LEGAL UPDATE

Legal Services Division

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IOWA SUPREME COURT DECISION — INSURANCE COVERAGE FOR BUSINESS' LOSS INCOME DURING THE COVID-19 PANDEMIC

Purpose. *Legal updates are prepared by the nonpartisan Legal Services Division of the Legislative Services Agency. A legal update is intended to provide legislators, legislative staff, and other persons interested in legislative matters with summaries of recent meetings, court decisions, Attorney General Opinions, regulatory actions, federal actions, and other occurrences of a legal nature that may be pertinent to the General Assembly's consideration of a topic. Although an update may identify issues for consideration by the General Assembly, it should not be interpreted as advocating any particular course of action.*

Wakonda Club v. Selective Insurance Company of America
Filed April 22, 2022, as amended June 22, 2022
No. 21-0374
iowacourts.gov/courtcases/14876/embed/SupremeCourtOpinion

Factual and Procedural Background. On March 17, 2020, Governor Reynolds issued an emergency proclamation closing dine-in service in bars and restaurants due to COVID-19. The Wakonda Club (Wakonda), a private golf and country club, closed completely from March 17 through March 28, and reopened for carryout food and restricted dine-in services on May 22. Wakonda submitted a claim to Selective Insurance Company of America (Selective), Wakonda's commercial property insurer, for income lost during the temporary closure. The applicable commercial property policy (policy) covered all losses, other than losses specifically excluded, and included a business income and extra expense coverage endorsement (business income endorsement) that provided coverage for actual loss of business income sustained due to a necessary suspension of operations during a "period of restoration." "Period of restoration" is defined in the policy, however, in general terms it is the period of time necessary for a business to resume its operations at its current location after the property has been repaired, rebuilt, or replaced; or the date the business resumes operations at a new permanent location. The policy also included an endorsement for loss or damage resulting from any virus, bacterium, or other microorganism that induces or is capable of inducing physical distress, illness, or disease.

Wakonda asserted the income it lost was solely due to its inability to fully use its property, and denied that COVID-19 had contaminated the property covered by the policy, or infected any of Wakonda's employees or members. Selective denied the claim, Wakonda filed suit, and the district court granted summary judgment in favor of Selective. Wakonda appealed to the Iowa Supreme Court (Court).

Issue. Whether the loss of use of business property constitutes "direct physical loss of or damage to property" under a business interruption endorsement to an all-risk commercial property insurance policy.

Holding. The Court concluded that to be covered under the applicable policy, "direct physical loss of or damage to property" requires a physical aspect to the loss of the business property, and unanimously affirmed the district court's order granting summary judgment in favor of Selective Insurance.

Analysis. Wakonda raised three issues on appeal:

- Whether the policy's "direct physical loss or damage to property" language covers its economic losses.
- Whether the virus exclusion endorsement is inapplicable because Wakonda's loss of income was due to the Governor's proclamation and not due to COVID-19.

- Whether Wakonda reasonably expected the policy would provide coverage for losses sustained due to the interruption of its business.

The Court reviewed the district court's summary judgment ruling for the correction of errors at law using well-established rules to determine the meaning of the contract's provisions: construe unambiguous contracts as written; give ordinary meaning to words, as viewed by an ordinary person, that are not defined in the policy; and interpret ambiguous policy provisions in favor of the insured.

The Court first analyzed the business income endorsement which required that a suspension of operations be "caused by direct physical loss or damage to property." The Court determined that the use of "or" meant that the policy provides business interruption coverage if Wakonda suffers either a "loss of" or "damage to" the property covered by the policy, however, the loss must be a "direct physical" loss. The Court noted that no Iowa case law specifically interprets the meaning of "direct physical" in the context of an all-risk commercial property business interruption policy. Selective relied on *Milligan v. Grinnell Mutual Reinsurance*, No. 00-1452, 2001 WL 427642, at *2 (Iowa Ct. Ap. April 27, 2001) to assert that physical loss or use of an insured's property must occur in order for coverage to apply. The Court stated that while the facts in *Milligan* are much different than the case at hand, *Milligan* interprets the phrase "direct physical loss or damage" and recognized that the policy language required the loss to be physical in nature. The Court cited *Kartridg Pak Co. v. Travelers Indem. Co.*, 425 N.W.2d 687, 688 (Iowa Ct. Ap. 1988), a case that explained that insurers started adding the term "physical" to commercial general liability policies to avoid covering intangible losses, which the Court cites as context for the term "physical" in Wakonda's policy, to mean tangible losses and not just economic losses.

