No. 21-5962

IN THE

United States Court of Appeals

For the Sixth Circuit

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WILD EGGS HOLDINGS, INC., ET AL.
Plaintiff-Appellants,

v.

STATE AUTO PROPERTY & CASUALTY INS. CO.
Defendant-Appellee.

——— ♦ ———

On Appeal from the United States District Court
for the Western District of Kentucky at Louisville
Hon. Rebecca Grady Jennings, U.S. District Judge
No. 3:20-cv-00501

——— ♦ ———

BRIEF FOR UNITED POLICYHOLDERS AS *AMICUS CURIAE* IN SUPPORT OF WILD EGGS AND REVERSAL

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

United Policyholders, Inc. states that it is a nonprofit corporation with no parent corporation and no public ownership.

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INTEREST OF *AMICUS CURIAE*[1]

United Policyholders ("UP") is a non-profit organization that advocates for policyholder interests to promote the evenhanded development of the law and to counterbalance pervasive and well-funded lobbying by insurance industry interests.

UP is committed to assisting courts in upholding the fundamental principles of insurance law that advance the goal of loss indemnification, fairness in interpreting policy language, and fair claim practices. In connection with COVID related losses, the insurance industry has sought a dramatic narrowing of historically broad "all risks" property and business-interruption insurance, disclaimed special and additional coverages sold to protect businesses against pandemic risk, and made misleading suggestions that accepting policyholders' reasonable views of the coverage they bought might bankrupt the entire insurance industry. UP's interest in this matter is to help courts recognize and reject the industry's campaign to upend decades of carefully reasoned decisions and fundamental principles.

[1] The parties consented to the filing of this brief. No party or its counsel authored this brief, in whole or in part. No party or person, besides UP and its counsel, contributed money intended to fund preparing or submitting this brief.

Public officials, state insurance regulators, academics, and journalists routinely seek UP's input on insurance and legal matters. UP's executive director has been appointed for twelve consecutive terms to officially represent consumers at the National Association of Insurance Commissioners. In this role, UP has for many years engaged with Sharon Clark, the Commissioner of the Kentucky Department of Insurance. UP is also a member of the Federal Advisory Committee on Insurance to the U.S. Treasury, and a regular participant before the National Association of Insurance Legislators.

UP is active in disaster-impacted regions and has Platinum status on the Guidestar charity rating platform. In the past year, over 600,000 Americans visited the libraries, reports, and resource materials available on UP's website. After the recent December 10, 2021, tornado disasters, UP launched a dedicated resource library to assist Kentucky homeowners and businessowners with the insurance claim and recovery process.[2]

[2] *December 2021 Tornadoes – Insurance Claim and Recovery Help*, UNITED POLICYHOLDERS (last visited Dec. 28, 2021), https://uphelp.org/disaster-recovery-help/december-2021-tornadoes-insurance-claim-and-recovery-help.

Over the last thirty years, UP has filed many amicus briefs in state and federal courts. *E.g.*, *Humana Inc.* v. *Forsyth*, 525 U.S. 299, 314 (1999) (favorably citing UP's amicus brief). UP filed three amicus briefs with this Court in the Covid-19 litigation, with the parties' consent. *Santo's Italian Café LLC* v. *Acuity Ins. Co.*, No. 21-3068 (Dkt. 20); *Kirsch* v. *Aspen Am. Ins. Co.*, No. 21-1038 (Dkt. 22); *Dakota Girls, LLC* v. *Phila. Indem. Ins. Co.*, No. 21-3245 (Dkt. 41). In the only argued case (*Santo's*) the Court granted UP's motion for leave to appear at argument (Dkt. 50), and Chief Judge Sutton remarked during the argument that UP's contributions were very helpful to the Court.

SUMMARY OF THE ARGUMENT

Wild Eggs' claims should be reinstated, but the stakes in this case are much higher. If the Court adopts the district court's analysis, then it will create serious, long-term problems for millions of Kentuckians who purchase property insurance and who are diverse from their insurer. UP submits this brief to give the Court a broader perspective on two of the district court's errors.

First, the district court failed to give the Restaurant Extension Endorsement the broad reading its context demands. Most customers know that core policy language is non-negotiable boilerplate. Endorsements address that rigidity by allowing the parties to "customize" coverage. Endorsements are often conspicuous and separate from the main forms. Customers can request them at the point of sale or the agent can offer them to earn extra commission. They are often front and center in the parties' bargain. When they extend coverage, customers reasonably expect courts to construe those terms broadly. The district court disregarded that essential context.

Second, the Court needs to reverse the district court's interpretation of "direct physical loss." The court held that this phrase required "tangible

harm or damage to" the property. (R. 32, PID 1968.) That has never been the law. Before Covid, every court construed the words "physical loss" to include property rendered dangerous (i.e., "lost," in whole or in part), due to a "physical" substance or condition. Courts developed the "tangible harm" test to explain why legal or economic injuries were not covered. That test was never meant to apply in dangerous-substance cases. It was error for the district court to employ it that way.

