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CASE ALERT
Sept. 29, 2020

Preventing Pitfalls in Policyholder Pandemic Pleadings: Lessons Learned from Recent Restaurant Rulings

Recently, federal courts in California and Florida dismissed claims brought by restauranteurs against their insurance companies after the insurers denied business-interruption coverage for losses related to COVID-19 quarantine orders. In both cases, the courts held that the policyholders had not sufficiently alleged that their properties had suffered "direct physical loss or damage," as required by both policies to trigger coverage. Fortunately, the courts allowed the policyholders leave to amend their complaints, and, hopefully, the amended pleadings will fare better. In the meantime, the dismissals serve as a dire warning to policyholders to retain skilled coverage counsel who knows how to plead their clients' cases within coverage. The stakes are particularly high now, when there are, as yet, few decisions related to coverage for COVID claims – a circumstance that presents a unique opportunity to shape decisional law concerning these types of losses. Inadequate pleading affects all policyholders in the long run.

The first dismissal involved a Miami restaurant seeking to recover business income losses that resulted from the government shutdown of its indoor dining operations. In Malaube, LLC v. Greenwich Insurance Company, Case No. 1:20-cv-22615, 2020 WL 5051581 (S.D. Fla. Aug. 26, 2020), Malaube was forced to close its restaurant's indoor dining services for more than five months following state and local government orders issued in March to mitigate the spread of COVID-19, causing it to incur "significant business losses." When Greenwich denied its claim to recoup these losses under its commercial property insurance policy, Malaube filed suit. Greenwich responded by moving to dismiss the case, arguing (among other things) that there was no insurance coverage because Malaube's claims failed to satisfy the policy's threshold requirement that business income losses be attributable to "direct physical loss of or damage to" covered property. The magistrate agreed and recommended the case be dismissed without reaching the other arguments raised in Greenwich's motion. Notably, however, the magistrate did *not* find a final dismissal with prejudice was required; rather, the magistrate recommended Malaube be granted leave to file an amended complaint, indicating the court's belief that the policyholder may still be able to plead a sufficient cause of action for coverage under the Greenwich policy.

The second dismissal involved 10e, LLC, a restaurant in downtown Los Angeles. In 10e, LLC v. Travelers Indemnity Co. of Connecticut, Case No. 2:20-cv-04418-SVW-AS, 2020 WL 5359653 (C.D. Cal. Aug. 28, 2020), the restaurant alleged that it suffered a "complete and total shutdown" of its business, caused by Los Angeles Mayor Eric Garcetti's COVID-19-related public health restrictions, which prohibited in-person dining at 10e and limited its operations to takeout and delivery service. 10e submitted a claim to its commercial property insurance carrier, Travelers, seeking compensation for lost business and other costs under its commercial property policy's Business Income and Extra Expense Coverage provision. This provision covered losses "caused by action of civil authority that prohibits access to the described premises," but "[t]he civil authority action

must be due to direct physical loss of or damage to property." After Travelers denied coverage, 10e brought suit, asserting claims for breach of contract, bad faith, and violation of Cal. Bus. & Prof. Code § 172000 et seq. Travelers moved to dismiss, arguing that 10e had not plausibly alleged that it suffered "direct physical loss of or damage to property," as required by the policy.[1] The court agreed with Travelers and dismissed 10e's complaint. But, as in Malaube, 10e was given leave to amend its complaint.

In both Malaube and 10e, the courts provided guidance on how the claims should be repleaded to survive future motions to dismiss. In 10e, for example, the court noted that 10e's allegations only went as far as "artfully plead[ing] impairment to economically valuable use of property" rather than actually alleging physical loss or damage to property. "Plaintiff," the court held, "only plausibly alleges that in-person dining restrictions interfered with the use or value of its property – not that the restrictions caused direct physical loss or damage." Under California law, "direct physical loss of or damage to property" occurs only when the property undergoes a "distinct, demonstrable physical alteration." But 10e failed to allege that the virus "'infect[ed]' or 'stay[ed] on surfaces of' its insured property." "Whatever physical alteration the virus may cause to property in general, nothing in [10e's complaint] plausibly supports an inference that the virus physically altered [its] property, however much the public health response to the virus may have affected business conditions for Plaintiff's restaurant."

