Insurance Law Update

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Majority of Courts Applying Illinois Law Have Not Found Coverage for Claims Arising from COVID-19

While access to federal courthouses has been limited during the COVID-19 pandemic, federal courts have been busy deciding the myriad of cases that have been filed regarding insurance coverage for COVID-19-related loss. While state courts have also weighed in on these issues, a large majority of the insurance coverage cases related to the pandemic were either filed in or removed to federal court.

Although many of the cases have not yet made their way to even the first level of appellate review, the current trend has frequently found there is no coverage. Several insurance companies have successfully filed motions to dismiss, motions for judgment on the pleadings, and summary judgment motions. Among the issues courts have been asked to decide are whether an insurer has sustained a direct loss to physical property so as to trigger a policy's "Business Income" and "Civil Authority" coverages, whether loss resulting from COVID-19 falls within a "virus" exclusion, and, where present, whether coverage is afforded for lost business income under a "Communicable Disease" endorsement.

Because the insured's property has not really sustained traditional physical damage, the "loss" claimed by insureds is typically for lost business income due to having to shut down or severely limit operations as a result of the "stay at home" orders issued by the State of Illinois. While the decisions lack uniformity because relevant policy language is not identical, the current trend—in Illinois as well as elsewhere in the country—is finding that the burdens and losses sustained by individuals and businesses as a result of the pandemic typically do not fall within the first-party property coverages provided under many insurance policies. The limited decisions that have found coverage—or the potential for coverage—have typically involved special endorsements providing coverage for loss of business income as a result of "communicable diseases," but even then, often times only if there has been an actual outbreak on the insured's premises.

Because this is an area of the law that has had to develop very fast with little guiding precedent and many appellate courts have yet had the opportunity to weigh in on these issues, this article is not intended to be a comprehensive survey of the status of Illinois law. Rather, it provides an understanding of how Illinois and other courts have decided some of the key—and common—coverage issues unique to the COVID-19 pandemic.

"Physical Damage" is the threshold issue

The threshold coverage issue in Illinois is whether Governor Pritzker's state shut-down for non-essential businesses as a result of COVID-19 meets the requirement in first-party policies that there be some type of physical damage to property caused by a covered cause of loss. The two most common coverage provisions under which coverage has been sought—business income and civil authority—both require the loss to result from "physical damage" to property or "physical loss." Thus far, most courts have found this threshold element of coverage has not been met because the shut-

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down orders did not cause "physical damage" or "physical loss" of the insured's property. In fact, most of these cases have not even survived a motion to dismiss.

For example, in *T & E Chicago LLC v. Cincinnati Insurance Company*, the U.S. District Court for the Northern District of Illinois dismissed a class action brought by a tavern owner because it concluded the complaint did not allege direct physical loss or damage to property. 501 F.Supp.3d 647 (N.D. Ill. 2020). The policy's business income, extra expense, and civil authority coverages all required, in some manner, direct physical loss or damage to property for coverage to exist. The court noted the policy's definition of "loss" required "accidental physical loss or accidental physical damage." *Id*. at 649.

After reviewing coverage decisions involving COVID-19 decided by Illinois and other courts, the *T & E Chicago* court stated, "most of these decisions, including the two from Illinois, have found for the insurance companies" and determined there was no coverage "for business closures resulting from civil authority closure orders." *Id*. at 651. The court then cited many of the cases from around the country that have found no coverage exists as well as a few that have found for the insured. It noted the seminal case finding coverage out of California was subsequently distinguished and another California court "explicitly declined to follow it." *Id*. After examination of these cases and in consideration of the plain language of the policy at issue, the *T & E Chicago* court concluded that "loss of use of property without any physical damage to that property cannot constitute direct physical loss or damage to the property." The court also noted its conclusion was consistent with the policy's reference to a "period of restoration," which "clearly implies a requirement of loss to property rather than loss of property." *Id*.

