S278481

IN THE SUPREME COURT OF CALIFORNIA

JOHN'S GRILL, INC. ET AL.,
Plaintiffs & Appellants,

v.

THE HARTFORD FINANCIAL SERVICES GROUP, INC. ET AL.,
Defendants & Respondents.

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

REPLY BRIEF ON THE MERITS

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REPLY BRIEF ON THE MERITS

Introduction

Standard form property insurance policies cover a broad range of risks for a wide variety of businesses. Most of these risks are unlikely to occur; some are extremely unlikely to occur. The policy that plaintiffs purchased, for instance, provides coverage if the property is struck by lightning or damaged by lava flow from an erupting volcano. The policy also provides some coverage specific to landlords and some to tenants, some to businesses with pets and some to businesses with fur coats. No policyholder is likely to benefit from all of these coverages, but that does not make the policy illusory.

Plaintiffs urge this Court to adopt a novel version of the illusory coverage doctrine that would require every insurance policy to be precisely tailored to every insured. (ABOM 29-30.) That would mark a dramatic shift in the way insurance policies

are interpreted, defeating long-settled contract rules and undermining the efficiencies and lower premiums offered by standard form policies.

Plaintiffs concede that their insurance policy provides coverage for damage caused by viruses only if the virus resulted from a "specified cause of loss." They admit their alleged virus-related damages did not result from a specified cause of loss. Yet they ask the courts to rewrite their contract by deleting this express coverage condition, transforming a "Limited" virus-coverage exception into unlimited coverage for any loss related to a virus. The Court of Appeal granted this request, but this Court should reverse for two independent reasons.

First, the illusory coverage doctrine does not apply here. Plaintiffs cite no authority holding that a court can use the doctrine to rewrite an insurance contract by striking an express coverage condition. They cite no authority – other than a footnote in an unpublished federal district court decision applying Pennsylvania law – that requires courts to assess whether every insured is likely to have material coverage from every single peril listed in a policy. And they provide no reasoned justification for their request that this Court expand the illusory coverage doctrine to fit this case. This Court should reverse the Court of Appeal's judgment striking the express "specified cause" condition of coverage.

Second, plaintiffs are not entitled to coverage because the coronavirus did not cause physical loss or damage to their property. This Court granted review of the decision below holding

that merely wiping and cleaning surfaces to remove viral particles qualifies as "loss or damage." In its opening brief, Sentinel explained why this conclusion is erroneous as matter of text, structure, and common sense. Plaintiffs offer virtually no response. They fail to engage the policy's text or structure, and they cite no supporting authority. Instead, they rest their argument on the conclusory assertion that their position is a "common-sense interpretation." (ABOM 41.) But it defies common sense and settled law to suggest that a restaurant can make a property damage claim every time it wipes its countertops. The Court can, and should, reverse on this independent ground as well.[1]

Argument

I. The illusory coverage doctrine does not apply

Plaintiffs' central argument is that the Limited Coverage is illusory because Sentinel has not provided examples that are sufficiently "explained" or "accompanied by . . . supporting authority" to demonstrate the likelihood of virus coverage at their restaurant. (ABOM 18.) But there is no requirement that a standard-form insurance policy guarantee some likelihood of coverage for each and every policyholder within each and every coverage provision. And even if there were, viruses could result

[1] Consistent with its opening brief, Sentinel refers to the "Endorsement" to mean the entire "Limited Fungi, Bacteria or Virus Coverage" endorsement (2AA 395-397), which is made up of a broad "Virus Exclusion" (2AA 395) followed by the "Limited Coverage" exception (2AA 396-397).

from a specified cause of loss in restaurants; Hepatitis A and norovirus can be spread through water leakages, for instance, and viruses can result from the breakdown of a refrigerator or ventilation system. (See *post*, Section I.D.4.) These risks may be unlikely, but that does not make the coverage illusory.

More importantly, plaintiffs' argument skips over the foundational analysis of whether the illusory coverage doctrine even applies here. It does not.

A. The illusory coverage doctrine does not apply to this express condition of coverage

As explained in the opening brief, California courts have rarely applied the illusory coverage doctrine, and have done so only (1) as a tool to resolve ambiguities in a policy exclusion (e.g., *Safeco Ins. Co. of America v. Robert S.* (2001) 26 Cal.4th 758, 764-766); or (2) to prevent a total failure of consideration where the enforcement of a policy exclusion would mean the policyholder had no coverage at all under the policy (e.g., *Maryland Casualty Co. v. Reeder* (1990) 221 Cal.App.3d 961, 978). (OBOM 29.) The doctrine has *never* been applied in the way plaintiffs invoke it here – to strike or rewrite an unambiguous *condition* of coverage.

Plaintiffs concede the "specified cause" term is not an exclusion, and admit it is an express "condition[ ] to obtain the Limited Virus Coverage." (ABOM 16.) They argue that the illusory coverage doctrine should be extended to conditions, like the one at issue here, because any distinction between conditions and exclusions would be "semantic." (ABOM 31.) But they ignore

the substantive differences between conditions and exclusions. (See OBOM 29-31.)

Unlike an exclusion, a condition of coverage must be satisfied for there to be an enforceable promise of coverage in the first place. (OBOM 31; 1 Witkin, Summary of Cal. Law (11th ed. 2023) Contracts, ch. XIII.C.1, § 799; see *Platt Pacific, Inc. v. Andelson* (1993) 6 Cal.4th 307, 313 ["Under the law of contracts, parties may expressly agree that a right or duty is conditional upon the occurrence or nonoccurrence of an act or event"].) Plaintiffs' policy promises coverage for loss or damage caused by a virus *only if* the virus resulted from a specified cause of loss. (2AA 396-397, § B.1.) If there is no specified cause of loss, then there is no promise of coverage at all. (See *Modern Development Co. v. Navigators Ins. Co.* (2003) 111 Cal.App.4th 932, 942-943 [when insured failed to satisfy a "condition of coverage," insurer's obligations were not triggered].)

