

Direct Physical Loss, Damage COVID Coverage Update

October 1, 2021

Direct Physical Loss or Damage – U.S. District Court for the Northern District of Illinois (Illinois Law)

3 Squares, LLC v. The Cincinnati Ins. Co.

No. 20-CV-2690, 2021 WL 4437817 (N.D. Ill. Sept. 23, 2021)

E. Coast Ent. of Durham, LLC v. Houston Cas. Co.

No. 20-CV-6551, 2021 WL 4437818 (N.D. Ill. Sept. 23, 2021)

In two separate actions, the U.S. District Court for the Northern District of Illinois found in favor of the insurers, ruling that the insureds did not show that they were entitled to coverage for their COVID-19 pandemic losses as they could not show they incurred a direct physical loss that would trigger coverage under the respective policies.

The insureds each submitted their claims with their respective insurers that sought coverage for business income losses and other related losses stemming from the pandemic and shut down orders. After each claim was denied, the businesses filed suit seeking coverage under their insurance policies. The insurers in both lawsuits filed dispositive motions, claiming that the insureds failed to demonstrate that they incurred a direct physical loss.

The district court agreed with the insurers, holding that the insureds were required to show a direct physical loss to trigger coverage. In its decision, the district court referenced the U.S. Court of Appeals for the Eighth Circuit opinion of *Oral Surgeons, P.C. v. The Cincinnati Ins. Co.*, 2 F.4th 1141 (8th Cir. 2021) (*Oral Surgeons*). In *Oral Surgeons*, the appellate court held that an Iowa dental clinic could not recover from its insurer for losses due to government imposed COVID-related restrictions. Applying this decision, the district court found in favor of the insurers, observing that the businesses similarly brought general allegations of economic losses that resulted from the pandemic, and that such losses are not covered by the policies.

The district court reasoned that “[t]he vast majority of courts in Illinois and around the country to have considered the question have concluded that under a plain and ordinary meaning analysis the phrase ‘physical loss or damage to property’ does not extend coverage to purely economic losses caused by COVID-19 related business shutdown orders.” The district court further held that the businesses failed to allege “physical alteration of plaintiffs’ properties,” or that the “virus particles have physically altered

their properties.” Thus, the district court granted the insurers’ motion to dismiss in each case.

By: Michael Hanchett

Direct Physical Loss or Damage – U.S. District Court for the Western District of Missouri (Missouri Law and Kansas Law)

K.C. Hopps, Ltd. v. Cincinnati Ins. Co., Inc.

--- F. Supp. 3d ---, 2021 WL 4302834 (W.D. Mo. Sept. 21, 2021)

The plaintiff K.C. Hopps Ltd. (Hopps), an owner of bars, restaurants, event spaces, and catering services throughout Kansas City, filed an action against Cincinnati Insurance Company Inc. (Cincinnati), seeking coverage under its all-risk commercial property insurance policy for business losses it sustained during the COVID-19 pandemic.

In deciding on Hopps’ and Cincinnati’s competing motions for summary judgment, the U.S. District Court for the Western District of Missouri initially noted that the parties disputed whether Missouri or Kansas law applied to the interpretation of the policy. The district court ultimately found that it did not need to decide this issue because Missouri and Kansas apply the same insurance principles, and, therefore, the outcome would be the same under either state’s laws.

Next, the district court distinguished the recent decision, *Oral Surgeons, P.C. v. The Cincinnati Ins. Co.*, 2 F.4th 1141 (8th Cir. 2021) (*Oral Surgeons*), recognizing that the U.S. Court of Appeals for the Eighth Circuit did not rule that COVID-19 could never constitute “direct physical loss” or “direct physical damage.” According to the district court, the appellate court in *Oral Surgeons* merely held that the government mandates due to COVID-19 were not direct accidental physical loss or physical damage. The district court noted that Hopps had submitted evidence supporting its contention that COVID-19 is physical, contaminated its premises, and made its properties unsafe.

More specifically, Hopps presented testimony from a molecular epidemiologist, who opined that it was “more likely than not – indeed, it is highly likely” that the virus was present on Hopps’ properties at the time the government stay-at-home orders were in effect. Hopps’ corporate representative also testified that 50 employees were infected with COVID-19 in the summer of 2020, which further supported Hopps’ position that COVID-19 was present on its properties. Based on this evidence, the district court found that whether the virus caused physical loss or physical damage, and the extent of that damage, was a question of fact for the jury.

Further, the district court rejected Cincinnati’s argument that Hopps did not incur an “actual loss” because Hopps received more in pandemic relief than its claimed damages. The district court

reasoned that the purpose of the relief was to “incentivize[] employee retention,” it did not compensate Hopps for its alleged loss of business income.

Finally, the district court ruled that Hopps was not entitled to summary judgment, noting that there was a genuine issue of material fact as to whether COVID-19 was actually present on the properties, whether Hopps' operations were reduced to remediate the physical loss or physical damage, and whether Hopps actually incurred damages.

Direct Physical Loss or Damage – U.S. District Court for the District of Massachusetts (Massachusetts Law)

BN Farm LLC d/b/a The Farm Bar and Grille Essex v. The Cincinnati Cas. Co.

No. 1:20-cv-10874-MBB (D. Ma. Sept. 16, 2021)

Ten restaurants (plaintiffs), with operations in Massachusetts and New Hampshire, filed a declaratory judgment action against their insurer, The Cincinnati Casualty Company (Cincinnati), seeking coverage for losses stemming from the COVID-19 pandemic and emergency orders issued by those states. The plaintiffs sought coverage under their Cincinnati commercial property insurance policy (the policy) pursuant to: (1) the building and personal property coverage form, and (2) the business income coverage form. The U.S. District Court for the District of Massachusetts denied the plaintiffs' motion for summary judgment and ordered entry of a final judgment in favor of Cincinnati.

Under the building and personal property coverage form, the policy pays for “direct loss to Covered Property at the premises caused by or resulting from any Covered Cause of Loss.” The business income coverage form contains similar language. Additionally, both forms include a provision covering “loss” caused by civil authority. The policy defines “loss” to mean “accidental physical loss or accidental physical damage.” The plaintiffs argued that “physical loss” does not require a structural change to the property, and instead the COVID-19 virus caused physical loss because it could not be removed entirely by cleaning and involved a “peril[] which render[ed] the covered property uninhabitable, inaccessible or dangerous to use for the owners and patrons.” Conversely, Cincinnati argued that the plain meaning of “physical loss” or “physical damage,” as incorporated in the business income, the extra expense, and the civil authority coverage provisions, unambiguously requires an actual, tangible structural alteration of property.

The district court noted that the policy did not define either phrase and instead the phrases had to be interpreted based on their plain meaning. After reviewing prior Massachusetts decisions, the district court concluded that the policy language was unambiguous, and “physical loss” or “physical damage” denoted tangible damage to the actual integrity or structure of the property. In other words, intangible losses or “transient phenomena” were not covered under the policy language. Thus, the COVID-19 contamination did not cause the requisite physical loss or damage to the property “because the virus

DIRECT PHYSICAL LOSS, DAMAGE COVID COVERAGE UPDATE Cont.

had no physical effect on the property.”

By: Joshua LaBar

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