Second-Level Scrutiny – The Appellate Review of Claims for COVID-19 Business Interruption Losses

American College of Coverage Counsel
2022 Annual Meeting

Intercontinental Chicago
May 11-13, 2022

Michael S. Levine
HUNTON ANDREWS KURTH LLP
Washington, DC
mlevine@huntonAK.com

John B. Mumford, Jr.
HANCOCK, DANIEL & JOHNSON, PC
Richmond, VA
jmumford@hancockdaniel.com

Christopher R. Mosely
FOLEY HOAG
Denver, CO
cmosley@foleyhoag.com

AMERICAN COLLEGE OF COVERAGE COUNSEL

CONTENTS

Lessons From Losses: What Insurers Can Glean From Pro-Policyholder Rulings in U.S. Coronavirus Business Interruption Coverage Disputes

John B. Mumford, Jr.

Hancock, Daniel & Johnson, P.C.
4701 Cox Road, Suite 400
Glen Allen, Virginia 23060
(804) 967-9604
jmumford@hancockdaniel.com

Introduction

As of early October 2021, over 1,900 lawsuits have been brought on the issue of whether the business interruption (business income and extra expense) coverages found in most commercial property insurance policies afford coverage to policyholder-businesses for income lost due to the COVID-19 pandemic and resulting shutdown/restriction orders. By and large, most courts have held in favor of insurers, finding that there is no coverage for COVID-19-related income losses under these coverages. To date, federal and state courts across the country have granted nearly 500 motions to dismiss and 29 summary judgment motions for insurance carriers. Tom Baker, *Covid Coverage Litigation Tracker*, U. Pa., https://cclt.law.upenn.edu/judicial-rulings/. (last visited Oct. 5, 2021).

However, some federal and state courts have found the insureds' allegations of "physical loss of or damage to property" sufficient to survive early dispositive motions and allowed the parties to progress to discovery. Additionally, several courts have granted policyholders' summary judgment motions holding that income losses resulting from the pandemic and orders are covered under these business interruption policy provisions. By current estimates, courts across the country have denied fifty-four motions to dismiss in favor of policyholders and denied one summary judgment motion in favor of policyholders, and at least ten policyholder summary judgment motions have been granted. *Id.*

Although the overwhelming majority of decisions have favored insurance carriers on this issue, the battle still rages. And while the pro-insurer decisions are excellent guideposts for insurers and their outside counsel facing COVID-19 business interruption claims, there is also much that we can learn from the pro-policyholder decisions and the arguments that those courts found compelling.

Lessons Learned

1) Venue Considerations

The federal forum has undoubtedly favored insurers. It is estimated that of all cases filed, 90% of cases filed in federal courts have been decided in favor of the insurer, as compared to 75% of cases filed in state courts. Judy Greenwald, *Early COVID-19 rulings tilt to insurers*, Business Insurance (Sept. 21, 2021), https://www.businessinsurance.com/article/20210901/NEWS06/912344081/Early-COVID-19-business-interruption-court-rulings-tilt-to-insurers-; *see supra* Baker, *Covid Coverage Litigation Tracker*. Specifically, of the approximately 486 motions to dismiss (or motions for judgment on the pleadings) granted in favor of carriers, federal courts account for roughly 402 of those pro-carrier decisions, whereas state courts account for only eighty-four pro-carrier decisions. Of the few motions to dismiss (or motions for judgment on the pleadings) denied in favor of policyholders, state courts account for thirty-two pro-policyholder decisions as compared to the twenty-two pro-policyholder decisions in federal courts. Perhaps

one of the most telling metrics is the motion for summary judgment. All but one of the pro-policyholder decisions on summary judgment motions have been granted in state court.

	Virus exclusion in policy		No virus exclusion in policy	
	State Court	Federal Court	State Court	Federal Court
MTD granted	376		179	
	57	319	40	139
MTD denied	26		31	
	13	13	19	12
Insurer MSJ granted	24		11	
	12	12	7	4
Insurer MSJ granted in part	1		3	
	0	1	2	1
Policyholder MSJ granted in part	3		7	
	2	1	7	0

Source: Baker, Covid Cov. Lit. Tracker 1

Legal scholars and experts have not reached a clear consensus as to the reason for the discrepancy between state and federal court decisions, but the pattern is worthy of note as it may be in the best interest of carriers to remove to federal court as soon as possible. For example, in some places, state courts have denied insurance company motions to dismiss while federal courts located in those same states have granted such motions (i.e., California, Florida, New Jersey, North Carolina, Ohio, Pennsylvania, and Texas). This intra-state discordance among the jurisdictions may be explained by a number of variables, including variations in policy language (i.e., the presence or absence of a virus exclusion or an anti-concurrent causation clause), differences in state and federal motion to dismiss/demurrer standards, and state specific doctrines (i.e., regulatory estoppel in New Jersey).

Accordingly, it is incumbent upon counsel for insurers to know the venue and assess or adjust their defense strategy to include a timely removal, if prudent and possible.

2) Loss of Use Arguments

One of the common arguments policyholders make in COVID-19 business interruption litigation is that the use of the conjunction "or" in the "direct physical loss of or damage to" indicates that "direct physical loss of" and "damage to" provide alternative means of coverage. Several courts have accepted this argument, concluding that "physical loss" must not be synonymous with "physical damage" to avoid rendering one of the terms as surplusage or duplicative. That is, the inclusion of both terms in the coverage provision indicates that the drafters of the policies intended that the term "physical loss" has a different meaning than

"damage to" such as to broaden the scope of coverage. *See* Order at 4, *Hill & Stout PLLC v. Mut. of Enumclaw Ins. Co.*, No. 20-2-07925-1 SEA (Wash. Sup. Ct., Nov. 13, 2020); *Studio 417, Inc., et al., v. The Cincinnati Ins. Co.*, 478 F. Supp. 3d 794, 802 (W.D. Mo. 2020) ("[T]he Policies provide coverage for 'accidental physical loss ***or*** accidental physical damage.' Defendant conflates 'loss' and 'damage' in support of its argument that the Policies require a tangible, physical alteration. However, the Court must give meaning to both terms.").

These courts have found that the dictionary definition of the word "loss" typically includes terms or phrases such as "deprivation" and/or "the act of losing possession". *See Blue Springs Dental Care, LLC, et al., v. Owners Ins. Co.*, 488 F. Supp. 3d 867, 873-74 (W.D. Mo. 2020); Mem. & Order at 11, *Timothy A. Ungarean, DMD, et al., v. CNA and Valley Forge Ins. Co.*, No. GD-20-006544, 2021 Pa. Dist. & Cnty. Dec. LEXIS 2, at *13-14 (Pa. Com. Pl. Mar. 22, 2021). Thus, these courts have concluded that the phrase "direct physical loss" includes the insureds' inability to use or possess something physical, real, tangible, or material, resulting from the alleged cause (with or without the intervention of other conditions, depending on the causation language in the policy) – such that the insured's inability to use its space as intended constitutes a physical loss. *See* Order & Op. at 6-7, *The Cherokee Nation et al., v Lexington Ins. Co., et al.*, No. CV-20-150 (Cherokee Cty., Okla., Jan. 29, 2021).

For example, in *Brown's Gym, Inc. v. The Cincinnati Insurance Company*, the Pennsylvania state court judge overruled the carrier's demurrer, finding that the insured's specific averments that the "continuous presence" of the virus on the insured premises rendered the property "unusable, unsafe, inaccessible, and unfit for its intended use" alleged "direct physical loss or damage" to its property were sufficient to trigger business interruption coverage. *Brown's Gym, Inc. v. The Cincinnati Ins. Co. et al.*, No. 20-CV-3113, 2020 WL 7646364, at *2, 7 (Pa. Com. Pl., July 13, 2021).

Additionally, courts have found sufficient allegations of "physical loss" when the policyholders have asserted that the on-site service restrictions ordered by the government-imposed shutdowns forced a physical limitation on the insureds' ability to use (at least partially) their physical space. *See* Mem. Op. & Order at 21, *In re: Soc'y Ins. Co. COVID-19 Bus. Interruption Prot. Ins. Litig.*, MDL No. 2964, No. 20 C 5965 (N.D. Ill. Feb. 22, 2021) (order partially denying insurer's motions to dismiss and summary judgment motions targeting claims for business interruption coverage).

Other courts have held that the differing interpretations of "physical loss" advocated by insurers and policyholders means, at best, that the language is susceptible to multiple reasonable interpretations, and therefore, is ambiguous in its construction. *See*, *Hill & Stout PLLC*, Order at 4-5. Thus, they have interpreted the language in favor of coverage and ruled for policyholders.

The most important take away from these cases is that insurer-side counsel must be prepared to provide to the court an interpretation of the phrase "direct physical loss of or damage to" that is persuasive and non-repetitive. The first line of attack on this argument is to explain to courts how the phrase "direct physical loss of or damage to" is not repetitive. For example, when a fire completely destroys a building, it is more common parlance to say that the building was a loss, versus the building was damaged. As such, the phrase is not repetitive, but merely describes the array of undesirable events – "loss of or damage to" – which the policy covers. Further, applying standard rules of grammar, the word "physical" modifies both "loss of" and "damage to", requiring some physical alteration of property for this insuring phrase to be triggered. And moreover, a close examination of the facts (as existing and/or as alleged in the complaint) is appropriate to determine whether there was any actual loss of the policyholder's ability to use the property – especially in those cases where a court is inclined to follow the reasoning of those pro-policyholder cases discussed above.

3) Physical Damage Arguments

In response to arguments on the carrier side that there must be some physical alteration of property to trigger coverage for "direct physical loss of or damage to" property, policyholders have also creatively argued that SARS-COV2 (the virus that causes COVID-19) in fact causes physical alteration to property. Insureds seeking coverage have pointed to the actual physical nature of the virus and emphasized that the "physical loss or damage" requirement has been met because coronavirus particles in the air or surfaces on their premises have forced closures by attaching to and damaging their property. Mem. & Order at 8, *SWB Yankees, LLC v. CNA Fin. Corp.*, No. 20-CV-2155 (Pa. Com. Pl., Aug. 4, 2021); *Brown's Gym, Inc.*, Mem. & Order at 3.

For example, in *Studio 417 v. The Cincinnati Insurance Company*, the policyholders sought coverage for losses incurred when the pandemic and the resulting government shutdown orders forced the closure of their hair salons and restaurants. The federal district court denied the carrier's motion to dismiss and rejected its argument that the insureds failed to adequately allege a "physical loss" because "direct physical loss requires actual, tangible, permanent, physical alteration of property." *Studio 417, Inc.,* 478 F. Supp. 3d at 800-03. In a win for policyholders, the court ruled that the insureds had sufficiently alleged that COVID-19 particles attached to and damaged their property such as to constitute "physical damage" and that the insureds also met the "physical loss" requirement by asserting that the presence of the physical virus at the premises rendered the property unsafe and unusable. *Id.* at 802-03.

Additionally, courts have found that allegations of physical alterations to the insureds' premises (i.e., the installation of social distancing barriers and sanitization stations, and the removal of service stations or workstations to comply with social distancing restrictions) qualify as distinct, demonstrable, or physical changes such

as to constitute "physical loss or damage to" the insureds' premises thereby triggering business interruption coverage. *See P.F. Chang's China Bistro v. Certain Underwriters at Lloyd's of London*, No. 20STCV17169, 2021 Cal. Super. LEXIS 10, at *2 (Cal. Super. Ct. Feb. 4, 2021).

In responding to these arguments, insurer-side counsel should be prepared to re-focus courts on the true nature of these losses – viruses (which have existed in various forms from the dawn of recorded history) damage people, not property. Further, it is important to draw the distinction for courts between preventative measures implemented to reduce the spread of disease (such as installing a soap dispenser in a bathroom) – which do not in themselves constitute a physical loss of or damage to property – versus actual physical loss of or damage to premises.

Insurer-side counsel should also examine the allegations of the policyholder complaints carefully to determine whether they allege that coronavirus was demonstrably present at the policyholder's premises versus a mere threat of contamination. Where there is no indication that coronavirus was ever actually present, courts are less likely to find that there has been some physical alteration of the premises. Moreover, even where policyholders have alleged that coronavirus was physically present on their property, insurer-side counsel should be prepared to argue that the need to disinfect the property (or otherwise clean it to kill the virus) is not sufficient to constitute direct physical loss of or damage to property. *See Mortar & Pestle Corp. v. Atain Spec. Ins. Co.*, No. 20-cv-03461-MMC, 2020 U.S. Dist. LEXIS 240060, *10-11 (citing *Mama Jo's, Inc. v. Sparta Ins. Co.*, No. 17-cv-23362-KMM, 2018 U.S. Dist. LEXIS 201852 (S.D. Fla. June 11, 2018) (holding that where dust that infiltrated the insured's restaurant could be wiped down and cleaned, there was no "direct physical loss")); *see also Universal Image Productions, Inc. v. Fed. Ins. Co.*, 475 F. App'x 569, 574 (6th Cir. 2012) (holding that policyholder was not entitled to recover lost business income where it temporarily vacated its premises to clean and remediate microbial contamination because it "did not suffer any tangible damage to physical property" as a result of the mold and bacterial contamination); *Mastellone v. Lightning Rod Mut. Ins. Co.*, 884 N.E.2d 1130 (Ohio Ct. App. 2008) (finding that mold which could be removed by cleaning was not physical damage, as it did not alter or otherwise affect the structural integrity of the building's siding).

4) Civil Authority: Partial or Complete "Prohibitions" of "Access"

In addition to the "direct physical loss of or damage to" property issue discussed above (which also rears its head in the context of civil authority coverage), a conflict exists among courts over what constitutes the necessary "prohibition" of "access" to trigger civil authority coverage.

