_____ COURT OF NEW JERSEY
DOCKET NO.: _____

MAC PROPERTY GROUP LLC & THE CAKE BOUTIQUE LLC, Plaintiff-Petitioner, vs. SELETCTIVE FIRE AND CASUALTY INSURANCE COMPANY, JOHN DOES (1-10) and ABC COMPANIES (1-10), Defendant-Respondent(s).	CIVIL ACTION ON APPEAL FROM THE SUPERIOR COURT OF NEW JERSEY LAW DIVISION, CAMDEN COUNTY APPELLATE DIVISION DOCKET NO.: _____

BRIEF AND APPENDIX IN SUPPORT OF UNITED POLICYHOLDERS' MOTION FOR LEAVE TO APPEAR AS AMICUS CURIAE

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STATEMENT OF INTEREST OF AMICUS CURIAE

United Policyholders ("UP") is a non-profit 501(c) (3) organization founded in 1991 that is a voice and an information resource for insurance consumers in New Jersey and throughout the United States. The organization assists and informs consumers with regard to buying insurance and navigating the claim process after a loss. Grants, donations and volunteers support its work. UP does not accept funding from insurance companies.

UP's work is divided into three program areas: *Roadmap to Recovery*™ (disaster recovery and claim help), *Roadmap to Preparedness* (insurance and financial literacy and disaster preparedness), and *Advocacy and Action* (advancing pro-consumer laws and public policy). With grant funding from the Hurricane Sandy New Jersey Relief Fund, UP provided three years of services to Garden State homeowners whose properties had been damaged or destroyed and needed insurance guidance. UP hosts a library of tips, sample forms and articles on commercial and personal lines insurance products, coverage and the claims process at www.uphelp.org.

Public officials, state insurance regulators, academics and journalists throughout the U.S. routinely seek UP's input on insurance and legal matters. UP's Executive Director has been appointed for eleven consecutive years as an official consumer

representative to the National Association of Insurance Commissioners. In that role, UP works with regulators, including the New Jersey Division of Banking and Insurance, and on matters related to policy sales, claims, and consumer rights. UP also serves on the Federal Advisory Committee on Insurance, which briefs the Federal Insurance Office and in turn, the U.S. Treasury Department.

UP assists courts by filing briefs *amicus curiae* in appellate proceedings throughout the United States where the interests of policyholders at large may be impacted. UP has appeared as amicus curiae before this Court on [____] prior occasions, and three times before the Third Circuit Court of Appeals.

PRELIMINARY STATEMENT

UP respectfully submits this Amicus Brief in order to preserve established principles of New Jersey insurance law with which the Superior Court's decision below erroneously conflicts. The Court below dismissed the complaint of Plaintiff-Petitioner, MAC Property Group LLC & The Cake Boutique LLC ("Petitioner"), with prejudice, holding that Petitioner had not suffered a "direct physical loss" under the Policy. Opinion at 16. The Court below also held that the Policy could not be interpreted as providing coverage in accordance with Petitioner's reasonable expectations because the Policy was unambiguous, thereby

rendering the reasonable expectations doctrine inapplicable. *Id.* Both holdings are in error.[1]

First, an unbroken series of cases applying New Jersey law have established that loss of functionality caused by a harmful substance constitutes "direct physical loss" insured under an all-risk insurance policy, such as the one purchased by Petitioner. Indeed, under New Jersey law, a physical alteration to tangible property is ***not*** required to find a "direct physical loss" to covered property. Rather, New Jersey courts have found "direct physical loss," even in the absence of any material alteration to insured property, when the policyholder has been deprived of the property's intended use or functionality. The Petitioner's claim is based on the exact type of "direct physical loss" of property covered by an all-risk insurance policy (including the specific Policy at issue in this case) under New Jersey law.

Second, the doctrine of reasonable expectations, a bedrock principle of New Jersey insurance law, applies regardless of whether the policy language is clear or ambiguous. The doctrine

[1] Determining insurance coverage is a two-step process pursuant to which the policyholder first has the burden to demonstrate that the claim falls within the coverage grant of the policy, and the insurer then has the burden of proving the applicability of an exclusion barring coverage. *S.T. Hudson Engineers, Inc. v. Pennsylvania Nat. Mut. Cas. Co.*, 388 N.J. Super. 592, 603, 909 A.2d 1156, 1163 (App. Div. 2006). In the case at bar, the Superior Court also held that a virus exclusion in the Policy barred coverage for Petitioner's claim. UP's Amicus Brief does not address the applicability of the virus exclusion, but rather is directed towards the Superior Court's holding regarding the first step in the coverage analysis, i.e., whether the Petitioner's claim falls within the coverage grant of the Policy.

arises from the recognition that insurance policies are inherently subject to disparate bargaining power, and it is utilized by New Jersey Courts to protect policyholders and prevent insurance companies from overreach. The Superior Court's refusal to consider Petitioner's reasonable expectations of coverage conflicts with established state law and was in error.

