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Ninth Circuit Issues Three Separate Rulings Favoring Insurers on Pandemic-Related Business Interruption Claims

In a single day, the Ninth Circuit handed down three decisions (one published, two unpublished) on insurance coverage for business interruption losses stemming from the COVID-19 pandemic. It addressed the meaning of "direct physical loss," the scope of the virus exclusion, and the applicability of the civil authority endorsement. Consistent with rulings by other federal circuit courts, the Ninth Circuit found that the claims were not covered.

Mudpie v. Travelers

Mudpie operates a children's store in San Francisco. After state and local authorities in California issued public health orders in response to the COVID-19 pandemic, Mudpie submitted a claim to Travelers under its commercial general liability policy. Specifically, it sought coverage under the policy's Business Income and Extra Expense coverage. Mudpie claimed that the orders prevented it from operating its store.

The relevant policy language provided as follows:

> [Travelers] will pay for the actual loss of Business Income [Mudpie] sustain[s] due to the necessary "suspension" of [Mudpie's] "operations" during the "period of restoration." The "suspension" must be caused by direct physical loss of or damage to property at the described premises. The loss or damage must be caused by or result from a Covered Cause of Loss. . . .

. . . .

> [Travelers] will also pay Extra Expense (including Expediting Expenses) to repair or replace the property, but only to the extent it reduces the amount of loss that otherwise would have been payable under [the "Business Income" provision].

Travelers denied coverage because the limitations on Mudpie's operations resulted from governmental orders, not direct physical loss or damage to property, and was otherwise barred by the exclusion for "loss or damage caused by or resulting from any virus."

Mudpie then filed a suit on behalf of itself and a putative class of all retailers in California that purchased comprehensive business insurance coverage from Travelers that included coverage for business interruption. The district court dismissed the action, ruling that Mudpie "failed to allege any intervening physical force beyond the government closure orders," and thus, was "not entitled to Business Income or Extra Expense coverage." Mudpie appealed.

The dispute centered on whether Mudpie adequately alleged a "direct physical loss of or damage to" property. Mudpie argued that the phrase does not require actual damage to the property but only that the property is no longer suitable for its intended purpose. Mudpie claimed it suffered a "loss of use" because the stay-at-home orders prevented Mudpie from operating its stores as intended.

The Ninth Circuit rejected Mudpie's argument because California courts have distinguished "intangible," "incorporeal," and "economic" losses from "physical" ones. The court noted that its conclusion that the phrase "direct physical loss of or damage to" property as requiring physical alteration of property was consistent with other provisions of the insurance policy as well as interpretations by other courts.

The Ninth Circuit also addressed the policy's virus exclusion. Mudpie argued that the exclusion did not apply because the losses were caused by the stay-at-home orders, not directly by the virus. Travelers contended that it was the virus that prompted the stay-at-home orders. The court agreed with Travelers. It found that Mudpie had not alleged an attenuated causal chain between the virus and Mudpie's losses. In other words, Mudpie had not plausibly alleged that the efficient proximate (predominant) cause – the one that set others in motion – was anything other than the spread of the virus or that the virus was the remote cause of its loss.

Chattanooga Professional Baseball v. National Casualty Company

Causation was the key issue in the Ninth Circuit's second ruling, but this time it looked at how that issue would be decided under the laws of ten different states. Several minor league baseball teams argued that the virus exclusion did not apply because their losses resulted from other causes, including government orders and Major League Baseball not supplying players. As the governing law depended on the principal location of the insured risk – in this case, each team's ballpark – the court considered how each of those jurisdictions treated causation.

Eight of the ten states (California, Idaho, Indiana, Maryland, Oregon, South Carolina, Tennessee, and West Virginia) either expressly adopted the efficient proximate cause theory or had been persuaded by it. Just like in *Mudpie*, the court found that the teams did not plausibly allege that causes other than the virus were the efficient proximate cause of their losses.

Texas applies concurrent causation. Where a loss is caused by concurrent perils – one of which is covered and one of which is excluded – the burden is on the insured to identify the portion of the loss attributed to the covered peril. The court found that all of the teams' alleged causes flowed from the virus.

Virginia applies proximate causation. "The proximate cause of an event is that act or omission which, in natural and continuous sequence, unbroken by an efficient intervening cause, produces the event, and without which that event would not have occurred." Again, the court found that the teams failed to plausibly allege that the other causes of their loss were efficient intervening causes that broke the causal chain stemming from the virus.