T & E Chicago LLC was one of the earliest cases in Illinois to address coverage for loss resulting from the pandemic. Subsequent cases have followed *T & E Chicago LLC* and expanded its analysis of the issue. For instance, in *L&J Mattson's Co., d/b/a Mattson's Steakhouse v. Cincinnati Insurance Company*, the Northern District of Illinois granted an insurer's motion to dismiss and rejected the insured's argument that "the SARS-CoV-2 particles have been 'physically present' at Mattson's, as have people carrying the virus," satisfies the policy's physical damage or loss requirement. No. 1:2020cv07784, 2021 WL 1688153 * 3 (N.D. Ill. April 29, 2021). While the insured's conclusory allegations that there was "physical damage to the property" were not accepted as being true when considering the merits of the motion to dismiss, the complaint's allegations that "the virus was physically present in the air at the premises and on surfaces at the premises" were assumed to be true. *L&J Mattson's Co*., 2021 WL 1688153, at *5. Yet, despite assuming these allegations were true, the court still concluded "the presence of the virus in the air or on surfaces does not constitute physical damage or physical loss. The word *physical* modifies loss in 'physical loss' and damage in 'physical damage'. The plain meaning of physical is tangible or concrete." *Id*. (emphasis in original). Thus, the court found that the term "physical injury" unambiguously "connotes damage to tangible property causing an alteration in appearance, shape, color or in other material dimension" and that no such damage had been alleged because "the presence of the virus in the air does not physically damage any of the property at the premises. *Id*.

In fact, the court found that even the presence of the virus on surfaces does not cause them to be tangibly altered, as no repairs are necessary. *Id*. at *5-6. Finally, the court rejected an argument by the insured that the absence of a "virus" exclusion somehow brought its claim within coverage, noting that the presence or absence of an exclusion would only be relevant if "the Policy already granted coverage." *Id*. at *6. Because there was no physical damage to property, neither the business income nor civil authority coverages applied and, therefore, the fact the policy lacked a virus exclusion was irrelevant. *Id*.

The above cases demonstrate that, thus far, courts have fairly consistently held that the presence of the COVID-19 virus in the air and on surfaces does not alter—and, therefore, does not physically damage—an insured's property. A recent case, however, reached a different conclusion based on its differing factual allegations. In *Legacy Sports Barbershop*

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LLC v. Continental Casualty Company, the court denied a motion to dismiss and found that the insured had alleged physical damage or loss to property. No. 20C4149, 2021 WL 2206161 (N.D. Ill. May 6, 2021) (emphasis added). In *Legacy Sports Barbershop LLC,* like the other cases discussed herein, coverage for business income, extra expense, and civil authority coverage all required physical damage or loss to property to trigger coverage. Unlike the other cases, however, the insured in *Legacy Sports Barbershop LLC* alleged the presence of the virus caused damage and required alterations to its property. Specifically, the insured alleged "they installed a new filtration system, built a new outdoor patio to accommodate patrons outside, installed social distancing barriers and germ sanitation stations, and removed 60% of their workstations to allow for social distancing indoors." *Legacy Sports Barbershop LLC,* 2021 WL 2206161, at *1.

The court's analysis began by acknowledging the general principle of law that "'physical loss of or damage to' property requires 'physical alteration or structural degradation of the property.'" *Id*. at *2. But unlike other decisions involving COVID-19, the court found the insured's complaint sufficiently alleged alterations to its property as a result of the pandemic and that "Plaintiffs have sufficiently alleged that the Properties underwent a 'distinct, demonstrable, physical alteration' and therefore suffered 'physical loss of or damage to' the Properties." *Id*. at *3. Consequently, the insured's complaint withstood the insurer's motion to dismiss. Significantly, however, the court concluded by stating that "[d]iscovery will shed light on the merits of Plaintiffs' allegations, including the nature and extent of COVID-19 on their premises." *Id*. (emphasis added).

