No. S278481

IN THE SUPREME COURT OF CALIFORNIA

JOHN'S GRILL, INC. et al.,
Plaintiffs and Appellants,

v.

THE HARTFORD FINANCIAL SERVICES GROUP, INC. et al.,
Defendants and Respondents.

AFTER A DECISION BY THE COURT OF APPEAL
FIRST APPELLATE DISTRICT, DIVISION FOUR
CASE NO. A162709

ANSWERING BRIEF ON THE MERITS

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Issues Presented

1. In the context of an insured restaurant seeking coverage for virus-related losses under its "Limited Fungi, Bacteria or Virus Coverage," did the Court of Appeal err in holding that a condition, which states that coverage is available only if the *virus "is the result of" windstorm* or other enumerated peril, is unenforceable under the illusory coverage doctrine?

2. Under California's rules for interpreting insurance contracts, did the Court of Appeal err in holding that an ordinary policyholder could reasonably interpret an insurer's promise to "pay for … [d]irect physical loss or direct physical damage … caused by … virus, *including the cost of removal of the ... virus*," as including coverage for the cost of removing virus particles from the inside of an insured restaurant during a viral pandemic, including by "wiping and cleaning surfaces"?

Introduction

The illusory coverage doctrine exists to protect consumers from insurance contracts purporting to provide coverage that, upon close inspection of the policy terms, turns out to be an "illusion." The doctrine has been widely adopted, in one form or another, by various states. For purposes of California law, this Court has indicated that the doctrine prohibits policy interpretations that would render promised coverage "practically meaningless" (*Safeco*) or "virtually illusory" (*Julian*).

This first-party coverage action comes to this Court from a unanimous decision of the First District Court of Appeal, which reversed an order sustaining defendant Sentinel Insurance Company's ("Sentinel") first demurrer without leave to amend. The complaint filed by San Francisco restaurant John's Grill alleges it suffered business interruption losses during the pandemic due to coronavirus droplets and particles being present

throughout the air and surfaces of its restaurant. John's Grill submitted a claim to Sentinel seeking coverage under the policy's "Limited Fungi, Bacteria or Virus Coverage" endorsement,[1] which has a $50,000 limit of insurance with 30 days of business interruption coverage. Shortly thereafter, John's Grill then received a letter from Sentinel denying the claim for failure to satisfy a condition in the endorsement that requires John's Grill to show that the virus on its premises "is the result of" windstorm, water damage, vandalism, or another enumerated peril. John's Grill then sued Sentinel for wrongful denial of insurance claim, arguing the condition is invalid because it makes no sense as applied to virus, is actually or virtually impossible to satisfy, and renders the Limited Virus Coverage illusory.

In a lengthy and careful decision, the Court of Appeal reversed, finding that the condition is not just ambiguous but "indecipherable when applied to viruses," and thus renders the Limited Virus Coverage "'virtually illusory.'" *John's Grill, Inc. v. The Hartford Fin. Services Group, Inc.* (2022) 86 Cal.App.5th 1195, 1212, 1221, 1224 ("*John's Grill*"), quoting *Julian v. Hartford Underwriters Ins. Co.* (2005) 35 Cal.4th 747, 756. The Court of Appeal noted that even if it agreed with Sentinel's strained interpretation of the condition, the few hypotheticals of non-illusory coverage that it offered the Court—such as a Nebraska case that suggested a windstorm/tornado may have transmitted a virus from a swine herd on another farm to the insured's swine herd—were too "oddball" and "freakish" to credit, and none were relevant to John's Grill's "reasonable

[1] This brief uses the term "Limited Coverage" to refer to the endorsement generally, and "Limited Virus Coverage" to refer to the endorsement as applied to coverage for losses caused by virus.

expectations of coverage." *Id.* at 1222, 1223-1224 ("We fail to see what these oddball scenarios have to do with this case. …. John's Grill is not a farm. … Imaginary exercises involving pigs caught in windstorms … will not do."). Just as this Court did in *Safeco*, the Court of Appeal declined to save the condition for the insurer by re-writing it, and instead applied the illusory coverage doctrine to hold the condition is unenforceable as applied to John's Grill claim for virus coverage. *Id.* at 1212, 1221-1222; *cf. Safeco Ins. Co. v. Robert S.* (2001) 26 Cal.4th 758, 764 ("*Safeco*") (declining to save ambiguous "illegal act" exclusion that rendered coverage illusory by rewriting it to be a "criminal act" exclusion).

Before reaching that conclusion, the Court of Appeal fully considered and rejected Sentinel's various arguments, including arguments (1) that the condition is clear and should be enforced as written to uphold the denial of coverage; (2) that the Limited Virus Coverage is not illusory because the Nebraska pig tornado case provides an example of possible coverage, and (3) even if the Limited Virus Coverage provides zero coverage, the illusory coverage doctrine does not apply if John's Grill has any non-illusory coverage under any other aspect of the *entire endorsement* (e.g., limited fungi coverage) or even the *entire policy*. The Court of Appeal correctly decided all these issues. Its unanimous decision should be affirmed.

In its opening brief, Sentinel reworks some of its arguments to make them even more far-reaching than those it presented to the Court of Appeal. In doing so, Sentinel urges this Court to announce a version of the illusory coverage doctrine that is virtually unrecognizable from how the doctrine has been articulated and applied in California and across the country. Specifically, Sentinel urges the court to limit the illusory coverage doctrine to an "interpretive tool" (Op. Br. 10, 29, 36) that applies only to ambiguous

(1) *exclusions* (*id.* 34-39) (i.e., not to conditions, definitions, etc.), and **(2)** only if the broader reading of the exclusion(s) would eliminate all coverages promised under *the entire policy* (*id.* 39-44) **(3)** for *all policyholders* (*id.* 44-49) (i.e., not just the contracting parties).

Every aspect of Sentinel's proposed rule is wrong.

First, the illusory coverage doctrine applies most often to exclusions, but case law establishes it also applies to conditions, definitions, and other policy provisions that limit the scope of coverage. Sentinel's proposed exclusions-only rule makes no sense analytically since many other kinds of policy provisions perform the same function (i.e., limiting the scope of coverage). The argument impermissibly elevates form over substance, contrary to Cal. Civ. Code § 3528 and applicable case law.

Second, Sentinel's notion that the illusory coverage doctrine has no application unless the court determines that policyholders will be left no non-illusory coverages under *the entire policy* is contrary to cases from virtually every jurisdiction, as well as the reasonable expectations doctrine. While it is easy to find cases (and Sentinel cites many) in which courts have applied the illusory coverage doctrine to avoid interpreting an ambiguous exclusion in a manner that would have eliminated all coverage in an entire policy, case law amply shows that courts also apply the doctrine to individual coverage provisions, including those within the same endorsement.

Finally, Sentinel's argument that the illusory coverage doctrine does not apply unless coverage is illusory as to *all policyholders* (it is unclear whether Sentinel means all *actual* policyholders or all *conceivable* ones) is wrong for multiple reasons. For starters, it jettisons first principles, including that insurance is contractual in nature (and thus looks to the

mutual intent of the parties) and subject to the reasonable expectations doctrine. It also overlooks the many cases where courts have considered the policyholder's line of business as a key factor in their illusory coverage analysis. While the policyholder's identity is irrelevant and thus not part of the analysis in many cases (e.g., cases where an exclusion threatens to eliminate all coverage for everyone), it is relevant in other cases, and in those instances, courts consider it.

