

2nd Circ. Delivers Another Virus Coverage Win For Insurers

By **Shane Dilworth**

Law360 (January 4, 2022, 6:04 PM EST) -- The Second Circuit kept the streak alive for insurance carriers fighting coverage of business losses stemming from COVID-19 shutdown orders in a recent decision that upheld the dismissal of a New York art gallery's suit against a Hartford unit.

The three-judge panel said that a business property insurance policy issued by Sentinel Insurance Co. Ltd. to 10012 Holdings Inc., which does business as Guy Hepner, does not provide coverage for losses unless there is direct physical damage to property.

And Guy Hepner's complaint alleges no such damage to its own property or any nearby structures. Instead, the gallery's losses were attributable to 2020 shelter-in-place orders that forced it to temporarily shutter its brick-and-mortar location and shift to online-only ordering, the panel found.

As a result, Guy Hepner is ineligible for coverage under its policy's business income and extra expense or civil authority provisions, according to the opinion.

"Shuttering a gallery because of possible human infection does not qualify as a 'risk of direct physical loss,'" U.S. Circuit Judge Raymond J. Lohier Jr. wrote for the panel in the Dec. 27 ruling, which affirmed a New York federal judge's decision in Sentinel's favor.

The Second Circuit's decision came less than a week after the Tenth Circuit affirmed tossing a breach of contract suit brought by an Oklahoma affiliate of Goodwill Industries Inc. against a Tokio Marine unit. Seven of the 11 federal appeals courts that have been presented with pandemic business interruption coverage cases have now found in favor of insurers.

The Eighth Circuit was the first federal appeals panel to issue a decision in a suit between a policyholder and its insurance carrier in July. The Sixth, Seventh, Ninth and Eleventh circuits have also ruled that business losses caused by government shutdown orders are not covered.

The First, Third, Fourth and Fifth circuits have yet to decide the issue.

John Ewell and Joanna M. Roberto of Gerber Ciano Kelly Brady LLP, who are not involved in the Guy Hepner case, told Law360 in a joint statement that the Second Circuit's decision is unsurprising since the gallery did not allege physical damage at its property.

"The Second Circuit emphasized that New York state and federal decisional law uniformly hold that if

there is no physical damage then there is no coverage; rendering it abundantly clear that the conditional requirement is mandatory in such a claim for coverage," Ewell and Roberto said.

The lack of success at the federal appeals court level did not alarm policyholder lawyers Michael Levine and Christopher Cunio of Hunton Andrews Kurth, who explained that the decided cases each involved claimed loss allegedly resulting from government orders, many of which explicitly disclaimed any presence of damage-causing virus at the insured premises.

"Whether you disagree (or not) with those decisions, there is a whole other wave of cases working their way through the court system now that are premised on a different cause of loss and should be decided anew and completely unimpacted by them," the policyholder attorneys told Law360.

Jeremy M. Creelan of Jenner & Block LLP told Law360 that the Second Circuit's ruling "did not address, and expressly left for another case, whether coverage would be found where a plaintiff has suffered and alleged detrimental physical damage or changes to their insured properties."

Creelan, who represented the Restaurant Law Center, New York State Restaurant Association and New York City Hospitality Alliance as amici curiae in support of the gallery, also pointed out that the federal appeals court's ruling is not binding on state courts. As a result, Creelan said that policyholders alleging physical damage should still obtain coverage from their insurers.

Levine and Cunio said that the new wave of coverage disputes involves allegations where COVID-19 and SARS-CoV-2 are on a policyholder's premises, which result in a negative physical alteration of the content of the air and composition of the surfaces within the insured property. The newer complaints also allege that the presence of the virus causes the property to be unfit for its fully insured use.

"The allegations in these cases are fundamentally and materially different than those in orders-only cases, and the science concerning things like duration and ability to clean and/or mitigate is at least case specific and, most likely, vigorously disputed," Levine and Cunio said.

Ewell and Roberto, who predominantly represent insurance carriers, countered that "science has taught that the virus only poses a threat to humans and no danger to inanimate property."

The duo explained that what is telling "is that no litigated fact pattern exists where a person or entity claims it was forced to repair or rebuild their structure due to COVID-19, or discard property due to COVID-19. Perhaps most notable is that the ensuing litigations have not progressed to the point of finding reliable or convincing expert or scientific testimony. The unavoidable reality is that policyholders still have possession of their property, and it is undamaged."

Ewell and Roberto anticipate that the Second Circuit's decision will lead to the dismissal of suits that do not allege property damage "on a more rapid and frequent basis."

Roughly 42% of the 1,321 federal court suits filed by policyholders seeking pandemic loss-related coverage from their insurance companies have been dismissed, according to Law360's COVID-19 Insurance Case Tracker. Another 17% of the pandemic insurance suits filed in federal courts have been voluntarily dismissed, the tracker reveals, though almost 40% have yet to be fully decided.

While there is an incomplete picture on state court results, policyholder attorneys argue they have fared better in those courts.

Claire Howard, senior vice president and general counsel for the American Property Casualty Insurance Association, which filed an amicus curiae brief in support of Sentinel, told Law360 that "actual physical loss is the total destruction of covered property by fire or tornado or the loss of covered property due to theft" and that "damage to covered property is the partial alteration of the structural integrity of covered property by fire or tornado."

Howard explained that insurers often do not price property insurance policies to include coverage pandemic-related losses or diseases and that policyholders do not pay for it.

"Lawsuits to mandate retroactive business interruption coverage to include COVID-19 losses not in contracts would undermine the stability of the insurance industry and its ability to pay claims on all existing insurance policies," Howard said.

According to the University of Pennsylvania's COVID-19 litigation tracker, there are still 10 cases before the Second Circuit. In December, the panel heard arguments in a dispute between a Buffalo, New York, Tae Kwon Do studio and Philadelphia Indemnity Insurance Co. and agreed to hold off on deciding that case until a decision was reached in Guy Hepner's suit.

The parties and their counsel did not respond to requests for comment Tuesday.

U.S. Circuit Judges John M. Walker Jr., Guido Calabresi and Raymond J. Lohier Jr. were on the panel.

Guy Hepner is represented by John V. Golaszewski of the Casas Law Firm PC.

Sentinel is represented by Jonathan M. Freiman and Shai Silverman of Wiggin and Dana LLP.

The Restaurant Law Center, New York State Restaurant Association and New York City Hospitality Alliance are represented by Jeremy M. Creelan, Michael W. Ross, John H. Mathias Jr., David M. Kroeger and Gabriel K. Gillett of Jenner & Block LLP.

The American Property Casualty Insurance Association is represented by Wystan M. Ackerman of Robinson & Cole LLP, by Laura A. Foggan of Crowell & Moring LLP and by James R. Martin of Zelle LLP.

The case is 10012 Holdings Inc. v. Sentinel Insurance Co. Ltd., case number 21-80-cv, in the U.S. Court of Appeals for the Second Circuit.

--Additional reporting by Pete Brush, Daphne Zhang and Shawn Rice. Editing by Nick Petruncio.