In addition, when an exclusion withdraws all coverage promised elsewhere, courts can remedy illusory coverage by striking or narrowing the exclusion, leaving the coverage that was promised. But eliminating or narrowing a precondition of coverage has the effect of *creating* coverage that would otherwise not exist and was not intended by the parties. (See *Hurley Construction Co. v. State Farm Fire & Casualty Co.* (1992) 10 Cal.App.4th 533, 540; *Pacific Employers Ins. Co. v. Superior Court* (1990) 221 Cal.App.3d 1348, 1358-1359 [eliminating notice requirement " 'is tantamount to an *extension of coverage* to the

insured gratis, something for which the insurer has not bargained' "].)

Finally, a condition on coverage that is written directly into the coverage grant – as it is here – does not frustrate the reasonable expectations of insureds. For these conditions, an insured cannot reasonably expect to receive coverage unless the condition is satisfied. Put another way, there can be no illusion when coverage is expressly conditioned on a trigger that has not been satisfied. (*Scottsdale Ins. Co. v. Essex Ins. Co.* (2002) 98 Cal.App.4th 86, 95.)

Because the difference between conditions and exclusions is not merely semantic, it is unsurprising that plaintiffs have not cited a single case in which a court found that a policy *condition* created illusory coverage. (E.g., *Safeco*, *supra*, 26 Cal.4th at pp. 764-765 [exclusion]; *Hays v. Pacific Indemnity Group* (1970) 8 Cal.App.3d 158, 164 [exclusion]; *Princeton Express & Surplus Ins. Co. v. DM Ventures USA LLC* (S.D.Fla. 2016) 209 F.Supp.3d 1252, 1257-1258, 1260 [exclusion].)

The only case plaintiffs cite to support their assertion that a condition can create the illusion of coverage is *Pena v. Viking Ins. Co. of Wisconsin* (Idaho 2022) 503 P.3d 201. But that case did not involve coverage conditions either; it involved a challenge to policy "definitions and exclusions." (*Id.* at pp. 205, 207.) In *Pena*, the insured paid a separate premium for underinsured motorist bodily injury coverage but received no such coverage. (*Id.* at p. 204.) The policy defined an "underinsured motor vehicle" as a vehicle with bodily injury limits less than the policy's liability

limit, which was $25,000. (*Ibid.*) But it then *excluded* from this definition all vehicles with liability limits less than the state's required minimum coverage, which was also $25,000. (*Id.* at pp. 203-205, 209.) That is, the insured paid a separate premium for underinsured motorist coverage, but this coverage was excluded by definition. The Idaho court declined to enforce the definition's exclusion, emphasizing that the broad exclusion conflicted with state statutes, and reasoning it would not enforce a provision whereby "what one hand giveth – the other taketh away." (*Id.* at p. 209.)

Here, nothing was taken away because the policy never gave plaintiffs unconditional virus coverage in the first place. Sentinel's policy promises limited coverage for loss or damage caused by a virus *only if* a virus was the result of a specified cause of loss and *only if* the virus resulted in property damage. (2AA 396.) These sorts of preconditions on coverage are common in the industry and accepted by the California Department of Insurance. (E.g., *Penn-America Ins. Co. v. Mike's Tailoring* (2005) 125 Cal.App.4th 884, 887-888 ["specified causes of loss" condition in exception to exclusion]; Cal. Dept. of Ins., *Commercial Insurance Guide*, Commercial Property <https://www.insurance.ca.gov/01-consumers/105-type/95-guides/09-comm/commercialguide.cfm#commercialproperty> [as of Nov. 20, 2023].)

As both sides agree, it is the function served by an insurance clause, and not its label, that matters most. (See *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1265.) The

policy here makes clear, and plaintiffs concede, that the "specified cause of loss" condition *functions* as a precondition "to obtain" policy coverage. (ABOM 16, 17 [the " 'specified cause of loss' " is a "*condition[ ] to obtain* the Limited Virus Coverage" and "[this] condition *requires the policyholder to show* that the virus that caused its loss or damage 'is the result of' . . . a 'specified cause of loss.' "], italics added and omitted.)

There is no need for the Court to adopt a bright line rule that a policy condition can *never* render coverage illusory; if the condition is entirely within the insurer's control, for instance, the coverage might be illusory. (*Forecast Homes, Inc. v. Steadfast Ins. Co.* (2010) 181 Cal.App.4th 1466, 1483-1484.) But as reflected in both parties' briefs, the illusory coverage doctrine is almost always applied in the exclusion context. The reason is not semantics or technical formalism, but rather reflects the purpose and nature of the doctrine: to ensure the insured obtains the promised coverage. The Limited Coverage did not create any illusion – the limited nature of the coverage was apparent from the insuring language itself. The Court of Appeal thus erred in striking the condition.

B. Courts do not apply the illusory coverage doctrine to delete or rewrite unambiguous policy terms

Plaintiffs admit that the most "common" use of the illusory coverage doctrine is to narrowly construe ambiguous policy terms, but they assert that the doctrine can also be used to "invalidat[e] *unambiguous* terms." (ABOM 36-37.)

To the extent plaintiffs suggest that courts can apply the illusory coverage doctrine to rewrite the unambiguous terms of a contract that is supported by adequate consideration, the assertion violates this state's foundational rule that when "contractual language is clear and explicit, it governs." (*Bank of the West*, *supra*, 2 Cal.4th at p. 1264.) And plaintiffs do not cite a single case to support their claim. They instead rely on two secondary authorities – the Rutter practice guide and a student law review comment. Neither supports their argument.

The cited portion of the Rutter guide cites three cases on this point. (Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2023) ch. 4-B, ¶ 4:29 (Rutter).) The first case, *Scottsdale*, recognized that an insurance contract can be illusory *if* one of the parties assumes no obligation, as Sentinel noted above. (*Scottsdale*, *supra*, 98 Cal.App.4th at pp. 94-95.) The court then held the policy at issue was *not* illusory because the challenged provision was a "clear" and "plainly"-worded coverage condition – just like the "specified cause of loss" condition here. (*Ibid*.) The other two cited cases examined whether an insurer may exclude certain risks without violating the proximate cause statute applicable to insurance coverage cases, Insurance Code section 530. (*Julian v. Hartford Underwriters Ins. Co.* (2005) 35 Cal.4th 747, 750; *De Bruyn v. Superior Court* (2008) 158 Cal.App.4th 1213, 1216.) Both courts *agreed* with the insurers' arguments that the exclusions at issue were enforceable, but noted in dicta the possibility that if an exclusion were too broad it could render coverage illusory under the rules of proximate

cause. (*Julian*, at pp. 750-751, 759-761; *De Bruyn*, at pp. 1216, 1222-1224.) None of these three cases support rewriting an unambiguous policy condition to expand the promised coverage.

