

# Insurers Owe No Coverage for COVID-19 Related Business Interruption Losses Under Commercial Property Policies Insuring “Direct Physical Loss of or Damage to Property”

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***Mudpie, Inc. v. Travelers Casualty Insurance Company of America***, — F.4th —, 2021 WL 4486509 (9th Cir. Oct. 1, 2021), Case No. 20-16858.

In March 2020, California state and local authorities issued orders limiting operations of businesses in response to the COVID-19 pandemic. Mudpie, Inc., a children’s retailer, alleged that it was not able to operate after March 16, 2020, due to these orders.

Mudpie then filed a claim with Travelers, its commercial property insurer, seeking business income and extra expense coverage. Travelers denied coverage because the limitations on Mudpie’s operations were the result of government orders, not “direct physical loss of or damage to” property, as required by the policy.

Mudpie filed suit in the United States District Court for the Northern District of California on behalf of itself and a putative class of all retailers in California that purchased business interruption coverage from Travelers. The District Court dismissed the suit, finding that the claim for business interruption losses due to COVID-19 related government closure orders did not constitute “direct physical loss of or damage to” property. Mudpie then appealed.

The Ninth Circuit Court of Appeals affirmed the District Court’s decision and held that California courts would construe the phrase “physical loss of or damage to” property as requiring an insured to allege either a “distinct demonstrable, physical alteration of the property” or permanent dispossession of property. The Ninth Circuit also noted that where, as here, the policy covers “direct physical loss of or damage to” property, this requirement “is part of the policy’s insuring clause and accordingly falls within [the insured’s] burden of proof.” Therefore, the Ninth Circuit affirmed the District Court’s dismissal of Mudpie’s complaint.

The Ninth Circuit rejected Mudpie’s contention that the phrase “direct physical loss of or damage to” property only requires “loss of use” of property, including temporary loss of use of property for its intended purpose. The court noted that, although Mudpie “urges us to interpret ‘direct physical loss of or damage to’ to be synonymous with ‘loss of use,’” “[w]e cannot endorse Mudpie’s interpretation because California courts have carefully distinguished ‘intangible,’ ‘incorporeal,’ and

‘economic’ losses from ‘physical’ ones.”

And because California courts have interpreted similar coverage provisions, the Ninth Circuit declined Mudpie’s request for certification to the California Supreme Court. In doing so, the court cited *MRI Healthcare Center of Glendale, Inc. v. State Farm General Insurance Co.*, 187 Cal. App. 4th 766 (2010), *Doyle v. Fireman’s Fund Ins. Co.*, 21 Cal. App. 5th 33 (2018), and *Ward General Insurance Services, Inc. v. Employers Fire Insurance Company*, 114 Cal. App. 4th 548 (2003). The court rejected Mudpie’s attempts to rely on *Hughes v. Potomac Insurance Co.*, 199 Cal. App. 2d 239 (1962), *abrogated on other grounds*.

The Ninth Circuit also observed that other policy provisions, including the period of restoration, buttressed that only physical losses could trigger coverage. The court explained that, if no physical damage was required, the period of restoration ending on “[t]he date when the property at the described premises should be repaired, rebuilt, or replaced with reasonable speed and similar quality; or . . . [t]he date when business is resumed at a new permanent location” would be superfluous.

The Ninth Circuit also held that the virus exclusion barred coverage. The court explained that California courts apply the efficient proximate doctrine, which provides that “the [cause] that sets others in motion . . . is the cause to which the loss is to be attributed, though the other causes may follow it, and operate more immediately in producing the disaster.” The Ninth Circuit found that Mudpie could not plausibly show that the efficient cause was anything other than the virus. In doing so, the court dismissed Mudpie’s argument that the exclusion was inapplicable because its losses were most directly caused by government orders, not a virus.

The panel also noted other COVID-19 BI coverage cases supporting its decision, including *Oral Surgeons, P.C. v. Cincinnati Insurance Co.*, 2 F.4th 1141 (8th Cir. 2021). The Ninth Circuit is the fourth Circuit Court of Appeals to find that coverage is not available for COVID-19 related business interruption losses – following the Sixth, Eighth, and Eleventh Circuits.

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