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Recent Issues in Property Coverage

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I. INTRODUCTION.................................................................................................. 178
II. INTERPRETING POLICY LANGUAGE................................................................. 178
III. PROPERTY INSURANCE..................................................................................... 186
   A. Builder’s Risk Insurance................................................................................. 187
   B. Insurable Interest ............................................................................................. 188
   C. Direct Physical Loss or Damage Requirement .............................................. 190
   D. Business Interruption Coverage..................................................................... 191
   E. Valuing Property Losses.................................................................................. 193
   F. Collapse Coverage............................................................................................ 197
   G. “Like Kind and Quality” Provision................................................................... 197
   H. Inland Marine Coverage ................................................................................... 200
   I. Boiler and Machinery Insurance..................................................................... 199
   J. Extra Expense Damages.................................................................................... 202
   K. Valuation Issues ............................................................................................... 204
   L. Mold-Related Losses ....................................................................................... 205
   M. E. coli Bacteria-Related Loss .......................................................................... 210
   N. Policy Exclusions............................................................................................. 211
       1. Faulty Workmanship and Design Exclusion .............................................. 211
       2. Ensuing loss exception.................................................................................. 214
       3. Freeze/Thaw or Pressure/Weight of Water Exclusion ......................... 216
       4. Latent Defect Exclusion ............................................................................. 216
       5. Surface Water Exclusion ........................................................................... 217
       6. Rust and Corrosion Exclusion .................................................................... 218
       7. Earth Movement Exclusion ........................................................................ 219
       8. Vacancy Exclusion ...................................................................................... 220
       9. Non-Permanent Property Exclusion.......................................................... 222
      10. Vandalism Exclusion .................................................................................. 222

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I. INTRODUCTION

Hundreds of significant insurance cases are issued each year in the construction industry. This paper focuses on cases issued within the last five years, with particular emphasis on property coverage. Subrogation issues are also addressed because these often arise in property coverage settings. While many insurance policies employ the same or similar language, when interpreting insurance policy language, the courts often employ too little uniform treatment. This certainly is so with respect to liability coverage, but occurs in the property field as well.

II. INTERPRETING POLICY LANGUAGE

The principles employed to interpret insurance contracts are well established in most jurisdictions. While the law differs a bit from jurisdiction to jurisdiction, broad agreement exists on the fundamental principles. For example, most insurance contracts are interpreted such that unambiguous terms are accorded their plain and ordinary meaning.\(^1\) Moreover, a contract is not rendered ambiguous just because one of the parties attaches a different, subjective meaning to one of its terms.\(^2\) If, however, an ambiguity is present, any doubt as to the existence of coverage must be resolved in favor of the insured.\(^3\)

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2. See id.

While uniformity on fundamental interpretation principles governing insurance contracts exists, the actual application of these principles to particular policy language is anything but uniform. The different approaches and conclusions reached by the Sixth Circuit and the Oregon Court of Appeals in interpreting the term “and/or” highlight the challenges in achieving consistent coverage interpretation. In *Detroit Water Team Joint Venture v. Agricultural Insurance Co.*, a builder’s risk policy led to dispute because the existing property exclusion listed two conditions connected by “and/or.” This clause raised the question of whether coverage was excluded when either condition existed or only if both conditions were satisfied. The Sixth Circuit found the term unambiguous and concluded that the exclusion applied “if either or both of the two specified conditions are met.”

The Oregon Court of Appeals, however, found the phrase to be ambiguous. In *Saif Corp. v. Donahue-Birran*, the language at issue was contained in a state statute that affected the amount of coverage afforded under a workers’ compensation policy. Unlike the Sixth Circuit, the Oregon Court of Appeals found the term “and/or” very difficult to interpret:

There is no easy answer to this conundrum because, in this context, the “and/or” either has to mean “and,” in which case SAIF is correct that claimant is not entitled to benefits under the rule, or it means “or,” in which case claimant is correct that he is entitled to benefits. There simply is no way to give effect to both words, because “and” leads to one result, and “or” leads to the other, and there is no middle ground.