Coverage under the civil authority provision centers on whether "access" to the insureds' premises was truly "prohibited" by the specific government order(s) identified in each complaint. Some courts have ruled that the civil authority

provision does not specify that *all* access to the premises be completely or absolutely prohibited. Order at 11, *Dino Palmieri Salons, Inc. v. State Automobile Mutual Ins. Co.*, No. CV-20-932117 (Ohio Ct. Com. Pl., Cuyahoga County, Nov. 17, 2020). For example, in *Studio 417*, although the court found that the insured restaurants' access to their premises was "prohibited" by the closure orders – even though the insured restaurants could still operate drive-thru, pickup, or delivery services – the court allowed the claim to proceed because the civil authority provision did not specify that *all* access or *any* access to the premises be prohibited. *Studio 417, Inc.,* 478 F. Supp. 3d at 804.

Careful examination of the language of the government order at issue is imperative. Although some orders incident to the pandemic have mandated the shutdown of particular businesses, commonly, the order of civil authority is more in the nature of an advisory or voluntary evacuation. Often access is not barred or prohibited but, rather, is discouraged. Additionally, some orders are not directed at policyholders at all and merely provide cautionary instructions to citizens. Or similarly, orders make exceptions for certain types of businesses (e.g., critical infrastructure sectors) such that the order does not apply to the policyholder's business at all. Insurers may find it beneficial to argue that a policyholder's voluntary closure due to concerns of the spread of the virus among employees or patrons is a business judgment decision of the insured, which no matter how sensible, will not provide a basis for civil authority coverage.

5) The Absence of a Virus Exclusion or the Ambiguity in the Virus Exclusion.

Where the virus exclusion is present, the vast majority of courts have held that it operates to bar recovery for COVID-19-related business shutdowns. Two particular issues have emerged over the presence or absence of policy exclusions for losses arising from virus or bacteria. First, some policyholders argue that because a virus exclusion exists, in general, the absence of the exclusion from a policy means that the policy provides coverage. Some courts have found that argument persuasive. *See In re: Soc'y Ins. Co. COVID-19 Business Interruption Prot. Ins. Litig.*, Mem. Op. & Order at 24 n. 6.

Second, while a virus exclusion may improve the insurer's likelihood of dismissing the insureds' claims at the pleading stage, the presence of a virus exclusion does not guarantee an insurer's success. A few courts have found that the specific virus exclusions included in some policies do not clearly and unambiguously apply to bar coverage as required under traditional principles of contract interpretation. *See Urogynecology Specialist of Florida, LLC v. Sentinel Ins. Co.,* 489 F. Supp. 3d 1297, 1302 (M.D. Fla. 2020); *Susan Spath Hegedus, Inc. v. Ace Fire Underwriters Ins.*, No. 20-2832, 2021 U.S. Dist. LEXIS 88041, at *34 (E.D. Pa. May 7, 2021) (finding that the insurer failed to establish that the virus exclusion applied because the structure and organization of the policy created ambiguity and uncertainty as to

whether the virus exclusion in part B of the policy applied to the additional coverages for business income and extra expense coverage in part A of the policy).

Notably, in *McKinley Development Leasing Company Ltd., et al. v. Westfield Insurance Company*, the court found that the virus exclusion did not apply to bar coverage because the insured alleged that its damages were the result of a pandemic and the corresponding government shutdown orders rather than a virus itself. *McKinley Development Leasing Company Ltd., et al. v. Westfield Ins. Co.*, No. 2020-CV-00815, 2021 WL 506266, at *5 (Ohio. Com. Pl., Stark County, Feb. 9, 2021). Reasoning that the insurer, as the drafter, could have, but failed to, explicitly exclude a "pandemic" from coverage if it so intended, the court concluded that the virus exclusion was open to more than one reasonable interpretation, and thus not specific or exact enough in its use to clearly exclude the insurer from liability. *Id.*

Facially, the virus exclusion will generally bar coverage for loss or damage allegedly caused by contamination from the novel coronavirus without regard to whether the coronavirus has caused a pandemic. However, insurers must be sure to include all relevant provisions of the policy, including all endorsements (and the sections modified by the endorsements), and provide the court with a clear picture of how the policy provisions and exclusions coincide to avoid potential ambiguities in the policy structuring and organization.

Moreover, carrier-side counsel should consider the policyholder's arguments regarding physical damage, as these are often inconsistent with arguments offered with respect to the virus exclusion. For example, a policyholder may argue that their property has sustained physical damage due to the presence of coronavirus particles on the premises, while at the same time arguing that civil authority coverage is triggered by government shutdown orders related to a pandemic, rather than the virus itself.

Reading Ahead: Appeals

Of course, trial court decisions may ultimately mean very little if overturned by appellate courts. To date, approximately 202 appeals are pending (or have been decided) in the federal appellate courts, and nearly 63 appeals are pending (or have been decided) in state appellate courts. Tom Baker, *Covid Coverage Litigation Tracker: Appeals*, U. Pa., https://cclt.law.upenn.edu/appeals/. (last visited Oct. 5, 2021). Of note, the U.S. Courts of Appeals for the Third and Ninth circuits have been the most popular venues for appeals to date, with more than a dozen pending in each.

Several recent appellate decisions indicate that policyholder arguments that have met with success at the trial court level may not carry water on review by appeals courts. For example, in *Santo's Italian Café LLC v. Acuity Insurance Company*, the Sixth Circuit recently held that the plain meaning of "direct physical loss of or damage to" property is unambiguous and provides no coverage for business-

interruption losses resulting from the coronavirus and the pandemic-related government shutdown orders. *Santo's Italian Café LLC v. Acuity Insurance Company*, No. 21-3068, — F.4th —, 2021 WL 4304607 (6th Cir. Sept. 22, 2021) (applying Ohio law) The insured's "loss of use" argument, the court held, "skates over the unrelenting imperative that the policy covers only 'physical' losses." *Id.* at *5.

The Sixth Circuit also recently vacated portions of the trial court's order in *Henderson Road Restaurant Systems, Inc. v. Zurich American Insurance Co.*, 2021 WL 168422, at *1 (N.D. Ohio Jan. 19, 2021) (a pro-policyholder decision that concluded that the phrase "direct physical loss of or damage to property" is ambiguous). Relying on its holding in *Santo's Italian Café*, the court remanded the case for further proceedings consistent with its holding that "a pandemic-triggered government order, barring in-person dining at a restaurant" does not qualify as "'direct physical loss of or damage to' the property" under Ohio law. *In re: Zurich Am. Ins. Co.*, Case No. 21-302 (6th Cir. Sept. 29, 2021).

Likewise, the Eleventh Circuit also recently held that neither the COVID-19 pandemic nor shelter-in-place orders caused "physical loss or damage to" the insured's dentistry practice. *Gilreath Family & Cosmetic Dentistry, Inc. v. Cincinnati Ins. Co.*, No. 21-11046, — F. Appx. —, 2021 WL 3870697, at *2 (11th Cir. Aug. 31, 2021) (applying Georgia law).

Similarly, in *Oral Surgeons, P.C. v. Cincinnati Ins. Co.*, No. 20-3211, 2 F.4th 1141, 1144 (8th Cir. July 2, 2021) (applying Iowa law), the Eighth Circuit affirmed the Iowa district court's decision to dismiss the policyholder's complaint, reasoning that dismissal was warranted where the policy required direct "accidental physical loss or accidental physical damage" and the complaint did not allege any physical alteration of property. *Id.* The court found that the insured's general allegation pleading "that Oral Surgeons suspended non-emergency procedures due to the COVID-19 pandemic and the related government-imposed restrictions" failed to show that the insured's property suffered physical loss or damage.

In early October 2021, the Ninth Circuit, in *Mudpie Inc. v. Travelers Casualty Insurance Company of America*, unanimously affirmed the federal district court's decision holding that COVID-19 related business interruption losses are not insured by property policies covering "direct physical loss of or damage to" property. *Mudpie, Inc. v. Travelers Casualty Ins. Co. of Am.*, Case No. 20-16858, --- F.4th ---, (9th Cir. Oct. 1, 2021) (applying California law). The court rejected the policyholder's efforts to convert claims for purely economic losses into claims for "physical loss of or damage to" covered property and ruled that the physical properties of policyholder's premises were not altered by the government orders, the policyholder suffered no covered loss. The court also ruled that other policy provisions – such as the period of restoration – underscored that only "physical" losses triggered coverage. The court concluded that if no physical injury were required, the "period of restoration" was surplusage. Lastly, applying California's

"efficient proximate cause" rule the court also held that the virus exclusion barred coverage because the coronavirus prompted the government orders closing the policyholder's business.

The Ninth Circuit then immediately applied *Mudpie* in *Selane Products, Inc. v. Continental Casualty Company*, Case No. 21-55123 (9th Cir. Oct. 1, 2021) to affirm the dismissal of a putative class action seeking coverage for COVID-19 business interruption losses under substantially identical policy language. The court found significant that the insureds failed to plead that the coronavirus was present on, or actually resulted in "physical alterations" to the insured. The court rejected the insured's argument that the policy's microbe exclusion shows that microscopic organisms could cause "physical loss of or damage to" property and, therefore, by extension so could viruses. The court found that insureds also failed to state a claim for civil authority coverage because the coronavirus caused no physical loss or damage.

While the federal appellate courts are so far trending heavily in favor of insurers, it is yet to be seen how state high courts will respond on these arguments. These early federal appellate decisions may also spur a barrage of motions to certify in light of the tepid reaction of federal appellate courts to policyholder arguments in favor of coverage.

Conclusion

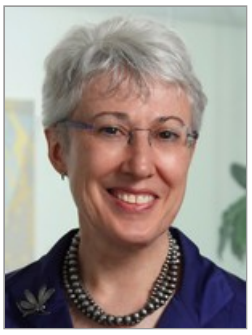
While insurers have won the lion share of COVID-19 business interruption coverage disputes, policyholders have had a few, but informative, wins. The decisions in those cases provide good intelligence to insurer-side lawyers as to how to refine and craft their future arguments - especially on appeals from those policyholder wins.

LAW360

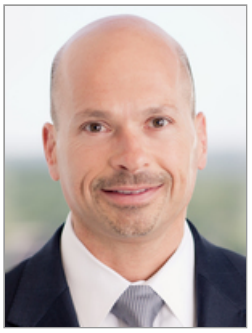
Portfolio Media. Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Federal Courts Make 2 Basic Errors In Virus Coverage Rulings

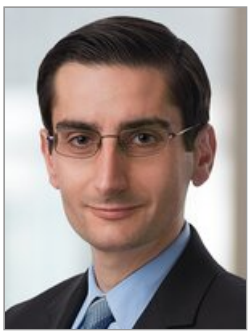
By **Lorelie Masters, Michael Levine and Nicholas Stellakis** (September 30, 2021, 4:43 PM EDT)



Lorelie Masters



Michael Levine



Nicholas Stellakis

Something odd is going on in the federal courts in COVID-19 coverage cases. As of late September, insurers have won 95% of the rulings in federal courts.[1] In contrast, policyholders have had considerably greater success in state courts.[2]

To be sure, conventional wisdom suggests that policyholders, which are typically plaintiffs, fare better in state courts,[3] but can that account for a significant disparity in state and federal court results?

Perhaps more importantly, most of the policyholder losses, in both federal and state courts, are on motions to dismiss or motions for judgment on the pleadings. Yes, this has happened in cases that allege only conclusory or threadbare statements; however, it has also happened in cases where complaints are replete with disputed factual allegations.

In our experience, most coverage cases, which, after all, focus principally on a written contract, survive a motion to dismiss or motion for judgment on the pleadings on considerably less factual information about the underlying claim or event than is currently being rejected by courts and particularly by federal courts as insufficient, conclusory or just plain implausible.

We posit that these anomalies arise from two fundamental errors recurring throughout the federal district courts: the Erie error and the Twombly-Iqbal error.[4] Acknowledging these errors is especially important in our view as decisions on coverage for COVID-19 losses proceed in the appellate courts.

Federal courts commit the Erie error when they simply cite other federal decisions — often from outside their respective forum state — as a basis for dismissal rather than citing and following governing state decisional law. This is problematic, because insurance coverage is a quintessential state-law issue. Federal judges must follow and apply state law when analyzing the relevant policy language and not simply cite, uncritically, decisions by colleagues on the bench from cases under different facts and different state law.

Federal courts, and state courts following a similar standard, commit the Twombly-Iqbal error when they decide the truth or falsity of facts rather than accept as true the plausible facts as alleged in the complaint for purpose of a motion on the pleadings. The burden of proof on a motion to dismiss is on the moving defendant, since all factual allegations must be construed, and all reasonable inferences must be drawn, in favor of the nonmoving party under Federal Rules of Civil Procedure 12(b)(6) and 12(c).

This necessarily precludes a court from injecting its own personal experience or belief when that experience or belief conflicts with the well-pleaded facts and derivative reasonable inferences.

From the very outset of COVID-19 insurance coverage litigation, many judges have disregarded these fundamental, black-letter, settled principles. To illustrate, in one case, a federal judge made an off-the-cuff comment that the virus "damages lungs. It doesn't damage printing presses [the

insured's property]."[5]

This passing remark, made with no evidence, in the context of a preliminary injunction hearing just days into the pandemic, has served as the springboard for federal judges to follow one another instead of accepting well-pleaded facts and reasonable inferences, all to the effect of precluding consideration of actual evidence, including expert opinions.

In this article, we will seek to outline these two errors as they are occurring in COVID-19 insurance coverage cases pending across the country.

The Erie Error

We all know Erie Railroad Co. v. Tompkins[6] from the canon of first-year civil procedure courses: federal courts, sitting in diversity, must apply state law. They cannot ignore pertinent authority from their forum state, which takes precedence over federal authority and out-of-state cases.