Plaintiffs' only other cited authority is a student law review comment that does not cite any California authority or identify a single case involving a coverage condition. (Weiss, *The Illusory Coverage Doctrine: A Critical Review* (2018) 166 U.Pa. L.Rev. 1545, 1545-1546 (Weiss).) Indeed, the comment characterizes the illusory coverage doctrine as one addressing how policy *exclusions* may render policies procedurally unconscionable. (*Id.* at pp. 1545-1548.) This student comment provides no grounds for disregarding the plain language of the policy.

1. The "specified cause of loss" condition is unambiguous and enforceable

The "specified cause of loss" condition in Sentinel's policy is unambiguous, as the other courts that have examined this identical provision have all held. (E.g., *Motherway & Napleton, LLP v. Sentinel Ins. Co.* (N.D.Ill. 2022) 631 F.Supp.3d 496, 502; *Wilson v. Hartford Casualty Co.* (E.D.Pa. 2020) 492 F.Supp.3d 417, 428; *Franklin EWC, Inc. v. Hartford Financial Services Group, Inc.* (N.D.Cal. 2020) 506 F.Supp.3d 854, 862; OBOM 32, 38.)

The Court of Appeal suggested that the Limited Coverage might be considered ambiguous based, in part, on its concern that the provision's "result of" phrase could mean two things: "Pathogenic causation – in the sense that, say, cancer may be said to be the 'result of' a toxic carcinogen" *or* "a vector for

transmission of a virus." (*John's Grill, Inc. v. Hartford Financial Services Group, Inc.* (2022) 86 Cal.App.5th 1195, 1221, italics omitted.)

But " '[t]he mere fact that a word or phrase in a policy may have multiple meanings does not create an ambiguity.' " (*Yahoo Inc. v. Nat. Union Fire Ins. Co.* (2022) 14 Cal.5th 58, 69; *Bay Cities Paving & Grading, Inc. v. Lawyers' Mutual Ins. Co.* (1993) 5 Cal.4th 854, 868; OBOM 38-39.) The analysis depends on the context of the policy as a whole. (*Bay Cities*, at p. 867; accord, *Bank of the West*, *supra*, 2 Cal.4th at p. 1265 [policy language "cannot be found to be ambiguous in the abstract"], italics omitted.)

Here, the issue is whether a reasonable insured had notice that the Limited Coverage applies only when a virus was the "result of" one of the specified causes. (2AA 396.) The plain meaning of "result" requires a causal connection. (*Sanders v. Kohler Co.* (8th Cir. 2011) 641 F.3d 290, 294; *CNG Transmission Management VEBA v. United States* (Fed. Cir. 2009) 588 F.3d 1376, 1379 ["The plain meaning of the term 'results in' is 'causes.' "].) The "result of" phrasing is used in numerous policy provisions (e.g., 2AA 294, 296, 301, 302-305, 366, 370), and plaintiffs have never claimed a reasonable person would not understand what it means. Under any definition, it is undisputed that no virus damages resulted from a specified cause of loss in this case.

Plaintiffs also suggest that the specified cause of loss condition "makes no sense" as applied to a virus because "viral

reproduction (or replication) requires access to the metabolism of a living host cell." (ABOM 25; see *John's Grill*, *supra*, 86 Cal.App.5th at pp. 1221-1222.) Yet plaintiffs' complaint alleges that the coronavirus can result from other means – for instance, they allege that the virus "can remain suspended in the air for up to three hours" and can "land indiscriminately on the surfaces of property," which can then transmit infection. (1AA 75.) Based on these allegations, a virus could result from one of the specified causes of loss (such as water damage, wind, explosion, or vandalism), as discussed in Section I.D.4, *post*.

Plaintiffs' argument also ignores the context of the "specified cause of loss" condition. The Endorsement broadly excludes from coverage all damage from fungi, rot, bacteria, and virus. (2AA 392.) The Limited Coverage provision serves a specific function – to identify any *potential exceptions* to that *broad exclusion*. (2AA 395-397.) That is, the Limited Coverage is not a stand-alone coverage grant that purports to broadly cover virus damage; rather it carves out some limited exceptions to the broad exclusion for damages caused by a virus (or fungi, rot, or bacteria) when the virus results from traditional covered perils. (OBOM 18-22, 48-49.) And it does so by using the specified-cause requirement, which is drawn from the traditional named perils covered by insurance policies: If an otherwise excluded loss results from one of these traditional named perils, the policy will still provide coverage.

"Ordinarily, an exception to a policy exclusion does not create coverage not otherwise available under the coverage

clause." (*Hurley*, *supra*, 10 Cal.App.4th at p. 540.) Because an exception's purpose is to potentially "restore" coverage eliminated by the exclusion (Rutter, *supra*, ch. 3-C, ¶ 3:41.5), a court must examine the exclusion before determining the meaning and scope of the exception. (See *TRB Investments, Inc. v. Fireman's Fund Ins. Co.* (2006) 40 Cal.4th 19, 30-31; see also *Old Republic Insurance Co. v. Superior Court* (1998) 66 Cal.App.4th 128, 145-146 [court's error in treating exception to exclusion as a coverage clause led to "an unfortunate rewriting of" the policy].)

Under these settled principles, it is not appropriate to consider the Limited Coverage's language in isolation. (*Minkler v. Safeco Ins. Co.* (2010) 49 Cal.4th 315, 322.) The Court of Appeal disagreed, finding it was required to first evaluate the Limited Coverage exception in isolation *before* even considering the Virus Exclusion. (*John's Grill*, *supra*, 86 Cal.App.5th at pp. 1212-1213, 1220-1224.) This improper analysis contributed to the court's errors (OBOM 47-49), and plaintiffs offer no defense of the Court of Appeal's approach on this issue.

2. The Limited Coverage provision is not ambiguous because of its location in the policy

Plaintiffs imply that the "specified cause of loss" condition is ambiguous because "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.' " (ABOM 26.)