In addition, the Court noted that a federal district court had applied Iowa law to construe a similar provision and in that case concluded that "physical" had to be given meaning so that "physical loss or damage generally requires some sort of physical invasion, however minor." *The Phoenix Insurance Co. v. Infogroup Inc.*, 147 F. Supp. 3d 815, 824 (S.D. Iowa 2015). In citing that case, the Court stated that "'physical has to mean something" and agreed with Infogroup's argument that there must be a physical aspect to the loss of property, not just the loss of use of the property, in order for Wakonda to satisfy the requirement in the policy that there is "direct physical loss of or damage to property."

The Court noted that as the policy provides coverage until the property is repaired, rebuilt, or replaced; or until the business resumes in another permanent location, the policy indicates there must be a physical alteration of the property. The Court also noted that Wakonda had affirmatively disavowed that COVID-19 had contaminated its property or infected any of its employees or members and removed any potential physical aspect to its loss of use of its property. The Court compared a similar case involving the loss of the use of commercial property in which the plaintiffs alleged that COVID-19 particles attached to and damaged the plaintiff's property making it unsafe and unusable. *Studio 417, Inc. v. Cincinnati Ins.*, 478 F. Supp. 3d 794, 802 (W.D. Mo. 2020). In that case, the court denied the defendant's motion to dismiss.

The Court stated the proclamation issued by Governor Reynolds was an attempt to prevent the further spread of COVID-19 and was not issued in response to the imminent danger of physical harm that would cause loss of property to businesses like Wakonda. The Court concluded that Wakonda's mere loss of use of its property with no physical aspect to the loss of use defeated Wakonda's claim.

Applying the doctrine of reasonable expectations for insured properties, the Court also addressed Wakonda's argument it had a reasonable expectation of coverage. Wakonda argued that an ordinary layperson would not understand the difference between "loss" and "damage." The Court noted that irrespective of an ordinary layperson's ability to understand the difference between "loss" and "damage," the business interruption endorsement explicitly required the loss be a direct physical loss, and Wakonda did not suffer such a loss. The Court affirmed the district court's order granting summary judgment in Selective's favor.

NOTE: The Court analyzed a similar contract provision in a companion case, *Jesse's Embers, LLC v. Western Agricultural Insurance Company*, filed April 22, 2022, No. 21-0623, and concluded that without an actual physical aspect to Jesse's Embers (Jesse's) loss of property, the plaintiff's claim fails. In addition, Jesse's had argued that the civil authority provision of its Farm Bureau policy applied because the Governor's proclamation prohibited access to Jesse's covered property and the area immediately surrounding Jesse's covered property. The civil authority provision required that a covered cause of loss damaged property not insured under Jesse's Farm Bureau policy and that was within a mile of Jesse's property. In addition, a civil authority must have prohibited access to Jesse's property

in response to dangerous physical conditions resulting from the damaged property. The Court determined the civil authority provision did not cover the losses experienced by Jesse's during the closures mandated by the proclamation simply because properties near Jesse's were also closed due to the proclamation. The Court noted Jesse's did not allege that properties near Jesse's property were damaged, and also noted the Governor's proclamation was issued to slow the transmission of COVID-19, and not in response to dangerous physical conditions resulting from property damage at a property located within a mile of Jesse's. The Court affirmed the district court's order granting summary judgment to Farm Bureau.

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