UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No.	LA CV20-07132 JAK (AFMx)	Date	June 25, 2021
Title	The Madera Group, LLC v. Mitsui Sumitomo Insurance USA, Inc.		

Present: The Honorable	JOHN A. KRONSTADT, UNITED STATES DISTRICT JUDGE

T. Jackson	Not Reported
Deputy Clerk	Court Reporter / Recorder
Attorneys Present for Plaintiffs:	Attorneys Present for Defendants:
Not Present	Not Present

Proceedings: **(IN CHAMBERS) ORDER RE DEFENDANT MITSUI SUMITOMO INSURANCE USA INC.'S MOTION TO DISMISS COMPLAINT PURSUANT TO RULE 12(B)(6) (DKT. 15);**

DEFENDANT'S OBJECTION TO PLAINTIFF'S SECOND NOTICE OF SUPPLEMENTAL AUTHORITY (DKT. 49); AND

PLAINTIFF'S MOTION TO SUPPLEMENT RECORD (DKT. 62)

The Madera Group, LLC ("Madera" or "Plaintiff") brought this action against Mitsui Sumitomo Insurance USA Inc. ("Mitsui" or "Defendant") in the Los Angeles Superior Court. Dkt. 1-1 (the "Complaint"). On August 7, 2020, Defendant removed the action on the basis of diversity jurisdiction. Dkt. 1. The Complaint advances causes of action for declaratory judgment and breach of contract.

On September 9, 2020, Defendant filed a Motion to Dismiss. Dkt. 15 (the "Motion"). In connection with the Motion, Defendant filed a Request for Judicial Notice. Dkt. 18 ("Defendant's First RFN"). Plaintiff filed an opposition on November 6, 2020. Dkt. 33 (the "Opposition"). Plaintiff also filed a Request for Judicial Notice. Dkt. 34 ("Plaintiff's First RFN"). On December 11, 2020, Defendant filed a reply in support of the Motion. Dkt. 35 (the "Reply"). Both parties subsequently filed numerous notices of supplemental authority. Dkts. 40, 43, 48, 51. Defendants filed two additional Requests for Judicial notice, as well as an Objection to Plaintiff's second notice of supplemental authority. Dkt. 41 ("Plaintiff's Second RFN"); Dkt. 42 ("Defendant's Second RFN"); Dkt. 49 ("Objection"); Dkt. 50 ("Defendant's Third RFN")

Hearings on the Motion were held on March 8, 2021, and March 22, 2021, and it was then taken under submission. Dkts 47, 52. On May 27, 2021, Plaintiff filed a Motion to Supplement Record and Notice of Supplemental Authority. Dkt. 62 (the "Motion to Supplement"). Plaintiff also filed an additional Request for Judicial Notice as to certain documents contained in the Motion to Supplement Record. Dkt. 63 ("Plaintiff's Third RFN"). On June 17, 2021, Defendants filed an opposition to the Motion to Supplement, Dkt. 64, and a fourth Request for Judicial Notice. Dkt. 65 ("Defendant's Fourth RFN").

For the reasons stated in this Order, the Motion is **GRANTED WITHOUT PREJUDICE**, *i.e.*, with leave to amend. Defendant's Objection is **MOOT**. The Motion to Supplement Record is **MOOT**.

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I. Factual Background

A. The Parties

Plaintiff, a California limited liability company, owns and operates restaurants in California and Arizona. Dkt. 1-1 ¶¶ 7, 12. Plaintiff is a citizen of California and Florida and has its principal place of business in California. Dkt. 1 ¶¶ 13-14; Dkt. 1-1 ¶ 7; Dkt. 26; Dkt. 28.

Defendant is a New York corporation with its principal place of business in New Jersey. Dkt. 1-1 ¶ 8. Defendant an insurance company that sells policies, including those that cover property. *Id.* ¶ 9.

B. Allegations in the Complaint

1. The Policy

It is alleged that Plaintiff purchased an all-risk insurance policy (the "Policy") from Defendant, and that it applied to 23 restaurants operated by Plaintiff in California and Arizona. Dkt. 1-1 ¶¶ 1, 13. It is further alleged that Plaintiff paid all premiums due under the Policy and has complied with all other conditions. *Id.* ¶ 41. It is further alleged that the Policy provides the "broadest coverage available to policyholders." *Id.* ¶ 42.

A copy of the Policy is attached to the Complaint. Dkt. 1-1 at 36-339. The Policy includes the following statements as to the scope of coverage:

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

Id. ¶¶ 44-51.

2. The Virus Exclusion

It is also alleged that the Policy includes "standard form language" excluding coverage for loss or

damage caused by viruses (the "Virus Exclusion"). Dkt. 1-1 ¶ 60. The Virus Exclusion provides:

> We will not pay for loss or damage caused by or resulting from any virus, bacterium or other microorganism that induces or is capable of inducing physical distress, illness or disease.

Dkt. 1-1 at 128.