Plaintiffs have never raised this argument before, and for good reason. The phrase "Specified Cause of Loss" is set out in

quotation marks to indicate that it (like many phrases in insurance policies) is a defined term. (2AA 315-316.) As a reasonable policyholder might expect, those definitions can be found in the "Definitions" section of the policy, which lists the defined terms and phrases in alphabetical order. (2AA 315-316.)

To be sure, most multi-line commercial insurance policies are lengthy, and this one is no exception. But this policy – approved by the Department of Insurance for use throughout California – is organized in a way that an insured can locate the applicable terms. The policy includes both liability and property insurance, with the core property insurance coverage starting at page 29. (2AA 290.) On the very next page, the policy contains a table of contents, called a "QUICK REFERENCE," which identifies where to find the sections pertaining to Coverages, Exclusions, and Definitions. (2AA 291.)

The requirement that the virus must be the result of a "specified cause of loss" was plainly communicated through the policy's language, organization, and structure.

C. This Court should reject plaintiffs' reliance on the reasonable expectations doctrine

Plaintiffs alternatively argue that the "specified cause of loss" condition is unenforceable because the condition was contrary to their reasonable expectations. (ABOM 37-39.) But it is only when the terms are ambiguous that this Court considers the insured's objectively reasonable expectations. (*Elliott v. Geico Indemnity Co.* (2014) 231 Cal.App.4th 789, 802-803 [" 'It is settled in this state that "the doctrine of reasonable expectation of

coverage comes into play *only* where there is an ambiguity in the policy." ' "]; see OBOM 32, fn. 4.)

Even if the Court were to reach the issue, any policyholder who reads the Limited Coverage could reasonably expect coverage "only . . . when the 'fungi', wet or dry rot, bacteria or virus' " that causes loss or damage "is the result of" a " 'specified cause of loss.' " (ABOM 33, italics omitted.) As discussed above, because this condition is written directly into the coverage grant, an insured cannot reasonably expect coverage if the condition is not satisfied. Any asserted ambiguity is thus immaterial. (*Bank of the West*, *supra*, 2 Cal.4th at p. 1265 [when considering a coverage argument "based on assertedly ambiguous policy language," court "must first attempt to determine whether coverage is consistent with the insured's objectively reasonable expectations"]; *Mez Industries, Inc. v. Pacific Nat. Ins. Co.* (1999) 76 Cal.App.4th 856, 868-869 [despite a potential ambiguity, "insured will not be able successfully to claim coverage where a reasonable person would not expect it"].)

Plaintiffs claim they had a reasonable expectation of unlimited coverage for viruses based solely on the policy's declarations page. (ABOM 37-39). But that page notifies plaintiffs of the applicable policy limits; it did not state or suggest this coverage included all loss regardless of the cause of the identified perils, and it described the coverage as "LIMITED." (2AA 272.) No reasonable insured would rely exclusively on the declarations page and ignore all the pages that follow, nor should the Court endorse a position that undermines the purpose of a

declarations page and basic contract principles. (*Estate of Murphy* (1978) 82 Cal.App.3d 304, 307-308 [endorsement reducing policy coverage effective though not referenced on declarations page].)

To support their claimed reasonable expectations, plaintiffs cite *Hays*, *supra*, 8 Cal.App.3d 158, but that case involved an ambiguous "products hazard" exclusion that essentially eliminated the promised liability coverage. (*Id.* at pp. 161-164.) As in *Safeco*, the court declined to read the ambiguous exclusion so broadly as to negate the expected coverage. (*Ibid.*; *Safeco*, *supra*, 26 Cal.4th at pp. 763-766.) That is a far cry from the situation here, where plaintiffs had no reasonable expectation of coverage because they failed to satisfy an express condition written into the coverage grant.

Plaintiffs also cite out-of-state decisions interpreting a policy in the insured's favor when an exclusion is obscurely worded and/or contains a "hidden trap or pitfall, or if the fine print purports to take away what is written in large print." (*Hallowell v. State Farm Mutual Auto Ins. Co.* (Del. 1982) 443 A.2d 925, 928.) But here the "specified cause" condition is located immediately before the Limited Coverage provision and written in plain language. (2AA 396.) The use of the term "specified cause of loss" was not a trap or pitfall; indeed, it mirrors the causes of loss traditionally covered by property insurance policies. (5 New Appleman on Insurance (Law Library ed. 2023) § 41.02.)

D. The policy is not illusory because plaintiffs concede it provides material coverage

Insurance policies that provide material coverage are not illusory. (OBOM 40-42, citing cases.) Plaintiffs concede that the Endorsement provides material coverage (ABOM 25), but argue the Court should evaluate material coverage at the smallest possible level: not whether they received material benefits in exchange for their premium, or whether they received material coverage in the Endorsement, but rather whether every single peril listed in the Limited Coverage provides a material benefit to every single insured. That standard is incorrect and unworkable.

1. Plaintiffs received material coverage under both the policy as a whole and the Endorsement as a whole

As explained in the opening brief, some courts evaluate materiality based on the policy as a whole, particularly where (as here) there was a single premium paid for all coverage.[2] (See, e.g., *Jostens, Inc. v. Northfield Ins. Co.* (Minn. Ct.App. 1995) 527 N.W.2d 116, 119 [illusory coverage doctrine is best applied "where part of the premium is specifically allocated to a particular type or period of coverage and that coverage turns out to be functionally nonexistent"]; *In re SRC Holding Corp.* (8th Cir. 2008) 545 F.3d 661, 671 [no illusory coverage where other

[2] In the opening brief, Sentinel explained that the policy shows a single premium amount and plaintiffs have never alleged they paid any additional premium for the Endorsement or virus coverage. (OBOM 18, fn. 1, 41-42, fn. 6, 49, fn. 6). Plaintiffs do not dispute these points.

coverage existed under policy and no separately allocated premium paid for the disputed coverage]; *Associated Industries Ins. Co. v. Bandari* (C.D.Cal., Aug. 10, 2023, No. 2:22-cv-05477) 2023 WL 5174901, at *8 [policy is not illusory if policy provides coverage "in many other circumstances."].)

Other courts focus on whether the particular endorsement or coverage provision provides material coverage. (OBOM 40-42; see, e.g., *St. Mary's Area Water Authority v. St. Paul Fire & Marine Ins. Co.* (M.D.Pa. 2007) 472 F.Supp.2d 630, 635.)

