PLUNKETT COONEY

Direct Physical Loss, Bad Faith Coverage Update

March 1, 2022

Direct Physical Loss – Sixth Circuit (Michigan Law)

Brown Jug Inc. v. Cincinnati Ins. Co.
--- F.4th ---, 2022 WL 538221 (6th Cir. Feb. 23, 2022)

The U.S. Court of Appeals for the Sixth Circuit found that insurance policies issued to restaurants and entertainment venues did not provide first-party coverage for losses resulting from closures due to COVID-19.

Cincinnati Insurance Company (Cincinnati) issued commercial property insurance policies to several restaurants and other similar venues, including Brown Jug Inc. d/b/a Little Brown Jug Inc. d/b/a The Backroom (collectively, the restaurants). These policies included business income coverage, under which Cincinnati would pay the insureds for actual loss of income "due to the necessary 'suspension' of []'operations,'" but the suspension of operations "must be caused by direct 'loss' to property." Other coverages also required that the insured sustain direct loss or damage to property.

Due to the COVID-19 pandemic and related government shutdown orders requiring certain businesses to close to customers (including dine-in restaurants), the restaurants were "unable to return to normal operations" and lost significant income. Two of the restaurants were allegedly sources of virus outbreaks. The restaurants submitted claims to Cincinnati to recoup some of their lost income. Cincinnati denied coverage because each of the coverage parts under which the restaurants sought coverage required physical loss or damage to the restaurants' properties.

The restaurants commenced lawsuits against Cincinnati for wrongful denial of coverage. The trial court in each of the lawsuits "not[ed] that the Michigan Supreme Court has yet to opine on the meaning of 'direct physical loss,' [and] elected to follow most courts and found that the plaintiffs were required to allege facts indicating that COVID-19 caused tangible harm to their property or resulted in a loss of functionality of the property, rather than merely a loss of use." The alleged presence of the virus at the restaurants did not constitute tangible harm. The restaurants appealed the district court's decisions to the appellate court.

The appellate court affirmed the findings of the trial court, noting that it was required to make "an Erie guess" as to how the Michigan Supreme Court would construe the policy term "direct physical loss."

Relying in part on a recent Michigan Court of Appeals case, the appellate court determined that "direct physical loss" is unambiguous and requires the insured to show "destruction or alteration of the property, or dispossession from the property." Noting that the COVID-19-related shutdown orders alone could not constitute direct physical loss or direct physical damage, the appellate court found that the restaurants' position that the virus was actually present at their premises did not "credibly allege[] that the presence of COVID-19 in any way caused 'direct physical loss of or damage to' a covered property, or that the virus 'physically and directly altered ... property' by its mere presence." The restaurants could only allege economic damages.

At the same time, the appellate court found that the restaurants had not adequately alleged "that COVID-19 caused loss or damage to properties 'other than the covered property' as required to plead a breach of the Civil Authority provision." The state's stay-at-home orders issued early in the pandemic were not similar to government-issued curfews put in place to prevent rioting and property damage in the 1967 and 1968 Detroit riots, in large part because "the Michigan shutdown orders issued in 2020 permitted and encouraged businesses to remain operational" despite restrictions on in-person services. For these reasons, the appellate court found that the restaurants did not adequately allege that Cincinnati's denial of coverage for civil authority coverage was wrongful.

By: Stephanie Brochert

Bad Faith – Eleventh Circuit (Florida Law)

Ellis v. GEICO Gen. Ins. Co.
2022 WL 454176 (11th Cir. Feb. 15, 2022)

The U.S. Court of Appeals for the Eleventh Circuit affirmed the district court's decision granting summary judgment to defendant, GEICO General Insurance Company (GEICO). The appellate court panel held that no reasonable jury could conclude that GEICO operated in bad faith in its handling of the insurance claim.

On Sept. 7, 2014, the insured, Jonathan Ellis, struck and killed a bicyclist named Timothy Brobek. At the time of the accident, GEICO insured Ellis under an automobile liability policy that provided bodily injury liability coverage in the amount of $10,000 per person and $20,000 per accident. After the accident, Ellis fled the scene, but he hired an attorney the next day and was arrested on Sept. 10. The attorney representing the estate of Brobek sent a letter to GEICO on Sept. 16, but GEICO did not receive the letter and was not notified of the accident until Oct. 9. An adjuster promptly attempted a phone call to Ellis and mailed both a first contact letter and a reservation of rights letter the same day. Thereafter, GEICO assigned a field investigator to the case, but she could not reach Ellis despite numerous attempts at in-person and telephone contact. On Oct. 29, the field investigator obtained a copy of the traffic crash report and tendered the full limits of the policy to the estate of Brobek. The estate's

attorney rejected the tender as untimely. In the attorney's opinion, GEICO had not acted in good faith towards Ellis in the investigation of the claim.

The estate of Brobek filed suit against Ellis and ultimately received a final judgment for $479,208.56. On May 21, 2019, Ellis filed a declaratory judgment action against GEICO, seeking a declaration that the insurer handled the estate's claim against Ellis in bad faith. On appeal, the appellate court explained that no reasonable jury could conclude that GEICO operated in bad faith for its investigatory efforts between Oct. 9 and Oct. 29. Moreover, once GEICO was able to confirm the extent to which Ellis' vehicle was involved in the accident, it immediately tendered its limits. Based on the totality of the circumstances, the appellate court concluded that Ellis had raised no possible inference of bad faith.

By: Joshua LaBar