IADC COMMITTEE NEWSLETTER

INSURANCE AND REINSURANCE

May 2022

IN THIS ISSUE

IADC Member Alex Henlin discusses the landmark decision of the Massachusetts SJC in Verveine v. Strathmore Ins. co., 4889 Mass. 534 (April 21, 2022). This is the first decision of any state supreme court to address coverage for business losses resulting from the COVID pandemic. The SJC unanimously held that property policies do not provide coverage for these claims.

Massachusetts High Court Declares That Restaurants Suffered No "Direct Physical Loss" From COVID-19 Closure Orders; Becomes First U.S. State High Court to Rule Against Policyholders

ABOUT THE AUTHOR

Alexander G. Henlin is part of the Insurance and Reinsurance Group at Sulloway & Hollis, P.L.L.C., which advises insurers across the New England region. For more than fifteen years, he has represented insurance carriers in litigation, arbitration proceedings, and mediations. Alex sits in his firm's office in Concord, New Hampshire, USA, where he can be reached at ahenlin@sulloway.com. He joined the IADC in 2018 and is the current vice chair of webinars for the Insurance and Reinsurance Committee.

ABOUT THE COMMITTEE

The Insurance and Reinsurance Committee members, including U.S. and multinational attorneys, are lawyers who deal on a regular basis with issues of insurance availability, insurance coverage and related litigation at all levels of insurance above the primary level. The Committee offers presentations on these subjects at the Annual and Midyear Meetings. Learn more about the Committee at www.iadclaw.org. To contribute a newsletter article, contact:

William A. Bulfer
Vice Chair of Newsletters
Teague Campbell Dennis & Gorham, LLP
wbulfer@teaguecampbell.com

In what is certain to be regarded as a landmark ruling in the on-going battles over coverage for COVID-19 Claims, the Massachusetts Supreme Judicial Court handed down its unanimous decision in *Verveine Corp. et als.. v. Strathmore Insurance Company et al.*, 489 Mass. 534, on April 21, 2022. As the first state supreme court in the United States to pronounce on the question of coverage for losses arising out of the COVID-19 pandemic, the decision has particular relevance for the insurance industry nationally, as well as for Massachusetts insurance practitioners.

The essence of the ruling is that government-ordered suspension of business operations, without any evidence of some "distinct, demonstrable, physical alteration of the property," does not constitute "direct physical loss of or damage to" real property. As a result, three restaurants that submitted claims to their property insurers for business-income loss could not satisfy the insuring agreement. The significance of the ruling lies in the categorical nature of the SJC's holding, and in the significant attention that the court paid to articulating and applying rules of insurance-policy construction that too often do not find expression in reported decisions.

The Facts

The plaintiffs in the case were three Massachusetts restaurants that operated in Boston and Cambridge. They had common ownership and management, and for several years before the pandemic had purchased insurance coverage from Strathmore Insurance Company, a wholly-owned subsidiary of Greater New York Mutual Insurance Company.[1]

When the pandemic began, the restaurants were covered by two different property and liability package policies – one that covered the two restaurants in Boston, and another that covered the restaurant in Cambridge. The policy for the Cambridge restaurant had a virus exclusion that was not present on the other policy.[2]

In an effort to combat the emergence of the novel coronavirus that causes COVID-19, on March 15, 2020, the governor of Massachusetts issued an emergency order that prohibited in-person dining at restaurants and bars. As providers of an "essential service," however, the three restaurants were allowed – and, in fact, were even encouraged – to remain open to offer takeout and delivery services.[3] The two Boston restaurants did so, but they experienced substantial declines in their revenues. The Cambridge restaurant was shuttered, although its kitchen was used as a meal-preparation site for medical and emergency personnel who were combatting COVID-19.[4]

The state modified its emergency orders in June 2020 to allow limited in-person dining, and all three restaurants resumed usual

[1] *See* Slip Op., at 3-4.
[2] *See id*., at 4.
[3] *See id*., at 5.
[4] *See id*., at 5-6.