It is because of the inherent ambiguity of the phrase “and/or” that virtually all reputable sources advise that the phrase not be used. In Bryan A. Garner, *A Dictionary of Modern Legal Usage* 56-57 (2d ed. 1995), the use of the term “and/or” is discussed at length. Garner notes that the term has been vilified in case law for the past century,

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4. 371 F.3d 336 (6th Cir. 2004).
5. Id. at 341–42.
6. Id. at 342. See also Mich. Pub. Serv. Co. v. City of Cheboygan, 37 N.W.2d 116, 129 (Mich. 1949) (“There are occasions where intent may properly be expressed by ‘and/or,’ indicating ‘both, or either.’”); Local Div. 589, Amalgamated Transit Union v. Massachusetts, 666 F.2d 618, 627 (1st Cir. 1981) (“[T]he words ‘and/or’ commonly mean ‘the one or the other or both.’”).
but that it is usually safe to assume that “x and/or y = x or y or both.” He points out, however, that sometimes the term is “inappropriate substantively as well as stylistically,” because it is too indecisive, such as in a will that makes a bequest “to Ann and/or John.” He observes that the problems of indecisiveness can be cured by using either “and” or “or,” depending on the meaning that is intended. This case presents an excellent example of why the term should not be used: The drafters of the rule must have meant either “and” or “or” but could not have meant both, as different results flow from each reading, and there is no possible alternative reading that somehow could give effect to both. 8

The Fourth Circuit engaged in an interesting analysis of policy language in the unpublished decision of Tankovits v. Del Suppo, Inc.9 The insured, Del Suppo, designed and constructed swimming pools.10 It was sued by one of its customers, although the court provided few details as to the nature of the complaint.11 Del Suppo’s general liability insurance policy is, conversely, discussed at length.12 In addition to the standard ISO policy form, the declarations page made reference to a “Professional Liability Coverage Part.”13 The policy itself, however, contained only oblique references to professional liability coverage.14 The policy also contained an endorsement entitled “Errors and Omissions

8. Id. at 1285 (citations omitted). See also Am. Gen. Ins. Co. v. Webster, 118 S.W.2d 1082, 1084 (Tex. Ct. App. 1938) (“[T]he abominable invention, ‘and/or’, is as devoid of meaning as it is incapable of classification by the rules of grammar and syntax.”); Employers’ Mut. Liab. Ins. Co. v. Tollefsen, 263 N.W. 376, 377 (Wis. 1935) (“[T]hat befuddling, nameless thing, that Janus-faced verbal monstrosity, [used] as a cunning device to conceal rather than express meaning . . . .”); Stanton v. Richardson, (1875) 45 L.R.Q.B. 78 (H.L.) (appeal taken from C.P.) ([S]ix judges had six separate interpretations of “and/or.”); Caulbert v. Cumming, (1855) 156 Eng. Rep. 668, (one of the first cases discussing the problems of interpreting “and/or.”). See also DAVID MELLINKOFF, THE LANGUAGE OF THE LAW 309 (1963) (“Ultimately the decision must be made, which is it — A or B or both? And this decision is not helped by and/or. That formula permits the one person who should know what he is talking about to dodge the decision, and fobs off the choice on a stranger — a lawyer, a judge — who may not have the slightest notion what the writer really meant.”).
9. 129 F. App’x 829 (4th Cir. 2005).
10. Id. at 830.
11. Id.
12. Id. at 830–82.
13. Id.
14. Id.
This endorsement provided additional coverage for "bodily injury" or "property damage" due to any negligent act, error or omission committed during the policy period. By its express terms, the endorsement was subject to all policy exclusions. The endorsement made no mention of the Professional Liability Coverage Part.

The insurer claimed that the extent of professional liability coverage was that set forth in the errors and omissions endorsement and, because policy exclusions applied to the claim, no coverage existed. In response to the charge that this position renders any professional liability coverage illusory, the insurer posited that coverage would apply if bodily injury arose from the insured’s negligent design of the swimming pool. The court was skeptical, concluding that subjecting the endorsement to all policy exclusions “appears to eliminate the potential for any coverage under the E&OE endorsement, thus making coverage under such endorsement illusory.” Notwithstanding the fact that the policy contained no express language describing the extent of professional liability coverage, the court found such coverage existed and that the allegations asserted against the insured fell within its scope:

Because professional liability coverage is generally understood to provide coverage for special risks inherent in the specific profession of the insured, one may reasonably interpret the Policy’s separate listing of the Professional Liability Coverage Part as providing coverage for risks not covered by the Commercial General Liability Coverage Part and its endorsements. Thus, at least one reasonable interpretation of the Policy is that Del Suppo is covered for all bodily injury and property damage claims arising from its negligence, errors, and/or omissions in the execution of its professional work, i.e., in the construction of swimming pools and the walkways that surround swimming pools.

