Insights: Publications

COVID All-Risk Policies

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In a ruling that bucked the national trend, the North Carolina Supreme Court recently held that restaurants' business interruption losses caused by the COVID shutdown were covered under an all-risk property policy. *North State Deli, LLC v. Cincinnati Ins. Co*., No. 225PA21-2 (N.C. Dec. 13, 2024). This ruling is a huge win for policyholders that are continuing to pursue claims for COVID losses under policies with no virus exclusion. And it offers opportunities to argue for coverage in other situations where there is a business interruption without physical damage to the property.

When the COVID-19 pandemic reached the United States in February 2020, millions of small businesses across the country found themselves subject to government orders that either severely restricted, or completely prohibited, their ordinary business operations. Many of these businesses had expansive business interruption or "all-risk" insurance policies that, subject to a variety of exclusions, purported to cover their lost revenue and income in the event they were unable to do business. Since the first COVID-19-related orders were issued in 2020, litigation regarding these policies has slowly weaved its way through the courts of virtually every state. Unfortunately for policyholders, courts across the country have consistently found that these policies require some physical damage to property before business interruption loss coverage is triggered. Almost uniformly, courts have affirmed insurers' denials of claims on that basis.[1] Most practitioners expected that North Carolina would follow this majority rule. Until now.

North State Deli involved a handful of insured restaurants seeking a declaration that government orders in response to COVID-19 triggered their "all-risk" policies, which covered "direct physical loss" to property from any peril, unless it is expressly excluded. The term "direct physical loss" was not defined in the policies. The insureds argued that since the government orders denied them access to and use of their restaurants, and there was no express exclusion for such orders, the policies were triggered. On the other hand, the insurers argued that "direct physical loss" under the policies required some physical damage to the property beyond merely losing access to it.

The trial court found that since the policies at issue did not define "direct physical loss," their ordinary meaning would include a loss of possession, access, or use; and that since the policies did not exclude virus related government orders, coverage was triggered. On appeal, the Court of Appeals *unanimously* reversed the trial court and followed the majority rule, finding "direct physical loss" does not result simply from loss of access to or use of property.

The Supreme Court granted the insureds' petition for discretionary review and reversed. Writing for a unanimous Court, Justice Anita Earls penned a colorful opinion that discussed hypothetical UFO crashes, angsty teens losing their driving privileges, and irremediable cat urine odor as insurable losses. Ultimately, the Court found that the term “direct physical loss” has “a range of reasonable interpretations—many of which include considerations of use, possession and function that are implicated by virus-related government orders.” The Court stated that “‘property loss' surely occurs when it is no longer usable for its insured purpose, as a policyholder would expect.” Finding that “direct physical loss” includes loss of use or access and that the policies did not exclude virus-related government orders, the Court ruled in favor of the insureds.

In a companion case decided the same day, the Court considered the impact of contamination exclusions found in other policies. In *Cato Corp. v. Zurich Am. Ins. Co.*, 2024 WL 5100679 (N.C. Dec. 13, 2024), a clothing retailer sought coverage under similar all-risk policies discussed in *North State Deli* due to pandemic-related government orders that forced it to close or curtail its operations. The Court applied *North State Deli*, finding that Cato had sufficiently alleged a “direct physical loss” from pandemic-related orders that would trigger coverage, absent an applicable exclusion. However, unlike the *North State Deli* policies, Cato's policy included a contamination exclusion, which expressly excluded “the inability to use or occupy property or any cost of making property safe for use or occupancy” due to contamination. The Court determined a reasonable person would believe the exclusion would apply to the presence of a deadly virus in a confined space, applied the contamination exclusion, and found no coverage for Cato's claim.

Reading *North State Deli* and *Cato* together, the North Carolina Supreme Court has adopted an expansive view of what constitutes a “direct physical loss” but has simultaneously enforced specific exclusions that limit that expansive view. *North State Deli* offers policyholder-friendly applications in a myriad of non-COVID contexts where a business interruption occurs because the insured cannot use its property for its intended purpose, but there has been no physical damage to the property.

Most importantly, the different outcomes for the parties in these cases highlights the importance of seeking knowledgeable counsel who can carefully review your insurance policy and offer advice on how best to present the claim to trigger coverage.

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[1] *See, e.g., Ungarean v. CNA & Valley Forge Ins. Co.*, 323 A.3d 593, 607–08 (Pa. 2024) (concluding that “direct physical loss . . . of property” requires “a physical disappearance, partial or complete deterioration, or absence of a physical capability or function of the property”); *Huntington Ingalls Indus., Inc. v. Ace Am. Ins. Co.*, 287 A.3d 515, 529 (Vt. 2022) (concluding that “direct physical loss” means “persistent destruction or deprivation, in whole or in part, with a causal nexus to a physical event or condition”); *Starr Surplus Lines Ins. Co. v. Eighth Jud. Dist. Ct.*, 535 P.3d 254, 262 (Nev. 2023) (“[D]irect physical loss to covered property requires material or tangible destruction or dispossession as a result of material or tangible impact directed toward the property itself.” (cleaned up)); *Cajun Conti LLC v. Certain Underwriters at Lloyd's*, 359 So.3d 922, 926 (La. 2023) (“[D]irect physical loss . . . requires [that a] property sustain a physical, meaning tangible or corporeal, loss or damage [or otherwise become uninhabitable].”); *Conn. Dermatology Grp., PC v. Twin City Fire Ins. Co.*, 288 A.3d 187, 198 (Conn. 2023) (“[D]irect physical loss of property . . . [requires] some physical, tangible alteration to or deprivation of the property that renders it physically unusable or inaccessible.” (cleaned up)); *Another Planet Ent., LLC v. Vigilant Ins. Co.*, 548 P.3d 303, 307 (Cal. 2024) (“[D]irect physical loss or damage to property . . . must result in some injury to or impairment of the property as property.”).

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