

1 THE SUPERIOR COURT OF THE STATE OF CALIFORNIA
2 FOR THE COUNTY OF MONTEREY

CERTIFIED COPY

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4 The Inns by the Sea)
5 vs.) CASE NO. 20CV001274
6 California Mutual Insurance)
7 Company)
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8 REPORTER'S TRANSCRIPT OF PROCEEDINGS

9 MONDAY, AUGUST 4, 2020

10 BEFORE THE HONORABLE LYDIA M. VILLARREAL, JUDGE

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13 APPEARANCES:

14 FOR PLAINTIFF: SAM FERGUSON
(APPEARING ON COURT CALL) ATTORNEY AT LAW
15
16 MICHAEL J. REISER
ATTORNEY AT LAW
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18 FOR DEFENDANT: RYAN Z. KELLER
(APPEARING ON COURT CALL) ATTORNEY AT LAW
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20 STEVEN HAYES
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24 REPORTED BY: JAMIE L. SETTERQUIST CSR 13362
25 OFFICIAL COURT REPORTER
MONTEREY COUNTY SUPERIOR COURT

1 MONTEREY, CA; Monday, August 6, 2020; 9:24 A.M.

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3 P R O C E E D I N G S

4 THE COURT: Inns by the Sea versus California
5 Mutual Insurance Company.

6 MR. KELLER: Good morning Your Honor. Ryan
7 Keller on the phone for Defendant, California Mutual
8 Insurance Company. I also have Steven Hayes from my
9 office on the phone.

10 THE COURT: I appreciate you doing it, but
11 it's easier for me if I do it. Sam Ferguson for Inns by
12 the Sea?

13 MR. FERGUSON: Good morning. Sam Ferguson for
14 Inns by the Sea.

15 THE COURT: Thank you very much. Steven Hayes
16 for California Mutual?

17 MR. HAYES: Good morning, your Honor.

18 THE COURT: And who is going to be speaking on
19 behalf of California Mutual? Will it be Mr. Hayes or
20 Mr. Keller?

21 MR. KELLER: Mr. Keller, your Honor.

22 THE COURT: Thank you very much. Mr. Keller
23 on behalf of The Inns by the Sea.

24 MR. REISER: Good morning, your Honor.
25 Michael Reiser.

1 THE COURT: And who will be speaking on behalf
2 of plaintiffs?

3 MR. FERGUSON: Sam Ferguson of the Meade Law
4 Firm will be speaking on behalf of Inns by the Sea as
5 plaintiffs.

6 THE COURT: All right. Thank you so much. So
7 I have gone over what you filed, and let me just start
8 by saying the economic damage caused by COVID is just
9 heartbreaking, and this case is yet one more of the
10 heartbreak.

11 There are two things that are of concern to
12 me. It seems to me that the language of the policy
13 supported the defendant's position that it talks about
14 the business suspension must be caused by direct
15 physical loss of or damage to property at the premises,
16 and it seems that the cases for the most part are --
17 seek to address some sort of physical destruction or
18 physical change in usefulness, and I am not sure that
19 COVID creates that physical change.

20 Now, what I think gives me pause is that I am
21 trying to understand the other cases that have been
22 referenced by the plaintiffs, and that is that smoke
23 damage is considered physical damage, persistent E. Coli
24 infestation is physical, gasoline vapors are physical,
25 carbon monoxide saturation is physical, and certainly

1 large quantities of asbestos in the air is considered
2 physical.

3 So I am just wondering whether or not COVID is
4 enough like these other things such that it should be
5 covered.

6 So that is sort of my thoughts, and let me
7 just start with Mr. Ferguson.

8 MR. FERGUSON: Thank you, your Honor. To
9 directly address your concerns here, I think there is an
10 important way we can view all of the cases you mentioned
11 of smoke damage, E. Coli, gas vapors, carbon monoxide,
12 and one way to view those cases is view the atmosphere
13 in the air within the insured property as part of the
14 physical premises of the property. I think this is
15 exactly what the *Oregon Shakespeare* case does, which as
16 you mentioned the case of smoke infestation of the
17 *Oregon Shakespeare Festival*, and one way to think about
18 coronavirus, there is actually a contamination of the
19 air within the physical spaces that results in a change
20 on the molecular level of the composition of the air and
21 space.

22 What these cases hold is that when there is a
23 physical change or when there is a physical invasion of
24 a harmful substance that renders a space functionally
25 useless, you have direct physical loss of or damage to

1 property within insurance coverage.