The present case is neither theoretical nor without significant consequences to the multitude of New Jersey businesses impacted by the COVID-19 pandemic. Indeed, this Court's decision is likely to affect businesses throughout this State whose operations were disrupted as a result of COVID-19 and who have sought coverage under their all-risk insurance policies. Because of the novel issues presented by this case, and the far-reaching implications any decision will have on similarly-situated policyholders within the State, a determination barring Petitioner's claim with prejudice at the motion to dismiss stage is premature – particularly since the Policy fails to define what constitutes a "physical loss of . . . property" under an all-risk insurance policy.

Accordingly, UP requests that the Court grant its motion for leave to appear as amicus curiae and find in favor of Petitioner.

STATEMENT OF FACTS

As to the operative facts, UP adopts the Statement of Facts submitted by Petitioner.

LEGAL ARGUMENT

A. NEW JERSEY RULES OF INSURANCE CONSTRUCTION CONTROL THIS CASE.

New Jersey courts have long given special scrutiny to insurance policies because of the stark imbalance between insurance companies and policyholders in their respective understanding of the terms and conditions of insurance policies, and in their respective bargaining power in respect of those terms and conditions. *Gibson v. Callaghan*, 730 A.2d 1278, 1282 (N.J. 1999). An insurance policy "is a special kind of contract. It is an adhesion contract, and special rules apply." *Longobardi v. Chubb Ins. Co.*, 121 N.J. 530, 537 (1990) (citing *Meier v. N.J. Life Ins. Co.*, 101 N.J. 597, 611 (1986)). Although an insurance policy is a contract, "the insurance company is the expert and unilaterally prepares the policy, whereas the insured 'is a layman unversed in insurance provisions and practices.'" *Villa v. Short*, 195 N.J. 15, 23 (2008) (quoting *Gibson v. Callaghan*, 158 N.J. 662, 669 (1999)). Therefore, New Jersey courts apply different rules to the interpretation of these contracts of adhesion and "assume a particularly vigilant role in ensuring their conformity to

public policy and principles of fairness." *Voorhees v. Preferred Mut. Ins. Co.*, 128 N.J. 165, 175 (1992); *see also Sparks v. St. Paul Ins. Co.*, 100 N.J. 325, 335 (1985) (noting that terms of insurance policies are subject to "careful judicial scrutiny to avoid injury to the public").

1. Contra Proferentem

One rule of insurance policy construction is that "[i]f the controlling language will support two meanings, one favorable to the insurer, and the other favorable to the insured, the interpretation sustaining coverage must be applied." *Mazzilli v. Acc. & Cas. Ins. Co.*, 35 N.J. 1, 7 (1961); *see also Doto v. Russo*, 140 N.J. 544, 556 (1995) (noting New Jersey courts have consistently construed ambiguous language in insurance policies in favor of the insured and against the insurer); *Salem Grp. v. Oliver*, 607 A.2d 138, 139 (N.J. 1992) (stating "the policy should be interpreted in favor of the insured"); *Customized Distrib. Servs. v. Zurich Ins.* Co., 862 A.2d 560, 564 (N.J. App. Div. 2004).).

In determining ambiguity, the court will consider whether an average policyholder could reasonably understand the scope of coverage, and whether better, crisper drafting could put the issue beyond debate. *Gibson*, 730 A.2d at 1282 (citing *Doto*, 659 A.2d 1371); *see also Kook v. Am. Sur. Co. of N.Y.*, 210 A.2d 633, 638 (N.J. App. Div. 1965) ("[C]onsideration should be given [to]

whether alternative or more precise language, if used, would have put the matter beyond reasonable question."). Where an ambiguity is caused by the language selected by the insurance company, *contra proferentem* applies. *CPS Chem. Co., Inc. v. Cont'l Ins. Co.*, 536 A.2d 311, 318 (N.J. App. Div. 1988).

2. *Policies* Are Interpreted According to Policyholder's Reasonable Expectations.

