

RECENT DEVELOPMENTS IN PROPERTY INSURANCE  
LAW

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#### I. COVERAGE FOR CHINESE DRYWALL CLAIMS

First-party Chinese drywall litigation sharply diminished in 2011 due, in large part, to the decision by the Judicial Panel on Multidistrict Litigation (MDL) on December 16, 2010, finding no coverage under homeowner's insurance policies for the damages due to the effects of Chinese drywall off-gassing.<sup>1</sup> Subsequent to the decision, the plaintiffs' steering committee dismissed all pending first-party cases in the MDL, with prejudice. Many courts then followed the same reasoning to preclude coverage for first-party Chinese drywall claims.

On May 6, 2011, the Virginia Circuit Court decided the case of *Proto v. Futura Group, LLC*<sup>2</sup> and found that the standard pollution exclusion encompasses the sulfur-dioxide released or discharged by the Chinese drywall and excluded coverage for the loss. In addition, the court found that the defective materials, corrosion, and latent defect exclusions excluded the insureds' claim for damage caused by the Chinese drywall. Similarly, later that month, a state court in Louisiana held that Chinese drywall is a faulty

1. *In re Chinese Manufactured Drywall Prods. Liab. Litig.*, 759 F. Supp. 2d 822 (E.D. La. 2010).

2. 2011 WL 2595637 (Va. Cir. Ct. May 6, 2011).

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or defective material excluded from coverage under the insurance policy's "faulty, inadequate or defective materials exclusion."<sup>3</sup>

On June 14, 2011, the state appellate court decision on Chinese drywall was rendered in *Ross v. C. Adams Construction & Design, LLC*.<sup>4</sup> In *Ross*, the insureds' home contained Chinese drywall emitting sulfuric gases that corroded electrical wiring, plumbing components, and other household items. Louisiana Citizens, the Ross' homeowner's insurer, argued that the house did not suffer a "direct physical loss" as required by the policy, because the drywall was physically intact and functional.<sup>5</sup> However, the court held that the inherent qualities of the Chinese drywall created a "physical loss to the home and required that the drywall be removed and replaced."<sup>6</sup> The court then went on to find no coverage under the exclusion for "faulty, inadequate, or defective materials."<sup>7</sup> The court found that the drywall emitted high levels of sulfuric gas which caused damage to the insured home's plumbing, electrical wiring, and metal components and that it was not "serving its intended purpose as a component of a livable residence because of its inherent qualities of emitting the sulfuric gas."<sup>8</sup>

In addition, the court opined that the Chinese drywall that caused the damage constituted a latent defect, which was hidden and unknown for two years. Therefore, the court held that the insureds' claims were excluded by the latent defect exclusion. Next, the court found that the corrosion exclusion applied to the damages claimed by the insureds since the insureds alleged in their petition that the emission of gases from the drywall caused corrosion of the components in their home. Finally, the court found that the sulfuric gas emitted from the drywall constituted a pollutant under the policy. As such, the policy's pollution exclusion precluded coverage for any damage to the home caused by the emission of sulfuric gases from the Chinese drywall.

In *Bishop v. Alfa Mutual Insurance Co.*,<sup>9</sup> the Southern District of Mississippi ruled that although the Chinese drywall in the house at issue was defective from the time it was initially installed, it had not been established that the defective drywall could not have been discovered by any known and customary test. The court, therefore, was unable to conclude that the "latent defect" exclusion applied. Similarly, there was no evidence that the

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3. *Vinson v. Royal Homes, LLC*, Case No. 2009-13336 (La. Jud. Dist. Ct. May 2011).

4. 70 So. 3d 949, (La. Ct. App. 2011).

5. *Id.* at 952.

6. *Id.*

7. *Id.*

8. *Id.* at 953.

9. 796 F. Supp. 2d 814 (S.D. Miss. 2011).

Chinese drywall in the house was damaging or destroying itself and the court thus concluded that the “inherent vice” exclusion did not apply.<sup>10</sup>

Thereafter, the court addressed the policy’s “contamination” exclusion and concluded that it applied to preclude coverage for the claimed losses. Next, the court held that it was undisputed that the damage to the “structural, mechanical and plumbing systems” of the residence was caused by the “action or process of corroding,” and the corrosion exclusion unambiguously applied.<sup>11</sup> Finally, the court held that the broad definition of “faulty materials” under common usage of a defect or imperfection in a physical thing, lends further support to the finding that the Chinese drywall constitutes a faulty material, which is excluded by the “faulty materials” exclusion.

On the same day the *Bishop* ruling was rendered, the same court decided *Lopez v. Shelter Insurance Co.*<sup>12</sup> Applying the same exclusions at issue in *Bishop*, the *Lopez* court held that the policy did not provide coverage for the defective Chinese drywall or the damage caused by off-gassing.

## II. BUSINESS INTERRUPTION/ CIVIL AUTHORITY

Joining a startlingly small number of courts nationwide that have addressed the construction of contingent business interruption (CBI) provisions, a federal court sitting in New York determined that the undefined term “direct suppliers” contained in a CBI provision was ambiguous.<sup>13</sup> In that case, an insured manufacturer claimed coverage under a CBI provision after an explosion at a facility operated by a wholly owned subsidiary of the insured disrupted the insured’s supply of a component used in a product produced by another subsidiary of the insured. The insurer argued that subsidiaries cannot be “direct suppliers” under a CBI provision as that would render ordinary business interruption coverage redundant. The court concluded that the term was ambiguous, and despite reviewing substantial extrinsic evidence, declined to apply the doctrine of *contra proferentem*, instead leaving the question to a jury.<sup>14</sup>

Two courts recently addressed the “physical damage” requirement for triggering civil authority coverage.<sup>15</sup> In *Dickie Brennan & Co. v.*

10. *Id.* at 818.

11. *Id.* at 823.

12. 2011 WL 2457872 (S.D. Miss. June 16, 2011).

13. *Park Electrochem. Corp. v. Cont’l Cas. Co.*, 2011 WL 703945 (E.D.N.Y. Feb. 18, 2011).

14. *Id.* at \*19–20.

15. *Dickie Brennan & Co. v. Lexington Ins. Co.*, 636 F.3d 683 (5th Cir. 2011); *Jones, Walker, Waechter, Poitevent, Carrere & Denegre, LLP v. Chubb Corp.*, 2010 WL 4026375 (E.D. La. Oct. 12, 2010).

*Lexington Insurance Co.*, New Orleans restaurateurs sought business interruption coverage for losses sustained in the wake of the mayor's August 30, 2008, mandatory evacuation order, which was issued as Hurricane Gustav approached Louisiana. The insurer argued that the policy's civil authority provision did not provide coverage as the order was not issued "due to direct physical loss of or damage to property."<sup>16</sup> The insureds countered that since the hurricane had already damaged property in the Caribbean when the order was issued, this policy requirement was satisfied. The court held that because there was no evidence of any nexus between the order and physical damage in the Caribbean or elsewhere, coverage was not available.<sup>17</sup> Similarly, recovery for business income losses under a civil authority provision was not permitted where the court concluded that the same evacuation order was not issued as a result of physical damage and the policy's ninety-six-hour waiting period terminated after the coverage ended; that is, when the mandatory evacuation order was rescinded.<sup>18</sup>

### III. COLLAPSE

The Supreme Court of South Dakota recently held that ambiguous language<sup>19</sup> on what involves a collapse of a building should be defined to include not only actual collapse, but also imminent collapse.<sup>20</sup> Imminent collapse is defined as "likely to happen without delay; impending or threatening; and require[ing] a showing of more than substantial impairment."<sup>21</sup> The adoption of this approach protects the insured without distorting the purpose of the clause to protect against damage from collapse.<sup>22</sup>

In *Waterway Gas & Wash Co. v. OneBeacon American Insurance Co.*,<sup>23</sup> a full-service gas station was insured under a business interruption and property insurance policy. Included in the building coverage were

16. *Dickie Brennan*, 636 F.3d at 685.

17. *Id.* at 686–87.

18. *Jones, Walker, Waechter, Poitevent, Carrere & Denegre, LLP v. Chubb Corp.*, 2010 WL 4026375, at \*4–5 (E.D. La. Oct. 12, 2010). It should be noted that although the court observed that a subsequent September 2, 2008, order, which continued the evacuation order already in place under the previous order, may have triggered coverage, the waiting period and duration of coverage issues were ultimately dispositive in the insurer's favor.

19. Policy language at issue states, "[w]e will pay for loss or damage caused by or resulting from risks of direct physical loss involving collapse of a building." *Zoo Props., LLP v. Midwest Family Mut. Ins. Co.*, 797 N.W.2d 779, 782 (S.D. 2011).