Erie presumes that a federal court sitting in diversity should reach the same result as would the forum state's courts.[7] Erie requires federal courts to look to a final decision of a state's highest court and, if none, then to predict how that court would decide the issue.

But an Erie prediction is not a shot in the dark: a "state is not without law save as its highest court has declared it."[8] Indeed, "[t]here are many rules of decision commonly accepted and acted upon by the bar and inferior courts which are nevertheless laws of the state although the highest court of the state has never passed upon them."[9]

Under Erie, federal courts are bound to consider the several sources of state law before turning for inspiration to decisions of other federal courts. They must not do what they think best or what a respected judge in another federal district court thought made sense in another case, with different parties, different facts, possibly different policy language — and different applicable law.

Rather, they are bound to do what the state supreme court in the state in which that court, sitting in diversity, would consider best.[10] This methodology — scouring state-law sources for state high court intent — preserves Erie's underlying objective: that federal courts sitting in diversity operate as neutral forums that follow their forum states' laws.

Yet in the COVID-19 context, federal courts are not abiding by Erie. An example of this comes from the U.S. Court of Appeals for the Eleventh Circuit's August 2020 decision in Mama Jo's Inc. v. Sparta Insurance Co., the facts of which predate COVID-19.[11] This unpublished decision, purportedly applying Florida law and decided upon summary judgment, considered whether construction dust caused "direct physical loss of or damage to" insured property.

As of this writing, over 80 federal courts inside and outside Florida have cited it for the proposition that COVID-19, much like the dust in Mama Jo's, is temporary and can be eliminated by "routine cleaning and disinfecting."[12]

For instance, in Bourgier v. Hartford Casualty Insurance Co., the U.S. District Court for the Southern District of Florida recently found Mama Jo's more instructive than a Florida state court decision.[13] It quoted Mama Jo's for the conclusion that "under Florida law, an item or structure that merely needs to be cleaned has not suffered a 'loss' which is both 'direct' and 'physical.'"[14] Meanwhile, it rejected Azalea Ltd. v. American States Insurance Co., a case from the Florida District Court of Appeals for the First District that found an insured sufficiently alleged physical loss to property despite the lack of physical alteration to it.[15]

As each court cites to the one before it, the Erie errors compound.[16] Federal courts nationwide are making critical coverage decisions — in the context of motions to dismiss — without making serious efforts to determine and apply the coverage law of their forum states and predict how those states' courts would decide the issue.

Instead, despite even acknowledging their duty to apply state law, sometimes these federal courts are still determining coverage by following federal courts in other jurisdictions that have made the same Erie error.[17] This amounts to the development of a federal general common law of insurance

coverage — a result outlawed since 1938 when the U.S. Supreme Court in Erie overruled Swift v. Tyson.[18]

The Twombly-Iqbal Error

Federal courts are also usurping the role of the fact-finder and inappropriately making factual determinations on motions to dismiss. Rather than apply the Twombly-Iqbal plausibility standard,[19] federal courts are routinely disregarding factual allegations that COVID-19 causes direct physical loss of or damage to the insureds' property. By making factual determinations different from the allegations in a complaint, these courts are commandeering the jury's role.

A complaint, per Federal Rules of Civil Procedure, Rule 8(a)(2), need only contain "a short and plain statement of the claim showing that the pleader is entitled to relief."[20] According to the U.S. Supreme Court's 2007 decision Bell Atlantic Corp. v. Twombly and its 2009 decision Ashcroft v. Iqbal, this "short and plain statement" should provide enough detail to "give the defendant fair notice of what the ... claim is and the grounds upon which it rests."[21]

Under Iqbal, the court must accept as true all factual allegations that are not legal conclusions or "[t]hreadbare recitals of the elements of a cause of action,"[22] and it must construe them in the light most favorable to the plaintiff.[23] The court must do so whether or not the court believes them, finds them incredible or believes that — as the U.S. Court of Appeals for the First Circuit noted in its 2011 decision Ocasio-Hernandez v. Fortuno-Burset —"proof of [the] facts is improbable."[24]

Per the U.S. Court of Appeals for the Ninth Circuit in its 2008 decision In re: Gilead Sciences Securities Litigation, this is because "a district court ruling on a motion to dismiss is not sitting as a trier of fact."[25]

A complaint that is well-pleaded must be allowed to proceed even if the judge believes, per the Gilead court, "that actual proof of those facts is improbable, and that a recovery is very remote and unlikely."[26] That is because "the court's skepticism is best reserved for later stages of the proceedings."[27]

For these reasons, a judge may not dismiss a complaint just because he or she disbelieves the factual allegations,[28] nor may the judge "attempt to forecast a plaintiff's likelihood of success on the merits" as discussed by the Ocasio-Hernandez court.[29]

The court should also draw all reasonable inferences in favor of the plaintiff.[30] Per the U.S. Court of Appeals for the First Circuit's 2013 Evergreen Partnering Group Inc. v. Pactiv Corp. decision, it may not choose between two plausible inferences that may be drawn from factual allegations, because it is not the court's role, at the pleading stage, to decide, "which inferences are more plausible."[31]

In short, the court may not engage in fact-finding on a motion to dismiss. Yet, this is exactly what courts are doing here. In the face of well-pleaded complaints that allege that the COVID-19 virus cause physical loss and damage to property, courts are finding — at the motion to dismiss stage — just the opposite: There is no possible way that the virus can cause physical loss or damage.

The example given previously[32] remains paradigmatic, where an off-hand remark by a judge that the virus damages lungs and not printing presses during a hearing on a preliminary injunction just days into the pandemic has been elevated to gospel by insurers and found its way into many decisions dismissing complaints.[33] Other impermissible factual findings by federal courts include the following:

- In Sandy Point Dental PC v. Cincinnati Insurance Co., decided Sept. 21, the U.S. District Court for the Northern District of Illinois, Eastern Division noted: "[T]he coronavirus does not cause physical damage."[34]
- The U.S. District Court for the District of Kansas in Promotional Headwear International v. Cincinnati Insurance Co. decided on Dec. 3, 2020, cited that "routine cleaning and disinfecting can eliminate the virus on surfaces."[35]

- According to the U.S. District Court for the Southern District of Florida in Town Kitchen LLC v. Certain Underwriters at Lloyd's decided on Feb. 26: "[T]he deadly coronavirus" can be eliminated "with Lysol and a rag. [I]t is widely accepted that life can go on with hand sanitizer and disinfecting wipes."[36]

- In BN Farm LLC v. The Cincinnati Casualty Co. decided on Sept. 16, the U.S. District Court for the District of Massachusetts found: "Unlike an odor, the presence of COVID-19 is undetectable and cleaning surfaces with certain disinfectants can deactivate or eliminate the virus,"[37] and that a virus is "incapable of damaging physical structures because 'the virus harms human beings, not property.'"[38]

These conclusions are inappropriate. Judges are not scientists, and should not make factual, scientific conclusions.

There are encouraging signs that the tide is turning. As Connecticut Superior Court Judge Thomas Moukawsher recently said in New Castle Hotels LLC v. Zurich American Insurance Co.:

> We do know a lot about viruses — but this one? We are learning something new every day. The court simply can't take notice at this stage that the virus does not degrade physical objects on at least a microscopic level. That question will have to wait for another day—on summary judgment perhaps or after trial. What matters for now is that physical damage is specifically alleged here. … The rush to judgment … without reasoning and without evidence — has been ill-advised.[39]

Conclusion

Insurers tout the box score in support of their arguments to nullify business interruption coverage for COVID-19 losses. The box score argument is simplistic and obscures the truth, because it is based on federal courts committing either the Erie error or the Twombly-Iqbal error — and, in some cases, both — in many of those decisions. Federal courts sitting in diversity must adhere to the law and defer to the judgment of state courts, the true arbiters of the law on insurance, and to juries, the arbiters of factual disputes.

State courts considering appeals of COVID-19 coverage decisions should disregard federal court decisions that neglect Erie on an issue that is predominantly one of state law and regulation and that bypass their fundamental duty to leave factual questions to the trier of fact.

Lorelie S. Masters and Michael S. Levine are partners, and Nicholas Stellakis is counsel, at Hunton Andrews Kurth LLP.

Hunton associate Rachel Hudgins contributed to this article.

Disclosure: Hunton submitted an amicus brief to the U.S. Supreme Court on behalf of United Policyholders in support of the certiorari petition in the Mama Jo's matter discussed above. Hunton represents Legal Sea Foods in Legal Sea Foods v. Strathmore referenced in footnote 34.

[1] See Ins. L. Ctr., U. Pa. Carey L. Sch., Covid Coverage Litigation Tracker, https://cclt.law.upenn.edu/ (last visited Sept. 23, 2021) ("UPenn COVID Coverage Tracker").

[2] These percentages are based on statistics from the UPenn COVID Coverage Tracker on trial courts' merits rulings in cases in federal courts, on the one hand; and state courts, on the other. The UPenn COVID Coverage Tracker compiles statistics on decisions on motions to dismiss in COVID-19 coverage cases in the following categories: (i) full dismissal with prejudice, (ii) partial dismissal with

prejudice, (iii) full dismissal without prejudice, and (iv) partial dismissal without prejudice. We added all dismissals and compared that total to the number of cases in which a motion to dismiss had been denied. The vast majority of cases in federal court have been dismissed with prejudice.

[3] Christopher A. French, Forum Shopping COVID-19 Business Interruption Insurance Claims, 2020 U. Ill. L. Rev. Online 187, 189, 192-93 (2020).

[4] Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007); Ashcroft v. Iqbal, 556 U.S. 662 (2009). Most federal courts have disposed of policyholders' claims under Rule 12(b)(6) motions to dismiss for failure to state a claim, but a minority of decisions were issued in response to Rule 12(c) motions for judgment on the pleadings. Motions under Rules 12(b)(6) and 12(c) are governed by the same standard, defined in Twombly and Iqbal.

[5] Soc. Life Magazine, Inc. v. Sentinel Ins. Co., Ltd., No. 20 Civ. 3311(VEC), 2020 WL 2904834 (S.D.N.Y. May 14, 2020).

[6] Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938) (Erie).

[7] Guar. Tr. Co. of N.Y. v. York, 326 U.S. 99, 111 (1945).

[8] West v. Am. Tel. & Tel. Co., 311 U.S. 223, 236 (1940).

[9] Id.

[10] See, e.g., id. at 236-37. Federal courts exercise jurisdiction in these cases under 28 U.S.C. § 1332, which provides for diversity-of-citizenship jurisdiction.

[11] Mama Jo's Inc. v. Sparta Insurance Co., 823 F. App'x 868 (11th Cir. 2020).

[12] Promotional Headwear Int'l v. Cincinnati Ins. Co., 504 F. Supp. 3d 1191, 1203-04 (D. Kan. 2020) ("Moreover, even assuming that the virus physically attached to covered property, it did not constitute the direct, physical loss or damage required to trigger coverage because its presence can be eliminated. Much like the dust and debris at issue in Mama Jo's, routine cleaning and disinfecting can eliminate the virus on surfaces.").

[13] Bourgier v. Hartford Cas. Ins. Co., No. 21-21053-CIV-MORENO, 2021 WL 3603601, at *4 (S.D. Fla. Aug. 12, 2021).

[14] Id. (quoting Mama Jo's, 823 F. App'x at 879).

[15] Id. at *5-6 (citing Azalea, Ltd. v. Am. States Ins. Co., 656 So. 2d 600, 602 (Fla. 1st DCA 1995).

[16] Our firm filed an amicus brief in support of the policyholder's petition for certiorari to the US Supreme Court in Mama Jo's, in part on this Erie Error. Amicus Curiae Brief of United Policyholders in Support of Petition and Reversal, Mama Jo's, Inc. v. Sparta Ins. Co., No. 20-998, 2021 WL 809356 (U.S. Feb. 25, 2021). Our brief explained how, among other errors, the Eleventh Circuit mischaracterized the loss suffered by Mama Jo's, which actually required heavy physical remediation and repainting, and loss of or damage to mechanical and audio systems and outdoor lighting. Id. at *4-5. This factual error has been compounded, as insurers cite to the case for the principle that substances that can be eliminated by "routine cleaning and disinfecting" have not caused, and cannot ever cause, direct physical loss or damage under first-party property insurance policies. Tappo of Buffalo, LLC v. Erie Ins. Co., No. 20-CV-754V(Sr), 2020 WL 7867553, at *4 (W.D.N.Y. Dec. 29, 2020) (quoting Promotional Headwear Int'l v. Cincinnati Ins. Co., 504 F. Supp. 3d 1191, 1203-04 (D. Kan. 2020)).

[17] E.g., Sandy Point Dental, PC v. Cincinnati Ins. Co., 488 F. Supp. 3d 690, 693-94 (N.D. Ill. 2020), recons. denied, No. 20 CV 2160, 2021 WL 83758 (N.D. Ill. Jan. 10, 2021) (relying, for substantive analysis, on federal decisions, mostly outside of forum state); Palmdale Estates, Inc. v. Blackboard Ins. Co., No. 20-CV-06158-LB, 2021 WL 25048 (N.D. Cal. Jan. 4, 2021) (citing not a single state-court decision); Jonathan Oheb MD, Inc. v. Travelers Cas. Ins. Co. of Am., No. 2:20-

CV-08478-JWH-RAOx, 2020 WL 7769880, at *3-4 (C.D. Cal. Dec. 30, 2020) (relying on federal precedent for substantive analysis): Sun Cuisine, LLC v. Certain Underwriters at Lloyd's London, No. 1:20-CV-21827-GAYLES/OTAZO-REYES, 2020 WL 7699672, at *3-4 (S.D. Fla. Dec. 28, 2020) (citing a single forum-state decision for general principle and otherwise relying only on federal precedent from inside and out of forum state); SA Palm Beach LLC v. Certain Underwriters at Lloyd's, London, 506 F.Supp.3d 1248, 1251-55 (S.D. Fla. 2020) (relying only on federal authority for substantive analysis); Geragos & Geragos Engine Co. No. 28, LLC v. Hartford Fire Ins. Co., No. CV 20-4647-GW-MAAX, 2020 WL 7350413, at *3 (C.D. Cal. Dec. 3, 2020) (relying only on federal authority for substantive analysis).