It is alleged that the Virus Exclusion is invalid and unenforceable, and that Defendant is estopped from relying on it to deny coverage. *Id.* ¶ 61. It is alleged that, prior to 2006, "a strong majority of courts" had held that "physical loss of or damage to property includes conditions that cause property to be simply too unsafe to inhabit or use," and that "insured property damage and resulting business income loss" could be caused by "an array of noxious and untenable conditions[.]" *Id.* ¶ 67. It is alleged that these determinations were made under the following circumstances:

- A house which "became perched on the edge of a cliff after a sudden landslide caused a large chunk of the ground surrounding their property to fall into a creek";
- A house which "was rendered dangerous by the presence of falling rocks";
- "Infusion of a factory with radioactive dust and radon gas";
- "The presence of carbon monoxide, pollutants, asbestos or lead in buildings";
- "The occurrence of vibrations that cause equipment to shut down without being damaged";
- "The malicious addition of chemicals to a sewage plant that destroy a bacteria colony";
- "The contamination of a well with E. coli bacteria";
- "The spread of dust, soot and smoke through a law firm as a result of 9/11";
- "The fumigation of otherwise undamaged food beans with a substance not acceptable to customers in the United States market";
- "The production of "off-tasting" soda that had not been rendered unfit for human consumption";
- "The impact of odor in a house from an illegal methamphetamine lab";
- "Exposures of meat, cardboard food containers and other products to ammonia, smoke and pesticides"; and
- "Infestation of a house with brown recluse spiders."

Id. ¶¶ 67, 68, 69.

Based on these holdings in prior proceedings, it is alleged that insurers have "long been aware" that the presence or suspected presence of a virus in a building or area will cause "direct physical loss of or damage to that property." *Id.* ¶ 70. It is also alleged that, notwithstanding these prior holdings, when insurers sought approval of the standard Virus Exclusion from state regulators, they represented that such events would not have been covered. *Id.* ¶ 77. In support of this position it is alleged that the Insurance Service Office, Inc. ("ISO"), a large insurer trade group, submitted a circular that stated as follows:

> **Introduction**
> The current pollution exclusion in property policies encompasses contamination (in fact, uses the term contaminant in addition to other terminology). Although the pollution exclusion addresses contamination broadly, viral and bacterial contamination are specific types that appear to warrant particular attention at this point in time.

> ***
> Disease-causing agents may render a product impure (change its quality or substance), or enable the spread of disease by their presence on interior building surfaces or the surfaces of personal property. When disease-causing viral or bacterial contamination occurs, potential claims involve the cost of replacement of property (for example, the milk), cost of decontamination (for example, interior building surfaces), and business interruption (time element) losses.
>
> **Current Concerns**
> ***
> While property policies have not been a source of recovery for losses involving contamination by disease-causing agents, the specter of pandemic or hitherto unorthodox transmission of infectious material raises the concern that insurers employing such policies may face claims in which there are efforts to expand coverage and to create sources of recovery for such losses, contrary to policy intent. In light of these concerns, we are presenting an exclusion relating to contamination by disease-causing viruses or bacteria or other disease-causing microorganisms.

Id. ¶ 80.

It is further alleged that the statement that property policies had "not been a source of recovery" for these losses was "simply not true." *Id.* ¶ 81. It is then alleged that this represented an intentional effort to deceive insurance regulators in California and elsewhere in the United States, and that the Virus Exclusion was approved as a result of "deception and misrepresentations." *Id.* ¶¶ 83, 84. It is further alleged that the insurance industry, including Defendant, benefited from these representations because they did not reduce premiums to account for the limitations on coverage. *Id.* ¶ 85. The Complaint also alleges that the insurance industry, including Defendant and/or its agents, have repudiated these statements. *Id.* ¶ 86.

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

The Complaint alleges that the COVID-19 pandemic spread rapidly in the United States during the first six months of 2020. Dkt. 1-1 ¶¶ 14-15. It is further alleged that COVID-19 spreads easily through close contact of individuals, and that asymptomatic persons may transmit the disease. *Id.* ¶¶ 17-18. It is also alleged that the disease spreads through droplets, which despite their size, are nonetheless "physical objects that can travel and attach to other surfaces." *Id.* ¶ 19. It is further alleged that the virus may "survive and remain virulent" once it attaches to various surfaces. *Id.* ¶ 20.

It is next alleged that, beginning in early March 2020, state and local authorities began suspending or limiting the operations of "non-essential businesses," including Plaintiff's restaurants, through the issuance of public health orders (the "Public Health Orders"). *Id.* ¶¶ 27-28. It is alleged that the Public Health Orders placed severe limitations on restaurant operations, including that they could only offer food for delivery, pick-up and drive-through operations instead of in-person dining. *Id.* ¶ 30. A list of the Public Health Orders is attached to the Complaint. *Id.* at 343-47. It is further alleged that some of these Public Health Orders state that the virus "causes and has caused or imminently threatens physical loss or damage to property and human health," and that this finding appears in other public health orders

issued in California and across the United States. *Id.* ¶¶ 31-33; *Id.* at 348-418.

It is further alleged that the Public Health Orders caused direct physical loss of or damage to properties at the insured restaurants. *Id.* ¶ 36. It is further alleged that the Public Health Orders, as well as the virus, caused direct physical loss of or damage to businesses and properties that are within one mile of Plaintiff's restaurants. *Id.* ¶ 37.