20. *Id.*

21. *Id.* (citations omitted).

22. *Id.* (citations omitted).

23. 2010 WL 3724846 (E.D. Mo. Sept. 16, 2010).

“tanks . . . below the surface of the ground.”<sup>24</sup> A nearby water main burst and caused water to flow into one of the tanks.<sup>25</sup> The tank ruptured and could not be repaired, and the area around the rupture was concave.<sup>26</sup> The insurer argued that the collapse exclusion applied.<sup>27</sup> The policy stated, “A building that is standing or any part of a building that is standing is not considered to be in a state of collapse even if it shows evidence of cracking, bulging. . . .”<sup>28</sup> The court held that it was a question of fact as to whether the collapse exclusion applied because there were no allegations as to whether the tank was still “standing” within the meaning of the collapse exclusion.<sup>29</sup>

In *Palma Vista Condominium Ass’n of Hillsborough County, Inc. v. Nationwide Mutual Fire Insurance Co.*,<sup>30</sup> the insured suffered a structural loss due to termite damage and decay. There was a conflict as to whether the policy exclusions for fungus, decay, deterioration, infestation, negligent construction, and maintenance were in conflict with the coverage for collapse caused by hidden decay or termite damage.<sup>31</sup> The court held whether a covered collapse occurred depended on which collapse standard applied, which in turn depended on the disputed factual issue concerning whether the insurer delivered a copy of the endorsement to the association before the loss occurred.<sup>32</sup>

In *Macheca Transport Co. v. Philadelphia Indemnity Insurance Co.*,<sup>33</sup> the insured sought insurance coverage for damages resulting from a pipe rupture in its refrigerated warehouse. It was undisputed that the pipe ruptured when the ceiling support system, from which the pipes were suspended, failed. The weight of ice which had accumulated on the pipe contributed to the failure. As a result, ammonia leaked from the ruptured pipe and caused damage to the warehouse and product stored therein.<sup>34</sup> The policy’s collapse provisions generally provided coverage for “loss caused by or resulting from risks of direct physical loss involving collapse of buildings or any part of buildings.”<sup>35</sup> The insurer argued that the pipe rupture did not constitute a collapse under the policy.<sup>36</sup> Limiting its task to determining whether the term “collapse” was ambiguous as used in the particular

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24. *Id.* at \*2.

25. *Id.* at \*1.

26. *Id.*

27. *Id.* at \*2.

28. 2010 WL 3724846, at \*2.

29. *Id.*

30. 2010 WL 4274747 (M.D. Fla. Oct. 7, 2010)

31. *Id.* at \*1.

32. *Id.* at \*6.

33. 649 F.3d 661 (8th Cir. 2011).

34. *Id.* at 664.

35. *Id.* at 667 (internal quotations and citation omitted).

36. 649 F.3d at 665.

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policy at issue, the court concluded that the term “collapse” should be defined as “any serious impairment of a building or part of a building’s structural integrity.”<sup>37</sup> In adopting the majority view under the current trend in the law to define collapse more broadly, the court concluded that it was more consistent with what the average lay person would understand the term to mean and was also consistent with the policy’s broad definition of “buildings” and held the less was covered.<sup>38</sup>

#### IV. COVERED PROPERTY

##### A. Structures

In *Ortiz v. State Farm Fire & Casualty Co.*,<sup>39</sup> the insured sought coverage for the damage to a bridge on the insured’s property after it collapsed under the weight of a large tow truck. The insurer denied the claim, finding that the bridge was not a “building” that qualified as an exception to the collapse exclusion of the policy.<sup>40</sup> The insured sued, claiming the bridge qualified as a “dwelling extension” covered as an exception to the collapse exclusion because it was a “structure” on the property, and that the term “building” as used in the policy was ambiguous and could plausibly encompass the bridge.<sup>41</sup> The trial court granted the insurer’s motion for summary judgment, finding that while the bridge was a “structure,” it did not constitute a “building” under the terms of the policy.<sup>42</sup> The appellate court affirmed, stating “it would seem from the various references to “building” in the policy that the policy contemplates the narrower common meaning of “building” and that a building is a “structure that can contain things and that has walls and a roof; the disputed bridge has none of these characteristics.”<sup>43</sup>

In *Keren Habinyon Hachudosh D’Rabeinu Yoel of Satmar BP v. Philadelphia Indemnity Insurance Co.*,<sup>44</sup> a property insurer denied a claim arising from theft and vandalism to a school building under the vacancy exclusion in the policy because the building had not been used for the customary operations of a school for more than sixty consecutive days before the loss. The insured filed suit, claiming that the term “customary operations” required the building to only be used for “some” customary operations of a school because the policy did not explicitly say all customary operations, and that

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37. *Id.* at 669.

38. *Id.*

39. 260 P.3d 678 (Or. Ct. App. 2011)

40. *Id.* at 679.

41. *Id.* at 680–81.

42. *Id.*

43. *Id.* at 682.

44. 2011 WL 891347 (E.D.N.Y. Mar. 11, 2011).

the school was being used for operations within sixty days of the loss.<sup>45</sup> The insured specifically noted that within sixty days of the loss, operations at the school included: (1) one visit from teachers and students during which the students were allowed to play on the roof and lunch was served; (2) visits from a maintenance man two to three times per week to move supplies and furniture; and (3) the continuous storage of supplies and furniture in the building.<sup>46</sup> The court granted the insurer's motion for summary judgment based on the vacancy exclusion, finding that the building was not being operated as a school within sixty days of the loss.<sup>47</sup> In so finding, the court noted that the building had no running electricity or gas, and that the building had no permanent student body or faculty.<sup>48</sup> The court further noted that the limited use of the building violated the purpose of the vacancy provision, which sought to limit the risk of theft and vandalism by requiring regular activity at the school.<sup>49</sup>

### B. *Insurable Interest*

Courts continue to struggle with the question of whether and to what extent title to real property must be possessed in order to have an "insurable interest" in the property for purposes of property insurance coverage. In *Fraddosio v. Proctor Financial, Inc.*,<sup>50</sup> a homeowner's mortgagee obtained a "force-place" homeowner's policy from Lexington Insurance Company after the homeowner failed to obtain the required homeowners policy.<sup>51</sup> After a fire damaged the homeowner's residence, Lexington made full payment to the insured mortgagee.<sup>52</sup> When the homeowner submitted a claim to Lexington, he was informed that he was not an insured under the policy.<sup>53</sup> The homeowner then filed suit, claiming that he had an insurable interest by virtue of his payment of the premium, ownership of the property, and ambiguous provisions of the policy.<sup>54</sup>

The Western District of West Virginia disagreed, finding that it is "well-settled that '[a]s the mortgagor and mortgagee each has an insurable interest in the mortgaged property, insurance taken by one on his or her own interest and in his or her own favor alone does not inure to the benefit of the other.'"<sup>55</sup> The court also stated that:

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45. *Id.* at \*3.

46. *Id.* at \*4.

47. *Id.*

48. *Id.*

49. *Id.*

50. 2011 WL 3844087 (D. W.Va. Aug. 30, 2011).

51. *Id.* at \*1–2.

52. *Id.*

53. *Id.*

54. *Id.* at \*3.

55. *Id.* (citations omitted).

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the mortgagor has no right to proceeds of the policy ensuring the mortgagee's interest only, even though the mortgagee had charged the mortgagor with the premium . . . even though a person owns a property insured by another, ownership of the property does not automatically grant the owner an interest in the insurance policy.<sup>56</sup>

In *Seaman v. Nationwide Mutual Fire Insurance Co.*,<sup>57</sup> a homeowner's son-in-law purchased property from her, but did not obtain the deed conveying the property until three days after the homeowner's insurance policy was issued.<sup>58</sup> After a fire destroyed the dwelling, Nationwide denied both claims by the son-in-law and the seller, stating that the son-in-law did not have an insurable interest in the property at the time the policy was issued.<sup>59</sup> After suit was filed against Nationwide, the court denied the son-in-law's claim because under Kentucky law he was required to have an insurable interest in the insured property both at the time of the making of the contract and at the time of the loss.<sup>60</sup> Further, the court stated that an insurance contract is "void from its inception if an insurable interest does not exist at the time the contract for insurance was made."<sup>61</sup> Because the son-in-law could not demonstrate that he had made a down payment on the property as of the date the policy was issued, the court declared the policy void. The court similarly denied the seller's claims under the policy because, as a putative mortgagee, her claims were derivative of her son-in-law's.<sup>62</sup>

In *Penn-America Insurance Co. v. Zertuche*,<sup>63</sup> after a fire loss at an apartment building insured under a commercial property policy, Penn-America denied coverage because the policy had been canceled for nonpayment of premium.<sup>64</sup> After litigation ensued, Penn-America argued that even if the policy had not been canceled, the claimant had no insurable interest in the apartment building.<sup>65</sup> The district court found, however, that one is not required to have legal title in a property in order to have an insurable interest in it. The court stated that "[a]n insurable interest exists when the [insured] derives pecuniary benefit or advantage by the preservation and continued existence of the property or would sustain pecuniary loss

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56. *Id.* (internal quotations and citations omitted).