Further, "[w]hen there is ambiguity in an insurance contract, courts interpret the contract to comport with the reasonable expectations of the insured, even if a close reading of the written text reveals a contrary meaning." *Zacarias v. Allstate Ins. Co.*, 775 A.2d 1262, 1264 (N.J. 2001). In fact, if the insurance policy's language is "insufficiently clear to justify depriving the insured of her reasonable expectation that coverage would be provided," the policy must be interpreted in favor of the policyholder. *Sparks v. St. Paul Ins. Co.*, 495 A.2d 406, 408 (N.J. 1985); *see also Royal Ins. Co. of Am. v. KSI Trading Corp.*, 563 F.3d 68, 74 (3d Cir. 2009). Under the doctrine of reasonable expectations, courts will depart from the literal text of the insurance policy and interpret the policy provisions in accordance with the policyholder's understanding, even if that understanding contradicts the insurance company's intent. *Zacarias*, 775 A.2d at 1269. New Jersey prohibits insurance companies from subjecting policyholders to "hidden

pitfalls" that violate the policyholder's reasonable expectations. *See Kievit v. Loyal Protective Life Ins. Co.*, 170 A.2d 22, 26 (N.J. 1961). The New Jersey Supreme Court has recognized that, because the average policyholder is not usually learned in insurance policy language, the court is obligated to prevent overreaching:

> [C]onsent can be inferred only to the extent that the policy language conforms to public expectations and commercially reasonable standards . . . . In instances in which the insurance contract is inconsistent with public expectations and commercially accepted standards, judicial regulation of insurance contracts is essential in order to prevent overreaching and injustice.

Sparks, 495 A.2d at 414.

3. While Coverage Provision Are Interpreted Broadly in Favor of the Policyholder, Exclusions Are Construed Narrowly against the Insurance Company.

Courts are required to read coverage provisions broadly in favor of the policyholder and construe exclusionary clauses strictly and narrowly against the insurance company, so "that the insured is entitled to protection to the full extent that any reasonable interpretation of them will permit." *Sealed Air Corp. v. Royal Indem. Co.*, 404 N.J. Super. 363, 376 (Super. Ct. App. Div. 2008); *see also Auto Lenders Acceptance Corp. v. Gentilini Ford, Inc.*, 181 N.J. 245, 270 (2004) (noting the Court's obligation "to protect the insured to the full extent that any fair interpretation [of the policy] will allow")

(alteration in original). If there is more than one possible interpretation of the language, courts apply the meaning that supports coverage rather than the one that limits it. *Cobra Prods., Inc. v. Fed. Ins. Co.*, 317 N.J. Super. 392, 401 (App. Div. 1998).

Courts must construe insurance policy exclusions narrowly, and the insurance company has the burden to bring the case within the exclusion. *Princeton Ins. Co. v. Chunmuang*, 151 N.J. 80, 95 (1997); *see also Hartford Acc. & Indem. Co. v. Aetna Life & Cas. Ins. Co.*, 98 N.J. 18, 26 (1984) (noting the insurance company has the burden of establishing the application of an exclusion); *Aetna Ins. Co. v. Weiss*, 416 A.2d 426, 428 (N.J. App. Div. 1980) (exclusions strictly construed against insurance company). Moreover, New Jersey courts will consider "whether more precise language by the insurer, had such language been included in the policy, 'would have put the matter beyond reasonable question.'" *Gibson v. Callaghan*, 158 N.J. 662, 670 (1999) (citation omitted).

To summarize, "coverage provisions are to be read broadly, exclusions are to be read narrowly, potential ambiguities must be resolved in favor of the insured, and the policy is to be read in a manner that fulfills the insured's reasonable expectations." *Selective Ins. Co. of Am. v. Hudson E. Pain Mgmt. Osteopathic Med.*, 46 A.3d 1272, 1273 (N.J. 2012); *see also*

Auto Lenders Acceptance Corp. v. Gentilini Ford, Inc., 854 A.2d 378, 393 (N.J. 2004) (noting court's obligation is "to protect the insured to the full extent that any fair interpretation [of the policy] will allow") (alteration in original).

B. THE SUPERIOR COURT ERRED IN HOLDING THAT PETITIONER'S LOSS OF USE OF ITS PROPERTY FOR ITS INTENDED PURPOSE DID NOT CONSTITUTE A "DIRECT PHYSICAL LOSS" UNDER THE POLICY.

The Policy provides coverage for losses as a result of "direct physical loss of or damage to property." In its Opinion, the Superior Court rejected Petitioner's argument that loss of use of its property for its intended purpose constituted a "direct physical loss" under the Policy. Opinion at 12, 16. Instead, the Superior Court held that there was no direct physical loss or damage to Petitioner's property or physical loss or damage which resulted in the closure orders. Opinion at 16. In so holding, the Superior Court distinguished the Appellate Division's seminal decision in *Wakefern Food Corp. v. Liberty Mutual Fire Insurance Company*, 406 N.J. Super. 524 (App. Div.), *certif. denied* 200 N.J. 209 (2009) ("*Wakefern*"), incorrectly characterizing that case as involving tangible property damage to an electrical grid. Opinion at 16. Specifically, the Superior Court held that "[t]he direct physical damage to the electrical grid present in *Wakerfern Food Corp.* is absent in this case." *Id.* Contrary to the Superior Court's characterization, as discussed further below, *Wakefern*,

like the case at bar, involved ***no*** tangible physical damage, but instead a temporary loss of use or functionality of the insured property for its intended purpose. The Court below, therefore, erred in its refusal to follow *Wakefern* and find that Petitioner's loss of use of its property constituted a "direct physical loss" under the Policy.

