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New York's Highest Court Weighs in on COVID-19-Related Commercial Property Insurance Claims

By Howard B. Epstein and Theodore A. Keyes

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The COVID-19 pandemic upended the lives of people throughout the world and continues to have lasting impacts four years later. In addition to the significant and sometimes devastating health issues caused by COVID-19, pandemic-related shut-downs gave rise to considerable economic loss. According to Reuters, COVID-19 caused insured losses of $44 billion in the first two years of the pandemic alone, making the COVID-19 pandemic the third largest event of loss ever—surpassed only by Hurricane Katrina and the Sept. 11 attacks.

Many businesses have sought to recover their pandemic losses under commercial property insurance policies, only to be denied coverage. A significant number of policyholders have filed lawsuits challenging these disclaimers, primarily in state courts. But to the dismay of the insureds, a growing majority of high state courts have sided with the insurers in these disputes.

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In early 2024, the New York Court of Appeals joined this majority, quashing policyholder hopes that the trend would be reversed. On Feb. 15, 2024, New York's highest state court determined that the presence of SARS-Co-V-2 (the virus that causes COVID-19) at insured properties and the related cessation and interruption of business activities were not sufficient to state a claim for "direct physical loss or damage" under a property insurance policy.

The court held that either a material alteration of insured property or a "complete and persistent dispossession" of the property is required to sustain a claim for coverage. *Consolidated Restaurant Operations v. Westport Insurance,* No. 7, 2024 WL 628047, at *1 (N.Y. Feb. 15, 2024). Since the plaintiff insured had not alleged any

such physical changes to its property, the court dismissed the claim.

The Insurance Dispute

Consolidated Restaurant Operations Inc. (CRO) is a Texas-based conglomerate that operates restaurants throughout the United States and United Arab Emirates. In February 2020, as governmental authorities began recognizing the increasing threat caused by COVID-19, CRO began implementing protective measures to mitigate transmission of the virus in its restaurants.

By mid-March 2020, CRO was forced to suspend indoor dining at its restaurants due to executive orders mandating cessation of nonessential activities. CRO was permitted to continue offering takeout and delivery services in some jurisdictions, but still suffered "tens of millions of dollars in revenue loss" due to the limitations on operation. *Consolidated Restaurant Operations v. Westport Insurance*, 167 N.Y.S.3d 15, 18 (App. Div. 2022). During the relevant time period, CRO was insured under a $50 million all-risk commercial property insurance policy issued by Westport Insurance Corporation (Westport).

The New York Court of Appeals agreed with Westport, holding that CRO failed to allege "direct physical loss or damage" because CRO did not allege "a material alteration or a complete and persistent dispossession of insured property."

The Westport policy insured CRO for "all risks of direct physical loss or damage to INSURED PROPERTY while on INSURED LOCATION(S)…" *Consolidated Restaurant Operations,* 2024 WL 628047, at *3. The policy also covered losses due to business interruption (also known as "time element" losses) "during the period of liability directly resulting from direct physical loss or damage insured by [such] POLICY to INSURED PROPERTY at INSURED LOCATION(S)."

The term "period of liability" included "'the period of time' '[s]tarting on the date of physical loss or damage insured by th[e] POLICY to INSURED PROPERTY,' and '[e]nding when with due diligence and dispatch the building and equipment could be repaired or replaced with current materials of like size, kind and quality and made ready for operations; . . . .'"

CRO sought coverage under the policy, but Westport denied the claim on the grounds that the virus could not cause "direct physical loss or damage." Brief for Appellant at 3, *Consolidated Restaurant Operations*, 2024 WL 628047. Following the disclaimer, CRO filed suit against Westport.

The Court of Appeals Weighs In

The New York Court of Appeals agreed with Westport, holding that CRO failed to allege "direct physical loss or damage" because CRO did not allege "a material alteration or a complete and persistent dispossession of insured property." *Consolidated Restaurant Operations*, 2024 WL 628047, at *3.

In doing so, the court affirmed the decision of the First Department, which had ruled that, in the absence of allegations of "actual, discernable, quantifiable change constituting 'physical' difference to the property from what it was before exposure to the virus," CRO had failed to state a viable claim. *Consolidated Restaurant Operations*, 167 N.Y.S.3d at 18.

The court emphasized that insurance policies are to be interpreted using "general principles of contract interpretation," including giving plain

and ordinary meaning to unambiguous terms. *Consolidated Restaurant Operations*, 2024 WL 628047, at *3. Since the terms "direct" and "physical" modify the phrase "loss or damage," the provision at issue requires either (1) "direct physical loss" or (2) "direct physical damage."

The court explained that "'[p]hysical damage' must be understood to require a material physical alteration to the property—one that is perceptible, even if not visible to the naked eye." It rejected CRO's argument that the presence of the virus at its restaurants caused physical damage because CRO had not alleged that its property needed to be repaired or replaced, and otherwise only identified risks that the virus creates for humans, rather than insured property.