4. Plaintiff's Claim and Defendant's Denial

Plaintiff made a claim for insurance coverage, and Defendant denied this claim on April 6, 2020. *Id.* ¶ 104. It is alleged that, in support of this position, Defendant stated as follows:

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

Id. ¶¶ 105-08.

C. Relief Requested

Plaintiff seeks a declaration that the Public Health Orders caused "direct physical loss of or damage to property," triggering coverage under the Policy. Plaintiff also seeks the entry of an order that the Virus Exclusion is unenforceable and that the presence or suspected presence of the virus in Plaintiff's restaurants caused "direct physical loss or damage to property," again triggering coverage under the Policy. Plaintiff also seeks damages for Defendant's alleged breach of contract in refusing to pay Plaintiff's claim.

II. Requests for Judicial Notice

As noted, the parties submitted many Requests for Judicial Notice.

In its First RFN, Plaintiff seeks judicial notice of various state and federal court decisions, associated transcripts, and filings. Plaintiff also seeks judicial notice of regulatory filings made by persons affiliated with the insurance industry. These include a copy of a circular published by ISO (Exhibit T), a screenshot of certain records from the California Department of Insurance (Exhibit U), and filings made by Greater New York Mutual Insurance Company, Insurance Company of Greater New York, and Strathmore Insurance Company (Exhibit V).

Defendant's First RFN seeks judicial notice of three transcripts of state and federal court proceedings, as well as a screenshot of Plaintiff's website. Plaintiff's Second RFN, Defendant's Second RFN and Defendant's Third RFN all seek judicial notice of orders issued in cases similar to this one. Plaintiff's Second RFN also seeks judicial notice of a list of cases where the insurer answered the operative

complaint.

To the extent the parties seek judicial notice of pleadings and transcripts in other matters, the Requests for Judicial Notice are **GRANTED**. *McVey v. McVey*, 26 F. Supp. 3d 980, 984 (C.D. Cal. 2014) ("Because court filings are 'capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned,' pleadings filed and orders issued in related litigation are proper subjects of judicial notice under Rule 201."). However, judicial notice is not necessary or warranted as to decisions by other courts. Each party has cited cases favorable to its position as non-binding precedent. As in any matter, such opinions may be considered "without a party requesting that they be judicially noticed." *Id*. (quoting *Lucero v. Wong*, No. C 10-1339 SI (pr), 2011 WL 5834963, at *5 (N.D. Cal. Nov. 21, 2011)). Accordingly, the Requests for Judicial Notice are **DENIED** as to these documents.

Although the materials submitted to insurance regulators, created by other insurance entities or posted on Plaintiff's website are related to the issues presented by the Motion, they are not determinative. Accordingly, Defendant's First RFN and Plaintiff's First RFN are **MOOT** to the extent they seek judicial notice of such documents.

Finally, Plaintiff's Third RFN seeks judicial notice of materials filed in *Hartford Fire Ins. Co. v. Moda LLC, et al.*, Case No. UWY-CV20- 6056095-S, an action pending in the Connecticut Superior Court. These materials are offered to support Plaintiff's argument that regulatory estoppel bars the application of the Virus Exclusion. Because, as discussed below, that doctrine is not available in California, Plaintiff's Third RFN is denied as **MOOT**.

III. Analysis

A. Legal Standards

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

When a claim for relief depends on fraud, the party must "state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b). To satisfy this heightened pleading requirement, the plaintiff must identify "'the who, what, when, where, and how' of the misconduct charged." *Kearns v. Ford Motor Co.*, 567 F.3d 1120, 1124 (9th Cir. 2009) (quoting *Vess v. Ciba-Geigy Corp. USA*, 317 F.3d 1097, 1106 (9th Cir. 2003)).

Fed. R. Civ. P. 12(b)(6) permits a party to move to dismiss a cause of action that fails to state a claim. It

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

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

B. Application

1. Choice of Law

a) Legal Standards

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

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

b) Application

Plaintiff argues that New Jersey law, rather than California law, applies to this dispute. The first step in considering this issue is to determine whether there is a material conflict in the laws of these two states. *Wash. Mut. Bank, FA v. Superior Court*, 24 Cal. 4th 906, 919-20 (2001) ("The fact that two or more states are involved does not in itself indicate there is a conflict of laws problem…if the relevant laws of each state are identical, there is no problem[.]").

The parties agree that New Jersey has adopted the doctrine of regulatory estoppel. It is "used to preclude insurers from taking a position contrary to one allegedly presented to a regulatory agency." *Nammo Talley Inc. v. Allstate Ins. Co.*, 99 F. Supp. 3d 999, 1005 (D. Ariz. 2015) (citing *Morton Int'l, Inc. v. Gen. Acc. Ins. Co. of Am.*, 629 A.2d 831 (N.J. 1993)). *But see Delaware Valley Plumbing Supply, Inc. v. Merchants Mut. Ins.*, ___ F. Supp. 3d ___, 2021 WL 567994, at *5 (D.N.J. Feb. 16, 2021) ("The Court's research has turned up very sparse case law in New Jersey regarding regulatory estoppel, with the cases citing the doctrine seeming to relate almost entirely to the specific type of clause, a standard pollution exclusion, at issue in the *Morton* case.").