The Kentucky Supreme Court would not adopt the district court's outlier view—and affirming its holding would be disastrous. Ordinary Kentuckians buy this broad coverage to protect against the unusual (but catastrophic) cases where some physical condition makes their property dangerous and unusable (in whole or in part). Insurers can avoid those losses by clearly excluding them—with the consent of state regulators—not by begging courts for narrow readings of their broad coverage grants. Affirming the judgment will hand insurers a massive windfall, enshrine that windfall in precedent, and sanction an end-run around Kentucky insurance regulators.

The Court should **REVERSE** and **REMAND** for further proceedings.

ARGUMENT

I. The district court's cramped view of the Restaurant Extension Endorsement impermissibly ignores context.

The district court took an unduly narrow view of the "Restaurant Extension Endorsement" in Wild Eggs' policy. (R. 25-2, PID 1034.) Wild Eggs ably identifies the textual errors in the court's ruling. But "[c]ontext is everything in interpretation," as it ensures text is anchored to a larger, harmonious whole. *Santo's Italian Café LLC* v. *Acuity Ins. Co.*, 15 F.4th 398, 407 (6th Cir. 2021) (Ohio law). The endorsement's context highlights the district court's error—and it makes Wild Eggs' reading unassailable.

"Generally, the purpose of a rider to an insurance policy, such as an attached endorsement, is to make additions to a policy." *Delta & Pine Land Co.* v. *Nationwide Agribus. Ins. Co.*, 530 F.3d 395, 400 (5th Cir. 2008) (cleaned up). Those terms "are actually for the purpose of modifying the general terms of the policy, and therefore, being specific, control the more general terms of the policy." *Id.*; *Goodin* v. *Gen. Acci. Fire & Life Assur. Corp.*, 450 S.W.2d 252, 256 (Ky. Ct. App. 1970). "Often, endorsements are issued to add coverages that would otherwise be excluded." *Mesa Operating Co.* v. *Cal. Union Ins. Co.*, 986 S.W.2d 749, 754-55 (Tex. Ct. App. 1999).

Endorsements also "act as a predominating influence in determining the meaning and intent of the policy." *Delta*, 530 F.3d at 400 (cleaned up); *Ronalco, Inc.* v. *Home Ins. Co.*, 606 S.W.2d 160, 161-63 (Ky. 1980) (coverage provided by endorsement influenced narrow construction of exclusions). Kentucky courts view such endorsements in a generous light, to ensure that the policyholder gets everything it paid for. *See Holzknecht* v. *Ky. Farm Bureau Mut. Ins. Co.*, 320 S.W.2d 115, 120 (Ky. Ct. App. 2010) (agreeing that "business endorsement" covered dog-bite lawsuit "because the dog was kept by the [business] on the property for security purposes."). Where the insurer adds an "extension" endorsement, the parties intend for it to sweep broadly. *Home Folks Mobile Homes, Inc.* v. *Meridian Mut. Ins. Co.*, 744 S.W.2d 749, 750 (Ky. Ct. App. 1987).

This is fundamental to how American insurance policies have always worked. The rule that an insurance policy "is to be liberally construed in [the policyholder]'s favor" is not an empty formalism, but rather is the reading "probably most consonant to the intention of the parties." 1 JOHN DUER, A TREATISE ON THE LAW AND PRACTICE OF MARINE INSURANCE 161 (1845). "It is certain that the assured desires as ample an indemnity as he can obtain, and it is probable that the insurer means he shall understand

the indemnity given, to be as expansive as its terms, upon any fair interpretation, import." *Id.* (emphasis added).

That rationale applies with particular force to extension endorsements, like the one here. Insurance advertisements often trumpet "customized" coverage, but nearly all insurers sell the same language (or materially similar language) to their customers. This is driven by the highly regulated nature of the insurance market. Like every state, Kentucky prohibits insurers from selling insurance language unless it is pre-approved by regulators. KY. REV. STAT. §304.14-120(1). Because of this, no one tries to negotiate the language of a standard insurance form.

Endorsements help fill the gap left by this regulatory structure. By securing pre-approval for a variety of endorsements, agents can offer (and customers can request) specific changes to the policy at the point of sale or afterward. *E.g.*, *Home Folks*, 744 S.W.2d at 750. Where the endorsement expands coverage, a higher premium often means an increased commission for the agent.

Thus, for both parties, the endorsements are often at the forefront of their mind when they close the deal. So too here. State Auto's policy has a "Virus or Bacteria" exclusion. (R. 25-2, PID 1040.) But Wild Eggs is also a

restaurant chain and knew that it could suffer losses that might fall within that exclusion. The Restaurant Extension Endorsement ensures that the Business Income Form covers losses due to the "actual or alleged . . . [e]xposure of the described premises to a contagious or infectious disease." (*Id.* at 1035.) That is exactly what happened to Wild Eggs during the pandemic.

