State COVID Insurance Rulings Highlight Errors In Dismissals

By Joseph Niczky and Michael Levine
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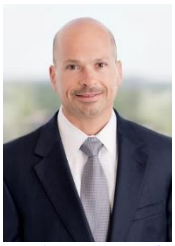

Whether the presence of COVID-19 on property causes physical loss or damage to the property is a question of fact that requires discovery. Since the start of the pandemic, policyholders have repeatedly pointed this out in the face of insurers' motions to dismiss.

But many courts improperly resolved these questions of fact on early motions and quickly embraced the so-called implausibility of such claims based on preliminary statements, such as the U.S. District Court for the Southern District of New York's opinion in Social Life Magazine Inc. v. Sentinel Insurance Co. that COVID-19 "damages lungs. It doesn't damage [property]."

The U.S. District Court for the Western District of Washington in Nguyen v. Travelers Casualty Insurance Co. likewise noted that "all that is needed to decontaminate is to wipe the virus off the surface with disinfectant, attesting to the fact that there is no underlying damage."[1]

Now, two-and-a-half years later, courts are finally taking a closer look, and the results are exactly as policyholders expected.

In the last month, a California appellate court reversed an early dismissal of a COVID-19 business interruption claim, and a jury in Texas found that the presence of SARS-CoV-2 damaged the policyholder's insured property and that the damage caused resulting covered business income loss.

And, most recently, the Supreme Court of Vermont thoroughly analyzed the difference between direct physical loss and direct physical damage to conclude that the presence of SARS-CoV-2 on property indeed may cause "damage" to that property as the term is used in all-risk insurance policies.

Early Appellate Rulings for Insurers

Consistent with their trial court brethren, federal circuit courts of appeal have kept the rhythm of summarily foreclosing recovery by concluding that a virus — including COVID-19 and its causative virus, SARS-CoV-2 — can never damage property as required to trigger coverage under most all-risk insurance policies.

The U.S. Court of Appeals for the Fourth Circuit's March opinion in Uncork and Create LLC v. Cincinnati Insurance Co. is typical of these decisions.[2] The U.S. District Court for the Southern District of West Virginia granted the insurer's motion to dismiss, and the policyholder appealed. The Fourth Circuit upheld the dismissal, and made factual findings contrary to the allegations in the complaint:

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> [N]either the closure order nor the virus itself prohibited Uncork from having access to the covered property.... Here, neither the closure order nor the Covid-19 virus caused present or impending material destruction or material harm that physically altered the covered property requiring repairs or replacement so that they could be used as intended. Thus, we hold that the policy's coverage for business income loss and other expenses does not apply to Uncork's claim for financial losses in the absence of any material destruction or material harm to its covered premises.[3]

Other appellate decisions have reached the same result.[4] In each of these cases, and many others, the policyholders alleged that COVID-19 and its causative virus was present on insured property and that the virus caused damage to the property. But in each case, the court summarily rejected the allegations as not plausible without considering whether the allegations could in fact be correct.[5]

The courts did not consider evidence in any of these cases, and did not even hear what medical, scientific or environmental experts had to say on the issue. Nor did they draw reasonable inferences in favor of the plaintiff, as settled state and federal procedure required.[6]

The courts failed to follow the plaintiff-friendly rule that a court ruling on a motion to dismiss must accept factual allegations in the complaint as true and not make findings of fact.[7]

The plaintiffs in these and many other cases pled that the presence of COVID-19 and SARS-CoV-2 damaged their property, including detailed allegations of how COVID-19 viral particles interacted with and negatively altered their property. The courts had to accept those allegations as true. But they failed to do so, instead making factual findings contrary to those included in the complaints.

Recent Appellate Rulings for Policyholders

In contrast, in Huntington Ingalls Industries Inc. v. Ace American Insurance Co., the Vermont Supreme Court held on Sept. 23 that the long-standing rules of pleading required a trial court to accept allegations in the complaint about the damage caused by the presence of COVID-19 as true and allow the case to proceed to discovery.[8] There, the superior court erred by contradicting the complaint's factual allegations and dismissing the case, requiring the Supreme Court to reverse.

