No. COA21-293 FOURTEENTH DISTRICT

NORTH CAROLINA COURT OF APPEALS

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NORTH STATE DELI, LLC d/b/a LUCKY'S DELICATESSEN, MOTHERS & SONS, LLC d/b/a MOTHERS & SONS TRATTORIA, MATEO TAPAS, L.L.C. d/b/a MATEO BAR DE TAPAS, SAINT JAMES SHELLFISH LLC d/b/a SAINT JAMES SEAFOOD, CALAMARI ENTERPRISES, INC. d/b/a PARIZADE, BIN 54, LLC d/b/a BIN 54, ARYA, INC. d/b/a CITY KITCHEN and VILLAGE BURGER, GRASSHOPPER LLC d/b/a NASHER CAFE, VERDE CAFE INCORPORATED d/b/a LOCAL 22, FLOGA, INC. d/b/a KIPOS GREEK TAVERNA, KUZINA, LLC d/b/a GOLDEN FLEECE, VIN ROUGE, INC. d/b/a VIN ROUGE, KIPOS ROSE GARDEN CLUB LLC d/b/a ROSEWATER, and GIRA SOLE, INC. d/b/a FARM TABLE and GATEHOUSE TAVERN,

Plaintiffs-Appellees,

v.

THE CINCINNATI INSURANCE COMPANY; THE CINCINNATI CASUALTY COMPANY; MORRIS INSURANCE AGENCY INC.; and DOES 1 THROUGH 20, INCLUSIVE,

Defendants-Appellants.

From Durham County

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BRIEF OF AMICUS CURIAE THE STATE OF NORTH CAROLINA IN SUPPORT OF PLAINTIFFS-APPELLEES

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NORTH STATE DELI, LLC d/b/a LUCKY'S DELICATESSEN, MOTHERS & SONS, LLC d/b/a MOTHERS & SONS TRATTORIA, MATEO TAPAS, L.L.C. d/b/a MATEO BAR DE TAPAS, SAINT JAMES SHELLFISH LLC d/b/a SAINT JAMES SEAFOOD, CALAMARI ENTERPRISES, INC. d/b/a PARIZADE, BIN 54, LLC d/b/a BIN 54, ARYA, INC. d/b/a CITY KITCHEN and VILLAGE BURGER, GRASSHOPPER LLC d/b/a NASHER CAFE, VERDE CAFE INCORPORATED d/b/a LOCAL 22, FLOGA, INC. d/b/a KIPOS GREEK TAVERNA, KUZINA, LLC d/b/a GOLDEN FLEECE, VIN ROUGE, INC. d/b/a VIN ROUGE, KIPOS ROSE GARDEN CLUB LLC d/b/a ROSEWATER, and GIRA SOLE, INC. d/b/a FARM TABLE and GATEHOUSE TAVERN, Plaintiffs-Appellees, v. THE CINCINNATI INSURANCE COMPANY; THE CINCINNATI CASUALTY COMPANY; MORRIS INSURANCE AGENCY INC.; and DOES 1 THROUGH 20, INCLUSIVE, Defendants-Appellants.	From Durham County

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BRIEF OF AMICUS CURIAE THE STATE OF NORTH CAROLINA IN SUPPORT OF PLAINTIFFS-APPELLEES*

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* No outside persons or entities wrote any part of this brief or contributed any money to support the brief's preparation.

INTRODUCTION

The COVID-19 pandemic—a public-health crisis with no modern parallel—has left small businesses across the country reeling. Many of these businesses maintain business-income insurance policies, which promise to help indemnify them if unforeseen events lead to a suspension of their normal operations.

This case is brought by a group of sixteen small businesses located in this State, all of whom purchased business-income insurance policies. Amid the pandemic, these Appellee Restaurants filed claims, all of which were denied by the Appellant Insurance Companies. The denial of these claims was improper.

At worst, the insurance policies at the heart of this case are ambiguous with respect to their business-income coverage.[1] And it is black letter law in North Carolina that ambiguous insurance policies must be construed in favor of the insured. Consistent with this longstanding rule, the court below

[1] The State need not—and does not—take a position as to whether the insurance policies in this case clearly grant the Appellee Restaurants coverage. The policies do not clearly *exclude* coverage.

read the terms in the Appellee Restaurants' policies that grant coverage expansively and the terms that carve out exceptions to coverage narrowly.

