Lawyer Insights

Federal Courts Make 2 Basic Errors In Virus Coverage Rulings

By Lorelie Masters, Michael Levine, Nicholas Stellakis and Rachel Hudgins
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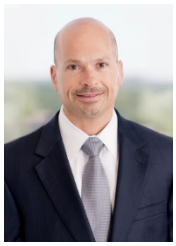
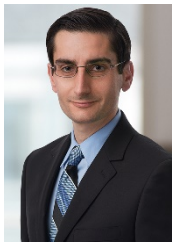


Something odd is going on in the federal courts in COVID-19 coverage cases. As of late September, insurers have won 95% of the rulings in federal courts.[1] In contrast, policyholders have had considerably greater success in state courts.[2]

To be sure, conventional wisdom suggests that policyholders, which are typically plaintiffs, fare better in state courts,[3] but can that account for a significant disparity in state and federal court results?

Perhaps more importantly, most of the policyholder losses, in both federal and state courts, are on motions to dismiss or motions for judgment on the pleadings. Yes, this has happened in cases that allege only conclusory or threadbare statements; however, it has also happened in cases where complaints are replete with disputed factual allegations.

In our experience, most coverage cases, which, after all, focus principally on a written contract, survive a motion to dismiss or motion for judgment on the pleadings on considerably less factual information about the underlying claim or event than is currently being rejected by courts and particularly by federal courts as insufficient, conclusory or just plain implausible.

We posit that these anomalies arise from two fundamental errors recurring throughout the federal district courts: the Erie error and the Twombly-Iqbal error.[4] Acknowledging these errors is especially important in our view as decisions on coverage for COVID-19 losses proceed in the appellate courts.

Federal courts commit the Erie error when they simply cite other federal decisions — often from outside their respective forum state — as a basis for dismissal rather than citing and following governing state decisional law. This is problematic, because insurance coverage is a quintessential state-law issue. Federal judges must follow and apply state law when analyzing the relevant policy language and not simply cite, uncritically, decisions by colleagues on the bench from cases under different facts and different state law.

Federal courts, and state courts following a similar standard, commit the Twombly-Iqbal error when they decide the truth or falsity of facts rather than accept as true the plausible facts as alleged in the complaint for purpose of a motion on the pleadings. The burden of proof on a motion to dismiss is on the moving defendant, since all factual allegations must be construed, and all reasonable inferences must be drawn, in favor of the nonmoving party under Federal Rules of Civil Procedure 12(b)(6) and 12(c).

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This necessarily precludes a court from injecting its own personal experience or belief when that experience or belief conflicts with the well-pleaded facts and derivative reasonable inferences.

From the very outset of COVID-19 insurance coverage litigation, many judges have disregarded these fundamental, black-letter, settled principles. To illustrate, in one case, a federal judge made an off-the-cuff comment that the virus "damages lungs. It doesn't damage printing presses [the insured's property]."[5]

This passing remark, made with no evidence, in the context of a preliminary injunction hearing just days into the pandemic, has served as the springboard for federal judges to follow one another instead of accepting well-pleaded facts and reasonable inferences, all to the effect of precluding consideration of actual evidence, including expert opinions.

In this article, we will seek to outline these two errors as they are occurring in COVID-19 insurance coverage cases pending across the country.

The Erie Error

We all know Erie Railroad Co. v. Tompkins[6] from the canon of first-year civil procedure courses: federal courts, sitting in diversity, must apply state law. They cannot ignore pertinent authority from their forum state, which takes precedence over federal authority and out-of-state cases.

Erie presumes that a federal court sitting in diversity should reach the same result as would the forum state's courts.[7] Erie requires federal courts to look to a final decision of a state's highest court and, if none, then to predict how that court would decide the issue.

But an Erie prediction is not a shot in the dark: a "state is not without law save as its highest court has declared it."[8] Indeed, "[t]here are many rules of decision commonly accepted and acted upon by the bar and inferior courts which are nevertheless laws of the state although the highest court of the state has never passed upon them."[9]

Under Erie, federal courts are bound to consider the several sources of state law before turning for inspiration to decisions of other federal courts. They must not do what they think best or what a respected judge in another federal district court thought made sense in another case, with different parties, different facts, possibly different policy language — and different applicable law.

Rather, they are bound to do what the state supreme court in the state in which that court, sitting in diversity, would consider best.[10] This methodology — scouring state-law sources for state high court intent — preserves Erie's underlying objective: that federal courts sitting in diversity operate as neutral forums that follow their forum states' laws.