It is difficult to see what these terms were meant to accomplish, if not to restore business-income coverage that might be taken away by the virus exclusion.[3] *Mesa Operating*, 986 S.W.2d at 754-55; *Goodin*, 450 S.W.2d at 256. This would be an easy question for the Kentucky courts: "[State Auto] has simply offered no reason, nor can we think of any, for including the endorsement unless it was to provide the expanded [business income] coverage [to] the insured." *Home Folks*, 744 S.W.2d at 750. That

[3] We take no position on the scope or enforceability of Wild Eggs' virus exclusion, or whether the presence of one in a property-insurance policy always defeats coverage for virus-related losses. Not all virus exclusions speak clearly, and UP has reason to believe that the insurance industry misrepresented the scope of these exclusions to regulators when they sought approval. The record is not adequate for UP to address either of those questions here.

result is compelled by the context of the endorsement and Wild Eggs' reasonable expectations. *Id.* This Court should so hold.

II. "Physical loss of or damage to" property includes property made unsafe by the presence of a physical hazard.

The district court's ruling on the scope of the Restaurant Extension Endorsement is manifestly wrong and should be reversed. But this Court should also confront and correct the district court's antecedent error: that all property-insurance policies require "tangible" injury to property.

They do not. Before the pandemic, courts always found a "physical loss" when a physical substance was physically present on property, rendering it physically dangerous for people to use, even if that did not result in "tangible" harm to the structure. Insurance law—dictated by state high courts—has not changed since then. The Court's role is not to change that law or to assume the Kentucky courts will change it in response to Covid-19. Instead, the Court should follow existing law and let the state courts depart from it themselves if they so choose.

Disregarding the law will devastate Kentuckians. Their coverage was priced and written based on this consensus. If this Court changes the rules now, then it will hand insurers a windfall at the expense of ordinary

people. Worse, as most people are diverse from their insurer, it will enshrine that windfall in precedent. The Court should reject that path.

A. This case is fundamentally different from government-order cases like *Santo's*, and it should be treated accordingly.

Not all Covid-19 claims are the same. Before addressing the merits, the Court should understand where this dispute lies in the broad gamut of cases decided (and not yet decided) by the courts.

Modern property-insurance policies are all triggered by some variant of the words "direct physical loss of or damage to" property. In the insurance world, there has always been debate about what those terms mean. Most states hold that any loss of use or function, caused by a physical force, triggers the policy. *E.g.*, *Wakefern Food Corp.* v. *Liberty Mut. Fire Ins. Co.*, 968 A.2d 724, 734 (N.J. App. Div. 2009); *Gen. Mills, Inc.* v. *Gold Medal Ins. Co.*, 622 N.W.2d 147, 152 (Minn. Ct. App. 2001); ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES §11.41 (6th ed. 2013). Other courts (mostly federal courts) find that these arguments wrongly seek "intangible" losses and conclude there must be some physical alteration of the property. *E.g.*, *Port Auth. of N.Y. & N.J.* v. *Affiliated FM Ins. Co.*, 311 F.3d 226, 230 (3d Cir. 2002).

That debate dominated the first round of Covid-19 litigation. Some policyholders argued, citing cases like *Wakefern* and *General Mills*, that government orders dispossessed them of their property and thus caused a "direct physical loss of" that property. They made this argument to avoid the potential effect of virus exclusions. *E.g.*, *Santo's*, 15 F.4th at 403-04. Applying Ohio law, this Court viewed such government-order cases as seeking coverage for "intangible" losses, and so it denied coverage. *Id.*

The correctness of that decision does not matter here. This case presents a much different issue: the pervasive, physical presence of a dangerous, physical substance. *Santo's* left this question open as a "harder case" involving "some physical change to the property." *Id.* at 404.[4] But as we will show, the question is not hard at all. Wild Eggs' argument draws upon a formidable—and unanimous—line of precedent finding that these circumstances always generate a "physical loss." The Court's close attention

[4] Another panel of the Court was asked to resolve that question, but declined to do so. *Bridal Expressions LLC* v. *Owners Ins. Co.*, 2021 U.S. App. LEXIS 35676, *5-7 (6th Cir. 2021) (Ohio law) (Sutton, C.J., Stranch & Bush, JJ.). It found that the dangerous-substances theory "has not made an appearance today either" because the complaint "d[id] little more than repeat the language of the policy" and alleged the restrictions "were preventative, not reactive." *Id*. Such facts are representative of Circuit-level decisions to date. *See id.*, at *7.

to the distinction is necessary to prevent district courts from confusing government-order cases with dangerous-substance cases.

B. All-risk property insurance has always been triggered when a physical substance is present on property, making it dangerous.

For decades, insurance companies argued that property-insurance policies require "tangible" damage to the property. Until the Covid-19 litigation, courts universally rejected that position in dangerous-substance cases. The Kentucky Supreme Court would not depart from this view without a compelling justification. None exists.

1. All-risk insurance and dangerous substances.

The policy before the Court is what insurance lawyers call an "all risk" policy, rather than a "specified perils" policy. *Aetna Cas. & Sur. Co.* v. *Commonwealth*, 179 S.W.3d 830, 844-45 & n.1 (Ky. 2005). Specified-perils coverage only insures against the risks explicitly identified in the policy. Richard P. Lewis, et al., Couch*'s "Physical Alteration" Fallacy: Its Origins and Consequences*, 56 TORT, TRIAL & INS. L.J. 621, 623 n.9 (2021) [hereinafter "Lewis, et al."]. "All risk" insurance is a more modern coverage that is meant to be "broader basically than specified perils coverage." WILLIAM H. RODDA, PROPERTY & LIABILITY INSURANCE 185 (1966).