Selane Products v. Continental Casualty Company

Like in *Mudpie,* the Ninth Circuit found that the Business Income and Extra Expense coverage did not apply because Selane did not allege that the coronavirus was present on its property to cause any damage. Also, Selane did not plausibly allege that the stay-at-home orders caused its property to sustain any physical alterations.

The court further addressed the Civil Authority endorsement. Under that endorsement, the insured must prove: (1) a "direct physical loss of or damage to" property at locations, other than the insured premises; (2) a civil authority action was required because of that physical loss or damage; and (3) the civil authority action prohibited access to the insured's property. Because Selane did not allege any direct physical loss of or damage to property, the court found that this coverage also did not apply.

The cases are: (1) *Mudpie, Inc. v. Travelers Cas. Ins. Co. of Am.*, No. 20-16858 (9th Cir. Oct. 1, 2021); (2) *Chattanooga Prof'l Baseball LLC v. National Cas. Co.,* No. 20-17422 (9th Cir. Oct. 1, 2021) (unpublished); and (3) *Selane Prods. v. Continental Cas. Co.,* No. 21-55123 (9th Cir. Oct. 1, 2021) (unpublished).

Nevada Supreme Court: Insured Has Burden to Prove Exceptions to Exclusions, But It May Use Extrinsic Facts to Show Potential for Coverage

On a certified question from the Ninth Circuit, the Nevada Supreme Court held that the insured bears the burden of proving that an exception to an exclusion applies. The insured, however, may rely on any extrinsic evidence that was available to the insurer when the insured tendered the defense to the insurer.

The Case

Homeowners sued developers in 14 separate actions alleging construction defects. The developers asserted third-party claims against subcontractors. The subcontractors were insured by Zurich when building the homes. They switched insurance companies after completing their work but before the homeowners' lawsuits were filed.

The subcontractors tendered the suits to Zurich, who agreed to defend. Zurich then tendered to the subcontractors' current insurer, Ironshore. The Ironshore policies contained a Continuous or Progressive Injury or Damage Exclusion that provided the policy did not apply to existing bodily injury or property damage, except for "sudden and accidental" property damage. The underlying suits did not say when or how the property damage occurred.

Ironshore investigated and disclaimed on the basis of the exclusion, contending that the property damage had taken place due to faulty work that predated the policy's start date. Zurich settled the claims against the subcontractors and then sued Ironshore for contribution and indemnification. The trial court awarded Ironshore summary judgment, finding that the sudden and accidental exception did not apply.

Zurich appealed. Observing that two federal district courts handed down conflicting decisions under Nevada law on who has the burden of proving the applicability or inapplicability of

an exception to an exclusion in an insurance policy, the Ninth Circuit certified the question to the Nevada high court.

The Nevada Supreme Court's Decision

The Nevada Supreme Court surveyed cases around the nation and found that the majority of courts place the burden on the insured to "re-establish coverage where it would not otherwise exist" and that this rule was in accord with Nevada insurance law and basic tenets of evidence law.

In Nevada, the court explained, the burdens of production and persuasion rest with the insured, who has the initial burden of proving that the claim falls within policy coverage. Assigning the burden of proof to the insured to prove that the claim potentially falls within the exception to the exclusion, which in effect re-establishes coverage, the court held, is in alignment with these principles as well.

The Nevada Supreme Court therefore adopted the majority rule and concluded that the burden of proof is on the insured, not the insurer, to prove the potential that an exception to an exclusion applies when determining whether the insurer owes a duty to defend.

The court noted, however, that Nevada law was silent on what particular extrinsic facts an insured may use to fulfill its burden. As the duty to defend is to be determined at the outset of the litigation based on the complaint and any other facts available to the insurer, the court held that the insured may use extrinsic facts that were available to the insurer at the time it tendered its defense to prove there was a potential for coverage under the policy.

The case is *Zurich Am. Ins. Co. v. Ironshore Spec. Ins. Co.,* No. 81428 (Nev. Oct. 28, 2021).

Ohio Supreme Court Applies Water-Backup Exclusion to Damage Caused by Sewage

The Ohio Supreme Court, in a case of first impression, held that a water-backup exclusion in a commercial insurance policy included damage caused by sewage carried into an insured property by a backup or overflow event.