The Vermont Supreme Court appears to be the only high state court that has allowed a COVID-19-related business interruption claim to survive beyond a motion to dismiss.

The court similarly rejected CRO's argument that the phrase "direct physical loss" includes "impaired functionality and either a partial or complete loss of use for a limited period of time." "Direct physical loss," the Court stated, requires "more than loss of use; it requires an actual, complete dispossession."

The court analogized the concept of loss of use to forgetting a phone password, which, the court said, is "quite different than losing possession of [the phone] entirely." To hold otherwise, it explained, would "collapse coverage for 'direct physical loss' into coverage for 'loss of use.'"

The court distinguished cases cited by CRO which held that loss of use due to the presence of noxious substances (such as gasoline or asbestos) qualified as "direct physical loss," suggesting that these cases seemingly reached such a holding when the contamination was "persistent" and "complete," such that the property was completely unusable.

In contrast, CRO had not alleged that COVID-19 caused a complete shutdown of its operations, but rather that it was forced to "'suspend[] or severely curtail[][its] operations' and 'limit[] [its] on-premises dining and operations.'" Although CRO's indoor dining options were limited, CRO was able to continue takeout, drive-through and delivery services.

While CRO also alleged that it had to close 30 of its restaurants, it had not linked these closures with any contamination of the properties. These closures, the court explained, could have been due to other reasons, such as economic decisions to reduce the company's scale of operations due to "lost 'foot-traffic.'"

Consistency with Precedent and Other State and Federal Courts

The *Consolidated* decision is in line with established New York precedent involving identical policy language.

In *Roundabout Theatre Company v. Continental Casualty Company*, 751 N.Y.S.2d 4 (App. Div. 2002), the First Department found that a theater could not recover for losses due to a street closure that caused the theater to cancel scheduled shows. Similar to the facts in *Consolidated*, the closure in *Roundabout* was due to a governmental order issued to address safety concerns, although in *Roundabout* these concerns were due to a nearby construction accident and there were no allegations of any physical impact to the insured property.

The California Supreme Court also recently sided with an insurer in a similar case, settling dissonance among the state's lower courts.

In *Another Planet Entertainment v. Vigilant Insurance*, a concert venue operator sought coverage for "direct physical loss or damage to property" under its commercial property insurance policy, after it was forced to limit—and in some cases cease entirely—its operations due to COVID-19.

In its May 23, 2024, opinion, the court unanimously affirmed the trial court's dismissal of the claim, holding that "allegations of the actual or potential presence of COVID-19 on an insured's premises do not, without more, establish direct physical loss or damage to property within the meaning of a commercial property insurance policy." *Another Planet Entertainment v. Vigilant Insurance*, 548 P.3d 303, 307 (Cal. 2024). Just as with *Consolidated*, *Another Planet* was litigated in a major commercial venue in which policyholders were hoping that a high-court reversal would create favorable precedent.

On the same day that the California Supreme Court issued its opinion in *Another Planet*, the U.S. Court of Appeals for the Fourth Circuit unanimously affirmed a trial court's dismissal of claims by multinational candy manufacturer, Mars Incorporated (Mars), challenging its insurer's denial of coverage for COVID-19-related losses.

The Fourth Circuit also denied Mars' motion to certify a question of Virginia law to the state's highest court. The court issued this opinion without hearing oral argument, as it found that "the facts and legal contentions [were] adequately presented…" and that "argument would not aid the decisional process." *Mars v. Factory Mutual Insurance*, No. 23-1395, 2024 WL 2355438, at *1 (4th Cir. May 23, 2024).

These decisions accord with the decisions of the highest state courts of Connecticut, Iowa, Louisiana, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, Ohio, Oklahoma, South Carolina, Washington and Wisconsin, and the District of Columbia Court of Appeals, all of which sided with insurers in similar COVID-19-related commercial property insurance claims.

In fact, the Vermont Supreme Court appears to be the only high state court that has allowed a COVID-19-related business interruption claim to survive beyond a motion to dismiss (*see Huntington Ingalls Industries v. Ace American Insurance*, 287 A.3d 515 (Vt. 2022)).

Looking Forward

The *Consolidated* decision is significant in that it continues the nationwide trend and likely provides the final word on COVID-19-related coverage disputes in New York under similar commercial property insurance policies.

Prospective insureds looking for coverage not tied to direct physical loss or damage should seek out policies that cover the loss of egress or ingress at an insured property or losses related to communicable diseases, without the need for physical loss or damage. While *Consolidated* will control for any policies containing "direct physical loss or damage" language or phrases with a similar effect, parties remain free to contract for additional coverage to better mitigate other potential losses.