operations, albeit at diminished capacities. As a result, all three continued to lose revenue because of the government-imposed operational restrictions.[5]

The restaurants submitted business-income claims to Strathmore, citing their losses and their expected continuing losses. Strathmore denied the claims under both policies, citing the lack of any "physical loss of or damage to" the properties, as well as the virus exclusion on the policy for the Cambridge restaurant.[6] The restaurants sued, and the court of first instance (the Massachusetts Superior Court) granted Strathmore's motion to dismiss, holding that the absence of "direct physical loss or damage" resulting from the COVID-19 virus was fatal to the restaurants' claims.[7] The restaurants appealed. The SJC transferred the case from the Appeals Court on its own motion.

Insurance Policy Construction

The Supreme Judicial Court's opinion opens forcefully, with a detailed summary of the controlling law on questions of insurance-policy construction. The interpretation "of language in an insurance contract is no different from the interpretation of any other contract," the court wrote.[8] It requires the court to "determine the fair meaning of the language used, as applied to the subject matter."[9]

Significantly, the court stated that it "must also assume that every word in an insurance contract serves a purpose, and must be given meaning and effect whenever practicable."[10] When the policy terms are "unambiguous," the court said, "we construe the words of the policy in their usual and ordinary sense."[11] If the language is at all unclear or in doubt, the court inquires "into what an objectively reasonable insured, reading the policy language, would expect to be covered."[12]

The court then said what it would do with ambiguities in the policy language. Although holding that any ambiguities in the language of the insurance contract are to be interpreted against the insurer who used them and in favor of the insured,[13] the court went on to state that "a term is ambiguous where it is susceptible of more than one meaning *and reasonably intelligent persons would differ as to which meaning is the proper one*."[14] Ambiguity, the court said, is not created merely because the parties disagree about the meaning, or the mere

[5] *See id*., at 6.
[6] *See id*.
[7] *See id*., at 6-7.
[8] *See id*., at 8, *citing Metro. Life Ins. Co. v. Cotter*, 464 Mass. 623, 634-35 (2013), *quoting Metro. Prop. & Cas. Ins. Co. v. Morrison*, 460 Mass. 352, 362 (2011).
[9] *See id*., *citing Gordon v. Safety Ins. Co*., 417 Mass. 687, 689 (1994), *quoting Manning v. Fireman's Fund Am. Ins. Cos.*, 397 Mass. 38, 40 (1986).
[10] *See id*., *citing Dorcester Mut. Ins. Co. v. Krussell*, 485 Mass. 431, 437 (2020).
[11] *See id*., *citing Citation Ins. Co. v. Gomez*, 426 Mass. 379, 381 (1998), *quoting Hakim v. Mass. Insurers' Insolvency Fund*, 424 Mass. 275, 280 (1997).
[12] *See id*., at 9, *citing Dorcehester Mutual*, *supra*.
[13] *See id*.
[14] *See id*., at 9, *citing Dorchester Mutual* (emphasis added).

existence of multiple dictionary definitions of a word.[15] In a footnote, the court made it clear that a term is "not ambiguous or construed against the insurer merely because it is not explicitly defined in an insurance policy." Undefined terms may still be unambiguous.[16]

The court then turned to the specific insurance policies that Strathmore had sold, noting that although they did not use the term, they were "somewhat inaccurately referred to as an 'all-risk' property insurance policy." In a footnote, the court said that, regardless of how the policies were marketed, the "relevant question is what the terms of the policies themselves say. "Even if we were to inquire into the expectations of the insured," the court wrote, "the focus is on what an insured reading the relevant policy language would expect to be covered, not the insured's more general perceptions of the policy."[17] Even so, the court held, the burden remained on the insured to "demonstrate that such loss or damage, within the meaning of the policy, actually occurred."[18]

Direct Physical Loss

Turning to the "Building and Personal Property Coverage Form" in both policies, the court recited that the critical language in the insuring agreement stated: "[Strathmore] will pay for direct physical loss of or damage to Covered Property at the [insured] premises...caused by or resulting from any Covered Cause of Loss."[19] In the context of the policies, the court declared that "direct physical loss of or damage to Covered Property" characterizes the effects that the covered causes must have on the property to trigger coverage, not the causes themselves.[20]