California has not adopted the doctrine of regulatory estoppel. *See Pez Seafood DTLA, LLC v. Travelers Indemnity Co.*, ___ F. Supp. 3d ___, 2021 WL 234355, at *7 n.6 (C.D. Cal. Jan. 20, 2021) (quoting 1 Barbara O'Donnell, Law & Prac. Of Ins. Coverage Litig. §§ 1:15-16 (2020)). Extrinsic evidence may only be used to support a reasonable construction of ambiguous language. Thus, California courts have considered the drafting history of insurance policies, including representations made to regulatory agencies, as part of the determination of the meaning of ambiguous language. *See MacKinnon v. Truck Ins. Exch.*, 31 Cal. 4th 635, 653 (2003) ("The history and purpose of the clause, while not determinative, may properly be used by courts as an aid to discern the meaning of disputed policy language."); *Montrose v. Chemical Corp. v. Admiral Ins.*, 10 Cal. 4th 645, 671 (1995) ("[W]e find the drafting history relevant in evaluating Admiral's argument that, from a public policy standpoint, the insurance industry will be harmed by the adoption of a continuous injury trigger that the industry assertedly never anticipated would be applied to these policies."). However, when policy language is clear and unambiguous, it is unnecessary to rely on such evidence. *See, e.g.*, *ACL Technologies, Inc. v. Northbrook Prop. & Casualty Ins.*, 17 Cal. App. 4th 1773, 1790 (1993) (when policy language is clear, introducing drafting history "is inconsistent with the rules of insurance contract interpretation articulated in *Bank of the West* and *AIU*").

A difference between the laws of two states is material when it would lead to a different result in the matter at issue. *Stonewall Surplus Line Ins. Co. v. Johnson Controls, Inc*., 14 Cal. App. 4th 637, 645 (1993). There is such a material difference here because New Jersey law permits the use of regulatory estoppel to override the plain language of an insurance contract; California law does not. In its decision adopting the doctrine, the Supreme Court of New Jersey expressly "declin[ed] to give effect to the literal provisions" of an exclusion clause. *Morton Int'l*, 629 A.2d at 875. Accordingly, the application of New Jersey law could lead to an outcome-determinative interpretation of the Virus Exclusion clause.

Because a conflict has been identified, the next step is to apply the test set forth in Section 1646. This favors the application of California law. The Complaint alleges that the insurance contract was "to be performed" in Los Angeles County. Dkt. 1-1 ¶ 11. The insured properties are in California and Arizona.

Id. at 341. Therefore, the application of California law is proper.[1] *See Frontier Oil*, 153 Cal. App. 4th at 1461 (intended place of performance of a liability insurance policy is the location of the insured risk). Even if there were ambiguity as to where the contract should be performed, the Complaint also alleges that the contract was entered in Los Angeles County. Dkt. 1-1 ¶ 11. Accordingly, the second prong of Section 1646 also favors the application of California law.

Plaintiff argues that the choice-of-law matter presents factual issues inappropriate for resolution on a motion to dismiss. California courts recognize that in limited circumstances, the choice-of-law inquiry may require an evidentiary hearing on disputed facts. *See, e.g.*, *Mencor Enters. v. Hets Equities Corp.*, 190 Cal. App. 3d 432, 440-41 (1987). However, there is no factual dispute here. The only facts relevant to the Section 1646 inquiry -- the place of performance and the place where the contract was made -- are clearly alleged and undisputed. Thus, determining the intended place of performance does not "depend on the credibility of extrinsic evidence." *Frontier Oil*, 153 Cal. App. 4th at 1450-51. Although Plaintiff argues that further discovery is needed to determine whether New Jersey has a compelling interest in the application of the regulatory estoppel doctrine. However, because that issue is not relevant under Section 1646, *id.* at 1462, no discovery is needed.[2]

Plaintiff also argues that the doctrine of dépeçage requires that a choice-of-law analysis be made for each issue presented by the action, and that New Jersey's interests may require regulatory estoppel to apply while California law governs other aspects of the case.[3] However, regulatory estoppel is neither a claim or cause of action in this matter. Rather, it is a rule of contract interpretation. Because Section 1646 mandates that California law should apply, New Jersey's doctrine is not applicable.

* * *

For the foregoing reasons, California insurance contract law applies in this action.

2. Whether There Is Coverage

a) Legal Standards

Under California law, an insured has the initial burden of establishing "that the occurrence forming the

[1] Neither party has suggested that Arizona law applies, although certain of the insured properties are located there. However, like California, Arizona has not adopted the doctrine of regulatory estoppel. *Nammo Talley*, 99 F. Supp. 3d at 1005. Therefore, the outcome here is not affected by the consideration of California law.