Notably, the Policy does not define the critically important terms "direct," "physical loss," or "physical damage," making these terms ambiguous. The inclusion of the disjunctive "or" in the coverage grant for "direct physical loss of ***or*** damage to," suggests that "physical loss" is different and distinct from "physical damage." This interpretation accords with New Jersey law.

1. New Jersey Law Compels a Finding that Petitioner's Claim for Relief Is Based on "Physical Loss of" Its Property.

Courts applying New Jersey law have univocally held that loss of use of property and inability of property to function as intended constitutes a "physical loss" covered under "all-risk" insurance policies like the one at issue here. Under New Jersey law, "physical loss" does not require a material alteration of property for losses to be covered. *See Customized Distribution Servs*, 862 A.2d at 565, *certif. denied*, 183 N.J. 214 (2005). In *Customized Distribution Services*, for example, the Appellate Division stated that a "direct physical loss" did "not require

actual physical damage to or alteration of the material composition of the property." *Id.*

That case involved a warehouseman's liability policy that covered "direct physical loss." The warehouse faced liability for shipping a manufacturer's drink product out of rotation with the drink's expiration date – forcing the manufacturer to sell the product at a discount because of its impending expiration at the time it reached the retail market. The insurance company denied coverage arguing the misrotation of the product did not cause "direct physical loss" because the product had not expired or "gone bad." Rather, because of the shortened expiration period, the product merely could not be sold at full market value. The insurance company argued the reduction in value did not constitute a "direct physical loss." The Appellate Division disagreed, holding the term "direct physical loss" was ambiguous and, therefore, had to be construed against the insurance company and in favor of coverage. *Id.* Specifically, "[s]ince 'physical' can mean more than material alteration or damage, it was incumbent on the insurer to clearly and specifically rule out coverage in the circumstances where it was not to be provided, something that did not occur here." *Id.* at 566. Accordingly, the court held the term included coverage for the drink product even though there was no physical material alteration to the product's composition. *Id.* at 565. The

Appellate Division thus reversed a trial court ruling that had granted summary judgment to the insurance company.

Subsequently, the Appellate Division in *Phibro Animal Health Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 446 N.J. Super. 419, 437 (N.J. App. Div. 2016), reaffirmed that property damage can exist even in the absence of a material alteration in property. The court in *Phibro* found that broiler chickens with a diminished size and weight, caused by the unintended effects of their feed, constituted property damage under a commercial general liability policy. *Id.* The damage did not need to be physiological to constitute a covered loss. *Id.*

Wakefern, which the Court below incorrectly distinguished and erroneously did not follow, was the first New Jersey case to address the requirement of "direct physical loss or damage" in property policies as a coverage trigger. 406 N.J. Super. 524. In *Wakefern*, the Appellate Division found the term "physical damage" to be ambiguous and held that summary judgment should have been granted to the policyholders – not the insurance company. In so holding, the Appellate Division concluded that "physical damage" included loss of "functionality" even if the insured property remained intact and even if the loss of functionality was temporary. 406 N.J. Super. at 543, 544.

The claim in *Wakefern* arose out of the 2003 electrical blackout across the Northeast United States. Wakefern, a collective of supermarkets, suffered food spoilage and business interruption as a result of the blackout. Wakefern's property insurance policy provided coverage for off-site power failure if caused by "physical damage." Wakefern's insurance company, Liberty Mutual, denied coverage claiming that no "physical damage" had occurred to trigger its policy. Rather, Liberty Mutual argued that the electrical grid had properly shut itself down in order to prevent physical damage, and the shutdown had been effective. The trial court agreed and granted Liberty Mutual summary judgment.

The Appellate Division reversed. It held the term "physical damage," which was undefined in the policy, was ambiguous, and under general principles of contract interpretation had to be interpreted in favor of coverage and in accordance with the policyholder's reasonable expectations. *Id.* at 538-39. The Appellate Division found the trial court had erred in defining "physical damage" "too narrowly, in a manner favoring the insurer and inconsistent with the reasonable expectations of the insured." *Id.* at 540. The Appellate Division concluded the electrical grid, indeed, had been physically damaged because it was rendered "physically incapable of performing [its] essential function of providing

electricity." *Id.* Significant to the Appellate Division's holding was its observation that the supermarkets "paid for what they believed was protection against…the loss of electrical power to refrigerate their food," and "the average policyholder in plaintiffs' position would not be expected to understand … the narrowly parsed definition of 'physical damage' which the insurer urges us to adopt." *Id.* at 541. Accordingly, the Appellate Division stated "if Liberty intended that its policy would provide no coverage for an electrical blackout, it was obligated to define its policy exclusion more clearly." *Id.*

