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Update on Business Interruption Litigation for Pandemic-Related Claims

Over the past month, there were several court decisions addressing business interruption claims caused by the coronavirus pandemic. Many policies require "direct physical loss or damage" to property for coverage to apply. And some expressly exclude coverage for damage caused by viruses. Policyholders have also sought to invoke the "civil authority" provisions contained in some policies.

For the most part, these decisions have been favoring insurers, although one court recently permitted a business interruption claim to proceed under an all-risk policy (without a virus exclusion). We discuss several recent decisions below.

But we start first with a decision addressing a housekeeping issue: Where should these cases be litigated?

MDL Decision

On August 12, the Judicial Panel on Multidistrict Litigation wrestled with whether to centralize pretrial proceedings for hundreds of declaratory judgment and breach of contract claims against commercial property insurers. *In re Covid-19 Business Interruption Protection Insurance Litigation,* MDL No. 2942. Plaintiffs-policyholders alleged that their insurance policies cover business interruption losses caused by the pandemic and the related government orders suspending operations of non-essential businesses. The various plaintiffs, however, could not agree on where these cases should be centralized, how they should be organized, which ones

should be exempt, or even if centralization is appropriate. The defendant insurers, on the other hand, uniformly opposed centralization.

The Panel concluded that industry-wide centralization will not serve the convenience of the parties and witnesses or otherwise improve efficiency. The Panel found commonality was lacking because there are many different insurers using policies with different language, which policies were purchased by businesses in different industries in different states. The Panel noted that although many policies use standard forms, these policies are often modified by endorsement and seemingly minor differences can have significant impacts on the scope of coverage.

The Panel also found, from a managerial perspective, that an industry-wide MDL would be too unwieldy and would not promote quick resolution of these claims. It also found that proposals for regional and state-based MDLs suffer from many of the same problems.

But the Panel left open the possibility for insurer-specific MDLs. The Panel ordered further briefing with respect to four insurer groups to determine whether centralization would promote efficiency. The Panel will consider this at its next hearing session on September 24. As to actions against the remaining insurers, the Panel suggested that the parties could informally seek to coordinate actions against a single insurer before a single judge.

Jurisdictional Issues

On a related note, a Kentucky federal district court dismissed Governor Beshear from a COVID-19 business interruption coverage suit between a retailer and its insurer. The retailer said that it was seeking clarification that the governor's shutdown order was issued for a much broader reason than the virus itself and claimed he was a necessary party to the suit. If so, diversity would be destroyed, and the case would be remanded to state court.

But the court was having none of it. The court said that it "strains credulity" to argue that the governor has an interest in an action that expressly does not challenge the validity of his actions or allege that he caused any harm. The court noted that the complaint sought relief only against the insurer and that the insurer was the only real party in interest to the action. In dropping the governor from the case, the court assured the retailer that to the extent the governor's executive orders need to be interpreted, the court can do so without his help. The case is *J&H Lanmark, Inc. v. Twin City Fire Ins. Co.*, No. 5:20-333-DCR (E.D. Ky. Sept. 16, 2020).

Turning to the individual decisions, the District of Columbia Superior Court, along with federal courts in California, Florida, Illinois, Michigan, and Texas, have recently found that Covid-19 business interruption claims are not covered.

Restaurants

In *Rose's 1, LLC v. Erie Insurance Exchange,* No. 2020 CA 002424B (D.C. Super. Ct. Aug. 6, 2020), District of Columbia restaurant owners sought coverage under their commercial property policy resulting from an order by the mayor prohibiting table service at restaurants and bars and ultimately ordering the closure of all non-essential businesses. The policy covered "loss of 'income' and/or 'rental income'" sustained "due to partial or total 'interruption of business' resulting directly from 'loss' or damage." Plaintiffs asserted three reasons why they believed their claims were covered.

First, they argued that the loss of use was "direct" because the restaurant closures resulted directly from the mayor's order. But the court found that those orders merely commanded individuals and businesses to take certain actions; the orders did not cause any direct changes to the property.

Second, they argued their losses were "physical" because the coronavirus is material and tangible. But the court found that plaintiffs offered no evidence that the virus was actually present on their properties when they were required to close. And the mayor's orders did not affect the tangible structure of the properties.