Yet in the COVID-19 context, federal courts are not abiding by Erie. An example of this comes from the U.S. Court of Appeals for the Eleventh Circuit's August 2020 decision in Mama Jo's Inc. v. Sparta Insurance Co., the facts of which predate COVID-19.[11] This unpublished decision, purportedly applying Florida law and decided upon summary judgment, considered whether construction dust caused "direct physical loss of or damage to" insured property.

As of this writing, over 80 federal courts inside and outside Florida have cited it for the proposition that COVID-19, much like the dust in Mama Jo's, is temporary and can be eliminated by "routine cleaning and

disinfecting."[12]

For instance, in Bourgier v. Hartford Casualty Insurance Co., the U.S. District Court for the Southern District of Florida recently found Mama Jo's more instructive than a Florida state court decision.[13] It quoted Mama Jo's for the conclusion that "under Florida law, an item or structure that merely needs to be cleaned has not suffered a 'loss' which is both 'direct' and 'physical.'"[14] Meanwhile, it rejected Azalea Ltd. v. American States Insurance Co., a case from the Florida District Court of Appeals for the First District that found an insured sufficiently alleged physical loss to property despite the lack of physical alteration to it.[15]

As each court cites to the one before it, the Erie errors compound.[16] Federal courts nationwide are making critical coverage decisions — in the context of motions to dismiss — without making serious efforts to determine and apply the coverage law of their forum states and predict how those states' courts would decide the issue.

Instead, despite even acknowledging their duty to apply state law, sometimes these federal courts are still determining coverage by following federal courts in other jurisdictions that have made the same Erie error.[17] This amounts to the development of a federal general common law of insurance coverage — a result outlawed since 1938 when the U.S. Supreme Court in Erie overruled Swift v. Tyson.[18]

The Twombly-Iqbal Error

Federal courts are also usurping the role of the fact-finder and inappropriately making factual determinations on motions to dismiss. Rather than apply the Twombly-Iqbal plausibility standard,[19] federal courts are routinely disregarding factual allegations that COVID-19 causes direct physical loss of or damage to the insureds' property. By making factual determinations different from the allegations in a complaint, these courts are commandeering the jury's role.

A complaint, per Federal Rules of Civil Procedure, Rule 8(a)(2), need only contain "a short and plain statement of the claim showing that the pleader is entitled to relief."[20] According to the U.S. Supreme Court's 2007 decision Bell Atlantic Corp. v. Twombly and its 2009 decision Ashcroft v. Iqbal, this "short and plain statement" should provide enough detail to "give the defendant fair notice of what the ... claim is and the grounds upon which it rests."[21]

Under Iqbal, the court must accept as true all factual allegations that are not legal conclusions or "[t]hreadbare recitals of the elements of a cause of action,"[22] and it must construe them in the light most favorable to the plaintiff.[23] The court must do so whether or not the court believes them, finds them incredible or believes that — as the U.S. Court of Appeals for the First Circuit noted in its 2011 decision Ocasio-Hernandez v. Fortuno-Burset —"proof of [the] facts is improbable."[24]

Per the U.S. Court of Appeals for the Ninth Circuit in its 2008 decision In re: Gilead Sciences Securities Litigation, this is because "a district court ruling on a motion to dismiss is not sitting as a trier of fact."[25]

A complaint that is well-pleaded must be allowed to proceed even if the judge believes, per the Gilead court, "that actual proof of those facts is improbable, and that a recovery is very remote and unlikely."[26] That is because "the court's skepticism is best reserved for later stages of the proceedings."[27]

For these reasons, a judge may not dismiss a complaint just because he or she disbelieves the factual

allegations, [28] nor may the judge "attempt to forecast a plaintiff's likelihood of success on the merits" as discussed by the Ocasio-Hernandez court.[29]

The court should also draw all reasonable inferences in favor of the plaintiff. [30] Per the U.S. Court of Appeals for the First Circuit's 2013 Evergreen Partnering Group Inc. v. Pactiv Corp. decision, it may not choose between two plausible inferences that may be drawn from factual allegations, because it is not the court's role, at the pleading stage, to decide, "which inferences are more plausible." [31]

In short, the court may not engage in fact-finding on a motion to dismiss. Yet, this is exactly what courts are doing here. In the face of well-pleaded complaints that allege that the COVID-19 virus cause physical loss and damage to property, courts are finding — at the motion to dismiss stage — just the opposite: There is no possible way that the virus can cause physical loss or damage.