The Supreme Court first recognized the historical distinction between "physical loss" and "physical damage," and in doing so, properly rejected the third edition of Couch on Insurance's flawed application of its damage formulation — physical alteration — to loss.[9]

The Supreme Court then reiterated the plaintiff's detailed allegations of how SARS-CoV-2 affected its property, and thoroughly analyzed the operative policy language — including how it has been applied in the context of a peril like "virus" in prior cases — to conclude that the allegations, if proven, would make out a claim for physical damage.[10]

In support of its analysis and conclusion, the Supreme Court emphasized that the inquiry is necessarily fact-laden and that it is not appropriate to resolve factual issues on a motion for judgment on the pleadings. The Supreme Court explained:

> To end this litigation based on the limited information before us, simply because the alleged facts and the inferences therefrom may seem implausible at first based on what we think we know about COVID-19, would be premature. ... Although the science when fully presented may not support the

> conclusion that presence of a virus on a surface physically alters that surface in a distinct and demonstrable way, it is not the Court's role at this stage in the proceedings to test the facts or evidence. We cannot say beyond a doubt that the virus does not physically damage surfaces in the way insured alleges.[11]

Huntington Ingalls is the first state high court decision to acknowledge the factual issues posed by the presence of virus on property, but the decision is no outlier.

Several weeks earlier, on July 13, the California Court of Appeal for the Second District reached the same result in Marina Pacific Hotel and Suites LLC v. Fireman's Fund Insurance Co.[12]

Much like the Vermont Supreme Court, the California Court of Appeal closely reviewed the plaintiff's allegations: that COVID-19 viral particles "not only [live] on surfaces but also [bond] to surfaces ... which transform[s] the physical condition of the property. The virus was present on surfaces throughout the insured properties. ... As a direct result, the insureds were required to close or suspend operations."[13]

The court concluded "the insureds have unquestionably pleaded direct physical loss or damage to covered property ... a distinct, demonstrable, physical alteration of the property."[14]

In reaching its conclusion, the Marina Pacific court rejected the reasoning and conclusion of another California appellate court — the California Court of Appeal for the Second District, Division Four, which affirmed the dismissal of a COVID-19 business interruption claim — because the other court failed to accept the allegations pled in the complaint as true.

In criticizing the other California appellate panel, the Marina Pacific court explained that in United Talent Agency v. Vigilant Insurance Co. the court:

> affirmed a trial court ruling that, like the decision we review, found — without evidence — the COVID-19 virus does not damage property. But the insureds here expressly alleged that it can and that it did, including the specific allegation they were required to dispose of property damaged by COVID-19. We are not authorized to disregard those allegations when evaluating a demurrer, as the court did in United Talent, based on a general belief that surface cleaning may be the only remediation necessary to restore contaminated property to its original, safe-for-use condition.[15]

The Huntington Ingalls and Marina Pacific courts took the correct approach by accepting the allegations in the complaint as true and allowing plaintiffs the opportunity to present factual evidence.

Jury Verdict in Baylor College of Medicine

Perhaps the greatest validation for each of these recent appellate decisions is the jury verdict reached in the COVID-19 business interruption case Baylor College of Medicine v. XL Insurance America Inc.

A jury concluded, as a matter of fact, that the presence of SARS-CoV-2 on site at Baylor's insured properties caused a tangible alteration of Baylor's property sufficient to meet the plain and ordinary meaning of the undefined phrase "direct physical loss of or damage to property."

Policyholders have waited patiently for a court to recognize what scientists and insurers know: that the presence of a virus like SARS-CoV-2 can cause physical loss or damage.[16] Now, finally, a jury has

pronounced it.

Baylor brought suit in the District Court of Harris County, Texas against its insurers seeking coverage for its losses caused by the presence of COVID-19 viral particles on its property. The insurers moved for summary judgment, arguing that COVID-19 cannot cause physical loss or damage to property and that certain exclusions in the policies applied.

The court granted summary judgment for certain insurers based on exclusions contained in their policies. But for the insurers that did not have these exclusions, the court held that "a question of fact exists as to whether COVID-19, if present, caused direct physical loss or damage to [Baylor]'s insured property."[17]

The case proceeded to trial in August, and the jury reached its verdict for Baylor on Aug. 31. The jury found that the evidence, including testimony from medical and science experts, proved that COVID-19 caused physical loss or damage to Baylor's property.

The Baylor College verdict underscores the error that courts are making by dismissing COVID-19 business interruption lawsuits without consideration of the facts and evidence in each case. A trial court should never make factual findings on a motion to dismiss, contrary to the allegations in the complaint.

