COVID-19: COVID-19 INSURANCE COVERAGE DEVELOPMENTS THE NATIONAL LANDSCAPE AND THE STATE OF PLAY IN PENNSYLVANIA

Date: 21 January 2021

Insurance Recovery and Counseling

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The number of lawsuits commenced by policyholders in the United States seeking insurance coverage for COVID-19 losses is approaching 1,500, and judicial decisions on insurer-filed motions to dismiss these cases now exceed 100 in number.[1] From these decisions, some clear trends are emerging, including the ability to identify those states that are adopting approaches to policy interpretation that are favorable to policyholders and those whose analysis is more favorable to insurers.

Policyholders have brought the great majority of these cases in federal courts, based on diversity of citizenship.[2] It is a common defense tactic in these cases for the insurer-defendants to file early motions to dismiss, based on the pleadings, for failure to state a claim. In federal courts, these motions are typically brought pursuant to Fed. R. Civ. P. 12(b)(6). Courts in approximately 30 states have issued decisions on early motions to dismiss and this evolving body of case law reflects the following analytical trends.

- The insurers have prevailed on their motions to dismiss approximately 85 percent of the time.
- Policyholders have generally fared better in state courts than in federal courts.
- Court decisions in favor of insurers are most often based on the court's conclusion that the policyholder failed to satisfy the policy requirement of “direct physical loss of or damage to” covered property.
- In the majority of the motions decided in favor of the insurers, the policies also contained some form of a virus exclusion.
- In the pro-insurer decisions where a virus exclusion is present, the courts' decisions fall into one of three categories: (i) dismissal based solely on the conclusion that the policyholder failed to satisfy the “direct physical loss” requirement, with the court not reaching the question whether a virus exclusion applied; (ii) dismissal based on the conclusion that the policyholder failed to satisfy the “direct physical loss” requirement and additionally, or alternatively, based on the virus exclusion; or (iii) dismissal based solely on the virus exclusion (with the court failing to address the “direct physical loss” issue).
- States where decisions favorable to insurers are accumulating and solidifying include California,[3] Florida,[4] and Texas.[5]
- With respect to the pro-policyholder decisions, many of them come from state courts and many of them are not decisions on substantive issues, e.g., they are denials of dismissal motions based on there being an insufficient factual record, i.e., discovery is required.

- The strongest pro-policyholder decisions have been issued by courts in Missouri,[6] North Carolina,[7] Nevada,[8] Virginia,[9] and Washington.[10]

THE STATE OF PLAY IN PENNSYLVANIA

According to the UPenn Covid Tracker, approximately 180 COVID-19-related coverage suits have been brought in Pennsylvania courts. As is the case nationally, most of the Pennsylvania cases are pending in federal courts. Also, according to the UPenn Covid Tracker, there have been 12) "merits" decisions by Pennsylvania courts' rulings on insurer motions to dismiss. Nine of these decisions have been issued by the Eastern District of Pennsylvania, (1) by the Western District of Pennsylvania and (2) by the Court of Common Pleas of Philadelphia County.

Decisions by Pennsylvania State Courts (Pennsylvania Court of Common Pleas)

Ridley Park Fitness v. Philadelphia Indem. Ins. Co.[11] and *Taps & Bourbon on Terrace, LLC. V. Underwriters at Lloyds London*[12]

Both of these decisions were issued by Judge Glazer in the Pennsylvania Court of Common Pleas, Philadelphia County. In both cases, the insurer-defendants sought to dismiss the complaints based on preliminary objections. In both cases, the court issued a one-sentence order overruling the preliminary objections without prejudice. And in both cases, the court included a lengthy footnote, nearly identical to one another, that it was premature for the court to resolve the factual allegations supporting the insurers' arguments that certain clauses in the insurance policies—a virus exclusion and the "direct physical loss" language—barred coverage. These decisions suggest that challenges by insurers based on Pennsylvania's unique preliminary objections process may face a higher bar to success as compared to Rule 12(b)(6) dismissal motions brought in federal courts.