California courts have not yet taken a clear position on this issue, but it is undisputed that plaintiffs received material coverage under either standard. The policy as a whole provides ample coverage – it provides protection if the building burns down, a car crashes into it, or vandals destroy it. And even if the court looks only at the Endorsement there is still material coverage, as plaintiffs concede. (ABOM 25 [conceding that the Endorsement provides material coverage for damage caused by fungi and wet rot].) Indeed, there is even material coverage for loss or damages due to viruses specifically (see *post*, Section I.D.4), although as explained below materiality should not be assessed on a peril-by-peril basis.

2. Plaintiffs err in asserting that materiality should be assessed on a peril-by-peril approach

Plaintiffs make no attempt to distinguish or even mention the main cases cited in Sentinel's opening brief showing materiality should be assessed based on the policy or Endorsement, not on a peril-by-peril basis. (OBOM 39-41.)

Instead, plaintiffs assert that Sentinel's position is "contrary to cases from virtually every jurisdiction." (ABOM 11). But they cite only one such case – a footnote in an unpublished federal district court decision interpreting Pennsylvania law. (ABOM 33, citing *Great Northern Ins. Co. v. Greenwich Ins. Co.* (W.D.Pa., May 12, 2008, No. 05-635) 2008 WL 2048354, at *5, fn. 3.)

In the main body of the *Great Northern* opinion, the court acknowledged that "[a]s a general rule, an endorsement is *not* rendered illusory by an exclusion if, despite the exclusion, the endorsement continues to cover at least one risk reasonably anticipated by the parties." (*Great Northern*, *supra*, 2008 WL 2048354, at *5, italics added.) Plaintiffs ignore this aspect of *Great Northern*, and instead rely on a footnote that says – without citation to any authority – the opposite of what the court said in the body of the opinion. (*Id.* at *5, fn. 3.) In the footnote, the district court suggested that "the illusory coverage issue must be examined" by viewing the likelihood of coverage for each individual peril in a single coverage provision. (*Ibid*.) And the court then applied *this* rule in analyzing the issues in the case. (*Id.* at *6-7.) This Court should decline to follow this unpublished federal trial court case on a point that is unsupported and not well-reasoned.

Plaintiffs assert "[o]ther cases are broadly in agreement" with *Great Northern*. (ABOM 34.) But that is incorrect. The federal courts – many applying California law and examining the same Limited Coverage provision – have overwhelmingly applied the general rule that when a coverage provision insures against

several perils, the coverage is not illusory if any one of those perils will result in coverage. (E.g., *Westside Head & Neck v. Hartford Financial Services Group, Inc.* (C.D.Cal. 2021) 526 F.Supp.3d 727, 733; *GCDC LLC v. Sentinel Ins. Co.* (D.D.C., Sept. 28, 2021, No. 20-1094) 2021 WL 4438908, at *4; *Mostre Exhibits, LLC v. Sentinel Insurance Co, Ltd.* (S.D.Cal., Feb. 2, 2022, No. 20-cv-1332) 2022 WL 316685, at *3 (9th Cir. No. 22-5191, app. pending); *Sweetberry Holdings LLC v. Twin City Fire Ins. Co.* (D.N.J., July 29, 2021, No. 20-08200) 2021 WL 3030269, at *8; *Barbizon School of San Francisco, Inc. v. Sentinel Ins. Co.* (N.D.Cal., Dec. 3, 2021, No. 20-cv-08578) 2021 WL 5758890, at *9.)

While California courts have not directly weighed in, no California court has previously required a peril-by-peril evaluation, nor declared a policy illusory unless there is material coverage for every single peril. California law in fact supports the opposite conclusion. (E.g., *Energy Ins. Mutual Limited v. Ace American Ins. Co.* (2017) 14 Cal.App.5th 281, 306 [exclusion did not result in illusory coverage where it "did not withdraw virtually all of the coverage extended by the insuring agreement"]; *Medill v. Westport Ins. Co.* (2006) 143 Cal.App.4th 819, 836 [exclusion did not render coverage illusory where "not every lawsuit that could conceivably be brought against the [insured] would necessarily arise out of [the exclusion]"]; *Blackhawk Corp. v. Gotham Ins. Co.* (1997) 54 Cal.App.4th 1090, 1097; see OBOM 40.)

Not even the four decisions that plaintiffs cite as "in agreement" with *Great Northern* (ABOM 34) support plaintiffs' peril-by-peril analysis. The sole California case they cite dealt with an illegality issue, where the policy appeared to provide coverage for malicious prosecution claims even though state law barred coverage for this claim. (*Downey Venture v. LMI Ins. Co.* (1998) 66 Cal.App.4th 478, 512-516.) The court *rejected* the insured's contentions that the insurer committed promissory fraud, noting the provision was "hardly an empty or illusory promise" because there were still some benefits provided. (*Id.* at p. 516.)

Plaintiffs' three other cited decisions likewise did not analyze the multiple perils issue, and in fact support the rule that an exclusion is illusory only when it "completely" or "total[ly]" eliminates the promised coverage. (*Karas v. Liberty Ins. Corp.* (Conn. 2019) 228 A.3d 1012, 1038 [rejecting illusory argument, and stating that "[u]nless the exclusionary language eliminates coverage altogether, it does not render the coverage illusory"]; *Princeton Express*, *supra*, 209 F.Supp.3d at p. 1260 [refusing to uphold an "advertising injury" exclusion because that exclusion "completely contradict[s]" the unconditional promise of advertising injury coverage]; *Hernandez v. Liberty Mutual Ins. Co.* (Wis. Ct.App. 2014) 844 N.W.2d 657, 741-742 [holding an insurance provision is illusory if it would " 'produce a total forfeiture of coverage' "].)

3. Plaintiffs also err in arguing that standard form policies must provide material coverage for every peril to every individual insured

Plaintiffs' focus on whether each individual peril in the Limited Coverage benefits John's Grill is also mistaken because the policy was not tailored for plaintiffs. Instead, it is a standard form policy that was approved by the Department of Insurance for broad use by California businesses. (OBOM 44-47.)

Plaintiffs do not suggest that their policy was individually negotiated. But they cite "first principles" to argue that insurance policies are purely contractual transactions and therefore this Court should not consider the nature of the standardized policy form. (ABOM 35-36.)