The basic premise of "all risk" insurance is that "[a]ll risks not expressly excluded are covered, including those not contemplated by either party." *James Graham Brown Found.* v. *St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 278 (Ky. 1991). Although they are not "all loss" policies, that label refers only to the requirement of fortuity and the presence of clear exclusions. *See, e.g.*, *Pan Am. World Airways, Inc.* v. *Aetna Cas. & Sur. Co.*, 505 F.2d 989, 1004 (2d Cir. 1974); *Sebo* v. *Am. Home Assur. Co.*, 208 So.3d 694, 696-97 (Fla. 2016).

Historically, "specified perils" property insurance only insured against perils that damaged property. Fire insurance is the classic example. When insurers designed "all risk" coverage, they meant for it to cover a much broader class of losses (such as theft), but wanted to avoid turning it into title insurance, a performance bond, or a product warranty. *See* Lewis, et al., at 633, 636-38.

Insurers settled on the word "physical" to impose the latter constraint. *Id.* Still, to maintain the broad character (and consumer appeal) of "all risk" policies, insurers wrote two distinct categories of coverage: "physical loss" and "physical damage." In the insurance industry, "[p]hysical loss is not synonymous with damage or physical damage." DONALD S.

MALECKI, COMMERCIAL PROPERTY COVERAGE GUIDE 8 (Nat'l Underwriter Co., 5th ed. 2013). "Too often, when reference is made to this insuring agreement, physical loss is mentioned as if it does not exist." *Id.* "It does exist, and it is different from physical damage." *Id.*

The difference is subtle but important. "Physical loss" extends coverage to perils that "do not alter the property itself but do affect the person's ability to possess or use the property." MARY ANN COOK & ARTHUR L. FLITNER, PROPERTY COVERAGES §3.5 (2011). As one leading insurance treatise puts it, the words "can be satisfied by any 'detriment,' and a 'detriment' can be present without there having been a physical alteration of the object." 3 WINDT §11.41; 5 JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW & PRACTICE 2D §3092 (1970 & 2012 Supp.). The word "physical" simply makes it clear that it is not providing insurance for legal or economic perils.

There is a minority view, taken by Steven Plitt in *Couch on Insurance 3d*. His view (at least in *Couch*) is that both "physical loss" and "physical damage" require a "physical alteration" to trigger coverage. 10A COUCH ON INSURANCE 3D §148:46. *Santo's* followed *Couch*'s minority rule because the Ohio courts have done so. 15 F.4th at 403-04; *Mastellone* v.

Lightning Rod Mut. Ins. Co., 884 N.E.2d 1130, 1143 (Ohio Ct. App. 2008). As Wild Eggs notes (at 43-44), Kentucky diverges from Ohio on this point. In addition, Mr. Plitt recognized in a popular insurance trade publication that the *Couch* test is inconsistent with the "modern trend," because "courts are not looking for physical alteration, but for loss of use." Steven Plitt, *Direct Physical Loss in All-Risk Policies: The Modern Trend Does Not Require Specific Physical Damage, Alteration*, CLAIMS J. (Apr. 15, 2013).[5] As scholars have recently explained, this portion of *Couch* is also out of step with decades of case law and basic principles of risk and insurance. Lewis, et al., at 622-29, 635-39.

Under the majority rule, theft is the classic example of a "physical loss"—it physically interferes with use but does not always (or even usually) alter the property. COOK & FLITNER §3.5; *Curry* v. *Fireman's Fund Ins. Co.*, 784 S.W.2d 176, 176 (Ky. 1989) (theft covered under an all-risk policy). Another textbook example is a dangerous physical substance present at (or near) the property, rendering it unsafe for its intended purpose. The presence of a physical substance satisfies the word "physical." And if

[5]amp.claimsjournal.com/magazines/idea-exchange/2013/04/15/226666.htm

that physical substance renders the property dangerous, then there has been a "physical loss." *E.g.*, *W. Fire Ins. Co.* v. *First Presbyterian Church*, 437 P.2d 52, 54-56 (Colo. 1968).

Thus, coverage existed when gasoline infiltration "ma[de] further use of [a] building highly dangerous." *Id.* at 55. It existed when homes were no longer "a place fit for occupancy, a safe place in which to dwell or live" due to a physical peril. *Murray* v. *State Farm Fire & Cas. Co.*, 509 S.E.2d 1, 16-17 (W. Va. 1998). It existed when a tenant operated a meth lab in a landlord's unit, contaminating surfaces with toxic residue. *Farmers Ins. Co.* v. *Trutanich*, 858 P.2d 1332, 1335 (Or. Ct. App. 1993). And it existed when radon permeated a factory, making it unsafe and unusable for calibrating medical instruments. *Am. Alliance Ins. Co.* v. *Keleket X-Ray Corp.*, 248 F.2d 920, 925 (6th Cir. 1957). The casebooks are replete with other examples. Lewis, et al., at 624, 627-29.