Exclusions also play a role

While the applicability of an exclusion only matters if a policy is first deemed to provide coverage, at least one Illinois court decided to forego the analysis of whether there was physical damage or physical loss to property because, in its opinion, it was clear a "virus" exclusion within the policy applied and excluded coverage. In *M&E Bakery Holdings, LLC d/b/a Bittersweet, et. al. v. Westfield National Insurance Company*, the Northern District concluded that there was no business income coverage because a "virus" exclusion applied. No. 1:2020cv05849, 2021 WL 1837393 (N.D. Ill. May 7, 2021). The virus exclusion applied to all loss caused by "[a]ny virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease." *M&E Bakery Holdings, LLC,* 2021 WL 1837393*,* at *2. The court relied on another case, *Dental Experts, LLC v. Massachusetts Bay Ins. Co.*, No. 1:2020cv05887, 2021 WL 1722781 (N.D. Ill. May 1, 2021), which had a similar virus exclusion. The court in *Dental Experts, LLC* concluded the exclusion was "plain and unambiguous: it excludes loss or damage caused by or *resulting* from any virus." *Dental Experts, LLC,* 2021 WL 1722781, at *4 (emphasis in original).

In applying the same analysis, the court in *M&E Bakery Holdings, LLC* also concluded a virus exclusion applied and, in doing so, rejected the insured's argument that it was the shut-down orders, and not the coronavirus itself, that caused the damage. Specifically, the court held:

> "[T]he virus exclusion unambiguously excludes claims for the loss of business income *indirectly* caused by a virus. As such, the plaintiffs' argument that the closure orders, not the coronavirus, caused their loss of business income, lacks merit: the closure orders were issued because of the coronavirus pandemic.

M&E Bakery Holdings, LLC, 2021 WL 1837393, at *4. The court acknowledged the Court of Appeals for the Seventh Circuit had not yet addressed these issues but noted that several federal district court judges in Illinois had previously reached the same conclusion. *Id.*; *see also Green Beginnings, LLC v. West Bend Insurance Company*, No. 2020cv1661, 2021 WL 2210116 *7 (E.D. Wis. May 28, 2021) (applying Illinois law and holding that language of

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virus exclusion would "clearly and unambiguously exclude coverage" and denying an argument that the virus exclusion should be subject to "regulatory estoppel").

While courts have found that "virus" exclusions are unambiguous and bar pandemic-related claims, other exclusions relied on by insurers have not been held to unambiguously apply to COVID-19-related claims. For instance, in *Legacy Sports Barbershop LLC*, the court acknowledged that virus exclusions that exclude coverage for "loss or damage caused by or resulting from any virus" unambiguously applied because "this language is clear, sweeping, and all-encompassing." 2021 WL 2206161, at *3, *citing*, *Riverwalk Seafood Grill, Inc. v. Travelers Cas. Ins. Co. of Amer.*, No. 2020C3768, 2021 WL 81659, at *3 (N.D. Ill. January 7, 2021); *Mashallah, Inc. v. West Bend Mut. Ins. Co.*, No. 20C5472, 2021 WL 679227, at *2-3 (N.D. Ill. February 2, 2021). The *Legacy Sports Barbershop LLC* policy exclusion, however, did not specifically apply to viruses. Instead, the *Legacy Sports Barbershop LLC* policy had what was essentially a fungi/mold exclusion that excluded loss caused by the "[p]resence, growth, proliferation, spread or any activity of 'fungi', 'wet or dry rot', or 'microbes.'" 2021 WL 2206161, at *3. The insurer argued the exclusion of "microbes", defined by the policy as "any non-fungal micro-organism or non-fungal, colony-form organism that causes infection or disease," brought the pandemic-related loss within the exclusion. *Id*. But the court noted the exclusion also stated that "'microbe' does not mean microbes that were transmitted directly from person to person." *Id*. Based on this language, the court found it was unclear whether "microbe" as defined in the policy's exclusion included a virus such as SARS-CoV-2 "because that virus, of course, can spread from person to person." *Id*. Thus, the court concluded the insurer had not met its burden at the motion to dismiss stage of the litigation of establishing the exclusion applied.

The "Communicable Disease" endorsement

Some policies provide business income coverage caused by a "communicable disease" which is often subject to a separate limit for pandemic-related loss and may apply even when coverage is otherwise excluded. The determinative coverage issue is whether the suspension of the insured's operations was due to an actual outbreak at the insured's premises versus simply complying with a state-wide stay-at-home order.

