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VIEWPOINT
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Court of Appeals rules that COVID-19 does not trigger business interruption coverage

In July 2023, we wrote about the status of COVID-19 business interruption claims around the country and previewed an upcoming case at the New York Court of Appeals, *Consolidated Restaurant Operations, Inc. v. Westport Insurance Corporation*, Case No. 2022-00160.

On February 15, 2024, the Court of Appeals issued its decision in *Consolidated Restaurant Operations*. Consistent with the decisions of most courts around the country to have previously taken up the issue, the Court of Appeals held that the presence of SARS-Co-V-2, the virus that causes COVID-19, at an insured's property does not amount to "direct physical loss or damage," as is required under most property insurance coverage forms. The Court construed the phrase "direct physical loss or damage" to require "a material alteration or a complete and persistent dispossession of insured property." The Court affirmed the prior orders of Supreme Court and the First Department dismissing the complaint.

The plaintiff had contended that the Appellate Division's construction of "direct physical loss or damage" to require "tangible, ascertainable damage, change or alteration to the property" was error, because that formulation does not give the words "physical loss" independent meaning. The plaintiff advocated for the Court of Appeals to read the phrase more broadly, to encompass situations where a physical event occurs on insured property and impairs its functionality or renders it, in whole or in part, unusable for its intended purpose.

The Court rejected the plaintiff's arguments based on the plain meaning of the policy terms. "Physical damage," the Court explained, "must be understood to require a material physical alteration to the property." And drawing an analogy to forgetting the password to one's cellphone versus losing it entirely, the Court held that "direct physical loss" must require more than just loss of use, but an actual, complete dispossession.

The plaintiff further argued that even if "direct physical loss or damage" requires physical alteration of property, it had sufficiently alleged such physical alteration, but the Court disagreed. Allegations as to the virus being physically present on objects and persisting for days or weeks were insufficient, because the plaintiff did not allege any need to repair or replace any insured property that came into contact with the virus; only business interruption losses. "Even generously construed to allege that various surfaces in the restaurants became vectors for transmission of the coronavirus, [Plaintiff] "fails to identify . . . a single item that it had to replace, anything that changed, or that was actually damaged at any of its properties. As the Appellate Division found, '[n]othing stopped working.'

And the allegations themselves confirm that the presence of the coronavirus was temporary."

The Court did express sympathy for the losses suffered by policyholders: "We do not take lightly the severe economic losses incurred by restaurants and other businesses serving the public as a result of the COVID-19 pandemic. But our task is to faithfully interpret the terms of the insurance policy before us, not to 'rewrite the language of the polic[y] at issue' to reach a result with 'equitable appeal.'"

In light of the Court of Appeals' decision in Consolidated Restaurant Operations and prior decisions in federal courts in New York, the door is likely closed on any remaining COVID-19 business interruption claims in New York State.

SDNY finds insured has no right to veto settlements of claims against co-insureds

On February 8, 2024, Judge Jennifer Rochon of the Southern District of New York issued a decision granting a motion to dismiss in a case concerning whether one co-insured has the right to block an insurer's settlement of claims as to other co-insureds under a directors and officers insurance policy.

In *Modell v. Argonaut Insurance Company*, No. 23-cv-01488, 2024 WL 495135 (S.D.N.Y. Feb. 8, 2024), the former CEO of Modell's Sporting Goods sued to challenge the Argonaut Insurance Company's ("Argo") provision of insurance benefits to the company's former CFO under the company's D&O Policy.

Modell argued that the former CFO had breached the terms of the policy by making unauthorized admissions in underlying litigation in bankruptcy. Argo continued to defend the CFO and ultimately paid to settle claims on the CFO's behalf. Modell argued that he did not consent to the settlement, and sought a declaration that Argo could not pay the settlement without his consent.

The policy provision that the plaintiff relied on stated that "Notwithstanding the Insurer's right and duty to defend any Claim under this Coverage Section, the Insureds shall have the option to . . . consent to a settlement, which consent shall not be unreasonably withheld" ("Consent Clause").

In granting Argo's motion to dismiss, the Court held that Modell failed to state a claim. In reaching its conclusion, the Court held that the plain and unambiguous meaning of the Consent Clause conferred on each insured the right to consent to a settlement on its own behalf, but did not give other insureds the right to block settlements with respect to other insureds.

Department of Financial Services issues proposed circular letter on the use of AI in insurance underwriting

On January 17, 2024, the New York State Department of Financial Services (DFS) issued a proposed Circular Letter addressing the use of external consumer data and information sources together with artificial intelligence systems (AI) in the insurance underwriting process. DFS recognizes that AI tools may simplify and expedite the underwriting process, but notes that such processes "may reflect systemic biases," and have potential adverse effects or discriminatory outcomes. DFS set forth a number of fairness principles in the use of AI in underwriting so that insurers can avoid any discriminatory effects and analyze for potential unfair or unlawful discrimination.

DFS requests feedback on its Circular Letter, which is available at: https://www.dfs.ny.gov/industry_guidance/circular_letters/cl2024_nn_proposed

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