UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No.	LA CV20-07132 JAK (AFMx)	Date	May 27, 2022
Title	The Madera Group, LLC v. Mitsui Sumitomo Insurance USA, Inc.		

Present: The Honorable	JOHN A. KRONSTADT, UNITED STATES DISTRICT JUDGE
T. Jackson-Terrell	Not Reported
Deputy Clerk	Court Reporter / Recorder
Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
Not Present	Not Present

Proceedings: **(IN CHAMBERS) ORDER RE DEFENDANT MITSUI SUMITOMO INSURANCE USA INC.'S MOTION TO DISMISS FIRST AMENDED COMPLAINT PURSUANT TO RULE 12(B)(6) (DKT. 71);**

PLAINTIFF'S MOTION FOR LEAVE TO FILE A SUR-REPLY (DKT. 82)

JS-6

I. Introduction

On July 7, 2020, The Madera Group, LLC ("Plaintiff") brought this action against Mitsui Sumitomo Insurance USA Inc. ("Defendant") in the Los Angeles Superior Court. Dkt. 1-1 ("Complaint"). The Complaint advances causes of action for declaratory relief and breach of contract. *Id.* at 30-32.

On August 7, 2020, Defendant removed the action on the basis of diversity jurisdiction. Dkt. 1. On September 9, 2020, Defendant filed a motion to dismiss. Dkt. 15. On June 25, 2021, that motion to dismiss was granted without prejudice, i.e., with leave to file an amended complaint. Dkt. 66 ("Dismissal Order"). On July 16, 2021, Plaintiff filed the First Amended Complaint. Dkt. 68 ("FAC"). It advances the same two causes of action presented in the Complaint, and adds a third cause of action for regulatory estoppel. *Id.* at 1.

On August 20, 2021, Defendant filed a Motion to Dismiss First Amended Complaint Pursuant to Rule 12(b)(6). Dkts. 71, 72 ("Motion"). On October 27, 2021, Plaintiff filed an Opposition to the Motion. Dkt. 77 ("Opposition"). Plaintiff also filed a Request for Judicial Notice. Dkt. 78 ("Plaintiff's RFN"). Defendant filed a Reply in Support of the Motion on December 6, 2021. Dkt. 79 ("Reply"). Defendant also filed a Request for Judicial Notice. Dkt. 81 ("Defendant's First RFN").

On December 14, 2021, Plaintiff filed a Motion for Leave to File a Sur-Reply. Dkt. 82 ("Motion to File Sur-Reply"). Defendant filed an Opposition to the Motion to File Sur-Reply on December 20, 2021. Dkt. 84 ("Opposition to Motion to File Sur-Reply"). On February 4, 2022, Defendant filed a second Request for Judicial Notice. Dkt. 88 ("Defendant's Second RFN").

A hearing on the Motion and the Motion to File Sur-Reply was held on March 7, 2022. For the reasons stated in this Order, the Motion is **GRANTED** and the Motion to File Sur-Reply is **GRANTED**.

II. Factual Background

A. Parties

Plaintiff, which is a California limited liability company, owns and has operated several restaurants in California and Arizona. FAC ¶¶ 9, 14. Plaintiff is a citizen of California and Florida, and its principal place of business is in California. *Id.* ¶ 9.

Defendant is a New York corporation, whose principal place of business is in New Jersey. *Id.* ¶ 10. Defendant is an insurance company that issues a range of policies, including those that cover real property. *Id.* ¶ 11.

B. Allegations in the FAC

1. The Policy

It is alleged that Plaintiff obtained an all-risk insurance policy (the "Policy") from Defendant, which applied to 23 restaurants operated by Plaintiff in California and Arizona. FAC ¶¶ 1, 15. It is further alleged that Plaintiff paid all premiums due under the Policy and complied with all of its other conditions. *Id.* ¶ 81. It is alleged that the Policy provides the "broadest coverage available to policyholders." *Id.* ¶ 82.

A copy of the Policy is attached to the FAC. Dkt. 68-1 at 2-305. The Policy includes the following statements as to the scope of its coverage:

- "Building and Personal Property," which covers "direct physical loss of or damage to Covered Property at the premises . . . caused by or resulting from any Covered Cause of Loss."
- "Business Income" and "Extra Expense," which cover "actual loss of Business Income . . . sustain[ed] due to the necessary 'suspension' of [Plaintiff's] 'operations'" due to "direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss." This is supplemented by "Extended Business Income," which "appl[ies] through the time it takes to restore your 'operations', with reasonable speed, to the level which would generate the business income amount that would have existed if no direct physical loss or damage had occurred."
- "Civil Authority," which provides coverage "when a Covered Cause of Loss causes damage to property other than property at the described premises," and "action of civil authority . . . prohibits access to the described premises," and as a result the policyholders sustain "actual loss of Business Income";
- "Dependent Properties," which provides coverage when direct physical loss of, or damage to "dependent properties" causes the suspension of the operation of Plaintiff's restaurants.

FAC ¶¶ 84-85, 91-93.

2. The Virus Exclusion

It is alleged that the Policy includes "standard form language" excluding coverage for loss or damage caused by viruses (the "Virus Exclusion"). *Id.* ¶ 102. The Virus Exclusion provides: "We will not pay for

loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease." Dkt. 68-1 at 94.

It is alleged that Defendant "should be estopped from relying upon" the Virus Exclusion "due to misrepresentations to New Jersey and California state insurance regulators in the process of obtaining each state's approval." FAC ¶ 103. It is alleged that the standard Virus Exclusion was introduced by the insurance industry in 2006, and that it was ultimately approved by insurance regulators in New Jersey and California. *Id.* ¶ 106. It is alleged that the insurance industry made false statements to state insurance regulators that "contamination of property with 'disease-causing agents' was not covered by property insurance policies and that the newly proposed virus exclusions were a mere 'clarification' of existing coverage." *Id.* ¶ 107. It is alleged that this statement was false because by 2006, "a strong majority of courts interpreting property and business income insurance policies had concluded that physical loss of or damage to property includes physical conditions that cause property to be simply too unsafe to inhabit or use." *Id.* ¶ 122.

