No. 20-16858

IN THE

United States Court of Appeals for the Ninth Circuit

MUDPIE, INC.,

Plaintiff-Appellant,

v.

TRAVELERS CASUALTY INSURANCE COMPANY OF AMERICA,

Defendant-Appellee.

On Appeal from the United States District Court
for the Northern District of California
No. 4:20-cv-03213-JST

MOTION OF *AMICUS CURIAE* UNITED POLICYHOLDERS TO SUBMIT BRIEF IN PARTIAL SUPPORT OF APPELLANT MUDPIE, INC.

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February 9, 2021

United Policyholders ("UP") moves the Court for an order permitting it to file the enclosed *amicus curiae* memorandum of points and authorities in partial support of the Appellant. The memorandum, a copy of which is attached, brings to the Court's attention longstanding California precedents and maxims of insurance law that bear directly on the issue of whether coronavirus-related losses are insurable under commercial property policies, but which some lower courts have for far too long overlooked during this pandemic. *Amicus* support is especially vital here because the issues implicated by this case are far-reaching and of critical importance, as they may affect the fate of insurance recoveries for small businesses throughout California.

I. INTEREST OF *AMICUS CURIAE*

UP is a respected national non-profit 501(c)(3) organization and policyholder advocate. Founded in 1991, for nearly three decades UP has operated as a dedicated information resource for individual and commercial insurance consumers throughout the entire United States, and has helped secure important trial and appellate victories for policyholders. During this historic pandemic, UP's commitment to defending and arguing for policyholders' rights to coverage for their wide-scale COVID-19 losses is more critical than ever.

UP assists purchasers of insurance when seeking a policy or pursuing a claim for loss. For example, UP is routinely called upon to help individual policyholders in the wake of large-scale national disasters such as floods and windstorms in the Midwest, wildfires in Arizona, California, Colorado, New Mexico, Oregon and Washington, and hurricanes in the Gulf States and across the Eastern Seaboard. This past year, UP has been engaged in the critical effort to assist business owners around the country whose operations have been affected by COVID-19 and public safety orders. UP is conducting educational workshops for businesses and trade associations and maintaining an online help library at uphelp.org/COVID.

In addition, UP's Executive Director has been an official consumer representative to the National Association of Insurance Commissioners since 2009. In that role, UP assists regulators in monitoring policy language and claim practices through presentations and collaboration and the development of model laws and regulations.

Since 1991, UP has filed *amicus* briefs in federal and state appellate courts across 42 states and in more than 500 cases, including more than 40 published appellate decisions applying California law and at least ten cases before this Court. UP's *amicus* briefs have been cited in the opinions of many state supreme courts, including the Supreme Court of California, as

well as the U.S. Supreme Court. *See, e.g., Humana Inc. v. Forsyth*, 525 U.S. 299, 314 (1999); *Pitzer Coll. v. Indian Harbor Ins. Co.,* 8 Cal. 5th 93, 104-05 (2019); *Julian v. Hartford Underwriters Ins. Co.*, 110 P.3d 903, 911 (Cal. 2005); *Cont'l Ins. Co. v. Honeywell Int'l, Inc.*, 188 A.3d 297, 322 (N.J. 2018); *Allstate Prop. & Cas. Ins. Co. v. Wolfe*, 105 A.3d 1181, 1185-86 (Pa. 2014).[1]

II. UP FULFILLS THE CLASSIC ROLE OF *AMICUS CURIAE*

By submitting a brief in this matter, UP seeks to assist the Court on an important issue to many of the policyholders that UP advocates for—namely, the insurability of coronavirus-related losses—by drawing the Court's attention to controlling law that has escaped lower courts' attention to date. This is a quintessential role for *amicus curiae*, and courts in this Circuit routinely authorize the filing of *amicus* briefs in such circumstances. *See Miller-Wohl Co. v. Comm'r of Lab. & Indus.*, 694 F.2d 203, 204 (9th Cir. 1982) (describing "the classic role of amicus curiae [as] assisting in a case of general public interest, supplementing the efforts of counsel, and drawing the court's attention to law that escaped consideration").

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[1] A complete listing of all cases in which UP has appeared as *amicus curiae* can be found in UP's online Amicus Project library at www. https://www.uphelp.org./resources/amicus-briefs.

Further, "courts frequently welcome amicus briefs from nonparties concerning legal issues that have potential ramifications beyond the parties directly involved." *Safari Club Int'l v. Harris*, 2015 WL 1255491, at *1 (E.D. Cal. Jan. 13, 2015) (quoting *NGV Gaming, Ltd. v. Upstream Point Molate, LLC*, 355 F. Supp. 2d 1061, 1067 (N.D. Cal. 2005)). Such is the case here. This Court's adjudication of the recurring legal issue of whether the perils posed by the coronavirus pandemic constitute an insurable loss may bear directly on the prospects of insurance recovery for pandemic-affected policyholders throughout California (and beyond). As a policyholder advocate, UP has a strong interest in ensuring that policyholders receive the full amount of insurance coverage available to them under the insurance policies that their insurers prepared and sold to them.

Moreover, "most courts have granted amicus participation … 'when the amicus has unique information or perspective that can help the court beyond the help that the lawyers for the parties are able to provide.'" *Duronslet v. Cnty. of Los Angeles*, 2017 WL 5643144, at *1 (C.D. Cal. Jan. 23, 2017) (quoting *Cmty. Ass'n for Restoration of Env't (CARE) v. DeRuyter Bros. Dairy*, 54 F. Supp. 2d 974, 975 (E.D. Wash. 1999)). Again, that is precisely the case here. As a policyholder advocate with deep insurance industry knowledge that has filed *amicus* briefs in more than 500

cases, UP's *amicus* brief represents a different perspective from that of the Appellant in this case, which is not represented by an insurance coverage specialist. UP's brief also offers a helpful perspective because its briefs have been cited with approval by the California Supreme Court, the highest tribunal enunciating the law that governs this case.