As Wild Eggs observes, Kentucky would follow this rule. Its courts have already found coverage when an "offensive odor" pervades the property, even without a showing of danger. *State Farm Fire & Cas. Co.* v. *Aulick*, 781 S.W.2d 531, 532 (Ky. Ct. App. 1989). *Aulick*, like every other

dangerous-substance case, did not require "tangible injury" or "physical alteration."

Nor would Kentucky require that the property become "practically useless for anything," as might be required in a government-orders case. *Santo's*, 15 F.4th at 404-05. The "loss" required is a loss of the property's intended use due to the presence of a dangerous, physical substance. It has always included partial or temporary impairments, including cleanable injuries. *Trutanich*, 858 P.2d at 1335 (policy covered lost income while meth decontamination occurred); *Mellin* v. *N. Sec. Ins. Co.*, 115 A.3d 799, 806 (N.H. 2015) (policy covered lost income for partial loss of unit due to cat urine odor); *Gregory Packaging, Inc.* v. *Travelers Prop. & Cas. Co.*, 2014 WL 6675934, *5-6 (D.N.J., Nov. 25, 2014) (cleanup of ammonia spill); *Sentinel Mgmt. Co.* v. *Aetna Cas. & Sur. Co.*, 615 N.W.2d 819, 825-26 (Minn. 2000) (abatement of asbestos fibers).

This bedrock principle is addressed in the policy text. The insurer promises to pay for a "suspension" of operations, including a "slowdown" in business. (R. 25-2, PID 1082, 1089.) In exchange, it requires that the business "minimize" the suspension and "resume [its] 'operations,' in

whole or in part" to the extent reasonably possible—or suffer reduced income payments. (*Id.* at 1086-87, §C.3.c-d.) A total loss is not required.

2. The "tangible harm" and "physical alteration" test was developed to distinguish intangible-loss cases from dangerous-substance cases.

In light of this law, the Court might ask where the "tangible harm" and "physical alteration" concepts came from. The answer is simple. Some courts, like *Santo's*, denied coverage for claims they viewed as seeking coverage for "intangible" losses. At the same time, they agreed the policy language was satisfied in dangerous-substance cases. So they developed these concepts to explain why the latter were covered and the former were not. Thus, demanding "tangible harm" or "physical alteration" in a dangerous-substance case effectively overrules the very precedent those words were crafted to protect.

The Third Circuit's decision in *Port Authority* is a perfect example. 311 F.3d at 234-35. The case involved asbestos that, by law, had to be removed. *Id.* However, the asbestos was intact and not dangerous to anyone in its current state. *Id.* The policyholder argued, by analogy to dangerous-substance cases involving asbestos fibers, that the presence of the asbestos was a "physical loss." The court disagreed—but only because the property

was safe. *Id*. Indeed, the Third Circuit emphasized that it would have found coverage if the evidence had shown "the presence of large quantities of asbestos in the air of a building" rendering it unsafe or unusable. *Id.* at 236. The "physical alteration" test was not meant as an absolute rule, but as a vehicle to explain this distinction.

This Court's unpublished opinion in *Universal Image Productions* v. *Federal Ins. Co.* is similar. There, the mold (1) adhered to property belonging to a third party, and (2) the policyholder conceded the mold had not made its property dangerous. 475 F. App'x 569, 570-71 (6th Cir. 2012). The panel applied a "physical alteration" test, but only to distinguish the policyholder's situation from the dangerous-substance cases. *Id.* at 573-74. Indeed, the main case the panel relied upon found that mold caused "tangible damage" when it was actually present on the policyholder's property. *See de Laurentis* v. *United Servs. Auto. Ass'n*, 162 S.W.3d 714 (Tex. Ct. App. 2005).

The distinction holds, even if one goes all the way down the rabbit hole. None of the pre-pandemic cases denying coverage for want of "tangible harm" or "physical alteration" were dangerous-substance cases. They

involved economic losses,[6] preemptive shutdowns,[7] inherent defects,[8] electronic data,[9] or harmless physical conditions.[10] The same is true for the insurer-side cases the district court cited. *Bluegrass Oral Health Ctr., PLLC* v. *Cincinnati Ins. Co.*, 2021 WL 1069038, *4 (W.D. Ky., Mar. 18, 2021) (preemptive closure); *LexFit, LLC* v. *W. Bend Mut. Ins. Co.*, 2021 WL 2382519, *1 (E.D. Ky., June 10, 2021) (same).

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[6] *Pentair, Inc.* v. *Am. Guar. & Liab. Ins. Co.*, 400 F.3d 613, 614-15 (8th Cir. 2005) (supply chain disruption); *Newman Myers Kreines Gross, P.C.* v. *Great N. Ins. Co.*, 17 F. Supp. 3d 323, 324-25 (S.D.N.Y. 2014) (power outage preventing access to property).