Third, plaintiffs argued that "loss" was distinct from "damage." "Loss" only required that plaintiffs become deprived of the use of their properties, not that the properties suffered physical damage. The court was unpersuaded, finding that the terms "direct" and "physical" modified the term "loss." Any "loss of use" must be caused by a direct physical intrusion on to the property. The mayor's orders were not such a direct physical intrusion. The court also found no judicial support for plaintiffs' contention that a government edict, standing alone, constitutes a direct physical loss under an insurance policy. It granted summary judgment to the insurer.

See also 10E, LLC v. Travelers Indem. Co., No. 2:20-cv—4418-SVW-AS (C.D. Cal. Aug. 28, 2020) (dismissing complaint and rejecting argument that direct physical loss requirement is met by the temporary impairment of restaurant's ability to run business due to mayor's shutdown orders, finding that physical damage occurs only when a property undergoes a "distinct, demonstrable, physical alteration").

Barbershops

A Texas federal district court judge reached a similar conclusion in *Diesel Barbershop, LLC v. State Farm Lloyds*, No. 5:20-CV-461-DAE (W.D. Tex. Aug. 13, 2020). Barbershops sought coverage for business losses due to executive shutdown orders. The policies covered "accidental direct physical loss" to covered property and also contained an exclusion for "virus, bacteria or other microorganism that induces or is capable of inducing physical distress, illness or disease." The insureds argued that the policies did not require complete physical loss to the properties, but

rather allowed for a partial loss, including a loss of use due to the executive orders. The insureds also sought to get around the virus exclusion by arguing that the executive orders caused the direct physical loss.

But applying the plain language of the policies, the court found there was no direct physical loss to the property in question as there was no physical alteration of the property. Unlike a noxious odor, for example, COVID-19 did not make the barbershops uninhabitable. The court also found that the virus exclusion applied, noting that the exclusion had anti-concurrent language that barred coverage regardless of whether other causes acted concurrently with the excluded event to cause the loss. This clause excluded coverage for losses the barbershops incurred in complying with the executive orders.

The barbershops also sought coverage under a "civil authority" endorsement. The endorsement provided coverage for losses incurred when a government order bars access to the insured's premises because of direct physical loss or damage to another property nearby. The court found that the civil authority endorsement did not apply as the barbershops' inaccessibility was not a direct result of physical damage to other premises in proximity of the insured's property. The court granted the insurer's motion to dismiss.

On September 11, a federal judge from the U.S. District Court for the Southern District of California denied a barbershop owner's proposed class action for similar reasons. *See Poppy's Barber Shops, Inc. v. Farmers Ins. Group, Inc.,* No. 3:20-cv-00907.

Chiropractors

On September 3, a federal judge from the Eastern District of Michigan dismissed a chiropractor's suit alleging that an insurer failed to pay loss of income and extra expense under an all-risk policy. *Turek Enterprises, Inc. v. State Farm Mut. Auto. Ins. Co.,* No. 20-11655 (E.D. Mich.).

The insurer denied coverage on the basis that the losses were not the result of an "accidental direct physical loss to Covered Property" and were otherwise barred by the virus exclusion. The chiropractor argued that "direct physical loss" was not limited to tangible property but included loss of use. It argued that coverage was triggered because the covered property was unusable or uninhabitable. It further argued that the coronavirus never entered its premises and that its claim arises only from the state suspension orders.

Based on a plain reading of the policy, the court determined that the policy required that there be loss *to* Covered Property, not loss *of* Covered Property. Therefore, some tangible damage to Covered Property was required.

The court rejected the insured's argument that the complaint stated tangible damage because it alleged tangible deterioration during the several months that the insured's operations had been suspended, such as damage to chiropractic equipment, leased equipment, medication and supplements with expiration dates, and other depreciating assets. The court reasoned that the insured was simply adding an extra step to its original theory. It noted that rather than the loss of use being the "direct physical loss," the insured was now contending that the "direct physical loss" is the passive deterioration *caused by* the loss of use. The court found no legal authority to support the theory that passive depreciation counts as a "direct physical loss to Covered Property."

