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COVID Decision of Interest

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In a recent New York Court of Appeals opinion, the court found that business losses due to the COVID-19 pandemic were not covered under an "all-risk" commercial property insurance policy. In *Consolidated Rest. Operations, Inc. v Westport Insurance Corp.**[1]***, plaintiff Consolidated Restaurant Operations (CRO) sought a declaration that their insurance provider, Westport Insurance Corporation (Westport), had obligations under CRO's insurance policy to compensate CRO for losses sustained at CRO's properties due to the COVID-19 pandemic. The court held for the defendant, finding that the effects of the coronavirus did not constitute "direct physical loss or damage" to the properties, and dismissing the breach of contract and declaratory judgment claims.

CRO, a company that owns and operates restaurants, obtained an "all-risk" commercial property insurance policy from Westport in 2019. The policy, which is governed by New York law, insured "all risks of direct physical loss or damage to insured property," as well as business interruption losses "directly resulting from direct physical loss or damage" to insured property. *2024 NY Slip Op 00795*.

Due to the COVID pandemic, CRO's revenue dropped off precipitously, as they were forced to reduce or halt their operations.

CRO sued Westport for enforcement of their contract on the basis that CRO suffered "direct physical loss or damage" as a result of the pandemic. The lower court dismissed these claims in part because they found that "direct physical loss or damage" requires "tangible, ascertainable damage, change or alteration to the property."

CRO appealed, arguing first that the phrase "direct physical loss or damage" encompasses scenarios in which a physical event occurring on the property (like the presence of a virus) renders the property unusable for its intended purpose. The Appellate Division disagreed, as did the Court of Appeals, both holding that direct physical loss or damage "requires a material alteration or a complete and

persistent dispossession of insured property, which CRO did not allege." They asserted that CRO's interpretation of "direct physical loss or damage" would conflate coverage for direct physical loss with coverage for loss of use. Direct physical loss, the court concluded, "requires more than loss of use; it requires an actual, complete dispossession." The court further elucidated this point by citing to a provision in the policy which covers loss of use stemming from physical loss, inherently suggesting that there is a distinction contemplated in the policy.

CRO cited to cases which hold that loss of a premises' use due to the presence of gasoline or fumes constituted direct physical loss. The court distinguished these, noting that these cases found that there must be coverage when physical contamination is persistent and complete, eliminating the function of the building. The court additionally pointed to contradictory holdings, which held that contamination to the point of uninhabitability was insufficient to constitute physical loss, as physical loss requires a physical alteration. The court did not ultimately consider whether persistent contamination or total uninhabitability of its restaurants constituted actual material dispossession, and thus direct physical loss, since the plaintiff's submissions did not include this allegation.

CRO also argued that there was in fact a direct physical alteration of the property. They claimed that the presence of droplets carrying the virus compromised the physical integrity of the structures they permeate and pose an imminent risk of physical damage to all other structures. The court dismissed this with brevity, noting that the complaint did not allege that there is any need to repair or replace the property, only business interruption losses. Citing to another case, the court noted that nothing in the allegations supports the conclusion that the coronavirus damaged physical structures, as opposed to those who come into contact with them.

Ultimately, the court held that "direct physical loss or damage" requires a material alteration or a complete and persistent dispossession of insured property. The presence of the coronavirus in businesses and the temporary reduction or discontinuance of in-person dining does not meet this threshold.

[1] Corp. 2024 NY Slip Op 00795