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Via Email

The Honorable Patricia A. Howard
Clerk of Court
South Carolina Supreme Court
P.O. Box 11330
Columbia, SC 29211

Re: ***Sullivan Management, LLC v. Fireman's Fund Insurance Company et al.***
("Sullivan matter")
Appellate Case No. 2021-001209

Dear Ms. Howard:

Pursuant to Rule 208(b)(7) of the South Carolina Appellate Court Rules, Plaintiff is writing to notify the Court of two recent appellate level decisions, and their content pertinent to the pending certified questions.

The first decision is from the California First Appellate District: *Amy's Kitchen, Inc. v. Fireman's Fund Ins. Co*., No. A163767, 2022 WL 4875656 (Cal. Ct. App. Oct. 4, 2022). The *Amy's Kitchen* Court addressed an all-risk Fireman Fund's policy that contains several identical policy coverages, extensions, and exclusions as Sullivan's policy, e.g., the same Communicable Disease Extension ("CD Extension") and the same Loss Avoidance or Mitigation Extension ("Mitigation Extension"). The insured in *Amy's Kitchen* sought coverage under the CD Extension and the Loss Avoidance and Mitigation Extension.

The *Amy's Kitchen* Court concluded it was error at the motion to dismiss stage to conclude that COVID-19 cannot cause direct physical loss or damage to property, especially as it relates to the coverage under the CD Extension. In finding error, the Court stated:

> Although the "Definitions" section of the policy defines over 80 terms, it does not define "direct physical loss or damage" or any of its component terms. Nor does the operative paragraph define that phrase. Rather, the paragraph specifies three categories of costs that, if incurred as a result of a covered communicable disease event, are covered. […]
>
> Notwithstanding that plain language, Fireman's contends that "direct physical loss or damage" does not include "necessary costs incurred to ... [m]itigate, ... clean, ... disinfect, ... test for, [etc.] the communicable disease" unless the communicable

> disease event physically altered the property. "[P]hysical alteration" appears nowhere in the text of the policy. […]

2022 WL 4875656, at *4 (Cal. Ct. App. Oct. 4, 2022).

The Court went on to explain that subparagraph (c) of the CD Extension, which provides that Fireman's will pay for direct physical loss or damage to Property Insured including the necessary costs to " '[m]itigate, contain, remediate, treat, clean, detoxify, disinfect, neutralize, cleanup, remove, dispose of, test for, monitor, and assess the effects [of] the communicable disease' " would be rendered illusory if physical alteration was indeed a prerequisite to coverage:

> Moreover, treating physical alteration as an additional condition of coverage, as Fireman's urges, would render subparagraph (c) illusory—both redundant and meaningless. Subparagraphs (a) and (b) address the situation in which the presence of a communicable disease leads to physical alteration of the insured's property, where property must be torn out, repaired, or replaced. If subparagraph (c) were construed to apply only if there is a physical alteration of the property, the provision would have no possible application not covered by subparagraphs (a) and (b). […]
>
> Thus, the only plausible interpretation of subparagraph (c) of the communicable disease extension in this policy is that the need to clean or disinfect infected or potentially infected covered property constitutes "direct physical loss or damage" of that property within the meaning of the policy. The trial court erred in holding otherwise.

Id. at *5-6. The provisions cited by the *Amy's Kitchen* court are identical to those which exist in Sullivan's Policy; and, although Sullivan is seeking broader coverage than the insured in *Amy's Kitchen*, the court's interpretation of this unique policy's provisions is instructive.

The second decision is from the Supreme Court of Vermont: *Huntington Ingalls Indus., Inc. v. Ace Am. Ins. Co.,* 2022 VT 45, ¶ 3 (Vt. Sept. 23, 2022).[1] There, the court reviewed the trial court's decision to grant judgment on the pleadings in favor of the insurer. *Id.* at ¶ 17. The trial court conceded that there may be instances when COVID-19 could cause "direct physical loss or damage," but erroneously concluded that the insured there had only suffered an uncovered loss of

[1] The policy at issue in *Huntington Ingalls* was issued by the insured's captive insurance subsidiary, Huntington Ingalls Industrial Risk Management, LLC. The insurer in turn purchased policies from multiple reinsurers, including Ace American Insurance Company. The reinsurers moved for judgment on the pleadings, which was granted by the trial court. *Id.* at ¶¶ 1-3. The language of the policy at issue contains a similar triggering phrase as Sullivan's Policy; however, the actual policy at issue is not appended to the opinion or to the lower court's decision, and therefore the undersigned cannot comment on any other similarities between the two policies.

income because the insured property remained in limited operation and was not uninhabitable. *Id.* at ¶ 15.

The Supreme Court of Vermont first made clear that the triggering phrase— "direct physical loss or damage"— required the court to give separate and distinct meanings to "loss" and "damage." *Id.* at ¶ 24. ("Further, the rule against surplusage requires we give value to the decision to write the policy to cover "'loss or damage.'") (emphasis in original).