The well-settled interpretive principles that the trial court applied make good sense and promote several important public policies. First, they protect consumers, who typically face vast disparities in sophistication and bargaining power when negotiating an insurance contract. Second, they incentivize insurers to draft clear policies. This increased clarity helps improve customers' understanding of the insurance products that they are purchasing, which, in turn, makes the insurance markets more efficient. Finally, interpreting ambiguous insurance provisions in favor of the insured helps bolster public confidence in insurance, reassuring would-be customers that insurers will not be able to escape liability by dint of obscure drafting. This reassurance matters, because consumer confidence is critical to the vitality and sustainability of the insurance industry. Indeed, without a large pool of customers who are willing to purchase insurance, the risk-pooling on which the entire industry is predicated falls apart. The court below vindicated all of these important interests in granting summary judgment to the Appellee Restaurants.

The breadth of the harm inflicted upon small businesses across this country by the COVID-19 pandemic makes this case critically important to the State and its citizens. To advance the many public-policy interests discussed above, and because the decision below properly applied state law, the State of North Carolina, acting through Attorney General Joshua H. Stein, respectfully asks this Court to affirm the decision below.

ARGUMENT

I. North Carolina Has a Longstanding Doctrine Favoring the Insured Whenever an Insurance Policy Is Ambiguous.

Under well-settled law, a North Carolina court faced with an ambiguous insurance policy must choose the interpretation that favors the insured. *Wachovia Bank & Tr. Co. v. Westchester Fire Ins. Co.*, 276 N.C. 348, 354, 172 S.E.2d 518, 522 (1970); 1 New Appleman North Carolina Insurance Litigation § 1.05 (2020). In accordance with this rule, courts must construe insurance provisions granting coverage expansively and exceptions or limitations to coverage narrowly. David B. Goodwin, Book Review, *Disputing Insurance Coverage Disputes*, 43 Stan. L. Rev. 779, 783-84 (1991).

A. North Carolina courts must construe ambiguous policy language in favor of more expansive coverage.

Where a provision of an insurance contract "is uncertain or capable of several reasonable interpretations, the doubts will be resolved against the insurance company and in favor of the policyholder." *Woods v. Nationwide Mut. Ins. Co.*, 295 N.C. 500, 506, 246 S.E.2d 773, 777 (1978). In other words, "uncertain or ambiguous" provisions "should receive that construction which is most favorable to the insured." *Penn v. Standard Life and Accident Ins. Co.*, 158 N.C. 29, 31, 73 S.E. 99, 100 (1911) (cleaned up); *see also* 2 Steven Plitt et al., Couch on Insurance § 22:14 (3rd ed. 2021) ("If an insurer uses language that is uncertain, any reasonable doubt will be resolved against it; if the doubt relates to extent or fact of coverage . . . the language will be understood in its most inclusive sense, for the insured's benefit.").

This rule does not empower courts to introduce ambiguity where none exists. But it does mean that when a policy term "is fairly and reasonably susceptible to either of the constructions asserted by the parties," the term "must be construed liberally so as to provide coverage . . . *whenever possible* by reasonable construction." *Maddox v. Colonial Life & Accident Ins. Co.*, 303 N.C. 648, 650, 280 S.E. 2d 907, 908 (1981); *State Cap. Ins. Co. v. Nationwide Mut. Ins. Co.*, 318 N.C. 534, 538, 350 S.E.2d 66, 68 (1986) (emphasis added).

This interpretive principle has been reiterated by court after court in this State for well over a century. *See, e.g.*, *Harleysville Mut. Ins. Co. v. Buzz Off Insect Shield, L.L.C.*, 364 N.C. 1, 9, 692 S.E.2d 605, 612 (2010); *First Nat'l Bank v. Nationwide Ins. Co.*, 303 N.C. 203, 216, 278 S.E.2d 507, 515 (1981); *Roach v. Pyramid Life Ins. Co.*, 248 N.C. 699, 701, 104 S.E.2d 823, 824-25 (1958); *Jones v. Pa. Cas. Co.*, 140 N.C. 262, 262, 52 S.E. 578, 578 (1905).