The second issue presented in this appeal concerns the meaning of Sentinel's promise to "pay for … [d]irect physical loss or direct physical damage … caused by … virus, *including the cost of removal of the … virus*." 2:AA:396 (emphasis added). The plain meaning of this "cost of removal of the … virus" language provides coverage for the cost of disinfectant cleaning and other widely accepted methods for the removal of infectious virus from a property; it is difficult to see how it could be interpreted otherwise. Yet, Sentinel spends at least ten pages arguing that this obvious meaning is not only an incorrect interpretation but an absurd one. *See* Op. Br. 50-60. In support, Sentinel cites pandemic-era case law interpreting *undefined* uses of the phrase "direct physical loss or damage" (or similar) as requiring a kind of physical alteration that (according to Sentinel) viruses do not cause. But, as the decision below noted, that whole line of cases is distinguishable because the policy here expressly defines loss or damage as including the cost of removal of virus. *John's Grill,* 86 Cal.App.5th at 1201, 1215, 1216, 1218, 1219.

As to Sentinel's related argument—i.e., that the Policy's general insuring clause, which requires that property suffer "direct physical loss [] or physical damage" (undefined) (2:AA:292), applies throughout the entire policy including the Limited Coverage—that argument just introduces a

second illusory coverage problem. If the general insuring clause's "direct physical loss or damage" requirement applies to the Limited Virus Coverage, and if viruses can virtually never satisfy that requirement (as Sentinel argues), then the Limited Virus Coverage is illusory. The Court of Appeal addressed this very challenge. Assuming without deciding that the physical presence of virus on property would not constitute "direct physical loss or damage" (undefined), the Court of Appeal correctly interpreted the Limited Virus Coverage's special definition of "loss or damage" (2:AA:396, § B.1.b) as overriding the coverage grant's undefined "directly physical loss or damage" for purposes of the Limited Virus Coverage only. *John's Grill*, 86 Cal.App.5th at 1217-1219. Despite the logic of this position, Sentinel opposes it.

In sum, having voluntarily promised to provide John's Grill Limited Virus Coverage including paying for the cost of removal of virus, Sentinel should be required to keep its promise. Interpretations of policy conditions or definitions that render the promised coverage illusory should be rejected. John's Grill respectfully requests that the Court affirm.

Statement of the Case

A. Statement of Facts[2]

John's Grill is a restaurant in downtown San Francisco with over fifty employees. 1:AA:65, 73-74 (FAC ¶¶ 1, 34). To protect itself from risk, it purchased a Hartford Spectrum Business Owner's Policy issued by Sentinel. 1:AA:65, 69 (FAC ¶¶ 2, 14); 2:AA:262-483 (Policy). The policy has an annual premium of $48,535 and purports to provide a wide array of

[2] Because this appeal comes to this Court from an order sustaining a demurrer, the facts are based on the allegations in John's Grill's operative first amended complaint ("FAC") (1:AA62-102).

coverages, including business interruption coverages and Limited Virus Coverages. 2:AA:270, 270-284.

In March 2020, the SARS-CoV-2 coronavirus that causes Covid-19 began to be continually physically present at the restaurant, including through "physical droplets containing COVID-19" being "suspended in the air" and on the surfaces inside its restaurant, thereby rendering its business premises "unusable" due to the "substantial risk of people getting sick, transmitting infection to others, and possibly dying as a result." 1:AA:75-77, 84-85 (FAC ¶¶ 37-43, 70-73); *accord John's Grill*, 86 Cal.App.5th at 1204. That same month, John's Grill submitted a claim to Sentinel. 1:AA:86 (FAC ¶ 77).

The following month, John's Grill received a form letter denying the claim, which misleadingly notes "potentially applicable" exclusions that would render coverages illusory. 1:AA:86-88 (FAC ¶¶ 79-87); 1:AA:176-182 (claim denial letter). With respect to the Limited Virus Coverage, Sentinel's stated it was denying the claim because "the virus did not result from a specified cause of loss; therefore, there is no coverage for your claim based on the limited coverage for virus." 1:AA:182.

In its complaint, John's Grill claims the Limited Virus Coverage's "specified cause of loss" condition should be invalidated because it is "actually or virtually impossible to satisfy," "absurd," "unconscionable," and "renders the Limited Virus Coverage illusory," as applied to virus. 1:AA:65-66., 69, 95-97, 101 (FAC ¶¶ 3, 15, 128-131, 159). John's Grill also alleges that the virus's physical presence caused physical loss or damage, as well as lost business income and extra expense, within the meaning of the policy. 1:AA:69-70, 83, 85-86, 100-101 (FAC ¶¶ 15-17, 68, 74-76, 154-158).

B. Disputed Policy Provisions

The policy is 221 pages of various disclosures, schedules, notices, forms, and endorsements,[3] with no overall table of contents, index, or continuous page numbering.[4] The policy begins with 15 pages of declarations and summaries of coverage. 2:AA:270-284. The declarations show that the policy generally provides 24 months of business interruption coverage up to a $4 million limit of insurance. 2:AA:273, 284 (declarations). With respect to losses caused by virus, however, the Limited Virus Coverage provides only 30 days of business interruption coverage up to a $50,000 limit of insurance.

1. Limited Virus Coverage

The policy declarations summarize the policy's "Limited Fungi, Bacteria or Virus Coverage" as follows:

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[3] As with many insurance policies, the policy here contains numerous amendatory endorsements, such that a reader cannot be sure that any given policy provision is actually part of the policy (i.e., is operative) until the reader has reviewed all the various amendatory endorsements to determine if that provision has been deleted, replaced, modified, or supplemented. *Cf. Susan Spath Hegedus, Inc. v. ACE Fire Underwriters Ins. Co.* (E.D. Pa. May 7, 2021, No. 2:20-cv-02832-BMS) 2021 WL 1837479, at *1 ("The over-100-page Policy at issue here can only be described as a labyrinth of pages, paragraphs, and pronouncements. The terms of the Policy require the insured to fall down a rabbit hole and wander through a vast thicket of verbiage that would leave even the most careful reader mystified by the mazes of pages to be pieced together and deciphered in order to determine if there is coverage on the other side.").

[4] The continuous page numbering referenced in this brief and visible in the lower right corner of each page of the copy of the policy in the record was added by the parties for ease of reference.

PROPERTY OPTIONAL COVERAGES APPLICABLE TO THIS LOCATION	LIMITS OF INSURANCE
* * *	
LIMITED FUNGI, BACTERIA OR VIRUS COVERAGE: **FORM SS 40 93** **THIS IS THE MAXIMUM AMOUNT OF INSURANCE FOR THIS COVERAGE, SUBJECT TO ALL PROPERTY LIMITS FOUND ELSEWHERE ON THIS DECLARATION.** **INCLUDING BUSINESS INCOME AND EXTRA EXPENSE COVERAGE FOR:**	$ 50,000 30 DAYS

2:AA:272. More than 100 pages later into the policy, the text of the Limited Coverage endorsement reiterates these limitation on the scope of coverage, stating that "the coverage described under this Limited Coverage is … not greater than $50,000" and "not more than 30 days" of "Time Element Coverage." 2:AA:396 (§§ B.1.c, B.1.f). The phrase "Time Element Coverage" is undefined and not used elsewhere in the policy, but the parties and Court of Appeal all agree that it includes the policy's business interruption coverages. *See John's Grill*, 86 Cal.App.5th at 1217.

