

3rd Circ. Denies Coverage For Businesses' Pandemic Losses

By **Matthew Santoni**

Law360 (January 6, 2023, 2:25 PM EST) -- The Third Circuit said a group of New Jersey and Pennsylvania businesses aren't entitled to insurance coverage for their lost income during pandemic-related closures, ruling Friday that the COVID-19 virus and its associated government closure orders did not create a "direct physical loss of or damage to" their properties.

The panel followed many other courts around the country in finding that there wasn't coverage, predicting that the high courts of New Jersey and Pennsylvania would likely agree that the policy language required properties to be physically damaged or totally unusable — not just closed or limited in their use.

"The businesses lost the ability to use their properties for their intended business purposes because the governors of the states in which they operate issued orders closing or limiting the activities of nonessential businesses, not because there was anything wrong with their properties. The properties were not destroyed in whole or in part; their structures remained intact and functional," Chief Judge Michael A. Chagares wrote in the panel's opinion.

"The loss of the ability to use property in certain ways does not render the properties useless or uninhabitable. The properties could certainly be used or inhabited, just not in the way the businesses would have liked. Restaurants remained open for carry out, and medical providers could perform emergency procedures."

Friday's opinion affirmed multiple district court rulings against coverage. In the opinion and in a separate order Thursday, the Third Circuit also denied the businesses' requests to wait and ask the Supreme Court of Pennsylvania for its interpretation of the critical "physical loss" policy language.

In 14 cases consolidated for appeal to the Third Circuit, policyholders including a law firm, restaurants, optical filter shops, a gallery and a beer garden had claimed there was ambiguity in their insurance policies' definition of "physical loss of or damage to" property, and under Pennsylvania law, courts should err on the side of granting coverage.

Friday's ruling said the term had to include some actual, palpable damage or destruction of the property to trigger coverage, and the loss of a property's full intended use did not meet that standard.

"The businesses ... must show that the functionalities of their properties were nearly eliminated or destroyed, that the structures were made useless or uninhabitable, or that there was an imminent risk

of either of those things happening," the opinion said. "The definition of the term 'loss' can include loss of use. But it does not follow that every loss of use is necessarily a physical loss, and for the reasons explained above, there was no physical loss here."

Though some of the businesses had argued that the likely presence of the COVID-19 virus should count as contamination damage, similar to premises rendered unusable by chemical fumes or damage from leaking gasoline, the panel pointed to "essential" businesses that were potentially rife with the virus but remained open.

"The presence of a dangerous substance alone does not constitute a loss; there is no physical loss until the substance is in such form or quantity as to make the building unusable," Judge Chagares wrote. "No business alleged that the coronavirus was present in its property in such a form or quantity as to make the property dangerous and uninhabitable. Even at its peak, buildings in which the coronavirus inevitably amassed — such as hospitals and grocery stores — remained open and inhabitable."

As an alternative to a ruling on the lower courts' denials of coverage, the businesses had asked the panel to send the question to the Supreme Court of Pennsylvania, which has not yet weighed in on any of the many COVID-19 insurance suits still working their way through the courts since the 2020 closure orders.

After the cases were argued before the Third Circuit in September, the Superior Court of Pennsylvania issued a pair of rulings in cases brought by other businesses, with two panels finding in November that a dental practice and a proposed class of CNA Insurance customers had suffered a physical loss, while a Pittsburgh tavern insured by Erie Insurance Exchange had not.

Nine of the 14 businesses had already asked the Third Circuit to pause its ruling to see how the state courts interpreted the key terms, and the seemingly contradictory rulings from the Pennsylvania Superior Court led the businesses to renew their push for the panel to punt to the state Supreme Court for its interpretation

"These two rulings — reflecting the views of nine of the Superior Court's fourteen active judges — establish the ambiguity of 'physical loss,' the reasonableness of plaintiffs' interpretation of the term, and the concomitant need for a definitive resolution of the disputed coverage issues by the Pennsylvania Supreme Court," counsel for Butler County, Pennsylvania, restaurant and event center 1 S.A.N.T. Inc. wrote in their December motion.