It is further alleged that the insurance industry has been reprimanded previously and estopped from enforcing certain exclusions due to "misrepresenting to insurance regulators and policyholders that 'pollution' exclusions introduced in standard-form comprehensive general liability policies in 1970 were not reductions in coverage, but merely 'clarifications' for which no rate change would be required." *Id.* ¶¶ 113-20.

It is alleged that, due to judicial decisions prior to 2006 holding that "covered property damage and resulting business income loss and extra expenses could be caused by an array of noxious and untenable conditions impacting property," insurance companies had "long been aware" that an event such as the presence of the COVID-19 virus at a building or property "causes direct physical loss of or damage to that property." *Id.* ¶¶ 125-26. It is alleged that in 2006, "insurance companies worldwide were well aware of this truth when they told state insurance regulators the opposite—just as they are now misinforming courts and impacted policyholders like [Plaintiff]." *Id.* ¶ 127.

It is next alleged that the statement by the insurance industry that policies covering property had "not been a source of recovery" for these losses "simply was not true." *Id.* ¶¶ 132-33. It is alleged that this misrepresentation was an intentional act that was part of an effort to mislead insurance regulators in California and elsewhere in the United States, and that this caused them to approve the Virus Exclusion due to such "deception and misrepresentations." *Id.* ¶¶ 141-51. It is further alleged that the insurance industry, including Defendant, benefited from these misrepresentations because they did not reduce premiums to account for what were new limitations on coverage. *Id.* ¶ 151. The FAC also alleges that Defendant and/or its agents have repudiated these statements about the prior scope of coverage. *Id.* ¶ 152. Further, it alleges that although Defendant "now contends that the ISO Virus or Bacteria Endorsement does not involve a *significant* decrease in coverage," its representatives previously took "contrary positions and succeeded in reducing coverage without any premium reduction or appropriate scrutiny." *Id.* ¶ 153 (emphasis added).

3. The Effect of the COVID-19 Pandemic on Plaintiff's Business

The FAC alleges that the COVID-19 virus is highly transmissible and spreads rapidly. *Id.* ¶ 16. It is alleged that the virus has infected more than 33 million people in the United States and spreads readily

from person to person and person to surface or object. *Id.* ¶¶ 16, 19. It is alleged that the virus is spread by droplets that leave a person's nose or mouth, that may cause COVID-19 virions to enter the air and land on surfaces. *Id.* ¶¶ 19-20. It is alleged that the virus-containing droplets are small but remain "physical objects that can travel within property and attach to surfaces." *Id.* ¶ 22. It is alleged that the virus "remains active and dangerous suspended in the air in properties and on common surfaces." *Id.* ¶ 24. Further, it is alleged that the particles "cannot be eliminated by routine cleaning." *Id.* ¶ 34.

It is also alleged that the federal government "failed to prevent the spread of the pandemic." *Id.* ¶ 47. It is alleged that due to the "state of the public health system in the United States . . . [it] was unable to stop the rampant spread of the pandemic, which led to the presence of [COVID-19] . . . in [Plaintiff's] insured locations." *Id.* ¶ 48. It is also alleged that, as a result of "the United States government and public health system's failure to contain the spread of the COVID-19 pandemic," Plaintiff responded to the pandemic by making physical alterations to restaurants, "resulting in additional physical loss of or damage to property." *Id.* ¶ 56.

Further, the FAC alleges that, beginning in March 2020, state and local governments imposed orders that mandated closure of certain businesses, including Plaintiff's restaurants. *Id.* ¶ 57. Copies of the public health orders are attached to the FAC as Exhibit C. *Id.* ¶ 58. It is alleged that the orders "physically impacted and caused losses to [Plaintiff]'s business operations without regard to whether [the] virus was or was not present at any [of Plaintiff's] restaurant[s] or insured location[s]." *Id.* ¶ 71.

It is also alleged that the federal government and "public health system's failure to contain the spread of the COVID-19 pandemic, the issuance of the civil authority orders by state and local governmental authorities, and the statistically probable and ubiquitous presence of [COVID-19] virions at or near [Plaintiff]'s restaurants are all covered causes of loss" under the Policy. *Id.* ¶ 72. It is alleged that those actions "have also caused direct physical loss of or damage to the immediate surrounding properties [Plaintiff] depends on to attract business to its insured locations." *Id.* ¶ 74. The FAC also alleges that Plaintiff's restaurants are within one mile of other establishments that have suffered "direct physical loss of or damage due to" those actions. *Id.* ¶ 75.

4. Plaintiff's Claim and the Denial by Defendant

It is alleged that Plaintiff notified Defendant of its claim under the Policy, and that Defendant denied the claim on April 6, 2020. *Id.* ¶¶ 170-71. It is alleged that, in support of the denial of coverage, Defendant stated:

- Plaintiff did not suffer "direct physical loss of or damage to property" at insured premises that is "caused by or results from a Covered Cause of Loss";
- The Virus Exclusion excludes coverage for Plaintiff's claim;
- "Business Income" coverage is not triggered because "it does not appear that COVID-19 caused 'direct physical loss of or damage to' insured property";
- "Civil Authority" coverage is not triggered because it "does not appear that a covered cause of loss caused 'damage to property' within one mile of the insured premises."

Id. ¶¶ 171-74.

C. Relief Requested

Plaintiff seeks a declaration that the failure of the federal government and the public health system "to contain the spread of the COVID-19 pandemic caused 'direct physical loss of or damage' to property, within the meaning of that phrase as used in the . . . Policy, sufficient to trigger coverage." *Id.* ¶ 184. Plaintiff also seeks a declaration that closure orders caused "direct physical loss of or damage" to property, sufficient to "trigger coverage" under the Policy. *Id.* Plaintiff seeks declarations that the Virus Exclusion is "invalid and unenforceable," Defendant "is estopped from relying upon or seeking to enforce its terms," and the presence of the virus caused "direct physical loss or damage" to Plaintiff's property sufficient to trigger coverage. *Id.* Plaintiff also seeks a declaration that Defendant must pay Plaintiff "up to the limits of liability for direct loss of or damage to Covered Property." *Id.*

Plaintiff next seeks an order requiring Defendant to pay Plaintiff "all monetary damages" suffered by Plaintiff that have been caused by Defendant's breach of contract. *Id.* ¶ 188.