The endorsement's text provides three conditions to obtain the Limited Virus Coverage. Two are in dispute.[5] Those require that (1) the virus must *itself* be "the result of" either a "'specified cause of loss' other than fire or lightning" or an "Equipment Breakdown Accident … to

[5] The other condition is that the policyholder must use "all reasonable means … to save and preserve the property from further damage" 2:AA:396 (§ B.1.a), which is not in dispute.

Equipment Breakdown Property" 2:AA:396 (§ B.1.a), and (2) the virus must cause "loss or damage."

a. "Specified Cause of Law" condition (§ B.1.b)

John's Grill alleges that the specified-cause-of-loss condition renders Sentinel's promise of providing John's Grill Limited Virus Coverage illusory. *See* AA 65-66, 95-97 (FAC ¶¶ 3, 128-131). The Court of Appeal agreed. *John's Grill*, 86 Cal.App.5th at 1212, 1220-1224 (holding this condition "is unenforceable under the illusory coverage doctrine").

The condition requires the policyholder to show that the *virus* that caused its loss or damage "is the result of" either (1) a "'specified cause of loss' other than fire or lightning," or (2) "Equipment Breakdown Accident occurs to Equipment Breakdown Property." *See* 2:AA:396 (§ B.1.a).[6] The Limited Coverage endorsement does not define any of these terms, nor does it provide any indication of where to find them. So one must search manually through the 221 pages to find them.

- **Specified cause of loss** means: "Fire; lightning; explosion, windstorm or hail; smoke; aircraft or vehicles; riot or civil commotion; vandalism; leakage from fire extinguishing equipment; sinkhole collapse; volcanic action; falling objects; weight of snow, ice or sleet; water damage." 2:AA:316 (§ G.19); *accord John's Grill*, 86 Cal.App.5th at 1213.

- **Equipment Breakdown Accident** is defined as "[m]echanical breakdown," "[a]rtificially generated electric current," "[e]xplosion of [certain] steam [equipment]," or damage to steam equipment or water-heating equipment from an internal condition. 2:AA:295 (§ A.5.c); *accord John's Grill*, 86

[6] For simplicity, and because Sentinel does not argue the Equipment Breakdown prong, this brief refers to this condition as the specified-cause-of-law condition.

Cal.App.5th at 1213-1214 (providing a paraphrased version of this definitions).

- **Equipment Breakdown Property** is defined as any "Covered Property" (again, defined elsewhere in the Policy, without any indication of where) that is "built to operate under vacuum or pressure, other than weight of contents, or used for the generation, transmission or utilization of energy," subject to numerous exceptions. 2:AA:295 (§ A.5.c); *accord John's Grill*, 86 Cal.App.5th at 1213-1214 (same).

Consistent with its briefing below, Sentinel's opening brief narrows the issues on the specified-cause-of-loss question. Of the nineteen "specified cause of loss" perils, Sentinel advances only one possibly non-conclusory argument: that a virus could be "the result of" **windstorm**. *See* Op. Br. 42, 47. As before, Sentinel's sole support for this is the Nebraska Supreme Court decision in *Curtis O. Griess & Sons, Inc. v. Farm Bureau Ins. Co. of Neb.* (Neb. 1995) 528 N.W.2d 329, 331 ("*Griess*").

Beyond this sole windstorm argument, Sentinel makes a few bare assertions that water damage, vandalism, civil commotion, and Equipment Breakdown could also satisfy, but they are neither explained nor accompanied by any supporting authority, and thus are impossible to credit. *See* Op. Br. 43 (single conclusory statement that "waterborne viruses can result from 'water damage,' and a virus could result from other specified causes like 'vandalism' or 'civil commotion'"); *id.* 20 n.2 (single conclusory statement that Equipment Breakdown Accident provides "another way" that John's Grill could satisfy the coverage condition, but declining to explain "[f]or simplicity").[7] Sentinel provides no explanation

[7] Sentinel's opening brief contains a handful of other mentions of specified-cause-of-loss perils, but none are for the proposition that a virus

about chain of events that could lead a virus to being "the result of" any of these perils. *Cf. John's Grill*, 86 Ccal.App.5th at 1224 ("Where an insured properly raises the issue of illusory coverage, as John's Grill has done here, unsubstantiated speculation, untethered to the insured's actual business circumstances as underwritten by the insurer, is not enough to defeat the argument.").

b. "Loss or Damage" condition (§ B.1.b)

The other disputed condition is the Limited Coverage's "loss or damage" condition. With respect to the Limited Virus Coverage, it provides that Sentinel "will pay for loss or damage by … virus. As used in this Limited Coverage, the term loss or damage means: **(1)** Direct physical loss or direct physical damage to Covered Property caused by … virus, including the cost of removal of the … virus." 2:AA:396 (§ B.1.b(1)). That final phrase ("including the cost of removal of the … virus") is a subject of dispute.

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can be "the result of" that peril. They are all cited for some other proposition. *See* Op Br. 11 (arguing policy's specified causes are "perils traditionally covered by property insurance, such as wind, water damage, and vandalism"); *id.* 12 (arguing "fungi, wet rot, dry rot, and bacteria … could result … from … water damage"); *id.* 19 (example of "when wet rot results in water damage"); *id.* 20 (noting that "windstorm, hail, water damage" are examples of specified causes of loss); *id.* 20 (reproducing policy definition of "specified cause of loss"); *id.* 26 (noting Court of Appeal acknowledgement that wet rot can be the result of water damage); *id.* 29 (arguing "windstorms and water damage" are "typical property perils"); *see also id.* 13, 15 (mentioning "vandalism" in unrelated discussion of Electronic Vandalism Coverage).

C. Procedural History

1. Proceedings in the Superior Court

In April 2020, John's Grill filed its original complaint against Sentinel.[8] In October 2020, before any defendant had responded, John's Grill filed its operative amended complaint with seven causes of action, including for declaratory relief, breach of contract, bad-faith denial of insurance claim, and violations of the Unfair Competition Law (Cal. Bus. & Prof. Code § 17200, *et seq.*). 2:AA:62-182.

In December 2020, Sentinel filed a demurrer to the FAC, arguing the Limited Virus Coverage is not illusory and that John's Grill simply does not meet the conditions of coverage. *See* 2:AA:248-252; *see also* AA 248-249 n.6 (demurrer) (relegated discussion of the Limited Virus Coverage's "loss or damage" condition to a footnote); 3:AA:660 n.4 (reply) (same). In opposition, John's Grill made its illusory coverage argument that it "meets all the elements or requirements for the Limited Virus Coverage … except for the … one requirement [i.e., the third coverage condition] that … is factually impossible to satisfy and, thus, renders the Limited Virus Coverage illusory." 3:AA:621 (citing FAC ¶¶ 3, 130, 159). "For over a decade, it appears that Defendants have been marketing and selling to John's Grill and thousands of other policyholders Limited Virus Coverage

[8] John's Grill also sued its insurance broker and the Hartford Financial Services Group, Inc. (Sentinel's parent company), but neither are currently part of the case. *See John's Grill,* 86 Cal.App.5th at 1203 n.3, 1206 (noting John's Grill chose not to appeal the dismissal of the broker, and affirming the Superior Court's dismissal of Hartford).

that, because of this coverage requirement, will never cover a loss." 3:AA:621 (referencing FAC ¶¶ 3, 131).[9]

In February 2021, the Superior Court heard the matter and sustained Sentinel's demurrer without leave to amend. 4:AA:743-747. Judgment was entered. 4:AA:778-779. John's Grill timely appealed. 4:AA:807.

