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COZEN O'CONNOR

First Appellate Ruling Holds COVID-19 Business Losses Are Not Physical Loss or Damage

The first appellate court to consider a COVID-19 business interruption claim has ruled in favor of the insurer holding that coverage for business losses resulting from the COVID-19 pandemic and related government orders is not triggered under a commercial property policy because there is no "physical loss" or "physical damage" to property.

In *Oral Surgeons, P.C. v. The Cincinnati Insurance Company*, No. 20-3211, Slip. Op. (8th Cir. July 2, 2021), the insured oral surgery practice stopped performing non-emergency procedures in late March 2020 after the governor of Iowa declared a state of emergency and imposed restrictions on dental practices because of the COVID-19 pandemic. The insured's policy provided coverage for lost business income and extra expense sustained due to the suspension of operations "caused by direct 'loss' to property." The policy defined loss as "accidental physical loss or accidental physical damage."

The insurer denied coverage on the basis that there was no direct physical loss or physical damage to the insured's property, and the insured filed a lawsuit. The district court granted the insurer's motion to dismiss, concluding that the insured was not entitled to declaratory judgment and that it had failed to state claims for breach of contract and bad faith.

On appeal, the insured maintained that the COVID-19 pandemic and the related government-imposed restrictions on performing non-emergency dental procedures constituted a "direct 'loss' to property" because the insured was unable to fully use its offices. The insured argued that the policy's disjunctive definition of loss as physical loss or physical damage created an ambiguity that must be construed against the insurer. To give the terms separate meanings, the insured suggested defining physical loss to include "lost operations or inability to use the business" and defining physical damage as a physical alteration to property.

Interpreting Iowa law, the Eighth Circuit held that the policy required "some physicality to the loss or damage of property — e.g., a physical alteration, physical contamination, or physical destruction." The court held that the policy could not reasonably be interpreted to cover mere loss of use when the insured's property has suffered no "physical loss or damage." To support its interpretation of the coverage provision, the court noted that the policy provided coverage for lost business income and extra expense during the "period of restoration," which was defined as beginning on the date when the property "should be repaired, rebuilt or replaced." This definition, the court pointed out, assumed physical alteration of the property, not mere loss of use.

The court held that the insured failed to satisfy this definition because it did not allege any physical alteration of property. Rather, the insured alleged only that it suspended non-emergency procedures, which did not constitute "accidental *physical* loss or accidental *physical* damage," regardless of the precise definitions of the terms loss or damage. Because the insured's alleged loss of use of its offices and suspension of procedures were not physical, they did not trigger coverage under the policy. Accordingly, the Eighth Circuit affirmed the district court's judgment.

This appellate ruling is a great victory for insurers and will bolster arguments that coverage is precluded under commercial property policies because there is no physical loss or physical damage to property.

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