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Weber Gallagher

COVID-19 Suit Seeking Coverage Under Commercial Property Policy Survives Motion to Dismiss

The Western District of Missouri recently determined that a group of hair salons and restaurants can maintain a lawsuit against their insurance carrier for business interruption losses caused by the coronavirus pandemic. The insured alleges the damages were caused by a "direct physical loss" to their premises under certain "all-risk" property insurance policies.

In *Studio 417, Inc., et al. v. The Cincinnati Insurance Company*, No.20-cv-03127-SRB (W.D. Mo.), the insureds seek a declaration that the COVID-19 pandemic is covered under the business income, civil authority, ingress and egress, dependent property, and sue for labor coverage provisions in their respective policies. For the foregoing coverages to apply, the insured must demonstrate direct "physical loss" or "physical damage" to the premises at issue. As noted by the Court, the policies do not include a definition of "physical loss" or "physical damage." There is also no virus exclusion in the policies.

By way of a motion to dismiss the plaintiffs' amended complaint, the insurer argued there was no coverage available because the plaintiffs failed to allege "direct physical loss," which the insurer contended "requires actual, tangible, permanent, physical alteration of property." In contrast, the insureds asserted the insurer's focus on an actual physical alteration ignores the coverage for a "physical loss." The Court explained the insureds' argument as follows:

The plaintiffs emphasize that the policies expressly covers "physical loss or physical damage.". . . (emphasis supplied). This "necessarily means that either a 'loss' or 'damage' is required and that 'loss' is distinct from 'damage.'" As such, the plaintiffs assert that the defendant's focus on an actual physical alteration ignores the coverage for a "physical loss." The plaintiffs further allege the defendant could have defined "physical loss" and "physical damage," but failed to do so.

Thus, in denying the insurer's motion to dismiss, the Court acknowledged that "physical loss" and "physical damage"—both undefined terms in the respective policies—are distinct and not synonymous, and that "loss" potentially includes "the act of losing possession" and "deprivation," as well as the property being in a condition that is "unusable for its intended purpose." As a result, the Court held that the insured's complaint sufficiently alleged a "direct physical loss" because the insureds claimed the presence of COVID-19 on their premises hobbled their operations.

In particular, the Court focused on specific allegations in the amended complaint addressing the "physical loss" requirement, specifically that COVID-19 "is a physical substance" and that it "live[s] on" and is "active on inert physical surfaces," and is also "emitted into the air." The plaintiffs further allege COVID-19 attached to and deprived the plaintiffs of their property, making it "unsafe and unusable, resulting in direct physical loss to the premises and property." Based on these allegations, the Court determined that the amended complaint plausibly alleges a "direct physical loss" based on "the plain and ordinary meaning of the phrase."

The Court also pointed to existing case law in both the Third and Eighth Circuit, which held that "even absent a physical alteration, a physical loss may occur when the property is uninhabitable or unusable for its intended purpose." *Hampton Foods, Inc. v. Aetna Cas. & Sur. Co.*, 787 F.2d 349 (8th Cir. 1986); *Port Auth. of New York and New Jersey v. Affiliated FM Ins. Co.*, 311 F.3d 226, 236 (3d Cir. 2002) which affirmed the denial of coverage but recognizing that "[w]hen the presence of large quantities of asbestos in the air of a building is such as to make the structure uninhabitable and unusable, then there has been a distinct [physical] loss to its owner."

With respect to civil authority coverage, unlike other jurisdictions that have held that access to a restaurant's locations was never prohibited where the businesses were allowed to remain open for food preparation, takeout, and delivery, the *Studio 417* Court also determined that a ban and/or limitation on indoor dining at these establishments could prohibit access "to such a degree as to trigger the civil authority coverage." It is significant to note that the Court emphasized that the ruling means only that the business owners presented enough facts to defeat the insurer's motion to dismiss.

Discovery will shed light on the merits of the plaintiffs' allegations, including the nature and extent of COVID-19 on their premises. In addition, the Court emphasizes that all rulings herein are subject to further review following the discovery. Subsequent case law in the COVID-19 context, construing similar insurance provisions, may be persuasive under related facts.

Comment: Most of the Court's decisions to date have ruled in favor of the insurance companies, indicating that the risks posed by COVID-19 do not meet the direct physical loss or damage requirement in similar all-risk property insurance policies without some alteration to the physical structure of a property. However, the Studio 417 Court explained that in the cases favoring insurers, the insureds failed to allege or proffer evidence that COVID-19 was present or had physically damaged their properties or include allegations of physical loss. As the case proceeds to discovery, it will be interesting to see how the insureds prove their allegations that employees, customers, or other visitors brought the coronavirus onto their premises when most businesses have been shut down or subject to the limited capacity, such that coverage may be available.