2. Proceedings in the Court of Appeal

Before the First District Court of Appeal (Division 4), the parties briefed the question of whether the Limited Virus Coverage's specified-cause-of-loss provision rendered coverage illusory. *See generally* Appellants' Opening Br. at 26-39 (Aug. 5, 2021); Respondents' Br. at 35-42 (Dec. 17, 2021); Appellants' Reply Br. at 15-22 (Mar. 7, 2022). The parties also addressed the question of whether John's Grill adequately had alleged it suffered "loss or damage." *See* Respondents' Br. at 44-46; Appellants' Reply Br. at 23-35. On November 8, 2022, the Court of Appeal requested supplemental briefing on how the Limited Coverage's "Time Element Coverage" related to John's Grill's business interruption claims. *See* 2:AA:396 (§ B.1.f). The parties filed their supplemental briefs on November 21, 2022.

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[9] Interestingly, Sentinel has never disputed or responded, whether by proffers of its counsel or otherwise, to John's Grill's repeated allegations, on information and belief, that Hartford and Sentinel have never paid out a claim for loss or damage caused by virus under the Limited Virus Coverage. *See* 1:AA:66, 97 (FAC ¶¶ 3, 131); 3:AA:621, 623 (demurrer opposition); Appellants' Opening Br. at 39; Appellants' Reply Br. at 22; *see also* Reporter's Tr. at 20:19-25 (demurrer hearing on Feb. 10, 2021) ("MR. KIRTLEY: … We have alleged that, upon information and belief, this limited virus coverage has never paid out a claim in the fifteen years that it has existed … [¶] THE COURT: To your client – to your client as an insured or to any insured? [¶] MR. KIRTLEY: To any insured ….").

On December 27, 2022, the Court of Appeal issued a unanimous decision in favor of John's Grill on the illusory coverage issue. *John's Grill*, 86 Cal.App.5th at 1228. It also held that Superior Court "erred in sustaining Sentinel's demurrer without leave to amend," and that John's Grill "should have been given leave to amend." *Id.* at 1205, 1216. The Panel reversed the judgment as to Sentinel,[10] and "remanded for further proceedings." *Id.* at 1228. Sentinel declined to file a petition for rehearing and proceeded directly to filing a Petition for Review on February 3, 2023.

Standard of Review

A. Order Sustaining a Demurrer Without Leave to Amend

Dismissals following the sustaining of a demurrer are reviewed "*de novo* to determine whether [the complaint] alleges facts stating a cause of action under any legal theory." *Landmark Screens, LLC v. Morgan, Lewis & Bockius, LLP* (2010) 183 Cal.App.4th 238, 243-244. "[T]he reviewing court must accept as true not only those facts alleged in the complaint but also facts that may be implied or inferred from those expressly alleged." *Lockley v. Law Office of Cantrell, Green, Pekich, Cruz & McCort* (2001) 91 Cal.App.4th 875, 881. "The question of a plaintiff's ability to prove the allegations, or the possible difficulty in making such proof, does not concern the reviewing court and plaintiffs need only plead facts showing that they may be entitled to some relief." *Brown v. Los Angeles Unified Sch. Dist.* (2021) 60 Cal.App.5th 1092, 1103.

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[10] The Court of Appeal also affirmed the Superior Court's entry of judgment in favor of Hartford, *John's Grill*, 86 Cal.App.5th at 1205 (not certified for publication), but no party has sought review of that aspect of the decision.

Unless there is no "reasonable possibility that the defect [in a complaint] can be cured by amendment," it is reversible abuse of discretion for a trial court to sustain a demurrer without leave to amend. *Id.*; *see also* The Rutter Group, CAL. PRAC. GUIDE CIV. PRO. BEFORE TRIAL, Ch. 7(I)-A (when a demurrer is sustained, "[c]ourts are very liberal in permitting amendments, not only where a complaint is defective in form, but also where substantive defects are apparent."). This is particularly true where, as here, the court denies leave to amend upon sustaining the first demurrer filed in the case. *See Tarrar Enters., Inc. v. Assoc. Indem. Corp.* (2022) 83 Cal.App.5th 685, 688-689.

B. Interpretation of Insurance Contracts

The interpretation of insurance policies is generally a question of law. *Waller v. Truck Ins. Exch., Inc.* (1985) 11 Cal.4th 1, 18. If the policy language "is clear and explicit, it governs." *Yahoo Inc. v. Nat'l Union Fire Ins. Co.* (2022) 14 Cal.5th 58, 67 ("*Yahoo*"), quoting *Boghos v. Certain Underwriters at Lloyd's of London* (2005) 36 Cal.4th 495, 501; *see also* Cal. Civ. Code § 1638 ("The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity."). If, however, "the terms are ambiguous [i.e., susceptible of more than one reasonable interpretation], we interpret them to protect the objectively reasonable expectations of the insured." *Yahoo*, 14 Cal.5th at 67 (brackets in original; internal quotation marks omitted). If this fails to resolve the ambiguity, then courts apply "the rule that ambiguities are to be resolved against the insurer." *Id.*

"When coverage is in dispute, the initial burden is on the insured … to prove that its claim falls within the scope of potential coverage." *Id.* at 68. "If the insured establishes that the policy provides at least the potential

for coverage, the burden shifts to the insurer … to show the claim falls within one of the policy's exclusions." *Id.* "In other words, the insured need only show that the underlying claim *may* fall within policy coverage; the insurer must prove it *cannot*." *Id.* (emphasis in original), quoting *Liberty Surplus Ins. Corp. v. Ledesma & Meyer Constr. Co., Inc.* (2018) 5 Cal.5th 216, 222.

Argument

I. THE SPECIFIED-CAUSE-OF-LOSS CONDITION, AS APPLIED TO VIRUS, RENDERS THE LIMITED COVERAGE ILLUSORY AND THUS UNENFORCEABLE.

In the decision below, the Court of Appeal correctly held that the specified-cause-of-loss condition is indecipherable as applied to viruses; correctly articulated the illusory coverage doctrine; and correctly applied the doctrine to hold that the specified-cause-of-loss condition rendered the Limited Virus Coverage illusory, and thus unenforceable.

In doing so, the Court of Appeal carefully considered and ultimately rejected Sentinel's many contrary arguments. Now, before this Court, Sentinel repeats many of the same arguments, and in some instances advances versions that are even more far-reaching than those rejected by the Court of Appeal. The version of the illusory coverage doctrine that Sentinel urges on this Court would be a radical departure from existing law and put California far out of step with other states. The Court of Appeal's decision should be affirmed.

A. The specified-cause-of-loss condition does not make sense as applied to virus.

The specified-cause-of-loss condition requires that a policyholder seeking the Limited Virus Coverage show that the virus that caused its losses is itself "the result of" a "specified cause of loss." 2:AA:396 (§ B.1.a). Interpreting the Limited Virus Coverage according to the everyday, ordinary meaning of its words makes clear it is not illusory with respect to fungi or wet rot, both of which can certainly be "the result of" a specified cause of loss, such as "water damage." For example, certain kinds of water damage could create abiotic conditions (such as dampness and humidity) that are conducive to the establishment, growth, and reproduction of many species of fungi. It is easy to understand how this could lead to property damage for which a policyholder would desire coverage.