Sentinel agrees that "first principles" are central to insurance policy interpretation. Insurance policies must be interpreted according to their plain meaning; clear and explicit policy language governs; and policy language must be enforced, regardless of the insured's claimed subjective expectations. (*Yahoo*, *supra*, 14 Cal.5th at p. 67; *Forecast Homes, supra,* 181 Cal.App.4th at pp. 1475, 1482.)

But plaintiffs are asking the Court to apply special illusory coverage rules that benefit them because this case involves an insurance policy. In the context of analyzing *these* arguments, the Court can and should consider that the Limited Coverage is not an individually negotiated provision to cover only plaintiffs' potential risks. Standard form policies may include extra coverages that benefit only some policyholders, but that does not mean the coverage is illusory. Creating an interpretative rule

that requires an insurer to demonstrate how each peril provides a material benefit to each insured would limit California policyholders' access to routine standardized coverages and greatly increase costs for both insurers and insureds. It would also require courts to speculate as to what precisely is likely to occur during the policy period or risk a policy interpretation that goes far beyond the parties' intentions. (See OBOM 44-47.)

In opposing these points, plaintiffs rely on language in two California decisions: *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.* (2000) 78 Cal.App.4th 847, 874 and *Blackhawk*, *supra*, 54 Cal.App.4th at pages 1096-1097. But both cases involved individually negotiated, non-standard provisions where the premiums were presumably likewise adjusted. (*Shade Foods*, at pp. 872-874 [policy specially tailored to insured's business needs and coverage provision added at request of insured's agent]; *Blackhawk*, at p. 1097 [the exclusion at issue "is not part of the standard, boilerplate policy. Rather it is a specially drafted endorsement"].) Plaintiffs do not claim their own policy was similarly customized, and do not dispute that they did not pay any additional premium for the Limited Coverage. (OBOM 18, fn. 1, 41, fn. 6, 49, fn. 7.) As the *Blackhawk* court explained in rejecting the insured's illusory coverage argument, "where the language of a contract is clear, we ascertain intent from the plain meaning of its terms and go no further." (*Blackhawk*, at p. 1098.)

Insurance companies do not tailor every policy to every potential policyholder's particular needs. That is why insurers

create standard form policies, and why the California Department of Insurance reviews and approves these forms for widespread distribution. If this Court adopts a rule of interpretation that does not account for the realities of the insurance market, the inevitable result is that premiums will rise and insurers will be less likely to extend unique or limited coverages in California. If California wants to adopt the novel rule plaintiffs advance – a rule that has not been adopted in any other state and that would upend California's insurance system – it should do so through the Legislature, and not through the misapplication of a common-law contract doctrine. (Cf. *Helfend v. So. Cal. Rapid Transit Dist.* (1970) 2 Cal.3d 1, 13; *Sheen v. Wells Fargo Bank, N.A.* (2022) 12 Cal.5th 905, 948 ["the Legislature is better situated than we are to take the 'significant policy judgments affecting social policies and commercial relationships' implicated in this case"].)

4. The policy here provides material coverage even assessed peril by peril because a virus could result from a specified cause of loss

Even if Sentinel were required to identify a "realistic prospect" that a virus could result from a specified cause of loss, it has done so by pointing to an *actual* case involving precisely this chain of causation. (*Curtis O. Griess & Sons, Inc. v. Farm Bureau Ins. Co.* (1995) 528 N.W.2d 329.) Plaintiffs complain that *Griess* is too "oddball" a case (ABOM 28), and likewise dismiss other examples that the Court of Appeal acknowledged could result in covered virus damage at businesses such as a "dog

kennel or a pet store." (*John's Grill*, *supra*, 86 Cal.App.5th at p. 1223.)

Plaintiffs provide no objective standard for assessing what circumstances are "realistic" enough to demonstrate material coverage. The Court of Appeal cited no authority for its "realistic prospect" standard, and plaintiffs make no attempt to justify that standard in their brief.

Instead, relying on the student comment discussed above (Weiss, *supra*, 166 U.Pa. L.Rev. 1545) as well as a few out-of-state cases, plaintiffs argue that a provision should be declared illusory when there is no " ' "reasonably expected set of circumstances" under which the policyholder would be able to collect benefits from the policy.' " (ABOM 29-30.) But as even the student author recognizes, this standard is unworkable – an insurer or an insured should not need to expect coverage scenarios to enforce a policy condition or exclusion. (Weiss, *supra*, 166 U.Pa. L.Rev. at pp. 1562-1563.)

In any event, this question is academic because California courts have already articulated a more rigorous standard. This Court in *Safeco* referred to illusory coverage as coverage that is "practically meaningless" (*Safeco*, *supra*, 26 Cal.4th at p. 764), and in *Julian* the Court cited a Court of Appeal decision referring to the "virtually illusory" coverage concept as an exclusion that " 'if given routine effect, could render a policy valueless almost at random' " (*Julian*, *supra*, 35 Cal.4th at p. 756). The Courts of Appeal have similarly strictly defined illusory coverage. (See *Scottsdale*, *supra*, 98 Cal.App.4th at p. 95 ["agreement is illusory

and there is no valid contract when one of the parties assumes *no* obligation"], italics added; *Medill*, *supra*, 143 Cal.App.4th at p. 836.)[3]

Under this standard, insurance coverage is not illusory merely because coverage would be provided only in rare circumstances or even if it is " 'difficult to imagine any factual scenario' " in which the coverage might apply. (*Motherway & Napelton*, *supra*, 631 F.Supp.3d at p. 501; accord, *Fagundes v. American Internat. Adjustment Co.* (1992) 2 Cal.App.4th 1310, 1318 [fact that underinsured motorist insurance coverage "will rarely be used does nothing to render the coverage illusory"].) This is because a core purpose of an insurance policy is to protect against harms that may be unusual or unexpected.

The *Griess* case shows that viruses *can* result from specified causes of loss and cause physical damage to covered property. (*Griess*, *supra*, 528 N.W.2d at pp. 530-532.) And it undermines plaintiffs' central argument that a virus cannot arise from a specified cause of loss because it cannot itself replicate outside a living cell.

