and 'physical loss or damage' synonymous.").

See, e.g., Henry's Louisiana Grill, Inc. v. Allied Ins. Co. of Am., No. 1:20-cv-2939-TWT, 2020 WL 5938755, at *5 (N.D. Ga. Oct. 6, 2020) (rejecting the argument that a shelter-in-place order caused a restaurant's physical loss of its property because no "physical element of the dining rooms—the floors, the ceilings, the plumbing, the HVAC, the tables, the chairs—underwent [a] physical change as a result of the [o]rder"); *Karmel Davis and Associates, Attorneys-at-Law, LLC v. The Hartford Financial Services Group, Inc.*, No. 1:20-cv-02181-WMR, 2021 WL 420372, at *4 (N.D. Ga. Jan. 26, 2021) (dismissing the case because "the 'likely' presence of COVID-19 cannot be regarded as a physical change, as it does not and has not physically altered the insured property" and explaining that "[a]lthough the virus is transmitted through the air and may adhere to surfaces briefly, there is no indication that it causes any sort of physical change to the property it touches"); *El Novillo Rest. v. Certain Underwriters at Lloyd's, London*, No. 1:20-cv-21525-UU, 2020 WL 7251362, at *6 (S. D. Fla. Dec. 7, 2020).