After a lengthy discussion, the *Huntington Ingalls* court concluded that "direct physical damage" requires "a distinct, demonstrable, physical alteration to property." *Id.* at ¶ 38. "Direct physical loss" requires "persistent destruction or deprivation, in whole or in part, with a causal nexus to a physical event or condition." *Id*. The *Huntington Ingalls* court ultimately found that the insured had plausibly alleged direct physical damage, and reversed the trial court on that ground alone without discussing whether direct physical loss had been adequately pled:

> First, we ask whether the complaint sufficiently pleads direct physical damage. As stated above, "direct physical damage" requires a distinct, demonstrable, physical alteration to property. In summary, the complaint alleges the following salient facts. The virus causing COVID-19 has been continuously present at insured's shipbuilding facilities. This fact is provable because insured had COVID-positive employees, those employees were infected at work, and infected persons spread the virus to surfaces. The virus can "adhere" to surfaces, transforming the surface into a fomite. This process of the virus "adhering" to surfaces caused "detrimental physical effects" that "altered and impaired the functioning of the tangible, material dimensions" of the property. Because of this alteration, the property cannot function for its intended purpose and insured's business has had to operate at a reduced capacity. To redress these physical alterations, insured took and will continue to take "steps that involve physical alterations to its insured locations," such as installing barriers and devices and redesigning physical spaces.
>
> Taken together, these statements in the complaint adequately allege that the virus physically altered property in insured's shipyards when it adhered to surfaces. […] Moreover, if insured can prove such alteration occurred, it may constitute "direct physical damage" even if it is at a microscopic level.

Id. at ¶¶ 41-42 (emphasis added). In addressing the dissent's argument that COVID-19's simply "rests on surfaces and can easily be remediated through simple cleaning techniques," the *Huntington Ingalls* majority reasoned as follows:

> The dissent therefore concludes that it is impossible for COVID-19 to cause direct physical damage to property. We need not tick off each of the dissent's inferences, all of which are drawn against insured, that lead to its conclusion. Suffice to say, the dissent argues that its inferences are reasonable and that all other inferences to the contrary, specifically those that favor insured in this case, are not. However, we are inclined to allow experts and evidence to come in to evaluate the validity of insured's novel legal argument before dismissing this case based on a layperson's understanding of the physical and scientific properties of a novel virus.[…]

> […] To end this litigation based on the limited information before us, simply because the alleged facts and the inferences therefrom may seem implausible at first based on what we think we know about COVID-19, would be premature.

Id. at ¶¶ 44-45 (emphasis added).

Continuing to address the dissent, the *Huntington Ingalls* majority rejected using the language in the "period of restoration" as a means to limit the scope of coverage:

> The dissent views the "rebuild, repair, replace" language as creating a separate requirement in the definition of "direct physical loss or damage" that must be met for coverage to be triggered. We respectfully disagree. In this case, the period-of-recovery section informs interpreting "direct physical loss or damage" but does not impose additional requirements upon the policy language describing coverage-triggering events. This is particularly important because, as the dissent notes, the period-of-recovery section does not even directly apply to the section on when coverage is triggered. It is relevant only when "direct physical loss or damage" causes business interruption. We likewise find unpersuasive the dissent's proposition that under the plain terms of the policy, a "repair" must "restore property 'to the condition that would have existed had no loss occurred.' " The policy states that the period of recovery includes "[s]uch additional length of time to restore the insured's business to the condition that would have existed had no loss occurred." It is not necessarily true in all situations that a property must be in the exact state it was in pre-damage in order for a "repair" to take place that would restore the business to the condition it was in before.

Id. at ¶ 27, fn. 11 (internal citations omitted) (emphasis added).

Finally, the *Huntington Ingalls* majority also addressed the notion that COVID-19 is harmful to people and not to property:

> The dissent repeats variations of a maxim commonly used in recent COVID-19 insurance cases: COVID-19 harms people not property. Though oft repeated, it is not "beyond doubt" that this maxim is true based on insured's pleadings. We accordingly decline to conclude that an event which allegedly causes a physical alteration to property, renders property such that it cannot be used as intended, and requires physical remediation efforts targeted at the physical alteration cannot be "direct physical damage" at this pre-discovery stage.

Id. at ¶44, fn. 14. (internal citations omitted).

Ultimately, the *Huntington Ingalls* court reversed the trial court's judgment on the pleadings "because the complaint plausibly alleges direct physical damage," and did not ultimately discuss whether the insured had adequately pled "direct physical loss" because it was unnecessary

to do so. However, the court clarified that its Opinion did not preclude the insured from prevailing "on a theory of loss in addition to, or in lieu of, a theory of damage." *Id.* at ¶¶46-47.

As the decisions are only recently published, they are appended hereto for the Court's convenience.

Respectfully submitted,

/s/ *Justin Lucey*

Justin Lucey, Esq.