While insurers are "repeat players" in coverage litigation, most policyholders are not. *Coleman v. Gulf Ins. Group*, 41 Cal. 3d 782, 806 n.9 (1986) (Bird, C.J., dissenting); *see also Travelers Ins. Co. v. Budget Rent-A-Car Sys., Inc.*, 901 F.2d 765, 771 (9th Cir. 1990) (describing insurance companies as "institutional litigants"). Thus, if UP were denied the opportunity to present its arguments, from the perspective of a policyholder advocate steeped in insurance law, while the appellee insurance company retained its position as the only institutional litigant in this case, the Court would then be deprived of a symmetry of advocacy necessary for the fair and even-handed development of the law.[2]

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[2] UP recognizes that *amicus* briefs are ordinarily due seven days after the party's principal brief is filed. However, "[a] court can grant leave for an amicus to file a brief later than Rule 29(a)(6) provides." 16AA Fed. Prac. & Proc. Juris. § 3975.3 (5th ed.). UP only learned of this appeal in mid-January, and it has been working diligently since that time to draft this brief in a timely manner. Furthermore, two California Superior Court decisions addressing COVID-19 coverage issues were issued only days ago, and UP has been working to review and incorporate these developments.

Finally, there is no downside to granting UP's motion for leave to file the *amicus* brief. In this Circuit, courts have oft "held it is 'preferable to err on the side of permitting amicus briefs.'" *Earth Island Inst. v. Nash*, 2019 WL 6790682, at *2 (E.D. Cal. Dec. 12, 2019) (quoting *Duronslet*, 2017 WL 5643144, at *1, and in turn citing *Neonatology Assocs., P.A. v. C.I.R.*, 293 F.3d 128, 133 (3d Cir. 2002) (Alito, J.)) (brackets and some quotation marks omitted). This is so because "if the filed amicus brief turns out to be unhelpful, the court can then simply disregard it." *Id.* (internal quotation marks omitted). "On the other hand, if a good brief is rejected, the Court will be deprived of a resource that might have been of assistance." *Duronslet*, 2017 WL 5643144, at *1 (brackets omitted).

For the foregoing reasons, UP respectfully requests leave to file the attached *amicus curiae* brief.[3]

DATED: February 9, 2021

Respectfully submitted,

COVINGTON & BURLING LLP

By: */s/ David B. Goodwin*
David B. Goodwin

Attorney for *Amicus Curiae*
UNITED POLICYHOLDERS

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[3] The undersigned is representing UP in this matter on a *pro bono* basis.

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BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS IN PARTIAL SUPPORT OF APPELLANT MUDPIE, INC.

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February 9, 2021

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, United Policyholders certifies that it is a non-profit 501(c)(3) organization with no parent company and no publicly traded stock.

COVINGTON & BURLING LLP

By: */s/ David B. Goodwin*
David B. Goodwin

Attorney for *Amicus Curiae*
UNITED POLICYHOLDERS

February 9, 2021

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STATEMENT OF INTEREST OF *AMICUS CURIAE*[4]

Amicus curiae United Policyholders ("UP") is a non-profit organization whose mission is to serve as an effective voice for insurance policyholders throughout the country. UP is funded by donations and grants and does not sell insurance or accept money from insurers.

During this pandemic, UP's commitment to arguing for policyholders' rights to coverage for their wide-scale COVID-19 losses is more vital than ever. By submitting this brief, UP seeks to assist the Court on an issue of critical importance to the many policyholders for whom UP advocates—namely, the insurability of COVID-related losses—by drawing the Court's attention to controlling law that has escaped lower courts' attention to date.

INTRODUCTION

This case follows an unfortunate but all-too-common script: A small California business is forced to curtail its operations severely due to the viral pandemic and attendant government restrictions. The business turns to its property insurer for coverage for its business losses, and yet the insurer refuses to assist—asserting that while operations at the

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[4] Pursuant to Federal Rule of Appellate Procedure 29(a)(4)(E), UP affirms that no counsel for a party authored this brief in whole or in part and that no person other than UP or its counsel made any monetary contributions intended to fund the preparation or submission of this brief.

policyholder's physical premises may have been impaired, such harm does not satisfy the coverage trigger of "physical loss or damage" to property.

When the small business goes to federal court to pursue its insurance coverage rights, its insurer—a repeat player in coverage litigation, armed with disproportionately high-powered counsel and an incentive to secure early COVID-19 judicial "wins"—immediately files a motion to dismiss its policyholder's insurance claim. And the federal court, without the benefit of having before it the full range of relevant state precedents (much less critical discovery into and expert testimony concerning the physical impacts of the coronavirus), agrees to dismiss the claim, based on a faulty prediction that California courts would not treat pandemic-related damage to the usability of physical property as "physical loss or damage."

This Court need not, and ought not, affirm this erroneous prediction on appeal. Rather, the most appropriate course is to (a) decline to certify the "physical loss or damage" issue to state courts or endorse the district court's physical injury analysis, and (b) remand this case with instructions to permit re-pleading (or, alternatively, to sustain the dismissal based only on narrow policy exclusion grounds, an issue on which this brief takes no position). The reasons for this course of action are four-fold.

First, this case presents a poor vehicle for certification of the "physical loss or damage" issue. The record on appeal lacks the factual details necessary to adequately investigate the existence of "physical loss or damage" such that a sufficiently helpful response could be obtained from California's high court. Moreover, resolution of the "physical loss or damage" question may not be outcome-determinative here, as the policy includes a standard form virus exclusion that arguably (although, as noted, UP takes no position on the matter) strips coverage for COVID-related losses even if "physical loss or damage" is alleged. Given those complications, certification here would be ill-advised.[5]

Second, if this Court were to set aside the virus exclusion (rather than affirm on that basis), then this case would be a strong candidate for remand with instructions to grant leave to amend. Such remand would allow Mudpie to further connect its business losses to dangerous physical viral perils.