Turning to the policies' "Business Income (and Extra Expense) Coverage Form," the language said: "[Strathmore] will pay for the actual loss of Business Income you sustain due to a necessary 'suspension' of your 'operations' during a 'period of restoration'. The 'suspension' must be caused by direct physical loss of or damage to property" at the insured premises, caused by a covered cause of loss.[21]

The Court held that the term "direct physical loss of or damage to" should be construed to have the same meaning in both coverage form. The fact that the Property Coverage Form used the term to describe the "effect" of the damage, while the Business Income Form used the term to describe the "cause" of the damage, was immaterial, the Court said.[22] In the latter case, for purposes of business-income coverage, the suspension of business operations had to have been caused by the kind of loss or damage

[15] *See id*., at 10.
[16] *See id*., at 9 & fn. 9.
[17] *See id*., at 10 & fn. 10, *citing Dorchester Mutual*.
[18] *See id*., at 11, *citing Boazova v. Safe Ins. Co.*, 462 Mass. 346, 351 (2012).
[19] *See id*., at 11 (underlining in original).
[20] *See id*.
[21] *See id*. (underlining in original).
[22] *See id*., at 12 & fn. 11.

covered by the Business Property form, which in turn had to be caused by a non-excluded risk.

Having held that the critical question was the same under both coverage forms, the court then proceeded to frame the issue as being "not whether the virus is physical, but rather it has a direct physical effect on property that can be fairly characterized as 'loss or damage.'"[23] It held, unequivocally, that "direct physical loss of or damage to" property "requires some distinct, demonstrable, physical alteration of the property."[24] As the court noted, every appellate tribunal in the United States that has ever been asked to review COVID-19 insurance claims has agreed with this definition of the quoted language.[25]

The court then had little difficulty in concluding that "the suspension of business at the restaurants was not in any way attributable to a direct physical effect on the plaintiffs' property that can be described as loss or damage." The restaurants' continuing ability to provide takeout and delivery services, and to make the kitchen in Cambridge available for meal preparation, demonstrated that there were no physical effects on the properties themselves. Similarly, the COVID-19 orders issued by government authorities standing alone could "not possibly constitute 'direct physical loss of or damage to' property" because they did not physically alter the property.[26]

Evanescent Presence

Driving its point home, the court continued that, even if the restaurants' argument that their business was suspended because of the "presence" of the virus on surfaces and in the air at the restaurants were correct, as opposed to the danger that the virus would be introduced to the restaurants or spread directly from person to person if indoor dining were allowed, "mere 'presence' does not amount to loss or damage to the property."[27]

The court held that "[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 physically alter or affect the property."[28] The court went on to note that there was no suggestion whatsoever in the pleadings that the novel coronavirus had somehow saturated, ingrained, or infiltrated into the materials of the building, or that there was any indication that they were a type of persistent pollution.[29] The court held that the use of the disjunctive term "or" in the phrase "loss or damage" simply did not present any kind of relevant distinction in the context of the

[23] *See id*., at 14.
[24] *See id*., at 15.
[25] *See id*., at 15-16.
[26] *See id*., at 17.
[27] *See id*., at 18, *citing Kim-Chee LLC v. Phila. Indem. Ins. Co.*, 535 F. Supp. 3d 152, 159 (W.D.N.Y. 2021), *aff'd in unreported decision in* Case No. 21-1082-cv (2d Cir. Jan. 28, 2022).
[28] *See id*.
[29] *See id*.

presented claims because both were subject to the terms "direct physical," which required direct, physical deprivation of possession.[30]

Negative Implications

The SJC went on to state that, because the insuring agreement could not be satisfied, there was no need for it to reach the issue of any exclusions or of the contours of the policies' civil authority coverage. The court also disposed of claims against the restaurants' insurance broker, which are not discussed in this article.[31]

One issue, however, did draw the court's attention. The restaurants had argued that the presence of the virus exclusion on the Cambridge restaurant's policy, and not on the two Boston restaurants' policy, created a "negative implication" that the policy without the exclusion should cover the Boston restaurants' claims. The court categorically rejected that argument.