Numerous other courts interpreting this same policy have agreed that the *Griess* scenario precludes an illusory finding because it shows the possibility that a virus could be transmitted

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[3] Federal courts applying California law have similarly held that "[to render] the [p]olicy 'illusory,' the exclusion must result in a complete lack of any policy coverage. [Citation.] Thus, the mere possibility of some coverage is enough." (*Secard Pools, Inc. v. Kinsale Ins. Co.* (C.D.Cal. 2017) 318 F.Supp.3d 1147, 1153, italics omitted, affd. (9th Cir. 2018) 732 F. App'x 616; accord, *Franklin*, *supra*, 506 F.Supp.3d at p. 861.)

by a specified cause of loss. (See, e.g., *Motherway & Napleton*, *supra*, 631 F.Supp.3d at pp. 501-502; *Franklin*, *supra*, 506 F.Supp.3d at p. 861; *Ultimate Hearing Solutions II, LLC v. Twin City Fire Ins. Co.* (2021) 513 F.Supp.3d 549, 563; *Westside Head & Neck*, *supra*, 526 F.Supp.3d at pp. 733-734; *Sweetberry*, *supra*, 2021 WL 3030269, at *8, fn. 9.)

But one need not rely on the scenario in *Griess* to conclude that a virus can result from a specified cause of loss. In the restaurant context, water damage (which is a "specified cause of loss") could cause viruses like Hepatitis A or norovirus to spread, causing loss or damage to property, such as contaminated food that must be discarded. (See, e.g., Centers for Disease Control and Prevention, *Common Settings of Norovirus Outbreaks* <https://www.cdc.gov/norovirus/outbreaks/common-settings.html> [as of Nov. 20, 2023] ["About 50% of all outbreaks of food-related illness are caused by norovirus," "[m]ost of these outbreaks occur in food service settings like restaurants," and norovirus can infect "oysters harvested from contaminated water"]; San Francisco Dept. of Public Health, *Hepatitis A* <https://www.sfcdcp.org/infectious-diseases-a-to-z/hepatitis-a/> [as of Nov. 20, 2023] [hepatitis A virus infection can result "from food or drinks prepared by someone who is infected, or by eating shellfish harvested from sewage-contaminated water"].) An Equipment Breakdown – such as the failure of a refrigerator or cooling system – can likewise result in contaminated food or water. And any living organism can be damaged by a virus; John's Grill and other restaurants could make a claim for damage

to live shellfish or plants caused by a virus that resulted from a specified cause of loss. The fact that the coronavirus did not cause this type of covered property damage does not make the coverage illusory.

California law does not require insurers to prove that the insured has a reasonable expectation of benefiting from every peril in every coverage provision in a standard-form policy. But even if that were the standard, Sentinel has met it as to virus coverage.[4]

E. Plaintiffs are not entitled to business interruption insurance without satisfying the "specified cause" condition

Finally, plaintiffs summarily assert that the "specified cause" condition does not apply to business interruption coverage because subsection B.1.a (the provision that imposes the "specified cause" condition) says it applies to the coverage "described in [B.]1.b. below," while business interruption coverage is set out in subsection B.1.f. (ABOM 39-40; 2AA 396.) This argument – made without any support or meaningful analysis – reads the provisions out of context. (See *Cosmetic*

[4] Moreover, as plaintiffs recognize, the insured has the initial burden to establish its claim falls within the scope of potential coverage. (ABOM 23; *Aydin Corp. v. First State Ins. Co.* (1998) 18 Cal.4th 1183, 1188.) As such, plaintiffs have the burden to establish their illusory coverage claim. (See *Jones v. GEICO Choice Ins. Co.* (E.D.Pa. 2022) 617 F.Supp.3d 275, 281.)

Laser, Inc. v. Twin City Fire Ins. Co. (D.Conn. 2021) 554 F.Supp.3d 389, 403-404 [rejecting identical argument].)

Subsection B.1.a establishes the conditions under which the policy will provide coverage for loss or damage caused by virus and other perils – the peril must be the "result of" a "specified cause of loss" or an "Equipment Breakdown Accident." Subsection B.1.b then describes the scope of coverage as limited to "loss or damage" caused by the virus or other perils.

Subsection B.1.f provides that Sentinel will pay for up to 30 days of lost income and expense if, as relevant here, "the loss which resulted in . . . virus does not in itself necessitate a suspension of 'operations', but such suspension is necessary due to loss or damage to property caused by . . . virus." (2AA 396.) Subsection B.1.f could potentially be triggered if, for instance, burst pipes did not cause enough damage to require a restaurant to suspend operations, but the dirty water contaminated the premises with fungi, rot, bacteria, or virus that in turn caused physical loss or damage to property that required a suspension.

John's Grill appears to be arguing that the conditions in subsection B.1.a apply only to claims for physical loss or damage *to property* (as described in subsection B.1.b) and do not apply to claims for loss of income or expense arising from that physical loss or damage (as described in subsection B.1.f). This reading is untenable – even the Court of Appeal rejected it, observing that the "loss or damage" covered in subsection B.1.b is the same "loss or damage" that triggers coverage in subsection B.1.f. (*John's Grill*, *supra*, 86 Cal.App.5th at p. 1218.)

As the *Cosmetic Laser* court explained, "[v]iewing Section B.1 as a whole," the business interruption coverage "under Subsection B.1.f is limited by Subsection B.1.a," and any other reading would "take[ ] Subsection B.1.f entirely out of context and violate[ ] basic principles of contract interpretation." (*Cosmetic Laser*, *supra*, 554 F.Supp.3d at pp. 402-403.)

In context, after subsection B.1.a sets out the "specified cause of loss" condition and B.1.b sets out the Endorsement's coverage for damage or loss to property caused by fungi, virus, or bacteria, the next three subsections each expound on and limit the coverage provided under B.1.b. (2AA 396.) Subsection B.1.f is the next and last subsection in the Limited Coverage. There is nothing in this subsection suggesting that it is a standalone coverage provision intended to eliminate the Endorsement's preconditions. Rather, subsection B.1.f expressly links to the earlier provisions of the Limited Coverage by referring to "the loss which resulted in . . . virus," which can only be a reference to the coverage precondition described in B.1.a.