Third, this federal appeal is simply not the right case to attempt to determine when pandemic-affected property suffers physical injury for insurance purposes, because that is an issue of state law on which

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5 Although UP files this *amicus* in support of the position of policyholder Mudpie on the merits of the "physical loss or damage" issue, it does not support Mudpie's request for certification.

California courts should speak first. And indeed, there are several pending California state court cases that are expected to resolve this issue.

Fourth, if this Court does address the merits of the dismissal, it should hold that the district court erred in declining to find "physical loss or damage" in the circumstances of this pandemic. Multiple California state trial courts have so found at the pleading stage, and for good reason: It has long been the rule in California state courts that property is physically lost or damaged when its utility is materially impaired by an external peril, even if the property's basic structure remains intact. And settled California law confirms that noxious substances that impair the safety of property give rise to physical injury for purposes of insurance coverage.

Under this established authority, a business suffers physical loss or damage when a viral pandemic and related civil restrictions undermine the safety and fitness for use of such premises. Almost none of this authority was brought to the attention of the district court by the insurer (or the policyholder), and the district court erred when it failed to locate, and follow, that controlling California precedent.

ARGUMENT

I. This Is Not the Right Case to Certify to the California Supreme Court

"Even where state law is unclear, resort to the certification process is not obligatory." *Riordan v. State Farm Mut. Auto. Ins. Co.*, 589 F.3d 999, 1009 (9th Cir. 2009). Instead, the decision to certify questions of state law to state courts "rests in the sound discretion of this court." *McLinn v. F/V Fjord*, 744 F.2d 677, 681 (9th Cir. 1984). This case presents a poor vehicle for the Court to exercise its discretion to certify questions concerning the insurability of COVID-19 losses, both because this case is being appealed from an undeveloped record, and because such questions may not be outcome-determinative here.

First, in considering whether to approve or withhold certification, this Circuit considers whether the legal issue can be framed to produce a "helpful response" from the state court. *McLinn*, 744 F.2d at 681. In this appeal, however, the potential helpfulness of a certified determination is hampered by the thin record from the district court, which dismissed a 16-page complaint unaccompanied by any extrinsic factual support. In order for resolution of a certified question to be "sufficiently helpful" in guiding California courts on the stream of cases that must evaluate the fact-intensive questions of coverage and attendant physical injury issues, the

Court should have before it a record that would allow future courts to analogize facts related to their own damages to those relied upon in the certified question.

Notably, as a consequence of the complaint's barebones allegations and the termination of the case before discovery, the record has no evidence of, among other things, the rapid transmissibility of the coronavirus, scientific studies reflecting the virus's capacity to alter and adhere to surfaces or linger and circulate in the air for extended periods of time, the array of remedial measures necessary to contain or manage the virus, or the full range of government restrictions that attend viral spread. *See* Section IV.C.1., *infra*. Thus, if this matter were certified, and if the California Supreme Court were to accept the certification, that Court (or this Court, were it to address the merits of the "physical loss or damage" argument) would be guessing about the physical implications of the pandemic and their effect on property. Judgments of that type, with substantial insurance proceeds depending on the answer, should be made on the basis of expert testimony and fact-finding.

Second, a certified determination as to whether Mudpie has adequately pleaded a claim for insurance coverage would not necessarily resolve this appeal, because the record reveals potential alternative grounds

for affirming the dismissal of Mudpie's claim. Specifically, the Travelers policy includes a standard form Insurance Services Office virus exclusion, which Travelers has argued excludes "'loss or damage caused by or resulting from any virus'—such as the COVID-19 virus." Dismissal Order at 2. Although the district court did not address the virus exclusion argument in its Dismissal Order, *id.* at 12 n.9, this Court "may affirm for any reason supported by the record," *Griffin v. Arpaio*, 557 F.3d 1117, 1121 (9th Cir. 2009), or alternatively, remand for further consideration by the district court of the unaddressed issue, *Hawkins v. Kroger Co.*, 906 F.3d 763, 773 n.11 (9th Cir. 2018).

While UP does not take a position on applicability of the ISO virus exclusion in this *amicus* brief, it notes that the Court cannot certify this appeal to the California Supreme Court unless the Court first finds that the exclusion does *not* provide a potential alternative basis for rejecting coverage. After all, the California Supreme Court *requires* that the certified issue be determinative in the pending matter, California Rule of Court 8.548(a)—which the coverage issue will not be if a policy exclusion applies to strip any coverage that could otherwise be established. *See Hodsdon v. Mars, Inc.*, 891 F.3d 857, 865 n.7 (9th Cir. 2018) (denying request to certify

to the California Supreme Court where "the answer to Plaintiff's question [would] not [be] outcome-determinative").

In short, this case's undeveloped record and the language of the subject policy make it a poor candidate for certification.

II. The Court Can and Should Resolve This Appeal by Remanding with Instructions to Grant Leave to Amend

If this Court were to conclude that the virus exclusion does not bar coverage for pandemic-related losses, then this case would be a prime candidate to remand with instructions to the district court to grant leave to amend the complaint and, if the complaint pleads a claim, allow discovery, so that the trier of fact can assess on a proper record whether the proliferation of the virus does cause physical loss or damage. Indeed, if the virus exclusion were set aside, then Mudpie would presumably be in a stronger position to plead a nexus between its business losses and the physical viral perils posed by the pandemic.