[7] *Phila. Parking Auth.* v. *Fed. Ins. Co.*, 38 F. Supp. 2d 280, 281-82 (S.D.N.Y. 2005) (FAA order preemptively grounding airlines after 9/11); *United Air Lines, Inc.* v. *Ins. Co. of Pa.*, 385 F. Supp. 2d 343, 346 (S.D.N.Y. 2005) (same); *Source Food Techs., Inc.* v. *U.S. Fid. & Guar. Co.*, 465 F.3d 834, 835 (8th Cir. 2006) (preemptive USDA import ban); *Roundabout Theatre Co.* v. *Cont'l Cas. Co.*, 302 A.D.2d 1, 3, 7 (N.Y. App. Div. 1st Dep't 2002) (government order barring use of streets needed to access theatre).

[8] *MRI Healthcare Ctr. of Glendale, Inc.* v. *State Farm Gen. Ins. Co.*, 187 Cal. App. 4th 766, 769-70 (Cal. Ct. App. 2010) (defective MRI machine); *Trinity Indus., Inc.* v. *Ins. Co. of N. Am.*, 916 F.2d 267, 268 (5th Cir. 1990) (misaligned boat hull); *City of Burlington* v. *Indem. Ins. Co. of N. Am.*, 332 F.3d 38, 40-41 (2d Cir. 2003) (faulty welds).

[9] *Ward Gen. Ins. Servs., Inc.* v. *Emplr's Fire Ins. Co.*, 114 Cal. App. 4th 548 (Cal. Ct. App. 2003) (database crash); *AFLAC, Inc.* v. *Chubb & Sons, Inc.*, 581 S.E.2d 317, 318 (Ga. Ct. App. 2003) (impact of Y2K computer bug).

[10] *Mama Jo's* v. *Sparta's Ins. Co.*, 823 F. App'x 868, 870 (11th Cir. 2020) (harmless dust); *Harry's Cadillac-Pontiac-GMC Truck Co.* v. *Motors Ins. Corp.*, 486 S.E.2d 249, 250-52 (N.C. Ct. App. 1997) (inaccessible dealership); *Mastellone*, 884 N.E.at 1144 (mold growing on exterior of building).

In short, it is error for a court to apply a "physical alteration" or "tangible harm" test to a dangerous-substance case. That test was never meant to control here, and it was never invoked to deny coverage in such cases before the Covid-19 litigation. Instead, it was simply a vehicle to explain why, in the view of some courts, intangible or economic perils were not covered under standard-form language. The Court should reject the recent attempt to foist it on facts it was not designed to address.

3. Denying coverage for the actual presence of SARS-CoV-2 because it does not cause "tangible harm" creates more problems than it solves.

Faced with this overwhelming consensus, insurers and courts have tried to distinguish the dangerous-substance cases. They argue that SARS-CoV-2 is "different" from other physical hazards because it does not change the "material dimensions" of the property, is not "persistent," or can be cleaned easily. *E.g.*, *Circle Block Partners, LLC* v. *Fireman's Fund Ins. Co.*, 2021 U.S. Dist. LEXIS 140711, *16-17 (S.D. Ind., July 27, 2021). There are good reasons why pre-pandemic courts never drew those distinctions, though insurers repeatedly asked them to do so.

The major problem with these arguments is that they require impossible line-drawing. True, SARS-CoV-2 particles are small. But so are

radium particles, lead atoms, meth residue, and odor molecules. Courts have found coverage for all of those substances, and there is no compelling reason to treat SARS-CoV-2 differently. It is dangerous, just like other physical hazards.

So too with the "persistence" argument. What is "persistent" enough to be deemed an "alteration"? That is not an easy question for courts to answer. How long must the substance be harmful to count? A week? A month? Should courts measure it in time, or by how much it costs to fix? Such speculation is also unhelpful because the policy deductibles address it. State Auto need not make business-income payments until "72 hours after the time of direct physical loss." (R. 25-2, PID 1089, §F.3.a.(1).) Contriving a "persistence" requirement renders this deductible pointless.

Cleaning, too, is a bad proxy. Most, if not all, of the harmful substances in the case law can (or could) be cleaned. And once again, the policies tackle this point themselves. They provide coverage for "Extra Expense" incurred to clean up property and get the business running again. (R. 25-2, PID 1082, §A.2.b.) Denying coverage because something *can* be cleaned violates this structure and is impermissible.

In the end, insurers must find all of these nuances "clearly stated" in the word "physical," because the policy text must "apprise the insured of [its] limitations." *Bidwell* v. *Shelter Mut. Ins. Co.*, 367 S.W.3d 585, 588 (Ky. 2012). These finely parsed distinctions thus create the same problems that bothered the panel in *Santo's*: they raise a host of questions for which there are no answers. 15 F.4th at 404. And they invite confusion and consternation down the road.

The traditional rule is simple, clear, and easily applied. The presence of a physical substance satisfies the word "physical." When that substance makes the property too dangerous for its intended use, there is a "physical loss." All other things being equal, Kentucky would favor this clear, easy-to-administer rule over the convoluted mess created by an "alteration" test. *Bidwell*, 367 S.W.3d at 588.

C. Narrowing coverage to require "tangible" harm would devastate Kentucky policyholders and provide a windfall to insurers.

