

California Appellate Court Affirms Dismissal Of Business Income And Civil Authority Coverage Claims

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The first California appellate court held that a hotel operator was not entitled to insurance coverage for its COVID-19-related business losses. *The Inns by the Sea v. Cal. Mut. Ins. Co.*, 2021 WL 5298480 (Cal. Ct. App. 4th Dist. Nov. 15, 2021).

The hotel operator sought coverage for business losses incurred after the state issued various shutdown orders aimed at slowing the spread of COVID-19. The insurer denied coverage based on the lack of “direct physical loss of or damage to” property. A trial court dismissed the claims and the appellate court affirmed.

The appellate court held that the complaint did not allege that the hotel’s operations were suspended because of direct physical damage to insured property. The court noted that the complaint was “vague” as to the actual presence of the virus on insured property, but held that even assuming that the complaint alleged (or could be amended to allege) that infected individuals were present at insured property, there would be no coverage. The court explained that the hotel’s losses were caused by shut down orders issued in response to viral presence throughout several counties—not because the virus was present at the insured premises. The court stated:

The lack of causal connection between the alleged physical presence of the virus on Inn’s premises and the suspension of Inn’s operation can best be understood by considering what would have taken place if Inns had thoroughly sterilized its premises to remove any trace of the virus after the Orders were issued. In that case, Inns would *still* have continued to incur a suspension of operations because the orders would *still* have been in effect and the normal functioning of society *still* would have been curtailed. . . . ‘[T]he property did not change. The world around it did.’ (Citations omitted).

The court distinguished cases in which the presence of asbestos or harmful fumes was held to constitute direct physical damage, noting that those cases involved property that was uninhabitable or unusable because of a physical force on the premises, not because of orders aimed at general surrounding conditions. In addition, the court ruled that the hotel’s operations were not suspended due to direct physical loss of insured property. A loss of use of property, standing alone, does not amount to a direct physical loss of property under common law or policy language, the court held.

The court expressly rejected the hotel’s contention that the absence of a virus exclusion in the policy should be considered *prima facie* proof that the insurer intended to provide coverage for virus-related losses. The court explained that the absence of an exclusion cannot create ambiguity in otherwise clear policy language.

Finally, the court ruled that civil authority coverage was not available based on the absence of allegations of direct physical loss of or damage to property, other than the insured property. The court reasoned that the government orders were expressly issued to slow the spread of COVID-19, and not in response to any direct physical loss or damage at a particular location.

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