"The standard for granting leave to amend is generous." *Balistreri v. Pacifica Police Dept.*, 901 F.2d 696, 701 (9th Cir. 1990). Where a complaint's "deficiencies [are] readily curable with some guidance from the court," further amendment may be warranted. *Bautista v. Los Angeles Cnty.*, 216 F.3d 837, 841-42 (9th Cir. 2000); *see also Moss v. U.S. Secret Serv.*, 572 F.3d 962, 972 (9th Cir. 2009) (granting leave to amend where

plaintiff "initiated the present lawsuit without the benefit of the Court's latest pronouncements" on pleading requirements).

At present, uncertainty regarding whether the virus exclusion applies appears to have hampered Mudpie's ability to fully allege that virus-related perils acting upon its physical premises caused "physical loss or damage."[6] If this Court were to eliminate this uncertainty by clarifying that the virus exclusion is either unenforceable or inapplicable in the pandemic context, then Mudpie may have greater leeway to plead such allegations. In that scenario, this Court would have solid grounds to grant leave to amend so that Mudpie could further strengthen its complaint with the benefit of this Court's intervening guidance.

III. This Is Not the Right Case to Delineate What Causes Physical Loss or Damage

Although there are multiple lines of cases construing "physical loss or damage" terms in insurance policies (discussed in Section IV *infra*), applying those cases to the specific facts of this pandemic presents novel questions that are currently being addressed by multiple California state courts. Under these circumstances, this Court is well-served allowing the state courts to speak first on the coverage question.

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6 *See* Dismissal Order at 10 (emphasizing that Mudpie "does not allege, for example, that the presence of the COVID-19 virus in its store created a physical loss").

The Court has long exercised restraint and declined to "express [its] construction of a novel question of state law where it is not necessary to do so." *Avila v. Travelers Ins. Co.*, 651 F.2d 658, 660 (9th Cir. 1981). The Court's restraint is rooted in the sound conviction that "[i]t is unnecessary [for it] to put [its] imprimatur on emerging and as yet unsettled issues of California [] law." *Id.* at 661.

Property loss or damage from the novel coronavirus, and ensuing insurance implications, is just such an "emerging and as yet unsettled" state law issue. The widespread losses and civil authority orders associated with COVID-19 began less than a year ago. California courts have not yet engaged in a trial on the merits of any claim presenting losses associated with the pandemic and related civil orders, let alone addressed the nuances and subtle distinctions between policies that may impact this body of law. Although there is authority on physical loss or damage in first-party insurance policies like this one, California state courts have largely not yet had the opportunity to apply that case law to the specific conditions associated with the pandemic. And jumping ahead of those state courts in this coverage context would be especially unusual, given that "insurance is traditionally an area of state regulation." *Galilea, LLC v. ACGS Marine Ins. Co.*, 879 F.3d 1052, 1058 (9th Cir. 2018).

It is also unnecessary for this Court to weigh in on the issue at this time because it will be imminently addressed by state courts. At present, more than 60 cases pending in California state courts allege some form of property policy coverage related to losses arising during the pandemic.[7] Addressing the issue in this case before those courts have had a chance to weigh in on a fuller record is thus "unnecessary." *Avila*, 651 F.2d at 660.

The additional defects in this case described in the sections above further militate against using this case as the platform to test the physical loss or damage issue. The thin record from the district court would make it more difficult for future courts to rely on any precedent generated by this Court, as physical injury inquiries are often fact-intensive. Furthermore, the existence of a virus exclusion in the policy presents additional complications in both pleading and reviewing allegations of physical injury. A future case without those deficiencies would provide a better record to address this important legal issue without creating confusion or requiring subsequent courts addressing the issue to revisit this Court's rulings based on an actual factual record.

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[7] *See* Covid Coverage Litigation Tracker, University of Pennsylvania Carey Law School, https://cclt.law.upenn.edu/cclt-case-list/ (viewed on Feb. 5, 2021); COVID Loss Recovery Initiative - Lawsuits, United Policyholders, https://www.uphelp.org/covid-loss-recovery-initiative (viewed on Feb. 6, 2021).

IV. If the Court Does Decide to Address the Physical Loss or Damage Issue, it Should Hold that the District Court Erred

Finally, if (despite the alternative options available to it) this Court were to reach the issue of whether pandemic-related perils can cause "physical loss or damage" and thus trigger coverage, the Court should answer that question in the affirmative.

As detailed below, California courts have long adhered to the commonsense position that property is physically lost or damaged when its use or function is materially impaired by a fortuitous peril, even if the property's basic structure remains intact. Further, settled California law confirms that noxious substances that compromise the safety of property give rise to physical injury for purposes of insurance coverage.

Under this established authority, a business suffers physical loss or damage when—as Mudpie has alleged—it is deprived of substantial use of its premises due to a pandemic and related government restrictions, whether temporarily or permanently. Indeed, this conclusion has only been reinforced in recent days, as California state trial courts have sustained COVID-19 coverage complaints over insurer demurrers, and dismissed federal district court rulings to the contrary as "not control[ling]." *P.F. Chang's China Bistro, Inc. v. Certain Underwriters at Lloyd's*, (Feb. 4,

2021, No. 20STCV17169); *Goodwill Indus. of Orange Cnty., Cal. v. Phila. Indem. Ins. Co.*, (Jan. 28, 2021 No. 2020-01169032).

A. Physical Property Suffers "Physical Loss or Damage" When a Fortuitous Peril Impairs the Property's Use or Function

Mudpie's "all risks" policy covers its real and personal property. Under California law, such real or personal property may be physically lost or damaged when an external peril frustrates the property's intended use.