[18] Swift v. Tyson, 41 U.S. 1 (1842).

[19] Ashcroft v. Iqbal, 556 U.S. 662 (2009); Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).

[20] Fed. R. Civ. P. 8(a)(2).

[21] Twombly, 550 U.S. at 555 (alteration in original) (quoting Conley v. Gibson, 355 U.S. 41, 47 (1957)); see also Richard P. Lewis, Lorelie S. Masters, Scott Greenspan, & Christopher Kozak, Couch's Physical Attention Fallacy: Its Origins and Consequences, Tort, Trial & Ins. L.J. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3916391.

[22] Iqbal, 556 U.S. at 678.

[23] Ariix, LLC v. NutriSearch Corp., 985 F.3d 1107, 1114 (9th Cir. 2021); Disability Rights Mont., Inc. v. Batista, 930 F.3d 1090, 1097 (9th Cir. 2019).

[24] Ocasio-Hernandez v. Fortuno-Burset, 640 F.3d 1, 12 (1st Cir. 2011) (quoting Twombly, 550 U.S. at 556); Hartman v. Gilead Scis., Inc. (In re Gilead Scis. Sec. Litig.), 536 F.3d 1049, 1057 (9th Cir. 2008).

[25] Hartman, 536 F.3d at 1057.

[26] Id. (quoting Twombly, 550 U.S. at 556).

[27] Id.

[28] Ocasio-Hernandez, 640 F.3d at 12 (quoting Neitzke v. Williams, 490 U.S. 319, 327 (1989)).

[29] Id. at 12-13.

[30] Khoja v. Orexigen Therapeutics, Inc., 899 F.3d 988, 1012 (9th Cir. 2018); Nayab v. Capital One Bank (USA), N.A., 942 F.3d 480, 497-99 (9th Cir. 2019).

[31] Evergreen Partnering Grp., Inc. v. Pactiv Corp., 720 F.3d 33, 45 (1st Cir. 2013).

[32] Soc. Life Magazine, Inc. v. Sentinel Ins. Co., Ltd., No. 20 Civ. 3311(VEC), 2020 WL 2904834 (S.D.N.Y. May 14, 2020).

[33] Green Beginnings, LLC v. W. Bend Ins. Co., No. 20-CV-1661, 2021 WL 2210116, at *5 (E.D. Wis. May 28, 2021), appeal filed, No. 2:20-cv-01661 (7th Cir. June 25, 2021), ECF No. 31; see also Food for Thought Caterers Corp. v. Sentinel Ins. Co., No. 20-CV-3418 (JGK), 2021 WL 860345, at *5 (S.D.N.Y. Mar. 6, 2021) (same); Town Kitchen LLC v. Certain Underwriters at Lloyd's, London, No. 20-22832-CIV-MORENO, 2021 WL 768273, at *6 (S.D. Fla. Feb. 26, 2021) (same); Sandy Point Dental, PC v. Cincinnati Ins. Co., 488 F. Supp. 3d 690, 693-94 (N.D. Ill. 2020), recons. denied, No. 20 CV 2160, 2021 WL 83758 (N.D. Ill. Jan. 10, 2021).

[34] Sandy Point Dental, PC488 F. Supp. 3d at 694 n.2; see also Legal Sea Foods, LLC v. Strathmore Ins. Co., No. 20-10850-NMG, 2021 WL 858378, at *3 (D. Mass. Mar. 5, 2021) ("[a] virus is incapable of damaging physical structures" despite allegations in the operative complaint that SARS-CoV-2 damaged insured property by attaching to surfaces and hanging in the indoor air, and that SARS-CoV-2 caused the loss of insured property by rendering it dangerous, unsafe and unfit for its

intended and insured use as a restaurant).

[35] Promotional Headwear Int'l v. Cincinnati Ins. Co., 504 F. Supp. 3d 1191, 1204 (D. Kan. 2020).

[36] Town Kitchen LLC, 2021 WL 768273, at *7. When Judge Federico A. Moreno issued this decision, the U.S. District Court for the Southern District of Florida was under its Eighth Order Concerning Jury Trial and Other Proceedings. That order continued all jury trials until May 2020 and encouraged judges to conduct court proceedings by telephone or video conferencing.

[37] BN Farm LLC v. Cincinnati Cas. Co., No. 1:20-cv-10874-MBB, slip op. at 34 (D. Mass. Sept. 16, 2021) (citing Promotional Headwear, 504 F. Supp. at 1203).

[38] Id., slip op. at 35 (quoting Select Hosp., LLC v. Strathmore Ins. Co., No. 20-11414-NMG, 2021 WL 1293407, at *3 (D. Mass. Apr. 7, 2021)).

[39] New Castle Hotels, LLC v. Zurich Am. Ins. Co., No. X07-HHD-CV-21-6142969-S, slip op. at 5-7 (Conn. Super. Ct. Sept. 7, 2021).

COUCH'S "PHYSICAL ALTERATION" FALLACY: ITS ORIGINS AND CONSEQUENCES

Richard P. Lewis,* *Lorelie S. Masters*,**
*Scott D. Greenspan**** & *Chris Kozak*****

I. INTRODUCTION

Look at virtually any Covid-19 case favoring an insurer, and you will find a citation to Section 148:46 of *Couch on Insurance*.[1] It is virtually ubiquitous: courts siding with insurers cite *Couch* as restating a "widely held rule" on

1. 10A Steven Plitt, et al., Couch on Insurance 3d § 148:46. As shown below, some courts quote *Couch* itself, while others cite cases citing *Couch* and merely intone the "distinct, demonstrable, physical alteration" language without citing *Couch* itself. *Couch 1st* and *Couch 2d* were published in hardback books (with pocket parts), in 1929 and 1959 respectively. As explained below (*infra* n.5), *Couch 3d*, a looseleaf, was first published in 1995.

* *Partner, ReedSmith LLP, New York.*
** *Partner, Hunton Andrews Kurth LLP, Washington D.C.*
*** *Senior Counsel, Pillsbury Winthrop Shaw Pittman LLP, New York.*
**** *Associate, Plews Shadley Racher & Braun, LLP, Indianapolis.*

the meaning of "physical loss or damage"—words typically in the trigger for property-insurance coverage, including business-income coverage. It has been cited, ad nauseam, as evidence of a general consensus that all property-insurance claims require some "distinct, demonstrable, *physical alteration* of the property."[2] Indeed, some pro-insurer decisions substitute a citation to this section for an actual analysis of the specific language before the court.

Couch is generally recognized as a significant insurance treatise, and courts have cited it for almost a century.[3] That respect began with the first edition written by George Couch and subsequent editions written by his successors.

This particular section, however, as formulated in the third edition of *Couch*, contains an unfortunate, and serious, error. *Couch*'s apparent conclusion—that "direct physical loss" requires a "distinct, demonstrable, physical alteration"—is wrong. It was wrong when *Couch* first made it in the 1990s, and it is wrong today. As another well-respected treatise puts it, "when an insurance policy refers to *physical loss of or damage* to property, the 'loss of property' requirement can be satisfied by any 'detriment,' and a 'detriment' can be present *without there having been a physical alteration of the object*."[4]

A review of the three editions of *Couch* shows that this statement first appeared in the third edition.[5] As originally published, it supported its assertion by citing to five cases for support and two cases holding to the contrary, presenting the former as the "widely held" majority rule.[6]

But none of these cases used the "distinct, demonstrable, physical alteration" test that *Couch 3d* presents, and it was far from the majority rule. As of March 2020, there were at least *thirty-five* cases adopting a broader rule (including many binding appellate decisions and several rulings by state high courts), and significantly fewer following the *Couch* test. The "physical

2. *Id.* (emphasis added); Oral Surgeons, P.C. v. Cincinnati Ins. Co., 2 F.4th 1141, 1144 (8th Cir. 2021).

3. Girard Fire & Marine Ins. Co. v. Winfrey, 26 S.W.2d 701, 705 (Tex. Ct. App. 1930) (citing 4 George J. Couch, Cyclopedia of Insurance Law § 915).

4. 3 Allan D. Windt, Insurance Claims & Disputes § 11:41 (6th ed. 2013) (emphasis added).

5. The authors conducted searches in an effort to identify when this phrase first appeared in *Couch*. The authors ran searches on the first edition through HeinOnline and reviewed the hard copy of *Couch 2d* to see if those editions used this language. We found no language in either of the first two editions that was similar to that in section 148:46 of *Couch 3d* ("distinct, demonstrable, physical alteration"). *Couch 3d*, unlike *Couch 1st* and *Couch 2d*, was published in loose-leaf format. Without saving all versions of superseded pages in the updates published over the years, it is not possible at this point in time for us to say with certainty when language first appeared. We were able to verify that the first time that a court cited the "distinct, demonstrable" phrase in *Couch 3d* was in 1999. Columbiaknit, Inc. v. Affiliated FM Ins. Co., 1999 WL 619100, at *7–8 (D. Or. Aug. 4, 1999).

6. 10A Couch on Insurance 3d § 148:46. Couch added four cases to supplement this position following the original publication date.

alteration" test gained traction only because courts relied on *Couch*'s initial mischaracterization—inferred from a single district court opinion that was disapproved three years later by the governing court of appeals, rather than from the thirteen extant cases then holding to the contrary.

We may never know why *Couch* got the law so profoundly backwards on this key issue. But one thing is clear: courts need to stop citing it as the *sine qua non* of what "physical loss or damage" means. It is not. If the courts, and particularly the federal courts,[7] continue down this path without addressing *Couch*'s fallacy, there will be serious practical consequences. They risk overruling decades of insurance law and drastically narrowing the scope of property insurance that forms the backbone of risk protection for homeowners, businesses, and the banks that lend to them. All of those policies rest on the same terms *Couch* misconstrued. More immediately, courts will deprive American businesses of billions of dollars in coverage they paid for and need to survive the worst public health crisis in a century. Until *Couch* reckons with this error, busy trial and appellate judges cannot, and should not, trust it to give them the straight answer on this foundational question.

II. THE LAW OF "DIRECT PHYSICAL LOSS"

Modern property-insurance policies are triggered by some "direct physical loss or damage" to the property (or some variant of that term).[8] After this standard-form language was adopted, courts were quickly called upon to determine what it meant. Plainly it included injuries by fire, lightning, or tornado. But the breadth of the words—layered on the broad "all risk"[9] template—generated questions about whether a loss of use or function was sufficient to trigger these policies.

7. There is a stark disparity between the way state and federal courts are treating these claims in the Covid-19 context. *Trial Court Rulings on the Merits in Business Interruption Cases*, *Covid Coverage Litigation Tracker*, U. Pa. L. Sch., https://cclt.law.upenn.edu/judicial-rulings (last viewed Oct. 9, 2021). As of this writing, state courts have heard fewer than 130 insurer motions to dismiss and have denied 32 of them. Federal courts have heard 484 motions, yet they have denied even fewer (25), with the balance finding, as a matter of law, that there is no claim. *Id.* Since federal courts are constitutionally bound to follow state insurance law under the *Erie* doctrine, this massive disparity simply should not exist. That it does may require corrective action from the U.S. Supreme Court. *See* Brief of *Amicus Curiae* United Policyholders, Mama Jo's, Inc. v. Sparta Ins. Co., No. 20-998 (U.S. Feb. 25, 2021) (raising similar concerns, though in a non-Covid case and without the benefit of current case data), *cert. denied*, 141 S. Ct. 1737 (Mar. 29, 2021).

8. 5 New Appleman on Insurance Law, Libr. Ed. § 42.02[3].

9. There are two general types of property insurance. The first is "all risk" insurance. As its name suggests, it is the broadest of all insurance products because it "creates a type of coverage not ordinarily present under other types of insurance, and recovery is allowed for all fortuitous losses unless the loss is excluded by a specific policy provision." 10A Couch on Insurance 3d § 148:50. The second is "named perils" insurance, which insures only for specified causes of loss.

From 1950 to 1990, courts uniformly found that such losses qualified. Over the insurance industry's objections at the point of claim, courts asked only whether the property was unsafe or unusable for its intended purpose. If the answer to either question was "yes," then there was "direct physical loss or damage" to the property. The contrary view—requiring "distinct, demonstrable, physical alteration"—emerged in the 1990s but was in the distinct minority. Despite this backdrop, *Couch* wrongly portrayed "physical alteration" as the "widely held" majority rule.

A. *The Original Meaning of "Physical Loss": 1950 to 1995*

Until the 1990s, courts uniformly gave "direct physical loss" and its variants their broad, ordinary meaning. That phrase included cases where property became unsafe or unusable for its intended purpose. Standard-form policies were triggered in such circumstances in the 1950s,[10] the 1960s,[11] the 1970s,[12] the 1980s,[13] and the 1990s.[14]

In 1995, the Third Edition of *Couch on Insurance* added a new section, titled "*Generally; 'Physical' loss or damage*."[15] The first case to cite this section

10. Am. Alliance Ins. Co. v. Keleket X-Ray Corp., 248 F.2d 920, 925 (6th Cir. 1957) (finding coverage when a release of radon dust and gas made the policyholders' building unsafe to work in and unusable for its purpose, which was calibrating medical instruments); Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co., 98 N.W.2d 280, 295, 300 (Minn. 1959) (finding that egg powder, which had been exposed to smoke, was physically damaged because it suffered a loss of market value even without actual injury).