[2] If the governmental interest analysis applied to whether there is regulatory estoppel, substantial questions would be presented as to New Jersey's continued interest in applying this rule. *See Costco Wholesale*, 472 F. Supp. 2d at 1202 (strength of state's commitment to rule is relevant to whether its interest would be impaired). The New Jersey Supreme Court has rejected the proposition that New Jersey has a broad interest in applying the regulatory estoppel doctrine. Rather, whether it applies is determined by considering the locations of the insureds and of the insured property. *See Pfizer Inc. v. Employers Ins. Co. of Wausau*, 712 A.2d 634, 641 (N.J. 1998) (*Morton Int'l* did not apply to dispute involving New Jersey insurer, when policyholders were "from another state and waste sites in yet others"). Other federal district courts have noted that the doctrine has only been applied to a specific type of pollution exclusion clause. *Delaware Valley Plumbing Supply*, 2021 WL 567994, at *5.

[3] This argument was the subject of Defendant's Objection, on the grounds that a supplemental notice of authority was an improper place to make such an argument. That objection is **OVERRULED**.

basis of its claim is within the basic scope of insurance coverage.... [O]nce an insured has made this showing, the burden is on the insurer to prove the claim is specifically excluded." *Aydin Corp. v. First State Ins. Co.*, 18 Cal. 4th 1183, 1188 (1998) (internal citations omitted).

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

A term of an insurance policy is ambiguous when its language "is capable of two or more constructions, both of which are *reasonable*." *Bay Cities Paving & Grading, Inc. v. Lawyers' Mut. Ins.*, 5 Cal. 4th 854, 867 (1993) (emphasis in original and citation omitted). The absence of a definition does not itself create ambiguity. *Id.* at 866 (quoting *Bank of the W.*, 2. Cal. 4th at 1264-65). When policy language is ambiguous, courts "must admit a party's offered extrinsic evidence if it is relevant to prove a contract 'is reasonably susceptible' to the meaning the party alleges." *Aerotek, Inc. v. Johnson Grp. Staffing Co.*, 54 Cal. App. 5th 670, 683 (2020) (citing *Pac. Gas & E. Co. v. G.W. Thomas Drayage etc. Co.*, 69 Cal. 2d 33 (1968)). *See also Lee v. Fidelity Nat. Ins. Co.*, 188 Cal. App. 4th 583, 598 (2010) ("In determining whether an ambiguity exists, a court should consider not only the face of the contract but also any 'extrinsic evidence that supports a reasonable interpretation.'") (quoting *Am. Alternative Ins. Corp. v. Superior Court*, 135 al. App. 4th 1239, 1246 (2006)).

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

b) Application

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

Business Income provides for payment when "direct physical loss of or damage to property" causes a suspension in operations. Dkt. 1-1 at 89. Defendant argues that neither the suspected presence of COVID-19 nor the Public Health Orders qualify as "direct physical loss of or damage to property."

Under California law, physical loss or damage is "widely held to exclude alleged losses that are intangible or incorporeal, and, thereby, to preclude any claim against the property insurer when the insured merely suffers a detrimental economic impact unaccompanied by a distinct, demonstrable, physical alteration of the property." *MRI Healthcare Center of Glendale, Inc. v. State Farm Gen. Ins.*,

187 Cal. App. 4th 766, 779 (quoting 10A Couch on Insurance (3d ed. 2010) § 148.46, p. 148-81).

District courts in the Ninth Circuit have reached different outcomes as to whether the presence of the COVID-19 can cause physical loss or damage to an insured property. Many have concluded that the alleged presence of COVID-19 is not sufficient, because "disinfectant and other cleaning methods can be used to remove or lessen the virus from surfaces." *Unmasked Management, Inc. v. Century-National Ins. Co.*, ___ F. Supp. 3d ___, 2021 WL 242979, at *6 (S.D. Cal. Jan. 22, 2021) (collecting cases). Others have held that the presence of COVID-19 constitutes a "physical intrusion that compromises the physical integrity of property." *Pez Seafood DTLA*, 2021 WL 234355, at *4-5. The latter approach is adopted here. On a motion to dismiss, this gives appropriate weight to potential factual disputes as to the necessary extent of cleaning and other remedial measures.

The Complaint sufficiently alleges that respiratory droplets, which transmit COVID-19, are physical objects that may attach to surfaces. Dkt. 1-1 ¶¶ 17, 19-20. Construing the allegations in the Complaint as true, it cannot be determined, as a matter of law, that the "statistically certain" presence of COVID-19 in Plaintiff's restaurants could not cause a "direct physical loss of or damage to property."

In contrast, the Complaint does not sufficiently allege that the Public Health Orders caused "direct physical loss of or damage to property." Most district courts in the Ninth Circuit have concluded that such orders do not cause physical loss or damage. *See, e.g.*, *Pez Seafood DTLA*, 2021 WL 234355, at *4-5 (collecting cases); *Plan Check Downtown III, LLC v. AmGuard Ins. Co*., 485 F. Supp. 3d 1225, 1231-32 (C.D. Cal. 2020); *but see Kingray, Inc. v. Farmers Group, Inc.*, ___ F. Supp. 3d ___, 2021 WL 837622, at *7-*8 (C.D. Cal. Mar. 4, 2021) ("[I]t is plausible that 'direct physical loss of' property includes physical dispossession because of…a civil authority order requiring [the property] to close."). The Public Health Orders temporarily restricted Plaintiff's use of the Property, but they did not physically alter the Salon or permanently take the Property from Plaintiff. *See Mudpie, Inc. v. Travelers Cas. Ins. Co. of Am*., 487 F. Supp. 3d 834, 839 (N.D. Cal. 2020). Accordingly, the Public Health Orders are not a sufficient basis for coverage.

