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PERSPECTIVE

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The evolving law of COVID-19 business interruption cases

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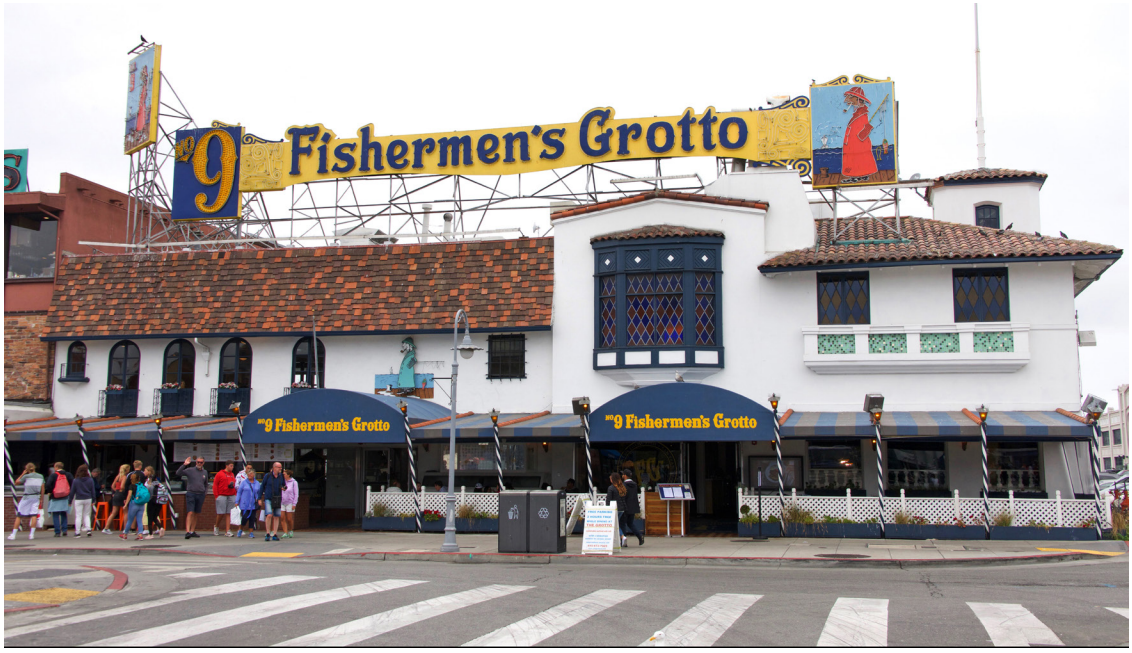

Fisherman's Grotto, a San Francisco restaurant owned by Apple Annie,LLC | Shutterstock

For two years, courts across the country dealt blow after blow to businesses seeking to recover for losses they sustained because of the COVID-19 pandemic. California followed suit in a trio of cases affirming demurrers without leave to amend in favor of the insurers: *Inns-by-the-Sea v. California Mutual Ins. Co.*, 71 Cal.App.5th 688 (2021), *Musso & Frank Grill Co., Inc. v. Mitsui Sumitomo Ins. USA Inc.*, 77 Cal.App.5th 753 (2022), and *United Talent Agency v. Vigilant Ins. Co.*, 77 Cal.App.5th 821 (2022). After these opinions, many businesses felt like continuing to fight for coverage was futile. However, some recent decisions may have shed some light on an important issue with the earlier opinions and may have opened an avenue for these businesses to receive the coverage they purchased.

In the vast majority of the insurance policies at issue in these cases, "direct physical loss of or damage to property" is a prerequisite to coverage. This term is not defined in commercial property policies, despite the plethora of definitions throughout such policies. Interpreting this term has fallen to the courts. The courts who have found in favor of insurers have interpreted "direct physical loss of or damage to property" in the same way that the words "accidental direct physical loss" were interpreted in MRI Healthcare of *Glendale, Inc. v. State Farm General Ins. Co.*, 187 Cal.App.4th 766 (2010), i.e., to require a demonstrable "physical alteration" in the condition of the property. Two divisions of the Fourth District then ruled that the COVID-19 virus does not physically alter or cause physical damage to property as a matter of law.

