

# Diversity and Direct Physical Loss Coverage Update

October 16, 2023

## Diversity and Direct Physical Loss – Fifth Circuit (Texas Law)

*LNy 5003, LLC v. Zurich Am. Ins. Co.*

No. 22-20573, 2023 WL 6621677 (5th Cir. Oct. 11, 2023)

Subsidiaries of Fertitta Entertainment, Inc. and Fertitta Hospitality, LLC (the Fertitta entities) owned 17 restaurants around the world, which included several high-end chains. The restaurants owned by the Fertitta entities suffered significant business losses as a result of the COVID-19 pandemic and sought insurance coverage from Zurich American Insurance Company, which denied coverage.

The Fertitta entities assigned their claims to LNY 5003, an entity that shared Illinois citizenship with Zurich, which filed suit in a Texas state court. Zurich removed the action to federal court in Texas. The Fertitta entities sought to remand, which the trial court denied. The trial court also granted Zurich's motion to dismiss.

The appellate court first examined the federal trial court's jurisdiction. The appellate court started by reviewing the Fertitta entities' assignment to LNY 5003 and held that it was invalid. First, the assignment violated the insurance policy's anti-assignment clause. Second, the appellate court recognized that the sole purpose of the assignment was to destroy diversity. As a result, the appellate court upheld the trial court's denial of the request for remand.

The Fertitta entities also appealed the trial court's ruling on a motion to dismiss in Zurich's favor. The appellate court noted that, "[a]ccording to the operative complaint, these losses were due to the presence of COVID-19 on the premises, the ensuing public panic, and related local government lockdown orders." The complaint further alleged that the presence of the COVID-19 virus altered the covered properties by rendering them unsafe.

The appellate court ruled that these allegations did not allege "direct physical loss of property" which means "a tangible alteration or deprivation of property." The suspension of services, resulting from the presence of a virus, does not constitute "direct physical loss of property." The appellate court reasoned that "contamination of objects or properties by COVID-19 is transient and does not physically alter them."

DIVERSITY AND DIRECT PHYSICAL LOSS COVERAGE UPDATE Cont.

By: Patrick Winters