The court also found that the virus exclusion applied and noted that the anti-concurrent causation clause extended the virus exclusion to all losses where a virus is part of the causal chain. Coverage would therefore be excluded even if the suspension orders were a more proximate cause than COVID-19.

Dentists

In *Martinez v. Allied Insurance Company of America,* No. 2:20-cv-00401-FtM-66NPM (M.D. Fla. Sept. 2, 2020) a dentist claimed that he incurred costs to decontaminate his dental office of the coronavirus and lost business income because of the governor's limitation of dental services to only emergency procedures during the pandemic. The court dismissed the dentist's complaint on the basis that the policy excluded liability for loss or damage caused "directly or indirectly" by any virus. Because the damages resulted from the coronavirus, neither the governor's orders narrowing dental procedures to only emergency procedures nor the disinfection of the dental office was a "Covered Cause of Loss" under the policy's plain language.

See also Sandy Point Dental PC v. Cincinnati Ins. Co., No. 1:20-cv-02160 (N.D. Ill. Sept. 21, 2020) (holding that dental office failed to show direct physical loss and stating that "[t]he coronavirus does not physically alter the appearance, shape, color, structure, or other material dimension of the property").

Retailers

In *Mudpie Inc. v. Travelers Casualty Insurance Co. of America,* No. 4:20-cv-03213 (N.D. Cal. Sept. 14, 2020), the court dismissed without prejudice a proposed class action by a children's clothing store on the basis that its loss of business was caused by government shutdown orders, not physical damage to its property. Such orders are preventative in nature and not issued in response to physical loss or damage, the court reasoned. The court noted that once the orders are lifted, the store will get its property back without any need to repair, replace, or disinfect the property. The court was also influenced by language in the policy that the insurer would not pay for loss or damage caused by or resulting from a loss of use or loss of market. The court, however, allowed the retailer to amend its complaint.

The Outlier

Bucking this trend, the Western District of Missouri in *Studio 417, Inc. v. Cincinnati Insurance Company,* No. 20-cv-03127-SRB (Aug. 12, 2020), allowed business interruption claims by hair salons and restaurants in the Kansas City metropolitan area to proceed. The claims were made under all-risk policies that paid for "direct loss" unless excluded. A "Covered Cause of Loss" was defined to mean "accidental direct physical loss or accidental direct physical damage." The policies did not contain a virus exclusion.

Plaintiffs alleged that the presence of COVID-19 and governmental closure orders caused a direct physical loss or direct physical damage to their premises "by denying use of and damaging the covered property, and by causing a necessary suspension of operations during a period of restoration." Plaintiffs emphasized that the policies covered "physical loss *or* physical damage." According to plaintiffs, this means that either a "loss" or "damage" is required and that "loss" must be distinct from "damage." Plaintiffs argued that the insurer's focus on actual physical alteration ignores the coverage for a "physical loss."

The court found that the insureds had adequately stated, for purposes of a motion to dismiss, a claim for direct physical loss, as they alleged that COVID-19 particles attached to and damaged their property making their premises unsafe and unusable. The court also agreed that physical loss was not synonymous with physical damage and that physical loss could be found without structure damage.

The court further found that plaintiffs plausibly stated a claim under the "civil authority" coverage. Plaintiffs alleged that they suffered a physical loss and that such loss is applicable to other property. They also alleged that civil authorities issued closure and stay at home orders throughout the state, which included property other than plaintiffs' premises. Because of those

closure orders, access to hair salons and indoor dining was prohibited. The court noted that the policy required only that the civil authority prohibit "access" as opposed to "all or any" access to the premises.

In denying the insurer's motion to dismiss, the court emphasized that plaintiffs have merely pled enough facts to proceed with discovery and that discovery will shed light on the merits of plaintiffs' claims.

Its should be noted that the *Turek* court, discussed above, distinguished *Studio 417* on the basis that the policy language was different and because the insureds in *Turek* did not allege that the coronavirus entered its premises.

Possible Federal Relief

Small businesses may find solace in a House bill, the Business Interruption Relief Act. If passed, the bill would create a voluntary program for insurers to pay claims and be reimbursed by the federal government.

Meanwhile, the insurance industry has proposed the Business Continuity Protection Program, a federal program that would allow businesses to purchase revenue replacement coverage up to 80% of payroll and other expenses with aid from the Federal Emergency Management Agency.