Subsection B.1.f is also inapplicable because plaintiffs have not alleged (or suggested they could allege) a "loss which resulted in . . . [a] virus," as required by this subsection. (See *Robert E. Levy, D.M.D., LLC v. Hartford Financial Services Group Inc.* (E.D.Mo. 2021) 520 F.Supp.3d 1158, 1169.) And finally, even if the Endorsement's preconditions did not apply, plaintiffs would *still* have to show "direct physical loss" or "physical damage" to

property (2AA 292), which they have not and cannot do.[5] (See Section II, *post*.) For all these reasons, plaintiffs are not entitled to lost business income under subsection B.1.f.

II. Plaintiffs did not and cannot allege physical loss or damage

This Court granted review on two questions. The first was the illusory coverage issue discussed above, and the second was whether " 'simply wiping and cleaning surfaces' " of evanescent virus particles is enough to trigger coverage for " '[d]irect physical loss or direct physical damage to Covered Property caused by . . . virus, including the cost of removal of the . . . virus[.]' "

Sentinel's opening brief discussed both issues at length, explaining how the second question provides an independent basis for reversal. (OBOM 50-61.) Plaintiffs devote barely two pages to the second question, most of which is taken up with a new illusory coverage argument. (ABOM 40-41.)

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[5] Subsection B.1.f requires "loss or damage to property caused by . . . virus," which, as B.1.b makes clear, requires *physical* loss or damage to property. (2AA 396-397; OBOM 50-60.) Further, subsection B.1.f applies only if the "terms and conditions of [an] applicable Time Element Coverage" have been "satisfie[d]." (2AA 396.) "Time Element Coverage" refers to coverage measured in time – namely, the policy's standard "Business Income" coverage, for lost business income if the insured suspends operations while property that has experienced "physical loss" or "physical damage" is being "repaired, rebuilt or replaced." (2AA 392-393; see *Cosmetic Laser*, *supra*, 554 F.Supp.3d at p. 394; *John's Grill*, *supra*, 86 Cal.App.5th at p. 1217.)

In the single page where plaintiffs address the issue, they simply assert that their position is a "common-sense interpretation." (ABOM 41.) Yet they never advanced their "common-sense" interpretation below (the Court of Appeal raised it on its own), and they offer virtually no defense of it now. The only cases they cite stand for the undisputed proposition that ambiguities are generally resolved against the insurer. (*Ibid.*) Plaintiffs vaguely claim that differences in policy language make most cases "readily 'distinguishable' " (*ibid.*), but they make no attempt to actually distinguish the numerous cases that addressed exactly the same language (OBOM 60-61). Nor do they cite a single case other than the decision below that accepted their "common-sense interpretation."

Plaintiffs do not engage the Limited Coverage's text or structure, which show that merely wiping down surfaces does not qualify as loss or damage. (OBOM 54-58.) As the opening brief explains, plaintiffs incorrectly attempt to read "the cost of removal" phrase in isolation, as if it were an independent grant of coverage. It is not. It is a component that is "includ[ed]" as part of "[d]irect physical loss or direct physical damage to Covered Property":

> "Direct physical loss or direct physical damage to Covered Property caused by . . . virus, including the cost of removal of the 'fungi,' wet rot, dry rot, bacteria or virus."

(2AA 396, § B.1.b.)

This provision does not cover the cost of removal of "any" virus on the premises; it includes only the cost of removal of "the" virus that "caused" "[d]irect physical loss or direct physical

damage." (2AA 396, § B.1.b.) In other words, if a virus has not "caused" any direct physical loss or damage, it cannot be "the" virus referred to in the cost of removal clause. (OBOM 54-57.) Because the core ingredient of direct physical loss or damage under California law is a " 'distinct, demonstrable, physical alteration' " to property (*MRI Healthcare Center of Glendale, Inc. v. State Farm General Ins. Co.* (2010) 187 Cal.App.4th 766, 779), the cost of wiping down tables without any predicate property damage does not qualify. And, of course, the business income losses that plaintiffs seek have nothing at all to do with the alleged costs of wiping down tables.

Plaintiffs' failure to provide any reasoned argument to support the Court of Appeal's reading of the "cost of removal" phrase is telling. Instead, plaintiffs raise a new argument, suggesting that the "loss or damage" requirement would be illusory if the definition from the "[p]olicy's general insuring clause" were deemed to apply. (ABOM 41-42.) But the definition in the Limited Coverage itself limits coverage to situations where there is first "[d]irect physical loss or direct physical damage" to the property (2AA 396, § B.1.b.1), and that term should be interpreted as it has been for decades in California to require physical alteration. Because it may not be visibly apparent without testing that fungi, rot, bacteria, or virus have been successfully removed, the policy simply clarifies that such removal and related monitoring are part of the policy's benefit as well.

Plaintiffs' new illusory coverage argument also fails for the reasons discussed in Section I, *ante*. Courts cannot rewrite unambiguous policy provisions; even if this provision were ambiguous, plaintiffs would have no reasonable expectation of coverage absent a physical alteration to their property; the Limited Coverage is an exception to a broad coverage exclusion and thus could not create new coverage; and it is undisputed there is material coverage for property damage caused by other perils, even those in the same coverage provision.

Finally, plaintiffs' new argument is based on an incorrect predicate. Plaintiffs assert that "if virus can virtually never satisfy [the physical loss or damage] requirement (as Sentinel argues), then the Limited Virus Coverage is illusory." (ABOM 41.) But Sentinel does not contend that viruses can never cause physical loss or damage. While viruses cannot damage *inert* property (OMOB 50-51), viruses can cause physical loss or damage to *living* property, including plants and animals that are covered under the policy. But plaintiffs do not dispute that *this* virus, SARS-CoV-2, did not and could not cause "property damage" at plaintiffs' premises. (OBOM 58-60; see *MRI Healthcare*, *supra*, 187 Cal.App.4th at p. 779.)

Both issues in this case provide independent bases for reversal. Even if plaintiffs could show the virus resulted from one of the specified causes, there would still be no coverage because plaintiffs did not suffer loss or damage "to Covered Property."

Conclusion

This Court should reverse the Court of Appeal's decision overturning the order sustaining Sentinel's demurrer, and affirm the judgment in all other respects.

Respectfully Submitted,

November 21, 2023

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Dated: November 21, 2023

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/s/ Stacey Schiager
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STATE OF CALIFORNIA
Supreme Court of California

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