The example given previously[32] remains paradigmatic, where an off-hand remark by a judge that the virus damages lungs and not printing presses during a hearing on a preliminary injunction just days into the pandemic has been elevated to gospel by insurers and found its way into many decisions dismissing complaints.[33] Other impermissible factual findings by federal courts include the following:

- In Sandy Point Dental PC v. Cincinnati Insurance Co., decided Sept. 21, the U.S. District Court for the Northern District of Illinois, Eastern Division noted: "[T]he coronavirus does not cause physical damage." [34]

- The U.S. District Court for the District of Kansas in Promotional Headwear International v. Cincinnati Insurance Co. decided on Dec. 3, 2020, cited that "routine cleaning and disinfecting can eliminate the virus on surfaces." [35]

- According to the U.S. District Court for the Southern District of Florida in Town Kitchen LLC v. Certain Underwriters at Lloyd's decided on Feb. 26: "[T]he deadly coronavirus" can be eliminated "with Lysol and a rag. [I]t is widely accepted that life can go on with hand sanitizer and disinfecting wipes." [36]

- In BN Farm LLC v. The Cincinnati Casualty Co. decided on Sept. 16, the U.S. District Court for the District of Massachusetts found: "Unlike an odor, the presence of COVID-19 is undetectable and cleaning surfaces with certain disinfectants can deactivate or eliminate the virus." [37] And that a virus is "incapable of damaging physical structures because 'the virus harms human beings, not property.'"[38]

These conclusions are inappropriate. Judges are not scientists, and should not make factual, scientific conclusions.

There are encouraging signs that the tide is turning. As Connecticut Superior Court Judge Thomas

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Moukawsher recently said in New Castle Hotels LLC v. Zurich American Insurance Co.:

We do know a lot about viruses — but this one? We are learning something new every day. The court simply can't take notice at this stage that the virus does not degrade physical objects on at least a microscopic level. That question will have to wait for another day—on summary judgment perhaps or after trial. What matters for now is that physical damage is specifically alleged here. … The rush to judgement … without reasoning and without evidence — has been ill-advised. [39]

Conclusion

Insurers tout the box score in support of their arguments to nullify business interruption coverage for COVID-19 losses. The box score argument is simplistic and obscures the truth, because it is based on federal courts committing either the Erie error or the Twombly-Iqbal error — and, in some cases, both — in many of those decisions. Federal courts sitting in diversity must adhere to the law and defer to the judgment of state courts, the true arbiters of the law on insurance, and to juries, the arbiters of factual disputes.

State courts considering appeals of COVID-19 coverage decisions should disregard federal court decisions that neglect Erie on an issue that is predominantly one of state law and regulation and that bypass their fundamental duty to leave factual questions to the trier of fact.

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Notes

1. See Ins. L. Ctr., U. Pa. Carey L. Sch., Covid Coverage Litigation Tracker, https://cclt.law.upenn.edu/ (last visited Sept. 23, 2021) ("UPenn COVID Coverage Tracker").

2. These percentages are based on statistics from the UPenn COVID Coverage Tracker on trial courts' merits rulings in cases in federal courts, on the one hand; and state courts, on the other. The UPenn COVID Coverage Tracker compiles statistics on decisions on motions to dismiss in COVID-19 coverage cases in the following categories: (i) full dismissal with prejudice, (ii) partial dismissal with prejudice, (iii) full dismissal without prejudice, and (iv) partial dismissal without prejudice. We added all dismissals and compared that total to the number of cases in which a motion to dismiss had been denied. The vast majority of cases in federal court have been dismissed with prejudice.

3. Christopher A. French, Forum Shopping COVID-19 Business Interruption Insurance Claims, 2020 U. Ill. L. Rev. Online 187, 189, 192-93 (2020).

4. Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007); Ashcroft v. Iqbal, 556 U.S. 662 (2009). Most federal courts have disposed of policyholders' claims under Rule 12(b)(6) motions to dismiss for failure to state a claim, but a minority of decisions were issued in response to Rule 12(c) motions for judgment on the pleadings. Motions under Rules 12(b)(6) and 12(c) are governed by the same standard, defined in Twombly and Iqbal.

5. Soc. Life Magazine, Inc. v. Sentinel Ins. Co., Ltd., No. 20 Civ. 3311(VEC), 2020 WL 2904834 (S.D.N.Y. May 14, 2020).

6. Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938) (Erie).

7. Guar. Tr. Co. of N.Y. v. York, 326 U.S. 99, 111 (1945).

8. West v. Am. Tel. & Tel. Co., 311 U.S. 223, 236 (1940).

9. Id.

10. See, e.g., id. at 236-37. Federal courts exercise jurisdiction in these cases under 28 U.S.C. § 1332, which provides for diversity-of-citizenship jurisdiction.