Dust from Road Construction Did Not Result in Direct Physical Loss to Insured's Restaurant, 11th Circuit Holds

The Eleventh Circuit affirmed a district court's ruling that a Miami restaurant's business interruption claim was not covered because any loss of income was not caused by direct physical

loss or damage to property. “Direct physical loss” did not include cleaning dust from the restaurant caused by nearby road construction.

The Case

The insured operated a restaurant with a retractable awning and roof system that allowed for open air dining. For about 18 months, there was roadway construction at different locations in the vicinity of the restaurant. During this time, dust and debris migrated into the restaurant. The insured performed daily cleaning, using its normal methods.

The restaurant had the ability to serve the same number of customers before the construction work began, but because of the roadwork, customer traffic decreased. The insured submitted a claim under its “all-risk” policy for the costs to clean and paint the restaurant and for its lost business income. The insured sought coverage under the Building and Personal Property form and the Business Income and Extra Expense form.

The Building and Personal Property form covered "direct physical loss of or damage to Covered Property . . . caused by or resulting from any Covered Cause of Loss." The policy defined "Covered Causes of Loss" as "Risks of Direct Physical Loss unless the loss is" excluded or limited.

The Business Income and Extra Expense form covered "the actual loss of Business Income you sustain due to the necessary 'suspension' of your 'operations' during the 'period of restoration.'" The "'suspension' must be caused by direct physical loss of or damage to" covered property.

The insured hired a public adjuster to assist with its claim. The public adjuster submitted an estimate of $16,275.58 to clean and paint the restaurant. The adjuster testified that at such time, nothing in the restaurant needed to be removed or replaced. The public adjuster also submitted to the insurer a proof of loss in the amount of $292,550.84 contending that the

restaurant's sales were lower than expected compared to its rate of sales growth in the previous years.

The insurer denied the claim because under the Building coverage, the proof of loss did not reflect any physical damage. Under the Business Income Coverage, the suspension must be caused by the direct physical loss of or damage to property at the premises.

The insured sued and sought to include additional categories of damages in its claim, such as the costs to replace the restaurant's awning and retractable roof systems, HVAC repairs, and replacement of the restaurant's lighting and audio systems. The insured retained three experts to support its claim for these additional categories of damages, but the district court found their opinions unreliable and precluded their testimony.

The district court further determined that the insured's initial claim for cleaning was not covered because property that simply must be cleaned, but is not damaged, has not sustained a direct physical loss. It also found that the insured's loss of business income claim was not covered because the insured could not show that suspended operations were the result of a direct physical loss.

The Eleventh Circuit's Decision

On appeal, the insured argued that the district court erred in three ways: (1) by concluding that "direct physical loss" does not include cleaning, but rather requires a showing that the property be rendered uninhabitable or unusable; (2) by requiring the insured to show that a suspension of operations was the result of physical damage in order to establish business income coverage; and (3) in striking the insured's causation experts.

The Eleventh Circuit affirmed the district court's ruling.

It first performed a *Daubert* analysis and found that the district court did not abuse its discretion in precluding the insured's causation experts on the basis that their opinions were unreliable. It upheld dismissal of the new categories of damage.

As for the insured's initial claim, the court observed that Florida law has addressed the meaning of "direct physical loss." A "loss" is the diminution of value of something. "Direct" and "physical" modify "loss" and impose the requirement that the damage be actual.

The Eleventh Circuit concluded that the district court correctly granted summary judgment on the insured's cleaning claim because, under Florida law, an item or structure that merely needs to be cleaned has not suffered a "loss" which is both "direct" and "physical."

As for the business income claim, the insured contended that the district court was wrong when it found that the restaurant had not suspended its operations. But the Eleventh Circuit held that even if the insured had shown a "suspension" of operations, the insured did not demonstrate that the suspension was the result of direct physical loss of or damage to its property as required by the policy.

The Eleventh Circuit therefore affirmed the district court's grant of summary judgment in favor of the insurer.

The case is *Mama Jo's, Inc. v. Sparta Ins. Co.,* No. 18-12887 (11th Cir. Aug. 18, 2020).

