Recent Similar Pandemic-Related Coverage Cases Reaching Opposite Results

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By Kevin M. Bergin on October 19, 2022

This article discusses two recent insurance coverage cases presenting opposite viewpoints regarding whether the presence of COVID-19 triggers coverage: *Huntington Ingalls Indus., Inc. v. Ace American Insurance Co.*, 2022 VT 45 (Vt. Sept. 23, 2022) and *Buffalo Xerographix, Inc. v. Sentinel Ins. Co., Ltd.*, No. 21-1502 (2d Cir. Sept. 15, 2022). While the Supreme Court of Vermont has signaled that the virus's presence may satisfy the "direct physical loss or damage to property" requirement in many insurance policies, the Second Circuit has echoed New York's position that this alone would not cause property to be physically lost or damaged. A brief commentary follows on where these cases fall within the current spectrum of pandemic-related insurance coverage case law that our firm has been following.

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As businesses continue to adjust to new realities in the wake of the COVID-19 pandemic, the highest court in the State of Vermont recently took a second look at whether the mere presence of the coronavirus triggers insurance coverage. In *Huntington Ingalls Indus., Inc. v. Ace American Insurance Co.*, 2022 VT 45 (Vt. Sept. 23, 2022), the Supreme Court of Vermont reversed the lower court's grant of summary judgment on the pleadings for the defendant-reinsurers, holding that the plaintiff-insured sufficiently alleged "direct physical loss or damage to property" under Vermont's "extremely liberal" notice-pleading standards.

Huntington Ingalls Industries, Inc. (Huntington) is the largest military shipbuilding company in the United States. Huntington obtained a policy from its captive insurance subsidiary, who then purchased policies from multiple reinsurers to cover its obligations. During the pandemic, Huntington's policy insured "[a]ll real and personal property" and "against all risks of direct physical loss or damage to property." The policy also included a "business interruption" clause, which covered "[l]oss due to the necessary interruption of business conducted by [the insured], whether total or partial . . . caused by physical loss or damage insured herein."

In September 2020, Huntington filed for declaratory judgment seeking coverage from the reinsurers, alleging that the coronavirus caused "direct physical loss or damage to property" when the virus adhered to surfaces for several days and lingered in the air for several hours at its shipbuilding yards. As a result, Huntington implemented safety measures to continue even its reduced operations, including physically altering its property, initiating sanitization procedures, installation of physical barriers and devices, and the redesign of physical spaces. The reinsurers successfully obtained judgment on the pleadings in the lower court before discovery commenced, arguing the familiar position that Huntington had not alleged "direct physical loss or damage to property."

On appeal, the central issue for the Vermont Supreme Court was interpreting this undefined phrase. Finding no ambiguity in the language "direct physical loss or damage to property," the court utilized dictionary definitions, cannons of construction, and the rule against surplusage to conclude that this phrase includes two distinct parts, either of which would trigger coverage. The court noted that the first

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component, "direct physical damage," requires a distinct, demonstrable, physical change to property. The second, "direct physical loss", involves persistent destruction or deprivation, in whole or in part, with a causal nexus to a physical event or condition. Purely economic harm, however, would not satisfy either standard.

Applying this interpretation, the court concluded that the complaint adequately alleged that the virus physically altered property in Huntington's shipyard, and therefore caused "direct physical damage". The court reasoned that the virus could "adhere" to surfaces, which caused "detrimental physical effects" that "altered and impaired the functioning of the tangible, material dimensions" of the property. Indeed, a "distinct, demonstrable, physical alteration need not necessarily be visible; alterations at the microscopic level may meet this threshold." As a result, the property could not function for its intended purpose, causing Huntington to implement steps to remedy the situation. According to the court, Huntington's remedial measures bolstered the argument that a distinct, demonstrable physical alteration occurred and was something that required "repair" to restore business operations.

Considering that a theory of "direct physical damage" alone was sufficient to reverse, the court did not reach other arguments raised in the briefs, including whether the complaint alleged facts entitling Huntington to relief under a theory of "direct physical loss." Supplying a final caveat, the Vermont Supreme Court noted that "[a]lthough the science when fully presented may not support the conclusion that presence of a virus on a surface physically alters that surface in a distinct and demonstrable way, it is not the Court's role at this stage in the proceedings to test the facts or evidence."

From the outset of their analysis, the Supreme Court of Vermont acknowledged the jurisdictional split regarding the interpretation of similar policy language, emphasizing that this divide would not influence the outcome of their decision. Those following similar coverage matters could quickly read between the lines to conclude that most jurisdictions simply do not share in Vermont's logic. Indeed, roughly one week prior to *Huntington Ingalls Indus., Inc.* Vermont's own neighborhood of the Second Circuit Court of Appeals issued an unpublished Summary Order affirming the dismissal of a similar coverage action.

In *Buffalo Xerographix, Inc. v. Sentinel Ins. Co., Ltd.*, No. 21-1502 (2d Cir. Sept. 15, 2022), certain New York business owners appealed the Western District of New York's dismissal of a putative class action complaint against various insurers who denied coverage for losses related to COVID-19 business closures. The plaintiff-businesses argued that their losses qualified as "direct physical loss" under the applicable policies and, therefore, should be covered by the insurers. The federal appellate court was quick to note that "under New York law the terms 'direct physical loss' and 'physical damage' [ ] do not extend to mere loss of use of a premises." According to the Second Circuit, "[e]ven if there are circumstances in which a virus might cause the actual physical loss of or damage to property, the presence of COVID-19 on surfaces at a retail store or office would not cause the store or office to be physically lost or damaged."

From a practical standpoint, the Supreme Court of Vermont's decision does little to shift the national balance of state appellate cases holding that COVID-19 losses cannot satisfy the physical loss or damage to property requirement. According to information collected by the University of Pennsylvania's Covid Coverage Litigation Tracker, *Huntington Ingalls Indus., Inc.* is Vermont's only decision on the subject and, notably, represents the apparent outlier to other states within the Second Circuit.[1] As of the date of this article, New York's First and Fourth Judicial Departments have decided ten of such cases

consistent with the reasoning of *Buffalo Xerographix, Inc.* It remains to be seen, however, which approach Connecticut will adopt; its Appellate and Supreme courts have yet to render decisions on their five total pending matters.

Nationally, Louisiana is the only full partner to Vermont's outcome without internal disagreement amongst its courts. In contrast, the appellate courts of nine states have held that COVID-19 cannot satisfy this physical loss or damage requirement. In-between this few and many are four states, who have ruled without division that COVID-19 can, potentially, satisfy this standard. Regardless, this division in an already novel legal landscape may very well bring about similar surprises as we approach the twilight of the pandemic. Surely, however, it does not appear that Vermont's decision will be ushering in a sea of change.

[1] Appeals in Business Interruption Cases – Covid Coverage Litigation Tracker (upenn.edu)