The *Wakefern* court concluded "one could certainly argue that the system was not physically damaged;" however, "from the perspective of the millions of customers deprived of electric power for several days, the system certainly suffered physical damage, because it was incapable of providing electricity." *Id.* The court held that "the loss of function of the system as a whole" constituted physical damage. *Id.*

Similar to *Wakefern*, in the case as bar, Petitioner was deprived of its ability to use its property for its intended purpose – as a bakery selling baked goods and cakes for weddings, birthday parties, and other special occasions and offering on-site parties and decorating classes. The Court below declined to follow *Wakefern* because that case involved "specific language" contemplating coverage for "physical damage"

resulting from an interruption of electrical power. Opinion at 13. The policy language in both cases, however, is similar – and arguably, the provision in Petitioner's Policy covering "direct physical loss of or damage to" property contemplates even broader coverage than the policy in *Wakefern* which only covered "physical damage." The Court below, therefore, should have followed *Wakefern* and held that Petitioner's loss of use of its property constituted a "direct physical loss" under the Policy.

Although the Superior Court attempted to dismiss other New Jersey decisions on the basis that they are unpublished (Opinion at 12), the overwhelming number of New Jersey courts that have considered this issue find in accord with *Wakefern* and hold that "direct physical loss" is distinct from "direct physical damage," and contemplates a loss of use that does not require tangible physical alteration.

In *Gregory Packaging, Inc. v. Travelers Property Casualty Company*, No. 12-cv-04418, 2014 WL 6675934, *6 (D.N.J. Nov. 25, 2014), for example, the New Jersey District Court held the inability to use property as intended constituted physical loss or damage even in the absence of any material alteration to the property. In that case, ammonia was inadvertently released in a building. There was no allegation that the ammonia physically damaged or altered the property. Because of the health threat

raised by the presence of ammonia, however, the government authorities ordered the building evacuated, and it remained unoccupied for approximately one week. Although there was "no genuine dispute" that the ammonia release rendered the building unfit for human use until after the ammonia dissipated, *id.* at *4, the insurance company, nevertheless, argued that the release did not cause "direct physical loss or damage," because there was no "physical change or alteration to insured property requiring its repair or replacement," *id.* at *2. The insurance company further argued the policyholder's inability to use the building as intended did not constitute "physical loss or damage." *Id.*

The court rejected the insurance company's argument. It held that "the ammonia discharge inflicted 'direct physical loss or damage to' Gregory Packaging's facility, as that phrase would be construed under New Jersey law by the New Jersey Supreme Court, because the ammonia physically rendered the facility unusable for a period of time." *Id.* at *6. Thus, in *Gregory Packaging*, the loss of the building's essential functionality – similar to the loss of the functionality of the electric grid in *Wakefern* – constituted a "physical loss or damage."

In so holding, the *Gregory Packaging* court noted the Third Circuit Court of Appeals, in *Port Authority of N.Y. & N.J. v. Affiliated FM Insurance Co.*, 311 F.3d 226, 236 (3d Cir. 2002),

also held under New Jersey law that "property can be physically damaged, without undergoing structural alteration, when it loses its essential functionality." *Gregory Packaging*, 2014 WL 6675934 at *5. Specifically, in *Port Authority*, the Third Circuit stated that the presence of free-floating asbestos in the air of an insured building, which made the building uninhabitable and unusable, could constitute a distinct physical loss covered under an all-risk policy. *Port Authority*, 311 F.3d at 236.

Most recently, in *Optical Services USA/JC1 v. Franklin Mutual Insurance Co.*, the court applied these principles of New Jersey law to a coronavirus case. Transcript of Decision on Motion to Dismiss, Case No. 20-cv-08069 (N.J. Law Div. (Bergen Co.) Aug. 13, 2020) (Doc. 17-3) ("Tr."). The insurance company in *Optical Services* brought a motion to dismiss the plaintiff's coronavirus-related business interruption insurance claim on the basis that no "direct physical loss or damage" had occurred. The policyholder relied on *Wakefern*, and asserted the New Jersey Governor's executive order "deemed all non-essential business unsafe given the risk of transmission of Covid-19 thus the closure order had a specific relationship to a specific condition within the plaintiff's business." *Id.*, Tr. at 27. The court denied the insurance company's motion. It found

Wakefern "compelling" in the context of a motion to dismiss. *Id.*, Tr. at 28.

These decisions establish that loss of functionality of property caused by a dangerous condition constitutes "direct physical loss or damage" under a property insurance policy, and that physical alteration of the property is not required. At a minimum, "direct physical loss" is ambiguous as a matter of law and must be construed in favor of coverage.

2. The Superior Court Erred in Relying on *Arthur Andersen v. Federal Insurance Company*, 416 N.J. Super. 334 (App. Div. 2010).

