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Mich. Eateries' Loss Highlights COVID-19 Coverage Hurdles

By **Jeff Sistrunk**

Law360 (July 7, 2020, 10:17 PM EDT) -- A Michigan judge gave teeth to one of insurers' chief arguments against coverage for losses during the COVID-19 pandemic with a first-of-its-kind ruling last week that a restaurant owner cannot tap its business interruption policy because its eateries did not sustain "direct physical loss or damage."

Ruling from the bench via Zoom on July 1, 30th Circuit Judge Joyce Draganchuk dismissed Gavrilides Management Co. LLC's suit seeking $650,000 from Michigan Insurance Co. for losses it suffered after Gov. Gretchen Whitmer issued executive orders in March that limited its two restaurants to take-out and delivery orders. It was the first time any court had decided a COVID-19 coverage case on the merits.

Gavrilides' policy with Michigan Insurance extended coverage for its loss of business income due to a "suspension of operations" caused by direct physical loss or damage to at least one of its insured properties. Gavrilides asserted this requirement was met because its restaurants, the Soup Spoon Cafe in Lansing and The Bistro in Williamston, were "damaged during the pendency of the [executive orders] because people were physically restricted from dine-in services."

Judge Draganchuk, however, deemed that argument "simply nonsense," saying during the July 1 hearing that she was persuaded by Michigan case law finding that direct physical loss or damage must take a tangible form and somehow alter "the physical integrity of the [insured] property."

The judge also emphasized that Gavrilides' complaint repeatedly stated that no confirmed cases of COVID-19 had ever been traced to either of the two restaurants, and none of the eateries' employees had tested positive.

"The complaint here does not allege any physical loss of or damage to the property," Judge Draganchuk said. "The complaint alleges a loss of business due to executive orders shutting down the restaurants for dine-in services due to the COVID-19 threat. But the complaint also states that at no time has COVID-19 entered the Soup Spoon or The Bistro through any employee or customer, and in fact states it has never been present in either location. So there simply are no allegations of direct physical loss of or damage to either property."

Gavrilides' attorney, Matthew J. Heos of The Nichols Law Firm PLLC, told Law360 his client was disappointed in the ruling and plans to appeal. An attorney for Michigan Insurance, Henry S. Emrich of Secrest Wardle, declined to comment.

Attorneys who represent insurance carriers told Law360 the ruling is another early vindication of insurers' position that the COVID-19 virus and resulting government stay-at-home orders have not caused any direct physical loss or damage that would trigger policyholders' business interruption coverage.

"The judge correctly identified that being physically unable to access the premises is not the same as 'direct physical loss or damage,'" said Kaufman Dolowich & Voluck LLP partner David Group.

Clark & Fox partner Michael Savett said Judge Draganchuk's analysis was similar to that employed by a New York federal judge who issued a highly publicized oral decision in May denying a culture magazine's request for a preliminary injunction compelling its insurer to immediately pay its coronavirus-related losses. The New York ruling, though not dispositive, was also hailed as an early victory for insurers.

Savett said the two decisions are likely to prove influential in the hundreds of COVID-19 business interruption cases still pending in state and federal courts, because "the 'direct physical loss or damage' question is going to be part and parcel of the analysis."

"This is the second court to have addressed the issue, and both held there must be a tangible physical change or alteration to the business location for that policy requirement to be satisfied," he said.

Attorneys who represent policyholders were quick to point out that a number of jurisdictions outside of Michigan have case law on the books holding that an insured's mere loss of the ability to use its property for its intended purpose can satisfy the direct physical loss or damage requirement.

For instance, in one case frequently cited by policyholders, a New Jersey federal court ruled in 2014 in Gregory Packaging v. Travelers that an ammonia release at a factory constituted direct physical loss or damage to the building. From policyholders' perspective, the same logic applies to the presence, or potential presence, of COVID-19 at an insured property.