11. Hughes v. Potomac Ins. Co., 18 Cal. Rptr. 650, 655 (Ct. App. 1962) (finding "physical loss" because policyholder's home was unsafe for occupancy after a landslide deprived it of support); W. Fire Ins. Co. v. First Presbyterian Church, 437 P.2d 52, 54 (Colo. 1968) (en banc) (finding a "direct physical loss" where gasoline vapors made "use of the building highly dangerous").

12. Cyclops Corp. v. Home Ins. Co., 352 F. Supp. 931, 937 (W.D. Pa. 1973) (finding business-income coverage where vibration of motor, without apparent damage, caused it to be shut down).

13. Hampton Foods, Inc. v. Aetna Cas. & Sur. Co., 787 F.2d 349, 352 (8th Cir. 1986) (finding Business Income coverage where danger of collapse required abandonment of grocery store); Intermetal Mexicana, S.A. v. Ins. Co. of N. Am., 866 F.2d 71, 76 (3d Cir. 1989) (theft of property, depriving policyholder of possession and control, qualified as "direct physical loss"); Blaine Richards & Co. v. Marine Indem. Ins. Co., 635 F.2d 1051, 1055–56 (2d Cir. 1980) (finding policyholder could recover lost value of beans exposed to chemical not accepted in the United States but not actually harmed).

14. In chronological order: Hetrick v. Valley Mut. Ins Co., 1992 WL 524309, at *3 (Pa. Comm. Pl. May 28, 1992) (finding coverage for loss of use of a house if an outside oil spill made the house uninhabitable); Largent v. State Farm Fire & Cas. Co., 842 P.2d 445, 446 (Or. Ct. App. 1992) (noting insurance company conceded meth fumes could cause "direct physical loss"); Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1335 (Or. Ct. App. 1993) (finding costs of meth odor covered as direct physical loss or damage); Azalea, Ltd. v. Am. States Ins. Co., 656 So. 2d 600, 602 (Fla. Ct. App. 1995) (chemicals that destroyed a bacteria colony necessary for sewage treatment plant to operate caused "direct damage to the structure").

15. 10A Couch on Insurance 2d § 148:46.

was decided in 1999.[16] The fourth paragraph in that section (as reprinted without relevant change in the June 2021 update) reads:

> The requirement that the loss be "physical," given the ordinary definition of that term, is widely held to exclude alleged losses that are intangible or incorporeal and, thereby, to preclude any claim against the property insurer when the insured merely suffers a detrimental economic impact unaccompanied by a *distinct*, *demonstrable*, *physical alteration of the property*.[17]

The origin of this matter-of-fact statement is puzzling. At the time this section first appeared, only one reported case had adopted this test in the circumstances relevant here—*Great Northern Ins. Co. v. Benjamin Franklin Federal Savings & Loan Ass'n*, decided by a federal district court in Oregon, in 1990.[18]

Benjamin Franklin involved the sudden discovery of non-friable (or intact) asbestos in a building.[19] The property insurer refused to pay for its removal, arguing there was no "direct physical loss."[20] The district court agreed, citing a 1978 Oregon Supreme Court case (*Wyoming Sawmills v. Transportation Ins. Co.*) finding that a lumber manufacturer's third-party liability-insurance policy did not cover a lawsuit seeking labor expenses for removing defective 2 × 4 studs from a building.[21] Despite the many cases actually addressing "direct physical loss" language in this context—and universally coming out the other way—the *Benjamin Franklin* court found this liability-insurance case "most helpful."[22] The court held that property insurance, like liability insurance, does not "include consequential or intangible damages such as depreciation in value, within the terms property damage."[23] Ignoring the distinction between first-party and third-party coverage, the court held that, since the building was "physically intact and undamaged," there was no "*physical* loss, direct or otherwise."[24]

16. Columbiaknit, Inc. v. Affiliated FM Ins. Co., 1999 WL 619100, at *7–8 (D. Or. Aug. 4, 1999) (finding that policyholder could bear its burden to demonstrate that clothes contaminated with mold or mildew suffered "direct physical loss or damage" if it established "at trial a class of garments which has increased microbial counts and that will, as a result, develop either an odor or mold or mildew").

17. 10A Couch on Insurance 3d § 148:46 (emphasis added).

18. Great N. Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 793 F. Supp. 259, 263 (D. Or. 1990). There were other cases favoring insurers, but they involved (for example) claims that a title impairment was a "physical loss," which it obviously is not. Those cases are discussed in more detail below. *Benjamin Franklin* was the first to apply this rule in the context of physical effects on property.

19. *Id.* at 261.

20. *Id.* at 263.

21. *Id.* (citing Wyoming Sawmills v. Transp. Ins. Co., 578 P.2d 1253, 1256 (Or. 1978)).

22. *Id.*

23. *Id.* (quoting *Wyoming Sawmills*, 578 P.2d at 1256).

24. *Id.* (emphasis in original). Third-party and first-party insurance serve significantly different functions. Third-party insurance is essentially fault-based; it provides compensation for loss suffered by "third parties" that is caused by the policyholder's wrongful acts.

The "physically intact and undamaged" gloss was brand new in *Benjamin Franklin*. At that time, the major decisions predating it—*Hughes* and *First Presbyterian*—had rejected that precise logic. *Hughes* was particularly forceful:

> To accept [the insurer's] interpretation of its policy would be to conclude that a building which has been overturned or which has been placed in such a position as to overhang a steep cliff has not been "damaged" so long as its paint *remains intact and its walls still adhere to one another*. Despite the fact that a "dwelling building" might be rendered completely useless to its owners, [the insurer] *would deny that any loss or damage had occurred unless some tangible injury to the physical structure itself could be detected*. Common sense requires that a policy should not be so interpreted in the absence of a provision specifically limiting coverage in this manner.[25]

Similarly, *First Presbyterian* found that a church rendered too dangerous for occupancy because it was permeated with gasoline fumes had suffered a "loss of use" that triggered the policy.[26]

Perhaps because the "intact and undamaged" rule was invented by a single district judge, it did not stick. Three years after *Benjamin Franklin*, the Oregon Court of Appeals refused to follow it in *Farmers Ins. Co. v. Trutanich*, a case involving methamphetamine contamination.[27] *Trutanich* distinguished *Wyoming Sawmills* (the liability-insurance case *Benjamin Franklin* found "most helpful") and instead followed *First Presbyterian*.[28]

When *Couch 3d* cited *Benjamin Franklin* as evincing a "distinct, demonstrable, physical alteration" rule,[29] it ignored that *Trutanich* had rendered the "intact and undamaged" rule a dead letter three years earlier.[30] It also added the modifiers "distinct" and "demonstrable" out of thin air—we have found no pre-*Couch 3d* case where a court frames the test using those adjectives. In spite of this, *Couch 3d* crafted its own rule out of whole cloth, and

---

First-party insurance, in contrast, provides coverage for loss regardless of fault. This distinction is important in understanding *Wyoming Sawmills*. Most commercial third-party policies have "business risk" exclusions—in *Wyoming Sawmills*, it was an exclusion for liability arising from damage to "your product" or "your work" (i.e., the defective 2 × 4s). The aim of such exclusions is to enforce the general third-party rule that coverage exists only for damage to *someone else*'s property, and so that liability insurance is not equated with a builder's "performance bond." Thus, *Wyoming Sawmills* is not properly read to require a "physical alteration" rule, even in the third-party context. Loss of use to a third party's property is indisputably "property damage" under standard-form general liability insurance.

25. Hughes v. Potomac Ins. Co., 18 Cal. Rptr. 650, 655 (Ct. App. 1962) (emphasis added).
26. W. Fire Ins. Co. v. First Presbyterian Church, 437 P.2d 52, 54 (Colo. 1968) (en banc).
27. Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1335 (Or. Ct. App. 1993).
28. *Id.* at 1335–36.
29. 10A Couch on Insurance 3d § 148:46 (emphasis added).
30. *Trutanich*, 858 P.2d at 1335 n.4 (limiting *Benjamin Franklin* to asbestos that was "intact" and nonfriable).

then then included a paragraph, written in the passive voice, suggesting that there was only some case law to the contrary:

> The opposite result has been reached, allowing coverage based on physical damage despite the lack of physical alteration of the property, on the theory that the uninhabitability of the property was due to the fact that gasoline vapors from adjacent property had infiltrated and saturated the insured building, and the theory that the threatened physical damage to the insured building from a covered peril essentially triggers the insured's obligation to mitigate the impending loss by undertaking some hardship and expense to safeguard the insured premises.[31]

This lukewarm counterpoint cited only *First Presbyterian* and *Hampton Foods*—two of at least *thirteen* cases that had adopted the broader rule when the section was first drafted.[32]

B. *The One-Sided Portrayal Grows: 1995–2019*

Like any treatise updated regularly, *Couch 3d* over the years generally added citations as the law developed. However, a problem appeared on this issue as *Couch 3d* began discussing it—the third edition only added cases favorable to its made-up "majority" position.[33] Every one of these decisions cited *Couch 3d*'s "physical alteration" doctrine.[34] For example, under facts identical to *Benjamin Franklin*, the Third Circuit denied coverage by declaring (citing *Couch* and nothing else) that this was the "widely accepted definition."[35]

Yet this rule was neither "widely accepted" nor correct. *Couch 3d* did not address many of the significant decisions adopting the contrary and earlier generally accepted position. In fact, the only case supporting *Couch 3d*'s

31. 10A Couch on Insurance 3d § 148:46.

32. The others are similar. *See* Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co., 98 N.W.2d 280, 295, 300 (Minn. 1959) (unsalable goods); Hughes v. Potomac Ins. Co., 18 Cal. Rptr. 650, 655 (Ct. App. 1962) (erosion); Am. All. Ins. Co. v. Keleket X-Ray Corp., 248 F.2d 920, 925 (6th Cir. 1957) (radon contamination); Intermetal Mexicana, S.A. v. Ins. Co. of N. Am., 866 F.2d 71, 76 (3d Cir. 1989) (theft); Blaine Richards & Co. v. Marine Indem. Ins. Co., 635 F.2d 1051, 1055–56 (2d Cir. 1980) (unsalable goods); Cyclops Corp. v. Home Ins. Co., 352 F. Supp. 931, 937 (W.D. Pa. 1973) (inoperable motor); Hetrick v. Valley Mut. Ins Co., 1992 WL 524309, *3 (Pa. Comm. Pl. May 28, 1992) (oil spill); Largent v. State Farm Fire & Cas. Co., 842 P.2d 445, 446 (Or. Ct. App. 1992) (meth contamination); Farmers Ins. Co. v. Trutanich, 858 P.2d 1332, 1335 (Or. Ct. App. 1993) (same); Azalea, Ltd. v. Am. States Ins. Co., 656 So. 2d 600, 602 (Fla. Ct. App. 1995) (chemical contamination).

33. 10A Couch on Insurance 3d § 148:46 (adding Port Auth. of N.Y. & N.J. v. Affiliated FM Ins. Co., 311 F.3d 226, 236 (3d Cir. 2002); Universal Image Prods., Inc. v. Fed. Ins. Co., 475 F. App'x 569, 573 (6th Cir. 2012); Newman Myers Kreines Gross Harris, P.C. v. Great N. Ins. Co., 17 F. Supp. 3d 323, 331 (S.D.N.Y. 2014); MRI Healthcare Ctr. of Glendale, Inc. v. State Farm Gen. Ins. Co., 115 Cal. Rptr. 3d 27, 38 (Ct. App. 2010)).

34. *Port Authority*, 311 F.3d at 235; *Universal Image*, 475 F. App'x at 573–74; *Newman Meyers*, 17 F. Supp. 3d at 331; *MRI Healthcare*, 115 Cal. Rptr. at 778–79.

35. *Port Authority*, 311 F.3d at 235.

assertion was at the trial level, was not binding, and had been disapproved by the governing state's court of appeals. Beyond that, more and more cases began to recognize that the *Hughes* rule—and not the *Couch 3d* theory—was correct. There were five such cases (including two from state courts of last resort) before the turn of the twenty-first century.[36] *Couch 3d* to date has ignored all of them.

The law continued to snowball in policyholders' favor after that. In 2000,[37] 2001,[38] 2002,[39] 2003,[40] 2005,[41] courts rendered eleven decisions for policyholders on this issue without requiring "physical alteration." *Couch 3d*

36. Arbeiter v. Cambridge Mut. Fire Ins. Co., 1996 WL 1250616, at *2 (Mass. Super. Ct. Mar. 15, 1996) (finding oil fumes present in house after discovery of oil leak constituted physical damage to the house); Sentinel Mgmt. Co. v. N.H. Ins. Co., 563 N.W.2d 296, 300 (Minn. Ct. App. 1997) (asbestos); Dundee Mut. Ins. Co. v. Marifjeren, 587 N.W.2d 191 (N.D. 1998) (power outage causing potatoes to freeze); Murray v. State Farm Fire & Cas. Co., 509 S.E.2d 1, 16–17 (W. Va. 1998) (concluding that a home rendered dangerously unlivable by the presence of falling rocks had suffered a "direct physical loss to the property"); Matzner v. Seaco Ins. Co., 9 Mass. L. Rptr. 41, 1998 WL 566658, at *4 (Mass. Super. Ct., Aug. 12, 1998) (concluding that the phrase "direct physical loss or damage" was ambiguous and could mean either "only tangible damage to the structure of insured property" or "more than tangible damage to the structure of insured property," and that "carbon monoxide contamination constitutes 'direct physical loss of or damage to' property"); Bd. of Educ. v. Int'l Ins. Co., 720 N.E.2d 622, 625–26 (Ill. Ct. App. 1999) (citing liability insurance coverage cases finding that incorporation of asbestos into buildings caused "property damage," defined under liability policies to be "physical injury to or destruction of tangible property," and finding that policyholder had established that the asbestos fiber contamination constituted physical damage).