Waiver, Estoppel, and Reservation of Rights: Three Recent Decisions Discuss Some General Principles

It is often stated that an insurer cannot waive coverage that does not otherwise exists. But an insurer can waive conditions to coverage and can be estopped from denying coverage where it has not properly reserved its rights. Three recent cases apply these principles.

The first case addresses a situation that straddles the line between these two principles. In *Topp's Mechanical, Inc. v. Kinsale Insurance Company,* No. 19-1991 (8th Cir. Aug. 4, 2020), the Eighth Circuit considered under Nebraska law whether the doctrines of waiver and estoppel were appropriate where the insured delayed providing written notice under a claims-made policy's reporting requirement due to its purported reliance on the insurer's representation. The insured purchased a liability policy with an absolute pollution exclusion. The policy had a Time Element Pollution Endorsement that created a limited exception to the pollution exclusion. For the exception to apply, the pollution incident must be discovered by the insured within 7 days and reported to the insurer in writing within 45 days.

The insured discovered a pollution incident involving one of its employees within 7 days but was unsure whether it needed to report it. It called its insurer and was told by a person in the claims department that it could not yet report the incident as a claim and that it should wait until the employee filed a formal demand or suit.

Eighteen months later, the injured employee made a formal demand. The insured sent the request to its insurer for indemnification. The insurer denied coverage and the insured sued. The insured conceded that it did not provide written notice within the required 45-day period. But it argued that the insurer waived the 45-day requirement, or should be estopped from asserting it,

because the insurer told the insured not to report the claim until a formal demand was made or a lawsuit was filed.

The district court granted the insurer's motion to dismiss.

On appeal, the Eighth Circuit affirmed. It found that waiver and estoppel did not apply because they would have expanded coverage or the scope of the policy. The court emphasized the difference between "occurrence" and "claims-made and reported" policies. Both require prompt notice. But under a claims-made and reported policy, notice is not simply part of the insured's duty to cooperate. Rather, it defines the limits of the insurer's obligation – if notice is untimely, there is no coverage. Because the insured did not satisfy the 45-day written notice requirement of the Time Element Pollution Endorsement, the exception was not satisfied, and neither waiver nor estoppel could be invoked to broaden coverage.

The second case, from the Tenth Circuit applying Wyoming law, recognizes that waiver and estoppel cannot be used to expand policy coverage, but addresses an exception to that rule where an insurer assumes the insured's defense without first reserving rights. In *Interstate Fire & Casualty Company v. Apartment Management Consultants, LLC,* No. 18-8058 (10th Cir. Aug. 27, 2020), a tenant injured by carbon monoxide poisoning from a malfunctioning furnace obtained a $1.95 million punitive damages award against a management company. The management company was insured under primary and excess policies issued by the same insurer. The primary policy excluded coverage for punitive damages by way of an endorsement. The excess policy did not expressly exclude punitive damages but followed form to the primary policy.

The insurer promptly assumed the management company's defense in the underlying suit but did not reserve the right to disclaim coverage for punitive damages until 18 months later and just 11 days before trial. A few days before judgment was entered in the underlying action, it

sought a declaration that it owed no coverage for punitive damages under the primary or excess policies. The district court ruled that the insurer was estopped from invoking the primary policy's punitive damages exclusion because it unconditionally assumed the insured's defense and did not reserve rights to disclaim coverage for punitive damages until shortly before trial. It also found that the excess policy covered the remainder above the policy limits.

The Tenth Circuit affirmed, finding that the insured was prejudiced by the insurer's less than vigorous effort to have the punitive damages claims dismissed from the suit coupled with its failure to inform the management company that punitive damages were not covered until past the point where the management company could have hired independent counsel to protect its interests on the uncovered claims. The court found that this prejudice flowed from the management company having relinquished control of the defense to the insurer.

Courts have departed from the general rule that waiver and estoppel cannot create coverage where the insurer failed to timely assert a defense based on a condition to coverage – such as timely notice or cooperation. Here, the court did not do that. Rather, it found that estoppel can create coverage where the insurer's delay prejudices the insured. There was no question that the primary policy excluded coverage for punitive damages. But the court found coverage for the punitive damages award anyway based on the insurer's conduct. This is in stark contrast the Eighth Circuit's reasoning above.