11. Mama Jo's Inc. v. Sparta Insurance Co., 823 F. App'x 868 (11th Cir. 2020).

12. Promotional Headwear Int'l v. Cincinnati Ins. Co., 504 F. Supp. 3d 1191, 1203-04 (D. Kan. 2020) ("Moreover, even assuming that the virus physically attached to covered property, it did not constitute the direct, physical loss or damage required to trigger coverage because its presence can be eliminated. Much like the dust and debris at issue in Mama Jo's, routine cleaning and disinfecting can eliminate the virus on surfaces.").

13. Bourgier v. Hartford Cas. Ins. Co., No. 21-21053-CIV-MORENO, 2021 WL 3603601, at *4 (S.D. Fla. Aug. 12, 2021).

14. Id. (quoting Mama Jo's, 823 F. App'x at 879).

15. Id. at *5-6 (citing Azalea, Ltd. v. Am. States Ins. Co., 656 So. 2d 600, 602 (Fla. 1st DCA 1995).

16. Our firm filed an amicus brief in support of the policyholder's petition for certiorari to the US Supreme Court in Mama Jo's, in part on this Erie Error. Amicus Curiae Brief of United Policyholders in Support of Petition and Reversal, Mama Jo's, Inc. v. Sparta Ins. Co., No. 20-998, 2021 WL 809356 (U.S. Feb. 25, 2021). Our brief explained how, among other errors, the Eleventh Circuit mischaracterized the loss suffered by Mama Jo's, which actually required heavy physical remediation and repainting, and loss of or damage to mechanical and audio systems and outdoor lighting. Id. at *4-5. This factual error has been compounded, as insurers cite to the case for the principle that substances that can be eliminated by "routine cleaning and disinfecting" have not caused, and cannot ever cause, direct physical loss or damage under first-party property insurance policies. Tappo of Buffalo, LLC v. Erie Ins. Co., No. 20-CV-754V(Sr), 2020 WL 7867553, at *4 (W.D.N.Y. Dec. 29, 2020) (quoting Promotional Headwear Int'l v. Cincinnati Ins. Co., 504 F. Supp. 3d 1191, 1203-04 (D. Kan. 2020)).

17. E.g., Sandy Point Dental, PC v. Cincinnati Ins. Co., 488 F. Supp. 3d 690, 693-94 (N.D. Ill. 2020), recons. denied, No. 20 CV 2160, 2021 WL 83758 (N.D. Ill. Jan. 10, 2021) (relying, for substantive analysis, on federal decisions, mostly outside of forum state); Palmdale Estates, Inc. v. Blackboard Ins. Co., No. 20-CV-06158-LB, 2021 WL 25048 (N.D. Cal. Jan. 4, 2021) (citing not a single state-court decision); Jonathan Oheb MD, Inc. v. Travelers Cas. Ins. Co. of Am., No. 2:20-CV-08478-JWH-RAOx, 2020 WL 7769880, at *3-4 (C.D. Cal. Dec. 30, 2020) (relying on federal precedent for substantive analysis): Sun Cuisine, LLC v. Certain Underwriters at Lloyd's London, No. 1:20-CV-21827-GAYLES/OTAZO-REYES, 2020 WL 7699672, at *3-4 (S.D. Fla. Dec. 28, 2020) (citing a single forum-state decision for general principle and otherwise relying only on federal precedent from inside and out of forum state); SA Palm Beach LLC v. Certain Underwriters at Lloyd's, London, 506 F.Supp.3d 1248, 1251-55 (S.D. Fla. 2020) (relying only on federal authority for substantive analysis); Geragos & Geragos Engine Co. No. 28, LLC v. Hartford Fire Ins. Co., No. CV 20-4647-GW-MAAX, 2020 WL 7350413, at *3 (C.D. Cal. Dec. 3, 2020) (relying only on federal authority for substantive analysis).

18. Swift v. Tyson, 41 U.S. 1 (1842).

19. Ashcroft v. Iqbal, 556 U.S. 662 (2009); Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).

20. Fed. R. Civ. P. 8(a)(2).

21. Twombly, 550 U.S. at 555 (alteration in original) (quoting Conley v. Gibson, 355 U.S. 41, 47 (1957)); see also Richard P. Lewis, Lorelie S. Masters, Scott Greenspan, & Christopher Kozak, Couch's Physical Attention Fallacy: Its Origins and Consequences, Tort, Trial & Ins. L.J. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3916391.

