

Five Federal Appellate Courts Affirm Dismissal Of COVID-19 Coverage Suits, Finding That Loss Of Use Is Not Direct Physical Loss Under Policy (Insurance Law Alert)

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The Second, Fifth, Sixth, Tenth and Eleventh Circuits recently ruled that policyholders were not entitled to coverage under property policies for business losses incurred in the wake of pandemic-related shut downs.

In *10012 Holdings, Inc. v. Sentinel Ins. Co.*, 21 F.4th 216 (2d Cir. 2021), the Second Circuit held that an art gallery's suspension of business operations in compliance with executive orders did not constitute physical damage for insurance coverage purposes under New York law. Additionally, the court held that civil authority coverage was unavailable because the executive orders did not result from direct physical loss to property in the vicinity of the insured premises, but rather from the pandemic itself and the risk it posed to human beings. Citing its decision in *10012 Holdings*, the Second Circuit also upheld dismissals of policyholders' COVID-19 coverage claims in *Kim-Chee LLC v. Philadelphia Indem. Ins. Co.*, 21-1082-cv (2d Cir. Jan. 28, 2022) and *Rye Ridge Corp. et al. v. Cincinnati Insurance Co.*, 2022 WL 120782 (2d Cir. Jan. 13, 2022).

In *Terry Black's Barbecue, LLC v. State Auto. Mutual Ins. Co.*, 2022 WL 43170 (5th Cir. Jan. 5, 2022), the Fifth Circuit, applying Texas law, ruled that losses stemming from the suspension of dine-in services at a restaurant were not covered by a property policy because there was no "direct physical loss" of covered property.

In compliance with government orders, the restaurant suspended its dine-in services. Thereafter, it sought coverage under business interruption and civil authority policy provisions. The insurer denied coverage, and in ensuing litigation a Texas district court dismissed the restaurant's complaint, ruling that physical loss required a "distinct, demonstrable, physical alteration of the property" and that loss of use of property did not satisfy that requirement. The Fifth Circuit affirmed.

Adopting the district court's interpretation of "physical loss," the Fifth Circuit stated: "Nothing happened to TBB's restaurants at all. In fact, TBB had ownership of, access to, and ability to use all physical parts of its restaurants at all times. And importantly, the prohibition on dine-in services did nothing to physically deprive TBB of any property at its restaurants."

The Fifth Circuit expressly rejected the restaurant’s assertion that the loss of use of its dining rooms for their intended purpose amounted to a loss of “physical space” sufficient to implicate coverage. The court noted that the policy did not include the phrase “physical space” and that, in any event, the restaurant was not deprived of access to the dining rooms.

Finally, the court ruled that civil authority coverage was unavailable because that provision required the suspension of operations due to a civil authority order “resulting from” actual or alleged exposure to a disease. Declining to determine what standard of causation was required to meet “resulting from,” the court held that the restaurant “failed to allege even a remote causal relationship between the civil authority orders and its restaurants’ alleged or actual exposure to COVID-19.” Rather, the orders were issued in response to the global pandemic in order to slow the spread of the virus.

In *Estes v. Cincinnati Ins. Co.*, 2022 WL 108606 (6th Cir. Jan. 12, 2022), the Sixth Circuit, applying Kentucky law, ruled that “physical loss” means that “a property owner has been tangibly deprived of the property or that the property has been tangibly destroyed.” Ruling that the insured dental practice did not meet this standard, the court noted that “COVID-19 did not destroy its dental offices, and the government shutdown orders did not dispossess it of them for a single day.”

Applying similar reasoning, the Tenth and Eleventh Circuits held that government orders, which temporarily impeded the policyholders’ ability to use property for its intended purpose, did not constitute a direct physical loss. In *Goodwill Indus. of Central Oklahoma, Inc. v. Philadelphia Indem. Ins. Co.*, 21 F.4th 704 (10th Cir. 2021), the Tenth Circuit, applying Oklahoma law, explained that allowing a loss of use to satisfy the “direct physical loss” policy requirement would ignore the word “physical.” Likewise, in *Ascent Hospitality Management Co., LLC v. Employers Ins. Co. of Wausau*, 2022 WL 130722 (11th Cir. Jan. 14, 2022), the Eleventh Circuit, applying New York law, rejected the contention that physical loss includes more than actual physical damage, explaining that both physical loss and physical damage require “an actual physical change to property that COVID-19 particles cannot cause’ because a contaminated location can be immediately restored to its previous state by cleaning and disinfecting—no repair or replacement required.”

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