Insurance policies contain provisions excluding certain losses

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15. Id. at 831.
16. Id.
17. Id.
18. Id. at 832.
19. Id. at 834.
20. Id.
21. Id. at 836 n.2.
22. Id. at 836 (citations omitted).
from the scope of coverage. Policy exclusions are quite varied and numerous. Whereas the insured has the burden of establishing that a claim falls within the insuring clause, the insurer has the burden of proving the facts necessary for the operation of a policy exclusion. Policy exclusions are strictly construed, and any ambiguities are interpreted in the insured's favor. Nevertheless, where policy exclusions unambiguously preclude coverage, courts will not re-write policy language to afford protection. Moreover, undefined terms will be given their plain and ordinary meaning.

Because insurance policies are contracts, courts routinely apply one or more contract interpretation rules when making coverage determinations. The policies are also standard form agreements drafted by insurance companies; so, many courts employ a variety of adhesion contract principles. This is particularly the case with respect to interpreting policy exclusions. A federal court, faced with having to interpret several insurance policies in connection with a claim of property damage to a television transmission tower, had occasion to use a variety of interpretation principles under Nebraska law. The court's description of the interpretation rules governing policy language hits upon many common themes:

Under Nebraska law, courts must construe insurance policies to give effect to the parties' intentions at the time the contract was made . . . . A contract must be construed as a whole, and if possible, effect must be given to every part thereof. In discerning the parties' intentions, courts should first determine as a matter of law whether a policy is ambiguous. An insurance policy is ambiguous when a word, phrase, or provision in the contract has, or is susceptible of, at least two reasonable but conflicting interpretations or meanings. Where a clause in an insurance contract can be fairly interpreted in more than

24. 17 WILLISTON & LORD, supra note 1, § 49.111.
25. Id.
26. Id.
one way, there is ambiguity to be resolved by the court as a matter of law.

Courts should determine whether a contract is ambiguous on an objective basis, not by the subjective contentions of the parties and are therefore not compelled to find ambiguity simply because the parties suggest opposing interpretations. The resolution of an ambiguity in a policy of insurance turns not on what the insurer intended the language to mean, but what a reasonable person in the position of the insured would have understood it to mean at the time the contract was made. If a court concludes that a policy is ambiguous it may employ rules of construction and look beyond the language of the policy to ascertain the intention of the parties. Rules of construction require that in the case of such ambiguities, the construction favorable to the insured prevails so as to afford coverage. When an insurer wishes to limit its coverage, it is the duty of the insurer to draft the terms precisely.

However, if a court determines that a policy is not ambiguous then it may not resort to rules of construction, and the terms are to be accorded their plain and ordinary meaning as the ordinary or reasonable person would understand them. In such a case, a court shall seek to ascertain the intention of the parties from the plain language of the policy . . . . [A] court prefers the natural and obvious meaning of the provisions in a policy . . . .

Where coverage is denied, the burden of proving coverage under a policy is upon the insured. However, the burden to prove that an exclusionary clause applies rests upon the insurer. Exclusionary clauses will be liberally construed in favor of the insured.29

A New York decision employed the contract interpretation principle of *ejusdem generis* to conclude that exclusions in a property

