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SC Justices Say COVID-19 Orders Don't Trigger Coverage

By **Hope Patti**

Law360 (August 10, 2022, 5:34 PM EDT) -- The South Carolina Supreme Court sided with a number of state high courts Wednesday in ruling that government shutdown orders implemented in response to the COVID-19 pandemic do not constitute physical loss or damage in order to trigger insurance coverage.

Answering just one of five certified questions, the high court held that Sullivan Management LLC, which owns nine Carolina Ale House locations, cannot recover business interruption losses during the pandemic under a commercial property policy issued by Fireman's Fund Insurance Co. and Allianz Global Risks US Insurance Co.

"The presence of COVID-19 and corresponding government orders prohibiting indoor dining do not fall within the policy's trigger language of 'direct physical loss or damage,'" Justice Kaye G. Hearn said in the court's opinion.

In a case removed to South Carolina federal court in June 2020, Sullivan said Fireman's Fund and Allianz wrongly denied coverage of its claim for loss of income as a result of the presence of COVID-19 in its restaurants and related government orders that prohibited indoor dining.

The high court, which heard oral arguments in June, declined to answer four of the certified questions Wednesday, saying they present an issue of contract interpretation that is best reserved for the federal court.

Citing the Sixth Circuit's 2021 ruling in Santo's Italian Cafe LLC v. Acuity Insurance Co., Justice Hearn said "the triggering language for coverage under an all-risks policy — direct physical loss or damage — is the 'North Star' of a property insurance policy."

The contention that a government shutdown order caused direct physical loss or damage is without merit, the justices said, adding that the prohibition on indoor dining certainly affected Sullivan's financial well-being but was not directly physical.

The justices held that mere loss of use or economic loss does not constitute physical loss or damage — an argument that has been widely dismissed by courts nationwide in deciding COVID-19 coverage disputes. The presence of COVID-19 also cannot trigger coverage as it does not physically alter property, the high court said.

The Fireman's Fund and Allianz policy's period of restoration provision — which limits business interruption coverage to the time it takes for property to be repaired, rebuilt or replaced — only supports the notion that direct physical loss or damage requires actual or tangible loss or damage, the justices said.

"While Sullivan took steps to mitigate the spread, such as increasing cleaning or installing plexiglass, these acts are different than restoring damaged or lost property," Justice Hearn said.

Laura Foggan of Crowell & Moring LLP, who authored an amicus brief for the American Property Casualty Insurance Association and National Association of Mutual Insurance Companies, said it was refreshing to see the court clearly denounce the idea that government orders caused physical loss or damage.

"It's gratifying that another state supreme court has unanimously concluded that COVID-19-related business interruption claims do not trigger property insurance coverage, which covers situations where there actually is direct physical loss of or damage to property, not simply economic loss," Foggan said.

The high court's finding that shutdown orders do not cause physical loss or damage is not unexpected, Rani Gupta, a partner at Covington & Burling LLP, told Law360; however, it is disappointing that the justices came to the conclusion that the presence of the virus does not alter property.

Courts have held that the virus does physically and tangibly alter property, Gupta said, adding that the virus makes people sick by altering the surfaces and the air of property. The idea that the virus must alter the appearance, shape, color, structure or other material dimension of the property is not in the policy language, Gupta said, noting that the policy only requires physical loss or damage.

"I don't think that part of the court's opinion is particularly well grounded in pre-COVID insurance law," Gupta said.

Federal courts across the country have permanently tossed about 48% of the 1,394 suits from policyholders against their insurance companies seeking pandemic loss-related coverage, according to Law360's COVID-19 Insurance Case Tracker. Another 17% of the pandemic insurance suits filed in federal courts have been voluntarily dismissed, the tracker shows, though about 32% have yet to be fully decided.

Meanwhile, state high courts across the country have consistently sided with insurers in finding that policyholders can't recover for pandemic-related losses without demonstrating physical loss or damage.

The Massachusetts Supreme Judicial Court was the first to rule on a COVID-19 coverage dispute in April, finding no coverage for a trio of restaurants. The Iowa Supreme Court followed suit, when it held that a golf club and a restaurant weren't covered for their pandemic-related losses. The Wisconsin Supreme Court in June also ruled that a group of restaurants were not entitled to coverage without physical alteration to their properties.

Brett Ingerman, counsel for the insurer in the Sullivan case, told Law360 that "Fireman's Fund is pleased that the South Carolina Supreme Court concluded, like nearly every other appellate court in the country, that neither the presence of the COVID-19 virus nor related government shutdown orders cause physical loss or damage under its property insurance policy."

Justin O'Toole Lucey, counsel for Sullivan, said he was disappointed by the ruling, especially the court's discussion of the difference between "loss" and "damage."

"Under the court's analysis, while 'loss' and 'damage' are recognized as not synonymous, the term 'loss' is rendered superfluous/redundant because it always includes damage," Lucey said.

The court's analysis, he added, "ultimately violates a cannon of insurance contract construction — in favor of the insurance industry — to the detriment of South Carolina insureds."

Sullivan is represented by Justin O'Toole Lucey, Anna McCann, Sohayla R. Townes and Amanda Nicole Funai of Justin O'Toole Lucey PA.

Fireman's Fund and Allianz are represented by Brett Ingerman and Brett Solberg of DLA Piper and D. Larry Kristinik, A. Mattison Bogan and Blake Terence Williams of Nelson Mullins Riley & Scarborough LLP.

The case is Sullivan Management LLC v. Fireman's Fund Insurance Co. et al., case number 2021-001209, in the Supreme Court of South Carolina.

--Additional reporting by Shawn Rice and Shane Dilworth. Editing by Amy Rowe.
