

New Jersey Court Sees Potential in Optical Services COVID-19 Coverage Suit

In Optical Services USA/JCI v. Franklin Mut. Ins. Co.,¹ the New Jersey Superior Court denied the insurer's motion to dismiss the policyholders' COVID-19 coverage suit. The Plaintiffs, in this case, were optometrists' offices forced to close by New Jersey Governor Phil Murphy's Executive Order No. 107, which temporarily shut down non-essential businesses to help slow the spread of COVID-19 in New Jersey. Because the Plaintiffs' offices were deemed "non-essential," Plaintiffs closed their offices on March 20, 2020, and submitted claims under their Franklin Mutual Insurance Company ("Franklin Mutual") Businessowners Coverage Form for loss of business income and related expenses. Within three weeks, Franklin Mutual denied the claims, arguing that the Plaintiffs had not suffered physical loss or damage and that Plaintiffs' losses were excluded under the policy's virus exclusion. Following the denial, the Plaintiffs filed their insurance coverage action, and Franklin Mutual moved to dismiss.

At oral argument, Franklin Mutual made three strategic choices that may have influenced the court's decision. First, it admitted that the virus exclusion did not apply. It appears from the court transcript that Franklin Mutual's counsel was trying to draw a distinction between "an exclusion for virus proliferation," which he argued the policy had, and "an exclusion for a closure of business based on the risk of a virus proliferation," which he argued the policy did not have. However, he then acknowledged that "there is no exclusion that would apply on the facts as alleged in this Complaint."

Second, Franklin Mutual praised the recent decision issued by the U.S. Judicial Panel on Multidistrict Litigation, which denied certain policyholders' motions to centralize COVID-19 coverage lawsuits related to business interruption. Doing so drew particular attention to the Panel's recognition of the peculiar nature of individual business interruption claims and the "significant differences" between various insurers' policy forms and the "facts of particular cases."

Third, despite the court's warning that it was bound only by New Jersey precedent, Franklin Mutual called the court's attention to the recent decision in Studio 417 v. Cincinnati Insurance Co.,² a COVID-19-related insurance coverage case currently pending United States District Court for the Western District of Missouri. In Studio 417, the court held that the policyholders had sufficiently alleged direct physical loss or damage so as to trigger business interruption coverage and denied the insurer's motion to dismiss. Undaunted by the court's warning or by Studio 417's strong advantage to policyholders, Franklin Mutual discussed the decision at considerable length in an attempt to distinguish it from the matter at hand, until the judge again warned, "[w]e're concerned about New Jersey" and not the Western District of Missouri.

¹No. BER-L-3681-20, 2020 WL 5806576 (N.J. Super. Aug. 13, 2020).

²No. 20-cv-03127-SRB, 2020 WL4692385 (W.D. Mo. Aug. 12, 2020).

Counsel for Optical Services kept his argument focused on New Jersey law, citing a case decided by the United States District Court for District of New Jersey, Gregory Packaging, Inc. v. Travelers Property Casualty Company of America.³ Gregory Packaging held that a dangerous condition on the property can constitute a physical loss for purposes of insurance coverage. Optical Services' counsel analogized Gregory Packaging to the case at bar, arguing that the State of New Jersey's executive order "found that plaintiffs' businesses were deemed unfit and unsafe because of a dangerous condition." The executive order's conclusion that there was a dangerous condition constituted a direct physical loss that caused plaintiffs' business interruption.

The court denied Franklin Mutual's motion to dismiss from the bench. As it turned out, Franklin Mutual's determination to highlight the unique nature of individual COVID-19-related claims and its attempts to distinguish Optical Services' claim from a case in another jurisdiction had no influence on a court interested in applying New Jersey law. The insurer, the court held, failed to provide any controlling legal authority that undermined the Plaintiffs' argument that the government order closing their properties constituted direct physical loss. In reaching its decision, the court relied in part on Wakefern Food Corp. v. Liberty Mutual Fire Ins. Co.,⁴ a New Jersey Appellate Division case which found coverage for a grocery store that lost power due to the failure of the electrical grid and transmission lines. The Wakefern court held the transmission lines were rendered physically incapable of functioning even though they were not necessarily damaged. Following this logic, Optical Services argued that "the term 'physical' can mean more than material alteration or damage," which the court found "compelling" for purposes of surviving Franklin Mutual's motion to dismiss. By denying the motion, the court allowed the policyholders to develop and prove the "interesting argument . . . that physical damage occurs where a policyholder loses functionality of their property and by operation of civil authority such as the entry of an executive order results in a change to the property."

The Optical Services decision has already influenced the pleadings in at least one similar coverage case. On September 29, 2020, the policyholders in Out West Restaurant Group Inc. v. Affiliated FM Insurance Co.⁵ cited both Optical Services and Studio 417 in their complaint to show that it was per se reasonable to construe business interruption insurance as coverage for "losses because of physical loss of and/or damage to, property from COVID-19 and government orders that resulted from same."

SDV will continue to monitor the progress of the Optical Services litigation. If you have any questions concerning this case or any other matter related to coverage for COVID-19 losses, please contact Bethany L. Barrese at blb@sdvlaw.com or Brian J. Clifford at bjc@sdvlaw.com.

³No. 2:12-cv-04418 (D. N.J. Nov. 25, 2014).

⁴406 N.J. Super.524 (App. Div. 2009).

⁵No. 3:20-cv-06786, United States District Court for the Northern District of California.