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Mich. Ruling Isn't Last Word On COVID-19 Insurance Claims

By **Adrian Azer, Micah Skidmore and Wesley Dutton** (July 28, 2020, 4:55 PM EDT)

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On July 1, in Gavrilides Management Co. LLC v. Michigan Insurance Co., 30th Circuit Judge Joyce Draganchuk granted the insurance company's dispositive motion denying a $650,000 business interruption claim brought by restaurant owner Nick Gavrilides in the Circuit Court of the County of Ingham, Michigan.

Judge Draganchuk rejected as "simply nonsense" Gavrilides' argument that an executive order by Michigan Gov. Gretchen Whitmer prohibiting customers from dining at his restaurant amounted to a physical loss under his commercial property insurance policy.

Instead, Judge Draganchuk sided with the insurer, construing "direct physical loss of or damage to" the covered properties to require "something with material existence. Something that is tangible. Something ... that alters the physical integrity of property." Judge Draganchuk found the absence of any allegation of the presence of the virus to be dispositive of the issue of whether a physical loss had occurred and therefore whether coverage attached.

While Judge Draganchuk's denial of Gavrilides' claims garnered significant media coverage as the first dispositive ruling in a COVID-19 coverage dispute, there are several distinguishing features of this case which limit the impact of the court's verbal ruling.

As a preliminary matter, it is important to note the procedural posture of Judge Draganchuk's decision. Her ruling on the insurer's dispositive motion was made under Michigan Court Rule 2.116(C)(8), which provides for summary disposition where "[t]he opposing party has failed to state a claim upon which relief can be granted."

Unlike the "no genuine issue as to any material fact" standard in Rule 2.116(C)(10), a dispositive motion under Rule 2.116(C)(8) is based solely on the allegations in the pleadings, without consideration of additional evidence supporting those allegations. As a result, Judge Draganchuk's ruling was confined to the allegations in Gavrilides' pleadings — which denied the presence of COVID-19 at his restaurants.

Consequently, her holding does not apply to the broader evidentiary question of whether the presence of COVID-19 on a covered property could constitute a physical loss. Given substantial uncertainty regarding the ability of the virus to linger in open air and on surfaces for extended periods of time, a review of evidence relating to the effect of the coronavirus on a given property might yield a different outcome in a future case.

Additionally, Michigan law appears to take a more restrictive view of physical loss than many other U.S. jurisdictions. At least one federal court applying Michigan law held that the presence of foul-smelling mold and bacteria within a building's air ducts was not a direct physical harm, even where the insured was required to physically clean the ductwork to remove the mold and bacteria.[1]

While some jurisdictions echo Michigan in finding that physical remediation is not necessarily indicative of the existence of physical loss, other jurisdictions take a more expansive view of physical loss — particularly where an insured is required to take physical action to prevent or remedy the damage caused by a virus or other contaminant.[2]

The diversity of constructions of physical loss in jurisdictions throughout the country indicates that Judge Draganchuk's ruling under Michigan law may not prove persuasive in the majority of jurisdictions.

Even under Michigan law, Gavrilides could have bolstered his chances of surviving a dispositive motion by utilizing alternative legal arguments. Gavrilides did not argue that the virus exclusion in his policy is an implicit acknowledgment that physical loss does not necessarily require damage to the physical integrity of the property to trigger coverage. In other words, if viruses never cause physical loss in the first place, a virus exclusion would be completely unnecessary.

Gavrilides did argue that the virus exclusion in the policy was ambiguous, and alternatively argued that civil authority coverage would apply in the event of a government-mandated shutdown to remediate subterranean pollution or a loss of power caused by a computer virus.

But while Gavrilides' response to the defendants' motion for summary disposition cited extensive case law in its discussion of the legal standards applicable to the dispute, the brief relied almost entirely on the language of the policy itself in supporting Gavrilides' argument that a civil authority order prohibiting dine-in services amounted to physical loss.

Without citing to case law — in Michigan or elsewhere — construing loss of use as physical loss, Gavrilides' coverage argument required the judge to rule that physical loss was broader than physical damage based solely on the physical loss provision of the policy and alleged ambiguity in the virus exclusion.