Arthur Andersen LLP v. Federal Insurance Company, 416 N.J. Super. 334 (App. Div. 2010), upon which the Superior Court relied (Opinion at 13), is inapposite and does not justify the Superior Court's failure to follow *Wakfern* and its progeny. In *Arthur Andersen*, the plaintiff argued that the September 11th attacks on the World Trade Center ("WTC") and Pentagon caused it to suffer a revenue shortfall, which was the basis for Arthur Andersen's business interruption claim. Arthur Andersen, however, had no interest (insurable or otherwise) in either the WTC or Pentagon properties, and unlike the Petitioner, it was not alleging that it lost its ability to use its property as intended. 416 N.J. at 349-50. Here, the Petitioner, like the policyholders in *Wakefern* and *Gregory Packaging* lost its ability to use its own insured property. Under the Petitioner's Policy,

the loss of functionality of its property constitutes a "direct physical loss" under its Policy.

C. CONSISTENT WITH NEW JERSEY LAW, COURTS IN OTHER JURISDICTIONS HAVE UPHELD COVID-19-RELATED PROPERTY DAMAGE AND BUSINESS INTERRUPTION CLAIMS, RECOGNIZING THAT LOSS OF USE OF PROPERTY CONSTITUTES A "DIRECT PHYSICAL LOSS."

Numerous courts in other jurisdiction have ruled in favor of policyholders and sustained COVID-19-related property damage and business interruption claims as claims for "physical loss" of covered property. For example:

- In *Elegant Massage, LLC v. State Farm Mutual Automobile Ins. Co.*, Civil Action No. 2:20-cv-265 (E.D. Va. Dec. 9, 2020), a Virginia District Court sustained a massage facility's COVID-19-related claims on an insurer's motion to dismiss. In so holding, the district court found the policy terms "direct physical loss" ambiguous and, construing the ambiguity against the insurance company as the drafter of the policy, held that the terms included "property that is uninhabitable, inaccessible, or dangerous to use because of intangible, or non-structural, sources;"

- In *Perry Street Brewing Co., LLC v. Mutual of Enumclaw Ins. Co.*, Case No. 20-2-02212-32 (Wash. Supr. Ct. Nov. 23, 2020), the Washington Superior Court granted policyholder's motion for partial summary judgment. The court held that the interruption of policyholder's business as a result of COVID-19-related closure orders constituted a "direct physical loss" of property under a businessowner's policy, like the one at issue in the case at bar, because the closure orders resulted in a deprivation of policyholder's use of its property;

- In *Hill & Stout v. Mutual of Enumclaw*, No. 20-2-07925-1 (Wa. Supr. Ct. Nov. 12, 2020), the Washington Superior Court denied the insurance company's motion to dismiss plaintiff's COVID-19-related claims because "direct physical loss" was ambiguous under the policy,

and therefore, had to be construed in favor of coverage to include loss of use of property;

- In *Cajun Conti LLC v. Certain Underwriters at Lloyd's London*, Case No. 2020-02558(La. Civil Dist. Ct. Nov. 4, 2020), the Louisiana Civil District Court denied the insurance company's motion for summary judgment, holding that the issue of whether policyholder suffered "physical loss or damage" as a result of the COVID-19-related suspension of its restaurant operations constituted a genuine issue of material fact inappropriate for determination on summary judgment;

- In *North State Deli LLC v. Cincinnati Insurance Company*, Case No. 20-CVS-02569 (N.C. Gen. Ct. Oct. 9, 2020), the North Carolina General Court of Justice granted policyholder's motion for partial summary judgment that its policies covered its business interruption claim for loss of use of its property as a result of COVID-19-related closure orders. In so holding, the court concluded that "physical loss" and "physical damage," which were undefined under the policy, had distinct and separate meanings, and "direct physical loss" includes the inability to utilize or possess something;

- In *Blue Springs Dental Care, LLC v. Owners Ins. Co.*, Case No. 20-CV-00383-SRB, 2020 WL 5637963, at *4 (W.D. Mo. Sept. 21, 2020), the Missouri District Court denied the insurance company's motion to dismiss, holding that the policyholder had sufficiently stated a claim for "direct physical loss" under its businessowner's policy. The court ruled that the undefined term "physical loss" included deprivation and loss of use of property for its intended purpose and did not require a physical alteration. *Id.* at *4;

- *See also Studio 417, Inc. v. Cincinnati Ins. Co.*, No. 20-CV-03127-SRB, 2020 WL 4692385, at *4 (W.D. Mo. Aug. 12, 2020) (denying insurance company's motion to dismiss COVID-19-related claims and holding that term "direct physical loss" included deprivation of property not requiring a physical alteration and was not synonymous with term "physical damage"); *K.C. Hopps, Ltd. v. The Cincinnati Ins. Co., No. 20-cv-*00437 (W.D. Mo. Aug. 12, 2020) (holding that

> Plaintiff's claims are "adequately stated" for "substantially the same reasons as those in the *Studio 417* Order").