Decisions by Pennsylvania Federal Courts

Eastern District of Pennsylvania

Of the nine decisions thus far by the Eastern District of Pennsylvania, seven of them favored the insurer-defendants. Those seven decisions were issued in the following cases:

Wilson v. Hartford Casualty Co.[13]

The *Wilson* decision is notable because the court "skipped" over the threshold issue whether the policyholder had sufficiently pled "direct physical loss" and granted (with prejudice) the insurer's motion to dismiss based solely on the virus exclusion present within the policy. The court found the virus exclusion to be "clear and unambiguous" and further found that a virus coverage exception to the exclusion (providing US$50,000 in coverage limits under certain circumstances) did not apply. The court recognized that the Pennsylvania Supreme Court has not ruled on the meaning and application of virus exclusions and, accordingly, it is unsettled law. But the court was comfortable predicting that Pennsylvania's highest court would enforce the virus exclusion in the policy before it.

Brian Handel D.M.D. v. Allstate Ins. Co.[14]

First, in reliance on 3rd Circuit decisions in *Port Auth. of N.Y. & N.J. v. Affiliated FM Ins. Co*., 311 F.3d 226 (3d Cir. 2002) (applying New Jersey law) and *Motorists Mut. Ins. Co. v. Hardinger*, 131 F. App'x 823 (3d Cir. 2005) (applying Pennsylvania law), the court found that distinct, demonstrable, physical alteration of a structure was required to establish "direct physical loss." Here, the policyholder's dental office was not rendered completely

unusable. It remained open for some procedures. Accordingly, the policyholder was found to have failed to plead the requisite “direct physical loss.” Second, even if sufficient “direct physical loss” had been pled, the virus exclusion was unambiguous and clearly applied to bar coverage. Additionally, the court rejected the policyholder's regulatory estoppel argument on the basis that the court found nothing inconsistent between Allstate's arguments to the court regarding the application of the virus exclusion and statements to insurance regulators when the exclusion was first proposed and approved.

Toppers Salon & Health Spa, Inc. v. Travelers, E.D. Pa.[15]

The policy at issue in Toppers also included a virus exclusion, which the court found unambiguous and applicable to preclude coverage. Even if the virus exclusion did not apply, the court further found that the policyholder's claim failed to satisfy the “direct physical loss” requirement of the policy. The court agreed with the policyholder that loss of use can suffice to establish “direct physical loss,” but the loss of use must result from physical damage, which was not pled or shown to be present. Civil authority coverage did not apply for the same reason, i.e., there was no allegation of physical damage to nearby property.

4431, Inc. v. Cincinnati Ins. Co.[16]

The plaintiff owner of several restaurants conceded that its properties were not physically damaged but, rather, claimed they were physically lost to it because of the governor's shut down orders. The court found the policy to be unambiguous in requiring that the covered property must suffer a direct “physical” loss and, for an economic loss to be covered, it must have some causal connection to the physical condition of the premises that completely or almost completely precludes operation of the premises as intended. The court relied on *Port Authority of NY and NJ v. Affiliated FM* (relying on N.Y. and N.J. law) and the Eastern District of Pennsylvania decisions in Handel and Toppers Salon (discussed above).

Kessler Dental Assoc. v. The Dentists Ins. Co.[17]

Judge Wolson reached the same conclusions in this case as he did a week earlier in Toppers Salon (discussed above). Coverage was precluded by a virus exclusion. Regulatory estoppel did not apply because plaintiff did not satisfy the elements of the doctrine. And even when the virus exclusion was not applicable, the policyholder's loss did not satisfy the “direct physical loss” requirement of the policy because there was no distinct, demonstrable, physical alteration to covered property.