Finally, Plaintiff seeks "entry of an award declaring that [Defendant] may not purport to rely on the [Virus Exclusion] to oppose [Plaintiff's] claims." *Id.* ¶ 197.

III. Plaintiff's Motion for Leave to File Sur-Reply

Plaintiff sought leave to file a sur-reply to respond to Defendant's citation in the Reply of two recent Ninth Circuit decisions. Dkt. 82 at 4. Defendant opposed the request because the decisions were publicly available prior to when Plaintiff filed its Opposition. Dkt. 84 at 3.

The first case, *Chattanooga Professional Baseball LLC v. National Casualty Co.*, No. 20-17422, 2021 WL 4493920 (9th Cir. Oct. 1, 2021) is unpublished and does not constitute binding precedent. It was issued approximately four weeks prior to the filing of Plaintiff's Opposition. The second case, *Mudpie Inc. v. Travelers Casualty Insurance Co. of America*, 15 F.4th 885 (9th Cir. 2021), was decided the same day as *Chattanooga*. Plaintiff had sufficient opportunity to discuss the two cases in the Opposition. However, because Defendant will not suffer any prejudice from the filing of the Sur-Reply and in the interest of considering all arguments in the most efficient manner, the Motion for Leave to File Sur-Reply is **GRANTED**.

IV. Requests for Judicial Notice

Plaintiff's RFN seeks notice of an article published in the Washington Post on April 2, 2020. Dkt. 78. The Request is **GRANTED**; provided, however, that notice is taken only of "what was in the public realm at the time, not whether the contents of th[e] article[] were in fact true." *Von Saher v. Norton Simon Museum of Art at Pasadena*, 592 F.3d 954, 960 (9th Cir. 2010) (quoting *Premier Growth Fund v. Alliance Cap. Mgmt.*, 435 F.3d 396, 401 n.15 (3d Cir. 2006)); *see also* Fed. R. Evid. 201(b).

Defendant's First RFN seeks notice of a prior Order by this Court in another action. Dkt. 81. Defendant's Second RFN seeks notice of two decisions by the Ninth Circuit, and its issuance of the corresponding mandates. Dkt. 88. Defendant's requests are **DENIED**. These opinions may be considered by providing their citations. Therefore, judicial notice is unnecessary. *McVey v. McVey*, 26

F. Supp. 3d 980, 984 (C.D. Cal. 2014) ("It is unnecessary to take judicial notice of the opinion, which plaintiff cites as precedent and which the court can consider as such."). Further, Fed. R. Evid. 201 applies only to "adjudicative fact(s)."

Approximately two months after the hearing on the Motion, Defendant filed an *Ex Parte* Application for an Order Permitting Defendant Mitsui Sumitomo Insurance USA Inc. to File a Second Request for Judicial Notice in Support of its Motion to Dismiss Amended Complaint. Dkt. 98 ("Defendant's Third RFN"). Defendant's Third RFN requested notice of two recent appellate decisions. *Id.* at 2. Plaintiff filed an Opposition to Defendant's *Ex Parte* Application. Dkt. 99. On May 11, 2022, Defendant's Third RFN was denied for the same reasons stated above. Dkt. 100 at 2 ("It is unnecessary to take judicial notice of the opinions identified in the [RFN] because the court may routinely consider such legal authorities in doing its legal analysis.").

V. Analysis

A. Legal Standards

Fed. R. Civ. P. 8(a) provides that a "pleading that states a claim for relief must contain . . . a short and plain statement of the claim showing that the pleader is entitled to relief." The pleading must allege facts that if established would be sufficient to show that a claim for relief is plausible on its face. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). A complaint need not include detailed factual allegations but must provide more than a "formulaic recitation of the elements of a cause of action." *Id.* at 555. "The plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully. Where a complaint pleads facts that are 'merely consistent with' a defendant's liability, it stops short of the line between possibility and plausibility of entitlement to relief." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (internal quotation marks and citations omitted).

Fed. R. Civ. P. 12(b)(6) permits a party to move to dismiss a cause of action that fails to state a claim. It is appropriate to grant such a motion only where the complaint lacks a cognizable legal theory or sufficient facts to support one. *See Mendiondo v. Centinela Hosp. Med. Ctr.*, 521 F.3d 1097, 1104 (9th Cir. 2008). In considering a motion to dismiss, the allegations in the challenged complaint are deemed true and must be construed in the light most favorable to the non-moving party. *See Cahill v. Liberty Mut. Ins. Co.*, 80 F.3d 336, 337-38 (9th Cir. 1996). However, a court need not "accept as true allegations that contradict matters properly subject to judicial notice or by exhibit. Nor is the court required to accept as true allegations that are merely conclusory, unwarranted deductions of fact, or unreasonable inferences." *In re Gilead Scis. Sec. Litig.*, 536 F.3d 1049, 1055 (9th Cir. 2008) (quoting *Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001)).

If a motion to dismiss is granted, the court should "freely give leave [to amend] when justice so requires." Fed. R. Civ. P. 15(a)(2). Although this policy is to be applied "with extreme liberality," *Owens v. Kaiser Found. Health Plan, Inc.*, 244 F.3d 708, 712 (9th Cir. 2001) (citation omitted), allowing leave to amend is inappropriate in circumstances where litigants have failed to cure previously identified deficiencies, or where an amendment would be futile. *See Foman v. Davis*, 371 U.S. 178, 182 (1962); *Allen v. City of Beverly Hills*, 911 F.2d 367, 374 (9th Cir. 1990).

