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IN THIS ISSUE

This article discusses whether there is coverage under first-party insurance policies for losses caused by the COVID-19 pandemic in the New England states.

New England States Reach Divergent Outcomes on COVID-19 Coverage Disputes

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In the popular imagination, New England is synonymous with prep schools, colleges, and the sort of old-moneyed families that speak of "summer" as a verb. These six states that occupy the northeastern corner of the United States, between New York and Canada, are often perceived as a unit, albeit with some regional quirks that sometimes – and somewhat infamously – play out in the types of cuisine on offer and in colorful patterns of local speech.

But, like seasoned farmers, experienced lawyers correctly understand that place matters. Just as corn will not grow in some types of soil, certain legal arguments will not find purchase in specific venues. So it is in the world of insurance coverage, where the New England states – so alike in temperament, but so different in outlook – have adopted different approaches to whether there is coverage under first-party insurance policies for losses caused by the COVID-19 pandemic.

Four of the six states have weighed in, and three – Connecticut, Massachusetts, and New Hampshire – have categorically declared that COVID-19 does not cause "physical loss or damage" as a matter of law, with the result that claims arising from COVID-19 do not fall within first-party insurance policy insuring agreements. Vermont, standing alone, has somewhat timorously held that the question cannot be resolved on the pleadings. Maine and Rhode Island have yet to decide the issue definitively.

This note focuses on the recent decisions in New Hampshire and Vermont, identifying their similarities and their differences. Coverage practitioners should take note of the standards for insurance-policy construction articulated by the respective state high courts, and the fact that multiple jurisdictions have no patience for the so-called doctrine of "negative implication."

Background

Before discussing the two recent decisions, some background is important. From the start of the COVID-19 pandemic, federal courts have consistently held that losses arising out of pandemic-era orders to stay at home did not satisfy property-insurance policy insuring agreements requiring that the loss be caused by some kind of "direct physical loss or damage" to covered property. But those holdings were predictions of how state high courts would likely rule on the question, because there was virtually no controlling precedent about the coverage issues presented by what was then called the "novel coronavirus."

The Massachusetts Supreme Judicial Court was the first state supreme court in the United States to issue a coverage decision involving COVID-19, on April 21, 2022. In *Verveine Corp. v. Strathmore Insurance Company*, 489 Mass. 534 (2022), the high court considered whether the closure of restaurant dining rooms to the public, with attendant consequences to the restaurants' business income, fell within the coverage of what were marketed to the restaurants as "all-risk" insurance policies. Holding that the terms "direct physical loss or damage" required that there be some "distinct, demonstrable, physical alteration of the

property" and that the closure of the dining rooms by government order could not be attributable to a direct physical effect on the property that could be described as loss or damage, the Massachusetts court unanimously held that losses caused by COVID-19 could not satisfy the policies' insuring agreements. *See id*., at 542-44.

In language that has often been quoted since, the Massachusetts court went on to write that the "[e]vanescent presence of a harmful airborne substance that will quickly dissipate on its own, or surface-level contamination that can be removed by simple cleaning, does not alter or affect property." *See id*., at 544.

As a final fallback, the restaurants argued that they should receive some coverage because one of the restaurants had a policy that included a virus exclusion, while the other two restaurants did not have a virus exclusion on their policy. The Massachusetts high court wrote that "no such negative implication can or should be drawn." See id., at 546. Indeed, the court went further, holding that the law in Massachusetts emphasized the importance of not drawing "negative implications." See id. The plain language of the policy controlled its construction, and the court took pains to explain that the language of other insurance contracts "is irrelevant" to whether another contract provides coverage. See id.

Nine months later, on January 27, 2023, the Connecticut Supreme Court issued its decision in *Connecticut Dermatology v. Twin City Fire Insurance*, 346 Conn. 33 (2023). As in Massachusetts, the Connecticut Supreme Court unanimously held that the term "direct physical loss or damage" did not encompass losses arising out of the COVID-19 pandemic, because the loss was not "physical" and the virus did not tangibly alter the property. See id. The court's holding was succinct, even though the decision was somewhat lengthy because it addressed the claimants' multiple alternative arguments.

New Hampshire

At this writing, the New Hampshire Supreme Court's decision in *Schleicher & Stebbins Hotels, LLC v. Starr Surplus Lines Insurance Company*, ___ N.H. ___, 2023 N.H. LEXIS 69, 2023 WL 3357980 (May 11, 2023), is the latest COVID-19 coverage case to be handed down by a New England state supreme court. In its sweep and reach, the decision is much closer to the one issued by the *Verveine* court in Massachusetts than to the *Connecticut Dermatology* court, but it is animated by spirit that suffused both of those other decisions.

The claimants in *Schleicher* were twenty-three hotels, located in New Hampshire, Massachusetts, and New Jersey. For the period from November 1, 2019, to November 1, 2020, the hotels had purchased $600 million in insurance coverage. The policies each insured "against risks of direct physical loss or damage to property described" in the policies, "except as hereinafter excluded." *See* 2023 N.H. LEXIS 69, *5. The sole question that the court

decided to answer was whether the presence of SARS-CoV-2 in the air or on surfaces at a premises, if proven, satisfies a requirement under a property insurance policy of "loss or damage" or "direct physical loss of or damage to property." *Id.* at *4.