57. 2011 WL 2413366 (E.D. Ky. June 9, 2011).

58. *Id.* at \*3.

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. 770 F. Supp. 2d 832 (W.D. Tex. 2011).

64. *Id.* at 836.

65. 770 F. Supp. 2d at 842.

from its destruction.”<sup>66</sup> While the property at issue was not owned by the claimant’s partnership, the policy was issued to one of the partners, and the property was found to be owned “for the benefit of” the partnership.<sup>67</sup> Thus, the partnership enjoyed an insurable interest in the property.

### C. *Newly Acquired*

In *On-Site Fasteners and Construction Supplies, Inc. v. MAPFRE Insurance Co. of Florida*,<sup>68</sup> an insured construction supply business obtained a commercial property policy covering two locations. The policy included a provision extending coverage for up to thirty days for “newly acquired” property. After obtaining the policy, the insured leased separate warehouse space in the same business park in which one of its insured premises was located. Several weeks later, the newly leased space was burglarized.<sup>69</sup> The insurer initially denied coverage, arguing that the loss was excluded from coverage because it occurred as a result of theft.<sup>70</sup> The trial court found that the theft exclusion was inapplicable, as it applied only to one of the two insured locations. The trial court also held that an “off-premises” clause applied, which carried significantly lower limits than the “newly acquired” clause.<sup>71</sup> After both parties appealed, the Florida District Court of Appeals found that the theft exclusion was inapplicable, and that the “newly acquired” property clause applied because the insured acquired a new warehouse to store new inventory.<sup>72</sup>

## V. EXCLUSIONS

### A. *Causation*

In *Vision One, LLC v. Philadelphia Indemnity Insurance Co.*,<sup>73</sup> the insured suffered property damage as a result of a shoring structure collapse. The insurer alleged that the insurance policy did not cover the loss because the collapse was due to faulty workmanship, which was excluded under the policy.<sup>74</sup> The faulty workmanship exclusion contained a resulting loss provision. The court began its analysis with an overview of the principles governing insurance contract interpretation, noting that when the term “cause” appears in an exclusionary clause, it must be read as “efficient

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66. *Id.* at 843 (citation omitted).

67. *Id.*

68. 2011 WL 3558162 (Fla. Dist. Ct. App. Aug. 15, 2011).

69. *Id.* at \*1.

70. *Id.*

71. *Id.* at \*2.

72. *Id.*

73. 241 P.3d 429 (Wash. Ct. App. 2010), *review granted*, 249 P.3d 182 (Wash. 2011).

74. *Id.* at 431–32.

proximate cause.”<sup>75</sup> “Whenever covered and excluded perils combine to cause a loss, the loss will be covered only if the predominant or efficient proximate cause was a covered peril.”<sup>76</sup> Noting that the resulting loss provision was only an exception to the faulty workmanship exclusion, the court remanded the matter for a jury to determine the cause of the collapse—faulty workmanship, defective design, and/or faulty equipment. If faulty workmanship caused the shoring and concrete slab to collapse, then the collapse resulted directly from the initial excluded peril of faulty workmanship and loss resulting directly from the “initial excluded peril remains uncovered.”<sup>77</sup> The court further held that the resulting loss provision is not automatically triggered when the defective shoring structure damaged separate, nondefective property.<sup>78</sup> Thus, the court observed that the collapse will only be covered if the jury determines that faulty equipment caused the collapse or, if the jury determines that multiple perils caused the collapse, that faulty equipment was the efficient proximate cause.<sup>79</sup>

In *Boazova v. Safety Insurance Co.*,<sup>80</sup> the insured discovered that moisture had gotten into the wood sill on top of the foundation at the back of the house and had caused the sill and adjoining floor joists and wall studs to rot. The insurer argued that the exclusion for water damage applied and, thus, it was not liable for the damage.<sup>81</sup> The insured argued that seepage from rain and snow, not surface water, was the active efficient cause of the loss. The court disagreed with the insured: “The active efficient cause that sets in motion a train of events which brings about a result without the intervention of any force started and working actively from a new and independent source is the direct and proximate cause. . . .”<sup>82</sup> Thus, in this context, the snow and rain set in motion the train of events.<sup>83</sup> The means by which water entered the house, whether seeping or leaking, was not a separate cause of loss nor did it transform the water into something other than surface water.<sup>84</sup>

### B. *Earth Movement*

In *Brice v. State Farm Fire & Casualty Co.*,<sup>85</sup> a New York federal trial court found that an earth movement exclusion precluded coverage for a homeowner’s

75. *Id.* at 435–36.

76. *Id.* at 436 (citations omitted).

77. *Id.* at 437 (citation omitted).

78. *Id.* at 438–39.

79. *Id.* at 439.

80. 939 N.E.2d 793 (Mass. App. Ct. 2010), *review granted*, 942 N.E.2d 183 (Mass. 2011).

81. *Id.* at 797.

82. *Id.* at 798 (citations omitted).

83. *Id.*

84. *Id.*

85. 761 F. Supp. 2d 96 (S.D.N.Y. 2010).

damages caused by excavation and construction activities on an adjacent property.<sup>86</sup> The excavation allegedly caused significant structural and other damage to the homeowner's property due to faulty underpinning that permitted earth to slide away from the foundation of the homeowner's residence.<sup>87</sup> The insurer argued that the phrase "movement resulting from improper compaction, site selection or any other external forces" in its earth movement exclusion barred coverage for any damage caused by earth movement, whether of natural or man-made origin.<sup>88</sup> The court found that the acts causing the movement of earth and the resulting damage to the insured's house were committed by an external force, i.e., the contractor working on the adjacent lot.<sup>89</sup> Therefore, any damage flowing from such an external force was clearly and unambiguously excluded from coverage, so the court found that the insurer properly denied coverage and was entitled to summary judgment.<sup>90</sup>

In *Gillin v. Universal Underwriters Insurance Co.*,<sup>91</sup> a Pennsylvania federal trial court found that an insured's loss fell within the earth movement exclusion and, therefore, entered judgment in favor of the insurer finding it properly denied coverage for the insured's loss.<sup>92</sup> The insurer had argued that the damage to the insured's home was caused by the collapse of a retaining wall on neighboring property, and the policy excluded coverage for losses caused by soil and hydrostatic pressure, regardless of whether any other cause contributes to the loss.<sup>93</sup> The insured attempted to argue that the efficient proximate cause of the damage to their home was the negligent construction of a retaining wall; however, the court noted that the presence of the anticoncurrent causation language in the earth movement exclusion still precluded coverage for the insured's damage.<sup>94</sup>

In *Powell v. Liberty Mutual Fire Insurance Co.*,<sup>95</sup> a water pipe in the insured's house exploded, allegedly causing a shift in the house's foundation and extensive cracking and wall separation.<sup>96</sup> The insured's expert determined that while the house had some foundation movement throughout the life of the house, it was the sudden wetting of the foundation clay soil from the water line rupture that resulted in the high level of damage then present to the house.<sup>97</sup> The insurer denied coverage for the loss, citing the

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86. *Id.* at 98.

87. *Id.*

88. *Id.* at 100.

89. *Id.* at 102.

90. *Id.*

91. 2011 WL 780744 (E.D. Pa. Mar. 1, 2011).

92. *Id.* at \*7.

93. *Id.* at \*1, 7.

94. *Id.* at \*7-8.

95. 252 P.3d 668 (Nev. 2011).

96. *Id.* at 671.