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29. *Id.* at 1023–24 (citations omitted) (internal quotation marks omitted). *See also* Nova Cas. Co. v. Waserstein, 424 F. Supp. 2d 1325, 1333 (S.D. Fla. 2006) (holding that where policy language is plain and unambiguous, no special construction or interpretation is required, and the plain language of the policy will be given the meaning it clearly expresses); Tritschler v. Allstate Ins. Co., 144 P.3d 519, 529 (Ariz. Ct. App. 2006) (determining that where an insurance provision is susceptible to different interpretations, the court will attempt to discern its meaning by examining the language of the provision, the purpose of the transaction, and public policy considerations).
policy do not apply to damages caused by demolition work on adjoining property. In 242–44 East 77th Street, LLC v. Greater New York Mutual Insurance Co., an owner sought coverage for settling and cracking damage caused by demolition work. The insurer contended that the policy provided no coverage as an exclusion, entitled “Other Types of Loss,” set forth a list of excluded items including settling, cracking, shrinking or expansion, wear and tear, rust, corrosion, fungus, decay, deterioration or any quality in property that causes it to damage or destroy itself, smog, nesting or infestation, loss caused by dampness or dryness of atmosphere or changes in or extremes of temperature. While the owner’s damages took the form of settling and cracking injuries, the court concluded that the exclusion did not apply. Under the ejusdem generis rule of contract interpretation, the company the word keeps determines its meaning in a series of words. In this case, the long list of excluded items had one characteristic in common: they were limited to damages caused by natural phenomena. The owner’s property, however, was damaged by the human activity of construction operations on the adjoining property.

Courts seldom resort to analyzing extrinsic evidence when interpreting policy language. Nothing, however, forbids a court from delving into extrinsic matters, particularly when it concludes that policy language is ambiguous. Because insurance policies are standard contracts that are procured with limited negotiation, the amount of material extrinsic evidence can be quite limited. What little negotiation occurs often takes place between the insurer and a broker or agent. The legal consequence of extrinsic evidence can be influenced depending upon the status of the broker or agent. Knowledge about the extent of coverage afforded known to the insured’s agent may be imputed to the insured. On the other
hand, representations with respect to coverage by an agent of the insurer can bind the carrier to provide such coverage.\textsuperscript{37} Common types of extrinsic evidence encountered in policy interpretation include direct communications (often e-mail exchanges), premium information, and the insured’s application and disclosure statements. All three types of extrinsic evidence were evaluated in \textit{St. Paul Fire & Marine Insurance Co. v. Hebert Construction, Inc.}, and were found inadequate.\textsuperscript{38} Because insureds often do not know why or how insurers price insurance, premium information is often of little value unless a clear history of transparent premium information exists.\textsuperscript{39}

Some insurance policies can become quite lengthy and complex, given the number of coverage parts, endorsements, exclusions, and riders. On occasion, an insurer will suffer the consequences of this complexity if the exclusionary language it relies upon is buried within the fine text of a complex document. In \textit{USF Insurance Co. v. Clarendon America Insurance Co.}, a commercial general liability carrier sued a number of other insurers, claiming that they wrongfully refused to participate in the defense and indemnity of a contractor being sued by a homeowner for alleged construction defects.\textsuperscript{40} In concluding that an absolute earth movement exclusion was unenforceable, the court focused on its lack of conspicuousness and the insured’s reasonable expectations with respect to coverage:

The exclusions to coverage set forth in the Clarendon National and Clarendon America policies comprise slightly more than six pages of text. The absolute earth movement exclusion appears on the third of these pages, four pages after the general insuring clauses. It is the only exclusion in the Policies that contains any language altering the defense obligation set forth in the insuring clauses, and there is no heading or language in the

\begin{footnotesize}
\begin{enumerate}
\item See \textit{Nova Cas. Co. v. Waserstein}, 424 F. Supp. 2d 1325, 1340 (S.D. Fla. 2006) (acknowledging principle of promissory estoppel could well apply to deny insurer the right to rely upon policy exclusion where its agent represented to insured that coverage would be provided).
\item 450 F. Supp. 2d 1214 (W.D. Wash. 2006).
\item See \textit{Aetna Ins. Co. of Hartford v. Kent}, 540 P.2d 1383, 1387 (Wash. 1975) (suggesting that gross disparity of approximately thirty-to-one premium ratio between types of policies made it reasonable to believe that both parties intended the policies to provide mutually exclusive coverage).
\item 452 F. Supp. 2d 972 (C.D. Cal. 2006).
\end{enumerate}
\end{footnotesize}
Policies that puts the insured on notice of this fact. The relationship between the statement of the duty to defend found in the insuring clauses, and the limitation on that duty inserted in the absolute earth movement exclusion, therefore, is not plain and conspicuous. Additionally, the scope of the exclusion’s limitation on the duty to defend is ambiguous. The exclusion states that “where any claim or suit is based in whole or in part on earth movement,” the insurers will have the right, but not the obligation, to defend the “lawsuit.” . . . Clarendon National and Clarendon America contend that under the absolute earth movement exclusion, they have no duty to defend if the underlying complaint contains an allegation of earth movement, whether or not that allegation concerns the insured or some other defendant. The reference to “claim or suit” can be read more restrictively, however, to mean that the insurers have no duty to defend a lawsuit if it includes an allegation that property damage caused by the insured resulted, in whole or in part, from earth movement.  