But the specified-cause-of-loss condition makes no sense when applied to an obligate intracellular pathogen such as a virus, which cannot reproduce outside a living host cell. 1:AA:75 (FAC ¶ 36). By contrast, the other perils named in the limited coverage can and often do reproduce outside a host organism, such as when fungus or mold spores land in a humid environment, grow, and proliferate. A virus is different. It may survive briefly outside a host organism (such as when virus is shed), but it cannot reproduce there. 1:AA:75 (FAC ¶ 36). Instead, viral reproduction (or replication) requires access to the metabolism of a living host cell. *See* 1:AA:75 (FAC ¶¶ 35-36). *Accord John's Grill*, 86 Cal.App.5th at 1221-1222.

In the decision below, the unanimous panel reached the same conclusion: "none of the listed causes has anything to do with the biological processes that actually cause a virus." *Id.* (quoting AA 396 [§ B.1.a]).

While the panel found it could make the language make sense by *changing* the wording ("Only if the words are taken to refer to circumstances in which a specified cause is a vector for transmission of a virus does the language begin to make any sense"), "that is not what the words say, and more importantly, it is not the only interpretation to which the phrase 'result of' is reasonably susceptible." *Id.* "The applicable principles for interpreting insurance contracts do not compel us to resolve the ambiguity by placing a gloss on the text of the Policy, friendly to Sentinel, so that Subparagraph B.1.a. makes sense as applied." *Id.* at 1222. In so ruling, the Court of Appeal followed the same approach that this Court took in *Safeco*, when it declined to save an ambiguous "illegal act" exclusion that rendered coverage illusory re rewriting is to be a "criminal act" exclusion. *Safeco Ins. Co. v. Robert S.* (2001) 26 Cal.4th 758, 764.

In response, Sentinel insists that the specified-cause-of-loss condition as applied to virus is entirely "clear" and "unambiguous" (Op. Br. 32, 34, 37, 49), but it declines to address directly the ambiguities identified by the Court of Appeal. Instead, it brings in ancillary arguments, none which advance the ball. It argues that California courts enforce unambiguous conditions (*id.* 30-31), which is true but beside the point.

Sentinel makes much about the condition being written into the Limited Virus Coverage instead of lurking in some other part of the policy (*id.* 31-32), but it is difficult to see how that matters if the condition itself is indecipherable. Moreover, the argument ignores that the endorsement is located 134 pages into the policy, and once there neither defines nor provides any clue about where to find the definition for the key phrase: "specified cause of loss." As it turns out, the definition is located 80 pages before the Limited Coverage in the definitions section of the Special

Property Coverage Form. *Compare* 2:AA:396 (§ B.1.a) ("specified cause of loss" condition), *with* 2:AA:316 (§ G.19) ("specified cause of loss" definition), *and* 2:AA:295 (§ A.5.c) ("Equipment Breakdown" definitions).

In the final analysis, Sentinel wrote an endorsement with a specified-cause-of-loss condition that simply makes no sense as applied to virus. The condition renders the Limited Virus Coverage illusory, and thus the requirement cannot be enforced. *See Julian v. Hartford Underwriters Ins. Co.* (2005) 35 Cal.4th 747, 756 (explaining that California courts reject insurers' attempts to enforce "language that would have rendered the policies' coverage terms *virtually illusory*"); *Howell v. State Farm Fire & Cas. Co.* (1990) 218 Cal.App.3d 1446 (expressing concern that enforcing policy language as written would give insurance companies "carte blanche to deny coverage in *nearly all cases*").

B. The Court of Appeal correctly articulated and applied the illusory coverage doctrine to hold the specified-cause-of-loss condition rendered the Limited Virus Coverage illusory, and thus was unenforceable.

In response to the Court of Appeals' careful articulation and application of the illusory coverage doctrine, Sentinel continues to argue it can show the coverage is not illusory by identifying a single hypothetical scenario in which John's Grill would be able to satisfy the condition. Sentinel's only support for this assertion was, and continues to be, a case in which a policyholder contended that a tornado had "transmitted" a virus onto his farm and infected some of his pigs, and the insurer declined to dispute that contention before the Nebraska Supreme Court. *See Curtis O. Griess & Sons, Inc. v. Farm Bureau Ins. Co. of Neb.* (Neb. 1995) 528 N.W.2d 329, 331 ("*Griess*") ("Defendant does not dispute that the

pseudorabies virus was transmitted to plaintiff's farm by the windstorm."). The fact that Sentinel has convinced a handful of trial courts to adopt its erroneous reading of *Griess* via cursory analyses of that decision is not persuasive. *See John's Grill,* 86 Cal.Ap.5th at 1225-1228. The stubborn fact remains that *Griess* simply does not establish the factual proposition for which it is being cited.

And even if this were otherwise, "an insurer cannot avoid an illusory coverage problem by simply conceiving of a single hypothetical situation to which coverage would apply," as "the likelihood of coverage" would still be "sufficiently remote to be deemed illusory." *Great Northern Ins. Co. v. Greenwich Ins. Co.* (W.D. Pa. May 12, 2008, No. 05-635) 2008 WL 2048354, at *5, quoting *Monticello Ins. Co. v. Mike's Speedway Lounge, Inc.* (S.D. Ind. 1996) 949 F.Supp. 694, 701, and *Meridian Mut. Ins. Co. v. Richie* (Ind. 1989) 540 N.E.2d 27, 30. Stated slightly differently, courts will apply the illusory coverage doctrine even when they are convinced of "some small circumstance[s] where coverage could arguably exist." *Martinez v. Idaho Counties Reciprocal Mgmt. Program* (Idaho 2000) 999 P.2d 902, 907. This is because illusory coverage is a matter of degree not absolutes.

The Court of Appeal appropriately distinguished the livestock virus cases (*Griess* and a similar case, *Qualls*) as having little bearing on the virus-related risks underwritten by Sentinel in insuring a San Francisco restaurant:

> We fail to see with these oddball scenarios have to do with this case. … John's Grill is not a farm … [T]he test for illusory coverage must focus on objective reality and the insured's reasonable expectations of coverage. [citation] Imaginary

> exercises involving pigs caught in windstorms [*Griess*] and cows encountering wild animals [*Qualls*] will not do.
>
> It takes more than a "a mere drafting fiction" to overcome a well-pleaded illusory coverage argument. [citation] Where an insured properly raises the issue of illusory coverage, as John's Grill has done here, unsubstantiated speculation, untethered to the insured's actual business circumstances as underwritten by the insurer, is not enough to defeat the argument. [citation] Because Sentinel has not proffered enough to demonstrate a realistic prospect of John's Grill ever benefitting from the Limited Virus Coverage based on events the parties might reasonably have anticipated during the Policy period, we agree that Sentinel has, "through sweeping language," rendered the Policy's virus coverage terms "virtually illusory." [citation]

Id. at 1224.

The Court's ultimate conclusion—that "Sentinel has not proffered enough to demonstrate a realistic prospect of John's Grill ever benefitting from the Limited Virus Coverage based on events the parties might reasonably have anticipated during the Policy period," *id.* at 1224—is consistent with the prevailing illusory coverage statndard that a policy provision need not completely eliminate coverage in order to render that coverage illusory."

> The prevailing view is that the ICD [illusory coverage doctrine] can be triggered by exclusions that do not completely eliminate the possibility of the policyholder benefiting from the coverage in question. Courts have varied, however, in how they describe the degree to which an exclusion must eliminate coverage in order to trigger the ICD. One common … formulation of this non-absolutist standard is that coverage is illusory when there is no 'reasonably expected set of circumstances' under which the policyholder would be able to collect benefits from the policy.

