

NC Justices Topple Insurer Victory In COVID Coverage Battle

By **Ganesh Setty**

Law360 (December 13, 2024, 5:58 PM EST) -- The North Carolina Supreme Court handed policyholders a rare win Friday in their bid to get property insurance coverage for their pandemic-related business interruption losses, unanimously finding that the insuring phrase "direct physical loss" included the loss of use of property due to COVID-19 public health orders.

Agreeing with a trial court's grant of partial summary judgment to numerous restaurants, which a state appeals court had reversed in favor of Cincinnati Insurance Co., the high court said a "covered cause of loss must, absent an intervening factor, result in the material deprivation, dispossession, or destruction of property."

Writing for the court, Justice Anita Earls first noted that the property policies issued to lead appellant North State Deli LLC and the other restaurants were "all-risk" policies, meaning the policies protected property loss or damage from "any peril, unless the peril is expressly excluded," she said. The appellant restaurants' policies also included "business income (and extra expense) coverage," which insured against income losses from the suspension of operations due to a covered cause of loss.

Fighting against coverage, Cincinnati maintained in part that the COVID-19 virus and public health orders regulated the activity of people, and that the eateries' properties experienced no physical change.

"Contrary to Cincinnati's arguments, though, we fail to see why the ordinary meaning of 'direct physical loss' is entirely insensitive to the 'use' for which a property is insured," she wrote for the court. "Property 'loss' surely occurs when it is no longer usable for its insured purpose, as a policyholder would reasonably expect."

"Thus when the restaurants lost physical use of their properties as restaurants due to the pandemic orders, they experienced a direct physical loss," Justice Earls said.

Friday's decisions come as **numerous state high courts** have ruled in favor of insurers in COVID-19 business interruption disputes, including fellow Fourth Circuit states **South Carolina** and Maryland, though in Maryland's case, its justices **specifically held** that the presence of COVID-19 on property isn't enough to trigger coverage.

The Vermont Supreme Court, however, did **rule in favor of policyholders** in 2022, letting a lawsuit proceed past the motion-to-dismiss stage, though without directly interpreting the phrase "direct physical loss or damage to property."

Justice Earls further noted Friday that the policies at issue for the appellant eateries did not contain contamination exclusions barring coverage for damages stemming from the presence of viruses on insured property. In fact, one of the restaurants lodged claims against its broker, Morris Insurance Agency Inc., alleging that Morris specifically indicated that its policy would cover virus-related damages, the justice highlighted.

"Cincinnati may dismiss the existence of virus exclusions in other policies as extratextual, but where a contract defines coverage only by excluded risks, as this one does, a policyholder must know something about the universe of perils beyond the four corners of the document to know what coverage they have paid for," she said.

While both sides advanced reasonable interpretations of the phrase "direct physical loss," contractual ambiguities must be construed in favor of the insured, the court held.

Policyholders did not get a full win on Friday, though, as the state high court **unanimously ruled** in a separate "companion case" that a contamination exclusion applied to bar coverage for clothing retailer Cato Corp.'s claims against Zurich American Insurance Co. under its own all-risk property policy.

The exclusion at issue specifically barred coverage for "any cost due to contamination," including the "inability to use or occupy property or any cost of making property safe or suitable for use or occupancy." Contamination in turn was further defined in part as "any condition of property due to the actual presence of any ... virus."

While Cato did sufficiently allege "direct physical loss of or damage" under the court's rationale in the North State Deli decision, Zurich still "met its burden to prove the contamination exclusion applies," Justice Earls wrote for the court, affirming the dismissal of Cato's claims.

In a statement to Law360, Gagan Gupta, lead attorney for the appellant eateries, said Friday's decision "provides definitive confirmation of what my clients have known all along: that their insurance policy provides coverage for pandemic-related losses."

"It's a groundbreaking and powerful win for policyholders still recovering from the economic devastation brought about by COVID-19," he said.

Steven DeGeorge, a Cato attorney whose firm also served as amicus counsel for United Policyholders and the National Independent Venue Association in the North State Deli case, further praised the court's main decision, saying that "unlike so many other state and federal courts, the North Carolina Supreme Court got it right."

Representatives of the other parties did not immediately respond to a request for comment.

North State Deli and the other appellant restaurants are represented by Gagan Gupta and Stuart M. Paynter of the Paynter Law Firm PLLC.

Cincinnati Insurance, Cincinnati Casualty Co. and Morris Insurance Agency are represented by Kimberly M. Marston, Jim W. Phillips Jr. and Gary S. Parsons of Brooks Pierce McLendon Humphrey & Leonard LLP and Daniel G. Litchfield and Alan I. Becker of Litchfield Cavo LLP.

Cato Corp. is represented by Matthew W. Sawchak, R. Steven DeGeorge and Benjamin C. DeCelle of Robinson Bradshaw & Hinson PA and Benjamin J. Widlanski, Dwayne A. Robinson and Gail A. McQuilkin of Kozyak Tropin & Throckmorton LLP.

Zurich is represented by Gary S. Parsons and Kimberly M. Marston of Brooks Pierce McLendon Humphrey & Leonard LLP, Lauren S. Kuley of Squire Patton Boggs LLP and William A. Bulfer, Megan N. Silver and Daniel T. Strong of Teague Campbell Dennis & Gorham LLP.

The cases are North State Deli LLC et al. v. Cincinnati Insurance Co. et al. and Cato Corp. et al. v. Zurich American Insurance Co., case numbers 225PA21-2 and 353PA23, in the Supreme Court of North Carolina.

--Additional reporting by Abraham Gross, Ben Zigterman, Elizabeth Daley and Hope Patti. Editing by Bruce Goldman.