Such an interpretation [that the exclusion is limited to cases where the insured caused the harm] is consistent with the objectively reasonable expectations of the insured. An insured might reasonably anticipate, based on the absolute earth movement exclusion, that if it is sued for property damage caused in part by soil movement, the insurer will have no duty to defend that suit. An insured would not reasonably expect that its entitlement to a defense would disappear any time it is joined in a multi-defendant suit where a third-party claimant asserts a claim involving earth movement against some defendants, but not specifically against it.  

III. PROPERTY INSURANCE

Property coverage protects an insured from loss in which it is an insurable interest when the loss is caused by certain covered “causes of loss,” or perils. Common covered causes of loss include fire and wind. The form of property coverage often involved in construction activities is a builder’s risk policy. Builder’s risk

41. Id. at 996–97.
42. Id. at 998.
insurance protects those who have an insurable interest in a building that is under repair, renovation, or construction. Unlike commercial general liability (CGL) coverage, which protects the insured against claims of third parties arising out of its acts or omissions that result in bodily injury or property damage, property insurance is first-party coverage.

A. Builder's Risk Insurance

In the construction industry, the type of property policy most often encountered is the builder’s risk policy. This variant of property coverage applies to structures that are undergoing construction or renovation. The types and sources of risks to real property while a structure is under construction are materially different than the risks encountered once the building is occupied. Nevertheless, in terms of its general structure, the builder’s risk policy is similar to property policies for completed and occupied structures. One court discussed builder’s risk coverage thusly:

“Builders risk” insurance is a unique form of property insurance that typically covers only projects under construction, renovation, or repair . . . . The purpose of builder’s risk insurance is to compensate for loss due to physical damage or destruction caused to the construction project itself. A policy of insurance containing a “builder’s risk” clause or clauses should be construed reasonably and if uncertain in meaning, in favor of the contention of the insured so as to cover if possible a risk obviously sought to be insured.


In contrast, insurance coverage for damage to property owned by the insured or “first-party coverage,” pays the insured the proceeds when the damage occurs, it protects an interest “wholly different” from that protected by third-party coverage. “The principal distinction between liability and property insurance is that liability insurance covers one’s liability to others for bodily injury or property damage, while property insurance covers damage to one’s own property.”

44. See Royal Ins. Co. v. Duhamel Broad. Enters., 170 F. App’x 438 (8th Cir. 2006) (noting that the property policy did not respond to collapse of television tower undergoing alteration by way of replacement of eighteen of more than one thousand diagonal braces).

B. Insurable Interest

For a party to qualify for coverage under a property policy, that party must have an insurable interest in the property insured. As a general rule, the threshold for establishing an insurable interest is not high. Occasionally, however, it becomes a matter of dispute. For example, in Belton v. Cincinnati Insurance Co., an insured sought recovery under its property policy for a loss to a building destroyed by fire on which it had an option to purchase. The court held that the insured could not recover under the policy because he did not have any equity in the land and therefore, did not have an insurable interest.

Two property coverage cases arising out of the World Trade Center (WTC) disaster explore the concept of “insurable interest” as it relates to property coverage. In Zurich American Insurance Co. v. ABM Industries, Inc., a property insurer sought declaration as to the extent of coverage for losses suffered by a contractor that provided janitorial and heating, ventilating, and air conditioning (HVAC) services in common and tenanted areas of the WTC buildings. ABM did extensive maintenance and infrastructure work at the WTC, employing more than 800 people in connection with its operations at the complex. Zurich insured all of the properties that ABM serviced throughout North America. The policy


47. 602 S.E.2d 389 (S.C. 2004).