97. *Id.*

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earth movement exclusion.<sup>98</sup> The Supreme Court of Nevada held that, historically, the exclusion only applies to naturally occurring events, and since the insurer's exclusion contemplated human-caused events, the exclusion was ambiguous as to what precisely earth movement is when it is not a type of widespread calamitous event.<sup>99</sup> In support of its decision, the court noted that if the insurer had intended for the earth movement exclusion to exclude damage caused by soil movement from a ruptured pipe, then it would have had to clearly include that in the earth movement definition and show that the earth movement exclusion unmistakably applied to the damage at issue.<sup>100</sup> The court also refused to apply the anticoncurrent language, finding that it was "not sufficiently clear."<sup>101</sup>

In *Bentoria Holdings, Inc. v. Travelers Indemnity Co.*,<sup>102</sup> the insured's building allegedly sustained damage as a result of excavation of an adjacent lot.<sup>103</sup> The insurer disclaimed coverage pursuant to the earth movement exclusion.<sup>104</sup> The New York trial court found that, notwithstanding the fact that the exclusion refers to earth movement caused by "manmade" and "artificial" causes, the insurer failed to demonstrate prima facie that the facts of the case, which involved excavation of earth from a lot adjacent to the insured's property, fell squarely within the exclusion.<sup>105</sup>

In *Great American Insurance Co. v. Bogley*,<sup>106</sup> a wall attached to a farm building owned by the insured collapsed.<sup>107</sup> The insurer took the position that the wall collapsed due to lateral earth and hydrostatic pressure, while the insured argued that the wall collapsed because the weight of snow and ice on the ground, combined with its freezing and thawing, created a lateral load on the wall.<sup>108</sup> The Virginia federal trial court noted that both experts opined that earth movement caused the wall to collapse, and, therefore, there was no coverage for the insured's damages.<sup>109</sup>

In *High Street Lofts Condominium Ass'n, Inc. v. American Family Mutual Insurance Co.*,<sup>110</sup> vibrations from road repair work adjacent to the insured's building allegedly caused cracking in walls and sloping of floors.<sup>111</sup> The in-

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98. *Id.*

99. *Id.* at 672–73.

100. *Id.* at 673–74.

101. *Id.* at 674.

102. 84 A.D.3d 1135 (N.Y. App. Div. 2011).

103. *Id.* at 1136.

104. *Id.*

105. *Id.* at 1137.

106. 2011 WL 3206840 (E.D. Va. July 27, 2011).

107. *Id.* at \*1.

108. *Id.* at \*2.

109. *Id.* at \*3.

110. 2011 WL 4479120 (D. Colo. Sept. 26, 2011).

111. *Id.* at \*1.

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surer denied coverage under the earth movement exclusion on the grounds that the insured's expert indicated that the damage was the result of "soil consolidation/settlement" in response to the construction activities.<sup>112</sup> In support of its denial of coverage, the insurer argued that the policy language excluded from coverage damages caused by "earth sinking . . . or shifting including soil conditions which cause settling, cracking or other disarrangement of foundations" and, further, that the anticoncurrent causation language tied to the exclusion also applied.<sup>113</sup> The federal court for the District of Colorado found that the property was damaged by ground vibrations caused by the contractor's work, which traveled through the earth and caused the insured's building to vibrate, leading to property damage.<sup>114</sup> Nonetheless, the court found that there were issues of fact concerning whether the facts supported a denial based on the "improperly compacted soil" part of the exclusion.<sup>115</sup>

In *Mulbern v. Philadelphia Indemnity Insurance Co.*,<sup>116</sup> a building sustained damage when vibrations from pile driving adjacent to the insured's property caused alterations to the layer of urban fill in the building's floor slabs, which in turn caused the building's concrete floor slab to shift, settle, and develop structural cracks.<sup>117</sup> The insurer denied coverage for the loss, citing the earth movement exclusion, while the insured argued that the exclusion only applied to naturally occurring earth movement and not man-made events.<sup>118</sup> The Massachusetts federal trial court noted that since the exclusion precluded coverage for damage caused by "improperly compacted soil," a man-made condition, the policy was not ambiguous and contemplated damage caused by both natural and man-made conditions.<sup>119</sup> Nonetheless, the court ultimately found that there were issues of fact concerning the cause of the damage, which needed to be decided by a jury.<sup>120</sup>

### C. *Vacancy*

In *Columbia Lloyds Insurance Co. v. Mao*,<sup>121</sup> a Texas appellate court reversed a trial court's entry of summary judgment in favor of an insured on a breach of contract count, finding that there were genuine issues of material fact concerning whether a dwelling had been vacant for more than sixty days

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112. *Id.*

113. *Id.* at \*6.

114. *Id.* at \*4.

115. *Id.* at \*8.

116. 2011 WL 3563126 (D. Mass. Aug. 15, 2011).

117. *Id.* at \*2.

118. *Id.* at \*5.

119. *Id.* at \*5-6.

120. *Id.* at \*6.

121. 2011 WL 1103814 (Tex. App. Mar. 24, 2011).

prior to a fire.<sup>122</sup> The court noted that reasonable and fair-minded people could differ in their conclusions on whether a house devoid of contents, but undergoing renovations, was considered vacant, thereby invoking the policy exclusion.<sup>123</sup>

In *Bates v. Hartford Insurance Co. of the Midwest*,<sup>124</sup> a Michigan federal trial court found that an arson fire is covered by the fire and lightning loss provision in a policy and is not included within a vacancy/vandalism exclusion.<sup>125</sup> The court noted that the insured purchased an additional coverage for damages caused by vandalism and malicious mischief, but the provision precluded coverage for vandalism-related damages if the subject property had been vacant for more than thirty days prior to the claimed loss.<sup>126</sup> The court concluded that arson is contemplated as a peril within the class of losses caused by fire, not by vandalism.<sup>127</sup> Therefore, the court found that the vacancy/vandalism exclusion did not apply to the insured's claim.<sup>128</sup>

In *Fort Lane Village L.L.C. v. Travelers Indemnity Co. of America*,<sup>129</sup> an insured argued that the term "vandalism" is ambiguous because the policy distinguishes between "vandalism" and "fire" as two different types of covered causes of loss, so a loss resulting from a fire is not vandalism.<sup>130</sup> The insurer argued that the term "vandalism" is unambiguous and its ordinary meaning encompasses a claim arising from an arson fire.<sup>131</sup> The Utah federal trial court affirmed entry of summary judgment in favor of the insured, finding that the term "vandalism" as found in a vacancy exclusion was ambiguous and thus should be construed in favor of the insured.<sup>132</sup>

Similarly, in *New London County Insurance Co. v. Zachem*,<sup>133</sup> a Connecticut trial court found that the term "vacant" in a vacancy/vandalism exclusion was ambiguous and thus should be construed in favor of the insured.<sup>134</sup> The court noted that since the insurance policy used the words "vacant" and "unoccupied" in different places in the policy, the insurer could not have intended the two terms to have the same meaning, so the term "vacant" was ambiguous.<sup>135</sup>

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122. *Id.* at \*5–6.

123. *Id.*

124. 787 F. Supp. 2d 657 (E.D. Mich. 2011).

125. *Id.* at 662–63.

126. *Id.* at 661–62.

127. *Id.* at 662–63.

128. *Id.* at 663.

129. 2011 WL 3180487 (D. Utah July 27, 2011).

130. *Id.* at \*4.

131. *Id.*

132. *Id.* at \*5.

133. 2011 Conn. Super. LEXIS 381 (Conn. Super. Ct. Feb. 18, 2011).

134. *Id.* at \*3.

135. *Id.* at \*6.

#### D. Dishonest Acts

In *J&J Pumps, Inc. v. Star Insurance Co.*,<sup>136</sup> a California federal trial court dismissed an insured's complaint against an insurer pursuant to Federal Rule of Civil Procedure 12(b)(6), finding that the insured failed to allege that it sustained any direct physical loss or damage, which could have triggered coverage for employee dishonesty coverage found in a policy broadening endorsement.<sup>137</sup> The insured discovered that one of its employees failed to pay the company's taxes to the appropriate authorities, and, instead, the employee was hiding the funds with the intent to embezzle.<sup>138</sup> The court noted that the purpose and effect of the employee dishonesty provision in the broadening endorsement was to restore in part coverage excluded under the Causes of Loss—Special Form; a form that expressly requires a showing of physical loss or damage.<sup>139</sup> The court noted that the payment of tax penalties and interest simply do not constitute physical loss or damage.<sup>140</sup>

In *Arch Creek Yacht Sales, LLC v. Great American Insurance Co. of New York*,<sup>141</sup> a federal appellate court affirmed entry of summary judgment in favor of an insurer finding that the word "employee" in a dishonesty exclusion is unambiguous and encompasses someone who was employed full time for a salary by the insured.<sup>142</sup> The court rejected the insured's argument that the word "employee" has been interpreted by other courts differently where after-hours conduct is involved and thus was ambiguous.<sup>143</sup>

#### E. Faulty Workmanship

Litigation over faulty workmanship-related exclusions continues to focus on the interpretation of the "ensuing loss" exception. In *RK Mechanical, Inc. v. Travelers Property Casualty Co. of America*,<sup>144</sup> a residential construction project's HVAC subcontractor was an additional insured under the project's builders risk policy. Two flanges installed by the subcontractor cracked after their installation, causing water damage to the project. The subcontractor made a claim under the builders risk policy for the costs to remediate and repair property damaged by the water.<sup>145</sup> Travelers paid the claim. During its investigation of the flange failure, the subcontractor

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136. 2011 WL 2415101 (E.D. Cal. June 9, 2011).