See Ian Weiss, *The Illusory Coverage Doctrine: A Critical Review* (2018) 166 U. PENN. L.R. 1545, 1561 (citing cases); *see, e.g., Karas v. Liberty Ins. Corp.* (Conn. 2019) 228 A.3d 1012, 1038-1039 (doctrine applies when insured risks against risk for "a particular peril … would not result in coverage under any reasonably expected set of circumstances"); *Hanover Ins. Co. v. Vemma Int'l Holdings Inc.* (D. Arz. July 29, 2016, No. 16-01071) 2016 WL 4059606, at *8 (interpreting Arizona law to hold coverage is illusory if it "would result in no payment of benefits under any reasonably expected circumstances"); *Haag v. Castro* (Ind. 2012) 959 N.E.2d 819, 824 (doctrine applies when "the policy "would not pay benefits under any reasonably expected set of circumstances"); *see also Thomas v. State Farm Fire & Cas. Co.* (Ky. 2021) 626 S.W.3d 504, 506 ("when an insurer's interpretation of a contract term would deny the insured 'most if not all of a promised benefit'").

C. Sentinel's alternative formulation of the illusory coverage doctrine lacks merit.

Sentinel urges the Court to limit any future use of the illusory coverage doctrine to an "interpretive tool" that applies only to ambiguous **(1)** *exclusions* (i.e., not to coverage conditions), and **(2)** only if the broader reading of the exclusion(s) would eliminate all coverages promised under *the entire policy* **(3)** for *all policyholders* (i.e., not just the contracting parties). Every aspect of Sentinel's proposed rule is wrong. It articulates a version of the illusory coverage doctrine that is virtually unrecognizable from how it has been articulated and applied by courts in California and across the country. It should be rejected.

1. The doctrine applies to all provisions that are capable of limiting the scope of coverage, not just exclusions.

Sentinel's argument that the illusory coverage doctrine applies only to *exclusions* and not to coverage *conditions* is incorrect. This litigation-driven proposal is unsound, in part, because it is based on a semantic distinction that makes no legal or economic difference, as exclusions and conditions (as well as limitations, definitions, etc.) both perform the same *function*: limiting the scope of coverage. As one court noted: "Exclusions and conditions are in effect two sides of the same coin." *PAJ, Inc. v. Hanover Ins. Co.* (Tex. 2008) 243 S.W.3d 630, 635.

Yet, according to Sentinel, the illusory coverage doctrine should apply only when an insurer reduces the scope of coverage to the vanishing point by means of an exclusion, and not when it does the very same thing by using a coverage condition or definition. *Cf. Pena v. Viking Ins. Co. of Wisconsin* (2022) 169 Idaho 730, 737-738 (noting doctrine applies when promised coverage is taken away by a policy "definition"). Such a rule would signal to insurers that they could avoid the illusory coverage doctrine by simply rewriting their exclusions as conditions, without any impact on the amount of risk being underwritten. Perhaps this is why Sentinel often qualifies and softens its advocacy on this point. *See, e.g., Cf.* Op. Br. 29 ("doctrine has *generally* been applied only to exclusions, not conditions"); Op. Br. 31 ("doctrine has *typically* been applied to exclusions on coverage, not conditions").

In sum, Sentinel's exclusion-versus-condition argument is a semantic distinction-without-a-difference that makes no sense analytically and improperly elevates form over substance. *See* Cal. Civ. Code § 3528 ("The law respects form less than substance."); *Hicks v. Bd. of Supervisors*

(1977) 69 Cal.App.3d 228, 237 ("The end attained and not the form of the transaction must be considered by the court in determining its substance and legal effect."); *Schisler v. Mitchell* (1959) 174 Cal.App.2d 27, 29 ("It is an ancient axiom that the law regards the substance of the words used rather than their form"). This Court has previously applied the substance-over-form principle in the insurance and other contractual contexts. *Wm. R. Clarke Corp. v. Safeco Ins. Co.* (1997) 15 Cal.4th 882, 890 (holding insurer could not enforce a "pay if paid" contractual because it had "the same practical effect" as a statutorily prohibited "waiver of mechanic's lien rights"); *Steiner v. Thexton* (2010) 48 Cal.4th 411, 418 (noting that a contractual "label is not dispositive" and that courts must "look through the agreement's form to its substance"); *see also Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.* (2015) 232 Cal.App.4th 1332, 1356, *as modified on denial of reh'g* (Feb. 9, 2015) (courts "must determine a contract provision's true function and operation when evaluating its legality" and concluding that California law "does not allow unreasonable penalties or forfeitures simply because they are imaginatively drafted as contractual conditions"). The Court should reject the notion that the illusory coverage doctrine applies only to exclusions.

2. The doctrine protects insureds ending up with illusory coverage for individual coverages, as well as entire policies.

To avoid the conclusion that the Limited Virus Coverage is illusory, Sentinel argues the illusory coverage doctrine applies only if John's Grill receives no material benefit from any of the other coverages in the Limited Coverage endorsement (Op. Br. 12, 41-42), or even fails to receive any "material coverage under the policy" as a whole (Op. Br. 12). This is an

erroneous view that reads the word "virus" out of policy, in violation of basic contract interpretation principles and the reasonable expectations doctrine.

Sentinel's rule makes little sense. It would seem to allow, for example, a policyholder who has illusory virus coverage set forth in his own endorsement to bring a successful illusory coverage claim, but to prevent another policyholder with the exact same illusory virus coverage from bringing the same claim simply because her limited coverage is lumped in an endorsement with other (non-illusory) coverages. Both policyholders should have the same claim. To rule otherwise would be to ignore insureds' reasonable expectations and, once again, elevate form over substance. *See* Cal. Civ. Code § 3528; *Hicks v. Bd. of Supervisors* (1977) 69 Cal.App.3d 228, 237.

The error in this argument is illustrated well by *Great Northern Ins. Co. v. Greenwich Ins. Co.* (W.D. Pa. May 12, 2008) 2008 WL 2048354. The plaintiff there alleged the oil and gas well "blowout" coverage in his policy was illusory. The coverage was part of an endorsement titled "Blowout & Cratering Hazard" that provided coverage for "property damage … arising out of blowout or cratering hazard." *Id.*, at *5. Responding to the plaintiff's argument that an exclusion in the policy rendered the blowout coverage illusory, the insurer attempted to use the exact same kind of argument that Sentinel makes here—i.e., that the plaintiff's illusory coverage argument necessarily failed because the endorsement provided non-illusory coverage with respect to its other named peril, cratering. *Id.* n.3. The court rejected this:

> The court adheres to its view, expressed to Greenwich's counsel at the oral argument, that the illusory coverage issue

> must be examined with respect to blowout coverage, and that Greenwich cannot defeat plaintiffs' illusory coverage argument simply by relying on potential coverage for cratering. The policy language separates the words "blowout" and "cratering" with the disjunctive "or," thereby providing coverage for two alternative risks. Greenwich's insured payed a premium surcharge … for blowout *or* cratering coverage, and Greenwich cannot reasonably argue that the … sublimit does not render *blowout* coverage for the full $1,000,000.00 illusory simply because the full amount is nevertheless available to cover *cratering.*

Id. (citation omitted).

