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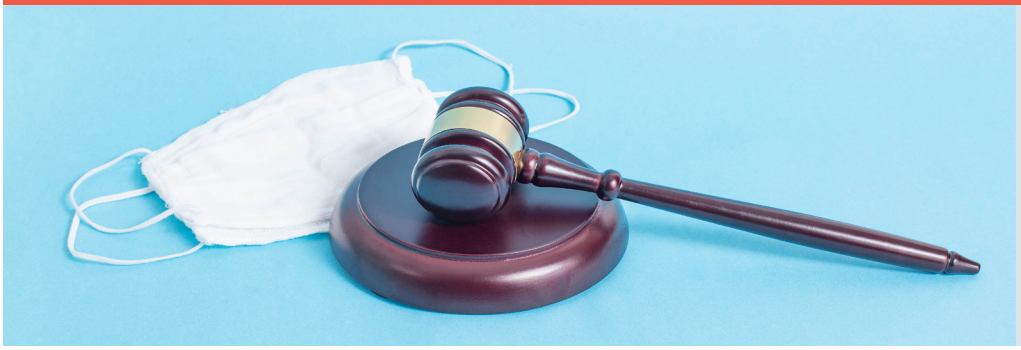
COVID-19 Insurance Update: Five Early Court Decisions on Insureds' Claims to Business Interruption Coverage for Their COVID-19 Losses

by Patrick Frye

A FREEBORN & PETERS LLP CLIENT ALERT



ABOUT THIS CLIENT ALERT

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Seeking to fill the financial void caused by our widespread and prolonged social distancing as we fight the COVID-19 pandemic, innumerable businesses have sued for recoveries under their property insurance policies. Now courts have rendered five substantive decisions on these claims, which we summarize below. All five decisions interpreted the common policy provision requiring that the insured suffer "direct physical loss" to trigger coverage.

In *Rose's 1 LLC v. Erie Insurance Exchange* (D.C. Sup. Ct. Aug. 6, 2020), a District of Columbia court awarded summary judgment in favor of the insurer. Rose's owned restaurants in Washington D.C. and maintained a commercial property insurance policy issued by Erie providing business interruption coverage. Earlier this year, the D.C. mayor banned dining-in at restaurants, forbade nonessential business from operating, and ordered everyone to stay home (with limited exceptions). Rose's closed its restaurants, lost its revenues, and asserted a claim for business interruption losses under its policy. When Erie denied the claim, Rose's filed a lawsuit.

The court ruled that Rose's could not show any "direct physical loss," as required by its policy. Rose's argued that the government's closure of its businesses was "direct," only for the court to find that no order alone effects any direct change to property. Rose's argued that the virus is "physical," yet had no evidence that the virus was ever present at the restaurants when they closed. Rose's argued that it suffered a "loss" insofar as it lost use of the restaurants. In the court's view, the mayor's "orders were not such a direct physical intrusion." Fifty years ago, a D.C. court ruled that another restaurant could not recover business interruption insurance after it closed in response to a government curfew intended to quell rioting that never touched that business. The court saw no reason why Rose's claim should fare any better and granted Erie's motion for summary judgment.

In *Diesel Barbershop v. State Farm Lloyd's* (W.D. Tex. Aug. 13, 2020), a Texas federal court dismissed the insureds' lawsuit. In response to the insureds' argument that their policies do not require tangible destruction of any property, the court held that this term nonetheless requires a distinct, demonstrable alteration of the property. The court further ruled that the insureds had not alleged any such alteration when they pled that government nonessential-business-closure and stay-at-home orders caused them to lose use of their properties. The court further found that even if the insureds had alleged direct physical loss, the policies' virus exclusion barred coverage. The lead-in language to the exclusion specified that State Farm does not insure loss resulting from the excluded cause regardless of whether other causes acted concurrently or in any sequence within the excluded event to produce the loss. The court reasoned that because the government orders came about sequentially as a result of the virus spreading throughout the community, the virus's presence was the primary cause of these barbershops' closures.

In *Gavrilides Management Co. v Michigan Insurance Co.* (Mich. Cir. Ct. July 1, 2020), a Michigan state court awarded summary disposition in favor of the insurer. Gavrilides, a restaurateur, sought coverage after closing his business as directed by an executive order issued by the Michigan governor. Presumably due to the virus exclusion in his policy, Gavrilides argued that the property damage did not result from the virus, because the virus only injures people. Instead, he argued that his physical loss was the lack of diners' physical presence in the restaurant. Rejecting that argument and concluding that his policy required him to show an alteration of the property's physical integrity or something similarly tangible, the court held that he presented no evidence of any direct physical loss of property or direct physical damage to property.

In *Social Life Magazine v. Sentinel Insurance Co.* (S.D.N.Y. May 14, 2020), a New York federal court denied the insured's motion for a preliminary injunction against the insurer. Because its employees could not print its magazine by working remotely, Social Life ceased publication and claimed insurance coverage after the New York governor issued an order commanding nonessential business to cease in-person work. Social Life argued that the virus can cause property damage in that someone could die after contracting COVID-19 from virus that was resting on that property. But the court found that this would be damage to the person, not to the property. It further found that the virus is not specifically present at Social Life property, rejecting Social Life's argument that the virus was sufficiently widespread that it was literally everywhere. Although a Social Life representative apparently had gotten sick, the court found that Social Life presented no evidence that he was infected at Social Life's office. At bottom, the court viewed the damage as having been caused by the government order to stay home, which is not any particular damage to the insured property that would impede Social Life from using it.