137. *Id.* at \*4–5.

138. *Id.* at \*2.

139. *Id.* at \*5.

140. *Id.*

141. 2011 WL 2555767 (11th Cir. June 28, 2011).

142. *Id.* at \*1.

143. *Id.* at \*1 n.1.

144. 2011 WL 3294921 (D. Colo. Aug. 1, 2011).

145. *Id.* at \*1.

discovered that many other flanges were cracked and showed signs of potential failure. As a result, the subcontractor removed and replaced the cracked flanges. The subcontractor then submitted a claim to Travelers for the cost of removing and replacing the potentially injurious flanges.<sup>146</sup>

Travelers denied the claim based on, among others, an exclusion precluding coverage for “loss” caused by faulty or defective materials, workmanship, or maintenance.<sup>147</sup> The exclusion included an exception providing coverage for “loss” by a covered cause of loss that results from the original “loss.”<sup>148</sup> The subcontractor sued, claiming that each flange that needed to be replaced posed a risk of direct physical loss, because each was at risk of failing and, when it did fail, it would contribute to or cause pipes to break that would result in more water damage to the project. This, the subcontractor argued, would be a covered loss under the exclusion’s “ensuing loss” provision. The district court disagreed, stating that an

ensuing loss provision does not cover loss caused by the excluded peril; it covers loss caused to the property wholly separate from the defective property itself, in this case the escaping water, not the cracked flange . . . [t]he costs of correcting defects does not constitute “loss” under the ensuing loss provision.<sup>149</sup>

In *Five Star Hotels, LLC v. Insurance Co. of Greater N.Y.*,<sup>150</sup> a sprinkler system failed at an insured’s hotel, resulting in extensive damage after a large volume of water flowed down to the hotel’s lower floors.<sup>151</sup> The insured submitted a claim under its commercial property insurance policy for, among other things, the property damage caused by the water.<sup>152</sup> After investigating and determining that sprinkler failure was the result of frozen water inside the system, the insurer denied coverage relying on the “protective safeguard” and the “faulty design or maintenance” exclusions.<sup>153</sup> The faulty design or maintenance exclusion barred coverage for “faulty, inadequate or defective . . . maintenance; of part or all of any property on or off the described premises.”<sup>154</sup> It also included an exception, stating that “if an excluded cause of loss . . . results in a Covered Cause of Loss, we will pay for the loss or damage caused by that Covered Cause of Loss.”<sup>155</sup>

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146. *Id.* at \*2.

147. *Id.*

148. *Id.* at \*5.

149. *Id.* at \*7 (citations omitted).

150. 2011 WL 1216022 (S.D.N.Y. Mar. 24, 2011).

151. *Id.* at \*2.

152. *Id.*

153. *Id.* at \*2–3.

154. *Id.* at \*10.

155. *Id.*

After the insured brought suit for breach of contract and bad faith, it moved for summary judgment on coverage issues, arguing that even if the exclusions applied, the faulty design or maintenance exclusion's "ensuing loss" provision restored coverage. The district court agreed. Noting that the policy included "leakage from fire extinguishing equipment" as a cause of loss, the court stated:

while the policy contains a general exclusion for such losses, it also contains an exception to this general rule, set forth in what is known as an 'ensuing loss provision.' The effect of the ensuing loss provision here is to restore coverage—even when a loss was caused by faulty design or faulty maintenance—where the damage was caused by a Covered Cause of Loss.<sup>156</sup>

Confirming its reasoning, the court added that "[b]ecause of the ensuing loss provision, the exclusion for faulty design or faulty maintenance does not bar coverage for water damage resulting from the frozen sprinkler system."<sup>157</sup>

#### F. *Mold and Water Damage*

A pro se insured in *Rooters v. State Farm Lloyds*<sup>158</sup> was unable to convince either a district court or the Fifth Circuit that her mold claim was covered because it flowed directly from water damage to her roof. Clarifying and reinforcing prior Fifth Circuit and Texas case law on coverage for mold, the appellate court in *Rooters* again refused to allow a policyholder to obtain coverage for an excluded risk by pigeonholing the particular loss.

Two other cases of note addressed the impact of surface and subsurface water exclusions during the survey period. In *American Family Mutual Insurance Co. v. Schmitz*,<sup>159</sup> the Wisconsin Court of Appeals affirmed that the homeowner's policy in question did not cover the collapse of the entire residence after a long period of heavy rain. The insured unsuccessfully argued that the collapse was covered even though the house, which was under renovation at the time, had had two feet of soil removed from under much of its foundation for the renovation, and surface water was able to enter this gap and remove the rest of the house's support. The court also rejected the insured's argument that the rain water was no longer "surface water" when it entered into trenches that had been dug as part of the repair work. Also, in *Colella v. State Farm Fire and Casualty Co.*,<sup>160</sup> the Third Circuit, following Pennsylvania law, upheld the application of a "subsurface water" exclusion to a loss that followed the rupture of a pipe beneath the insured

156. *Id.* at \*2–3.

157. *Id.* at \*11.

158. 428 F.App'x 441 (5th Cir. 2011).

159. 793 N.W.2d 111 (Wis. Ct. App. 2010).

160. 407 F. App'x 616 (3d Cir. 2011).

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house, and held that the policy's anticoncurrent causation introduction to the exclusion section of the policy did not allow for coverage under any other section of the policy.

## VI. DAMAGES

### A. *Hold Back*

In *Continental Casualty Co. v. F-Star Property Management, Inc.*,<sup>161</sup> a federal court sitting in Texas declined to grant summary judgment to plaintiff insurer on its claim that it properly withheld depreciation from the policyholder.<sup>162</sup> While the policy provided replacement cost coverage, it had a clause that stated: "if within one (1) year the process of repair, rebuilding or replacement in accordance with the provisions of this section (Section IV.12), has not begun then the value of the property will be *actual cash value*."<sup>163</sup> The court rejected the insurance company's argument that because the policyholder had not completed repairs within one year, it was entitled to holdback depreciation.<sup>164</sup> In reaching its holding, the court reasoned that the policy language was unambiguous that the policyholder forgoes replacement cost only if it fails to commence the repair process within one year.<sup>165</sup>

### B. *Overhead and Profit*

In *Excel Roofing, Inc. v. State Farm Fire & Casualty Co.*,<sup>166</sup> a federal court applying Minnesota law held that the suit limitations period in certain homeowners' insurance policies ran against a roofing contractor, which had sued an insurer to recover overhead and profit associated with repair work it performed on behalf of a group of the insured homeowners.<sup>167</sup> In reaching its holding, the court reasoned that Excel stood in the shoes of the policyholders and did not demonstrate that the limitations period conflicted with a specific statute or was unreasonable.<sup>168</sup> The court also held that Excel had failed to prove that the insurer should be estopped from asserting the suit limitations provision.

In *Dupree v. Lafayette Insurance Co.*,<sup>169</sup> the Supreme Court of Louisiana ruled that the trial court abused its discretion in certifying a class of

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161. 2011 WL 2887457, at \*5 (W.D. Tex. July 15, 2011).

162. *Id.* at \*5.

163. *Id.* at \*3.

164. *Id.* at \*3-4.

165. *Id.* at \*4-5.

166. 2010 WL 5211554 (D. Minn. Dec. 16, 2010).

167. *Id.* at \*5.