The Tenth Circuit also upheld the district court's finding that the excess policy stepped in when the limits of the primary policy were exhausted. It did so, even though the excess policy followed form to the primary policy and seemingly incorporated the punitive damages exclusion. The court reasoned that once the insurer had failed to timely reserve its rights under the primary policy, it was required to indemnify for both compensatory and punitive damages and that the

excess policy was triggered upon exhaustion of the primary limits. It should be noted that this decision is unpublished but should serve as a reminder to insurers on the importance of a timely reservation of rights. Whether the court's analysis was flawed or not, the end result is that the insurer was required to pay a punitive damages award under two policies that did not cover punitive damages because it failed to timely assert this coverage defense.

A similar lesson can be drawn from our third case. In *Penn-American Insurance Company v. Morgan Fleet Services, Inc.,* No. A20A1513 (Ga. Ct. App. Aug. 14, 2020), a school bus driver was injured during a bus fire and sued the insured, Morgan Fleet Services (MFS), for failing to adequately inspect the school systems buses. In its application for insurance, MFS described its business as a warehouse and stated that it installs seat covers on buses. Underwriting notes indicated that the policy was rated based on MFS's storage of seat covers. It was undisputed, however, that MFS performed inspections of school buses for a school district both before and after the application. The insurer claimed it would not have issued the specific policy to MFS if it had been informed that MFS was inspecting buses.

In response to the bus driver's suit, the insurer notified its outside counsel by email that it would be providing a defense to MFS under a reservation of rights and that a formal letter would be forwarded shortly. It copied MFS on the email.

In its letter, the insurer informed MFS that it was reserving the right to rescind the policy because the insurance application contained a material misrepresentation about the nature of MFS's business. But for whatever reason, the insurer did not send the reservation of rights letter until six months after assuming MFS's defense.

The insurer sought a declaration that the policy it issued to MFS was void. MFS countered by arguing that the insurer was estopped from denying coverage because it assumed MFS's defense without notifying MFS that it was doing so under a reservation of rights.

The Georgia Court of Appeals observed that "risks not covered by the terms of an insurance policy, or risks excluded therefrom, while normally not subject to the doctrine of waiver and estoppel, may be subject to the doctrine [when] the insurer, without reserving its rights, assumes the defense of an action or continues such defense with knowledge, actual or constructive, of noncoverage." But the insurer can avoid estoppel by "giving timely notice of its reservation of rights which fairly informs the insured of the insurer's position."

Siding with the policyholder, the court ruled that the insurer waived its right to deny coverage because its reservation of rights was untimely. The insurer recognized early on of the potential for rescission based on MFS's misrepresentation, the court reasoned, but did not send the "actual unambiguous reservation of rights" until six months later and only after having taken over the defense. The court affirmed the trial court's grant of summary judgment in favor of MFS.

This case differs from the first two because the policy as written covered the claim against the insured. The insurer's defense was that it would not have written the same policy (at least not for the premium charged) if the insured had accurately described its business. Thus, waiver here did not create or expand coverage. The insurer simply waited too long to inform the insured of its coverage defense.

But a straightforward lesson can be learned from these cases. Don't leave your fate in the hands of the court. Policyholders can protect their interests by notify insurers promptly of claims. And insurers can preserve their rights by promptly notifying insureds of their coverage defenses.

Third Circuit Finds Insurer Has No Duty to Defend Insured for Malicious Prosecution Action Arising from Property Sale

The Third Circuit, in an unpublished opinion applying Pennsylvania law, held that an insurer had no duty to defend or indemnify its insured for filing a frivolous lawsuit and lis pendens aimed at derailing the sale of a property because intentional malicious prosecution is not covered by the policy.

The Case

In November 2007, Kenneth Segal, the Karen and Kenneth Segal Descendants Trust, and Segal and Morel, Inc. (S&M), commenced an action against SEI, Strausser, and Leonard Mellon. The action arose from purchase agreements in which SEI sold several parcels of land to S&M (which then assigned its rights and obligations to several limited liability companies, of which Segal and the Trust were the sole members). Segal and the Trust subsequently contracted to sell their interests in the S&M LLCs to K. Hovnanian Pennsylvania Acquisitions, LLC. According to the underlying complaint, SEI, Strausser, and Mellon sabotaged the Hovnanian deal by manufacturing a frivolous state court lawsuit as well as a frivolous arbitration in which they sought to manufacture non-existent rights of first refusal. The Segal Action complaint asserted, among other causes of action, tortious interference with contract, abuse of process, and tortious interference with prospective contractual relations.