22. Iqbal, 556 U.S. at 678.

23. Ariix, LLC v. NutriSearch Corp., 985 F.3d 1107, 1114 (9th Cir. 2021); Disability Rights Mont., Inc. v. Batista, 930 F.3d 1090, 1097 (9th Cir. 2019).

24. Ocasio-Hernandez v. Fortuno-Burset, 640 F.3d 1, 12 (1st Cir. 2011) (quoting Twombly, 550 U.S. at 556); Hartman v. Gilead Scis., Inc. (In re Gilead Scis. Sec. Litig.), 536 F.3d 1049, 1057 (9th Cir. 2008).

25. Hartman, 536 F.3d at 1057.

26. Id. (quoting Twombly, 550 U.S. at 556).

27. Id.

28. Ocasio-Hernandez, 640 F.3d at 12 (quoting Neitzke v. Williams, 490 U.S. 319, 327 (1989)).

29. Id. at 12-13.

30. Khoja v. Orexigen Therapeutics, Inc., 899 F.3d 988, 1012 (9th Cir. 2018); Nayab v. Capital One Bank (USA), N.A., 942 F.3d 480, 497-99 (9th Cir. 2019).

31. Evergreen Partnering Grp., Inc. v. Pactiv Corp., 720 F.3d 33, 45 (1st Cir. 2013).

32. Soc. Life Magazine, Inc. v. Sentinel Ins. Co., Ltd., No. 20 Civ. 3311(VEC), 2020 WL 2904834 (S.D.N.Y. May 14, 2020).

33. Green Beginnings, LLC v. W. Bend Ins. Co., No. 20-CV-1661, 2021 WL 2210116, at *5 (E.D. Wis. May 28, 2021), appeal filed, No. 2:20-cv-01661 (7th Cir. June 25, 2021), ECF No. 31; see also Food for Thought Caterers Corp. v. Sentinel Ins. Co., No. 20-CV-3418 (JGK), 2021 WL 860345, at *5 (S.D.N.Y. Mar. 6, 2021) (same); Town Kitchen LLC v. Certain Underwriters at Lloyd's, London, No. 20-22832-CIV-MORENO, 2021 WL 768273, at *6 (S.D. Fla. Feb. 26, 2021) (same); Sandy Point Dental, PC v. Cincinnati Ins. Co., 488 F. Supp. 3d 690, 693-94 (N.D. Ill. 2020), recons. denied, No. 20 CV 2160, 2021 WL 83758 (N.D. Ill. Jan. 10, 2021).

34. Sandy Point Dental, PC488 F. Supp. 3d at 694 n.2; see also Legal Sea Foods, LLC v. Strathmore Ins. Co., No. 20-10850-NMG, 2021 WL 858378, at *3 (D. Mass. Mar. 5, 2021) ("[a] virus is incapable of damaging physical structures" despite allegations in the operative complaint that SARS-CoV-2 damaged insured property by attaching to surfaces and hanging in the indoor air, and that SARS-CoV-2 caused the loss of insured property by rendering it dangerous, unsafe and unfit for its intended and insured use as a restaurant).

35. Promotional Headwear Int'l v. Cincinnati Ins. Co., 504 F. Supp. 3d 1191, 1204 (D. Kan. 2020).

36. Town Kitchen LLC, 2021 WL 768273, at *7. When Judge Federico A. Moreno issued this decision, the U.S. District Court for the Southern District of Florida was under its Eighth Order Concerning Jury Trial and Other Proceedings. That order continued all jury trials until May 2020 and encouraged judges to conduct court proceedings by telephone or video conferencing.

37. BN Farm LLC v. Cincinnati Cas. Co., No. 1:20-cv-10874-MBB, slip op. at 34 (D. Mass. Sept. 16, 2021) (citing Promotional Headwear, 504 F. Supp. at 1203).

38. Id., slip op. at 35 (quoting Select Hosp., LLC v. Strathmore Ins. Co., No. 20-11414-NMG, 2021 WL 1293407, at *3 (D. Mass. Apr. 7, 2021)).

39. New Castle Hotels, LLC v. Zurich Am. Ins. Co., No. X07-HHD-CV-21-6142969-S, slip op. at 5-7 (Conn. Super. Ct. Sept. 7, 2021).

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Disclosure: Hunton submitted an amicus brief to the U.S. Supreme Court on behalf of United Policyholders in support of the certiorari petition in the Mama Jo's matter discussed above. Hunton represents Legal Sea Foods in Legal Sea Foods v. Strathmore referenced in footnote 34.