168. *Id.*

169. 51 So. 3d 673 (La. 2010).

homeowners, who among other claims, alleged their insurer had failed to pay overhead and profit for roofing repairs made to fix damage sustained during Hurricane Katrina.<sup>170</sup> In reaching its holding, the court reasoned that

[b]ecause the determination of whether the services of a general contractor would be reasonably likely to be required is a fact question that will be different for every insured, the trial court manifestly erred in finding that common factual issues exist and that such issues predominate over individual questions with regard to general contractor overhead and profit for wind-related roof damages.<sup>171</sup>

Similarly, in *Baldwin Mutual Insurance Co. v. Edwards*,<sup>172</sup> the Supreme Court of Alabama ruled that the trial court abused its discretion in certifying as a class a group of policyholders with claims for overhead and profit.<sup>173</sup> The named plaintiff originally filed a class action based on a claim for damage from Hurricane Katrina and defined the class to include individuals who had made actual cash value (ACV) claims and for which the insurer had not allowed overhead and profit. The insurer objected to the named plaintiff changing the class definition to include individuals who had been paid replacement cost value (RCV).<sup>174</sup> The named plaintiff subsequently revised his complaint to include a claim for losses arising from Hurricane Ivan, for which he had been paid on an ACV basis.<sup>175</sup> The supreme court ruled that the lower court had impermissibly expanded the class definition beyond that for which it had received evidence, thereby denying the insurer the opportunity for a meaningful hearing on class certification.<sup>176</sup>

### C. Matching

In *Enwereji v. State Farm Fire & Casualty Co.*,<sup>177</sup> a federal court sitting in Pennsylvania held that the damaged shingles on a roof, rather than the entire roof, were the “damaged part of the property” within the meaning of the policyholders’ homeowners insurance.<sup>178</sup> Further, the court found that the insurance company need not replace the damaged shingles with “sufficiently similar” shingles of “like kind and quality,” as the homeowners selected the “common coverage” option that exempted the carrier from paying to replace “obsolete, antique or custom construction with like kind and quality.”<sup>179</sup>

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170. *Id.* at 691.

171. *Id.*

172. 63 So. 3d 1268, 1272 (Ala. 2010).

173. *Id.* at 1272.

174. *Id.* at 1269.

175. *Id.* at 1270.

176. *Id.* at 1271–72.

177. 2011 WL 3240866, at \*5 (E.D. Pa. July 28, 2011).

178. *Id.* at \*5–6.

179. *Id.* at \*6–7.

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## VII. OBLIGATIONS AND RIGHTS OF THE PARTIES

### A. *Misrepresentation*

Three district courts published interesting opinions during the survey period on the consequences, or lack of consequences, of a policyholder's misrepresentations.

In *Pettinaro Enterprises, LLC v. Continental Casualty Co.*,<sup>180</sup> the policyholder suffered two fires at its vacant warehouse within four days of each other. Its proof of loss sought lost rent, even though the warehouse had not been rented for over a year before the fires, in addition to replacement cost. Finding that the “overwhelming evidence” supported the conclusion that the misrepresentations were material and knowing, the court held that the policy at issue was void under the “concealment, misrepresentation, or fraud” clause of the policy.<sup>181</sup> Interestingly, the lost rent claim was only about 1 percent of the replacement cost claim, meaning the policyholder lost any possibility of recovery under the policy by misrepresenting a very small fraction of its claimed damages.

Two other cases remind insurance practitioners that significant evidence is required, however, before a court will void coverage for a material and knowing misrepresentation in the application of the policy or during adjustment of a claim. In *Bates v. Hartford Insurance Co. of the Midwest*,<sup>182</sup> the insurer denied a claim for fire damage because evidence suggested that the insured house had suffered an earlier undisclosed fire and was vacant for a protracted time before the claimed fire damage. Opposing the insurer's motion for summary judgment, the insured submitted a lease showing that the house had, in fact, been rented out—even though the lessee testified under oath that she never actually took up residence in the house. The insured also disputed a police report about an earlier fire at the house. After reviewing the evidence, the court held that continuing to parse the competing evidence would be “an exercise in futility,” and denied the insurer's motion for summary judgment based on the disputed facts.<sup>183</sup> A similar result was reached in *Felman Production, Inc. v. Industrial Risk Insurers*.<sup>184</sup>

### B. *Duties*

#### 1. Examinations Under Oath

There is a continuing trend of cases finding that a policyholder's refusal to fully respond to questions asked during examinations under oath

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180. 2010 WL 5126006 (D. Del. Dec. 10, 2010).

181. *Id.* at \*6–7.

182. 787 F. Supp. 2d 657 (E.D. Mich. 2011).

183. *Id.* at 667.

184. 2011 WL 4543966 (S.D. W.Va. Sept. 29, 2011).

(EUO) constitutes a material breach of the insurance contract that discharges the insurer's obligations. For example, in *Deguchi v. Allstate Insurance Co.*,<sup>185</sup> the court affirmed summary judgment in favor of the insurer based on the insureds' failure to answer reasonable questions regarding their financial situation during their EUO. The appellate court found that the district court did not abuse its discretion by refusing to allow the policyholders a second opportunity to appear at an EUO after litigation commenced, noting that courts "have not been willing to enter such conditional judgments if there is a pattern of noncompliance without a reasonable justification or if the insurance company has been prejudiced by the passage of time."<sup>186</sup>

In *Assaf v. Allstate Indemnity Co.*,<sup>187</sup> the court granted summary judgment to the insurer based on the insured's breach of the policy's cooperation clause. The court found that the insured's agreement to appear for an EUO was of no moment because he ultimately refused to appear when asked to do so. The court found that Allstate demonstrated prejudice because the policyholder's breach of the cooperation clause prevented the insurer from being able to investigate the claim while the facts were fresh.

In contrast, in *El-Ad Enclave at Miramar Condominium Ass'n v. Mt. Hawley Insurance Co.*,<sup>188</sup> the court found a dispute of material fact as to whether the insured was in compliance with the insurer's demands for an EUO. In that case, the insured had agreed to appear, but the date was changed several times, and the EUO did not occur before suit was filed. The court held that "[t]he parties' confirmed agreement setting dates for . . . the submission of an EUO—an agreement established before Enclave field suit—creates a question of fact as to whether Enclave was in violation of the 'full compliance' requirement."<sup>189</sup> The court noted that "if an insured has not demonstrated willful disregard of the policy preconditions, courts have either stayed the action or dismissed the suit without prejudice in order to allow belated compliance."<sup>190</sup> Such relief was not necessary, however, because the EUO took place less than a month after suit was filed.

## 2. Proof of Loss

In *Northrop Grumman Corp. v. Factory Mutual Insurance Co.*,<sup>191</sup> the Central District of California ruled that a policyholder's proof of loss need not

185. 407 F. App'x 93 (9th Cir. 2010).

186. *Id.* at 94 (citation omitted).

187. 2011 WL 3178551 (E.D. La. July 27, 2011).

188. 752 F. Supp. 2d 1282 (S.D. Fla. 2010).

189. *Id.* at 1287 (citations omitted).

190. *Id.* (citations omitted).

191. 2011 WL 3189168 (C.D. Cal. July 27, 2011).

itemize losses by precipitating peril and applicable coverage.<sup>192</sup> In reaching its decision, the court reasoned that in identifying Hurricane Katrina as the origin of the loss, the policyholder had satisfied the policy's requirement that the insured identify the time and origin of the loss.<sup>193</sup> The court rejected the insurer's contention that the policyholder was required to identify the peril that caused the loss, opining that

[i]f the Excess Policy wanted that level of specificity in the proof of loss, the Policy should have required that level of specificity. For example, the Excess Policy does not say and could have said that Northrop must identify the 'time and peril,' nor does it say that Northrop must identify the 'time and coverage' in its proof of loss.<sup>194</sup>

Further, the court reasoned that the policyholder had not violated its duty of cooperation in declining to revise its proof after certain coverage issues had been clarified in a prior proceeding.<sup>195</sup> The court reasoned that the policyholder had met its duty of cooperation solely by submitting a completed proof of loss.<sup>196</sup>

In *Kittner v. Eastern Mutual Insurance Co.*,<sup>197</sup> a New York state court ruled that an insurance policy was not void due to misrepresentations in the proof of loss where the carrier tendered no proof that the policyholder had the intent to defraud.<sup>198</sup> The court affirmed summary judgment for the insurer on the basis of judicial estoppel, however, because the insured had valued the property at \$5,000 in a bankruptcy proceeding while claiming over \$200,000 in the proof of loss.

### C. Appraisal

#### 1. Scope of Appraisal

There continues to be fertile litigation regarding the distinction between "valuation," which is the subject of appraisal, and "coverage," the province of the courts. In *Keystone Asset Management, Inc. v. West American Insurance Co.*,<sup>199</sup> the court noted that, under Pennsylvania law, an appraisal clause can only be invoked when the insurer admits liability and the sole issue is a dispute over valuation. In that case, a water pipe burst flooding the insured's basement on Sunday, July 10, 2008. As a result, the building lost electrical power and phone service. The insured moved to a temporary

192. 2011 WL 3189168, at \*11.

193. *Id.*

194. *Id.*

195. *Id.* at \*12.

196. *Id.*

197. 80 A.D.3d 843 (N.Y. App. Div. 2011).

198. *Id.* at 846-47.