These cases all support Petitioner's interpretation and are in accord with New Jersey law that "physical loss" does not mean the same thing as "physical damage," and the former includes loss of use or functionality – even in the absence of tangible physical alteration to the property. Based on both New Jersey law and the decisions from outside jurisdictions, the Petitioner's COVID-19-related insurance claim states a claim for relief for "direct physical loss" under the Policy. Accordingly, the lower court's holding to the contrary was in error and should be reversed.

D. THE COURT BELOW ERRED IN FAILING TO APPLY THE DOCTRINE OF REASONABLE EXPECTATIONS.

In its decision, the Superior Court declined to interpret the Policy in accordance with Petitioner's reasonable expectations of coverage. Opinion at 16. In particular, the Superior Court concluded that the Policy was not ambiguous, and on this basis, concluded that the doctrine of reasonable expectations was inapplicable. *Id.* This decision was in error because the doctrine of reasonable expectations applies regardless of whether the policy is ambiguous or not. *See Morton Int'l v. Gen. Acc. Ins. Co.*, 134 N.J. 1, 76-77 (1993).

The New Jersey Supreme Court explained that, because of the unique nature or insurance contracts as contracts of adhesion, it is necessary to interpret insurance contracts in accordance with "the reasonable expectations of the insured, ***regardless of the existence of any ambiguity in the policy.***" *Id.* (quoting *Sparks v. St. Paul Ins. Co.*, 100 N.J. 325, 338 (1985)) (emphasis added; internal citations omitted).

Indeed, New Jersey courts have long applied the doctrine without consideration of or reference to policy ambiguity. *See Kievit v. Loyal Protective Life Ins. Co.*, 34 N.J. 475 (1961); *Mazzilli v. Accident & Cas. Ins. Co. of Winterthur, Switzerland*, 35 N.J. 1, 170 A.2d 800 (1961); *see also* Voorhees v. Preferred Mut. Ins. Co., 128 N.J. 165, 175 (1992) ("Moreover, if an insured's 'reasonable expectations' contravene the plain meaning of a policy, even its plain meaning can be overcome."); *Lehrhoff v. Aetna Cas. & Sur. Co.*, 271 N.J. Super. 340 (App. Div. 1994) (did not find any ambiguity before applying the doctrine); *Matchaponix Estates, Inc. v. First Mercury Ins. Co.*, No. A-4784-15T4, 2017 N.J. Super. Unpub. LEXIS 1697 (App. Div. July 10, 2017) (holding that policy provision was ***not*** ambiguous and then applying doctrine of reasonable expectations); *but see American Wrecking Corp. v. Burlington Ins. Co.*, 400 N.J. Super. 276 (App. Div. 2008) (declining to apply doctrine of reasonable expectations without a policy ambiguity because policyholder was

a sophisticated commercial entity). Thus, the Superior Court's conclusion that the Policy was not ambiguous should not have foreclosed application of the reasonable expectations doctrine.

E. NEW JERSEY LAW ESTABLISHINING THAT LOSS OF USE OR FUNCTIONALITY OF PROPERTY CONSTITUTES "DIRECT PHYSICAL LOSS" COMPORTS WITH PETITIONER'S REASONBLE EXPECTATIONS.

The Court below stated that Petitioner had pointed to no language in the insurance policy creating a reasonable expectation of coverage. Opinion at 16. On the contrary, Petitioner reasonably expected that damages incurred as a result of its loss of use or functionality of its property would fall within the coverage grant of the Policy for "direct physical loss of or damage to" insured property. Petitioner's reasonable expectation on this issue comports both with New Jersey law holding that "direct physical loss" does not require a material alteration of property and general rules of insurance policy interpretation.

The Policy covers "direct physical loss of" ***or*** "direct physical damage to" covered property. By using the disjunctive "or," Defendant-Respondent Selective Fire and Casualty Insurance Company ("Respondent"), as the drafter of the Policy, meant for the phrase "physical loss" to mean something different from "physical damage." Because these terms are undefined under the Policy, their meaning can be discerned through their dictionary definitions. *Cypress Point Condo. Ass'n, Inc. v. Adria Towers,*

LLC, 226 N.J. 403, 426 (2016). The term "direct" is defined as being "characterized by close logical, causal, or consequential relationship." *See* "Direct," Merriam-Webster (Online ed. 2020) available at www.meriam-webster.con/dictionary/direct. "Physical" is defined as something that is "perceptible especially through the senses and subject to the laws of nature." *See* "Physical," *id.* available at www.merriam-webster.com/dictionary/physical. "Loss" means "the act of losing possession: deprivation," and "harm or privation resulting from loss or separation." *See* "Loss," *id.* available at www.merriam-webster.com/dictionary/loss. "Damage," on the other hand, is defined as "harm resulting from injury to . . . property." *See* "Damage," *id.* available at https://www.merriam-webster.com/dictionary/damage. Thus, under Petitioner's reasonable expectations, the term "direct physical loss of or damage to" property covers two separate and distinct injuries – one for loss of use of the insured property and another for physical alteration to the insured property.