2 And now, your Honor, I certainly sympathize
3 with your struggle over whether coronavirus is similar
4 enough to smoke, E. Coli, gas vapors, carbon monoxides,
5 and asbestos, but it does seem to me that those concerns
6 raise a factual question of what are the characteristics
7 of coronavirus? How present was it on this premises?
8 How dangerous was it and what quantities? Those are all
9 factual questions that can be addressed in discovery.

10 And with respect to the demurrer, the
11 defendants are making a legal point here. They are
12 saying under no circumstances does our policy -- does
13 our insurance policy provide coverage for the insured in
14 the absence of tangible alteration to the property.

15 Now, I think as we point out in our brief --
16 and I won't belabor the point -- that is not actually
17 consistent with the language of their own policy, and
18 one of the primary interpretative goals in looking at
19 the insurance policy is you need to make sure that every
20 word in that policy makes sense. You can't reach an
21 interpretation of a policy that renders superfluous
22 language.

23 To point out the obvious, defendant excludes
24 from coverage the mere presence of bacteria. Now, that
25 exclusion only makes sense if it is against a backdrop

1 of damage that goes beyond tangible alteration of the
2 property. There would be no reason to exclude the
3 presence of bacteria if the policy only covered tangible
4 alteration to property.

5 So, your Honor, I think that addressed your
6 concern, and I will leave it there for now. I am happy
7 to speak more at length about other issues, but I will
8 leave it there for right now.

9 THE COURT: Well, let me ask you another
10 question about that. When I was struggling with the
11 smoke damage, gasoline vapors, et cetera, the
12 distinction in my mind -- and I don't know if this is
13 one that is valid or not, Mr. Ferguson -- the
14 distinction in my mind is that when California shut
15 down, when the Governor ordered us all to shelter in
16 place and businesses to close, it wasn't necessarily
17 because there was COVID at your hotels. It was because
18 there was a fear that COVID might arrive at your hotels,
19 and there was a fear by having people move around the
20 state, that that would cause us all to infect each
21 other.

22 So even if we assume that COVID infects the
23 air, which I get your point on that, I think the science
24 supports you on that, but I guess the question I have
25 is, was that the cause?

1 MR. FERGUSON: So, your Honor, to address your
2 concerns here, I think it is important to understand
3 that there are two independent possible sources of
4 coverage here. The first is the business interruption
5 insurance coverage, which would be triggered by the
6 physical presence of coronavirus on the insured
7 premises. That is our property, and that is what we
8 allege is our burden to prove that once we get into
9 discovery.

10 But I think on the allegations, we certainly
11 have met the requirements for the complaint that we have
12 alleged that there was coronavirus on the premises,
13 which caused physical loss of or damage to the premises.

14 The other independent source coverage that we
15 have under this policy is civil authority coverage, and
16 that doesn't require that there even be coronavirus on
17 our property. It merely requires that there is direct
18 physical loss of or damage to property somewhere else,
19 and that the civil authority take action based on the
20 presence of coronavirus on another property.

21 Now the coronavirus is widespread in both of
22 the county orders. The San Mateo County order and
23 Monterey County order mentioned there is coronavirus
24 virus within both of the counties. They mention
25 specific case numbers. They mention case numbers up in

1 the Bay Area. It is clear in our mind that the local
2 county authority and the Governor are responding to the
3 physical presence of coronavirus in enacting the shelter
4 in place order.

5 And to underscore the point, this is about the
6 physical presence of coronavirus. I think those orders
7 are designed to require people to avoid direct, physical
8 contact with the virus. That is the key issue here.
9 150,000 people in this county have died because they
10 have come into physical contact with the virus.

11 I think that the virus is certainly physical,
12 and the orders are in response to the physical presence
13 of the virus that is at other locations and inside the
14 insured premises.

15 THE COURT: Okay. So let me make sure I am
16 understanding you. So the business income is lost
17 because of the civil authority shutdown. Doesn't that
18 also require a direct physical loss, and don't we still
19 come back to the same problem of whether or not COVID
20 causes a physical loss?

21 MR. FERGUSON: Yes; that is correct, your
22 Honor. To trigger the civil authority coverage, it is
23 our burden in discovery to show that there was
24 coronavirus on another property.