In the context of COVID-19 business interruption cases, courts have found comfort in numbers, blindly pointing to the scoreboard and following the herd, in violation of the basic rules of pleading.[18]

Appellate courts are finally starting to fix these errors, and at least one jury has confirmed that a fix is required. The Baylor College jury had a full record and disagreed with courts that found that a virus can never cause physical loss or damage.

By dismissing these cases, courts rejected the plausibility that the presence of COVID-19 may cause physical loss or damage to property. The Baylor College jury not only found that it is plausible, but found that it actually happened.

The verdict should be a mandate that courts follow Marina Pacific and Huntington Ingalls and recognize that whether the presence of COVID-19 causes damage is a factual issue best resolved by the jury, not by a court on a preliminary motion.

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Notes

1. Soc. Life Mag., Inc. v. Sentinel Ins. Co., No. 20 Civ. 3311(VEC), 2020 WL 2904834 (S.D.N.Y. May 14, 2020); Nguyen v. Travelers Cas. Ins. Co., 541 F. Supp. 3d 1200, 1216 (W.D. Wash. 2021) (citing Mama Jo's Inc. v. Sparta Ins. Co., 823 F. App'x 868 (11th Cir. 2020)) (internal brackets and quotation marks removed).

2. Uncork and Create LLC v. Cincinnati Ins. Co., 27 F.4th 926 (4th Cir. 2022).

3. Uncork, 27 F.4th at 933.

4. See, e.g., Ferrer & Poirot, GP v. Cincinnati Ins. Co., 36 F.4th 656, 658 (5th Cir. 2022) ("While COVID-19 has wrought great physical harm to people, it does not physically damage property within the plain meaning of 'physical.'"); Consol. Rest. Operations, Inc. v. Westport Ins. Corp., 205 A.D.3d 76, 85 (N.Y. App. Div. 1st Dep't 2022) ("Neither the government orders, nor the presence of the coronavirus inflicted 'direct physical loss or damage'" to property).

5. Uncork, 27 F.4th at 930; Ferrer, 36 F.4th at 658; Cons. Rest. Operations, 205 A.D.3d at 79.

6. Ashcroft v. Iqbal, 556 U.S. 662, 679 (2009).

7. Id.

8. Huntington Ingalls Industries, Inc. v. Ace American Ins. Co., 2022 VT 45 (Vt. 2022).

9. Id. at ¶¶ 25–38.

10. Id.

11. Id. at ¶¶ 45–46 (internal citations and quotation marks omitted).

12. Marina Pac. Hotel and Suites, LLC v. Fireman's Fund Ins. Co., 81 Cal. App. 5th 96 (2022).

13. Id. at 108.

14. Id.

15. Id.

16. Insurers have publicly denied that a virus can cause physical loss or damage, but insurers' internal documents produced in cases that have reached discovery have revealed that insurers have long known that a virus can cause damage. Although insurers usually hide these documents behind confidentiality designations, sometimes the truth slips through. Most recently, in oral arguments in APX Operating Co. LLC v. HDI Glob. Ins. Co., No. 393, 2021 (Del. Sept. 21, 2022), before the Delaware Supreme Court, the insurer's counsel admitted "This is a property policy. The parties to that policy are thinking about the kinds of things that can damage property, and viruses are one of them."

17. Baylor Coll. of Medicine v. XL Ins. Am., Inc., No. 202-53316, at *1 (Tex. Dist. Ct. Dec. 6, 2021).

18. See, e.g., 44 Hummelstown Assocs., LLC v. Am. Select Ins. Co., 542 F. Supp. 3d 328, 335 (M.D. Pa. 2021) ("this Court joins the scores of courts that have rejected commercial insurance claims predicated on similar or identical allegations [regarding COVID-19]."); but see Oliveira v. New Prime, Inc., 857 F.3d 7, 19 (1st Cir. 2017) ("The numbers favoring a rule do not necessarily mean that the rule is the best one. . . . Instead of simply tallying the score, 'it is always incumbent on us to decide afresh any issue of first impression in our circuit.'"); JDS Constr. Grp., LLC v. Continental Cas. Co., No. 2020 CH 5678, at *4 (Ill. Cir. Ct. Oct. 25, 2021) (denying motion to dismiss COVID-19 business interruption lawsuit and declining to follow the "herd" because "Judges are not sheep, and I do not decide a case by counting noses.").

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