Newchops Restaurant Comcast LLC v. Admiral Ins. Co.[18] and
LH Dining LLC v. Admiral Ins. Co.[19]

In a single order, Judge Savage dismissed two cases, both against Admiral Insurance Company and under the same policy form. The policyholders did not allege physical damage to their properties, and the court found that pure economic losses are not tangible and, accordingly, are not physical loss or damage. Even if direct physical loss had occurred, the court alternatively found that several exclusions applied to bar coverage: the virus and government order exclusions. The court also rejected application of the doctrine of regulatory estoppel as if found nothing inconsistent between statements to regulators and the insurer's denial of coverage.

The remaining two decisions by the Eastern District of Pennsylvania are more nuanced and provide some encouragement for policyholders.

V&S Elmwood Lanes, Inc. v. Everest National Ins. Co.[20]

The policyholder (the owner of a bowling alley) brought a single count declaratory judgment complaint. The insurer-defendant brought a Fed. R. Civ. P. 12(b)(6) motion to dismiss on the basis of the virus exclusion contained in the subject policy, but the court did not reach the merits of the motion. Instead, the court determined, sua sponte, that it would decline to exercise its discretionary jurisdiction to hear the case under the Declaratory Judgment Act. The court considered the multifactor test of *Reifer v. Westport Ins. Corp.*,[21] and was most influenced to decline to exercise jurisdiction because of the unsettled nature of Pennsylvania law with respect to the controlling insurance policy interpretation issues. In this regard, Judge DuBois distinguished himself from other judges within the Eastern District of Pennsylvania (discussed above) who have been comfortable predicting Pennsylvania law based on precedents from New York and New Jersey.[22]

Humans & Resources, LLC v. Firstline National Ins. Co.[23]

Here, Judge Joyner joined the ranks of judges in the Eastern District of Pennsylvania in finding that the policyholder, a restaurant owner, had failed to satisfy the requirement for "direct physical loss of or damage to" covered property. In doing so, like his colleagues, he was influenced by 3rd Circuit, New York, and New Jersey case law in finding that the requisite damage "must be physical in nature." Additionally, the policy contained a virus exclusion which the court found unambiguous and applicable to bar coverage. In so ruling, the court also rejected the policyholder's regulatory estoppel argument. However, the court denied the insurer's motion based on Pennsylvania's doctrine of reasonable expectations, which, if proven, would serve to override the insurer's denial of coverage notwithstanding the otherwise plain language of the policy.

Western District of Pennsylvania

The United States District Court of Pennsylvania has issued only one decision addressing the merits of an insurer's motion to dismiss and did so very recently, on 15 January 2021, in *1 S.A.N.T., Inc. v. Berkshire Hathaway, Inc.* [24] In *1 S.A.N.T.*, the Western District of Pennsylvania observed that many courts around the country, including the Eastern District of Pennsylvania in *Newchops Restaurant Comcast* (discussed above), had found that the policyholder, in the absence of pleading any "actual impact to the property's structure, rather than the diminution of its economic value because of governmental actions that do not affect the structure," had failed to satisfy the policy requirement of "direct physical loss of or damage to" covered property. The court found those decisions persuasive and, further, expressly rejected the policyholder's argument that the physical nature of the COVID-19 virus and its "ubiquity" satisfied the policy's "direct physical loss" requirement. The policy at issue also included a virus exclusion but, because the court found that coverage was not triggered under the policy in the first instance, it did not reach the question whether the virus exclusion was applicable.

Lessons Learned from Pennsylvania Case Law Thus Far

- If a policyholder brings suit in Pennsylvania state court, and the case remains there—i.e., there is no diversity of citizenship, a diverse insurer-defendant does not transfer the case to federal court, or the case is removed by a diverse insurer-defendant but the federal judge refuses to accept the discretionary jurisdiction—then the preliminary objections process in state court may present a higher bar to dismissal than is the case with respect to Fed. R. Civ. P. 12(b)(6) motions in federal court and may allow a policyholder to survive an early dismissal motion and proceed to discovery.
- A Pennsylvania state court has yet to address whether (i) the physical presence of the COVID-19 virus on insured premises or (ii) the loss of use of insured premises resulting from the community presence of the

COVID-19 virus and resulting governmental shut-down orders constitutes “physical loss of or damage to” coverage property.