B. Application

1. Choice of Law

a) Legal Standards

"[A] court ordinarily must apply the choice-of-law rules of the State in which it sits." *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 243 n.8 (1981). California courts apply two choice-of-law tests in connection with claims that arise under contract law: Cal. Civ. Code § 1646, which sets forth a statutory test, and the general governmental interest analysis test. *Costco Wholesale Corp. v. Liberty Mut. Ins. Co.*, 472 F. Supp. 2d 1183, 1197-98 (S.D. Cal. 2007). Notwithstanding the historical "difference of opinion" in state courts, *see Arno v. Club Med Inc.*, 22 F.3d 1464, 1468 n.6 (9th Cir. 1994), federal courts have developed a consensus that the specific legislative statement of Section 1646 governs in contract matters. *See Glob. Commodities Trading Grp., Inc. v. Beneficio de Arroz Cholomo, S.A.*, 972 F.3d 1101, 1111 (9th Cir. 2020); *Channell Com. Corp. v. Wilmington Mach. Inc.*, No. ED CV 14-2240 DMG (DTBx), 2016 WL 7638180, at *7 (C.D. Cal. Jun. 17, 2016) (collecting cases). This is consistent with decisions by California Courts of Appeal. *See Frontier Oil Corp. v. RLI Ins. Co.*, 153 Cal. App. 4th 1436, 1443 (2007); *Gitano Grp., Inc. v. Kemper Grp.*, 26 Cal. App. 4th 49, 56 n.4 (1994).

Under Section 1646, "[a] contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made." *Id.* An insurance policy is a contract, Cal. Ins. Code § 22, and, therefore, state and federal courts have applied Section 1646 to determine how insurance policies should be construed. *See, e.g.*, *Frontier Oil Corp.*, 153 Cal. App. 4th at 1460-61; *Gitano Grp.,* 26 Cal. App. 4th at 56 n.4 (1994); *James River Ins. Co. v. Medolac Labs.*, 290 F. Supp. 3d 956, 963-64 (C.D. Cal. Feb. 22, 2018). Section 1646 governs only the interpretation of contractual terms. All other issues -- including whether a contract is valid -- are subject to the governmental interest analysis. *Glob. Commodities*, 972 F.3d at 1111.

b) Application

The Dismissal Order determined that California law applies, and provides the rules for the contractual interpretation for the Policy. Dkt. 66 at 7-9. That analysis is incorporated here by this reference. The Dismissal Order concluded that California has not adopted the doctrine of regulatory estoppel when considering clear and unambiguous language. *Id.* at 8. (citing *ACL Techs., Inc. v. Northbrook Prop. & Cas. Ins.*, 17 Cal. App. 4th 1773, 1790 (1993)). This is a material difference from New Jersey law. *Id.* The Dismissal Order also determined that the choice of law standards in Cal. Civ. Code § 1646 govern Plaintiff's claims. The Dismissal Order rejected Plaintiff's argument that, under the doctrine of dépeçage[1], a different choice of law analysis applies to regulatory estoppel. *Id.* at 9. The Dismissal Order concluded: "[R]egulatory estoppel is neither a claim [n]or cause of action in this matter. Rather, it

[1] Dépeçage is a legal doctrine that "arises in diversity cases when the court must engage in a choice of law analysis." *Bolt v. Merrimack Pharms., Inc.*, No. S-04-0893 WBS DAD, 2005 WL 2298423, at *6 (E.D. Cal. Sept. 20, 2005). "Although dépeçage is not a universally accepted principle and has not been explicitly adopted by the California Supreme Court, the concept behind it, that 'a separate conflict of laws inquiry must be made with respect to each issue in the case,' is found in California law." *Id.* (quoting *Wash. Mut. Bank, FA v. Super. Ct.*, 24 Cal. 4th 906, 920 (2001)).

is a rule of contract interpretation. Because Section 1646 mandates that California law should apply, New Jersey's doctrine is not applicable." *Id.*

Plaintiff argues that, pursuant to the doctrine of dépeçage, California's government interest analysis, rather than its contract interpretation analysis, "should be applied to [Plaintiff]'s newly-alleged regulatory estoppel cause of action." Dkt. 77 at 31-32. Defendant argues that the Dismissal Order previously determined that California law applies to Plaintiff's regulatory estoppel argument, which required dismissal of Plaintiff's claim. Dkt. 79 at 12. Defendant further contends that, even under California's government interest test, California law applies. *Id.* at 13-14.

Plaintiff has not provided any precedent to support the position that regulatory estoppel may be pleaded as a standalone cause of action, rather than presented as a matter to be considered as part of the contractual interpretation analysis. A California Court of Appeal considered the doctrine to be an alternative method of contract interpretation that incorporates extrinsic evidence. *ACL Techs., Inc.*, 17 Cal. App. 4th at 1787 n.39 ("[S]ome jurisdictions have relied on an 'estoppel' or regulatory history rationale not necessarily related to any textual ambiguity."); *id.* at 1791 ("Whatever else extrinsic evidence may be used for, it may not be used to show that words in contracts mean the exact opposite of their ordinary meaning.").[2] *See also Pez Seafood DTLA, LLC v. Travelers Indem. Co.*, 514 F. Supp. 3d 1197, 1208 n.6 (C.D. Cal. 2021) ("California courts have not adopted the doctrine of 'regulatory estoppel.'"); *id.* (because "the exclusion is unambiguous and Plaintiff's argument would render the entire exclusion meaningless, the Court will not consider the exclusion's drafting history").

Because regulatory estoppel may be part of the contractual interpretation process, but is not a cause of action, the allegations in the FAC that seek to avoid California choice of law rules are unpersuasive. As stated in the Dismissal Order, Plaintiff's reliance on regulatory estoppel falls under Cal. Civ. Code § 1646. Section 1646 requires that the Policy be interpreted pursuant to California law. Dkt. 66 at 9.

Because California does not recognize regulatory estoppel, *id.* at 8, Plaintiff's separate claim under that doctrine is dismissed. *See id.* at 9.[3] The Motion is **GRANTED** as to the Third Cause of Action, without prejudice to applying the principles of regulatory estoppel as part of the contractual interpretation process, to the extent that such an application is determined to be appropriate under California law. As explained in the Dismissal Order, California law also applies to Plaintiff's other causes of action. *Id.*

2. Whether There is Coverage

a) Legal Standards

Under California law, an insured has the initial burden of establishing "that the occurrence forming the basis of its claim is within the basic scope of insurance coverage . . . . [O]nce an insured has made this showing, the burden is on the insurer to prove the claim is specifically excluded." *Aydin Corp. v. First*

[2] One commentator concluded that *ACL Technologies* rejected the doctrine of regulatory estoppel because it "is inconsistent with the rules of insurance contract interpretation and improper." 1 Barbara O'Donnell, Law & Prac. of Ins. Coverage Litig. § 1:16 (2020).