In *Studio 417 v. The Cincinnati Insurance Co.*, (W.D. Mo. Aug. 12, 2020), a Missouri federal court found that the insured had pled a claim under its insurance policy and denied the insurer's motion to dismiss. This court ruled that the virus can cause direct physical loss insofar as it is a physical substance that can be present in the air and on surfaces and that its presence at the property deprived their owners of use of the hair salons and restaurants they operated because those properties were unsafe. The court also held that the insureds alleged that the government orders prohibited access to their property, even though the restaurants were allowed to sell meals for pickup or delivery. (This issue pertains to civil authority coverage, which coverage we explained here.) The court ended its opinion by noting that development of case law over these disputes may be persuasive and that the insurer could again press the same arguments against coverage after the parties engaged in discovery of evidence.

Any general observations are difficult to make at this time. These decisions were rendered in only five of the over fifty U.S. jurisdictions. Also, these five courts do not have the final say in their jurisdictions, assuming the decisions are appealed. They are trial courts, at the lowest levels of the judicial systems. Higher courts that may review these courts' decisions may ultimately disfavor these decisions. Last, while these cases presented two of the more common legal theories advanced in insureds' efforts to obtain coverage, other insureds have still other theories – and their own particular circumstances and various policy language – for courts to consider and decide. Dozens if not hundreds of motions similar to the ones discussed above are pending in the many similar lawsuits proceeding throughout the country, and it will take a lot more time and court decisions before the law of any state is decisively settled on these issues.

If you have any questions, contact Patrick Frye or visit Freeborn's COVID-19 webpage for more information as this situation develops.

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Patrick Frye is a Partner in the Litigation Practice Group and member of the Insurance/Reinsurance Industry Team. He represents clients in commercial litigation, including coverage disputes and antitrust claims. He advises clients on litigation strategy and appears before arbitration panels and state and federal courts.

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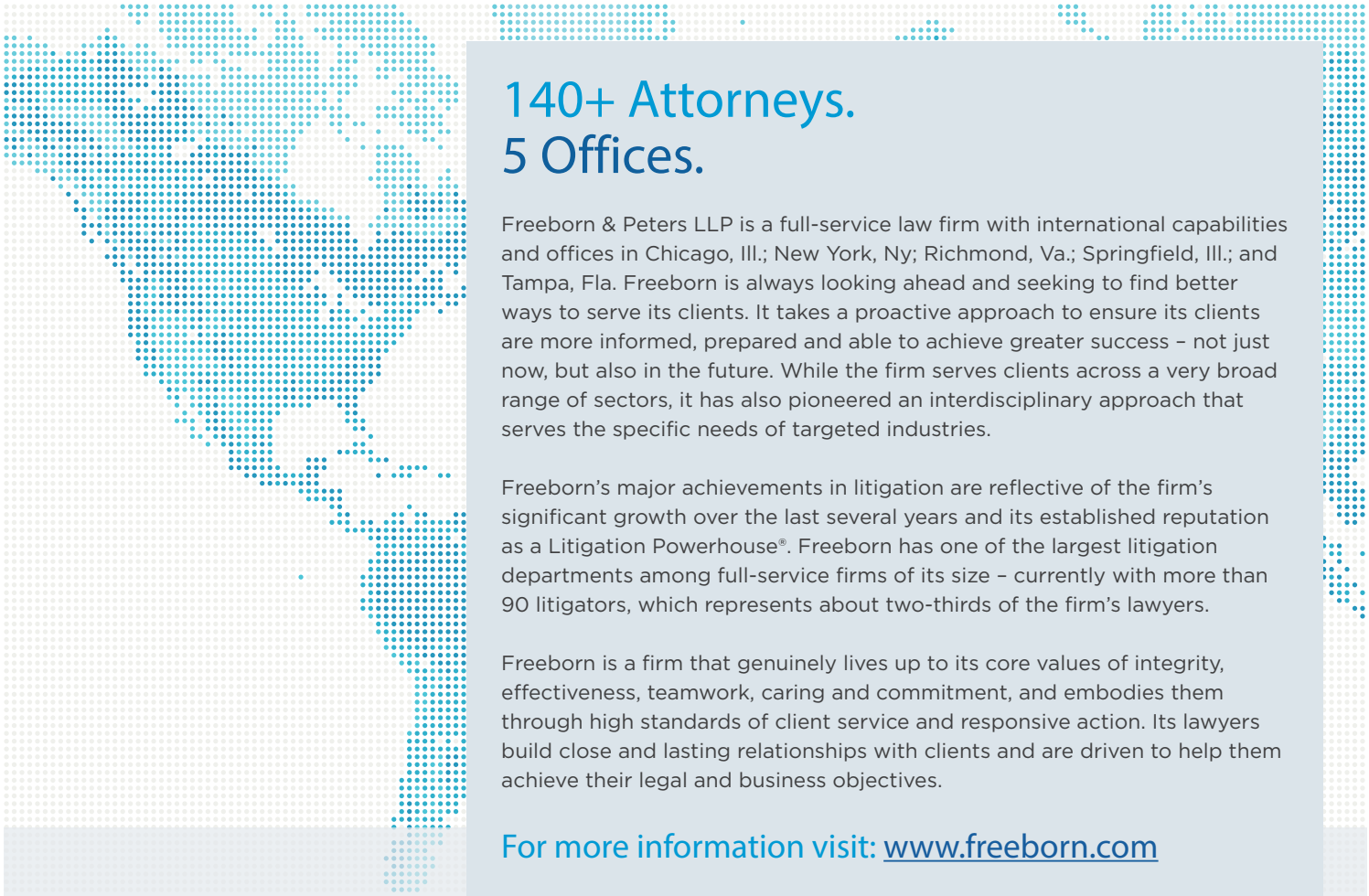

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