- The policyholder's ability to establish “physical loss of or damage to” covered property may be heightened by allegations in the complaint that the COVID-19 virus was present on the insured premises. Some policyholders, as a factual matter, are unable to so plead and others appear to have chosen for strategic reasons not to include such allegations (e.g., to avoid application of a virus exclusion), but several courts have suggested in their dismissal orders that such an allegation might have allowed the policyholder to survive the motion.
- If (i) a policyholder brings a single-count declaratory judgment suit in federal court, or (ii) a single-count declaratory judgment action originally brought in Pennsylvania state court is transferred to a federal court by a diverse insurer-defendant, under the Declaratory Judgment Act, the federal court's jurisdiction is discretionary such that (i) the defendant-insurer could oppose the transfer or (ii) the federal court could sua sponte decline to exercise jurisdiction on the basis that Pennsylvania law is unsettled with respect to key coverage issues, e.g., what constitutes “physical loss of or damage to” property. Note: If the complaint also includes a breach-of-contract claim seeking damages, a federal court sitting in diversity will have jurisdiction over that claim.
- Several Pennsylvania federal court judges have been comfortable relying upon 3rd Circuit, New York, and New Jersey case law to predict that the Pennsylvania Supreme Court will require some distinct, demonstrable, physical alteration of property to satisfy the policy's requirement of “physical loss or damage.”
- All but one of the pro-insurer Pennsylvania federal court decisions have involved policies with virus exclusions and, in those cases where the court considered its application, the courts found the virus exclusion to be unambiguous and enforceable. Further, policyholder arguments for application of regulatory estoppel to prevent enforcement of virus exclusions have uniformly failed in these courts for the reason that they are finding that insurer representations to regulators are not inconsistent with their application of such exclusions to COVID-19-related losses.
- Pennsylvania's recognition of the doctrine of reasonable expectations, if such can be pled, may allow a policyholder to withstand an early motion to dismiss and, if the necessary factual foundation is proven, could open up a basis for coverage notwithstanding otherwise applicable impediments to coverage, e.g., the absence of “physical loss or damage” and the application of virus exclusion.

There are few businesses, across most if not all industry segments, that have escaped damage wrought by the COVID-19 pandemic, and the impact of that damage continues to be felt. In seeking insurance coverage for these losses, policyholders face a number of hurdles, but state law across the United States continues to evolve, and there are encouraging signs in at least several states that a pathway to coverage under certain policies and in certain circumstances exists.

FOOTNOTES

[1] The University of Pennsylvania (UPenn) Carey Law School began tracking insurance coverage cases filed

across the United States in connection with COVID-19 property losses soon after the first such cases were filed in March 2020. The "UPenn Covid Tracker" reflects that, through the end of 2020, more than 1,440 COVID-19-related insurance coverage suits had been filed in state and federal courts in the United States, and new case filings continue to be made daily. The UPenn site notes, however, that the number of cases could be higher or lower: on the one hand, some state court systems do not use fully electronic filing systems and thus evade UPenn's tracking efforts and, on the other hand, follow up on a sample of suits identified suggested that as high as 15% may have been voluntarily dismissed by the plaintiff without much fanfare. Penn Law, *Covid Coverage Litigation Tracker*, here (last visited Jan. 20, 2021).

[2] The overwhelming majority of these cases seek coverage under commercial property policies—as opposed to other types of policies such as premises pollution liability policies which are the focus of a small number of cases.

[3] *E.g.*, 10E v. Travelers Indem. Co., Case No. 2:20-cv-04418-SVW-AS (C.D. Cal., Aug. 28, 2020); Pappy's Barber Shops v. Farmers Grp., Case No. 20-cv-907-CAB-BLM (S.D. Cal., Sept. 11, 2020); Mudpie v. Travelers Cas. Ins. Co. of Am., Case No. 20-cv-03213-JST (N.D. Cal., Sept., 14, 2020); and Franklin EWC, Inc. v. Sentinel Ins. Co., Case No. 20-cv-04434 JSC (N.D. Cal., Sept. 22, 2020).