[3] For the reasons stated in the discussion that follows, because the FAC fails to allege a loss that is covered by the Policy, it is unnecessary to determine whether the Virus Exclusion applies. Thus, even if Plaintiff's regulatory estoppel argument, which applies to the Virus Exclusion, were accepted, it would not change the outcome.

State Ins. Co., 18 Cal. 4th 1183, 1188 (1998) (internal citations omitted).

"While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply." *Bank of the W. v. Super. Ct.*, 2 Cal. 4th 1254, 1264 (1992). Thus, "[w]ords used in an insurance/annuity contract are to be interpreted in their 'plain and ordinary sense.'" *Connick v. Teachers Ins. & Annuity Ass'n of Am.*, 784 F.2d 1018, 1020 (9th Cir. 1986) (quoting *McKee v. State Farm Fire & Cas. Co.*, 145 Cal. App. 3d 772, 776 (1983)). The intent of the contracting parties "is determined solely from the written provisions of the insurance policy." *Perez-Encinas v. AmerUs Life Ins. Co.*, 468 F. Supp. 2d 1127, 1133 (N.D. Cal. 2006) (citing *Waller v. Truck Ins. Exch., Inc.*, 11 Cal. 4th 1, 18 (1995)). "If the policy language is clear and explicit, it governs." *Id*.

A term of an insurance policy is ambiguous when its language "is capable of two or more constructions[,] both of which are *reasonable*." *Bay Cities Paving & Grading, Inc. v. Laws.' Mut. Ins.* Co., 5 Cal. 4th 854, 867 (1993) (emphasis in original and citation omitted). The absence of a definition for a term does not itself create ambiguity. *Id.* at 866. When policy language is ambiguous, courts "must admit a party's offered extrinsic evidence if it is relevant to prove a contract is 'reasonably susceptible' to the meaning the party alleges." *Aerotek, Inc. v. Johnson Grp. Staffing Co.*, 54 Cal. App. 5th 670, 683 (2020) (citing *Pac. Gas & E. Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 37 (1968)). *See also Lee v. Fid. Nat'l Ins. Co.*, 188 Cal. App. 4th 583, 598 (2010) ("In determining whether an ambiguity exists, a court should consider not only the face of the contract but also any 'extrinsic evidence that supports a reasonable interpretation.'") (quoting *Am. Alt. Ins. Corp. v. Super. Ct.*, 135 Cal. App. 4th 1239, 1246 (2006)).

An ambiguity in a policy is construed against the insurer. *See AIU Ins. Co. v. Super. Ct.*, 51 Cal. 3d 807, 822 (1990) ("Because the insurer writes the policy, it is held 'responsible' for ambiguous policy language, which is therefore construed in favor of coverage."). Further, exclusions must be "conspicuous, plain and clear." *MacKinnon v. Truck Ins. Exch.*, 31 Cal. 4th 635, 639 (2003) (quoting *Gray v. Zurich Ins*. Co., 65 Cal. 2d 263, 271 (1966)). However, "when the terms of the policy are plain and explicit[,] the courts will not indulge in a forced construction so as to fasten a liability on the insurance company which it has not assumed." *First Am. Title Ins. Co. v. XWarehouse Lending Corp.*, 177 Cal. App. 4th 106, 115 (2009) (quoting *Jarrett v. Allstate Ins. Co.*, 209 Cal. App. 2d 804, 810 (1962)).

b) Application

(1) Whether "Direct Physical Loss of or Damage to" Property Has Been Alleged

The FAC alleges there is "a statistical certainty that [COVID-19] virions circulated in air and on property in [Plaintiff]'s restaurants and/or employees and customers at [Plaintiff]'s restaurants were inadvertently spreading [COVID-19] virions." FAC ¶ 54. The FAC also alleges that COVID-19 can be spread through droplets containing the virus, and that they are physical objects that can attach to surfaces. *See, e.g.*, FAC ¶¶ 22-26, 37-40, 54-55.

The Dismissal Order concluded that Plaintiff's allegations are sufficient to allege direct physical loss of, or damage to property under the Policy. Dkt. 66 at 10-11. A subsequent decision by a California Court

of Appeal, however, determined that such allegations are insufficient to state a claim for coverage. *See Inns-by-the-Sea v. Cal. Mut. Ins. Co.*, 71 Cal. App. 5th 688 (2021).

Inns-by-the-Sea considered nearly identical policy language and allegations as the ones presented in this action. The policy covered "direct physical loss of or damage to Covered Property . . . caused by or resulting from any Covered Cause of Loss." *Id.* at 694-95. The policy also provided "Business Income (and Extra Expense)" and "Civil Authority" coverage. *Id.* at 695. The Business Income coverage stated that the insurer would "pay for the actual loss of Business Income you sustain due to the necessary 'suspension' of your 'operations' during the 'period of restoration'. The 'suspension' must be caused *by direct physical loss of or damage to property at [Inns'] premises* . . . ." *Id.* (emphasis in original). The Civil Authority coverage applied to losses "caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, *other than at the described premises*, caused by or resulting from any Covered Cause of Loss." *Id.* (emphasis in original).

The insured in *Inns-by-the-Sea* alleged that public health orders issued by the California counties of Monterey and San Mateo and the presence of the COVID-19 virus caused the plaintiff to suspend business operations. *Id.* at 694. The allegations, however, described "a three-step chain of causation, beginning with the COVID-19 virus, in which 'the continued and increasing presence of the coronavirus on [Inns'] property and/or around its premises' led to the Orders, which in turn led to Inns' suspension of operations." *Id.* at 698. The decision in *Inns-by-the-Sea* assumed that COVID-19 was present on the plaintiff's property but interpreted the complaint to allege that "it was the presence of the virus *throughout* San Mateo and Monterey Counties—not the presence of the virus *specifically* on Inns' premises—that gave rise to the Orders, leading to Inns' suspension of operations." *Id.* at 699 (emphasis in original).

