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2023 COVID-19 Insurance Update:

The New York Court of Appeals Agrees to Weigh In

■ **Ryan A. Lema** SPECIAL TO THE RBJ

VIEWPOINT
Ryan Lema

In the spring of 2020, as a wave of COVID-19 shut-down orders swept the country, businesses began filing insurance claims for business interruption losses. Businesses suffered significant losses of revenue while they were closed by orders of civil authority as "non-essential" businesses, and customers stayed away due to safety concerns. Even after reopening, many businesses had to operate at reduced capacity or with various restrictions in place to ensure proper social distancing and prevent the spread of COVID-19.

In the face of nationwide losses impacting nearly every sector of the economy, insurers were quick to deny business interruption insurance claims, with some insurance carriers having adopted across-the-board policies to deny claims for business interruption without regard to the insured's individual circumstances.

COVID-19 BUSINESS INTERRUPTION LITIGATION TO DATE

After the insurance industry began uniformly denying claims for business interruption losses, a wave of insurance coverage litigation followed.

The overwhelming majority of trial court decisions to date have favored the insurance industry. These decisions have most often been on the grounds that the presence of a virus, such as SARS-CoV-2 (the virus that causes COVID-19), cannot constitute direct physical loss or damage to property, as is required by most business interruption coverage forms.

The University of Pennsylvania Law School publishes a coverage litigation tracker, https://cclt.law.upenn.edu, which tracks statistics on the outcome of COVID-19 business interruption litigation across the country. The data shows that the majority of cases nationwide have been dismissed at the motion-to-dismiss stage.

In many of these cases, insureds are losing on the threshold issue of whether COVID-19 causes physical damage that would trigger coverage. Most courts have found that the presence of a virus does not amount to "direct physical loss or damage" that would trigger coverage. Courts have reasoned that the inclusion of the modifier "physical" in a phrase such as "direct result of physical damage" clearly imposes a requirement that the damage actually be tangible in nature, i.e., this language unambiguously requires some form of physical harm to the location. *See, e.g., Michael Cetta, Inc. v. Admiral Indem. Co.*, 506 F. Supp. 3d 168, 176 (S.D.N.Y. 2020) ("Losing the ability to use otherwise unaltered or existing property simply does not change the physical condition or presence of that property and therefore cannot be classified as a form of 'direct physical loss' or 'damage'"). Many cases have also been dismissed based on virus exclusions, which are now commonly included in commercial property insurance forms as a result of prior outbreaks of communicable diseases. Most of the cases that have managed to survive a motion to dismiss have involved policies that did not contain any form of virus exclusion.

To date, every U.S. Court of Appeals has ruled in favor of the insurance industry. In one instance,

an insured that managed to succeed at the trial court had its victory overturned by the Sixth Circuit Court of Appeals. In re *Zurich Am. Ins. Co.*, No. 21-0302, 2021 WL 4473398 (6th Cir. Sept. 29, 2021). The Second Circuit Court of Appeals has ruled that COVID-19 does not satisfy the requirement of "actual physical loss of or damage to" an insured's property. The Second Circuit declined to certify the question to the New York Court of Appeals, finding that there was no disagreement among New York courts, as "every New York court interpreting the phrase 'direct physical loss' has read it the same way and denied coverage." *10012 Holdings, Inc. v. Sentinel Ins. Co., Ltd.*, 21 F.4th 216, 224 (2d Cir. 2021).

THE BATTLE IN STATE COURTS: NEW YORK'S COURT OF APPEALS SET TO WEIGH IN

Given the body of case law to date and the unanimity among federal appellate courts, policyholders' last hope is with state supreme courts. Although the majority of state supreme courts have yet to weigh in, the trend continues to favor the insurance industry.

Most recently in Louisiana, state supreme courts have ruled against policyholders seeking coverage for COVID-19-related business interruption losses. State high courts to have ruled against policyholders include Connecticut, Iowa, Maryland, Massachusetts, New Hampshire, Ohio, Oklahoma, South Carolina, Washington and Wisconsin. In addition, the Nevada Supreme Court heard oral arguments in a case in June, and the California Supreme Court accepted an appeal in March.

Only the Vermont Supreme Court has sided with a policyholder seeking COVID-19 coverage. In September, the Vermont Supreme Court revived shipbuilder Huntington Ingalls' coverage suit in *Huntington Ingalls Industries, Inc. v Ace American Insurance Company, 2022 VT* 45, 287 A.3d 515. In a 3-2 decision, the Vermont Supreme Court held that the plaintiff had cleared Vermont's "extremely liberal" notice-pleading standards, but would still have to prove that it suffered "direct physical loss or damage to property" on remand.

Now the New York Court of Appeals is poised to weigh in. In November, New York's Court of Appeals agreed to hear *Consolidated Restaurant Operations, Inc. v. Westport Insurance Corporation*, Case No. 2022-00160. In that case, a restaurant operator is appealing a decision from the Appellate Division, First Department affirming the dismissal of its suit seeking coverage for business interruption losses from the pandemic.

In *Consolidated Restaurant Operations*, the plaintiff ("CRO") argues that the First Department's interpretation of the phrase "direct physical loss" to require "tangible" damage to property is divorced from the language of the policy itself, and does not find support in prior insurance case law, which has previously held that certain invisible noxious substances, such as ammonia or asbestos, which impair the use of insured property, can cause physical loss or damage.

In opposition, Westport argues that the great weight of authority to date holds that a virus does not cause "direct physical loss," and that CRO's allegations to the contrary are conclusory. Westport argues that property that merely needs to be cleaned is not physically damaged, and viruses are easily cleaned. Westport argues that loss of use of property is not itself sufficient, and that there is no causal nexus between CRO's loss of use and alleged damage from COVID-19 because CRO's losses were caused by government orders and patrons who decided to stay home, not physical damage to property.

The *Consolidated Restaurant Operations* appeal is fully briefed, but the Court of Appeals has not yet scheduled oral argument. The appeal may be argued during the Court's October or November 2023 session.

Even if the Court of Appeals resolves the broader question of whether COVID-19 causes "direct physical loss or damage" in favor of policyholders, the plaintiff in Consolidated Restaurant Operations may still face an uphill battle. In addition to that threshold issue, the insurer in that case relies on several policy exclusions, including a contamination exclusion that expressly excluded claims arising from viruses.

Ryan A. Lema is a partner at Phillips Lytle LLP and member of the firm's Insurance Coverage Practice Team. He can be reached at rlema@phillipslytle.com or (716) 504-5790.