9th Circ. COVID Coverage Ruling Misapplies Burden Of Proof

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In a series of recent rulings, the U.S. Court of Appeals for the Ninth Circuit continued a federal appellate trend by affirming the dismissal of three COVID-19 insurance coverage cases.

In Mudpie Inc. v. Travelers Casualty Insurance Co. of America, the most expansive of the three opinions, the Ninth Circuit on Oct. 1 affirmed the dismissal after concluding, in part, that the policyholder failed to sufficiently allege direct physical loss of or damage to property.

In reaching that conclusion, the Ninth Circuit placed the burden of satisfying the "direct physical loss of or damage to" property limitation on the policyholder as opposed to the insurer.

The Ninth Circuit's placement of that substantial burden on the policyholder was erroneous. In so doing, the Ninth Circuit incorrectly applied the burden of proof applicable in a case involving third-party liability insurance policies.

As courts throughout the country have acknowledged, resorting to third-party liability insurance principles is not appropriate when interpreting first-party "all-risks" property insurance policies. The applicable burden of proof assigned to policyholders of first-party all-risks property insurance policies is far more limited and easier to satisfy than the burden imposed on the policyholder in Mudpie.

Under first-party all-risks property insurance policies, policyholders need only show that it suffered a fortuitous loss. Once that is established, the burden shifts to the insurer who must show that the loss is excluded by some language in the insurance policy.

The Applicable Burdens of Proof Under an All-Risks First-Party Insurance Policy

As its name implies, all-risk insurance insures against loss or damage resulting from all risks, except those that are specifically excluded from coverage. Unless a risk is specifically excluded, it is deemed covered.

Due to the special nature of all-risks insurance, a policyholder's burden of proof under this kind of insurance policy is quite limited. Policyholders need only show that a fortuitous loss occurred.

As stated in American Law Reports' "Construction and Application of 'Fortuitous Event' Provision of All-Risk Insurance Policy":

An "all risks" policy creates a special type of coverage extending to risks not usually covered under other insurance, and recovery under such a policy will be allowed for all fortuitous losses unless the policy contains a specific provision expressly excluding the loss from coverage; additionally, unlike with a specific peril policy, the insured does not have to prove that the peril proximately causing the claimed loss was covered by the policy.

The special nature of all-risks insurance has unique consequences when it comes to the respective burdens of proof borne by policyholders and insurers. Once a policyholder satisfies the minimal burden of showing that it suffered a fortuitous loss, the burden shifts to the insurer to show that the loss is excluded by some language set forth in the insurance policy.

The Ninth Circuit Failed to Apply the Correct Burden of Proof

Rather than applying the unique burdens of proof applicable to first-party all-risks insurance policies, the Mudpie court relied on and applied the inapposite burden of proof applicable to third-party liability insurance policies.

In holding that "the burden is on the insured to establish that a claimed loss 'is within the basic scope of insurance coverage,'" Mudpie relied on the California Supreme Court's 1998 decision in Aydin Corp. v. First State Insurance Co., a case involving third-party liability insurance, not all-risks first-party property insurance.

Then, Mudpie relied on the 2010 decision from the California Court of Appeal's Second Appellate District in MRI Healthcare Center of Glendale Inc. v. State Farm General Insurance Co. in holding:

Where, as here, a policy covers "direct physical loss of or damage to" property, the "direct physical loss requirement is part of the policy's insuring clause and accordingly falls within [the insured's] burden of proof."

In turn, the MRI Healthcare court relied on the same inapposite decision in Aydin, as well as the California Supreme Court's 1989 decision in Garvey v. State Farm Fire & Casualty Co.

While Garvey did involve first-party insurance, the California Supreme Court made clear in that case that the scope of coverage under first-party and third-party insurance policies are entirely different.

According to the court in Garvey:

> Liability and corresponding coverage under a third party insurance policy must be carefully distinguished from the coverage analysis applied in a first party property contract.

As further explained in Garvey, insurance policy exclusions are the sole determinant of coverage under a first-party insurance policy.

For that reason, cases interpreting third-party liability insurance policies are inapposite in cases involving first-party all-risks insurance. As the U.S. Court of Appeals for the Third Circuit explained in 2002 in Port Authority of N.Y. and N.J. v. Affiliated FM Insurance Co., a first-party all-risks insurance policy case:

> The fundamental differences between liability policies and first-party contracts make the multitude of appellate court opinions in third-party asbestos personal injury suits unhelpful in resolving the issues presented in this case. ... We are persuaded that the time-honored distinction between the two types of insurance coverage is valid and should be maintained.

In relying on third-party liability insurance principles in deriving the burden of proof eventually placed on the policyholder in Mudpie, the Ninth Circuit disregarded the crucial differences between third-party liability and first-party all-risks insurance policies.

The onerous burden of proof placed by the Ninth Circuit on the policyholder is incompatible with the burden of proof that is typically borne by policyholders of first-party all-risks insurance in California and elsewhere.

While the limitations on coverage under an all-risks first-party property insurance policy are found only in the policy exclusions — and insurers have the burden of showing that a loss falls within an exclusion — Mudpie erroneously placed the burden of establishing that the loss fell within the scope of coverage on the policyholder.

Once the policyholder in Mudpie established that its COVID-19 loss was fortuitous, which it most certainly was, the burden should have shifted to the insurer to prove any limitation on that coverage. It was the insurer's burden to prove that Mudpie's fortuitous loss resulting from COVID-19 was excluded by some language in the policy, including the language relating to direct physical loss of or damage to property.

The Mudpie court erred by applying the wrong and onerous burden of proof on the policyholder.

Whether the application of the correct burden of proof would have changed the outcome in Mudpie is uncertain, but what is certain is that all policyholders should focus on and seek application of the correct burden of proof in cases involving insurance coverage under a first party all-risks insurance policy, including cases involving insurance coverage for COVID-19 losses.

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