But the Third Circuit disagreed that the split precluded the panel from predicting how the Supreme Court would rule.

"We nevertheless have carefully reviewed the reasoning of both decisions and predict that the Supreme Court of Pennsylvania, like the overwhelming majority of state and federal jurisdictions that have considered the issue, would determine that the policies here are unambiguous and do not cover the businesses' losses," the opinion said. Several midlevel appellate court rulings in New Jersey indicated that the Garden State's justices would likely lean the same way, the panel said.

Counsel for the businesses and the insurers did not immediately respond to requests for comment Friday. An attorney for the American Property Casualty Insurance Association and the National Association of Mutual Insurance Cos., which submitted amicus briefs in the case, called the ruling a "full house" for insurers, noting that every appellate circuit so far had made similar decisions.

"The court applied the law of Pennsylvania and New Jersey, and having found no basis for certification of issues to those state high courts, the court ruled the policies were unambiguous in requiring a distinct, demonstrable, and physical alteration or failure to maintain tangible possession of the structure to demonstrate direct physical loss or damage," said Laura A. Foggan of Crowell & Moring, representing the insurance groups. "The court considered every argument advanced by the policyholders, and disposed of each of them. It's a resounding victory finding no ambiguity or room for doubt."

U.S. Circuit Judges Michael A. Chagares, Theodore A. McKee and David J. Porter sat on the panel.

The businesses are represented by attorneys from Hunton Andrews Kurth LLP, Reed Smith LLP, Lynch Carpenter LLP, Levin Sedran & Berman LLP, Golomb Spirt Grunfeld, the Law Offices of Rhonda Hill Wilson PC, Beasley Allen Crow Methvin Portis & Miles, Feldman Shepherd Wohlgerlenter Tanner Weinstock & Dodig LLP, Francis Mailman Soumilas, Sherman Silverstein Kohl Rose & Podolsky PC, Florio Perrucci Steinhardt Cappelli Tipton & Taylor LLC, Carella Byrne Cecchi Olstein Brody & Agnello, Seeger Weiss LLP, Robbins Geller Rudman & Dowd LLP and Spector Gadon Rosen Vinci PC.

The insurers are represented by attorneys from White and Williams LLP, Steptoe & Johnson LLP, Wiggin and Dana LLP, Butler Weihmuller Katz Craig LLP, Goldberg Segalla LLP, Duane Morris LLP, Fields Howell LLP, Stewart Smith, Walker Wilcox Matousek LLP and Kennedys CMK.

The cases are In the Park Savoy Caterers LLC et al. v. Selective Insurance Group Inc. et al., case number 21-1414; The Eye Care Center of NJ PA v. Twin City Fire Insurance Co., case number 21-1315; Boulevard Carroll Entertainment Group Inc. v. Firemans Fund Insurance Co., case number 21-1061; 4431 Inc. et al. v. Cincinnati Insurance Companies et al., case number 20-3594; 1 S.A.N.T. Inc. v. Berkshire Hathaway et al., case number 21-1109; Rhonda Wilson et al. v. USI Insurance Services LLC, case number 20-3124; LH Dining LLC v. Admiral Indemnity Co., case number 21-1038; Newchops Restaurant Comcast LLC v. Admiral Indemnity Co., case number No. 21-1039; Adrian Moody et al. v. Hartford Financial Services Group Inc., case number 21-1106; ATCM Optical Inc. et al. v. Twin City Fire Insurance Co., case number 21-1107; Independence Restaurant Group LLC v. Certain Underwriters at Lloyd's of London, case number 21-1175; Ultimate Hearing Solutions Li LLC v. Hartford Underwriters Insurance Co., case number 21-1240; and Whiskey Flats Inc. v. Axis Insurance Co., case number 21-1294, in the United States Court of Appeals for the Third Circuit.

--Additional reporting by Ben Zigterman and Hope Patti. Editing by Patrick Reagan.