Other cases are broadly in agreement. *See, e.g.*, *Downey Venture v. LMI Ins. Co.* (Cal. App. 1998) 66 Cal.App.4th 478, 516 (Croskey, J.) (analyzing doctrine at level of coverage for malicious prosecution claims within CGL policy, but ultimately finding no illusory coverage because material coverage remained, and insurer "fully performed" under policy as evidenced by insurer having paid defense costs); *Karas v. Liberty Ins. Corp.* (Conn. 2019) 228 A.3d 1012, 1038-1039 (doctrine applies to a "policy provision offering coverage for a particular peril"); *Princeton Express & Surplus Lines, Inc. v. DM Ventures USA LLC* (S.D. Fla. 2016) 209 F.Supp.3d 1252, 1257-1258, 1260 (focusing entire analysis on advertising injury coverage, and applying doctrine to save that coverage from an exclusion); *Hernandez v. Liberty Mut. Ins. Co*. (Wis. App. 2014) 844 N.W.2d 657, 741-742 (doctrine applies when insured cannot foresee any circumstance of collecting "under a particular policy provision").

Sentinel's other argument that "[t]here is no requirement that each peril potentially be the result of each and every specified cause of loss" or "that every specified cause of loss must result in a peril set out in the [] Limited Coverage" is a red herring. Op. Br. 42, quoting *Westside Head &*

Neck v. Hartford Fin. Servs. Grp., Inc. (C.D. Cal. 2021) 526 F.Supp.3d 727, 733. John's Grill has never taken such a ridiculous position. Rather, John's Grill's contention throughout this litigation has been that an endorsement purporting to provide "Limited Fungi, Bacteria or Virus Coverage" must provide at least some non-illusory coverage with respect to each of the perils listed in the title of the endorsement. It is contrary to the reasonable expectations of the insured to market an endorsement with that title if there is no realistic prospect it will ever pay out a claim for losses caused by virus. *See Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc.* (2000) 78 Cal.App.4th 847, 874, *as modified on denial of reh'g* (Mar. 29, 2000) (rejecting policy interpretation advanced by insurer that would defeat the insured's objectively reasonable expectations and result in illusory coverage).

3. Whether coverage is illusory in nature is determined policyholder by policyholder, because insurance is contractual in nature.

Sentinel's argument that the illusory coverage doctrine does not apply unless coverage is illusory as to *all policyholders* (i.e., it is unclear whether Sentinel means all actual policyholders or all conceivable ones) is wrong for multiple reasons. For starters, it jettisons first principles, including that insurance is contractual in nature (and thus looks to the mutual intent of the parties) and the central role of the reasonable expectations doctrine in role of construing insurance contracts.

It also overlooks the many cases where courts have considered the policyholder's line of business as a key factor in their illusory coverage analysis. *See, e.g., Shade Foods, Inc* 78 Cal.App.4th at 874 (insured's business of processing almonds for third parties was central to illusory

coverage analysis); *Blackhawk Corp. v. Gotham Ins. Co.* (1997) 54 Cal.App.4th 1090, 1096-1097 (in light of insured's actual business "as developer of raw land," subsidence exclusions not illusory when applied to housing development on property sold by insured); *Heller v. Pa. League of Cities and Muns.* (Pa. 2011) 32 A.3d 1213 (under the insurer's interpretation the only individuals who could recover would be "convicted criminals being transported in police vehicles," even though "virtually all" claims under the policy would be made by municipal workers); *Mike's Speedway Lounge*, 949 F.Supp. at 700-702 (analyzing policyholder's line of business as a bar as relevant to finding that "absolute liquor exclusion" rendered coverage illusory). While the policyholder's identity is irrelevant and thus not part of the analysis in many cases (e.g., cases where an exclusion threatens to eliminate all coverage for everyone), in those cases where it is relevant, it is often an important factor.

4. The doctrine is both an interpretative tool (in some applications) and a doctrine of enforceability (in others).

And Sentinel also errs when it suggests that the illusory coverage doctrine is not just an "interpretive tool" for construing *ambiguous* terms. Op. Br. 10, 29, 36. While this is most common application, it is not the only one. It is also a "doctrine of enforceability" for invalidating *unambiguous* terms that are unconscionable. Ian Weiss, *The Illusory Coverage Doctrine: A Critical Review* (2018) 166 U. Penn. L.R. 1545, 1546, 1548-1552 (collecting cases). As a leading treatise on California insurance law puts it: "Even plain language may not be enforced if doing so would render the promised coverage illusory." Hon. H. Walter Croskey (Ret.), et al. (The

Rutter Group, Aug. 2023 update) 4-B CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION § 4:29 (collecting cases).

D. The specified-cause-of-loss condition is also unenforceable because it is contrary to John's Grill's reasonable expectations of coverage.

Insurance policies are read in light of the parties' reasonable expectations and, when ambiguous, are interpreted to protect the objectively reasonable expectations of the insured. *Yahoo*, 14 Cal.5th at 69; *Delgado v. Interinsurance Exch. of Auto. Club of S. Cal.* (2009) 47 Cal.4th 302. When resolving ambiguities, the objectively reasonable expectations of the insured should be viewed in light of the nature and kind of risks covered by the policy. *Legacy Vulcan Corp. v. Superior Court* (2010) 185 Cal.App.4th 677. As a general matter, the reasonable expectations doctrine ensures that policyholders receive the coverage they expect, despite complicated or otherwise unclear provisions that would deny the coverage in an unexpected way. Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions* (1970) 83 Harv. L. Rev. 961, 967–68.

Declarations at the beginning of an insurance policy are critical in determining policyholders' reasonable expectations of coverage for the simple reason that the declarations are the one part of the policy that they might review before contracting. "The objectively reasonable expectations of applicants … regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations." *Hays v. Pac. Indem. Grp.* (1970) 8 Cal.App.3d 158, 164, quoting Keeton, *Insurance Law Rights*, 83 Harv. L. Rev. at 967. Accordingly, insurers "ought not to be allowed to use qualifications and exceptions from coverage that are inconsistent with the reasonable

expectations of the policyholder having an ordinary degree of familiarity with the type of insurance involved," even if "the insurer's form is very explicit and unambiguous because insurers know that ordinarily policyholders will not in fact read their policies, which cannot be fully understood without detailed study." *Id.* at 164-65.

One California insurance law treatise also notes the importance of the contents of policy declarations in determining the reasonable expectations of the insured. 1 Cal. Ins. Law Dictionary & Desk Ref. § D8 (2020 ed.) (available on Westlaw). It discusses this rules in the context of automobile insurance (the rationale of which is equally applicable here):

> The courts are persuaded that a conscientious policy holder, upon receiving the policy, will likely examine the declaration page to assure himself or herself that the coverages and their amounts …. It is unlikely that once having done so, the average auto-mobile policy holder would then undertake to attempt to analyze the entire policy in order to penetrate its layers of cross-referenced, qualified, and requalified meanings. Nor is it likely that the average policy holder would successfully chart his or her own way through the shoals and reefs of exclusions, exceptions to exclusions, conditions and limitations, and all the rest of the qualifying fine print, whether or not in so-called plain language.

Id. See also Hallowell v. State Farm Mut. Auto. Ins. Co. (Del. 1982) 443 A.2d 925, 928 (holding that the reasonable expectations doctrine may be used where policy terms "are ambiguous or conflicting, or if the policy contains a hidden trap or pitfall, or if the fine print purports to take away what is written in large print"); *Lehrhoff v. Aetna Cas. & Sur. Co.* (N.J. App. Div. 1994) 638 A.2d 889, 893 (noting "judicial regulation of insurance contracts is essential in order to prevent overreaching and injustice" and to protect the reasonable expectations of the insured).