Inns-by-the-Sea then analyzed whether the complaint at issue alleged physical "damage to" the plaintiff's property and whether such allegations established "direct physical loss of" property. *Id.* at 699-708. It concluded that the allegations failed to establish coverage under either theory. *Id.* at 705, 708. *First*, the Court of Appeal concluded that the plaintiff could not "reasonably allege that the presence of the COVID-19 virus on its premises is what caused the premises to be uninhabitable or unsuitable for their intended purpose." *Id.* at 703 (emphasis omitted). Rather, the public health orders that caused the plaintiff to close its business "were issued because the COVID-19 virus was present *throughout* San Mateo and Monterey Counties, not because of any particular presence of the virus on Inns' premises." *Id.* (emphasis in original). The plaintiff did not allege that its losses were proximately caused by "the particular presence of the virus on its premises." *Id.* Thus, "despite Inns' allegation that the COVID-19 virus was present on its premises, it [did] not identif[y] any direct physical damage to property that caused it to suspend its operations." *Id.* at 705.

Second, *Inns-by-the-Sea* held that the allegations did not cause a "direct physical *loss of*" property because such an argument "collapses coverage for 'direct physical loss' into 'loss of use' coverage." *Id.* It concluded that the case law and the "language of the Policy as a whole establish that the inability to use physical property to generate business income, standing on its own, does not amount to a "'suspension' . . . caused by direct physical loss of' property within the ordinary and popular meaning of that phrase." *Id.* (internal quotation marks omitted). Thus, *Inns-by-the-Sea* held that the plaintiff failed to allege that its claimed losses were covered under the policy at issue.

"Where there is no convincing evidence that the state supreme court would decide differently, a federal court is obligated to follow the decisions of the state's intermediate appellate courts." *Ryman v. Sears, Roebuck & Co.*, 505 F.3d 993, 995 (9th Cir. 2007) (brackets and internal quotation marks omitted) (quoting *Vestar Dev. II, LLC v. Gen. Dynamics Corp.*, 249 F.3d 958, 960 (9th Cir. 2001)). Although the Dismissal Order reached a different outcome, *Inns-by-the-Sea* is now accepted as a statement of California law and is applied. The Court of Appeal determined in a well-reasoned decision that the plaintiff's losses were caused by public health closure orders, rather than the presence of the virus on the property. *Inns-by-the-Sea*, 71 Cal. App. 5th at 699-705. Thus, the plaintiff failed to allege direct physical loss of or damage to property.

Applying *Inns-by-the-Sea*, the allegations of the FAC are not sufficient to establish that "direct physical loss of, or damage to" Plaintiff's property caused its claimed losses. *See id.* at 699-708. The FAC does not allege that the public health orders were directed primarily at Plaintiff's restaurants due to the presence of COVID-19 at those places of business. Nor does the FAC plausibly allege a reason for Plaintiff's losses other than the mandated closures and limitations on business operations. *See id.* at 704-05 (the plaintiff's "facilities would have remained shut regardless of whether the virus was present in its facilities"); FAC ¶ 71 ("The closure orders physically impacted and caused losses to [Plaintiff]'s business operations without regard to whether virus was or was not present at any [Plaintiff] restaurant or insured location."); FAC ¶ 155 ("As a result of the United States government and public health system's failure to contain the spread of the COVID-19 pandemic, or the civil authority orders restricting and/or barring access to [Plaintiff]'s businesses and properties, [Defendant] is obligated by the All Risk Policy to pay for direct physical loss of or damage to and all Business Income loss and Extra Expense incurred at the premises . . . ."); FAC ¶ 156 ("Virus was not, however, the predominant cause of loss . . . ."); FAC ¶ 158 ("Due to these covered causes of loss, [Plaintiff]'s restaurants were no longer able to serve their intended use, have suffered direct physical loss of or damage, and have sustained a necessary suspension of their operations, regardless of whether any virus was present or detected at any Madera restaurant.").

Certain allegations in the FAC state that the presence of the virus "at or near Madera's restaurants," as well as negligent actions by the government and the civil closure orders, caused Plaintiff's business losses. *See* FAC ¶¶ 73, 74. Although those allegations claim that the virus itself caused Plaintiff's business losses, they lack the required specificity. Thus, they do not allege that Plaintiff's restaurants, "which could have otherwise been operating[,] . . . had to shut down because of the presence of the virus within the facility." *Inns-by-the-Sea*, 71 Cal. App. 5th at 704. They do not allege circumstances analogous to a restaurant that "need[s] to close for a week if someone in its kitchen tested positive for COVID-19, requiring the entire facility to be thoroughly sanitized and remain empty for a period." *Id.* at 704-05. Instead, the FAC combines the effect of the claimed negligent government conduct, the closure orders, and the presence of the virus inside Plaintiff's restaurants. The specific allegations in the FAC state that Plaintiff's losses were directly caused by the closure orders, not by the presence of the virus on the property. *See* FAC ¶ 62 (alleging Plaintiff's restaurants in Arizona closed due to state closure orders), FAC ¶ 67 ("Under the California orders, on-site dining at [Plaintiff]'s restaurants in California did not qualify as Essential Critical Infrastructure. Accordingly, operations were necessarily suspended at [Plaintiff]'s restaurants in California, starting on or about March 16, 2020.").[4]

[4] Another California Court of Appeal has concluded that the "hypothetical scenario" identified in *Inns-by-the-Sea* also fails to demonstrate "direct physical loss or damage." *See United Talent Agency v. Vigilant Ins. Co.*, 77 Cal. App. 5th 821, 2022 WL 1198011, at *11 (2022).