But as we head into our third year with COVID-19, our understanding of the virus has changed. Scientists have learned more about how the virus transmits, how it bonds with the surfaces of objects altering cells and surface proteins, how long it can live on different materials, and how effective or ineffective different remedial measures can be in eliminating viral particles from surfaces and air. The science is constantly evolving. The world of knowledge about the virus and its particles is constantly growing. Even the understanding of how we interact with the virus particles is constantly changing. It was not long ago that people were spraying groceries with disinfectants before bringing them into the house and wearing disposable gloves to pump gas.

If the science is ever-changing, and we need to rely on the science to inform how the virus interacts with property, how can cases be dismissed solely on the pleadings and without any evidence?

A recent opinion by Division Seven of the Fourth District concluded they cannot. In *Marina Pacific Hotel and Suites, LLC v. Fireman's Fund Insurance Company*, 81 Cal.App.5th 96 (2022), the panel broke with the other divisions and found in favor of the insured. In overruling a demurrer without leave to amend, they said that the courts cannot substitute what they think they know about how the virus spreads and how to protect against it for actual scientific evidence that could be presented in opposition to a motion for summary judgment or at trial. Because the landscape is constantly and rapidly evolving, judicial notice should not be a proper basis for ruling on a demurrer; accordingly, there is no basis for concluding that, as a matter of law, the COVID-19 virus cannot cause physical

damage to property. In reversing the dismissal, the court concluded that, even under the "physical alteration" standard in *MRI Healthcare*, the insured had sufficiently alleged the virus caused physical damage to its property entitling it to business interruption coverage.

The critical distinction between the pleadings in *Marina Pacific* versus the cases finding in favor of the insurer may establish a possible roadmap to pleading coverage under these business interruption policies. First, the complaint's allegations should include scientific theories about how the viral particles transform the physical condition of the property. For example, the *Marina Pacific* complaint alleged that the virus not only lived on surfaces but bonded to them through physiochemical reactions involving cells and surface proteins. Second, the complaint should allege that the virus was actually present at the insured location, as opposed to a ubiquitous presence in the world. If the virus was not present, then it could not bond to the property's surfaces thereby causing physical damage. Finally, the complaint should identify the various remedial measures taken to restore the air and surfaces to a safe condition, such as closing or suspending operations, disposing of contaminated property, installing new air filters, etc. If these three categories of facts are properly alleged, or the complaint could be amended to properly allege them, then under *Marina Pacific* it may be sufficient to plead coverage under the policy and overrule a demurrer.

Be aware that, even if you successfully overcome the demurrer, you will almost certainly face a motion for summary judgment and need to present your evidence supporting the allegations. This may necessitate expert opinions from epidemiologists, materials specialists, virologists, or other experts and identifying the presence of the COVID-19 virus on the property.

This approach has been met with approval by the First District as recently as September 2022. In *Apple Annie, LLC v. Oregon Mutual Insurance Company*, 82 Cal.App.5th 919 (2022), the plaintiff proceeded only under the interpretation theories that had been previously rejected in *Inns-by-the-Sea* and the cases following it. The court noted the above distinction with *Marina Pacific*, that the plaintiff insured had adequately alleged direct physical loss or damage within the definition established by *MRI Healthcare*. The court suggested that if Apple Annie could amend its complaint to include allegations like those in *Marina Pacific*, such an amendment would cure the defects that resulted in sustaining the demurrer without leave to amend. (When Apple Annie's counsel was forthright that they could not make such allegations, the court denied leave to amend.)

COVID-19 business interruption cases remain challenging and will likely continue to require fortitude by those who represent the insured businesses. At least now, if their complaint is properly pleaded, insureds may get the opportunity to present the evidence supporting their claim for coverage.

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