Here, the Policy Declarations indicate that the Policy provides "Limited Fungi, Bacteria or Virus Coverage" up to a $50,000 limit of insurance and including 30 days of business interruption coverage. 2:AA:272 (Policy at 11). This provided John's Grill with a reasonable expectation that there would be a reasonable number of factual scenarios in which it would have limited coverage for property damage or loss caused by fungi, a reasonable number of factual scenarios in which it would have limited coverage for loss caused by bacteria, and a reasonable number of factual scenarios in which it would have limited coverage for loss caused by virus. But unlike with the limited fungus and bacteria coverage, the "specific cause of loss" coverage requirement is impossible to satisfy with respect to virus, thereby subverting John's Grill's reasonable expectations of coverage. *See Shade Foods, Inc.,* 78 Cal.App.4th at 874 (declining to adopt policy interpretation, as urged by insurer, that would defeat the objectively reasonable expectations of the insured, thereby rendering coverage described in the policy's definitions illusory).

Accordingly, the Limited Virus Coverage's specified cause of loss coverage requirement is also unenforceable under the reasonable expectations doctrine.

E. Even if the specified-cause-of-loss condition bars coverage, that conclusion would apply only to the removal and testing coverage under § B.1.b, not the business interruption coverage under § B.1.f.

Both the declarations and the Limited Coverage endorsement provide that the limited coverage includes 30 days of business interruption coverage. In the limited coverage endorsement, the business coverage provision is set forth at section B.1.f, which refers to "Time Element Coverage." Although this phrase appears only in section B.1.f and nowhere

else in the policy, the parties agree it refers to the policy's business interruption coverages. *Cf.* 2:AA:292-293 (Actual Loss Sustained Business Income & Extra Expense – Specified Limit Coverage endorsement). The Limited Coverage endorsement limits the application of the specified-cause-of-loss condition (§ B.1.A) by expressly stating that it applies only to the coverage for removal and testing (§ B.1.b). The specified-cause-of-loss condition states: "The coverage described in **1.b.** below only applies when the … virus is the result of … (1) A 'specified cause of loss' other than fire or lightning; (2) Equipment Breakdown Accident …." 2:AA:396 (§ B.1.a) (emphasis in original). Therefore, by the express terms of the endorsement, the specified-cause-of-loss does not apply to the promise of up to 30 days of business interruption coverage under section B.1.f.

II. JOHN'S GRILL SATISFIES THE LIMITED VIRUS COVERAGE'S "LOSS OR DAMAGE" CONDITION.

A. The Limited Virus Coverage endorsement expressly defines "loss or damage" to include "the cost of removal" of virus.

Whereas virtually all standard property policies require "direct physical loss or damage" (or similar language) but do not further define any aspect of that phrase, the Limited Virus Coverage endorsement *here expressly defines* the phrase as "including the cost of removal of the …virus." 2:AA:396 (§ B.1.b). As the Court of Appeal noted, the plain meaning of the phrase is "capacious enough to include cleaning the surfaces of the property." *John's Grill*, 86 Cal.App.5th at 1212. As the Court of Appeal found, "special definition, *id.* at 1201, 1215, 1216, 1218, 1219, makes the vast majority of Covid-19 business interruption cases

addressing the issue of physical loss or damage readily "distinguishable." *Id.* at 1211.

Sentinel can rail against the Court of Appeal's conclusion that the Limited Virus Coverage covering "the cost of removal of the … virus" is "broad enough to encompass simply wiping and cleaning surfaces," but that is a common-sense interpretation of the phrase that Sentinel chose to use. And even if the Court of Appeal's interpretation were not *mandated* by the plain meaning of the endorsement's text, it is axiomatic in California insurance law that ambiguities in policy language are generally resolved against the insurer. *Yahoo,* 14 Cal.5th at 67; *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 822. If Sentinel wishes its endorsement to not cover "the cost of removal of … virus," it is free to rewrite the endorsement for future use, but it cannot ask the courts to rewrite it with respect to policies already issued.

B. The Limited Virus Coverage's definition of "loss or damage" controls over the loss or damage clause of the Special Property Coverage Form.

Sentinel's argument that the Policy's general insuring clause, which requires that property suffer "direct physical loss [] or physical damage" (undefined) (2:AA:292), applies throughout the entire policy including the Limited Coverage is incorrect—it merely introduces a second illusory coverage problem. If the general insuring clause's "direct physical loss or damage" requirement applies to the Limited Virus Coverage, and if virus can virtually never satisfy that requirement (as Sentinel argues), then the Limited Virus Coverage is illusory. The Court of Appeal addressed this very issue. Assuming without deciding that the physical presence of virus on property would not constitute "direct physical loss or damage"

(undefined), the Court of Appeal correctly interpreted the Limited Virus Coverage's special definition of "loss or damage" (2:AA:396, § B.1.b) as overriding the coverage grant's undefined "directly physical loss or damage" for purposes of the Limited Virus Coverage only. *John's Grill,* 86 Cal.App.5th at 1217-1219.

This issue was correctly decided and should be affirmed.[11] Sentinel issued Limited Virus Coverage that promises to pay for the cost of removal of virus. It cannot escape that obligation by using the "physical loss or damage" clause in the Special Property Coverage Form to render the promised coverage illusory.

Conclusion

The Court of Appeal was correct in its articulation and application of California's illusory coverage doctrine, in its conclusion that the Limited Virus Coverage's express definition of loss or damage includes cleaning the surfaces of property to remove virus, and in its disposition of the appeal. This Court should affirm the decision below.

[11] To the extent this Court has a different analysis, the Court's forthcoming decision in *Another Planet Entertainment* would likely control regarding the meaning of the undefined "physical loss or damage" clause in the Special Property Coverage Form.

Respectfully submitted,

September 25, 2023 **COTCHETT, PITRE & McCARTHY, LLP**

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CERTIFICATE OF WORD COUNT

Pursuant to California Rule of Court 8.520(c)(1), I certify that this Answering Brief on the Merits, including footnotes, contains 9,698 words, as calculated by the Microsoft Word software used to prepare it.

September 25, 2023 **COTCHETT, PITRE & McCARTHY, LLP**

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CERTIFICATE OF SERVICE

I am a citizen of the United States and a resident of the State of California, over the age of 18 years, and not a party to this action. My business address is the Law Offices of Cotchett, Pitre & McCarthy, LLP, San Francisco Airport Office Center, 840 Malcolm Road, Suite 200, Burlingame, California, 94010. On September 26, 2023, I served the following documents:

ANSWERING BRIEF ON THE MERITS

☒ **BY E-SERVICE:** I electronically served the document(s) on the following parties in conjunction with electronically filing the document(s) through an e-filing vendor approved by this Court. I certify that said transmission was completed, that all pages were received, and that a report was generated by the vendor which confirms said transmission and receipt. The name of the vendor and the transaction receipt I.D. are provided in the vendor's e-mailed notification of service:

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Clerk's Office
California Court of Appeal
First Appellate District, Division 4

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Hon. Ethan P. Schulman
San Francisco Superior Court, Dept. 304
400 McAllister Street
San Francisco, CA 94102

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed at Burlingame, California, on September 26, 2023.

/s/ Jeanine Toomey
JEANINE TOOMEY

STATE OF CALIFORNIA
Supreme Court of California

PROOF OF SERVICE

STATE OF CALIFORNIA
Supreme Court of California

Case Name: **JOHN'S GRILL v. THE HARTFORD FINANCIAL SERVICES GROUP**
Case Number: **S278481**
Lower Court Case Number: **A162709**

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Date

/s/Andrew Kirtley

Signature

Kirtley, Andrew (328023)

Last Name, First Name (PNum)

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Law Firm