

COVID-19 Coverage Update

January 2, 2025

COVID-19 Coverage – North Carolina

N. State Deli, LLC v. Cincinnati Ins. Co., 908 S.E.2d 802 (N.C. Dec. 13, 2024)

Cato Corp. v. Zurich Am. Ins. Co., --- S.E.2d ---, 2024 WL 5100679 (N.C. Dec. 13, 2024)

The North Carolina Supreme Court, rebuffing the majority of rulings in other state and federal courts, issued two orders in the above cases, finding that coverage was available under all risk property insurance policies because the phrase “direct physical loss” was ambiguous and must be construed against the insurers. However, the policy in *Cato Corp.* contained a “contamination” exclusion which the Supreme Court determined applied to exclude coverage.

The plaintiffs in *North State Deli* were a group of bars and restaurants insured under all risk commercial property insurance policies issued by Cincinnati Insurance Company (Cincinnati). The policies provided coverage for “direct physical loss” to property unless otherwise excluded by the policies. The Cincinnati policies did not contain any exclusions for losses caused by contamination or viruses. The plaintiffs filed suit against Cincinnati in 2020 seeking a declaration that the governmental shutdowns caused by the Covid-19 pandemic constituted a covered peril. At issue in the case was the meaning of “direct physical loss.” The trial court granted the plaintiffs’ dispositive motion, finding that there was “direct physical loss” to the insureds’ property within the meaning of the policies.

The North Carolina Court of Appeals reversed the trial court’s order, concluding that there was no “direct physical loss” to the property because there was no physical harm to the property caused by the government shutdowns. The North Carolina Supreme Court reversed the lower appellate court finding that the phrase “direct physical loss” is ambiguous and, therefore, must be resolved in favor of the insured. The Supreme Court determined that a covered loss, absent any intervening factor, must “result in the material deprivation, dispossession, or destruction of property.” Because the plaintiffs were deprived the use of their property during the COVID-19 shutdowns, they sustained “direct physical loss” to their properties. In reaching its conclusion, the Supreme Court also relied on “special interpretive principles,” finding that a reasonable purchaser of the policies would find that the policies covered claims for governmental shutdowns issued in response to a virus.

In the companion case, *Cato Corp.*, the plaintiff was a clothing retailer with more than 1,300 stores across North Carolina and in 36 other states. At the time of the government-ordered shutdowns, *Cato Corporation* (Cato) was insured under an all-risk commercial property insurance policy issued by Zurich American Insurance Company (Zurich). Cato sought coverage for expenses incurred in attempting to remove the virus, including for alterations required to comply with government safety guidelines. While Zurich issued a reservation of rights letter, Cato sued Zurich before the expiration of the contractual

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statute of limitations.

The trial court, relying on the North Carolina Court of Appeals' decision in *North State Deli*, granted Zurich's dispositive motion as the loss was not one that resulted from physical harm to the property. The appellate court affirmed the trial court's dismissal of Cato's complaint on the same basis. The North Carolina Supreme Court, however, concluded that Cato sufficiently alleged a "direct physical loss of or damage" to the property as Cato alleged a loss of use of its property during the pandemic shutdown. Although coverage was triggered under the Zurich policy, the policy contained an exclusion for viral contamination, which the appellate court determined applied to preclude coverage for Cato's alleged losses. Thus, the North Carolina Supreme Court affirmed the lower appellate court's judgment, albeit for different reasons.