PLUNKETT COONEY

Covered Cause of Loss, Virus Exclusion, Duty to Defend, Wear & Tear Exclusion and Leakage Limitation Coverage Update

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Covered Cause of Loss and Virus Exclusion – Eastern District of Michigan (Michigan Law)

Turek Enterprises, Inc. v. State Farm Mut. Auto. Ins. Co.
--- F. Supp. ---, 2020 WL 5258484 (E.D. Mich. Sept. 3, 2020)

The U.S. District Court for the Eastern District of Michigan granted dismissal of a lawsuit alleging breach of an insurance contract for failure to pay for losses related to COVID-19. State Farm Mutual Automobile Insurance Company and State Farm Fire and Casualty Company (State Farm) issued a business owner's insurance policy to Turek Enterprises, Inc., d/b/a Alcona Chiropractic (Turek) for the policy period May 22, 2019 to May 22, 2020. The policy provided first-party property and business interruption coverage for accidental direct physical loss to covered property, and contained an exclusion for "any loss which would not have occurred in the absence of one or more of the following excluded events ... Virus, bacteria or other microorganism that induces or is capable of inducing physical distress, illness, or disease."

Pursuant to the Michigan Governor's Executive Order 2020-21 requiring businesses to suspend operations, Turek suspended operations on March 24, 2020 until May 28, 2020. It then made a claim for loss of income and extra expense as a result of the executive order. State Farm denied coverage on the basis that Turek suffered no direct physical loss to its property, and on the basis of the virus exclusion. Turek commenced the instant lawsuit, alleging breach of contract under the policy based on State Farm's denial.

State Farm moved to dismiss the complaint, and the district court granted the motion. The district court found that the closure of Turek's business did not constitute accidental direct physical loss to covered property, rejecting Turek's argument that "physical loss to Covered Property" included the inability to use its property. The district court further held that the virus exclusion precluded coverage for Turek's loss of income because it barred coverage for "any loss that would not have occurred but for" a virus.

The district court rejected Turek's argument that only the executive order caused Turek to suspend operations, and not COVID-19 itself, because the executive order expressly stated that its purpose was to quell the spread of the virus and the executive order would not have existed but for the presence of COVID-19. The district court ultimately held that "Plaintiff is therefore wrong to suggest that 'whether the reason for the [Order] was preventing the spread of a virus or an asteroid spreading magic dust is irrelevant'" because "[i]f it were the latter, the Virus Exclusion would not apply."

Duty to Defend – Fifth Circuit (Texas Law)

Waste Mgmt., Inc. v. AIG Specialty Ins. Co.
--- F.3d ---, 2020 WL 5268504 (5th Cir. Sept. 4, 2020)

The U.S. Court of Appeals for the Fifth Circuit determined that AIG Specialty Insurance Company (ASIC) does not have to cover $26 million in legal expenses incurred by Waste Management, Incorporated (Waste Management) in connection with defending criminal charges for environmental contamination. The appellate court determined that such fees were not covered under the ASIC pollution legal liability policy.

The underlying case arose when flooding occurred in Hawaii in 2010 and 2011, causing medical waste from one of Waste Management's landfills to contaminate Pacific Ocean beaches. The pollution legal liability policy provided that ASIC was obligated to defend Waste Management against "written demands" seeking a "remedy" following a pollution incident. Waste Management contended that the Administrative Order of Consent (AOC) that the Environmental Protection Agency issued was a claim triggering coverage under the policy, as it required Waste Management to engage in response work to clean up the discharge. Waste Management further argued that the subsequent federal government indictment against the company and two of its employees also fulfilled this policy requirement because the government could seek a "remedy" of payment of clean-up costs. ASIC, however, declined to cover Waste Management's costs of defending the case. Eventually, the case settled and Waste Management was ordered to pay a $400,000 criminal fine and $200,000 in restitution. Because ASIC declined to cover the fees arising from the settlement, Waste Management then sued ASIC for coverage.

In analyzing whether ASIC had a duty to defend Waste Management, the appellate court first rejected Waste Management's argument that the AOC constituted a claim for clean-up costs that triggered ASIC's duty to defend against the criminal charges. The appellate court found that, on its face, the AOC was independent from the criminal proceedings, it was issued months before the grand jury investigation, and the response work was completed almost three years before the grand jury's indictment. The appellate court also rejected Waste Management's argument that the indictment constituted a claim under the policy, as the indictment did not expressly seek any remedy from Waste

Management, and it was improper to look outside of the pleadings to determine a duty to defend. Ultimately, the appellate court affirmed the trial court's ruling that ASIC had no duty to defend.

Wear & Tear Exclusion and Leakage Limitation – Sixth Circuit (Michigan Law)

Matthews v. Harleysville Ins. Co..
--- Fed. Appx. ---, 2020 WL 5413005 (6th Cir. Sept. 9, 2020)

The U.S. Court of Appeals for the Sixth Circuit ruled that the "wear and tear" exclusion and "leakage limitation" in an all-risk policy applied to preclude coverage for property damage to a building caused by water pooling on the roof of the building. Specifically, in 2017, the insured, O.L. Matthews, M.D., P. C. (OLM), began experiencing water leaks into its building, which caused damage to the interior of the building. Following a coverage denial, OLM brought a breach of contract action against its insurer, Harleysville Insurance Company (Harleysville). The district court granted summary judgment in favor of Harleysville, reasoning that the "negligent work" exclusion applied based on evidence that the roof was improperly designed.

Initially, the appellate court found that the district court erred in relying on the "negligent work" exclusion because it applied an anti-concurrent rule of causation, instead of the policy's ensuing loss clause. The appellate court, nonetheless, upheld summary judgment in favor of Harleysville because there was "no genuine dispute" that the "wear and tear" exclusion applied to preclude coverage as the record evidence demonstrated wear and tear was a cause of loss in the case. In particular, the appellate court noted that the roofers that OLM hired to repair the roof opined that it had exceeded its lifespan by approximately 15 to 20 years. The appellate court also noted that the roofers observed "lots of little holes," "soft spots," "seams that were open," and "sagging" on the roof, which was further evidence of wear and tear.

Additionally, the appellate court found that the "leakage limitation," which precluded coverage for "loss or damage to … [t]he interior of any building or structure caused by or resulting from rain, snow, sleet, ice, sand or dust, whether driven by wind or not …" applied to exclude coverage for the damage to the interior of the building. Specifically, the appellate court noted that OLM did not dispute that the water infiltration was caused by the ponding or pooling of rain water that collected on the roof. Accordingly, the appellate court affirmed the lower court's ruling that there was no coverage for the loss.

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