The Case

In 2014, sewage from the local sewer system backed up into the Bank Nightclub in Akron, Ohio. The nightclub was insured by United Specialty Insurance Company. Soon after the nightclub was flooded, it hired AKC, Inc., d/b/a Cleantech, to clean up the site. The nightclub also submitted a claim to United Specialty, which denied the claim, citing an exclusion in the nightclub's policy for damage caused by water that backs up or overflows from a sewer. The exclusion provided that United Specialty would not pay "for loss or damage caused directly or indirectly by . . . [w]ater that backs up or overflows from a sewer, drain or sump."

The nightclub assigned AKC any claims it might have against United Specialty, and AKC eventually instituted a breach-of-contract action in Ohio state court. The trial court granted summary judgment for United Specialty. The Ninth District Court of Appeals reversed. United Specialty appealed.

The Decision

The Ohio Supreme Court reversed the Court of Appeals and held that the water-backup exclusion included damage caused by sewage. The court rejected the nightclub's "hyperliteral" argument that "water" in the exclusion applied only to pure forms of water (*e.g.*, rainwater) as opposed to less pure forms of water (*e.g.*, sewage.). The court reasoned that the average person

purchasing insurance would understand that "[w]ater that backs up or overflows from a sewer" will contain sewage.

The court noted that the question before it was not whether the water-backup exclusion could have been worded differently or should have specifically stated that it applied to sewage. Rather, the court said, the question was whether the water-backup exclusion, as written, applied to sewage carried onto an insured property during a backup or overflow event. The court found that it did. Thus, it found no coverage and reversed the judgment of the Court of Appeals.

The case is *AKC, Inc. v. United Specialty Ins. Co*., No. 2020-0405 (Ohio Oct. 6, 2021).

Tenth Circuit Holds That Insurer Had No Duty to Defend Satellite TV Provider in Telemarketing Suit

The U.S. Court of Appeals for the Tenth Circuit held that a suit against DISH Networks for marketing violations under the Telephone Consumer Protection Act (TCPA) was not covered by a commercial umbrella policy because the plaintiffs sought penalties and prospective injunctive relief, neither of which constituted damages. Also, the suit did not allege a covered injury.

The Case

DISH Networks sells satellite television programming to consumers throughout the United States. DISH markets its services through a variety of ways, including telemarketing.

The United States, along with four states, sued DISH in federal court in Illinois alleging that DISH's telemarketing practices violated the TCPA. The TCPA makes it "unlawful for any person . . . to initiate any telephone call to any [cell phone or] residential telephone line using an artificial or prerecorded voice to deliver a message without the prior express consent of the called party."

The complaint sought:

(1) Statutory damages of $500 for each violation of the TCPA;

(2) Statutory damages of $1,500 for each violation of the TCPA found by the court to have been committed by DISH willfully and knowingly; and

(3) A permanent injunction to prevent future violations of the TCPA and relevant state law.

DISH tendered the suit to its commercial umbrella insurer for defense and indemnity. (DISH had previously litigated coverage under its primary policies). The insurer denied coverage and then filed a declaratory judgment action in federal court in Colorado. The district court awarded the insurer summary judgment and DISH appealed.

The Tenth Circuit's Decision

The Tenth Circuit affirmed. It agreed with the district court that statutory damages available under the TCPA are penalties, and thus, are uninsurable as a matter of Colorado public policy. Also, the policies do not cover claims for injunctive relief.

The court explained that Colorado public policy prohibits insuring intentional or willful wrongful acts, and specifically prohibits an insurer from covering punitive damages. As the statutory damages available under the TCPA are to penalize for marketing violations, they are uninsurable.

As for injunctive relief, the court held that the umbrella policies do not cover the costs of preventing future harms. The umbrella policy covered expenses that DISH became legally obligated to pay by reason of liability imposed by law. The court found that the policies only covered damages arising from past injuries. The cost of preventing future violations, the court explained, is not an amount incurred "because of" an injury that occurred during the policy period.

The court found that the insurer was entitled to summary judgment for another reason – the TCPA complaint did not allege a covered injury. DISH argued that allegations of the complaint

potentially fell within the definitions of "Bodily Injury" and "Property Damage." The court disagreed.

Nothing in the complaint, the court noted, suggested any potential liability for "bodily injury, sickness, disability or disease." It contained no allegation that unsolicited telemarketing calls physically injured any consumer. The only "injury" alleged was the receipt of unwanted phone calls, which Congress has recognized as a legally cognizable concrete harm.

