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Tic-Tac-Toe, Sixth Circuit The Latest of Three United States Court of Appeals Decisions to Have Found No Coverage For COVID-19 Claims Based Upon The Absence of Direct Physical Loss

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Insights for Insurers

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The U.S. Court of Appeals for the Sixth Circuit recently affirmed the dismissal of a policyholder's COVID-19 insurance coverage action in *Santo's Italian Café LLC v. Acuity Insurance Co.*, No. 21-3068 (6th Cir. Sept. 22, 2021). In its decision, the Sixth Circuit began by pointing out that the COVID-19 pandemic was not good for the policyholder restaurant's business given the reluctance of patrons to enter enclosed public spaces such as restaurants and an order for Ohio restaurants to suspend all in-person dining operations to slow the spread of the virus. Although the closure order permitted restaurants to offer takeout services, the restaurant sustained significant losses and laid off employees.

The restaurant sued its insurer, Acuity Insurance Company, for coverage under a commercial property insurance policy, which covers business interruption "caused by direct physical loss of or damage to property." The suit was filed in Ohio state court, but removed to federal court. The district court granted Acuity's 12(b)(6) motion to dismiss, reasoning that the policy did not cover this kind of peril. The Sixth Circuit affirmed, determining that there was no direct physical loss as required for business interruption (and other) coverage.

Ohio law governed this dispute. The court recognized that the dispute is resolved by the contract language and afforded the undefined terms their "common and ordinary" meaning to the words "direct physical loss of or damage to" covered property. The heart of the court's analysis was as follows:

> Nothing unexpected arises from consulting dictionary definitions of the key disputed terms of this clause: "direct physical loss of" property. "Direct" means "[e]ffected or existing without intermediation or intervening agency; immediate." Oxford English Dictionary Online (3d ed. 2021). "Physical" means "natural; tangible, concrete." *Id*. "Loss" means "[p]erdition, ruin, destruction; the condition or fact of being 'lost,' destroyed, or ruined," or "being deprived of." *Id*. And "property" means "any residential or other building (with or without associated land) or separately owned part of such building (as an apartment, etc.)," as well as "[s]omething belonging to a thing; an appurtenance; an adjunct." . . . . Whether one sticks with the terms themselves (a "direct physical loss of" property) or a thesaurus-rich paraphrase of them (an "immediate" "tangible" "deprivation" of property),

> the conclusion is the same. The policy does not cover this loss. The restaurant has not been tangibly destroyed, whether in part or in full. And the owner has not been tangibly or concretely deprived of any of it. It still owns the restaurant and everything inside the space. And it can still put every square foot of the premises to use, even if not for in-person dining use. Think of the different potential sources of the restaurant's lost income—the virus and the State's shut-down orders—and whether either one created a "direct physical loss of or damage to" property. The novel coronavirus did not physically affect the property in the way, say, fire or water damage would. No one argues that the virus physically and directly altered the property. The restaurant indeed makes no such argument. The Governor's shut-down orders also did not create a direct physical loss of property or direct physical damage to it. They simply prohibited one use of the property—in-person dining—while permitting takeout dining and through it all did not remotely cause direct physical damage to the property. It was as if the government temporarily rezoned all restaurants in the State solely for takeout dining. Even as restaurant owners no doubt would suffer from such a decision and no doubt would have reason to object to it, the government regulation would not create a direct physical loss of property. A loss of use simply is not the same as a physical loss. It is one thing for the government to ban the use of a bike or a scooter on city sidewalks; it is quite another for someone to steal it. . . The imperative of a "direct physical loss" or "direct physical damage," moreover, does not suddenly appear in the policy's section for additional coverage, such as business interruption losses. It is the North Star of this property insurance policy from start to finish. Recall how the policy starts: "We will pay for direct physical loss of or damage to Covered Property . . . caused by or resulting from any Covered Cause of Loss.". . . . Other terms in the policy reinforce this conclusion. Acuity promised to pay for lost business income only during the "period of restoration." . . . . That period begins 24 hours after the "time of direct physical loss or damage" and ends either when the insured property "should be repaired, rebuilt or replaced with reasonable speed" or when "business is resumed at a new permanent location," whichever comes first. . . . Baked into this timing provision is the understanding that any covered "direct physical loss of or damage to" property could be remedied by repairing, rebuilding, or replacing the property or relocating the business. But what would that mean under Santo's Café's interpretation of the policy? It has not alleged any problem with the building. There is nothing to repair, rebuild, or replace that would allow the resumption of in-person dining operations. What the restaurant needed was an end to the ban on in-person dining, not the repair, rebuilding, or replacement of any of its property. The traditional uses of commercial property insurance also support this interpretation. Even when called "all-risk" policies, as these policies sometimes are, they still cover only risks that lead to tangible "physical" loss or damages, say by fire, water, wind, freezing and overheating.

While acknowledging some cases have held that a loss of the ability to use property may in some constitute a "physical loss," the Sixth Circuit pointed out that these cases, whether decided correctly or not, involved property that became practically useless for anything. It noted that Santo's Café has not alleged that its property is unusable or uninhabitable, only that it is "unsafe, dangerous and unfit for its intended use."

The court was sympathetic to the plight of hospitality businesses but recognized the solution was not in misreading the contract language:

> The singular challenges facing restaurants, bars, and other hospitality services over the last eighteen months are not lost on us. Staying in business through a once-in-a-century pandemic (let us hope) that has prompted all kinds of new government regulations, including prohibitions on many in-person services, has to be trying. Sure, state and federal loans and grants have offered some support for entities that suffered government-created losses of this sort, and surely that aid has allowed some companies to survive. But that truth provides little solace to those that did not. . . . That leaves a hard reality about insurance. It is not a general safety net for all dangers. If risk is not having money when you need it, insurance is one answer to perilous events that could prompt a sudden drop in revenue. Fair pricing of insurance turns on correctly accounting for the likelihood of the occurrence of each defined peril and the cost of covering it. 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. That is why courts must honor the coverage the parties did—and did not—provide for in their written contracts of insurance.

Apart from relying upon other two prior United States Court of Appeals decisions, the court believed *Mastellone v. Lightning Rod Mutual Insurance Co.*, 884 N.E.2d 1130, 1133 (Ohio Ct. App. 2008) supported the conclusion that a physical change or alteration is required to implicate coverage. In view of this ruling on coverage, the court found it unnecessary to address the virus exclusion.