[4] *E.g.*, Malaube v. Greenwich Ins. Co., Case No. 20-22615-CIV (S.D. Fla., Aug. 26, 2020); Mauricio Martinez, DMD v. Allied Ins. Co. of Am., Case No. 2:20-cv-00401-FtM-66NPM (M.D. Fla., Sept. 2, 2020); and El Novillo Rest. v. Certain Underwriters at Lloyd's, London, Case No. 1:20-cv-21525-UU (S.D. Fla., Dec. 7, 2020).

[5] *E.g.*, Diesel Barbershop, LLC v. State Farm Lloyds, Case No. 5:20-CV-461-DAE (W.D. Tex., Aug. 13, 2020); Vizza Wash v. Nationwide Mut. Ins. Co., Case No. 5:20-cv-0060-OLG (W.D. Tex., Oct. 26, 2020); and Sultan Hajer d/b/a Rug Outlet v. Ohio Sec. Ins. Co., Case No. 6:20-cv-00283 (E.D. Tex., Dec. 7, 2020).

[6] *E.g.*, Studio 417, Inc. v. The Cincinnati Ins. Co., Case No. 20-cv-03127-SRB (W.D. Mo., Aug. 12, 2020); Blue Springs Dental Care v. Owners Ins. Co., Case No. 20-cv-00383-SRB (W.D. Mo., Sept. 21, 2020).

[7] North State Deli LLC v. The Cincinnati Ins. Co., Case No. 20-CVS-02569 (N.C. Super. Ct., Durham Cty., Oct. 7, 2020).

[8] JGB Vegas Retail Lessee, LLC v. Starr Surplus Lines Ins. Co., Case No. A-20-816628-B (Nev. Dist. Ct., Clark Cty., Nov. 30, 2020).

[9] Elegant Massage, LLC v. State Farm Mut. Auto. Ins. Co., Case No. 2:20-cv-265 (E.D. Va., Dec. 9, 2020).

[10] Hill & Stout PLLC v. Mut. of Enumclaw Ins. Co., Case No. 20-2-07925-1 SEA (Wash. Super. Ct., King Cty., Nov. 13, 2020); Perry St. Brewing Co., LLC v. Mut. of Enumclaw Ins. Co., Case No. 20-2-02212-32 (Wash. Super. Ct., Spokane County, Nov. 23, 2020).

[11] No. 20080358 (Pa. Ct. Comm. Pl., Aug. 13, 2020).

[12] No. 200700375 (Pa. Ct. Comm. Pl., Oct. 26, 2020).

[13] Case No. 2:20-cv-03384 (E.D. Pa., Sept. 30, 2020).

[14] Case No. 2:20-cv-03198-HB (E.D. Pa., Nov. 6, 2020).

[15] 2020 WL 7024287 (E.D. Pa., Nov. 30, 2020).

[16] 2020 WL 7075318 (E.D. Pa., Dec. 3, 2020).

[17] 2020 WL 7181057 (E.D. Pa., Dec. 7, 2020).

[18] Case No. 2:20-cv-01949 (E.D. Pa., Dec. 17, 2020).

[19] Case No. 2:20-cv-01869 (E.D. Pa., Dec. 17, 2020).

[20] Case No. 2:20-cv-03444 (E.D. Pa., Jan. 8, 2021).

[21] Reifer v. Westport Ins. Corp., 751 F.3d 129 (3d Cir. 2014).

[22] In May of last year, Judge Fischer in the Western District of Pennsylvania denied an insurer's notice of removal of a policyholder's COVID-19 insurance coverage complaint originally filed in Pennsylvania state court for the same reasons. *Dianoia's Eatery, LLC v. Motorists Mutual Ins. Co*., Case No. 20-706 (May 19, 2020).

[23] Case No. 2:20-cv-02152 (E.D. Pa., Jan. 8, 2021).

[24] Case No. 2:20-cv-0862 (W.D. Pa., Jan. 17, 2021).

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