(2) Civil Authority

With respect to Civil Authority, the Policy provides:

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

the damaged property.

Dkt. 1-1 at 90.

As stated above, the Complaint plausibly alleges that the presence of the virus caused a covered loss. It also alleges that the virus was present at numerous restaurants, bars, and other facilities within one mile of Plaintiff's properties. *Id.* ¶ 37. To the extent that the presence of COVID-19 qualified as a covered cause of loss, *i.e.*, that it is not excluded from coverage, Plaintiff states a claim as to this potential coverage.

(3) Dependent Properties Coverage

As to Dependent Properties, the Policy provides:

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

Dkt. 1-1 at 155-56.

As stated above, the Complaint plausibly alleges that the presence of the virus would cause a covered loss. However, it does not allege that the virus was at such dependent properties. Rather, the Complaint alleges that the Public Health Orders "caused direct physical loss of or damage to properties Madera depends on to attract business to its insured restaurants." *Id.* ¶ 36. As discussed above, the Public Health Orders do not cause physical loss or damage.

* * *

For the foregoing reasons, the Complaint sufficiently alleges that certain of Plaintiff's claims fall within the scope of coverage. Therefore, the question is whether any exclusion bars coverage.

3. Whether the Virus Exclusion Applies

a) Positions of the Parties

Defendant contends that the Virus Exclusion unambiguously applies to all of Plaintiff's claims for coverage. Plaintiff disagrees for several reasons. *First*, Plaintiff argues that a motion to dismiss is an improper means to resolve whether the Virus Exclusion applies because such a determination must be based on conclusive evidence. *Second*, Plaintiff argues that the word "virus" should be read in together with other words used in the same part of the Policy*, e.g.,* "wet rot" and "fungi." Because the global

pandemic of COVID-19 is far more severe than these other excluded harms, Plaintiff argues that the Virus Exclusion cannot reasonably cover COVID-19. *Third*, Plaintiff argues that the failure expressly to exclude "pandemics" gives rise to an inference that the Virus Exclusion does not apply to COVID-19. *Fourth*, Plaintiff argues that the virus may not be the "proximate cause" of the claimed damages. *Finally*, Plaintiff argues that regulatory estoppel bars the application of the Virus Exclusion.

b) Application

(1) Plain Text of the Virus Exclusion

The Complaint alleges that, in response to the COVID-19 pandemic, state and local governments issued Public Health Orders that caused Plaintiff's restaurants to close. Dkt. 1-1 ¶¶ 30-33. The Complaint also alleges that COVID-19 is a highly infectious virus, and that it is statistically certain that the virus was present in Plaintiff's restaurants. *Id.* ¶¶ 15, 91.

The Virus Exclusion unambiguously applies. COVID-19 is a virus that "induces or is capable of inducing physical distress, illness, or disease." Dkt. 1-1 at 128. Any alleged loss caused by the actual or suspected presence of COVID-19 in Plaintiff's restaurants is due to the virus, and is barred by the plain language of the Exclusion. Further, California courts give a "consistently broad interpretation" to phrases such as "resulting from," requiring only a "minimal causal connection or incidental relationship." *St. Paul Fire and Marine Ins. v. Am. Dynasty Surplus Lines Ins.*, 101 Cal. App. 4th 1038, 1051 (2002). Given this minimal causal burden, any loss caused by the Public Health Orders was also due to the COVID-19 virus.

Although Plaintiff argues that this determination cannot be made without "conclusive evidence," the allegations in the Complaint make clear that the COVID-19 pandemic, which is viral in nature, is the basis for the claimed coverage. The Public Health Orders attached to the Complaint also state that they are being issued to combat COVID-19. *See, e.g.*, Dkt. 1-1 at 349 (emergency order from Mayor of Los Angeles, stating: "While we have previously taken strong action, now the City must adopt additional emergency measures to further limit the spread of COVID-19"). Finally, Plaintiff's position as to Business Income Coverage -- that the presence of COVID-19 on surfaces in Plaintiff's restaurants constitutes physical damage -- confirms that the virus is central to Plaintiff's claims. California courts have resolved the legal question of whether an exclusion applies when it is clear from the pleadings. *See, e.g.*, *Alterra Excess & Surplus Ins. Co. v. Snyder*, 234 Cal. App. 4th 1390, 1401 (2015).