According to the California Court of Appeal, "direct physical loss," or damage, "contemplates an actual change in insured property then in a satisfactory state, occasioned by accident or other fortuitous event directly upon the property *causing it to become unsatisfactory for future use* or requiring that repairs be made to make it so." *MRI Healthcare Ctr. of Glendale, Inc. v. State Farm Gen. Ins. Co.*, 187 Cal. App. 4th 766, 779 (2010) (citation omitted and emphasis added); *id.* at 780 ("For there to be a 'loss' within the meaning of the policy … , [property] must have been 'damaged' within the common understanding of that term.").

In keeping with this expansive standard, California courts have found physical loss or damage in a wide range of circumstances involving perils that rob real or personal property of its use without also altering the property's structural makeup. Such scenarios include changing soil

conditions that render homes uninhabitable by placing them at risk of collapse, *see Hughes v. Potomac Ins. Co. of D.C.*, 199 Cal. App. 2d 239, 248–49 (1962); *Strickland v. Fed. Ins. Co.*, 200 Cal. App. 3d 792, 799-801 (1988); the dispossession of property through theft or conversion, *see EOTT Energy Corp. v. Storebrand Int'l Ins. Co.*, 45 Cal. App. 4th 565, 569 (1996); *Pac. Marine Cntr., Inc. v. Phil. Indem. Ins. Co.*, 248 F. Supp. 3d 984, 993 (E.D. Cal. 2017); and the loss of property due to mistaken shipment, *see Total Intermodal Servs. Inc. v. Travelers Prop. Cas. Co. of Am.*, 2018 WL 3829767, at *3–4 (C.D. Cal. July 11, 2018).

The California Court of Appeal's decision in *Hughes* provides a vivid illustration of how property rendered unusable but otherwise intact is still "damaged" within the usual understanding of the term. In that case, the policyholders awoke one morning to discover that the land next to their home had washed away into a creek, leaving their otherwise intact home on the edge of a newly created cliff. 199 Cal. App. 2d at 242-43. The policyholders sought coverage for the cost of stabilizing their home under a property insurance policy that (much like Mudpie's policy) insured them against "all risks of physical loss of and damage to" their dwelling. *Id.* at 242. The insurer denied coverage, essentially arguing that the home could

"not be[] 'damaged' so long as its paint remains intact and its walls adhere to one another." *Id.* at 248.

The Court of Appeal rejected this narrow construction of the policy language. The Court held that, absent a specific limiting provision, "[c]ommon sense requires that a policy should not be [] interpreted" in such a way that an insured home "might be rendered completely useless to its owners, [yet] [the insurer] would deny that any loss or damage had occurred unless some tangible injury to the physical structure itself could be detected." *Id.* at 248-49; *accord Strickland*, 200 Cal. App. 3d at 801 (rejecting the notion that an "insured [must] absorb the dangers inherent in living atop a land mass which is close to the point of failure" and holding that such dangers are "the type of risk [a property insurer is] paid to assume").

The foregoing precedents in first-party cases align with settled California authority in the liability insurance context (thus far largely overlooked by district courts addressing the physical injury issue in COVID-19 cases) that holds that property is physically harmed and that property damage has therefore occurred when noxious substances, even in small or unrealized quantities, disturb the safe use of the property. *See Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co.*, 45 Cal. App. 4th 1, 91 (1995)

(when a policyholder is deemed liable for "the release of asbestos fibers, whatever the level of contamination," or for the "health hazard [] of the potential for *future* releases," the "injury to the buildings is a physical one") (emphasis in original). Likewise, these California first-party decisions find support in persuasive out-of-state authorities that also find physical loss or damage based on fortuitous loss of use, irrespective of structural harm.[8]

B. The "Physical" Injury Requirement Only Guards Against Intangible or Non-Fortuitous Losses, Not Unexpected Loss of Use of Real or Personal Property

To the extent that California courts have placed limits on the breadth of the standard for "physical" loss or damage, those limits have been quite modest. To date, California appellate courts have declined to find insurable physical injury only when (a) the property in question is itself not physical or (b) the property is physical but has not been altered by an external peril.

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[8] *See, e.g., Gregory Packaging, Inc. v. Travelers Prop. Cas. Co. of Am.*, 2014 WL 6675934, at *6 (D.N.J. Nov. 25, 2014) ("[C]ourts considering non-structural property damage claims have found that buildings rendered uninhabitable by dangerous gases or bacteria suffered direct physical loss or damage."); *Murray v. State Farm Fire & Cas. Co.*, 509 S.E.2d 1, 5, 17 (W.V. 1998) (holding that "[d]irect physical loss [] may exist in the absence of structural damage to the insured property," and holding that homes "suffered real damage when it became clear that rocks and boulders could come crashing down at any time," such that homes "became unsafe for habitation" due to said threat).

In the first line of cases, the property was intangible and so was not susceptible to physical loss or damage. This includes, for example, lost electronic computer data, *Ward General Insurance Services, Inc. v. Employers Fire Insurance Co.*, 114 Cal. App. 4th 548, 555-56 (2003)[9]; cancelled business contracts, *Simon Marketing, Inc. v. Gulf Insurance Co.*, 149 Cal. App. 4th 616, 623 (2007); or leaked trade secrets, *id.* at 623-24. None of these decisions concerns physical property that could be physically harmed.

The second line of cases involves tangible property that was neither lost nor damaged; rather, the property suffered from internal vice. This includes an MRI machine that could not turn on because of a defect "inherent" in "the machine itself," *MRI Healthcare*, 187 Cal. App. 4th at 780; wine that was discovered to be counterfeit and thus of lesser value, *Doyle v. Fireman's Fund Insurance Co.*, 21 Cal. App. 5th 33, 38–40 (2018); a defective title to property, *Commercial Union Insurance Co. v. Sponholz*, 866 F.2d 1162, 1163 (9th Cir. 1989) (California law); and a condominium tainted by "latent defects, faulty workmanship and construction code

9 In deeming electronic computer data "intangible," 114 Cal. App. 4th at 556, the *Ward* court was apparently unaware of Albert Einstein's theory articulated in 1906, and subsequently confirmed by experiment, that electricity has mass and, hence, is tangible.

violations," which the insurance policy excluded, *State Farm Fire & Casualty Co. v. Superior Court*, 215 Cal. App. 3d 1436, 1439, 1442-43 (1989). In none of those cases was the subject loss external and accidental, *i.e.*, fortuitous, and so those courts concluded that the property insurance policies at issue did not respond.