Emphasizing that its precedent highlighted the "importance of not drawing negative implications," the Massachusetts high court relied on "basic insurance law principles" to hold that the "absence of an express exclusion does not operate to create coverage."[32] "Rather, when an occurrence is clearly not included within the coverage afforded by the insuring clause, it need not also be specifically excluded."[33] It also noted that its holding did not render the virus exclusion in the Cambridge restaurant's policy surplusage, because it would have independent significance if, for example, the restaurant presented a claim for spoiled food that had become contaminated with a virus.[34]

Significance & Final Thoughts

The Massachusetts Supreme Judicial Court's decision has significance because, although virtually every federal appellate court in the United States has made similar declarations, those decisions were all based upon the federal judiciary's predictions of how the state courts would rule. The Massachusetts high court was the first state supreme court to issue a coverage decision concerning first-party claims for COVID-19. And it did so unanimously.

Beyond the immediate coverage question, though, the *Verveine* decision is significant because of the categorical holdings on a variety of insurance-coverage issues, ranging from policy construction standards to when the court should find ambiguity to how the court should construe a similar phrase in different parts of an insurance policy. The reminder that the insuring agreement controls, and only if it applies should an analysis of the exclusions be undertaken, is a message that cannot be repeated often enough. And the categorical rejection of the policyholder's "negative implication"

[30] *See id*., at 19-20.
[31] *See id*., at 20-25.
[32] *See id*., at 21.
[33] *See id*. (internal punctuation omitted).
[34] *See id*., at 22. The court cited cases involving listeria contamination and mad-cow disease.

argument is something that the industry will find helpful in Massachusetts and elsewhere.

For Massachusetts practitioners and insurers with exposures in Massachusetts, the *Verveine* decision is one of the most significant to be handed down in years, at least since the *VisionAid* case declared that the duty to defend does not extend to the prosecution of affirmative counterclaims.[35] The persuasive impact of the *Verveine* decision, however, is certain to be felt elsewhere.

[35] *Mt. Vernon Fire Ins. Co. v. VisionAid, Inc.*, 477 Mass. 343 (2017).

Past Committee Newsletters

Visit the Committee's newsletter archive online at www.iadclaw.org to read other articles published by the Committee. Prior articles include:

FEBRUARY 2022
Can We Ever Say Goodbye in California?
Maureen M. Middleton

DECEMBER 2021
Promissory Estoppel in Canadian Insurance Law
Harmon C. Hayden

OCTOBER 2021
The Duty to Defend Between Several Insurers: Northbridge General Insurance Corporation v. XL Specialty Insurance Company, 2021 BCSC 1682
Harmon C. Hayden

MARCH 2021
Addendum to Insurance Policies without Limits: Surespan Structures Ltd. v. Lloyd's Underwriters
Harmon C. Hayden

JANUARY 2021
Drawing Lines Between Insurance Misrepresentations & Fraudulent Omissions
Harmon C. Hayden

OCTOBER 2020
Vermont Supreme Court Holds That "Combined Single Limit" and "Limits of Liability" Provisions in UIM Policy Cap Auto Insurer's Total UIM Payout, Despite Multiple UIM Claimants
Walter Judge

SEPTEMBER 2020
Covid-19 and Insurance: French Lessons for New Realities
Emmanuèle Lutfalla and Simon Fitzpatrick

AUGUST 2020
Preparing for Possible Bad Faith Claims in COVID-19 Related First Party Property Lawsuits
Karen K. Karabinos and Eric R. Mull

JULY 2020
10th Circuit Creates Opportunity for Liability Insurers to Hedge Their Bets Against Future Bad Faith Litigation in Claims with Questionable Coverage
Eric R. Mull and Katelyn E. Fischer