SEI and Strausser advised its insurer, Regent Insurance Company, of the Segal Action and sought coverage. Regent provided a defense to the Segal Action subject to a reservation of rights and filed an action seeking a declaration that it had no duty to defend or indemnify SEI and

Strausser. The parties filed cross-motions for summary judgment. The district court granted SEI and Strausser's motion to the extent it sought a declaration that Regent had a duty to defend and indemnify them in the underlying action, with the exception of punitive damages. Regent appealed.

The Decision

The Third Circuit vacated the district court's order in part and remanded with instructions to grant Regent's motion for summary judgment.

The court concluded that the underlying complaint alleged intentional and knowing actions, and therefore, did not trigger Regent's duty to defend. The court noted that the Segal Defendants allegedly knew there was no right of first refusal to the properties before filing their lawsuit. The court also noted that the underlying complaint in the Segal action further alleged that SEI, Strausser, and Mellon proceeded with the claims against the Segal Plaintiffs despite the contrary rulings of the state court and the arbitration panel as well as their own prior own admissions. Because the malicious prosecution was intentional, the court ruled that there was no coverage.

The action is *Regents Ins. Co. v. Strausser Enters.*, No. 12-4135 (3d Cir. Aug. 7, 2020).

Exclusion for Damage to Property Bars Coverage for Construction Defect Claim, Texas Federal Court Holds

A federal court in Texas found that an insurer was entitled to a declaratory judgment that an exclusion for damages to real property barred coverage for a construction defect claim.

The Case

McBride Operating LLC hired ETOPSI as a consultant for the design and construction of a new injection well. However, the well was 200 feet too shallow to reach the desired geological formation. Efforts to expand the well's depth were unsuccessful and the well was considered valueless.

McBride sued ETOPSI in state court for this defect. ETOPSI's insurer, Kinsale Insurance Company, filed a declaratory judgment action that its liability policy does not require coverage. The parties cross-moved for summary judgment.

The Decision

The court granted Kinsale's motion and denied ETOPSI's motion. Applying Texas law, the court first rejected Kinsale's argument that McBride alleged only an economic loss rather than property damage under the policy. The court held that the presence of a non-functioning well constitutes a physical injury to tangible property because it was a loss of use of that property.

Nonetheless, the court held that coverage was barred by a policy exclusion for "'property damage' to . . . [t]hat particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations."

The court rejected ETOPSI's argument that the exclusion required "action" and did not apply because the underlying damages were wholly attributable to what ETOPSI did not do, that is, stop running pipe too soon, resulting in a well that was too shallow to use. The court found that ETOPSI relied on overly narrow constructions of both what McBride alleged ETOPSI's duties were and of the phrase "performing operations." The court noted that, under Texas law, it was required to "focus on the factual allegations that show the origin of the damages."

The underlying petition asserted that ETOPSI agreed to provide McBride with a functioning well but failed to do so. Therefore, the court found that the exclusion for damage to real property applied to the dispute.

The case is *Kinsale Ins. Co. v. ETOPSI Oil & Gas LLC,* No. 6:19-cv-00413 (E.D. Tex. Aug. 7, 2020).

New Jersey Appellate Court Rules That Assault-Or-Battery Exclusion Barred Tavern's Indemnification Claim

A New Jersey appellate court found that an exclusion for assault or battery in a commercial general liability policy barred the insured tavern's indemnification claim.

The Case

The estate of Roger Pickett, a tavern patron, sued the tavern owner, EMRO, Inc., for damages after a tavern invitee fatally shot Pickett following a verbal argument. The estate alleged EMRO negligently permitted the shooter to enter the tavern armed, remain there, and then intentionally shoot Pickett. EMRO and its insurance producer, whom EMRO sued for failing to procure adequate coverage, settled with the estate.

