# COVID INSURANCE COVERAGE:

## Herd Immunity for Insurers or is Coverage Spreading?

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**When COVID-19 ground the world to a halt, policyholders and insurance-coverage attorneys made predictions about the effectiveness of insurance against coronavirus-related losses. And the outlook wasn't great. This article examines a few of these predictions and how they played out. Understanding these issues will help policyholders better plan for, and protect themselves from, future outbreaks.**

### PREDICTION 1: Coverage, if any, would come from commercial property policies.

The first prediction stated that most businesses would only find coverage (if any) from commercial property policies. Specifically, coverage might come from business interruption (BI) coverage or from Civil Authority coverage, both of which are standard in property policies. BI coverage pays for lost income and other losses arising from disruptions to the insured's business operations caused by the direct loss of, or damage to, covered property. Civil Authority is similar but does not require direct loss or damage to an insured's property; instead, it covers losses caused by a government order that closes or prohibits access to the property.

This prediction came true. Except for specialized communicable disease coverage (sold to the healthcare and medical research industries), virtually all coronavirus-related claims have been made under commercial property policies.

## PREDICTION 2: Litigation would be necessary.

The second prediction was disheartening, but unavoidable: Policyholders would need to sue to secure coverage for coronavirus losses. The economic impact of the COVID-19 pandemic is unprecedented, dwarfing other massive-loss events like 9/11 or Hurricane Katrina, and paying even a fraction of the claims could bankrupt the insurance industry. Thus, insurers had no choice but to deny every coronavirus-related claim and let the courts decide coverage.

As predicted, coverage litigation surged and, since the first complaint was filed in Louisiana in March 2020, the curve of new lawsuits increased sharply throughout the country. By July 12, 2021, 1,958 lawsuits had been filed (*see* https://cclt.law.upenn.edu/). For reference, Superstorm Sandy previously held the (unofficial) record as the most-litigated loss event, with just 150 BI coverage cases filed within one year of the event.

The insurance industry was able to slow the spread of new lawsuits by defeating most of them at the outset of litigation. As of July 21, 2021, at least 497 lawsuits had been decided through motions to dismiss or summary judgment: nearly 90 percent of them in favor of the insurers. The inoculating effect of this early success is undeniable, even in Nevada. For example, two Nevada lawsuits demonstrate how insurers are flattening the curve of coverage litigation: In both *Levy Ad Grp., Inc. v. Chubb Corp.*, No. 2:20-cv-00763, 2021 WL 777210 (D. Nev. Feb. 16, 2021), and *Circus Circus LV, LP v. AIG Specialty Ins. Co.*, No. 2:20-cv-01240, 2021 WL 769660 (D. Nev. Feb. 26, 2021), the federal court granted insurers' motions to dismiss.

However, there is hope for Nevada policyholders. In the breakthrough case of *JGB Vegas Retail Lessee, LLC v. Starr Surplus Lines Ins. Co.*, No. A-20-816628-B, 2020 WL 7190023 (Nev. Dist. Ct. Nov. 30, 2020), the Eighth Judicial District Court denied an insurer's motion to dismiss. The case is set for trial in 2022.

## PREDICTION 3: Virus exclusions would immunize insurers from the pandemic.

The next prediction claimed that well-written virus exclusions would eliminate coverage for coronavirus claims. After the global SARS and MERS outbreaks in the 2000s, insurers adopted endorsements that exclude losses arising from communicable diseases. The dominant strain of these, ISO form CP 01 40 07 06 ("Exclusion for Loss Due to Virus or Bacteria"), excludes coverage for "loss or damage caused by or resulting from any virus, bacterium, or other microorganism that includes or is capable of inducing physical distress, illness or disease." Virus exclusions also appear in policies in other forms, such as mold exclusions, applying to "fungi, bacteria, and virus," and certain pollution exclusions that include viruses in the definition of "pollution."

Unfortunately for policyholders, this prediction proved true. A virus exclusion operates like a good vaccine—and more than 80 percent of insurers' motions to dismiss have been granted when the policy contains any form of a virus exclusion, and virtually no lawsuit has survived when the policy contains the ISO form CP 01 40 07 06 virus exclusion. In Nevada, for example, the U.S. District Court granted the insurer's motion to dismiss due to the policy's "Pollutants or Contaminants" exclusion, which included "virus" in its definition of "pollution." *See Circus Circus*, 2021 WL 769660 at *6.

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## PREDICTION 4: COVID-19 might not cause "direct physical loss or damage" to property.