And it is applied consistently across all types of insurance policies. *See, e.g.*, *Harleysville Mut. Ins. Co.*, 364 N.C. at 9, 692 S.E.2d at 612 (commercial general liability insurance); *Woods*, 295 N.C. at 505-06, 246 S.E.2d at 777 (automobile insurance); *Houpe v. City of Statesville*, 128 N.C. App. 334, 347, 497 S.E.2d 82, 91 (1998) (city liability insurance).

Woods—one of this State's seminal insurance cases—illustrates the rule in practice. In that case, the plaintiff insured two different automobiles with the defendant insurance company. The two materially identical policies provided all of the members of the insured's family with medical coverage up to a limit of $500 for injuries sustained while occupying a car owned by another party. Each policy also contained a separate provision stating that, when a customer had insured two or more automobiles with the

company, the policies would "apply separately" to each vehicle. *Woods*, 295 N.C. at 505, 246 S.E.2d at 777.

After the plaintiff's daughter was injured while riding in another person's vehicle, the plaintiff sought to recover under *both* of his vehicles' policies. In other words, because his policies "appl[ied] separately," the plaintiff argued that he was entitled to two separate payments of up to $500—or an aggregated cap of $1,000. The defendant insurance company, by contrast, acknowledged that the daughter's injuries were covered, but maintained that the $500-per-person cap applied *across* policies. The insurance company therefore refused to pay more than $500 total. *Id.*

The North Carolina Supreme Court found that the insurance policies provided no clear answer to the parties' dispute. So, to resolve this uncertainty, the Court applied the rule of construction that favors expansive coverage. *Id.* at 509, 246 S.E.2d at 779. "Absent express language in the policy that the 'per accident' limitation applies without regard to the number of vehicles covered by the policy," the Court said, "the ambiguity must be resolved against the insurer." *Id*. The Court, accordingly, ordered the insurance company to pay the plaintiff the full $1000. *Id.* at 510, 246 S.E.2d at 780.

B. The State's pro-insured rule of construction similarly mandates construing policy exceptions narrowly.

North Carolina courts construing *exceptions* to coverage must similarly read any ambiguous terms in favor of the insured. Here, the law's protection for the insured gives rise to the opposite interpretive principle: While provisions *granting* coverage must be read *expansively*, provisions *excluding* coverage must be read *narrowly*. *Wachovia Bank & Tr. Co.*, 276 N.C. at 355, 172 S.E.2d at 522-23; *see also State Cap. Ins. Co.*, 318 N.C. at 538, 350 S.E.2d at 68 ("[P]rovisions which exclude liability of insurance companies are not favored and therefore all ambiguous provisions will be construed against the insurer and in favor of the insured."). Together, these interpretive rules "provide the greatest possible protection to the insured." *State Cap. Ins. Co.*, 318 N.C. at 542-43, 350 S.E.2d at 71.

State Capital Insurance Company exemplifies how North Carolina courts "strictly construe[]" insurance policy exceptions. *Id.* at 546, 350 S.E.2d at 73. At issue in that case was whether the appellee's homeowners' insurance policy provided coverage after he accidentally shot another person while removing a rifle from his vehicle. In pertinent part, the insurance policy protected the homeowner "against liability for damages for which he was liable because of bodily injury or property damage, but excluded

coverage for such damages arising out of the ownership, maintenance, use, loading, and unloading of a motor vehicle." *Id.* at 541, 350 S.E.2d at 70 (internal quotation marks omitted). The Court found that the terms "use" and "loading and unloading" were ambiguous. It was therefore obliged to "strongly construe[]" those terms "against the insurer" and hold that the policy exclusion did not prevent coverage. *Id.* at 544, 350 S.E.2d at 72.

II. This Longstanding Doctrine Makes Sense as a Matter of Policy.

Interpretive rules that favor the insured are in the public interest. Specifically, this well-settled doctrine furthers at least three important public policy goals: First, it protects policyholders, who lack both the market power and sophistication of insurers. Second, it incentivizes clearer contracts, thereby enhancing fairness and market efficiency. And third, it promotes the soundness of the insurance industry as a whole by fostering consumer confidence—and thus participation—in insurance. These important public policy goals are all the more important in the context of a global pandemic that has triggered just the kinds of losses that insurance is designed to protect against.