(2) Whether Plaintiff Can Show That the Virus Exclusion is Ambiguous

The language in the Virus Exclusion is not ambiguous. However, even if there is ambiguous language, the proffered interpretation must be "consistent with the *objectively reasonable* expectations of the insured." *ACL Technologies*, 177 Cal. App. 4th at 1788 (emphasis in original). Given that the Virus Exclusion covers "loss or damage caused by or resulting from any virus," the contention that it does not apply to a viral pandemic is not objectively reasonable. Imposing this limiting construction, which conflicts with the text of the Exclusion, would amount to a "forced construction" of the Policy. *First Am. Title Ins.*, 177 Cal. App. 4th at 115.

Plaintiff has advanced several arguments in support of the claim of ambiguous language. None is persuasive. *First*, Plaintiff's contends that the words "fungi," "wet rot," and "dry rot" should be understood as limiting the scope of the Virus Exclusion. However, these terms appear in the Virus Exclusion to clarify that they are subject to a separate exclusion:

> [T]his exclusion does not apply to loss or damage caused by or resulting from "Fungus", wet rot or dry rot. Such loss or damage is addressed in a separate exclusion in this Coverage Part or Policy.
>
> The following provisions in this Coverage Part or Policy are hereby amended to remove reference to bacteria:
>
> 1. Exclusion of "Fungus", Wet Rot, Dry Rot And Bacteria; and
> 2. Additional Coverage - Limited Coverage for "Fungus", Wet Rot, Dry Rot And Bacteria, including any endorsement increasing the scope or amount of coverage.

Dkt. 1-1 at 128.

To support its position, Plaintiff relies on *Urogynecology Specialist of Florida LLC v. Sentinel Ins.*, 489 F. Supp. 3d 1297 (M.D. Fla. 2020). However, the insurance policy that was at issue there, grouped those terms together in a single exclusion. *Id.* at 1301.

Second, Plaintiff argues that the failure to refer to "pandemics" in the Virus Exclusion limits its scope. In general, "an insurance company's failure to use available language to exclude certain types of liability gives rise to the inference that the parties intended not to so limit coverage." *Fireman Funds Ins. Cos. v. Atlantic Richfield Co.*, 94 Cal. App. 4th 842, 852 (2001). However, the language of the Virus Exclusion clearly applies to pandemics caused by viruses or bacteria. Therefore, there was no need to add what would have been redundant language stating that damage caused by "pandemics" was excluded. As another district court observed, the term "pandemic… merely describes the geographical scope and effect of the virus on the population." *Pez Seafood DTLA*, 2021 WL 234355, at *7. *See also Boxed Foods Co., LLC v. Cal. Capital Ins. Co.*, 497 F. Supp. 3d 516, 523 (N.D. Cal. 2020) ("The Virus Exclusion's alleged failure to specify how widespread a disease must become to trigger the exclusion does not demonstrate that the exclusion is ambiguous.").

Third, in the Motion to Supplement, Plaintiff cites *Susan Spath Hegedus, Inc. v. ACE Fire Underwriters Insurance Co.,* ___ F. Supp. 3d ___, 2021 WL 1837479 (E.D. Pa. May 7, 2021), as supporting the view that the Virus Exclusion may not apply to business income and extra expense coverage losses. However, *Susan Spath Hegedus* held that "[a]mbiguities" in a different policy's "structure and organization" made it possible that a particular virus exclusion might only apply to Business Income and Extra Expense coverage. *Id.* at *11.[4] Here, the Virus Exclusion expressly applies to "business income, extra expense or action of civil authority" coverage. Dkt. 1-1 at 128.

[4] Judicial notice is taken *sua sponte* of that policy, which was filed as an exhibit to the complaint in that action. *Susan Spath Hegedus, Inc. v. Chubb Ltd. et al.*, No. 2:20-cv-02832-BMS, Dkt. 1-1 (E.D. Pa. Jun. 15, 2020). "[P]leadings filed and orders issued in related litigation are proper subjects of judicial notice under Rule 201." *McVey*, 26 F. Supp. 3d at 984; Fed R. Evid. 201(c)(1) (judicial notice may be taken sua sponte).

(3) Whether the Efficient Proximate Cause Doctrine Applies

The efficient proximate cause doctrine applies when "a loss is caused by a combination of a covered and specifically excluded risks." *Pyramid Techs, Inc. v. Hartford Cas. Ins.*, 752 F.3d 807, 820 (9th Cir. 2014) (quoting *Brown v. Mid Century Ins. Co.*, 215 Cal. App. 4th 841, 855 (2013)). Plaintiff argues that "to the extent virus was not present on Madera's premises and virus was only one of several links in a chain of causation leading to Madera's restaurants closing, if the predominate link is covered, coverage would exist despite the Exclusion." Dkt. 33 at 30. Such a chain of causation, however, is not alleged in the Complaint. The Complaint only alleges two sources of loss: the virus itself, and Public Health Orders, which were designed to slow and prevent the spread of the virus. Dkt. 1-1 ¶ 27 ("U.S. state and local governments issued orders suspending or severely curtailing the operations of… businesses in response to the virus. This included restaurants such as those owned and operated by Madera."); *id.* ¶ 28 ("In March 2020, states, counties, and cities where Madera's insured restaurants are located declared states of emergency to help prepare for broader spread of COVID-19."). No covered risks have been identified or alleged in the Complaint.