37. Sentinel Mgmt. Co. v. Aetna Cas. & Sur. Co., 615 N.W.2d 819, 825–26 (Minn. 2000) ("A principal function of any living space [is] to provide a safe environment for the occupants," and "[i]f rental property is contaminated by asbestos fibers and presents a health hazard to the tenants, its function is seriously impaired.").

38. Gen. Mills, Inc. v. Gold Medal Ins. Co., 622 N.W.2d 147, 152 (Minn. Ct. App. 2001) (oats rendered unsalable by FDA regulation suffered "direct physical loss").

39. Prudential Prop. & Cas. Ins. Co. v. Lillard-Roberts, 2002 WL 31495830, at *8–9 (D. Or. June 18, 2002) (concluding that mold damage to house could constitute "distinct and demonstrable" damage and that inability to inhabit a building may constitute "direct, physical loss"); Cooper v. Travelers Indem. Co. of Ill., 2002 WL 32775680, at *1 (N.D. Cal. Nov. 4, 2002) (coliform bacteria and E.coli); Graff v. Allstate Ins. Co., 54 P.3d 1266, 1269 (Wash. Ct. App. 2002) (methamphetamine vapors); Yale Univ. v. CIGNA Ins. Co., 224 F. Supp. 2d 402, 413 (D. Conn. 2002) (finding while the presence of asbestos and lead in buildings did not constitute "physical loss of or damage to property," contamination by such materials could, citing "the substantial body of case law" "in which a variety of contaminating conditions have been held to constitute 'physical loss or damage to property'").

40. S. Wallace Edwards & Sons, Inc. v. Cincinnati Ins. Co., 353 F.3d 367, 374–75 (4th Cir. 2003) (affirming finding that meat exposed to ammonia and thus less valuable even though not actually affected had suffered property damage).

41. Motorists Mut. Ins. Co. v. Hardinger, 131 F. App'x 823, 824, 826–27, 824–26 (3d Cir. 2005) (E. coli contamination); De Laurentis v. United Servs. Auto. Ass'n, 162 S.W.3d 714, 722–23 (Tex. Ct. App. 2005) (finding mold damage constituted "physical loss to property"); Pepsico, Inc. v. Winterthur Int'l Ins. Co., 24 A.D.3d 743, 744 (N.Y. App. Div., 2d Dep't 2005) (unmerchantable product); Schlamm Stone & Dolan LLP. v. Seneca Ins. Co., 800 N.Y.S.2d 356 (Sup. Ct. 2005) (finding that "the presence of noxious particles, both in the air and on surfaces of the plaintiff's premises, would constitute property damage under the terms of the policy").

took no notice. In 2007,[42] 2009,[43] and 2010,[44] courts decided eight more. Again, *Couch 3d* ignored them. Five more cases came in 2011,[45] 2013,[46] 2014,[47] 2015,[48] and 2016,[49] including from another state supreme court. None of these decisions were featured in *Couch 3d*, and even its June 2021 update failed to grapple with (or even cite) any of them.

Couch 3d may not have recognized these cases, but insurers did—when it served their purposes. In late 2019, Factory Mutual Insurance Company ("FM"), one of the largest and most sophisticated property insurers in the world, sued another insurer seeking to shift some of its liability for mold

42. Cook v. Allstate Ins. Co., 2007 Ind. Super. LEXIS 32, at *6–10 (Madison Cnty. Nov. 30, 2007) (finding that infestation of house with brown recluse spiders constituted "direct physical loss" to the house: "Case law demonstrates that a physical condition that renders property unsuitable for its intended use constitutes a 'direct physical loss' even where some utility remains and, in the case of a building, structural integrity remains"); Stack Metallurgical Servs., Inc. v. Travelers Indem. Co., 2007 WL 464715, at *8 (D. Or. Feb. 7, 2007) (finding "physical loss or damage" where the policyholder's heat treater for medical implants was contaminated by lead and could no longer be used); Fed. Ins. Co. v. Hartford Steam Boiler Inspection & Ins. Co., 2007 WL 1007787, at *12 (E.D. Mich. Mar. 31, 2007) (finding that food in cardboard containers exposed to ammonia was physically injured, despite the fact the food was judged fit to eat).

43. Essex v. BloomSouth Flooring Corp., 562 F.3d 399, 406 (1st Cir. 2009) (unpleasant odor in home); Wakefern Food Corp. v. Liberty Mut. Fire Ins. Co., 968 A.2d 724, 734 (N.J. Super. App. Div. 2009) ("In the context of this case, the electrical grid was 'physically damaged' because, due to a physical incident or series of incidents, the grid and its component generators and transmission lines were physically incapable of performing their essential function of providing electricity."); Manpower Inc. v. Ins. Co. of the State of Pa., 2009 WL 3738099, at *1 (E.D. Wis. Nov. 3, 2009) (finding "direct physical loss . . . or damage to" a building adjacent to a building which collapsed despite the fact that the collapse did not cause any noticeable damage to the policyholder's occupied space).

44. Travco Ins. Co. v. Ward, 715 F. Supp. 2d 699, 707–08 (E.D. Va. 2010) (finding that drywall emitting toxic gases, causing the policyholder to move out, caused a direct physical loss, despite the fact that it was "physically intact, functional and ha[d] no visible damage," noting the majority of cases nationwide find that "physical damage to the property is not necessary"); *In re* Chinese Mfr'd Drywall Prods. Liab. Litig., 759 F. Supp. 2d 822, 831 (E.D. La. 2010) (finding that "the presence of Chinese-manufactured drywall in a home constitutes a physical loss" because it "renders the [policyholders'] homes useless and/or uninhabitable").

45. Widder v. La. Citizens Prop. Ins. Corp., 82 So.3d 294 (La. Ct. App. 2011) (lead).

46. Ass'n of Apartment Owners of Imperial Plaza v. Fireman's Fund Ins. Co., 939 F. Supp. 2d 1059, 1068 (D. Haw. 2013) (finding that intrusion of arsenic into roof caused "direct physical loss or damage" to the roof).

47. Gregory Packaging, Inc. v. Travelers Prop. Cas. Co., 2014 WL 6675934, at *5–6 (D.N.J. Nov. 25, 2014) (concluding that "property can sustain physical loss or damage without experiencing structural alteration," that "the heightened ammonia levels rendered the facility unfit for occupancy until the ammonia could be dissipated," and therefore that the ammonia discharge caused direct physical loss).

48. Mellin v. N. Sec. Ins. Co., 115 A.3d 799, 806 (N.H. 2015) (rejecting "tangible alteration" rule and holding that pervasive odor of cat urine was "physical loss" to condominium).

49. Oregon Shakespeare Festival Ass'n v. Great Am. Ins. Co., 2016 WL 3267247, at *5–6 (D. Or. June 7, 2016), *vacated by joint stipulation*, 2017 WL 1034203 (Mar. 6, 2017) (smoke from wildfires, making operations hazardous to human health, caused a "direct physical loss").

and mold spore contamination at a biopharmaceuticals lab.[50] In the case, it brought a motion *in limine* contending that "physical loss or damage" to property exists when a physical substance renders property unfit for its intended use, despite that there was *no* physical alteration.[51] Citing cases like *First Presbyterian*, *Gregory Packaging*, and *Trutanich*, FM argued to the Court:

> Numerous courts have concluded that loss of functionality or reliability under similar circumstances constitutes physical loss or damage. *See*, *e.g.*, *Western Fire Insurance Co. v. First Presbyterian Church*, 437 P.2d 52 (Colo. 1968) (church building sustained physical loss or damage when it was rendered uninhabitable and dangerous due to gasoline under the building); *Gregory Packaging, Inc. v. Travelers Property and Casualty Company of America*, Civ. No. 2:12-cv-04418, 2014 U.S. Dist. LEXIS 165232, 2014 WL 6675934 (D. N.J. 2014) (unsafe levels of ammonia in the air inflicted "direct physical loss of or damage to" the juice packing facility "because the ammonia physically rendered the facility unusable for a period of time."); *Port Authority of N.Y. and N.J. v. Affiliated FM Ins. Co.*, 311 F.3d 226, 236 (3d Cir. 2002) (asbestos fibers); *Essex v. BloomSouth Flooring Corp.*, 562 F.3d 399, 406 (1st Cir. 2009) (unpleasant odor in home); *TRAVCO Ins. Co. v. Ward*, 715 F. Supp. 2d 699, 709 (E.D. Va. 2010), *aff'd*, 504 F. App'x 251 (4th Cir. 2013) ("toxic gases" released by defective drywall).[52]

Moreover, FM argued that, *at worst*, it had put forward a reasonable interpretation of the undefined phrase "physical loss or damage"—and even if Federal could propose a reasonable reading, this merely rendered the subject policy ambiguous and required the court to construe it in favor of coverage.[53]

The oddity and error in *Couch 3d*'s statement is further shown by other major insurance-coverage treatises. Allan Windt's *Insurance Claims & Disputes* (6th ed. 2013) is most explicit: "[W]hen an insurance policy refers to physical loss of or damage to property, the 'loss of property' requirement can be satisfied by *any* 'detriment,' and a 'detriment' can be present *without there having been a physical alteration of the object*."[54] Windt then proceeds to discuss the major cases that *Couch 3d* ignores, including *Murray*, *Sentinel*, and *Hardinger*.[55]

---

50. Factory Mut. Ins. Co. v. Fed. Ins. Co., 1:17-cv-00760-GJF-LF, 2019 U.S. Dist. LEXIS 191769 (D.N.M. Nov. 5, 2019).

51. Motion *in Limine* No. 5 re Physical Loss or Damage at 3, *Factory Mut. Ins. Co.*, filed Nov. 19, 2019, ECF#127, https://3inbm04c0p4j2h1w132uyb5e-wpengine.netdna-ssl.com/wp-content/uploads/2021/02/fm_v._federal.pdf.

52. *Id.* at 3–4 (emphasis added).

53. *See id.* at 3 n.1.

54. 3 Allan D. Windt, Insurance Claims & Disputes § 11:41 (6th ed. 2013) (emphasis added).

55. *Id.*

Appleman's *Insurance Law and Practice*, often cited side-by-side with *Couch*, contains a similar statement of the standard in its section on "all risk" insurance.[56] After discussing *First Presbyterian*, it concluded that "[t]he courts have construed the scope of what constitutes 'physical loss or damage' liberally," while still recognizing that some losses (such as a withdrawn warranty) were not "physical."[57] At the time it was discontinued, in favor of the *New Appleman* series, the "Old" *Appleman* recognized all, or nearly all, of the seminal decisions on "physical loss" that *Couch* omitted. Those cases include dispossession of property (*Intermetal Mexicana*), "unusable or uninhabitable" property (*Murray*), and contamination (*Board of Education*).[58]

The 1999 update to another treatise by Peter J. Kalis reaches the same conclusion.[59] Explaining that "direct" and "physical" loss or damage is the coverage trigger for property insurance, the authors correctly summarized the law at the time by saying that disputes over these words "generally have

56. 5 John Alan Appleman & Jean Appleman, Insurance Law & Practice 2d § 3092 (1970 & 2012 Supp.), *reprinted in* 5f-142f Appleman on Insurance Law & Practice Archive § 3092 (LEXIS 2011). *Appleman*, like *Couch*, is a venerable treatise, used for decades by coverage practitioners including authors of this article. The "Original" *Appleman*, first published in 1929, was updated for years after the death in 1936 of the original author, John Alan Appleman. The hard copy volume of the "original" *Appleman* containing § 3092 was last copyrighted in 1970 and thereafter was updated through pocket parts. From the authors' knowledge and research on provenance of this section, the last "cumulative supplement" for this volume (volume 5) of "Old" *Appleman* was copyrighted in 2012. The "original" *Appleman* was joined by a successor, *New Appleman*, in the last two decades, which overlapped with original *Appleman* and was called first *Holmes Appleman on Insurance* and later *Appleman on Insurance 2d*. The publisher also published *New Appleman on Insurance Law*, *Law Library Edition* (Jeffrey E. Thomas & Francis J. Mootz, III, eds., Lexis-Nexis 2009 & Dec. 2020 Supp.); and most recently, *New Appleman Insurance Law Practice Guide* (Leo P. Martinez, Marc S. Mayerson & Douglas R. Richmond eds., Lexis-Nexis 2020). *Appleman on Insurance 2d*, for example, while focusing on many issues of import in insurance law, includes little analysis of the relevant policy language in consideration in this article.

57. *Id.*

58. *Id.* The *New Appleman* successor to this work, rather than carrying forward the existing research, borrowed heavily from *Couch 3d*'s misstatement of the rule—down to the cases *Couch 3d* cited and some of the descriptive words *Couch 3d* used. 5 New Appleman on Insurance Law, Libr. Ed., § 46.03[2] (offering the "generally prevailing" rule as one that "preclude[s] coverage for losses that are solely intangible or incorporeal; for example, an economic loss unaccompanied by a distinct physical alteration to property"). To the *New Appleman* authors' credit, their statements are more restrained, and (unlike *Couch 3d*) they do follow this introduction with treatments of important cases like *Trutanich*, *Sentinel*, *Hardinger*, *Pepsico*, *General Mills*, and *Wakefern*, discussed throughout this article. *Id.* § 46.03[3] ("Contamination by Vapor, Bacteria, or other Foreign Substance," "Intact Property Rendered Unfit for Intended Purpose," "Destruction or Corruption of Electronic Data," and "Deprivation of Access by Government Authorities"). Although *New Appleman*'s decision to borrow its summary from *Couch 3d* was ill-advised, the balance of the section—and the nuance it explains—illustrates the severity of *Couch 3d*'s error.