A. The doctrine protects the insured from an imbalance in bargaining power and sophistication.

When it comes to the negotiation of insurance contracts, the insurance company will ordinarily be "the party that select[s] the words used" in a given policy. *Harleysville Mut. Ins. Co.*, 364 N.C. at 9, 692 S.E.2d at 612. Insurance companies will often make these selections "without the input of the insured." *Res. Bankshares Corp. v. St. Paul Mercury Ins. Co.*, 407 F.3d 631, 636 (4th Cir. 2005). As a result, the insurance companies—not insurance customers—"bear the burden of making their contracts clear." *Id.*; *accord Jamestown Mut. Ins. Co. v. Nationwide Mut. Ins. Co.*, 266 N.C. 430, 437, 146 S.E.2d 410, 416 (1966).

Placing the burden on the insurance companies is consistent with the fundamental tenet of contract law that contract language should be construed in favor of the non-drafting party. 2 E. Farnsworth, Contracts § 7.11 (3d ed. 2004); *Lamps Plus, Inc. v. Varela*, 139 S. Ct. 1407, 1417 (2019). That precept acknowledges that contract drafters often hold greater bargaining power and have a much deeper familiarity with the subject matter of the contract than non-drafters. In addition, contract drafters have a far stronger incentive to carefully protect their own interests than to

protect the interests of the non-drafting party. Construing contracts against the drafting party is one way of mitigating these inequities. *Id.*

The need to protect non-drafting parties applies with special force in the insurance context, where insurers enjoy several obvious and substantial advantages. First, insurance companies are typically larger and more powerful than their customers, enabling them to dictate terms and unilaterally define coverage parameters. *See* Goodwin, *supra*, at 787. Second, insurers are true subject-matter experts, drawing on deep experience in both risk management and claims adjustment when drafting policies. *See id.* at 782-91. This expertise equips them to identify salient policy ambiguities that ordinary purchasers like the small businesses in this case would struggle to appreciate. These advantages together counsel in favor of robust application of the rule favoring the non-drafter in the insurance context.

B. The doctrine promotes clearer insurance contracts, which ultimately makes the insurance market more efficient.

As discussed above, construing ambiguous policy terms in favor of the insured helps alleviate the power imbalance between the parties should an insurance dispute arise. But it also promotes more equitable outcomes even if the insured never experiences a loss event or files an insurance claim:

North Carolina's strong presumption in favor of the insured incentivizes the clear drafting of insurance contracts. This clarity enables purchasers to select the policies that are best suited to their needs. And this improved fit between purchasers' insurance needs and the insurance that they ultimately buy enhances the efficiency of the market overall.

For the formation of a contract to be fair, both parties necessarily must have a solid grasp of the consideration that they will receive. The need for clarity in contracting is particularly acute in the insurance context because "performance" on the part of the insurance company will not necessarily clarify whatever ambiguities exist in a particular contract: If a triggering event never occurs, and an insured never has to file a claim, they will never have an opportunity to discover discrepancies between the consideration (liability coverage) that they believe they are due and the coverage that the insurer actually intends to provide. *See Grabbs v. Farmers' Mut. Fire Ins. Ass'n of N.C.*, 125 N.C. 389, 399-400, 34 S.E.2d 503, 506 (1899). To ensure a meeting of the minds between the insured and the insurer, clarity must inhere in the contract itself.

North Carolina's rules of construction that favor the insured encourage clearer contracts. Because ambiguities in an insurance contract will be held

against the insurer, insurance companies have strong incentives to identify potential areas of confusion within the policies they offer and then to eliminate them.

These clearer contracts also improve market efficiency. An efficient and effective market requires that buyers understand the products on offer. *See* Herbert Hovenkamp, Principles of Antitrust 2 (2017); Irston R. Barnes, *False Advertising*, 23 Ohio St. L.J. 597 (1962) (discussing the importance to market efficiency of buyers understanding "the significant differences . . . among [available] products"). When buyers understand what products are available, at what price, and from which sellers, they make more informed—and, thus, better—purchasing decisions.