The fourth prediction stated that there would be a continued split in authority regarding BI coverage. Before the pandemic, courts were split about whether losses caused by an invisible virus met the first element of BI coverage: "direct physical loss of or damage to" covered property. Specifically, when examining "direct physical loss of or damage to" property, the majority of courts follow a "physical alteration" standard, which requires tangible damage to covered property. The minority view, however, is a more policyholder-friendly "loss of use or possession" standard, where invisible or odorless components (like asbestos, Chinese drywall, or bacteria) *can* rise to the level of "direct physical loss of or damage to" property if they cause a loss of use, possession, or habitability of covered property.

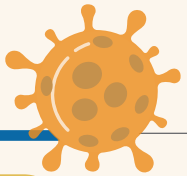
> The insurance companies' early success refuting coverage doesn't imply complete vaccination against coronavirus claims. Breakthrough cases (following the "loss of use or possession" standard), give policyholders hope.

As predicted, this split has continued throughout the pandemic. On one hand, demonstrating the intuitive appeal of the majority approach, a New York federal judge recently held that a policyholder cannot allege any physical damage or loss due to the coronavirus because "[i]t damages lungs. It doesn't damage [physical property]." *Social Life Magazine, Inc. v. Sentinel Insurance. Co. Ltd.*, No. 1:20-cv-03311, ECF No. 25, Ex. B at 5:3-4 (S.D.N.Y. 2020). The U.S. District Court for the District of Nevada appears to follow the majority view. Both *Circus Circus* and *Levy Ad Group* applied the "physical alteration" standard and granted the insurers' motions to dismiss on the grounds that the policyholders failed to allege any physical loss or physical damage to the covered property.

On the other hand, the seminal policyholder-friendly holding, embracing the minority view, is *Studio 417, Inc. v. Cincinnati Ins. Co.*, 478 F. Supp. 3d 794 (W.D. Mo. 2020), which denied Cincinnati Insurance's motion to dismiss a lawsuit brought by hair salons and restaurants to cover their coronavirus-related losses. The court focused on the threshold question: do the policyholders allege a "direct physical loss or damage" under the policies? Cincinnati Insurance argued that they did not, since physical loss or damage "requires actual, tangible, permanent, physical alteration of property." The court disagreed. It emphasized that the policies cover either physical loss *or* physical damage and reasoned that the "physical alteration" standard would conflate the two terms. Because the policies did not define either, the court gave the term "loss" its plain and ordinary dictionary meaning of "losing possession" and "deprivation." Since plaintiffs sufficiently alleged both the physical presence of coronavirus on the covered property and their loss of use because of the coronavirus, Cincinnati Insurance's motion to dismiss was denied.

Nevada state courts also appear to follow the "loss of use or possession" standard. In *JGB Vegas*, the court judge followed *Studio 417* in denying an insurer's motion to dismiss when the owner of Las Vegas' Grand Bazaar open-air mall alleged certain "known facts about the coronavirus, including that it spreads through infected droplets that 'are physical objects that attach to and cause harm to other objects' based on its ability to 'survive on surfaces' and then infect other people." The policyholder further alleged that: (a) it was "highly likely that the novel coronavirus that causes COVID-19 has been present on the premises of the Grand Bazaar Shops, thus damaging the property," and (b) "because the presence of COVID-19 at or near the Grand Bazaar Shops and [Nevada] Governor Sisolak's March 20, 2020 Order restricting and prohibiting access to non-essential business, the Grand Bazaar Shops were forced to close and the few restaurants that remained open were severely limited in their operations, resulting in significant losses." Citing *Studio 417*, the Nevada court ruled that the complaint "sufficiently allege[d] losses stemming from the direct physical loss and/or damage to property from COVID-19 to trigger Starr's obligations under the policy."[1]

The insurance companies' early success refuting coverage doesn't imply complete vaccination against coronavirus claims. Breakthrough cases (following the "loss of use or possession" standard), give policyholders hope. A new variant, in the form of appeals, is beginning to emerge, but it will take years before we obtain "herd immunity" in the form of any controlling judicial precedent.



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**ENDNOTE:**

1. *JGB Vegas* is also one of the rare cases where a policy with a virus exclusion survived a motion to dismiss. The policy contained a Pollution and Contamination Exclusion, which the court held did *not* unambiguously exclude coverage because the policyholder's interpretation of the exclusion as only applying to "traditional environmental and industrial pollution and contamination" rather than a "naturally-occurring, communicable disease" appeared reasonable.