The above lines of precedents are wholly inapposite in a case involving both *physical* property, such as Mudpie's retail store, and a *fortuitous* peril, such as a once-in-a-lifetime pandemic spurring changes to property and forcing the total or substantial shutdown of businesses.

C. Damage to the Usability of Property Due to a Viral Pandemic and Related Government Orders Constitutes Physical Loss and Damage

The coronavirus is a uniquely dangerous health and safety risk. The virus is potentially deadly, easily yet silently spread, and as such is one of the rare public health threats that have triggered government closure orders. Consequently, the unexpected coronavirus pandemic has caused policyholders like Mudpie to lose, in whole or in substantial part, safe use of their tangible property for business purposes—which, under the above-described *Hughes* and *Armstrong* lines of California precedents, constitutes "physical loss or damage" to property.

The following discussion reflects information in the public domain that is of the type that would be developed on remand were the case to

proceed through discovery or which, if the Court decides to address the issue presented on this appeal, would be appropriate for judicial notice.

1. The Coronavirus Pandemic is Physically Dangerous

The coronavirus is, without question, a serious physical peril. It has given rise to an infectious disease that has plagued more than 100 million people worldwide and has taken the lives of millions of victims thus far.[10] Because the virus has proven so hard to contain, it has led to a proliferation of governmental restrictions that have rendered numerous business properties unfit for their full intended use.

The coronavirus alters the physical conditions of property. The World Health Organization has advised that people can become infected with the coronavirus by touching virus-laden objects and surfaces, then touching their eyes, nose, or mouth. This mode of transmission—indirect transmission via objects and surfaces—is known as "fomite transmission."[11] To take one example, a study of a COVID-19 outbreak published in the

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[10] Johns Hopkins University & Medicine, COVID-19 Dashboard by the Center for Systems Science and Engineering, https://coronavirus.jhu.edu/map.html (viewed on Feb. 4, 2021).

[11] WHO, *Transmission of Sars-CoV-2: Implications for Infection Prevention Precautions* (July 9, 2020), https://www.who.int/news-room/commentaries/detail/transmission-of-sars-cov-2-implications-for-infection-prevention-precautions (viewed on Feb. 4, 2021).

Emerging Infectious Diseases journal identified indirect transmission via objects such as elevator buttons and restroom taps as an important possible cause of a "rapid spread" of the coronavirus in a shopping mall in China.[12] Unfortunately, the coronavirus has a proclivity to "stick." One recent study found that the coronavirus remained viable for up to 28 days on a range of common surfaces—e.g., glass, stainless steel, and money—left at room temperature.[13]

Also of note, infected persons can generate virus-laden aerosols that linger in the air even after the infected person has left the vicinity and can migrate substantial distances through a building's ventilation systems. One study found the presence of the coronavirus within the HVAC system servicing hospital ward rooms of COVID-19 patients. This study detected SARS-CoV-2 RNA in ceiling vent openings, vent exhaust filters, and central ducts that were located more than 50 meters from the patients' rooms.[14]

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[12] Jing Cai et al., *Indirect Virus Transmission in Cluster of COVID-19 Cases, Wenzhou, China, 2020*, 26 Emerging Infectious Diseases 1343 (2020), https://wwwnc.cdc.gov/eid/article/26/6/20-0412_article (viewed on Feb. 4, 2021).

[13] Shane Riddell et al., *The Effect of Temperature on Persistence of SARS-CoV-2 on Common Surfaces*, 17 Virology J. 145 (2020), https://virologyj.biomedcentral.com/articles/10.1186/s12985-020-01418-7 (viewed on Feb. 4, 2021).

[14] Karolina Nissen et al., *Long-Distance Airborne Dispersal of SARS-CoV-2 in Covid-19 Wards*, 10 Sci. Rep. 19589 (2020),

Another study of an outbreak at a restaurant in China concluded that the spread of the coronavirus "was prompted by air-conditioned ventilation," with persons who sat at tables downstream of the HVAC system's air flow becoming infected.[15] Based on "epidemiological evidence suggestive of [coronavirus] transmission through aerosol,"[16] the Environmental Protection Agency, the Occupational Safety and Health Administration, and the Centers for Disease Control and Prevention have recommended that facilities improve their ventilation and HVAC systems by, for example, increasing ventilation with outdoor air and air filtration.[17]

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https://www.nature.com/articles/s41598-020-76442-2 (viewed on Feb. 4, 2021).

15 Jianyun Lu et al., *COVID-19 Outbreak Associated with Air Conditioning in Restaurant, Guangzhou, China*, 26 Emerging Infectious Diseases 1628, 1629 (2020), https://wwwnc.cdc.gov/eid/article/26/7/20-0764_article (viewed on Feb. 4, 2021).

16 EPA, *Indoor Air and COVID-19 Key References and Publications*, https://www.epa.gov/coronavirus/indoor-air-and-covid-19-key-references-and-publications (viewed on Feb. 4, 2021) (capitalization omitted).

17 EPA, *Indoor Air and Coronavirus* (COVID-19), https://www.epa.gov/coronavirus/indoor-air-and-coronavirus-covid-19 (viewed on Dec. 5, 2020); CDC, *COVID-19 Employer Information for Office Buildings* (Oct. 29, 2020), https://www.cdc.gov/coronavirus/2019-ncov/community/office-buildings.html (viewed on Dec. 5, 2020); OSHA, *Guidance on Preparing Workplaces for COVID-19* 12 (2020), https://www.osha.gov/Publications/OSHA3990.pdf (viewed on Feb. 4, 2021).