In the alternative, Plaintiff argues that the public health orders requiring modification to, or closing of Plaintiff's restaurants establish a "direct physical loss." Dkt. 77 at 27. The Dismissal Order concluded that similar allegations were not sufficient to establish the basis for a claim of physical loss or damage. That analysis continues to apply, and is incorporated here by this reference. Dkt. 66 at 11. Furthermore, after the issuance of the Dismissal Order, *Mudpie, Inc. v. Travelers Casualty Insurance Co. of America*, 15 F.4th 885 (9th Cir. 2021), was issued. In *Mudpie*, the plaintiff alleged that stay-at-home orders "temporarily prevented [Plaintiff] from operating its store as intended." *Id.* at 892. On this basis, the plaintiff argued that it suffered a "direct physical loss of or damage to" its property. *Id. Mudpie* rejected this position, and explained that "California courts have carefully distinguished 'intangible,' 'incorporeal,' and 'economic' losses from 'physical' ones." *Id.* (collecting cases). For the same reasons, the FAC fails to allege that the public health orders caused a "distinct, demonstrable, physical alteration of the property." *Id.* (citation omitted); *see also Inns-by-the-Sea*, 71 Cal. App. 5th at 708 ("the phrase 'direct physical loss of' property was not intended to include the mere loss of use of physical property to generate income, without any other physical impact to property that could be repaired, rebuilt or replaced"); *United Talent Agency v. Vigilant Ins. Co.*, 77 Cal. App. 5th 821, 2022 WL 1198011, at *5 (2022) ("It is now widely established that temporary loss of *use* of a property due to pandemic-related closure orders, without more, does not constitute direct physical loss or damage."); *Musso & Frank Grill Co., Inc. v. Mitsui Sumitomo Ins. USA Inc.*, 77 Cal. App. 5th 753, 2022 WL 1182918, at *4 (2022) ("Under California law, a business interruption policy that covers physical loss and damages does not provide coverage for losses incurred by reason of the COVID-19 pandemic."); *Circus Circus LV, LP v. AIG Specialty Ins. Co.*, No. 21-15367, 2022 WL 1125663, at *2 (9th Cir. 2022) (unpublished) ("Circus Circus's argument that the presence of the virus rendered its property uninhabitable improperly 'collapses coverage for "direct physical loss" into "loss of use" coverage.'" (quoting *Inns-by-the-Sea*, 71 Cal. App. 5th at 705)).

(2) Whether Civil Authority Coverage Has Been Alleged

The Policy includes the following language with respect to Civil Authority coverage:

> When a Covered Cause of Loss causes damage to property other than property at the described premises, we will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises, provided that both of the following apply:
>
> > (1) Access to the area immediately surrounding the damaged property is prohibited by civil authority as a result of the damage, and the described premises are within that area but are not more than one mile from the damaged property; and
> >
> > (2) The action of civil authority is taken in response to dangerous physical conditions resulting from the damage or continuation of the Covered Cause of Loss that caused the damage, or the action is taken to enable a civil authority to have unimpeded access to the damaged property.

Dkt. 68-1 at 56.

Inns-by-the-Sea considered a very similar provision as to Civil Authority coverage. 71 Cal. App. 5th at 710-12. The policy at issue there stated:

> We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss.

Id. at 710.

Inns-by-the-Sea concluded that the Civil Authority coverage did not apply "because the plain language of the Orders shows that they were not based on 'direct physical loss of or damage to property' to other premises." *Id.* at 711. Rather, "the Orders make clear that they were issued in an attempt *to prevent the spread* of the COVID-19 virus." *Id.* at 711. Thus, because they gave "no indication that they were issued 'due to direct physical loss of or damage to' any property," the "Orders did not give rise to Civil Authority coverage." *Id.* at 711-12. The Court of Appeal also recognized that "[n]umerous district court opinions have made the same observation in concluding that government stay-at-home and closure orders resulting from the pandemic did not give rise to Civil Authority coverage." *Id.* at 712 (collecting cases). "In sum, the Orders were issued to prevent the spread of the pandemic, not because of any direct physical loss of or damage to property. Accordingly, the Orders did not trigger the Policy's Civil Authority coverage." *Id.*; *see also United Talent Agency*, 2022 WL 1198011, at *12 (following *Inns-by-the-Sea*).

As explained in the Dismissal Order, certain of the public health orders attached to the FAC were issued as part of an effort to prevent the spread of COVID-19, rather than to prohibit access to a premises that had suffered physical loss or damage. Dkt. 66 at 13, 15. Thus, like the complaint in *Inns-by-the-Sea*, the FAC fails to allege coverage under the Civil Authority provision based on these orders.

Two of the public health orders attached to the FAC do refer to property loss or damage. *First*, the City of Los Angeles Order, which was issued on March 19, 2020, and revised on April 10, 2020, states: "This Order is given because, among other reasons, the COVID-19 virus can spread easily from person to person and it is physically causing property loss or damage due to its tendency to attach to surfaces for prolonged periods of time." Dkt. 68-4 at 72. *Second*, the City of San Diego Order, which was issued on April 30, 2020, states: "The closures and restrictions in these orders were and remain necessary because of the propensity of the virus to spread person to person and also because COVID-19 physically causes property loss and damage." *Id.* at 83.

Although each of these orders recognized that COVID-19 could cause physical property loss or damage, the orders were intended to prevent harm. Thus, their language reflects that they were designed to limit the spread of COVID-19 to individuals and to the properties subject to the Orders. *See Inns-by-the-Sea*, 71 Cal. App. 5th at 712. The City of Los Angeles Order states that the City needed to "adopt additional emergency measures to further limit the spread of COVID-19." Dkt. 68-4 at 72. The City of San Diego Order states that it was "imperative . . . to implement locally all guidance and directives currently available from federal, state, and local public health officials to stem the spread of the virus and protect public safety and welfare." *Id.* at 83. Further, both orders applied to all businesses within the respective cities, with certain exemptions, rather than certain properties that had been damaged by the presence of COVID-19. *Id.* at 73, 84-85.

Although both public health orders referred to property loss or damage, they were issued to prevent the spread of the virus. Thus, "absent allegations of damage to adjacent property," the FAC "does not establish the requisite causal link between prior property damage and the government's closure order." *Mudpie, Inc. v. Travelers Cas. Ins. Co. of Am.*, 487 F. Supp. 3d 834, 844 (N.D. Cal. 2020), *aff'd on other grounds*, 15 F.4th 885 (9th Cir. 2021). The FAC does not allege a direct causal link between damage to adjacent property and denial of access to Plaintiff's restaurants. *Id.* at 843; *see also Madison Int'l v. Valley Forge Ins. Co.*, No. CV 21-8246-GW-KKx, 2022 WL 224853, at *3 (C.D. Cal. Jan. 18, 2022) ("And the civil authority endorsement does not apply here, as it did not in *Inns*, because, as Plaintiff appears to concede, the government orders were not issued due to direct physical loss or damage at other properties.").

