PLUNKETT COONEY

Direct Physical Loss, Bad Faith Failure to Settle Coverage Update

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Direct Physical Loss – Washington

Hill and Stout, PLLC v. Mut. of Enumclaw Ins. Co.
--- P.3d ---, No. 100211-4, 2022 WL 3651805 (Wash. Aug. 25, 2022)

The Washington Supreme Court unanimously found that a business property insurance policy issued to a pediatric dental office did not provide coverage for lost business income sustained when the dental office was required to close following the outbreak of COVID-19.

Two dentists operated a practice, Hill and Stout PLLC (Hill and Stout) with two office locations. Hill and Stout purchased a business property insurance policy from Mutual of Enumclaw Insurance Company (Enumclaw). The policy provided coverage for lost business income due to "direct physical loss of or damage to" the properties listed in the policy. It also contained a virus exclusion precluding coverage for "loss or damage caused directly or indirectly by" "[a]ny virus ... that induces or is capable of inducing physical distress, illness or disease."

In an effort to stop the spread of COVID-19, the governor of Washington issued a proclamation prohibiting non-emergency dental care for a time. Hill and Stout sought coverage for the income lost while their dental offices were closed for all but emergency procedures and filed a lawsuit against Enumclaw seeking a declaration that the policy issued to them covered their lost business income. The trial court first denied Enumclaw's motion to dismiss Hill and Stout's complaint, but later granted Enumclaw's motion for summary judgment following discovery. Hill and Stout appealed the district court's decision directly to the Washington Supreme Court.

The Supreme Court affirmed the trial court's grant of summary judgment. The high court held that any losses sustained as a result of the governor's proclamation did not constitute "direct physical loss" as required by the policy to allow for business income coverage. Specifically, the Supreme Court held that "[i]t is unreasonable to read 'direct physical loss of ... property' in a property insurance policy to include constructive loss of intended use of property. Such a loss is not 'physical.'" The high court rejected Hill and Stout's request to apply a "loss of functionality test" to the claim, noting that Hill and Stout's claim for coverage would nevertheless fail under that test.

While, in some cases, business income coverage may be available to an insured in the absence of a physical alteration to the property on the basis that the property loses functionality, that was not the case with respect to Hill and Stout's offices. The dental offices suffered neither physical alteration nor a

physical loss of functionality to the property. "The Proclamation did not cause a loss of functionality of the property because it continued to be functional."

While the Supreme Court noted that it "need not examine" the applicability of the policy's virus exclusion, it nevertheless held that the virus exclusion applied as it found there was no question of fact that the COVID-19 virus, an excluded peril under Enumclaw's policy, "initiated a causal chain," resulting in Hill and Stout's claimed losses, and therefore applied to preclude coverage.

By: Stephanie Brochert

Bad Faith Failure to Settle – California

Palma v. Mercury Ins. Co.
B309063, 2022 WL 3592722 (Cal. App. Ct. 2d Dist. Aug. 23, 2022)

The California Court of Appeal upheld the trial court's order granting summary judgment in favor of defendant Mercury Insurance Company (Mercury) and against plaintiffs, Julio Palma and Miriam Cortez (plaintiffs) in a case to recover damages arising from a wrongful death action involving the plaintiffs' son. The appellate court ruled that Mercury did not fail to accept a settlement offer in bad faith.

In September 2012, Frank McKenzie (McKenzie) was driving a vehicle that struck and killed the plaintiffs' son, who had been riding a moped. Mercury insured McKenzie under a policy with bodily injury limits of $15,000 and property damage limits of $10,000. The attorney for the plaintiffs, the Carpenter Firm, sent a settlement letter to Mercury demanding it tender the full policy limits to resolve the claim against the decedent's estate. Mercury's retained counsel, Jeffery Lim (Lim), responded by letter and indicated that Mercury would tender the $15,000 policy limits. The Carpenter Firm did not respond to the letter. A few days later, Lim contacted McKenzie to discuss the settlement offer. McKenzie agreed to accept the offer and signed a declaration stating there is no other insurance covering the loss.

Lim sent a letter to the Carpenter Firm with a $15,000 check enclosed and represented that aside from the Mercury policy, there were no other policies in existence for the loss. He inadvertently failed to attach McKenzie's declaration. Lim also included a standard release of claims form for signature and requested that the firm provide any changes to the release by Oct. 29, 2012. The Carpenter Firm did not respond. In January 2013, Lim wrote the firm and requested the signed release of claims form. The Carpenter Firm responded and claimed there had been no settlement because the demand was for the full policy limits, which included the property damage limits of $10,000. In a subsequent letter sent six months later, the Carpenter Firm also highlighted Lim's failure to timely deliver McKenzie's declaration.

The Carpenter Firm later filed a wrongful death lawsuit against McKenzie and obtained a $3 million judgment in favor of the plaintiffs. Notably, the judgment was not entered in favor of the decedent's estate. Mercury paid the plaintiffs the $15,000 bodily injury policy limits. McKenzie assigned its rights against Mercury to the plaintiffs who subsequently filed a bad faith action against Mercury. The trial court granted summary judgment in favor of Mercury and held that the offer had been made on behalf of the decedent's estate – not on behalf of the plaintiffs. Therefore, the offer was to settle any survival claims for medical bills on behalf of the estate and not a wrongful death claim on behalf of the plaintiffs.

The California Court of Appeal first explained that a bad faith failure to settle claim requires proof that the third party made a reasonable offer to settle the claims against the insured for an amount within the policy limits. The appellate court held that the letter could not reasonably be interpreted as an offer to settle plaintiffs' wrongful death claims. Wrongful death claims belong to the heirs, and the offer in the letter was only to settle the survival claim on behalf of the decedent's estate. Furthermore, the appellate court held that even if the offer had been made, Mercury did not act in bad faith because, at most, Lim's failure to deliver McKenzie's declaration was negligent. Mercury had taken all the necessary actions that it could, and the Carpenter Firm's inaction for approximately nine months was clearly evidence that it was preparing for litigation with an eye toward a future bad faith action. According to the appellate court, "if anyone acted in bad faith, it was Plaintiffs and the Carpenter Firm."

By: Joshua LaBar