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D.C. Judge Rules COVID-19 Closure Orders Do Not Constitute "Direct Physical Loss"

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On August 6, 2020, in *Rose's 1 LLC, et al. v. Erie Insurance Exchange*, a District of Columbia trial court granted an insurer's cross motion for summary judgment on the issue of whether COVID-19 closure orders constitute a "direct physical loss" under a commercial property policy. Plaintiff insureds ("Insureds") own several restaurants in Washington D.C. that were forced to close and suffered serious revenue losses stemming from the Mayor's orders to close non-essential businesses and ordering people to stay home. As a result, the Insureds made claims to Defendant Erie Insurance Exchange (the "Insurer") under their policies that included coverage for "loss of 'income' and/or 'rental income'" sustained "due to partial or total 'interruption of business' resulting directly from 'loss' or damage" to the property insured. The policy also stated that it "insures against direct physical 'loss.'"

Dictionary Definitions Open to Interpretation

As the Court framed the issue, "[a]t the most basic level, the parties dispute whether the closure of the restaurants due to Mayor Bowser's orders constituted a 'direct physical loss' under the policy." To support their argument, the Insureds relied on dictionary definitions of "direct" as "[w]ithout intervening persons, conditions, or agencies; immediate;" and "physical" as pertaining to things "[o]f or pertaining to matter, or the world as perceived by the senses; material as [opposed] to mental or spiritual." The policy defined "loss," as "direct and accidental loss of or damage to covered property."

The Insureds relied on these definitions to make three arguments. *First*, they argued that the loss of use of their restaurant properties was "direct" because the closures were the direct result of the Mayor's orders without intervening action. The Court rejected that argument because those orders commanded individuals and businesses to take certain actions and "[s[tanding alone and absent intervening actions by individuals and businesses, the orders did not affect any direct changes to the properties."

Second, the Insureds argued that their losses were "physical" because the COVID-19 virus is "material" and "tangible," and because the harm they experienced was caused by the Mayor's orders rather than diners being afraid to eat out. The Court also rejected that argument because the Insureds offered no evidence that COVID-19 was actually present on their properties at the time they

were forced to close and the mayor's orders did not impact the tangible structure of the properties.

Third, the Insureds argued that the policy's definition of "loss" as encompassing either "loss" or "damage," required the insurer to "treat the term 'loss' as distinct from 'damage,' which connotes physical damage to the property," and thus "loss" incorporates "loss of use." The Court rejected that argument and held that the words "direct" and "physical" modify the word "loss" and therefore any "loss of use" must be "caused, without the intervention of other persons or conditions, by something pertaining to matter—in other words, a direct physical intrusion [onto] the insured property." The Court held that the Mayor's orders did not constitute such a direct physical intrusion.

Insured's Failure to Cite Case Law or Evidence to Support Claim of "Direct Physical Loss"

The Court also noted that the Insureds failed to cite any case law supporting the "proposition that governmental edict, standing alone, constitutes a direct physical loss under an insurance policy." The Court then discussed cases, including *Roundabout Theatre Co. v. Continental Casualty Co.*, 302 A.D.2d 1, 2-3 (1st Dept. 2002), that "rejected coverage when a business's closure was not due to direct physical harm to the insured premises." In that case, the City of New York ordered the closure of a theater after a portion of a neighboring building under construction collapsed onto the street and adjacent buildings. Although the theater itself sustained minor damage that was repaired in one day, that court found that the theater did not suffer a "direct physical loss" as a result of the city-mandated closure that forced it to cancel 35 performances.

It should be noted that the specific facts in this case, including the definitions selected by the Insureds, which have not been uniformly adopted, may limit its application. At the heart of the Court's ruling was that the Insureds did not offer evidence that COVID-19 was present in their restaurants in order to support a claim for physical loss. Thus, such evidence in future cases may lead to a different result as to whether loss of use constitutes "direct physical loss." Although the science continues to develop around COVID-19, there have been studies that have found that COVID-19 can remain present on surfaces and in the air for an extended period of time. Such scientific evidence may bolster a claim for physical loss.

Indeed, even cases cited by the Insurer, arguably support the proposition that contaminants on a property can constitute direct physical loss. *See, e.g., Motorists Mutual Insurance Co. v. Hardinger*, 131 Fed. Appx. 823 (3d Cir. 2005) (applying Pennsylvania law and finding that bacterial contamination of a home's water supply constituted a direct physical loss to property because, despite the lack of physical damage, it rendered the home uninhabitable).

Similarly, in *Murray v. State Farm Fire & Casualty Co.*, 509 S.E.2d 1, 16-17 (W.Va. 1998), a West Virginia trial court held that a landslide rendering homes uninhabitable due to a "palpable future risk of physical damage from a follow-on landslide," was a "direct physical loss." A similar argument could be made that the threat of COVID-19 becoming present at a premises may, on its own, constitute a direct physical loss because it renders the property unusable. Notably, however, *Rose's 1 LLC* Court briefly distinguished *Murray* on the grounds that it involved some compromise to the physical integrity of the insured property (whereas, the Court found this not to be the case in *Rose's 1 LLC*).

Key Takeaway

Although *Rose's 1 LLC* is a win for insurers in COVID-19 lawsuits, its narrow holding does not address the countless issues raised in the hundreds of cases seeking business interruption coverage for losses caused by COVID-19. Stay tuned.

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