In *Green Beginnings, LLC*, the court first found there had been no physical loss or physical damage to the property because "direct physical loss" unambiguously requires "some form of actual, physical damage to the insured premises to trigger coverage," and the presence of COVID-19 particles on the insured's property was only temporary and did not permanently alter the insured's property. 2021 WL 2210116, at *4, *citing*, *Sandy Point Dental, PC v. Cincinnati Ins. Co.*, 488 F.Supp.3d 690, 693 (N.D. Ill. 2020). However, the policy also included, by endorsement, "Communicable Disease Business Income and Extra Expense" coverage, which provided coverage for loss sustained as a result of temporary shut-downs "as ordered by a local, state or federal board of health or similar governmental board that has jurisdiction over your 'operations.' The shutdown or suspension must be due to an outbreak of a 'communicable disease' or a 'waterborne pathogen' at the insured premises as described in the Declarations." 2021 WL 2210116, at *2.

The insurer in *Green Beginnings, LLC* argued there had been no outbreak at the insured's actual premises so that this additional coverage did not apply. The court noted there was nothing in the complaint alleging anyone tested positive for COVID-19 prior to the issuance of the stay-at-home orders by Governor Pritzker or that anyone was exposed to COVID-19 on the insured's premises. *Id*. at *7. This was significant to the court because the policy "requires that the shutdown or suspension of operations must be due to an outbreak 'at the insured premises.'" *Id*. Thus, any order to shut down must have been as a result of an actual outbreak on the insured's premises, and not

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elsewhere. *Id*. Accordingly, the court granted the insurer's motion to dismiss as to the communicable disease endorsement.

In contrast, the court in *Treo Salon, Inc. v. West Bend Mutual Insurance Company* denied an insurer's motion to dismiss under a policy that had a communicable disease business income and extra expense endorsement that was essentially identical to the one in *Green Beginnings, LLC.* No. 2020cv1155-SPM, 2021 WL 1854568 (S.D. Ill. May 10, 2021). The court framed the issue as whether a preemptively-issued shut-down order triggers the endorsement or is an actual outbreak at the insured's premises required in order to trigger the endorsement. *Treo Salon, Inc.*, 2021 WL 1854568, at *4.

The *Treo Salon, Inc.* court held the insurer had not established it was entitled to a dismissal at this stage of the litigation. Key to the court's conclusion was that the "government did not create any process through which Treo could prove it was virus free, was not a possible vector or was employing safety measures sufficient to justify continuous operation of its services." *Id*. This meant, to the court, that the insurer could not be certain there was no COVID-19 on the insured's premises. Thus, at least for purposes of a motion to dismiss, the court held the insured "sufficiently pled a cause of action against West Bend and has plausibly alleged potential coverage under the policy. Any disputed issues may be better suited for disposition on a motion for summary judgment, after the case has been more fully developed." *Id*.

Finally, the existence of coverage under these endorsements depends on the specific language in the endorsement. For instance, in contrast to the language of the endorsement in the *Green Beginnings, LLC* case, the insurer in the *Dental Experts LLC* case apparently accepted coverage under a communicable disease endorsement that had similar, but significantly different language. Rather than requiring that an outbreak take place at the insured's premises that is the cause of the required shut-down as required by the endorsement in the *Green Beginnings, LLC* case, the endorsement in *Dental Experts LLC* only required that the suspension of the insured's operations be "caused by a disease contamination event declared by the National Center for Disease Control, or the applicable city, county or state Department of Health." 2021 WL 1722781, at *2. Given this broad policy language, the insurer in *Dental Experts LLC* accepted coverage under the communicable disease endorsement and paid the insured $25,000 (the insured, however, claimed it was entitled to $25,000 for each of its locations and filed suit). *Id*. at *2, 5.

Conclusion

The current trend by federal district court judges in Illinois is to find that traditional business income and civil authority coverages do not apply absent physical loss or damage to the insured's property. Unfortunately, it will be some time before this is a settled issue under Illinois law because it is very likely there will be decisions addressing these issues by the Seventh Circuit, Illinois appellate courts, and possibly the Illinois Supreme Court. In the meantime, these cases provide a framework for how a court may currently approach the issues under Illinois law.

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