The court recited what, by now, is a familiar factual background. In January 2020, the World Health Organization first identified the SARS-CoV-2 virus. COVID-19 subsequently became a global pandemic, and all fifty states adopted public health measures to control its spread. Starting in March 2020, the governors of the three states where the hotels operated issued orders that required citizens to stay at home, and that also restricted the operations of the hotels. The hotels were permitted to remain open to serve vulnerable populations and essential workers, but they were unable to reopen to the public until June 2020, and even then could do so only subject to a number of restrictions. *See id*., at *6-*7.

The hotels claimed against their insurance for losses stemming from the pandemic, and they filed suit on June 19, 2020. On November 23 of that year, they moved for partial summary judgment, asking the superior (trial) court to declare that, under New Hampshire law, the policies' insuring agreements were satisfied when the property was "impacted" by COVID-19. *See id.,* at *9. The hotels did not seek a factual determination that there had been a loss or damage to specific property at any of the hotels, or elsewhere. *See id*. The court granted the motion.

On interlocutory review, the New Hampshire Supreme Court unanimously reversed. Interested practitioners should read the entire decision, but three points stand out. First, the court provided a helpful summary of the rules of insurance-policy construction that prevail in the Granite State, which begin with an examination of the insurance policy language, looking at the plain and ordinary meaning of the words in context and construing them as a reasonable person based upon "more than a casual reading of the policy as a whole." *Id*., at *10-*11, citing *Russell v. NGM Ins. Co*., 170 N.H. 424, 428 (2017). The court stressed that the standard is objective. *See id*. The court noted that, if more than one reasonable construction is possible, and one of them provides coverage, the policy contains an ambiguity that will be construed against the insurer – but the mere fact that the parties disagree about what a term means does not create an ambiguity.

Second, citing its own precedent as well as *Verveine*, the New Hampshire court went on to note that the threshold inquiry in a coverage case is whether the loss falls within the insuring agreement. The terms "all-risk" do not mean "every risk." "For coverage to be found," it wrote, "some actual loss or damage, within the meaning of the policy, must actually have occurred." *See id*., at * 12.

The court proceeded to undertake a deep textual analysis of the policy, in light of a prior decision called *Mellin v. Northern*

Security Insurance Company, 167 N.H. 544 (2015), and in the process observed:

- Introductory clauses modify each of the subclauses that follow them, and are incorporated into each of them, *see id*., at *20;

- In insurance policies, the repetition of certain words and phrases is commonplace, with the result that redundancies abound. While the court will not presume words in a contract to be "mere surplusage," it will be cautious about applying the interpretive canon to insurance policies, because it reads the policy as a whole, *see id*., at *20-*21; and

- The presence of the virus that causes COVID-19 in the air or on the surface of property cannot be said to have changed the property in a distinct and demonstrable way, because the virus will eventually dissipate on its own – which counters against a finding that the property has been changed consistent with what New Hampshire law requires. *See id*., at *26-*27.

Third, after disposing of a number of objections raised by the hotels, the New Hampshire Supreme Court rejected wholesale the argument that the failure of the insurers to exclude coverage for claims arising from SARS-CoV-2, particularly in light of their loss experience with the 2003-2004 outbreak of SARS-CoV-1 (the virus outbreak that introduced the world, first in Asia, to Sudden Acute Respiratory Syndrome), meant that the policy should be construed to afford coverage for COVID-19. Like the Massachusetts court in *Verveine*, the New Hampshire Supreme Court rejected out of hand the argument that the carrier's failure to add an exclusion means that the clear and unambiguous language of the policy should be construed against the carrier. *See id*., at *33-*34. Where the fundamental goal of the policy is to carry out the contracting parties' intent, the absence of an exclusion cannot be used to contradict what the contract says. *See id*., at *34-*35.

Vermont

Staking out a position seemingly at variance with its sister states in the New England region, Vermont's Supreme Court handed down its COVID-19 coverage decision on September 23, 2022. In *Huntington Ingalls Industries v. Ace American Insurance Company*, 2022 VT 45, 287 A.3d 515 (2022), a badly fractured Vermont Supreme Court reversed a coverage win for the industry and remanded the case for further proceedings before the trial court. It appears that the reversal rested mainly upon the uniquely low threshold for a case to survive judgment on the pleadings that is used in Vermont.

Huntington Ingalls Industries is the largest military shipbuilding company in the United States. It employs more than 42,000 people, the majority of whom work at its shipyards

in Virginia and Mississippi. This particular case came to be heard by the Vermont Supreme Court because Huntington Ingalls purchased insurance from its Vermont-domiciled captive, which in turn reinsured the global property insurance policy with various reinsurers. The various policies, which the court referred to in the singular, expressly state that they are to be construed according to Vermont law. *See* 2022 VT 45, 3-6.