"Michigan law is very different from that of other states that don't require an alteration of the physical integrity of the property, so I expect this decision will have limited reach," said Robin Cohen, head of McKool Smith PC's insurance recovery practice. "In many other states, if you have, say, E. coli or a hazardous substance in the air that you cannot see, and it is making the facility uninhabitable or unusable, that is sufficient to trigger the direct physical loss or damage requirement."

Haynes and Boone LLP partner Micah Skidmore said it is important to note that Judge Draganchuk's ruling was limited to the contents of the pleadings, which "specifically said no one with COVID-19 came on the premises, and no staff member was infected with the virus."

Since the judge relied on Gavrilides' own assertions that COVID-19 was never present on the restaurants' premises, she did not address whether the direct physical loss or damage requirement could be fulfilled if the virus were to be detected at an insured property. Other policyholders that have at least alleged the presence of the novel coronavirus on their premises could withstand insurers' bids for dismissal, according to attorneys.

"If the insured had alleged that the presence of [COVID-19] on its property was the cause of its losses, the court likely would have reached a different result," said Neal Gerber & Eisenberg LLP partner Seth Lamden, who is a member of the American College of Coverage Counsel, an organization of insurance

attorneys. "There is a robust body of case law holding that when property has been rendered unsafe due to contamination, it has incurred direct physical loss or damage."

Judge Draganchuk also had the opportunity to weigh in on another key issue in many COVID-19 business interruption coverage battles: whether a standard exclusion in many policies for losses stemming from any "virus, bacterium or other microorganism" encompasses the novel coronavirus.

Gavrilides had argued the virus exclusion is "vague relative to business interruption claims caused by actions of civil authority to protect public health and welfare." The restaurant owner further contended that the exclusion is inapplicable to its losses because they were actually caused by Whitmer's executive orders limiting restaurant operations and not COVID-19 itself.

Judge Draganchuk was unconvinced, saying Gavrilides failed to sufficiently explain how the exclusion was ambiguous or vague as applied to the facts of the case.

In addition, she said that Gavrilides' argument that its financial losses actually stemmed from the stay-at-home orders runs into another exclusion in the Michigan Insurance policy for losses caused by the "acts or decisions" of any "governmental body." There is an exception to that exclusion for government acts that result in covered direct physical loss or damage, but that did not happen here, Judge Draganchuk said.

According to Tittmann Weix LLP partner Raymond Tittmann, Judge Draganchuk's holdings will be a blow to some policyholders' efforts to dodge the virus exclusion by making arguments similar to Gavrilides'.

"Her analysis on the interplay between the virus exclusion and the government acts exclusion defeats the creative efforts we have seen to plead around the virus exclusion," Tittmann said.

However, McKool Smith's Cohen pointed out that policyholders in other cases have asserted numerous other arguments as to why the standard virus exclusion is inapplicable.

For example, one Pennsylvania restaurant has posited that, under the doctrine of "regulatory estoppel," the exclusion is void because the insurance industry misrepresented to state regulators that the clause — which dates back to 2006 — would not significantly narrow coverage. The regulatory estoppel argument and others may gain traction as other COVID-19 coverage cases move forward, Cohen said.

But attorneys who represent insurance companies said all the arguments regarding the virus exclusion may prove to be a sideshow if other courts follow Judge Draganchuk's lead and hold that policyholders must show tangible damage to their properties to meet the threshold requirement of direct physical loss or damage.

"The more courts that rule this way — which I believe is the correct way — the more of an uphill battle these policyholders' lawsuits will be," Savett said.

Gavrilides is represented by Matthew J. Heos of The Nichols Law Firm PLLC.

Michigan Insurance is represented by Henry S. Emrich, James Bradley and Drew W. Broaddus of Secrest Wardle.

The case is Gavrilides Management Co. LLC v. Michigan Insurance Co., case number 20-258-CB-C30, in the Circuit Court of the County of Ingham, Michigan.

--Editing by Philip Shea and Brian Baresch.