Due to the physical ramifications of the coronavirus, government officials have responded with restrictions that, among other things, seek to preserve property from viral contamination that could exacerbate this pandemic's human tragedy. In Executive Order N-33-20, Governor Newsom ordered all California residents (with limited exceptions) to stay home at their place of residence—which in effect barred residents from leaving their homes to patronize Mudpie's store.[18] Likewise, patrons were prohibited from accessing Mudpie's store under San Francisco orders dictating that operations cease at businesses requiring in-person worker attendance—restrictions that the San Francisco Board of Supervisors found were "necessary to protect the public from the Coronavirus ... and the *physical property loss or damage* [resulting from] its proclivity to adhere to surfaces for prolonged periods of time."[19]

2. The Coronavirus Pandemic Has Caused Physical Loss and Damage

The viral pandemic and attendant government restrictions have made it unsafe and, in many cases, unlawful for businesses to use property for its

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18 Governor Gavin Newsom, Executive Order N-33-20 (Mar. 19, 2020), https://covid19.ca.gov/img/Executive-Order-N-33-20.pdf (viewed on Feb. 4, 2021).

19 San Francisco Board Resolution No. 153-20 (Apr. 7, 2020) (emphasis added), https://sfbos.org/sites/default/files/r0153-20.pdf (viewed on Feb. 4, 2021).

full intended function. Property undermined in this manner has, under California law and basic principles of insurance interpretation, been physically lost and damaged.

Recent California state court rulings have confirmed as much. Last week, the Superior Court in Los Angeles County, in addressing a COVID-19 coverage complaint filed by the P.F. Chang's restaurant, held that "'physical loss of or damage to' property ha[d] been met in one or more ways, including" allegations of "(i) the actual or potential presence of virus in the air (whether in droplet nuclei, aerosols, droplets, or otherwise) in the vicinity of [the policyholder's] restaurants … ; (ii) the necessity of modifying physical behaviors through the use of social distancing, avoiding confined indoor spaces, and/or not congregating in the same physical area as others … ; (iii) government orders requiring that physical spaces such as [the policyholder's] dining rooms be shut-down; and/or (iv) the need to mitigate the threat or actual physical presence of virus on door-handles, tables, silverware, surfaces, in heating and air conditioning systems and any other of the multitude of places virus has or could be found." *P.F. Chang's*, (Feb. 4, 2021, No. 20STCV17169). Likewise, the Superior Court in Orange County recently overruled the insurer's demurrer, holding that the "coronavirus and COVID-19" may cause "direct physical loss" or "physical

damage" sufficient to plead a claim for coverage. *Goodwill*, (Jan. 28, 2021 No. 2020-01169032). Such reasoning is amply supported by science and pre-pandemic precedents.

Just as the home in *Hughes* was held to be physically harmed when the imminent risk of collapse rendered it "useless" but otherwise "intact," so too is actual or imminent viral intrusion and ensuing loss of use an apt example of physical loss and damage. 199 Cal. App. 2d at 248-49; *accord Strickland*, 200 Cal. App. 3d at 801.[20] Further, just as the *Armstrong* Court reasoned that a building sustains "physical injury" when its components are such that "common daily activities may cause asbestos fibers to be released," likewise a business also intuitively suffers physical injury where its common function of hosting employees and patrons at its physical premises suddenly becomes a health hazard. 45 Cal. App. 4th at 91.

Accordingly, Mudpie's injury—the forced closure of its retail operations due to the pandemic and related governmental limitations—fits squarely within the grant of coverage against "physical loss or damage." At minimum, Travelers has failed to carry its burden of establishing that its

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[20] *See also* 10A Couch on Ins. § 148:46 (citing cases "allowing coverage based on physical damage despite the lack of physical alteration of the property," where "threatened physical damage" rendered premises "uninhabitab[le]" and "trigger[ed] the insured's obligation to mitigate the impending loss").

contrary, restrictive interpretation of its insurance policy is "the *only* reasonable one," and so it is not entitled to dismissal of its policyholder's claim. *MacKinnon v. Truck Ins. Exch.*, 31 Cal. 4th 635, 655 (2003).

D. The Ruling Below Erects Barriers to Coverage that Lack a Precedential or Policy Basis

The ruling below identified various bases for excusing the insurer's coverage obligations, none of which find support in California law—which requires insurance coverage to turn on the language that the insurer actually uses in the insurance policy, construed in accordance with California's rules of insurance policy interpretation. *Universal City Studios Credit Union v. Cumis Ins. Soc'y*, 208 Cal. App. 4th 730, 737 (2012).

First, the district court suggested that, for loss of use of physical property to qualify as physical loss or damage, the subject loss must be a "permanent dispossession" or "unrecoverable." Dismissal Order at 6. This additional coverage hurdle, however, runs contrary to text, purpose, and California precedent. Nothing in the policy's "physical loss or damage" insuring agreement requires "permanent" physical deprivation in order to trigger coverage, let alone imposes that condition by the requisite "clear and unmistakable language," *MacKinnon*, 31 Cal. 4th at 648. *See generally Advance Cable Co., LLC v. Cincinnati Ins. Co.*, 2014 WL 975580, at *11 (W.D. Wisc. Mar. 12, 2014) ("The [Property] Policy does not state that

damage must reach some level of severity to trigger the coverage threshold.”), *aff’d*, 788 F.3d 743 (7th Cir. 2015).

