Restaurants Entitled to Recover Lost Profits on Business Interruption Claim Due to Government Shutdown

Insurers have secured a significant number of litigation victories on the issue of whether business interruption policy provisions cover alleged losses due to shutdown mandates by the government during the COVID-19 pandemic. However, recently, insureds have successfully alleged that the coronavirus was physically on their premises, and they suffered "physical loss."

In North Carolina, a trial-level court recently found coverage under first-party property insurance policies for the insured restaurants' COVID-19-related business income losses. In North State Deli, LLC, et al. v. Cincinnati Ins. Co., et al., Case No. 20-CVS-02569, the court (i) denied the defendant-insurers' motion to dismiss the policyholders' complaint and, more significantly, (ii) granted the policyholders' motion for partial summary judgment, ruling "the Policies provide coverage for Business Income and Extra Expenses for Plaintiffs' loss of use and access to covered property mandated by the Government Orders as a matter of law."

In North State Deli, LLC, after government orders forced the insureds restaurants to close, they submitted claims for business interruption losses to their insurer, Cincinnati Insurance Company. When Cincinnati denied coverage, the insureds filed suit. Cincinnati's main argument against coverage was from the policies' requirement of direct "accidental physical loss or accidental physical damage," meaning the restaurants had to suffer some "physical alteration." Cincinnati also asserted that the coronavirus did not cause a permanent physical change to the businesses. The insureds argued that the loss of physical use and access to their restaurant property and premises constituted a non-excluded "direct physical loss." The policies did not have a virus exclusion.

In granting partial summary judgment to the insureds, the court rejected Cincinnati's argument, pointing out that the policies insured losses caused by direct "physical loss" **or** direct "physical damage." In its analysis, the court examined the policies' "accidental physical loss or accidental physical damage" language and concluded, following the examination of various dictionary definitions, that "the ordinary meaning of the phrase 'direct physical loss' includes the inability to utilize or possess something in the real, material, or bodily world, resulting from a given cause without the intervention of other conditions." In other words, the court determined the insureds' loss of the ability to use or access their property for the income-generating purpose for which the property was insured, constituted a "direct physical loss."

The court determined Cincinnati's interpretation would mean there is no difference between "physical loss" and "physical damage," making the term "physical loss" unnecessary. To give effect to that term, the court noted, it must mean something different from "physical damage." Even if Cincinnati's interpretation of the foregoing language was reasonable, the court further noted that the "ordinary meaning" set forth by the court was also reasonable, thereby rendering the policies ambiguous. Thus, the court confirmed the government orders caused "physical loss" to the insureds covered by the policies.

Although the case appears to be beneficial for insureds, the ruling directly contradicts the North Carolina Insurance Commissioner's understanding of the law. In an April 17, 2020 letter to business owners, the North Carolina commissioner advised that the office cannot force insurers to pay for damages that are not covered. See https://files.nc.gov/doi/documents/mike-causey-letter-to-business-owners-covid-19.pdf .

Specifically, the Commissioner noted:

Standard business interruption policies are not designed to provide coverage for viruses, diseases, or

pandemic-related losses because of the magnitude of the potential losses. Insurability requires that loss events are due to chance and that potential losses are not too heavily concentrated or catastrophic. This is not possible if everyone in the risk pool is subject to the same loss at the same time.

New Jersey, New York and Pennsylvania previously introduced legislation requiring commercial property insurers to retroactively cover losses that insureds may have accumulated because of the COVID-19 pandemic. Still, it remains to be seen whether a version of these bills will ultimately be enacted into law. However, none of the commissioners from those jurisdictions have made such a broad proclamation as the North Carolina commissioner's position that there is no coverage for these types of claims.

Nonetheless, if an appeal is filed in North State Deli, it will be interesting to see whether the Commissioner's prior statement will influence the court on an appeal.

Comment: While North State Deli is a **win** for insureds, the decision, like other COVID-19 business interruption cases, raises many issues that will likely be the subject of litigation for the foreseeable future. Here, the court failed to address relevant North Carolina law interpreting "physical loss or damage" and relied solely on the dictionary definitions of terms. Further, although the policy did not have a virus exclusion, the court did not explain why other policy exclusions cited by Cincinnati did not apply. Finally, as noted in prior alerts, each of these cases relies specifically on the policy language at issue, and the language reviewed by this court will likely limit its application to other policies. In sum, insurers should prepare for courts assigning (or insureds arguing for) a broader meaning of the phrase "direct physical loss" when fighting back to support their denial of COVID-19 business interruption claims.