Nor did it matter, said the court, that the policy's language provided coverage for "direct physical loss *of or* damage *to*" the insured property. This "disjunctive phrasing" was insufficient to rescue 10e's inadequate pleading. California law will give separate effect to "loss" (distinct from "damage") in the phrase "direct physical loss or damage" only when there is "the permanent dispossession of something."[2] 10e, however, only alleged that the city's public health regulations kept "'large groups' and 'happy-hour goers' at home instead of in [10e's] dining room or at the bar." To be sure, 10e "remained in possession of its dining room, bar, flatware, and all of the accoutrements of its 'elegantly sophisticated surrounding.'"

Likewise, in Malaube, the magistrate identified and reiterated throughout the opinion that the Plaintiff had not alleged the actual presence of COVID-19 on or near its covered business property. In emphasizing that Malaube never claimed the restaurant was physically contaminated with the virus, the court left open the possibility that a cause of action for COVID-19 coverage may survive dismissal in cases where the onsite existence of the virus has been confirmed.

To that end, the Malaube opinion appears to favorably cite a recent policyholder victory in the Missouri federal district court case of Studio 417, Inc. v. The Cincinnati Insurance Company.[3] In that case, the operators of hair salons and restaurants filed suit against their carrier seeking insurance coverage for business interruption losses resulting from COVID-19. The court, however, *denied* the carrier's motion to dismiss the policyholders' claims, finding the plaintiffs' allegations involving the presence of COVID-19 in and around their business properties were sufficient to state a plausible cause of action for losses resulting from "direct physical loss of or damage to" covered property.

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[1]Travelers also argued that 10e's claim was subject to the policy's virus exclusion and that 10e failed to allege that public health restrictions had prohibited access to its property as required by the policy's civil authority coverage. However, because the court dismissed 10e's claim for not sufficiently alleging "direct physical loss of or damage to" its property, it never addressed these arguments.

[2]See Total Intermodal Servs. Inc. v. Travelers Prop. Cas. of Am., 2018 WL 3829767 (C.D. Cal. 2018).

[3]Case No. 6:20-cv-03127, 2020 WL 4692385 (W.D. Mo. Aug. 12, 2020). SDV examined this decision in a prior Case Alert posted August 14, 2020 – click here to read more.

In considering the Studio 417 decision but declining to follow its ruling, the Malaube court distinguished the Missouri case as "materially different" because the plaintiffs "'plausibly alleged that COVID-19 particles attached to and damaged their property, which made their premises unsafe and unusable.'"[4] Citing both Florida and Eleventh Circuit case law authority, the magistrate reasoned that the term "direct physical" modifies both "loss" and "damage" in the policy, such that the policy provisions require a tangible alteration to a covered building in order to qualify the resulting loss of business income for insurance coverage. Emphasizing that Malaube did not claim its business operations were suspended because the COVID-19 virus was physically present in the prohibited interior dining space, the magistrate concluded that the government shutdown orders alone "never made the restaurant uninhabitable or substantially unusable" to trigger coverage.

Although neither 10e nor Malaube are decisive wins for policyholders, savvy practitioners will see a silver lining and use the courts' emphasis on the actual physical presence of COVID-19 as guidance in developing and pleading business interruption claims. Whether and to what extent such allegations will be deemed sufficient to overcome dismissal remains to be seen, but, for the present, Florida and California courts have left the door open for such actions.

Epilogue.

Shortly before this Case Alert went to press, 10e exercised its right to amend by filing its Second Amended Complaint in the case. This time, 10e alleges that "the governmental shutdown orders affecting 10E are being driven by outside factors and nefarious forces that are neither based in logic nor science[,]" particularly government officials' "concern for the availability of hospital beds . . . and the desire to exert control over California citizens in order to influence politics during a national election year." 10e further asserts that "the COVID-19 virus has been universally found to cause 'physical damage to property', which means not simply economic losses to property owners (such as Plaintiff), but property damage[,]" and that "the COVID-10 virus is present all throughout Los Angeles County, including in downtown Los Angeles." But 10e also avers that "the actual presence (or absence) of the COVID-19 virus at Plaintiff's Insured Property is not dispositive as to whether its loss has been caused by property damage." Given the result in cases like Studio 417, it will be interesting to see how the 10e court responds to these new allegations.

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[4] Malaube, LLC, 2020 WL 5051581, at *7 (quoting Studio 417, Inc., 2020 WL 4692385, at *6).