Similarly, the complaint did not allege "Property Damage," including the loss of use of tangible property. DISH argued that unwanted telemarketing calls caused the loss of use of one's telephone because the recipient cannot use the phone for other purpose during that time. The court rejected this argument and noted that the complaint asserted no such allegation.

As the complaint did not allege any injuries that potentially fell within the definitions of "Bodily Injury" or "Property Damage," the insurer had no duty to defend DISH in the TCPA suit.

The case is *National Union Fire Ins. Co. v. DISH Network, LLC,* No. 20-1215 (10th Cir. Nov. 2, 2021).

Fifth Circuit: Auto Exclusion in CGL Policy Applies Regardless of Any Nexus Between Insured and Auto

The Fifth Circuit held that an absolute auto exclusion in a commercial general liability insurance policy barred coverage for any injury arising from an automobile accident, regardless of the car's ownership.

The Case

The policyholder, V& B International, Inc. (V&B), owned a sawmill. A motorist driving by the sawmill was killed when the sawmill's metal gate swung across the road.

V&B had a commercial general liability insurance policy with Colony Insurance Company that covered bodily injury and property damage suffered on V&B's premises during the coverage period. However, an endorsement titled the "absolute auto exclusion" excluded coverage for "bodily injury' or 'property damage' arising directly or indirectly out of the ownership, maintenance, use or entrustment to others of any aircraft, 'auto' or watercraft."

The decedent's wrongful-death beneficiaries notified Colony of their potential claims under V&B's policy. Colony denied coverage under the absolute auto exclusion. The beneficiaries later settled their claims against V&B and obtained a judgment that allowed them to collect only against applicable insurance proceeds.

Colony filed a declaratory judgment action in federal court in Mississippi. The district court granted summary judgment for Colony, concluding that the policy unambiguously excludes coverage for any injury arising from an automobile accident regardless of the car's ownership. The beneficiaries appealed.

The Appellate Court's Decision

The Fifth Circuit, applying Mississippi law, affirmed the district court's decision. The court found that policy unambiguously excluded coverage for any injury arising from an automobile accident, regardless of any nexus between the policyholder and the automobile.

The case is *Colony Ins. Co. v. Wright*, No. 20-61139 (5th Cir. Oct. 28, 2021).

Wisconsin Court of Appeals: Reckless Homicide Conviction Precludes Finding of Accident Under Homeowners Policy

A Wisconsin appellate court held that a father's criminal conviction for second-degree reckless homicide of his child precluded a finding of an "accident" under a homeowners policy, and therefore, there was no coverage for the mother's civil suit.

The Case

Curtis Strand's infant daughter died after sustaining a skull fracture and associated brain injury. The child was in Strand's care at the time. Strand was charged with first-degree reckless homicide. Following a jury trial, Strand was convicted of second-degree reckless homicide.

The child's mother, Lindsey Dostal, filed a civil suit in Wisconsin state court against Strand and his homeowners insurer. The insurer argued that there was no coverage for Dostal's claims because there was no "occurrence" under the policy and the claim was otherwise barred by the intentional acts exclusions. The policy defined "occurrence" as "an accident, including exposure to conditions" that results in bodily injury or property damage during the policy period.

The trial court granted the insurer's motion. It held that Strand's criminal conviction precluded any finding of an accident because criminal recklessness requires more than accidental conduct. To find Strand guilty, the court concluded, the jury had to find that Strand created an unreasonable and substantial risk of bodily harm, and that he acted with awareness of that risk.

Dostal appealed.

The Appellate Court's Decision

Dostal argued that a factual dispute remained as to the injury-causing event and that an awareness of risk does not mean an injury-causing event could not be an accident.

The Wisconsin Court of Appeals rejected Dostal's argument and affirmed the trial court's decision that the child's bodily injuries and death did not result from an "occurrence."

In convicting Strand of second-degree reckless homicide, the court explained, the jury in the criminal trial already found that his actions were not accidental. The court emphasized that the criminal court had instructed the jurors that they should find him not guilty if he did not possess the required awareness of the unreasonable and substantial risk of death or great bodily harm to the child. The guilty verdict meant that the jury found beyond a reasonable doubt that Strand was aware that his conduct created an unreasonable and substantial risk of harm to his child, such that her death did not result from an accident.

Thus, the court held that the policy provided no coverage for Dostal's claims because the child's injuries did not result from an "occurrence."

The case is *Dostal v. Strand*, No. 2020AP1943 (Wis. Ct. App. Oct. 19, 2021).

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