When governors across the country began to issue stay-at-home orders, the federal government designated Huntington Ingalls as a part of the nation's "essential critical infrastructure," which had a special responsibility to maintain its normal work schedule, to the extent practicable while following CDC and state and local guidelines to limit spread of the virus. Huntington Ingalls remained open, albeit at diminished capacity, from March 2020 onwards, and the COVID-19 virus has been continuously present at the shipyards over that entire period. *See id*., at 10.

Both sides cross-moved for judgment on the pleadings, and judge of the superior (trial) court ruled in favor of the insurers. *See id*., at 14. The Vermont Supreme Court reversed.

Acknowledging that courts across the country had split in their approaches to construing property insurance policies in the context of COVID-19 claims, the court recited its (unremarkable) rules of insurance-policy construction and remarked that it often referred to dictionaries (principally the Merriam-Webster Online Dictionary, in this case) to determine if undefined terms had a "plain meaning." *See id.,* at 21.

Having done so, the court held that the phrase "direct physical loss or damage to property" included separate coverage concepts: one for direct physical loss to property, and one for direct physical damage to property. *See id*., at 24. Direct physical damage to property, then, requires that there be a distinct, demonstrable, physical alteration to the property itself for damage to occur under the policy. *See id*., at 26.

The court went on at length about the second concept. Direct physical loss, according to the court, requires deprivation or destruction of the property – which necessarily embraces situations where the property itself is not harmed but cannot be used for some reason. *See id*., at 29. Purely economic loss is not "deprivation" of the property. *See id*., at 30. Rather, the loss must be a persistent destruction or deprivation, in whole or in part, with a causal nexus to some physical event or condition. *See id*., at 38. The court was clear that the insured had the burden to prove that the losses it alleged qualified for coverage under either part of the insuring agreement. *See id*., at 39.

Turning back to the question before it, the Vermont Supreme Court held that, under Vermont's "exceedingly liberal notice-pleading standards" – even though Vermont

Rule of Civil Procedure 12(c) mirrors its federal counterpart – the complaint had sufficiently pled a claim that could potentially show "direct physical damage" because it had alleged that (i) COVID-19 had been continuously present at Huntington Ingall's shipbuilding facilities, (ii) the virus could "adhere" to surfaces that would cause "detrimental physical effects" that "altered and impaired the functioning of the tangible, material dimensions" of the property, and (iii) the insured had to take steps to remedy the situation. *See id*., at 40-43. While stressing that "the science when fully presented may not support the conclusion that the presence of a virus on a surface physically alters that surface in a distinct and demonstrable way," the court nevertheless held that the case should be allowed to proceed past the pleadings stage. *See id*., at 46.

The Vermont Supreme Court has five members. Two of the sitting justices did not participate in the decision of *Huntington Ingalls*; the court filled out the bench by recalling a retired supreme court justice, and by specially designating a retired superior court judge to sit on the case. The three-justice majority that decided the case consisted of the chief justice, one of the associate justices, and the retired supreme court justice.

The remaining supreme court justice as well as the specially-designated former trial judge dissented – at length. The dissent contended that the majority was engaging in sophistry to avoid what that the Massachusetts and New Hampshire high courts had no difficulty seeing: that the fact that the "fomites" could be wiped from the surfaces of property with a paper towel and store-bought cleaner completely removed the virus, meaning that it did not change the property and therefore did not qualify for coverage. *See id*., at 62-63. The dissent wrote that the majority viewed provisions of the policy in "splendid isolation" to reach a result that had the effect of wholly gutting Rule 12(c) and setting Vermont apart as an outlier, even among notice-pleading jurisdictions whose decisions the majority cited to support its decision. *See id*., at 76-79.

Concluding Thoughts

The four New England states that have decided questions of insurance coverage for claims involving COVID-19 have tended to recite similar rules on insurance-policy construction and have professed a similar devotion to the parties' mutual intent made manifest in the words of the insurance contract. Where they have differed is in how far along that road they have gone.

The state supreme courts in Connecticut, Massachusetts, and New Hampshire seem to have been swayed most strongly by the plain language of the policies. All three rested their decisions on the words used and the logical consequences of the allegations in light of that meaning. Massachusetts and New Hampshire went even further, categorically declaring that the absence of an exclusion for a particular peril could not

vary the plain meaning of the insuring agreement – a development that is particularly welcome for the certainty that it provides to policy drafters, underwriters, claims personnel, and even policyholders. It cannot be overlooked, either, that none of these states broke with the emerging national consensus about the absence of first-party coverage for losses involving COVID-19.

Vermont is a surprising outlier, but the reach of its 3-2 holding in *Huntington Ingalls* seems limited because the decision is so deeply intertwined with the pleading rules that Vermont employs. Still, Vermont's captive insurance industry will be uneasy that the state supreme court so casually implied that expert testimony must help guide the outcome of coverage disputes. While Vermont has the advantage of a well-developed and mature infrastructure to support captives, and the composition of the court on this novel case was unusual, the fact of the holding seems assured to tarnish Vermont's reputation for predicable claim-handling outcomes.

Again, place matters. The New England states are generally similar, except when they are not. As the COVID-19 coverage decisions show, the similarities can be striking – and they make the unusual holdings of a distinct minority stand out even more.

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