The insurance market is no exception. When a buyer can read an insurance policy and easily understand the scope of the coverage, that buyer is better able to select the best insurance product for its needs, and the efficiency of the insurance market increases.

Promoting clearer contracts does not help buyers alone, though—it helps insurers too. When a buyer makes a suboptimal insurance purchase based on confusion, uncertainty, or outright deception, honest insurers suffer. *See* Edward S. Rogers, Book Review, 39 Yale L.J. 297, 297 (1929).

Those sellers have been, "in effect . . . deprived of equal access to the market and to the attention of the buyers." Barnes, *supra*. By construing contracts against insurers who draft ambiguous policies, courts benefit market participants who choose to operate aboveboard and who strive for transparency.

C. The doctrine makes the insurance industry itself more secure.

Lastly, construing ambiguous policy terms in favor of the insured strengthens the long-term viability of the insurance industry. A secure insurance industry, in turn, redounds to the benefit of a wide range of parties—including those businesses that choose to engage in economic activity because of the protection that insurance provides *and* the many consumers who partake in those businesses' services.

Imagine, for a moment, that the interpretive principles that govern in the insurance context worked in the opposite direction. In other words, imagine that North Carolina law required courts to construe ambiguous insurance provisions in favor of the insurer. Every time that a court permitted an insurance company to leverage an ambiguous policy provision to escape its obligations for coverage, customers' faith in insurance would be undermined.

This scenario, if repeated enough times, could destabilize the entire insurance industry. Consumer confidence, after all, is critical to the sustainability of insurance. If customers cannot trust insurance companies to provide coverage in the event of a loss, they have no reason to buy insurance. And, if enough consumers stop purchasing insurance, the entire industry model could collapse. Insurance companies are able to cover their customers' "undesirable risk of suffering . . . . without transferring insecurity to" themselves because they have a sufficiently large pool of customers from which to draw premiums and predict loss events. 1 New Appleman on Insurance Law Library Edition § 1.01 (2021). Anything that diminishes this pool threatens the industry itself.

The North Carolina Supreme Court has recognized this public interest as a justification for construing insurance policies in favor of the insured. In *Grabbs*, the Court explained that permitting insurance companies to evade covering insured losses by resort to "unreasonable stipulations" would undermine the viability of insurance risk pooling. 125 N.C. at 399, 34 S.E.2d at 506. When customers "begin to feel that they may, by some unforeseen technicality, be deprived of all benefit from the contract into which they have honestly entered, they will seek some safer place for the investment of

their savings." *Id.* at 400, 34 S.E.2d at 506. Thus, the rule exists "for the protection equally of the insurer and the insured." *Id.* at 399, 34 S.E.2d at 506.

In short, maintaining a robust insurance industry is an important public policy priority for a host of reasons. Obviously, insurance protects customers from incurring calamitous debts simply because they have had the misfortune to suffer a catastrophic loss or injury of some kind. Defraying the risk of devastating loss, moreover, catalyzes economic activity. When customers are confident that they are protected by insurance, they are more likely to take the kinds of economic risks from which we all benefit. The Appellee Restaurants—each of whom chose to open a small business in this State—are good examples.

III. The Court Below Correctly Held that the Appellee Restaurants Were Covered by Their Insurance Policies.

The court below granted summary judgment to the Appellee Restaurants and ordered the Appellant Insurance Companies to compensate them for some of the business income that they lost amid the pandemic. In so doing, the court invoked the longstanding presumption in favor of the

insured. (R pp 206-08).[2] This decision—which held the Appellant Insurance Companies responsible for any ambiguities in the restaurants' policies—was correct and should be affirmed.

To protect themselves from unforeseen and catastrophic events, the Appellee Restaurants took out "all risk" insurance policies. (R p 205). These policies include "Business Income Coverage," which insures the restaurants against any loss of business income that they incur as a result of a "Covered Cause of Loss." *Id.* The policies define "Covered Cause of Loss" as a "direct 'loss'" not otherwise excluded. *Id.* "Loss," in turn, is defined as "accidental physical loss or accidental physical damage." *Id.* The policies do not, however, further define "direct," "accidental," "physical loss," or "physical damage." (R pp 205-06). Nor do they make clear that "physical losses" caused by the outbreak of a virus are excluded from coverage. *See* Plaintiffs-Appellees' Br. Part II.