For the foregoing reasons, the FAC fails to allege coverage under the Civil Authority provision.

(3) Whether Dependent Properties Coverage Has Been Alleged

The Policy provides as follows as to Dependent Properties:

> We will pay the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by direct physical loss of or damage to "dependent property" at premises not described in the Declarations caused by or resulting from a Covered Cause of Loss.
>
> As used in this Additional Coverage, "Dependent Property" means property operated by others whom you depend on to . . .
>
> Attract customers to your business (Leader Locations).

Dkt. 68-1 at 121-22.

For the same reasons stated above regarding the Business Income coverage, the FAC fails to allege that COVID-19 caused a "direct physical loss of or damage to" any dependent property. Thus, the FAC does not plausibly allege coverage under the Dependent Properties provision.

(4) Allegations of Government Negligence

Finally, Plaintiff argues that the FAC plausibly alleges that "government negligence caused the spread of [COVID-19], the pandemic, state closure orders, and, as a result, [Plaintiff]'s loss and damages." Dkt. 77 at 26. Plaintiff contends that negligence of the government "was the triggering event" that set the spread of COVID-19 in motion, and that this, rather than the virus itself, was the efficient proximate cause of Plaintiff's losses. *Id.* at 26-27.

As explained above, the FAC does not allege a "causal connection between the alleged physical presence of the virus on [Plaintiff]'s premises and the suspension of [Plaintiff]'s operations." *Inns-by-the-Sea*, 71 Cal. App. 5th at 704. The allegations as to government negligence are insufficient for similar reasons. Thus, Plaintiff does not plausibly allege that something other than the closure orders

caused its business losses. *See id.* at 704-05. Assuming that government negligence caused the closure orders is also insufficient because, as explained above, the closure orders did not cause physical damage to Plaintiff's property. Because Plaintiff does not adequately allege "direct physical loss of or damage to property," Dkt. 68-1 at 55, it has failed "to establish that the occurrence forming the basis of its claim is within the basic scope of insurance coverage." *Aydin Corp.*, 18 Cal. 4th at 1188; *see Palmdale Ests., Inc. v. Blackboard Ins. Co.*, 510 F. Supp. 3d 874, 877 (N.D. Cal. 2021) (dismissing allegations that "a flawed public health response and government negligence allowed COVID-19 to spread" because complaint did not allege "[a] physical tangible injury (like a total deprivation of property) [that would] support 'loss of property' or a physical alteration or active presence of a contaminant to support 'damage to' property." (citation omitted)).

Furthermore, even assuming that the FAC alleged a loss that was otherwise covered by the Policy, allegations that government negligence caused the pandemic and, in turn, Plaintiff's losses are excluded under the plain language of the Policy. Dkt. 68-1 at 84 ("We will not pay for loss or damage caused by or resulting from . . . [a]cts or decisions, including the failure to act or decide, of any person, group, organization or governmental body.").

* * *

For the foregoing reasons, the FAC fails sufficiently to allege any injury that is within the scope of the coverage provided by the Policy. Further, because the FAC fails to allege that Plaintiff's losses were covered by the terms of the Policy, it is unnecessary to address whether the Virus Exclusion would also bar coverage.[5]

3. Leave to Amend

If a motion to dismiss is granted, the court should "freely give leave [to amend] when justice so requires." Fed. R. Civ. P. 15(a)(2). Although this policy is to be applied "with extreme liberality," *Owens*, 244 F.3d at 712, leave to amend is inappropriate in circumstances where an amendment would be futile. *See Foman*, 371 U.S. at 182; *Allen*, 911 F.2d at 374.

Plaintiff has not proposed additional allegations that it would include in a second amended complaint if leave to amend were granted. The Dismissal Order granted leave to amend, provided that "any amended complaint must be based on good faith allegations that sufficiently state claim(s) on grounds that have not already been addressed and rejected in this Order." Dkt. 66 at 16. The FAC included new allegations, but also repeated bases for relief that had been found insufficient in the Dismissal Order. As stated above, the allegations are insufficient to state a claim for relief.

There is now a significant body of law in the Ninth Circuit and the California Courts of Appeal that rejects similar claims. *See, e.g.*, *Mudpie, Inc.*, 15 F.4th at 892 ("Stay at Home Orders" did not constitute a "distinct, demonstrable, physical alteration of the property" (citation omitted)); *Inns-by-the-Sea*, 71

[5] It seems clear that the Virus Exclusion would also bar coverage. In *Musso & Frank Grill Co., Inc.*, which involved the same defendant as the one in this action, a California Court of Appeal held that an identical virus exclusion provision barred coverage. 2022 WL 1182918, at *5 ("The virus exclusion expressly bars coverage for all loss or damage caused by or resulting from 'any virus, bacterium or other micro-organism that induces or is capable of inducing physical distress, illness or disease.'").

Cal. App. 5th at 698-712 (allegations did not trigger business income coverage or civil authority coverage); *United Talent Agency*, 2022 WL 1198011, at *5-12 (same); *Musso & Frank Grill Co., Inc.*, 2022 WL 1182918, at *4-5 ("Under California law, a business interruption policy that covers physical loss and damages does not provide coverage for losses incurred by reason of the COVID-19 pandemic."). In light of these decisions, Plaintiff's prior opportunity to amend, and Plaintiff's failure to identify any additional allegations that it would include in a second amended complaint, any future attempt at amendment would be futile. *See Allen*, 911 F.2d at 374. Therefore, leave to amend is **DENIED**.

VI. Conclusion

For the foregoing reasons, Defendant's Motion is **GRANTED**. Plaintiff's Motion to File a Sur-Reply is **GRANTED**. The FAC is **DISMISSED** with prejudice.

IT IS SO ORDERED.

_____ : _____

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