199. 2010 WL 4159249 (E.D. Penn. Oct. 22, 2010).

location and had its servers and website running by 3:00 a.m. on Monday, July 21, 2008, though it did not open for business that day. It was in the temporary location for two weeks, but the location was not large enough to accommodate all of the insured's business purposes. The insurer paid the insured for moving and relocation expenses, but denied the insured's business interruption claim because the insured did not suffer a necessary suspension of operations or an actual loss of business income. The insured sued and demanded appraisal. The court granted the insurer's motion for partial summary judgment and dismissed the insured's claim demanding appraisal because the court held that the dispute related to coverage, not calculation.

Many courts find that the issue of liability must be resolved before appraisal can proceed. In *Citizens Property Insurance Corp. v. Michigan Condominium Ass'n*, the Florida District Court of Appeal disagreed with the insured's argument that appraisal should proceed while preserving the insurer's right to contest coverage and held that "[a] finding of liability necessarily precedes a determination of damages."<sup>200</sup>

In *Secord v. Chartis Inc.*,<sup>201</sup> the court held that appraisal would be premature because there was a dispute regarding scope of coverage and causation. The court found that "[t]he appraisers will be able to determine the amount of the loss only after this Court separates the losses attributable to the blasting activities (covered) from those attributable to general wear and tear (not covered)."<sup>202</sup> Similarly, in *LeBlanc v. Travelers Home and Marine Insurance Co.*,<sup>203</sup> the court held that the umpire went beyond the scope of appraisal, determining the amount of damage to property, by making the determination that all of the loss was attributable to tornado, a conclusion that was disputed.

The court reached a slightly different conclusion in *Hahn v. Allstate Insurance Co.*<sup>204</sup> In that case, Allstate opposed appraisal with respect to the insured's damages following a fire loss based on the argument that the appraiser may account for damages that were not a result of the fire. The Rhode Island Supreme Court affirmed the trial court's order of appraisal. The court explained that if Allstate were denying the claim in its entirety, a genuine dispute regarding the scope of insurance coverage would exist that would have to be resolved by the court. "However, because this dispute involves the

200. 46 So. 3d 177, 178 (Fla. Dist. Ct. App. 2010) (quoting *Engle v. Liggett Grp., Inc.*, 945 So. 2d 1246, 1262-63 (Fla. 2006)).

201. 2011 WL 814743 (S.D.N.Y. Mar. 7, 2011).

202. *Id.* at \*2.

203. 2011 WL 1107126 (W.D. Okla. Mar. 23, 2011).

204. 15 A.3d 1026 (R.I. 2011).

extent of damages and the amount of loss, it simply cannot be characterized as a scope-of-coverage issue.”<sup>205</sup> The court further cautioned that

in cases in which the insurer refuses to submit to the appraisal process in favor of litigation, the insurer must *specify with particularity* to the policyholder the alleged ambiguity in the policy and articulate why the issue is one of coverage for the loss rather than the amount of the loss.<sup>206</sup>

Some courts, however, do allow both appraisal and litigation regarding the scope of coverage to proceed on a dual track. In *Glenbrook Patriobome Owners Ass’n v. Lexington Insurance Co.*,<sup>207</sup> the policyholder opposed the insurer’s motion to compel appraisal because the dispute involved coverage and causation issues not subject to appraisal. However, under Texas law, “an insured cannot avoid appraisal because there might be a coverage or causation question that exceeds the scope of appraisal.”<sup>208</sup> The court determined that appraisers can allocate damages between covered and uncovered perils. Moreover, the court held that the insured cannot avoid appraisal simply because there may be coverage issues. Instead, the court determined that because there were coverage and valuation questions, the portion of the litigation involving valuation was properly stayed, while the portion of the litigation involving coverage issues should continue pending the appraisal.

## 2. Timeliness of Demand or Refusal to Appraise

During the survey period, Texas courts continued a recent trend of developing their appraisal jurisprudence with the Texas Supreme Court’s decision in *In re Universal Underwriters of Texas Insurance Co.*<sup>209</sup> In addition to reaffirming that any delay in invoking a policy’s appraisal provision is measured from the moment of impasse between the insurer and the insured with respect to the amount of a loss, the court went further, defining the point of “impasse” as the “apparent breakdown of good-faith negotiations.”<sup>210</sup> The court held that the insurer’s demand for appraisal in that case was timely as it was made within a reasonable time after the impasse.<sup>211</sup>

In Florida, a district appellate court declined to follow the ruling of a sister court that had allowed an appraisal to go forward while preserving the insurer’s right to contest coverage.<sup>212</sup> Certifying the conflict with its

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205. *Id.* at 1030.

206. *Id.* at 1031 (emphasis in original).

207. 2011 WL 666517 (S.D. Tex. Feb. 14, 2011).

208. *Id.* at \*6 (citation omitted).

209. 345 S.W.3d 404 (Tex. 2011).

210. *Id.* at 409–10.

211. *Id.* at 410.

212. *Citizens Prop. Ins. Corp. v. Michigan Condo. Ass’n*, 46 So. 3d 177 (Fla. Dist. Ct. App. 2010).

sister district, the court held that an insurer would not be compelled to participate in an appraisal prior to the resolution of all underlying coverage disputes.<sup>213</sup>

### 3. Enforcing and Modifying Appraisal Awards

The Ohio Court of Appeals held that the court below erred in modifying an appraisal award sua sponte where there was no evidence of fraud, mistake, or misfeasance on the part of the appraisers.<sup>214</sup> Observing that a “court’s review of an appraisal is extremely limited,” the court concluded that the award should not have been reduced to reflect amounts previously paid by the insurer where such reduction was not reflected in the appraisers’ award.<sup>215</sup>

In *LeBlanc v. Travelers Home & Marine Insurance Co.*, a federal court sitting in Oklahoma held that an insurer could only be partially bound by an appraisal award where the umpire had gone beyond determining the amount of damage to the property and had considered causation issues in rendering the award.<sup>216</sup> The court predicted that Oklahoma’s highest court would view an appraisal umpire’s role narrowly and preclude him or her from considering issues of coverage and causation. Thus, the court concluded that if the insured sought to rely on the award, he could only rely on the amount established as the cost to repair the house to its condition before the tornado.<sup>217</sup>

### 4. Appraiser Qualifications

In a dispute involving a fire insurance policy in Michigan, the insurer argued that the trial court erred by ruling that the insured’s appraiser was “independent” under the meaning of the Michigan Insurance Code.<sup>218</sup> The insurer argued that because an agreement was still in place between the insured and the public adjuster, which assigned 10 percent of the overall amount paid by the insurer to the public adjuster, that this agreement made the public adjuster not “independent.”<sup>219</sup> The court held that a contingency fee agreement does not prohibit an appraiser from being “independent” under the insurance code.<sup>220</sup> The presence of a contingency fee did not

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213. *Id.* at 178.

214. *Stuckman v. Westfield Ins. Co.*, 2011 WL 1944266, at \*6 (Ohio Ct. App. May 16, 2011).

215. *Id.* (citation omitted).

216. 2011 WL 1107126, at \*4–5 (W.D. Okla. Mar. 25, 2011).

217. *Id.* at \*5.

218. *White v. State Farm Fire & Cas. Co.*, 2011 WL 3208150 (Mich. Ct. App. July 28, 2011).

219. *Id.* at \*3.

220. *Id.* at \*5.

make the appraiser subject to “control, restriction, modification, or limitation” by anyone.<sup>221</sup> Specifically, the court held that the appraiser was capable of exercising his own judgment regarding the value of the loss as he was not an employee of plaintiffs or under any other legal duty, with the exception of the public-adjusting contract.<sup>222</sup> In the alternative, the insurer argued that Michigan Compiled Laws § 500.2833(1)(m) is unconstitutional as a violation of its due process rights because it permits appraisers with pertinent contingency fee contracts in effect to serve as appraisers in coverage disputes.<sup>223</sup> The court disagreed and found that appraisers are not held to the same standard of fairness as “impartial” umpires and are often appointed by the parties. Therefore, there was no denial of the insurer’s due process rights.<sup>224</sup>

##### 5. Miscellaneous Issues

In *Smith v. State Farm Fire & Casualty Co.*,<sup>225</sup> an insured’s home was damaged in an electrical fire. The insurer initially acknowledged that the electrical fire loss was covered, made damage and alternative living expense (ALE) payments, and agreed to appraisal.<sup>226</sup> The insurer later withdrew from the appraisal process and stopped making ALE payments when the insured’s air quality expert found chemical contamination issues in the home, informing the insured that the contamination involved losses from causes excluded under the policy.<sup>227</sup> The insureds asked the insurer to reconsider, stating they were only seeking an appraisal of fire damaged items in the appraisal, and the insurer refused.<sup>228</sup> The insureds then moved for a temporary restraining order (TRO) and preliminary injunctive relief directing the insurer to continue to participate in the statutory loss appraisal process and continue making ALE payments while the appraisal process continued.<sup>229</sup> The court granted the TRO and preliminary injunction, finding that the insureds faced an imminent threat of being homeless without receiving the ALE payments.<sup>230</sup> The court ordered the parties to return to the appraisal process and the insurer to pay two months of ALE for the appraisal period.<sup>231</sup>

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221. *Id.*

222. *Id.*

223. *Id.*

224. *Id.* at \*5–6.