Affirming the district court's holding would devastate Kentuckians. The words "direct physical loss or damage" are not limited to Wild Eggs' commercial property policy. They, or their variants, are at the core of the

tens of thousands of homeowners' policies sold in Kentucky every year.[11] Lenders mandate such coverage, typically at the owner's expense.

As we have shown, courts have historically construed policies to cover losses arising from hazardous substances. The whipsaw effect of changing course would be stunning and unfair. "When the all risk insurers wrote these policies, they took the law as they found it. Premiums were set and coverages were purchased in reliance on rules of construction and procedure." *Pan Am. World Airways, Inc.* v. *Aetna Cas. & Sur. Co.*, 505 F.2d 989, 1004 (2d Cir. 1974). The Court should not disturb those reliance interests, and particularly not without guidance from the state courts. A few real-life examples illustrate the risks the Court would shift back to families and businesses by rejecting the wisdom of the courts that came before it.

Although endemic to Kentucky and Tennessee, brown recluse spider colonies generally go unnoticed by homeowners (the spiders prefer to

[11] *Unprecedented Housing Market Numbers in an Unprecedented Year*, KENTUCKY REALTORS (Feb. 11, 2021) https://www.kyrealtors.com/about-us/news/archive/202102 (noting 56,218 homes sold in 2020).

hide).[12] Occasionally, however, the right combination of colony size and food scarcity causes them to cannibalize one another—and so they flee from their hiding places. The hordes of meandering spiders terrorize families, particularly those with young children who are most vulnerable to the bite. Extermination is expensive. Though the spiders do not cause a "tangible" injury to the property, they are a physical condition making it unsafe, and have historically caused a "physical loss."[13] Not if the Court affirms.

Even with screening, mom-and-pop landlords often endure significant grief from tenants. Some have taken possession of their units only to discover makeshift methamphetamine labs. Upon calling the police, they discover that meth residue has adhered to the surfaces, permeated the air, and could make new tenants sick. Decontamination costs tens of thousands of dollars and prevents leasing until complete. Historically, courts

[12] Michael F. Potter, *Brown Recluse Spider*, UNIV. OF KY. COLL. OF AGRIC., FOOD, & ENV'T (Jul. 12, 2018), https://entomology.ca.uky.edu/ef631.

[13] These facts are from *Cook* v. *Allstate Ins. Co.*, 2007 Ind. Super. LEXIS 32 (Madison Cnty., Nov. 30, 2007).

have found that these incidents qualify as a "physical loss," because the injury is physical, even if not "tangible."[14] Not if the Court affirms.

Lead particles do not cause any perceptible harm to property, but their harm to humans is well-documented. Low-income people are particularly vulnerable, as they tend to live in housing built before lead paint was prohibited. Nor is its presence typically open and obvious without testing. When discovered, families (and particularly families with children) must leave to avoid brain damage. Abatement can cost thousands of dollars. Courts have always found these situations to be a "physical loss," despite the absence of "tangible" injury to the property.[15] Not if the Court affirms.

The basic rule underpinning these cases has been around for over 50 years. *W. Fire Ins. Co.* v. *First Presbyterian Church*, 437 P.2d 52, 55 (Colo. 1968). If insurers do not like it, they can rewrite their policies and limit them to "tangible" damage—and take the rate reduction regulators will

[14] These facts are drawn from *Farmers Insurance Co.* v. *Trutanich*, cited above, and *Graff* v. *Allstate Insurance Co.*, 54 P.3d 1266, 1269 (Wash. Ct. App. 2002).

[15] These facts are drawn from *Widder* v. *Louisiana Citizens Property Insurance Corp.*, 82 So.3d 294 (La. Ct. App. 2011).

exact in exchange for narrower coverage. They can add exclusions, as some insurers have done for spiders, lead, or viruses—and again, take a rate reduction for providing less coverage.

That is the time-honored process for changing the risks insured by these policies. The Court should require insurers to use it. Affirming on this point will hand insurers an unearned windfall and scale back the scope of coverage that millions of Kentuckians purchased. And it will sanction an end-run around the right of Kentucky regulators to protect their constituents by determining whether, and under what terms, these losses can be excluded. Changing those rules is not the Court's job.

D. The Court needs to decide this issue now, because it matters to dozens of parties not before the Court and to the integrity of insurance law.

The virus exclusion in Wild Eggs' policy should not deter the Court from deciding this threshold issue. The district court did not address the exclusion, and the Restaurant Extension Endorsement trumps it under any circumstances. But Kentucky law requires the Court to start with the coverage grant, then move to exclusions, and then move to endorsements that restore coverage (or that enhance it beyond what the base form provided). *Am. Mining Ins. Co.* v. *Peters Farms, LLC*, 557 S.W.3d 293, 298-99

(Ky. 2018). Thus, it is essential for the Court to explain why "physical loss" exists here—the question is fundamental and is not going away.