59. I Peter J. Kalis, Thomas M. Reiter & James R. Segerdahl, Policyholder's Guide to the Law of Insurance Coverage § 13.04 (Aspen L. & Bus., Supp. 1999). As the name of this treatise suggests, its authors generally represented policyholders. But unlike this section of *Couch*, the discussion is balanced and accurately represents the case law.

been resolved in favor of coverage."[60] It then proceeds to discuss *Hampton Foods*, *First Presbyterian*, *Hughes*, and *Intermetal Mexicana*, among other cases, as representing the majority rule.[61] It acknowledged *Benjamin Franklin* but noted that it was an outlier.[62] It concluded that while insurers may argue for a more stringent version of "physical loss," "[t]hese arguments have generally been unsuccessful if the loss arises out of some external event or condition changing and devaluing the property."[63] In 2013, the principal author of *Couch 3d*, Steven Plitt, published an article in an insurance industry magazine entitled "Direct Physical Loss in All-Risk Policies: The Modern Trend Does Not Require Specific Physical Damage, Alteration."[64] He discussed recent case law and concluded that the "modern trend" is that "courts are not looking for physical alteration, but for loss of use." It is unclear why the current 2021 update of *Couch 3d* does not match its principal author's stated understanding of the law.

For whatever reason, this robust body of scholarship—all contrary to *Couch 3d*—has not caught the courts' attention. That is unfortunate. Windt, Appelman, and Kalis present a far superior resource for courts interested in understanding the full scope of the law, rather than *Couch 3d*'s truncated, one-sided version.

C. Couch 3d*'s 2021 Update Has Not Remedied This Significant Error*

In 2021, *Couch 3d* updated this section. The current edition repeats the error of the previous ones.

For the proposition that its "physical alteration" rule is "widely held," *Couch 3d* currently cites seven cases—none of which were decided in 1995, when it appears that *Couch 3d* first made this statement. Moreover, nearly all of these cases *themselves cite Couch 3d* (or cases citing *Couch 3d*) for this proposition.[65] This is a remarkable feat: state *ipse dixit* you wish was true, convince courts to cite it, and then cite *those* cases as establishing that the rule is "widely held."

60. *Id.*
61. *Id.* at 13-15 to 13-18.
62. *Id.* at 13-18 to 13-19.
63. *Id.* at 13-19.
64. Steven Plitt, *Direct Physical Loss in All-Risk Policies: The Modern Trend Does Not Require Specific Physical Damage, Alteration*, Claims J. (Apr. 15, 2013) (https://amp.claimsjournal.com/magazines/idea-exchange/2013/04/15/226666.htm) (discussing *Murray* and *Trutanich*, among other cases).
65. Port Auth. of N.Y. & N.J. v. Affiliated FM Ins. Co., 311 F.3d 226, 236 (3d Cir. 2002); Universal Image Prods., Inc. v. Fed. Ins. Co., 475 F. App'x 569, 573 (6th Cir. 2012); Newman Myers Kreines Gross Harris, P.C. v. Great N. Ins. Co., 17 F. Supp. 3d 323, 331 (S.D.N.Y. 2014); *In re* Chinese Mfd. Drywall Prods. Liab. Litig., 759 F. Supp. 2d 822, 831 (E.D. La. 2010); MRI Healthcare Ctr. of Glendale, Inc. v. State Farm Gen. Ins. Co., 115 Cal. Rptr. 3d 27, 38 (Ct. App. 2010); Welton Enters., Inc. v. Cincinnati Ins. Co., 131 F. Supp. 3d 827 (W.D. Wis. 2015); Shirley v. Allstate Ins. Co., 392 F. Supp. 3d 1185 (S.D. Cal. 2019).

For its claim that there must be a "distinct, demonstrable, physical alteration of the property," *Couch 3d* now cites five cases extant in 1995 (*Benjamin Franklin* and four others).[66] None of these pre-1995 cases cure *Couch 3d*'s original error. Nor do they offer support for the way courts are citing this section in Covid-19 cases.

For example, in the oldest case (*Cleland Simpson*) the Pennsylvania Supreme Court summarily affirmed the lower court's decision.[67] That case, however, involved a *named perils* policy for "all direct loss by fire [and] lightning."[68] The court held that an order of civil authority was not covered in the absence of fire or lightning damage.[69] In the context of a named-perils property-insurance policy, that made perfect sense: without a loss caused by an insured peril, there is no coverage. But the use of "physical loss" in an *all* risk policy is entirely different, because *all* (nonexcluded) perils are insured. *Cleland Simpson* fails to support *Couch*'s proposition at all.

In the next two cases (*Sponholz* and *HRG*) the courts held that a defect in the title to property was not a "physical loss."[70] That too, makes sense, but fails to support a "physical alteration" requirement. Title defects are *legal* injuries, not physical ones, and these cases are perfectly reconcilable with the loss-of-safe-use rule from *Hughes* and *First Presbyterian*, neither of which required "physical alteration."

The final case from this group of pre-1995 cases (*Covert*) involved products that were discarded because the manufacturer had rescinded its warranty.[71] The policyholder would not sell them without the warranty. This case comes the closest to supporting *Couch 3d*'s argument, but it still fails. As in the title-defect cases, the defect was legal or contractual (i.e., the manufacturer would not indemnify the seller from potential product defects). However, that can still be squared with the prevailing loss-of-safe-use and loss-of-function rules.[72] These cases did not support the rule *Couch 3d* derived from them.

In sum, *Couch 3d* seized on a single trial-level case with no support in the appellate law, asserted in the first instance that such a rule was "widely

66. Great N. Ins. Co. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 793 F. Supp. 259, 263 (D. Or. 1990) (asbestos), *disapproved by* Farmers Ins. Co. v. Trutanich, 858 P.2d 1332 (Or. Ct. App. 1993); Comm. Union Ins. Co. v. Sponholz, 866 F.2d 1162, 1162 (9th Cir. 1989) (title defect); HRG Dev. Co. v. Graphic Arts Mut. Ins. Co., 527 N.E.2d 1179, 1181 (Mass. Ct. App. 1988) (title defect); Cleland Simpson Co. v. Fireman's Ins. Co. of Newark, 140 A.2d 41, 44 (Pa. 1958) (named-perils coverage); Glens Falls Ins. Co. v. Covert, 526 S.W.2d 222, 223 (Tex. Ct. App. 1975) (products lacking manufacturer's warranty).

67. *Cleland Simpson*, 140 A.2d at 44.

68. Cleland Simpson Co. v. Fireman's Ins. Co., 1957 Pa. Dist. & Cnty. LEXIS 202, at *5 (Lackawanna Cnty. Jan. 11, 1957).

69. *Id.* at *8.

70. *Sponholz*, 866 F.2d at 1162; *HRG*, 527 N.E.2d at 1181.

71. *Covert*, 526 S.W.2d at 223.

72. *See supra* notes 10–13 and accompanying text.

held," did not confess error when that case was disapproved, convinced courts to cite it as authoritative, and then cited *those* cases as showing that its scantly supported test was correct. That circular process does not create sound jurisprudence, it is not persuasive, and it should not be followed any further.

D. *The Current Majority of Covid-19 Cases Adopt and Perpetuate* Couch 3d*'s Error*

To any objective observer, *Couch 3d*'s treatment of this issue is incorrect and unnerving. Despite this, a large number of courts are relying upon it to dismiss claims that the presence of SARS-CoV-2, the Covid-19 pandemic, and/or the associated orders of Civil Authority cause "physical loss or damage" to property. The result of these decisions is that many businesses—entitled to business-income coverage under the *actual* majority rule—are not receiving it.

At least twenty-eight of the early pandemic decisions ruling for insurers expressly rely on this section.[73] Another fifteen cases applied *Couch 3d*'s

73. E.g., Brunswick Panini's LLC v. Zurich Am. Ins. Co., 2021 WL 663675, at *8 (N.D. Ohio Feb. 19, 2021) (Ohio law); Kahn v. Pa. Nat'l Mut. Cas. Ins. Co., 2021 WL 422607, at *5 (M.D. Pa. Feb. 8, 2021) (Pennsylvania law); Wellness Eatery La Jolla LLC v. Hanover Ins. Grp., 2021 WL 389215, at *5 (S.D. Cal. Feb. 3, 2021) (California law); Frank Van's Auto. Tag, LLC v. Selective Ins. Co., 2021 WL 289547, at *5 (E.D. Pa. Jan. 28, 2021) (Pennsylvania law); Graspa Consulting, Inc. v. United Nat'l Ins. Co., 2021 WL 199980, at *5 (S.D. Fla. Jan. 20, 2021) (Florida law); 1 S.A.N.T., Inc. v. Berkshire Hathaway, Inc., 2021 WL 147139, at *6 (W.D. Pa. Jan. 15, 2021) (Pennsylvania law); Zagafen Bala, LLC v. Twin City Fire Ins. Co., 2021 WL 131657, at *4 (E.D. Pa. Jan. 14, 2021) (Pennsylvania law); TAQ Willow Grove, LLC v. Twin City Fire Ins., 2021 WL 131555, at *4 (E.D. Pa. Jan. 14, 2021) (Pennsylvania law); Ultimate Hearing Sols. II, LLC v. Twin City Fire Ins. Co., 2021 WL 131556, at *5 (E.D. Pa. Jan. 14, 2021) (Pennsylvania law); Moody v. Hartford Fin. Grp., Inc., 2021 WL 135897, at *4 (E.D. Pa. Jan. 14, 2021) (Pennsylvania law); ATCM Optical, Inc. v. Twin City Ins. Co., 2021 WL 131282, at *4 (E.D. Pa. Jan. 14, 2021) (Pennsylvania law); Indep. Rest. Grp. v. Certain Underwriters at Lloyd's, London, 2021 WL 131339, at *5 (E.D. Pa. Jan. 14, 2021) (Pennsylvania law); Santo's Italian Café LLC v. Acuity Ins. Co., 508 F. Supp. 3d 186, 197–98 (N.D. Ohio 2020) (Ohio law); Newchops Rest. Comcast LLC v. Admiral Indem. Co., 507 F. Supp. 3d 616, 623–24 (E.D. Pa. 2020) (Pennsylvania law); Terry Black's Barbecue, LLC v. State Auto. Mut. Ins. Co., 2020 WL 7351246, at *5 (W.D. Tex. Dec. 14, 2020) (Texas law); Richard Kirsch, DDS v. Aspen Am. Ins. Co., 507 F. Supp. 3d 835, 839 (E.D. Mich. 2020) (Michigan law); SA Palm Beach LLC v. Certain Underwriters at Lloyd's, London, 506 F. Supp. 3d 1248, 1253 (S.D. Fla. 2020) (Florida law); El Novillo Rest. v. Certain Underwriters at Lloyd's, London, 505 F. Supp. 3d 1343, 1349 (S.D. Fla. 2020) (Florida law); Hajer v. Ohio Sec. Ins. Co., 505 F. Supp. 3d 646, 650 (E.D. Tex. 2020) (Texas law); Promotional Headwear Int'l v. Cincinnati Ins. Co., 504 F. Supp. 3d 1191, 1198 n.38 (D. Kan. 2020); S. Fla. Ent. Assocs., Inc. v. Hartford Fire Ins. Co., 2020 WL 6864560, at *6 (S.D. Fla. Nov. 13, 2020) (Florida law); Dab Dental PLLC v. Main St. Am. Prot. Ins. Co., 2020 WL 7137138, at *5 (Fla. Cir. Ct. Hillsborough Cnty. Nov. 10, 2020); Hillcrest Optical, Inc. v. Cont'l Cas. Co., 497 F. Supp. 3d 1203, 1211 & n.4 (S.D. Ala. 2020) (Alabama law); Plan Check Downtown III, LLC v. AmGuard Ins. Co., 485 F. Supp. 3d 1225, 1229 (C.D. Cal. 2020) (California law); Malaube, LLC v. Greenwich Ins. Co., 2020 WL 5051581, at *5 (S.D. Fla. Aug. 26, 2020) (Florida law); Diesel Barbershop, LLC v. State Farm Lloyds, 479 F. Supp. 3d 353, 360 (W.D. Tex. 2020) (Texas law); Visconti Bus. Serv., LLC v. Utica Nat'l Ins. Grp., 71 Misc. 3d 516, 528 (N.Y. Super. Ct. 2021).

"distinct, demonstrable, physical alteration" rule without citing it directly.[74] And the first three published appellate decisions on this issue cite the section as authoritative.[75]

III. THINKING CRITICALLY ABOUT *COUCH* AND PROPERTY INSURANCE LAW

Whatever the ultimate outcome of the Covid-19 business-income-coverage litigation, the courts' treatment of this section in *Couch 3d* will have profound impacts on property-insurance coverage. The error originating from that section is poised to reshape insurance law without the rigorous intellectual analysis of a state appellate court charged with determining the law in its jurisdiction. If courts continue to blindly follow *Couch 3d* on this point, they will effectively overrule decades of property-insurance law without grappling with *stare decisis* or the usual stabilizing principles attached to precedent. Courts must dismantle *Couch 3d*'s fallacy, and the cases it has spawned, before it is too late—and, above all, stop citing *Couch 3d* on this point until the authors address the problem. We offer three general reasons for this position.