New Jersey State Executive Order No. 103 issued by Governor Murphy prevented Petitioner from operating its business as intended. Petitioner certainly had an objectively reasonable expectation that its inability to utilize its property constituted a "physical loss" under the Policy. Respondent's position that Petitioner's losses do not constitute a "physical

loss of" property in the absence of a tangible material alteration is contrary not only to New Jersey law, but Petitioner's reasonable expectations under the Policy.

CONCLUSION

For the foregoing reasons, UP respectfully requests that this Court grant its motion for leave to appear as amicus curiae and find in favor of the policyholder MAC Property Group LLC & The Cake Boutique LLC.

Dated: January __, 2021

By: _____

Robert D. Chesler, Esq.
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APPENDIX

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_____ COURT OF NEW JERSEY
DOCKET NO.: _____

MAC PROPERTY GROUP LLC & THE CAKE BOUTIQUE LLC, Plaintiff-Petitioner, vs. SELETCTIVE FIRE AND CASUALTY INSURANCE COMPANY, JOHN DOES (1-10) and ABC COMPANIES (1-10), Defendant-Respondent(s).	CIVIL ACTION ON APPEAL FROM THE SUPERIOR COURT OF NEW JERSEY LAW DIVISION, CAMDEN COUNTY APPELLATE DIVISION DOCKET NO.: _____

CERTIFICATION OF ROBERT D. CHESLER, ESQ. PURSUANT TO RULE 1:13-9(a) IN SUPPORT OF MOTION FOR LEAVE TO APPEAR AS AMICUS CURIAE

I, **ROBERT D. CHESLER**, certifies as follows:

1. I am an attorney in the State of New Jersey and a shareholder of the law firm of Anderson Kill P.C., counsel for proposed amicus curiae, United Policyholders ("UP"), and I respectfully submit this Certification in support of UP's motion for leave to appear as amicus curiae. I make this certification on behalf of UP pursuant to Rule 1:13-9(a).

2. United Policyholders ("UP") is a non-profit 501(c) (3) organization founded in 1991 that is a voice and an information resource for insurance consumers in New Jersey and throughout the United States.

3. The organization assists and informs consumers with regard to buying insurance and navigating the claim process after a loss.

4. Grants, donations and volunteers support its work. UP does not accept funding from insurance companies.

5. UP's work is divided into three program areas: *Roadmap to Recovery*™ (disaster recovery and claim help), *Roadmap to Preparedness* (insurance and financial literacy and disaster preparedness), and *Advocacy and Action* (advancing pro-consumer laws and public policy).

6. With grant funding from the Hurricane Sandy New Jersey Relief Fund, UP provided three years of services to Garden State homeowners whose properties had been damaged or destroyed and needed insurance guidance.

7. UP hosts a library of tips, sample forms and articles on commercial and personal lines insurance products, coverage and the claims process at www.uphelp.org.

8. Public officials, state insurance regulators, academics and journalists throughout the U.S. routinely seek UP's input on insurance and legal matters.

9. UP's Executive Director has been appointed for eleven consecutive years as an official consumer representative to the National Association of Insurance Commissioners.

10. In that role, UP works with regulators, including the New Jersey Division of Banking and Insurance, and on matters related to policy sales, claims, and consumer rights. UP also serves on the Federal Advisory Committee on Insurance, which briefs the Federal Insurance Office and in turn, the U.S. Treasury Department.

11. UP assists courts by filing briefs *amicus curiae* in appellate proceedings throughout the United States where the interests of policyholders at large may be impacted.

12. UP has appeared as amicus curiae before this Court on [____] prior occasions, and three times before the Third Circuit Court of Appeals.

13. UP's special interest in this case is to preserve established principles of New Jersey insurance law. In particular, UP seeks to preserve New Jersey law establishing that loss of functionality of property constitutes a "direct physical loss" under an all-risk insurance policy. Additionally, UP seeks to preserve the doctrine of reasonable expectations created as a result of judicial recognition that insurance policies are contracts of adhesion.

14. UP intends to address the underlying principles of these established issues of insurance law and the significance of the Superior Court's decision not to follow or apply them.

I certify that the foregoing statements made by me are true. I am aware that if any of the foregoing statements made by me are willfully false, I am subject to punishment.

Dated: January __, 2021

_____
Robert D. Chesler