Moreover, getting the right answer is crucial to maintain fairness. Seventeen percent of small businesses purchased policies without virus exclusions.[16] It is profoundly unfair to treat their policies as identical to those with virus exclusions. It is equally unfair to the insurers who (1) invested time and money to price, predict, and exclude an emerging risk, (2) used unambiguous language, (3) accepted a rate reduction due to the narrower coverage, and (4) provided clear notice of the reduction in coverage to their customers.

Some insurers have responded to this argument by saying that the virus exclusion provides a "belt and suspenders approach," and so omitting it makes no difference. *Santo's* made a similar argument by predicting that Ohio would take a dim view of the anti-surplusage rule: "It is no overstatement to say that it would not be an insurance contract if it did not come with some surplusage." *Santo's*, 15 F.4th at 406.

[16] *NAIC Covid-19 Report for 2020*, p.23, NAT'L ASS'N OF INS. COMM'RS (last accessed Dec. 20, 2021), *available at* https://content.naic.org/sites/default/files/naic-covid-19-report-update3-eoy-2020.pdf.

That is undoubtedly true of most boilerplate. With due respect, is not true of insurance policies, and it is not true in Kentucky. *Warford* v. *State Farm Mut. Auto. Ins. Co.*, 531 S.W.2d 522, 523-24 (Ky. Ct. App. 1975) (finding a phrase "more ambiguous than obvious" because the insurer's reading rendered terms superfluous); *Am. Nat'l Bank & Tr. Co.* v. *Hartford Acc. & Indem. Co.*, 442 F.2d 995, 999 (6th Cir. 1971) (Kentucky law) (acknowledging this rule). Indeed, the Kentucky Supreme Court has overruled its own cases for brushing off the rule against surplusage. *Phila. Indem. Ins. Co.* v. *Tryon*, 502 S.W.3d 585, 589-90 (Ky. 2016). This Court cannot ignore such matters under Kentucky law.

Regardless, Kentucky's rule better reflects how insurance works. Insurance contracts are not slapdash boilerplate. They are meticulously drafted and heavily regulated instruments for shifting risk. Insurers make money by levying premiums that match (1) the language of the policy, and (2) the risk existing in the real world. Every word used to describe risk and calculate premium is subject to searching scrutiny by state regulators. Regulators have power to veto or modify language they deem too confusing, too complicated, or too narrow, and to enforce rate reductions where

appropriate (though they generally lack adequate resources to exercise that power consistently).

In this process, redundancy and surplusage are an underwriter's worst enemies. Too much of it in a coverage grant, and the policy accepts too much risk for the company to make money. Too much of it in an exclusion, and regulators may deny approval (or enforce a rate reduction), both of which negatively influence the company's balance sheet. Instead, good insurance-policy drafters strive for precision and clarity.

Thus, when insurance policies use different words or seem to repeat themselves, it is not due to the "[l]awyerly doublets and triplets [that] amount to nothing more than manners of speaking and emphasis." *Santo's*, 15 F.4th at 406. Variances in policy language are deliberate competitive and underwriting choices, and the Court must respect them. *E.g.*, *Tryon*, 502 S.W.3d at 589-90. That is true even where those choices, like all business judgments, backfire or have costly ramifications.

That may seem harsh. But it is just another "hard reality about insurance." *Id.* at 407. Insurers compete with one another by tinkering with standard language, by omitting exclusions, or by adding endorsements. That competition produces winners and losers in mass-casualty events

like a pandemic, a hurricane, or a tornado. But the "[f]air pricing of insurance terms" depends not only on "correctly accounting for likelihood of the occurrence of each defined peril," but also on courts enforcing the choices insurers make to cover or exclude those perils. *Id.* Ignoring variances—and particularly in ignoring insurers' decisions to omit exclusions so that they can charge higher premiums—"creates a mismatch." *Id.* It produces policies that do not cover risks the customer did pay for, enriching insurance stockholders at individuals' expense.

All of this illustrates why the Court needs to straighten out the confusion over what "physical loss" requires in a dangerous-substance case. Before Covid, the presence of harmful substances on property caused a "physical loss" where the substance made the property dangerous. Property insurance was priced (and risks excluded) with that unanimous view in mind. *Pan Am.*, 505 F.2d at 1004. The Court needs to warn all insurers doing business in this Circuit that the law has not changed, and that they will be bound by the prices they charged and the choices they made before the pandemic disrupted our lives.

CONCLUSION

The Court should **REVERSE** and **REMAND** for further proceedings.

Respectfully Submitted,

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CERTIFICATE OF COMPLIANCE

The foregoing document complies with the typeface and typestyle requirements of FED. R. APP. P. 32(a)(5)-(6) because it was prepared in a proportionally spaced typeface using Microsoft Word in New Century Schoolbook 14-point font, including footnotes. The foregoing document also complies with FED. R. APP. P. 29(a)(4)(G), 29(a)(5), and 32(a)(7)(B)(i) because it contains 6,490 words, excluding those portions exempted by FED. R. APP. P. 32(f) and 6TH CIR. R. 32(b).

/s/ *Christopher E. Kozak* /

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the foregoing was filed electronically this 30th day of December, 2021. Notice of this filing will be sent to all parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's electronic filing system.

/s/ *Christopher E. Kozak* /