225. 737 F. Supp. 2d 702 (E.D. Mich. 2010).

226. *Id.* at 705.

227. *Id.* at 705–06.

228. *Id.* at 706.

229. *Id.* at 708.

230. *Id.* at 714.

231. *Id.* at 705.

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In *Gold v. State Farm Fire & Casualty Co.*,<sup>232</sup> an insurer and insured agreed to appraisal for a property damage claim. The court considered challenges from both the insured and insurer to the other party's arbitrator selections.<sup>233</sup> The court held that the insured's appraiser was not impartial since his fee was contingent on the insured successfully receiving replacement value for her loss.<sup>234</sup> The court also held the insurer's appraiser was not impartial because his appraisal was done before the appraisal process began and therefore he had essentially served as a consultant for the insurer.<sup>235</sup>

D. *Who Can Sue on the Policy and Collect Proceeds?*

In *First Star International Bank & Trust v. Peterson*,<sup>236</sup> a newly constructed condominium complex sustained damage in a hail storm. The complex's property insurer agreed to pay \$215,503 for roof repairs.<sup>237</sup> Thereafter, the complex's lender purchased the remaining forty units still owned by the developer in a foreclosure sale and then filed a declaratory judgment action asserting that it was an additional insured entitled to the insurance proceeds.<sup>238</sup> The condominium association for the ten sold units in the complex intervened in the action, claiming it was entitled to the insurance proceeds.<sup>239</sup> The North Dakota Supreme Court affirmed the trial court's grant of summary judgment in favor of the condominium association, holding that the association had standing to intervene because of its ownership in the common elements of the complex and that the association had a right to the proceeds because it was the successor to the unincorporated condominium association that was created by the developer to maintain the common elements of the complex during construction.<sup>240</sup>

In *Century-National Insurance Co. v. Garcia*,<sup>241</sup> the insureds' home was damaged when their adult son intentionally set fire to his bedroom. The insurer denied coverage for the fire loss and filed suit seeking a declaration that it had no duty to pay for the loss because its policy excluded coverage for the intentional act or criminal conduct of "any insured" under the policy.<sup>242</sup> The insureds contended that the policy provision excluding coverage for the intentional act or criminal conduct of "any insured" was invalid

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232. 2010 WL 3894141 (D. Colo. Sept. 30, 2010).

233. *Id.* at \*1.

234. *Id.* at \*1.

235. *Id.*

236. 797 N.W.2d 316 (N.D. 2011).

237. *Id.* at 319.

238. *Id.*

239. *Id.* at 320.

240. *Id.* at 324-25.

241. 246 P.3d 621 (Cal. 2011).

242. *Id.* at 622.

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because it impermissibly conflicted with provisions of the California Insurance Code that would not bar innocent insureds from recovering despite a co-insured's intentional criminal conduct.<sup>243</sup> The trial court and appellate court both found for the insurer, in part because the policy exclusions for intentional or criminal acts operated to exclude coverage for innocent co-insureds.<sup>244</sup> The California Supreme Court reversed, finding that the policy's application to innocent co-insureds violated California Insurance Code §§ 2070 and 2071 because it resulted in coverage that was not at least substantially equivalent to the level of protection required and provided in a statutory form fire policy.<sup>245</sup>

#### E. *Suit Limitations*

In a case arising out of Hurricane Katrina, Louisiana's highest court determined that a policy's one-year suit limitation provision was prescriptive and not contractual in nature, and therefore a state statute applied to suspend the applicable limitation period upon the filing of class action suits that included the insureds as putative class members.<sup>246</sup> Even though the insureds were later excluded by class restrictions, the court concluded that their homeowners' suit was timely given the suspension of the limitations period.<sup>247</sup>

Courts have recently grappled with the issue of whether statutes can be applied retroactively to lengthen contractual or statutory suit limitations periods. In *Royer v. USAA Casualty Insurance Co.*,<sup>248</sup> an Indiana federal court declined to apply a state statute enacted following the inception of the subject policy, thereby rejecting the insured's argument that the policy's contractual one-year limitations period was extended to two years by operation of the new statute. In a case involving a post-loss change to a statutory limitations period, the Fifth Circuit came to the opposite conclusion, holding that a statute increasing the statutory suit limitations period from one year to two years retroactively applied to allow an insured to proceed with his suit against his insurer in connection with a fire loss.<sup>249</sup>

#### F. *Bad Faith*

In *Dunn v. American Family Insurance*,<sup>250</sup> the Colorado Court of Appeals affirmed the entry of summary judgment on an insured's bad faith count,

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243. *Id.*

244. *Id.* at 623.

245. *Id.* at 626.

246. *Taranto v. La. Citizens Prop. Ins. Corp.*, 62 So. 3d 721 (La. 2011).

247. *Id.* at 731–34.

248. 781 F. Supp. 2d 767 (N.D. Ind. 2011).

249. *Holt v. State Farm Fire & Cas. Co.*, 627 F.3d 188 (5th Cir. 2010).

250. 251 P.3d 1232 (Colo. Ct. App. 2010).

concluding that the insurer's actions or omissions alleged in the complaint were unrelated to the adjustment and payment of claims, and, accordingly, the insured could not as a matter of law substantiate a claim for bad faith breach of contract.<sup>251</sup> More specifically, the court found that an insurer's duty of good faith and fair dealing did not include a duty to monitor and supervise an independent contractor retained by the insurer for purposes of water remediation or to ensure that the independent contractor had adequate liability insurance.<sup>252</sup> Furthermore, the court found that the insurer did not have a duty to ensure that the insured's home was winterized while it was unoccupied during the remediation or warn the insured that flooding could cause mold, thus leading to adverse health consequences.<sup>253</sup> The court noted that the policy required the insureds to protect their property from such collateral losses, and they were on notice to take necessary measures to prevent such damage.<sup>254</sup>

In *Christopher v. Residence Mutual Insurance Co.*,<sup>255</sup> the California Court of Appeal refused to strike a bad faith count asserted by an insured against its property insurer, finding that there was evidence to support the insured's claim that the insurer's litigation tactics in an underlying liability lawsuit were evidence of bad faith conduct and that such tactics were not protected by the litigation privilege.<sup>256</sup> The court noted that the fact that the insurer took a position in the underlying suit and engaged in litigation tactics for the admitted purpose of decreasing its insured's recovery from the third-party tortfeasor were inconsistent with its duty of good faith and fair dealing to its insured.<sup>257</sup> The court noted that the duty of good faith and fair dealing requires the insurer to refrain from employing litigation tactics that were injurious to the insured's rights to recover from a tortfeasor.<sup>258</sup>

In *Miller v. Safeco Insurance Co. of America*,<sup>259</sup> a Wisconsin federal trial court found that an insurer denied its insured's claims in bad faith because it lacked a reasonable basis for doing so and demonstrated a reckless disregard of the lack of such reasonable basis in denying the claim.<sup>260</sup> In awarding damages, however, the court only awarded those damages to the insureds that were proximately caused by the insurer's bad faith.<sup>261</sup> Despite

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251. *Id.* at 1234.

252. *Id.* at 1236.

253. *Id.* at 1237.

254. *Id.*

255. 2011 WL 1367419 (Cal. Ct. App. Apr. 12, 2011).

256. *Id.* at \*7.

257. *Id.* at \*9.

258. *Id.*

259. 761 F. Supp. 2d 813 (E.D. Wis. 2010).

260. *Id.* at 827.

261. *Id.* at 827-28.

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the court's finding of bad faith, it refused to award punitive damages to the insureds, finding that the insurer's conduct did not rise to the level that warrants the imposition of punitive damages.<sup>262</sup>

#### VIII. CONCLUSION

Overall, while property claims arising from Hurricane Katrina slowly fade away and Chinese drywall coverage issues are beginning to become settled, the property insurance field remained very active during the survey period. Additionally, the growing sophistication of policyholders and their counsel is leading to more disputes over issues surrounding claim handling and appraisal. Those issues will bear watching in the years ahead.

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262. *Id.* at 831.