25 And what is interesting about the civil

1 authority coverage in this insurance policy is it is
2 written incredibly broadly. Typically, in other civil
3 authority provisions, there is actually a proximity
4 requirement. In our case, there actually is no such
5 proximity requirement.

6 So we believe that there was the physical
7 presence of coronavirus that caused a loss of or damage
8 to property essentially anywhere within two counties.
9 And as a result of that, the civil authority within the
10 county's order to ensure premises to be shut down.

11 So when you look at the claim for civil
12 authority in the context of this case and the context of
13 the policy that is in front of you, we think that we
14 sufficiently allege that there is direct physical loss
15 of or damage to other premises, and if we can carry that
16 burden after the demurrer in discovery, then we win this
17 case.

18 But I think all you have to do right now is
19 ask yourself, can the coronavirus cause direct physical
20 loss of or damage to any property? And again, we would
21 submit that under the 16 cases we cited, the test is
22 whether there is a presence of a hazardous substance,
23 and whether the quantity of that substance renders the
24 property dangerous to human health and renders the
25 property unusable, we think that there is no tangible

1 alteration to the property required under this policy.

2 So our burden to invoke code civil authority
3 coverage is to show that somewhere within the County of
4 Monterey or the County of San Mateo that there was
5 coronavirus in such concentration that some property was
6 rendered uninhabitable or unusable because of the
7 concentration of coronavirus. And we certainly think we
8 can meet that burden in discovery, but for now, the
9 Court has to merely analyze whether we alleged enough to
10 meet that bar.

11 THE COURT: Thank you. Mr. Keller?

12 MR. KELLER: Yes, your Honor. So I think that
13 your analysis is spot-on and exactly how you should be
14 looking at these issues. So let me first address the
15 issue that gave you pause.

16 So the courts outside of California, as you
17 mentioned, got into issues like asbestos and carbon
18 monoxide, and those are, as you point out, ultimately
19 not just directed at losses. It also needs to have the
20 business income loss be caused by that direct physical
21 loss. Like the carbon monoxide situation, it's,
22 Everybody out of the building. You are going to die
23 from carbon monoxide.

24 The asbestos, there is direct health problems.
25 There is a smell that is related to a lot of those

1 claims that you are referring to. And so to have
2 everybody out of the building, that causes the business
3 income loss.

4 Here, the Court need not turn a blind eye to
5 the realities of the pandemic and the business situation
6 where the businesses are open while this pandemic is
7 still ongoing, and that's a result of the fact that it
8 is designed to keep people socially distanced and reduce
9 the spread of the pandemic, and that is why the the
10 shelter is in place so they don't prohibit access of
11 civil authority coverage requires to even allow the
12 hotels to keep people there, which they couldn't in the
13 case of a carbon monoxide, asbestos situation.

14 And further, those cases, again, are outside
15 of California. The direct physical requirement as
16 prefix to the insurance agreement have to be considered
17 under the context for *MRI Healthcare*, and *MRI Healthcare*
18 says that it's excluded and accompanied by demonstrable
19 physical alteration of the property.

20 So I believe that when you follow the analysis
21 of the policy language under the California case in *MRI*
22 *Healthcare*, that it is not a business income loss caused
23 by direct physical damage to property, and the plaintiff
24 has certainly not alleged that. At most, they've
25 alleged a physical presence on the property of the virus

1 and not that that has caused the business income loss,
2 nor can they because as I noted, they could have had
3 people there. They chose to cease and close down based
4 on the counties' orders, and that was the cause of their
5 loss.

6 THE COURT: Well, let me just correct you. I
7 don't think they chose to shut down. They were ordered
8 to shut down.

9 MR. KELLER: Yes. They followed the shelter
10 in place orders, and they -- what I meant by that was
11 there was some level of operations that they could have
12 had under the county order such as maybe economically
13 disadvantaged individuals that they still could have
14 provided shelter to. To completely shut down was not a
15 complete mandate by the counties.

16 But irrespective of that finer point, there is
17 no direct physical damage to property that caused the
18 business income loss.

19 THE COURT: Well, Mr. Ferguson, I completely
20 disagree with Mr. Keller that anyone had a choice. I
21 think we were all trying to follow the orders we were
22 given, but in spite of that issue, having looked at the
23 *MRI* case -- and I certainly agree with your
24 representation that once you get to the facts of the *MRI*
25 and the ramping up, the ramping down and all that, it

1 really is not at all like our case here.