At a minimum, the Appellee Restaurants' "all risks" policies are ambiguous. The Appellee Restaurants have reasonably argued—and the trial court reasonably found—that the loss of the physical use of and access to

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[2] Citations to the record refer to the Amended Record on Appeal filed on July 7, 2021.

their restaurants caused by the COVID-19 pandemic constituted a "direct physical loss" under the policy. (R p 208); Plaintiffs-Appellees' Br. Part I.b. As the trial court explained, one ordinary meaning of "direct physical loss" is "the inability to utilize or possess something in the real, material, or bodily world, resulting from a given cause." (R p 208). This is precisely what happened for much of 2020: the pandemic rendered the Appellee Restaurants unable to "utilize" "something in the real . . . world"—their restaurant premises. Because an ordinary insurance customer might very well read "direct physical loss" to include the restaurant closures brought about by the pandemic, the trial court's analysis was sound. And because "direct physical loss" could plausibly mean what the trial court and the Appellee Restaurants say, the policies were, at worst, ambiguous as to whether the Appellant Insurance Companies would cover the restaurants' business-income losses.

As discussed at great length above, when "a provision in a policy of insurance is susceptible of two interpretations, . . . one imposing liability, the other excluding it, the provision will be construed against the insurer." *Roach*, 248 N.C. at 701, 104 S.E.2d at 824-25. The trial court's decision accords with this longstanding doctrine.

Application of the well-settled principles of construction that favor the insured is particularly warranted here because the specific circumstances of this case—mass restaurant closures in the wake of a virus—were eminently foreseeable in light of past events. *See* Paul McHugh, *Business Income Insurance in the Time of Covid-19: Who Should Foot the Bill?*, 29 J.L. & Pol'y 491, 507-08 (2021); Todd C. Frankel, *Insurers Knew The Damage A Viral Pandemic Could Wreak On Businesses. So They Excluded Coverage.* Wash. Post (Apr. 2, 2020), https://tinyurl.com/53ha7sp7 (same). The SARS outbreak, "which infected 8,000 people mostly in Asia" in the early 2000s "led to millions of dollars in business-interruption insurance claims." Frankel, *supra*. As a result, "many insurers added exclusions to standard commercial policies for losses caused by viruses or bacteria." *Id.*; *see also* McHugh, *supra*, at 497. The Appellant Insurance Companies, by contrast, included no such exceptions in the policies at issue here, and, in fact, the Appellee Restaurants have alleged that they were explicitly told that "losses arising from viruses and virus-related causes" *would* be covered under their policies. (R p 70). Construing "direct physical loss" to exclude coverage against this backdrop would be particularly unjust.

* * *

This is the rare insurance case that is of critical importance to the State and its citizens as a whole. The COVID-19 pandemic has threatened small businesses across the country. Many of those small businesses, including the Appellee Restaurants here, had purchased insurance policies in the months and years before the pandemic, which they understood would compensate them for lost income if they were forced to close. If the Appellee Insurance Companies did not intend to provide coverage in the midst of a global pandemic, they needed to make that clear. Because they did not, the Appellee Restaurants should get the benefit for which they explicitly bargained and paid premiums. Any other result could have deeply troubling ramifications for consumer protection and for consumer confidence in the insurance industry.

CONCLUSION

The State of North Carolina, acting through Attorney General Joshua H. Stein, respectfully requests that this Court affirm the judgment of the Superior Court.

Respectfully submitted, this 29th day of November, 2021.

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CERTIFICATE OF COMPLIANCE

I certify that, in accordance with Rules 26(g)(1) and 28(j)(2) of the North Carolina Rules of Appellate Procedure, the attached brief uses Constantia type "no smaller than 12-point and no larger than 14-point." According to Microsoft Word, the brief (excluding the parts excluded by rule) contains no more than 3,750 words.

This 29th day of November, 2021.

/s/ Electronically submitted
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CERTIFICATE OF SERVICE

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