First, this section of *Couch 3d* never provides a precedent-driven or intellectual justification for its test (for it is, in reality, a test *Couch 3d* invented). Generally, when staking a position that rests at the core of a body of law, a treatise will either (a) rely on the reasoned decisions of then-extant judicial decisions to justify the rule, or (b) develop its own, independent reason that the rule is correct. *Couch 3d* does neither. This oversight is having

74. Café La Troya LLC v. Aspen Spec. Ins. Co., 2021 WL 602585, at *7 (S.D. Fla. Feb. 16, 2021) (Florida law); Vandalay Hosp. Grp. LP v. Cincinnati Ins. Co., 2021 WL 462105, at *1 (N.D. Tex. Feb. 9, 2021) (Texas law); Protégé Rest. Partners LLC v. Sentinel Ins. Co., 2021 WL 428653, at *4 (N.D. Cal. Feb. 8, 2021) (California law); Colgan v. Sentinel Ins. Co., 2021 WL 472961, at *3 (N.D. Cal. Jan. 26, 2021) (California law); Ba Lax, LLC v. Hartford Fire Ins. Co., 2021 WL 144248, at *3 (C.D. Cal. Jan. 12, 2021) (California law); O'Brien Sales & Mktg, Inc. v. Transp. Ins. Co., 2021 WL 105772, at *3–4 (N.D. Cal. Jan. 12, 2021) (California law); Humans & Resources, LLC v. Firstline Nat'l Ins. Co., 2021 WL 75775, at *5 (E.D. Pa. Jan. 8, 2021) (Pennsylvania law); Karen Trinh, DDS, Inc. v. State Farm Gen. Ins. Co., 2020 WL 7696080, at *4 (N.D. Cal. Dec. 28, 2020) (California law); Mortar & Pestle Corp. v. Atain Spec. Ins. Co., 2020 WL 7495180, at *3 (N.D. Cal. Dec. 21, 2020) (California law); Kessler Dental Assocs., P.C. v. Dentists Ins. Co., 505 F. Supp. 3d 474, 480 (E.D. Pa. 2020) (Pennsylvania law); Long Affair Carpet & Rug, Inc. v. Liberty Mut. Ins. Co., 500 F. Supp. 3d 1075, 1078 (C.D. Cal. 2020) (California law); Brian Handel D.M.D., P.C. v. Allstate Ins. Co., 499 F. Supp. 3d 95, 99 (E.D. Pa. 2020) (Pennsylvania law); Uncork & Create LLC v. Cincinnati Ins. Co., 498 F. Supp. 3d 878, 883 (S.D. W. Va. 2020) (West Virginia law); Mudpie, Inc. v. Travelers Cas. Ins. Co., 487 F. Supp. 3d 834, 839 (N.D. Cal. 2020) (California law); Pappy's Barber Shops, Inc. v. Farmers Group, Inc., 487 F. Supp. 3d 937, 944 (S.D. Cal. 2020) (California law); 10e, LLC v. Travelers Indem. Co., 483 F. Supp. 3d 828, 836 (C.D. Cal. 2020) (California law).

75. Oral Surgeons, P.C. v. Cincinnati Ins. Co., 2 F.4th 1141 (8th Cir. 2021); Mudpie, Inc. v. Travelers Cas. Ins. Co. of Am., __ F.4th __, 2021 WL 4486509 (9th Cir. Oct. 1, 2021); Santo's Italian Cafe, LLC v. Acuity Ins. Co., __ F.4th __, 2021 WL 4304607 (6th Cir. Sept. 22, 2021).

devastating consequences for businesses struggling to survive the Covid-19 pandemic, and it will have even greater consequences for the homeowners and lenders who purchase property insurance on a daily basis.

The *Couch 3d* test is largely circular. It does not flow from any substantial body of insurance law that existed (or that currently exists) outside of *Couch 3d*'s own sphere of influence. Nor is it compelling on its own. Property policies generally cover "direct physical loss or damage," which does not unmistakably communicate *Couch 3d*'s rule to an ordinary person. Perhaps insurers view "physical" as a term of art that means a "distinct, demonstrable, physical alteration." But they have not *communicated* that intent in the policy by actually defining "physical loss or damage," as courts have "begged" them to do for decades.[76]

Basic textual analysis shows why the opposite rule is correct. When property is stolen, unusable, unsafe, or nonfunctional, the policyholder has suffered a "physical loss." This comports with the distinction between "loss"[77] and "damage,"[78] two words with different meanings in the English language. If "physical" required some "distinct, demonstrable, physical alteration," then "physical loss" would be rendered meaningless.

The word "physical" simply restricts coverage to losses that are "of or relating to natural or material things, as opposed to things mental, moral, spiritual, or imaginary."[79] This draws the same line as pre-1995 decisions favoring policyholders (involving physically unsafe, physically unusable, or physically contaminated property) and pre-1995 cases favoring insurers (involving title insurance and voided warranties). An impaired title or an invalid warranty is a *legal* loss. It injures a legal right appurtenant to the

76. Cherokee Nation v. Lexington Ins. Co., 2021 WL 506271, at *3–6 (Okla. Dist., Cherokee Cnty. Jan. 28, 2021).

77. "[T]he act or fact of losing : failure to keep possession : deprivation." *Loss*, Webster's Third New Int'l Dictionary 1338 (Unabridged ed. 1966) [hereinafter Webster's]; *Loss*, I The Compact Edition of the Oxford English Dictionary 1666 (2d ed. 1986) [hereinafter Oxford's] ("**2.a.** The being deprived of, or the failure to keep (a possession, appurtenance, right . . . or the like). . . . **5.** Diminution of one's possessions or advantages; detriment or disadvantage involved in being deprived of something."); *Loss*, Merriam-Webster Online Dictionary, www.merriam-webster.com/dictionary/loss (last visited Sept. 1, 2021) ("2.a(2) the partial or complete deterioration or absence of a physical capability or function"); *Loss*, Dictionary.com, www.dictionary.com/browse/loss (last visited Sept. 1, 2021) ("1. detriment, disadvantage, or deprivation from failure to keep, have, or get").

78. "[L]oss due to injury : injury or harm to person, property, or reputation : hurt, harm." *Damage*, Webster's, *supra* note 77, at 571; *Damage*, I Oxford's, *supra* note 77, at 641 ("**2.** Injury, harm ; *esp.* physical injury to a thing."); *Damage*, Merriam-Webster Online Dictionary, *supra* note 77 ("[L]oss or harm resulting from injury to person, property, or reputation."); *Damage*, Dictionary.com, *supra* note 77 ("injury or harm that reduces value or usefulness").

79. *Physical*, Webster's, *supra* note 77, at 1706; *see Physical*, The American Heritage Dictionary of the English Language 1331 (5th ed. 2011) (same); II Oxford's, *supra* note 77, at 2161 ("Of or pertaining to material nature . . . as opposed to *psychical, mental, spiritual*"); *Physical*, Merriam-Webster Online Dictionary, *supra* note 77 ("of or relating to material things"); *Physical*, Dictionary.com, *supra* note 77 ("of or relating to that which is material").

property, and does not impair the property itself. Thus, *Couch 3d* is correct in observing that the term "physical loss" excludes losses "that are intangible or incorporeal," such as a defect in title.[80] But that statement, true as it is, does not support *Couch 3d*'s blanket "physical alteration" test. It simply illustrates one kind of "loss" that property insurance does not cover.

As the title-insurance litigation shows, the word "physical" exists in the policy for a good reason. English speakers often use the word "loss" in the mental, moral, spiritual, or imaginary sense. We speak of a "loss of reputation," a "loss of affection," or even (as John Milton wrote) a world in a state of "utter loss" and in need of divine intervention.[81] Or, in another direction, the unwitting purchaser of a house "widely reputed to be possessed by poltergeists" might have made a claim on his property insurer for a "loss," had the New York Appellate Division not excused him from the purchase by holding the seller "is estopped to deny their existence and, as a matter of law, the house is haunted."[82] In contrast to property overrun by chemicals[83] or spiders,[84] a house possessed by ghosts would seem to be the prototypical example of an "incorporeal," and thus a "nonphysical," loss.

However, this discussion of ghosts, titles, and damnation simply shows that the traditional analysis—supported by the decades of case law predating this section of *Couch 3d*—is not outlandish at all. A property perched on a cliff, inundated with gasoline, unusable due to odors or bacteria, or in danger of a rockfall is at risk due to the laws of the physical realm, not of perils legal or paranormal. *Couch 3d*'s rule erases this important distinction.

Second, the pre-*Couch* rule has a firm basis in the risk-based nature of insurance, in basic principles of insurance law, and in insurance-industry intent. Actuaries can predict the likelihood of physical phenomena that might affect property, even if those perils do not alter or structurally injure property, and even if the peril strikes the entire risk pool at the same time.[85] They can set appropriate premiums. But more difficult (or impossible) to predict, in advance, is the risk that décor will go out of style, that a house will be deemed haunted as a matter of law, or that a market meltdown will impair property values.

---

80. 10A Couch on Insurance 3d § 148:46.

81. *Loss*, I Oxford's, *supra* note 77, at 1666.

82. Stambovsky v. Ackley, 169 A.D.2d 254, 255–56 (N.Y. App. Div., 1st Dep't 1991).

83. Gregory Packaging, Inc. v. Travelers Prop. Cas. Co., 2014 WL 6675934, at *5–6 (D.N.J. Nov. 25, 2014).

84. Cook v. Allstate Ins. Co., 2007 Ind. Super. LEXIS 32, at *6–10 (Madison Cnty. Nov. 30, 2007).

85. Erik S. Knutsen & Jeffrey W. Stempel, *Infected Judgment: Problematic Rush to Conventional Wisdom and Insurance Coverage Denial in a Pandemic*, 27 Conn. Ins. L.J. 185, 194–95 (2020) (explaining that pandemic losses are "insurable in theory because the timing of the pandemic itself is a fortuitous event," because "not all industries will be affected at the same time and to the same degree," and because some portions of the risk pool "may profit from the pandemic in their specific industries and may have no loss at all").

Thus, the traditional distinction between physical and nonphysical losses matches up neatly with risks that insurers can price, predict, and guard against. *Couch 3d*'s test draws the line much further upstream, leaving homeowners, businesses, and lenders exposed to large swaths of perfectly insurable risks. That fact provides ample reason to doubt *Couch 3d*'s argument that insurers drew the line there.

The more likely explanation is that "physical loss" is what the *Restatement (Second) of Contracts* calls a "deliberately obscure" term.[86] It is broad enough to let insurers charge "all risk" premiums, but ambiguous enough so the insurer can "decide at a later date what meaning to assert,"[87] i.e., a narrower, "physical alteration" rule.[88] This is illustrated by the industry's acts of playing both sides of the "physical loss" question—restrictive when it faces the policyholder, and expansive when it faces another insurer to whom it might shift liability.[89] As the *Restatement of the Law*, *Liability Insurance* points out, this is the definition of ambiguity: when "there is more than one meaning to which the language of the term is reasonably susceptible when applied to the facts of the claim."[90] If the insurance industry interprets the language both ways, surely both readings must be reasonable. But it is in these situations that both *Restatements* and every jurisdiction in the country calls for words to be construed against the drafter.[91]

Third, property insurance is one of the least negotiable types of insurance. Millions of homeowners are required, by their lenders, to maintain insurance on mortgaged property. Homeowners lack the kind of leverage that a multinational company would have to negotiate manuscript commercial-property coverage. They must have it, and due to insurers' antitrust immunity, they have no power to negotiate the terms of the policy. Yet they (and the banks that hold their mortgages) would be among the ones who suffer the most if *Couch 3d*'s rule actually becomes "widely held."

Homeowners' policies, like commercial property policies, are written on "physical loss" forms. If property insurance is construed as *Couch 3d* (incorrectly) suggests, the courts will unwittingly shift an enormous body of risks

86. Restatement (Second) of Contracts § 206, cmt. a (Am. L. Inst. 1981).

87. *Id.*

88. This is far from speculation. One writer recounts the story of an "experienced policy underwriter justifying an ambiguous draft policy as follows: 'We draft them this way so we can say later that the policy means whatever we want it to mean.'" George M. Plews & Donna C. Marron, *Survey: Environmental Law Developments: Hope and Ambiguity in Achieving the Optimum Environment*, 37 Ind. L. Rev. 1055, 1058–59 (2004).

89. *See supra* notes 50–53 and accompanying text.

90. Restatement of the Law, Liability Insurance § 4(1) (Am. L. Inst. 2019).

91. Restatement (Second) of Contracts, *supra* note 86, § 206, cmt. a. The *Restatement of the Law*, *Liability Insurance* provides for the same outcome, for the same reasons. Restatement of the Law, Liability Insurance, *supra* note 90, § 4(2), *see id.* §§ 3(3), (4), cmt. d ("The *contra proferentem* rule gives the supplier of the terms the incentive to take all reasonable steps to eliminate ambiguity in the drafting of terms.").

back on consumers and financial institutions. Homes condemned due to contamination, health hazards, or nearby natural perils could suddenly lack coverage. And if there are outstanding mortgages on those homes, the loss would be borne by the homeowner (saddled with five-or-six-figure debt or an additional mortgage payment) or the lender (unable to sell foreclosed property for anywhere near its mortgaged value). Given the long-term nature of these arrangements, blindly following *Couch* threatens to upend the law mid-stream and throw these reliance interests into disarray.

IV. CONCLUSION

The current Covid-19 coverage litigation is important in its own right. However, it is also a test of the courts' ability to be curious, thorough, and prudent in the way they resolve disputes. There is no substitute for a court's thorough review and analysis of the actual language before it and the actual law governing that language. Consulting a treatise is helpful. But they are only aids in legal analysis and can, as we have shown, be grievously wrong.

This particular section of *Couch 3d* does not aid courts whatsoever in their efforts to faithfully apply the law. Not only does it get the law wrong, but it invites courts to set dangerous precedent that could unravel decades of settled property-insurance law, on which ordinary businesses, banks, and families rely. If courts accept *Couch 3d*'s "physical alteration" fallacy, the results could be catastrophic. The ensuing legal regime could well deny policyholders the benefit of the all-risk coverage they purchased and, under the pressure of the greatest health and economic dislocation in a century, send droves of policyholders into bankruptcy. That is both bad law and bad policy.