Moreover, refusing coverage when a business premises retains some function but cannot operate to normal standards flouts the well-recognized “purpose … of ‘business interruption’ insurance,” which is to “indemnify the insured against losses arising from his inability to continue the *normal* operation and functions of his business.” *Northrop Grumman Corp. v. Factory Mut. Ins. Co.*, 2013 WL 3946103, at *12 (C.D. Cal. July 31, 2013) (quoting *Pac. Coast Eng’g Co. v. St. Paul Fire & Marine Ins. Co.*, 9 Cal. App. 3d 270, 275 (1970)) (emphasis added and ellipses omitted). Further, imposing an atextual “total loss of use” requirement on property insureds would be at odds with the California Court of Appeal’s holding, not mentioned by the district court, that when an insurance contract covers “loss of use,” “the reasonable expectations of the insured would be that ‘loss of use’ means the loss of *any* significant use of the premises, not the total loss of all uses.” *Thee Sombrero, Inc. v. Scottsdale Ins. Co.*, 28 Cal. App. 5th 729, 737 (2018) (liability coverage) (emphasis in original).

Second, the district court conditioned coverage on loss of functionality being a result of “an intervening physical force.” Dismissal Order at 7. Again, such a requirement finds no home in the policy text. But

even if Travelers had included such a requirement in its insurance policy, the pandemic that spurred restrictions on the functionality of Mudpie's property is plainly an "intervening physical force." That is, the pertinent limitations on use were not induced by an *internal* physical vice, such as a machine defect, *see MRI Healthcare*, 187 Cal. App. 4th at 780, or faulty workmanship, *see State Farm*, 215 Cal. App. 3d at 1442-43, but by an "outside physical force" (Dismissal Order at 8) in the form of the fortuitous viral pandemic.

Third, while the court below placed weight on the lack of confirmed coronavirus on-site, *see* Section II n.5, *supra*, whether the virus is conclusively shown to be at the insured premises and corrupting property thereon is in no way dispositive, much less so at the pleading stage. Nothing in the text of the insuring agreement covering "physical loss or damage" conditions insurance coverage on adverse impacts to the structural makeup of property. Indeed, *Hughes* long ago rejected the narrow view of coverage that "would deny that any loss or damage occurred unless some tangible injury to the physical structure itself could be detected." 199 Cal. App. 2d at 248.

Further, it is settled law in California that "[d]irect physical loss under an all-risk policy generally may include losses due to either theft or

conversion"—*i.e.*, perils defined not by structural alterations but by their capacity to destroy the use and enjoyment of property. *Pac. Marine*, 248 F. Supp. 3d at 993 (citing *EOTT Energy*, 45 Cal. App. 4th at 569). Injury owing to loss of use of property due to physical viral proliferation and related government restrictions is no less "physical" than injury based on mere property theft.

Fourth, the court below cited the period of restoration measure—*i.e.*, the time in which injured property "should be repaired, rebuilt or replaced"—to justify its view that "inability to occupy" property during this pandemic is not a covered event since there is supposedly nothing to "repair." Dismissal Order at 6-7. The premise of this reasoning is wrong. Loss of utility can be repaired—i.e., property that is unusable or non-functional can be restored to its previous functional purpose. In most cases involving COVID-19, unusable premises can be restored to usable business space only through physical remedial measures—such as extensive and repeated cleaning and disinfecting, reconfiguring building layouts to accommodate social distancing, and modifying air-conditioning systems to improve ventilation. *See P.F. Chang's*, (Feb. 4, 2021, No. 20STCV17169) (finding physical loss or damage to be sufficiently pled based on, *inter alia*, the need to implement mitigation measures as to "heating and air

conditioning systems," as well as "the necessity of modifying physical behaviors through the use of social distancing").

Finally, the court below erred in invoking a so-called "loss of use or loss of market" exclusion to buttress its rejection of coverage. Dismissal Order at 10-11. Virtually "any direct physical loss" or damage—from a fire to a tornado to a virus—will give rise to "some type of loss in use" of property. *Customized Dist. Servs. v. Zurich Ins. Co.*, 862 A.2d 560, 567-68 (N.J. App. 2004). Read in context, then, the loss of use exclusion "only makes sense" if it applies to property whose diminished usability was prompted by *something other than* an external insured peril—such as a machine that has become obsolete over time or that shuts down due to an internal defect. *Oreg. Shakespeare Festival Ass'n v. Great Am. Ins. Co.*, 2016 WL 3267247, at *6 (D. Or. June 7, 2016), *vacated by stipulation*. Were it otherwise—i.e., were the exclusion applicable to any and all losses of use—then the exclusion "would void the entire purpose of the policy," *id.*, which promises to pay for revenue losses resulting from impairment of the policyholder's use of its premises. "This interpretation is unreasonable." *Id.*

Thus, as courts in California and elsewhere have held, the "loss of use" exclusion is inapposite with regard to property, like Mudpie's store, rendered unusable or less usable due to the fortuitous pandemic and

associated restrictions. *See, e.g., P.F. Chang's*, (Feb. 4, 2021, No. 20STCV17169) (overruling demurrer of COVID-19 coverage claim, notwithstanding insurer's argument that the policy "excludes coverage for 'loss of use' of property"); *Henderson Road Rest. Sys., Inc. v. Zurich Am. Ins. Co.*, 2021 WL 168422, at *16 (N.D. Ohio Jan. 19, 2021) (refusing to apply loss of use exclusion to income losses arising out of property rendered less usable due to government pandemic orders, because such an interpretation would "vitiate the Loss of Business Income coverage").

CONCLUSION

For the foregoing reasons, the Court should remand to the district court with instructions to grant leave to amend (or in the alternative, affirm on narrow exclusionary grounds), and not take any further actions to certify or affirm the "physical loss or damage" issues discussed in this case.

Respectfully Submitted,

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February 9, 2021

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FOR THE NINTH CIRCUIT

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