



Is Loss of a Business License or Permit a Loss of Use of Tangible Property?

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In *Thee Sombrero, Inc. v. Scottsdale Ins. Co.*, 28 Cal. App. 5th 729, 239 Cal. Rptr. 3d 416 (Ct. App. 2018), *review denied* (Jan. 30, 2019) (review denied) Sombrero owned property. Its lessees operated that property as a nightclub pursuant to a conditional use permit. CES provided security guard services at the nightclub. The permit was revoked after a fatal shooting at the nightclub. The permit was replaced with a permit that only allowed operation as a banquet hall.

Sombrero sued CES for negligence alleging that CES's negligence caused the shooting, which in turn caused the revocation of the CUP, which in turn caused a diminution in value of the property. Sombrero obtained a default judgment against CES.

Sombrero then sued CES's general liability insurer, Scottsdale, in a direct action on the judgment under Cal. Ins. Code § 11580 (b)(2) (West). Scottsdale argued that the loss was an economic loss and not "property damage." The trial court ruled for Scottsdale. The Court of Appeal reversed. It held that Sombrero's loss of the ability to use the property as a nightclub constituted loss of use of tangible property and thus was "property damage" within the meaning of the general liability policy.

One condition of the conditional use permit issued for use of the property was that the city had to approve the floor plan, which then could not be modified without city approval. Part of that floor plan included a single door with a metal detector.

One patron shot and killed another. After that, Sombrero learned that CES had converted a storage area into a "VIP entrance" with no metal detector. The gun used in the shooting was brought in through that entrance.

At the default prove-up hearing, Sombrero submitted an affidavit averring that the property had been valued at \$2,769,231 with its nightclub entitlement, and after the shooting was valued at \$1,846,153 with the modified conditional use permit allowing for private banquet use. The difference in value was \$923,078. Judgment was entered for that amount against CES.

The court held that “The loss of the ability to use the property as a nightclub is, by definition, a ‘loss of use’ of ‘tangible property.’”

The court was not persuaded by the insurer's arguments based on *Scottsdale Ins. Co. v. Int'l Protective Agency, Inc.*, 105 Wash. App. 244, 19 P.3d 1058 (2001). There, IPA allowed a minor to enter a restaurant owned by Northwest. Because of that, Northwest lost its liquor license. Northwest sued IPA. That appellate court ruled for Scottsdale. It reasoned that a liquor license represents a privilege granted by the state. Therefore, it is intangible property. So loss of a liquor license is not “property damage.” Northwest did not lose the right to occupy the premises.

The Court of Appeal in *Thee Sombrero* did not follow *IPA*. First, while it agreed that a liquor license is intangible property, the court stated that the loss of the license leads to a loss of use of the premises.

Second, the court held that the reasonable expectations of the insured would be that “loss of use” would be any significant use of the premises, not merely the total loss of all uses.

Third as to *IPA*'s holding that “a right to occupy premises is not a tangible property interest” the court in *Thee Sombrero* disagreed. Land and buildings are tangible. The question is whether an insured would understand “tangible property” to include property he leases.

Scottsdale argued that this was a “mere economic loss” and therefore it was not a loss of use of tangible property. The court noted the rule regarding “strictly economic losses” not being “property damage.” “Strictly economic” losses like “lost profits, loss of goodwill, loss of the anticipated benefit of a bargain, and loss of an investment, do not constitute damage or injury to tangible property covered by a comprehensive general liability policy.” However, where these intangible economic losses provide ‘a measure of damages to physical property’ this is within a general liability insurance policy’s coverage for property damage. Diminution in value is accepted as a method of measuring any property damage that may have been sustained. It can be an alternative measure of any property damage actually sustained.

The court held that the correct principle is not that economic losses, by definition, do not constitute property damage. Rather, the correct principle is that losses that are exclusively economic, without any accompanying physical damage or loss of use tangible property, do not constitute property damage.

In *Scottsdale Ins. Co. v. Int'l Protective Agency, Inc.*, 105 Wash. App. 244, 19 P.3d 1058 (2001) IPA provided security services at Cheers West, a restaurant which Northwest Visions owned and operated. Under the service contract, IPA agreed to be responsible for crowd control and safeguarding of property. Northwest Visions and its on-site manager, Oleson, sued IPA under theories of negligence and breach of contract, alleging that IPA’s services included checking and policing customers, so that minors were not admitted to the premises. Nonetheless, a minor gained

admission. As a result, Northwest Visions lost its liquor license. This destroyed the business of the restaurant and caused great economic loss to it and Oleson.

Scottsdale insured IPA. The policy's security and patrol agencies endorsement provided coverage for sums that IPA would be legally obligated to pay because of any negligent act, error or omission committed by which resulted in property damage. The policy defined property damage as physical injury to tangible property, including all resulting loss of use of that property, and loss of use of tangible property that is not physically injured.

The court held that a liquor license "is merely representative of a privilege granted by the state and, as such, is intangible property." In this regard it cited a statute, Wash. Rev. Code Ann. § 84.36.070(2)(c) (West), which provides that a license is intangible property for tax purposes. The court also held that a business is likewise intangible for it merely describes a "commercial activity engaged in for gain or livelihood."

Although Northwest Visions alleged that it lost its liquor license and that this destroyed its business, it did not allege, nor was there evidence in the record, that Northwest Visions lost its use of or right to occupy the premises. "Even if it had, a right to occupy premises is not a tangible property interest." Nor did plaintiffs allege that Oleson, the manager, suffered property damage as defined by the policy.

As a point of comparison, the court cited *United Pac. Ins. Co. v. Van's Westlake Union, Inc.*, 34 Wash. App. 708, 664 P.2d 1262 (1983). In that case businesses near a service station spill were closed after an 80,000 gallon gasoline leak. Government authorities promptly closed the service station and cordoned it off along with an adjacent several square block area while the gasoline was pumped out of the ground. The court held that third party claims for damages resulting from the 6-week closure of the nearby businesses while the spilled gasoline was being pumped out of the ground were losses contemplated by the definition of "property damage."

Thee Sombrero and *IPA* provide different answers to the question of whether the loss of a business license or permit is a loss of use of tangible property. *Thee Sombrero* holds that a change in a conditional use permit was "property damage." *IPA* holds that loss of a liquor license was not "property damage."

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