This narrow argument made it easy for Judge Draganchuk to adopt a rigid reading of the requirement of "direct physical loss of or damage to" the covered property and to rule in favor of the insurer.

A more nuanced argument on the construction of physical loss by reference to the policy's virus exclusion and policyholder-friendly opinions from other jurisdictions would have provided additional support for Gavrilides' policy-based arguments — potentially altering Judge Draganchuk's ruling on the insurer's dispositive motion.

Likewise, Gavrilides did not attempt to raise factual issues regarding other losses caused by civil authority orders. Given the relative paucity of research and the lack of scientific consensus regarding key attributes of the virus — e.g., whether it is airborne, how long it can survive on surfaces, how commonly it is spread by asymptomatic carriers, what sanitation measures are effective for killing the virus — it would have been prudent for Gavrilides to plead, in the alternative, that he incurred additional losses apart from those allegedly caused by the cessation of dine-in services.

Judge Draganchuk clearly found the lack of any alleged presence of the virus persuasive in ruling in favor of the insurer on the issue of physical loss, and additional allegations regarding the potential presence of the virus — in addition to losses caused by civil authority orders and additional actions responsive to the virus — would potentially have allowed Gavrilides to survive summary disposition at such an early stage of the proceedings.

When considered as a whole, the procedural limitations of Judge Draganchuk's ruling — considering only Gavrilides' allegations in the pleadings — in the context of pro-insurer Michigan law on the meaning of physical loss and without the benefit of alternative policy and fact-based arguments that Gavrilides might have utilized, all suggest that the ruling will be limited to the unique circumstances of that case.

Not only do many jurisdictions reject the notion that physical loss requires physical damage and hold instead that loss of use can constitute a physical loss, but our ever-evolving understanding of the coronavirus creates new opportunities for policyholders to identify factual issues precluding summary disposition of coverage claims.

While Judge Draganchuk's ruling will be remembered as the first dispositive ruling on a COVID-19 coverage claim, it will certainly not be the last word on the unique coverage issues presented by this unprecedented global pandemic.

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[1] Universal Image Productions, Inc. v. Chubb Corp. , 703 F. Supp. 2d 705 (E.D. Mich. 2010).

[2] Widder v. Louisiana Citizens Property Insurance Corporation , 82 So. 3d 294 (La. App. 2011), writ denied, 76 So. 3d 1179 (La. 2011) (holding that the intrusion of gaseous fumes constituted direct physical loss); TRAVCO Ins. Co. v. Ward , 715 F.Supp.2d 699 (E.D. Va. 2010) (release of toxic gas by drywall constituted a direct physical loss, even in the absence of structural damage); Cooper v. Travelers Indemnity Co. of Illinois , No. 01-2400, 131 Fed. Appx. 198 (N.D. Cal. Nov. 4, 2002) (E.coli contamination of water well, causing insured's bar to close for six months pending extensive decontamination efforts, was a direct physical loss); Matzner v. Seaco Ins. Co. , 9 Mass. L. Rptr. 41, 1998 WL 566658 (Aug. 12, 1998) (carbon monoxide contamination constituted "direct physical loss of or damage to" covered property); Port Authority v. Affiliated FM Insurance Co. , 311 F.3d 226 (3d Cir. 2002) (holding that, although the mere presence of asbestos on a covered property was not enough to trigger coverage, contamination—or threatened release—which was substantial enough to "nearly eliminate or destroy" the use of the property "or render it uninhabitable" was sufficient to support a finding of "physical loss or damage").

While Texas courts have not expressly decided the issue of whether a virus can constitute a direct physical loss, there are analogous precedents suggesting that loss of use can constitute physical loss in the absence of any visible or structural damage. See, e.g. Trinity Industries, Inc. v. Insurance Co. of North America , 916 F.2d 267, 270-271 (5th Cir. 1990) (construing "physical loss or damage" to include "an initial satisfactory state that was changed by some external event into an unsatisfactory state."); Fidelity Southern Fire Ins. Co. v. Crow , 390 S.W.2d 788, 792 (Tex. App.—Waco 1965, writ ref'd n.r.e.) (refusing to define "all risks of physical loss" narrowly to include only "damage or harm to the building or structure" described in the policy).