2 However, I do think -- and help me with this,
3 Mr. Ferguson -- I do think the *MRI* case is intended to
4 be the framework by which we analyze these cases, and
5 that case pretty much says that because of the need for
6 a physical damage, that it precludes any claim in which
7 the insured suffered a detrimental economic impact
8 without the distinct, demonstrable physical alteration
9 of the property. Help me out with that, Mr. Ferguson.

10 MR. FERGUSON: Yes. So a couple points on
11 *MRI*, your Honor. First, the term 'physical, as the *MRI*
12 court understands it is, losses that are intangible or
13 incorporeal. That is what it is using to distinguish
14 against physical, and I don't think that we alleged an
15 intangible or incorporeal loss here.

16 We allege there are specific, physical
17 microbes within our property that are contaminating the
18 air that are hazardous to human health that are
19 rendering it unusable. And I think to adopt the
20 definition of direct physical loss of or direct physical
21 damage to property, that it excludes the situation where
22 you have an invasion by a physical force into the
23 atmosphere of your property onto all the surfaces of
24 your property and says that is not direct physical loss
25 of or damage to property, it can't be the case.

1 When an insured purchased insurance, they are
2 expecting that when there is a physical catastrophe that
3 shuts down their operation, the insurance coverage will
4 kick in and cover that, and I think that to the extent
5 that *MRI* case suggests that there has to be tangible
6 alteration in the sense that it is perceptible to the
7 eye or to touch, that is simply dicta in that case.
8 This Court is not required to follow *MRI Healthcare* on
9 that rationale.

10 *MRI Healthcare* actually could have said what
11 we are saying here. It could have said physical damage
12 actually does include the physical invasion by hazardous
13 substances that renders a property unusable, and the
14 outcome would have been exactly the same in *MRI*
15 *Healthcare*, and I am pointing that out to say that
16 discussion of the meaning of direct physical loss of or
17 damage to property wasn't central.

18 One other point about *MRI Healthcare* is the
19 language of coverage in that case and the relevant
20 policy is actually different. The language of coverage
21 in that policy, direct physical loss to or damage to
22 property. In our case, it is direct physical loss
23 of...property, and we think that difference in language
24 is critical as we have suffered a direct physical loss
25 of our property because it's been invaded, contaminated,

1 polluted by the hazardous substance that renders it
2 unfit for human use, and the government saw the same
3 hazard was present and ordered us to shut down our
4 operations as a consequence of that.

5 And, your Honor, I think you previously had
6 characterized the shutdown orders as requiring people to
7 distance. And while that is part of the orders, they
8 actually do go further than that, and this is critical.
9 This is paragraph three of the Monterey order: All
10 businesses within the facility in the county except
11 essential businesses are required to cease all activity
12 at facilities located within the county. That is a
13 direct shutdown and a closure of our business that
14 prohibits access to the business, which we think is
15 enough to trigger the civil authority coverage.

16 Mr. Keller has made the point that there were
17 very specific uses that we could have made about
18 properties under these orders. We could have sheltered
19 homeless people and possibly allowed a limited number of
20 individuals to use the hotel as a residence.

21 What he is trying to do is read into the civil
22 authority provision in our policy of requiring that
23 there be a total prohibition of access to the insured
24 premises. Well, that word 'total' doesn't actually
25 appear in our insurance policy. All it says is the

1 government prohibits access to your premises and has
2 done so as a consequence of a direct physical loss of or
3 damage to the properties elsewhere, then insurance
4 coverage kicks in.

5 I hope that addresses your concerns about *MRI*,
6 your Honor.

7 THE COURT: It is helpful. Thank you.
8 Mr. Keller, anything you would like to close with?

9 MR. KELLER: Yes, your Honor. So at the end
10 of the day, the virus, whether it is present on the
11 property or not, does not cause the business income
12 loss, which it is required to under the policy, and it
13 is not a direct physical loss as -- not a direct
14 physical damage to property as described by *MRI*
15 *Healthcare*.

16 And at the end of the day, they cannot allege
17 that there was a direct physical damage to property that
18 was, in fact, the cause of their business income loss.
19 Thank you.

20 THE COURT: Any last words, Mr. Ferguson?

21 MR. FERGUSON: Yes, your Honor. Thank you.
22 One last word is, I would urge the Court to reread *Ward*,
23 which is the other case that California Mutual cites
24 with the idea that you need a tangible alteration.