Susan Spath Hegedus held that the efficient proximate cause doctrine might bar the application of a similar virus exclusion. However, it is distinguishable. There, the court determined that California's closure orders were a distinct cause of loss separate from the virus, because "the virus remains a risk to business employees and customers... but businesses are no longer subject to the same operational restrictions." 2021 WL 1837479, at *10. "Regardless of what may have precipitated the closure order, the virus continues to exist." *Id.* In contrast, the Complaint in this action includes express allegations that the Public Health Orders were caused by COVID-19. The Public Health Orders attached to the Complaint also state that they were issued as a direct response to COVID-19. *Id.* at 349 (city of Los Angeles order states that the city "must adopt additional emergency measures to further limit the spread of COVID-19"); *id.* at 358 (city of San Diego order states that "restrictions… remain necessary because of the propensity of the [COVID-19] virus to spread person to person and also because COVID-19 physically causes property loss and damage"); *id.* at 363 (Santa Barbara County order states it is meant to "slow the spread of COVID-19 to the maximum extent possible"); *id.* at 369 (Napa County order states it is meant to "further slow transmission of Novel Coronavirus Disease 2019 ('COVID-19')").

For the foregoing reasons, the efficient proximate cause doctrine does not apply.

(4) Whether Regulatory Estoppel Applies

Plaintiff argues that California law recognizes regulatory estoppel, and that its application warrants a different interpretation of the Virus Exclusion. This position is not persuasive. Although California courts have considered the drafting history of certain exclusions, they did so under circumstances in which the exclusion at issue was susceptible to more than one reasonable interpretation. For example, *MacKinnon* considered the meaning of a pollution exclusion in commercial general liability insurance policies. 31 Cal. 4th at 649. The insurance company argued for a broad reading of the term "irritant or contaminant," and cited dictionary definitions to support its position. *MacKinnon* found this reading implausible, noting that "[v]irtually any substance can act under the proper circumstances as an 'irritant or contaminant.'" *Id.* at 650. The drafting history of the pollution exclusion supported this conclusion: "[t]he history and purpose of the clause, while not determinative, may properly be used by courts as an

aid to discern the meaning of disputed policy language." *Id.* at 653.

This was not an adoption of the policy of regulatory estoppel, but a straightforward application of the general rule that extrinsic evidence may be admitted as part of the analysis of a reasonable interpretation of disputed language. As noted above, New Jersey law permits regulatory estoppel to override the plain language of a contract. That position has not been adopted in California. Because Plaintiff's construction of the Virus Exclusion is not reasonable, extrinsic evidence need not be considered. *Cf. ACL Technologies*, 17 Cal. App. 4th at 1791.

The parties disagree as to whether, if regulatory estoppel were to apply, the alleged misstatements by insurers would be sufficient to support a claim of regulatory estoppel. District courts applying Pennsylvania and New Jersey law have held that the 2006 ISO Circular does not reflect a later change in position that would support a regulatory estoppel claim. *Delaware Valley Plumbing Supply*, 2021 WL 567994, at *5-6 ("[T]he claim's denial is premised upon the very same reasons advanced to justify approval of the virus exclusion in the first place."); *Newchops Restaurant Comcast LLC v. Admiral Indemnity Co.*, ___ F. Supp. 3d ___, 2020 WL 7395153, at *10 (E.D. Pa. Dec. 17, 2020) (same); *Brian Handel D.M.D., P.C. v. Allstate Ins. Co.*, 499 F. Supp. 3d 95, 101 (E.D. Pa. 2020) (same). The parties also disagree as to whether the alleged misstatements are pleaded with particularity, as required by Fed. R. Civ. P. 9(b). Because regulatory estoppel does not apply, it is not necessary to reach these issues. Accordingly, the Motion to Supplemental Record is **MOOT**.

* * *

For the foregoing reasons, the Virus Exclusion bars Plaintiff's claims for coverage. This determination is bars the causes of action for declaratory judgment and breach of contract.

C. Whether Leave to Amend Should be Granted

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

District courts have made different determinations as to whether leave should be granted in similar circumstances. *Compare Boxed Foods Co.*, 497 F. Supp. 3d at 526 ("[A]ny attempt to amend the Complaint would be futile considering the breadth of the Virus Exclusion") *with Mudpie*, 487 F. Supp. 3d at 845 (leave to amend granted given that "the law concerning business interruption coverage linked to the COVID-19 pandemic is very much in development").

Based on a review of the Complaint and other filings made by Plaintiffs, leave to amend is granted; provided, however, any amended complaint must be based on good faith allegations that sufficiently state claim(s) on grounds that have not already been addressed and rejected in this Order.

IV. Conclusion

For the reasons stated in this Order, the Motion is **GRANTED WITHOUT PREJUDICE**, *i.e.*, with leave

to amend. Any amended complaint, or a statement that Plaintiff does not intend to file an amended complaint, shall be filed on or before July 16, 2021. If an amended complaint is not filed, the action will be dismissed with prejudice.

IT IS SO ORDERED.

_____ : _____

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