Then, EMRO sought indemnification from its insurer, Northfield Insurance Co., for its settlement share and defense costs. In denying coverage, Northfield invoked the assault-or-battery exclusion. The exclusion applied to any damages "arising out of any act of 'assault'' or 'battery' committed by any person." The exclusion expressly encompasses claims "arising out of . . . any act or omission in connection with the prevention or suppression of such 'assault' or 'battery.'" The trial court granted summary judgment to Northfield based on the assault-or-

battery exclusion.

The Decision

The appellate court affirmed. The court held that the assault-or-battery exclusion in the policy unambiguously barred the insured tavern's indemnification claim. The court noted that the exclusion encompassed not just assault or battery, but negligent acts or omissions that fail to prevent or suppress the assault or battery.

The court pointed to the estate's general allegations that the insured negligently failed to exercise reasonable care to assure the tavern was a safe place. As a result of the insured's negligent management of personnel, the insured's staff allowed the patron to enter with a gun, allowed him to retain the gun throughout the evening as he became more intoxicated, did not intervene when he began arguing with the other patron, and ultimately did not prevent the patron from shooting the other patron.

The case is *Pickett v. Moore's Lounge*, Docket No. A-2330-1772 (N. J. App. Div. Aug. 25, 2020).

Missouri Appellate Court Affirms Admission of Insurers' Expert Testimony Regarding Allocation of Groundwater Contamination

A Missouri appellate court, siding with insurers, ruled that a trial court did not abuse its discretion in admitting testimony from an expert regarding allocation of groundwater contamination before a jury.

The Case

The case concerned coverage for an environmental action arising out of Northrop Grumman Guidance and Electronics Company, Inc.'s manufacturing operations at a facility in Springfield, Missouri. Northrop initiated the action in the Circuit Court of Jackson County against its insurers – Employers Insurance Company of Wausau, OneBeacon America Insurance Company, and Certain Underwriters at Lloyd's, London and Certain London Market Insurance Companies – seeking coverage for contamination at the Springfield facility that resulted in property damage.

The insurers presented the expert testimony of Robert Karls, who testified that there was a scientifically recognized methodology by which to determine to a reasonable degree of scientific certainty the relative percentage of groundwater contamination attributable to each Area of Concern on the site. Relying on this methodology, he testified that the majority of the groundwater pollution at the site was attributable to the Original Acid Pits.

Following a fourteen-day jury trial, Northrop requested the jury to award damages totaling over $10 million. The jury found in favor of Northrop on its coverage claim against Wausau and awarded Northrop $199,624 in damages. But the jury found in favor of the insurers on Northrop's claims against OneBeacon and London.

After trial, Northrop requested the trial court enter a judgment declaring Wausau's future defense and indemnity obligations to Northrop. The trial court entered its final judgment on the jury's verdicts and declared that Wausau was responsible for only a portion of Northrop's future defense and indemnity costs despite applying an "all sums" allocation methodology.

On appeal, Northrop argued that the trial court abused its discretion in admitting Karls's "allocation" testimony to a jury. Northrop also argued that the trial court erred in limiting Wausau's future indemnity obligations.

The Decision

The appellate court ruled that the trial court did not err in admitting evidence from Defendants' expert, Robert Karls, regarding allocation of groundwater contamination from various areas of concern at the site. The court noted that this was not "allocation" evidence, but rather permissible "divisibility" evidence presented to show that no covered property damage occurred during the insurers' policy periods. The court reasoned that the insurers were entitled to rebut Northrop's evidence that groundwater contamination was commingled and indivisible – namely, that the contamination could be attributed to specific locations and that those areas did not begin operation until after their policy periods ended.

The court also rejected Northrop's argument that the trial court erred by declaring that Wausau's future indemnity obligation does not include payment for all of Northrop's liability for the 2010 Consent Decree and state environmental agency's lawsuit up to the policy limits. The court emphasized that, even though it was applying an all sums allocation, there must a determination of liability before any allocation analysis. As the jury found that only Wausau was liable and only for the property damage resulting from contamination at the Sanitary lagoon, the court refused to find that the property damage was indivisible.

The case is *Northrop Grumman Guidance & Elecs. Co. v. Emplrs. Ins. Co. of Wausau*, No. WD82615 (Mo. Ct. App. Aug. 4, 2020).