25 But what is critical in the *Ward* case is that

1 you have to analyze the scope of coverage within the
2 context of the claims that are asserted. And so, you
3 know, language that might appear unambiguous in the
4 context of one particular claim might eventually appear
5 ambiguous in the context of another claim.

6 So the two cases the defendant cites, *Ward* and
7 *MRI*, are in such different factual circumstances of
8 their own that I think, given the claims that we are
9 asserting, the scope of the coverage within the policy
10 has to be viewed within the lens of the claims that we
11 are asserting.

12 And given the claims that we are asserting, I
13 think that the insurance policy is, at a minimum,
14 subject to two reasonable constructions. One is that as
15 the defendants assert that there has to be physical
16 alteration to the property. The other is the
17 construction.

18 We think this is a reasonable interpretation,
19 and given the Court's struggle with how to resolve this
20 case, we think it's clear that reasonable minds can
21 differ on this. If that is the case, the tie goes to
22 the plaintiff as ambiguities are construed in favor of
23 the insured.

24 And, your Honor, one last point. California
25 Mutual actually has a virus exclusion that they include

1 in other policies. We raised this in the complaint. In
2 fact, in their reply, they cite the *Michigan* case where
3 the insurance policy issue in that case also had a virus
4 exclusion. This is a well-known exclusion that is
5 included in many, many, many policies throughout the
6 country, and many of the cases in the wave of COVID
7 litigation in the last few months are going to be
8 decided on that virus exclusion angle.

9 Our client has dutifully paid almost \$40,000 a
10 a year in insurance premiums to California Mutual under
11 a policy that does not have a virus exclusion. This is
12 critical, your Honor. The fact that California Mutual
13 and the insurance industry at large has a virus
14 exclusion very strongly suggests to us that they believe
15 a virus -- the presence of a virus can cause direct
16 physical loss of or damage to property. That was not
17 included in this policy.

18 California Mutual very easily could have
19 tacked on the word 'virus' using a comma after the word
20 'bacteria' in the bacteria exclusion. They could have
21 included the presence of virus from the insurance
22 policy, and they failed to do so.

23 So California Mutual having failed to define
24 the central term in this case, direct physical loss of
25 or damage to property, and having failed to include a

1 virus exclusion, we think the Court should adopt the
2 plaintiff's very reasonable construction of this
3 insurance policy and find that our allegation that there
4 is physical presence of coronavirus and hazardous
5 concentration on our property is sufficient to trigger
6 business income interruption insurance coverage, as well
7 as the fact that there is coronavirus-inhabited
8 concentration on other properties triggered the
9 government to close our facilities.

10 Or in the alternative, we are also entitled to
11 civil authority coverage. And I think with that, your
12 Honor, we would submit.

13 THE COURT: All right. The Court is going to
14 take this under submission. It seems to me that if the
15 Court decides to sustain the demurrer, that the motion
16 to strike is moot, so I don't want to hear argument on
17 that.

18 Anyway, I just want to spend more time
19 thinking about it, and I appreciate your thoughtful
20 argument. If for any reason I decide that I need
21 additional argument, I will let you know, but otherwise,
22 I hopefully will be able to let you know very soon.
23 Thank you.

24 MR. FERGUSON: Thank you, your Honor.

25 MR. KELLER: Thank you, your Honor.

1 MR. FERGUSON: Should there be any additional
2 briefing or legal issues you should like us to address,
3 we would be happy to do so.

4 THE COURT: This is Mr. Ferguson talking?

5 MR. FERGUSON: I am sorry. Mr. Ferguson, yes,
6 your Honor.

7 THE COURT: Thank you very much.

8 (Whereupon, the proceedings adjourned at 9:55
9 a.m.)

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1 STATE OF CALIFORNIA)
2) SS.
3 COUNTY OF MONTEREY)
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5 I, Jamie L. Setterquist, an official reporter
6 for the Superior Court of the State of California, in
7 and for the County of Monterey, do hereby certify:

8 That, as such reporter, I reported
9 stenographically the above proceedings on Monday, August
10 4, 2020, and that the above and foregoing transcript,
11 consisting of pages numbered from 1 to 19, inclusive,
12 contain a true and correct transcript of all of said
13 proceedings.

14
15 Dated at Salinas, California, this August 7,
16 2020.

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19 
20 JAMIE L. SETTERQUIST CSR 13362
OFFICIAL COURT REPORTER