An insurable interest may be a special interest entirely disconnected from any title, lien, or possession. Thus, an insurable interest is not dependent upon the insured having title to the property, but instead may be derived from possession, enjoyment, or profits of the property, security or lien resting upon it, or it may be other certain benefits growing out of or dependent upon it. Moreover, to be an insurable interest, the interest need not be such that the event insured against would necessarily subject the insured to loss; it is sufficient that it might do so, and that pecuniary injury would be the natural consequence. Courts make every effort to find insurable interest, and to sustain coverage, when there is any substantial possibility that the insured will suffer loss from the destruction of the property.

Id. at 887 (citations omitted) (internal quotation marks omitted).

49. 397 F.3d 158, 161 (2d Cir. 2005).
50. Id. at 161-62.
51. Id.
contained an insurable interest provision, which covered loss or damage to “real and personal property, including but not limited to property owned, controlled, used, leased or intended for use by the insured.”\(^{52}\) In addition, extra expenses “incurred resulting from loss, damage, or destruction covered herein . . . to real or personal property as described in [the Insurable Interest provision]” were also covered.\(^{53}\) Another provision in the policy provided business interruption coverage for losses resulting from a lack of business due to “physical loss or damage, not otherwise excluded, to insured property at an insured location.”\(^{54}\)

The dispute between Zurich and ABM focused on the extent of business interruption coverage, which, in turn, was governed by the scope of the insurable interest provision.\(^{55}\) Zurich argued that ABM had to have a property interest such as ownership or tenancy in order to have the requisite level of “use” or “control” of insured property.\(^{56}\) The court disagreed, finding that “[t]he existence and configuration of the common areas and tenants’ premises were vital to the execution of ABM’s business purpose.”\(^{57}\) “These areas and premises were the means by which ABM derived its income and were as essential to that function as ABM’s cleaning tools.”\(^{58}\) ABM, therefore, “used” or “controlled” this property, so the court found that ABM had an insurable interest in the covered property.

In light of ABM’s substantial influence over, and availment of, the WTC infrastructure to develop its business, it is difficult to imagine what would constitute a “legally cognizable ‘interest’ in the property,” apart from ownership or tenancy. The terms of the insurance policy, however, do not limit coverage to property owned or leased by the insured. To the contrary, the policy’s scope expressly includes real or personal property that the insured “used,” “controlled,” or “intended for use.”\(^{59}\)

The Second Circuit revisited an insurable interest question in

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52. Id.
55. Id.
54. Id.
55. Id. at 161.
56. Id. at 165.
57. Id. at 165–66.
58. Id. at 166.
59. Id.
60. Id. at 167 (citations omitted) (internal quotation marks omitted).
the context of the WTC disaster in *Citigroup, Inc. v. Industrial Risk Insurers*.

Citigroup leased twenty-four floors at Seven WTC. The lease “obligated Citigroup to carry insurance on ‘Tenant’s Property,’ defined as property ‘which can be removed without jeopardizing the structural integrity of the Building’ or causing ‘irreparable damage . . . to the Building systems.’”

Citigroup sought recovery under the landlord’s property policy for the loss of its permanent but removable property. The landlord’s property policy, however, did not cover “Tenant’s Property,” as defined in the lease, and, therefore, the landlord’s insurer did not have an insurable interest in Citigroup’s property.

**C. Direct Physical Loss or Damage Requirement**

In *John S. Clark Co. v. United National Insurance Co.*, the court considered whether a general contractor could recover under an all-risk property policy for the costs incurred to repair defectively built portions of a Parish Life Center for the Roman Catholic Diocese of Charlotte, North Carolina. Interestingly, the design/build construction agreement required the owner to secure “all risk” insurance for physical loss or damage, including damage resulting from defective design, workmanship, or materials.

The owner purchased a property policy that agreed to indemnify the owner and design/builder for all risks of physical loss or damage to real and personal property occurring during the period of insurance. During the course of construction, high winds and inadequately reinforced masonry walls resulted in a partial collapse of the building. The design/builder repaired not only the collapsed portion, but also the defectively built portions of the construction that suffered no wind damage. The court concluded that the policy did not respond to the costs incurred to repair the “undamaged” property as the repair of one’s own faulty workmanship or negligent construction does not constitute

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61. 421 F.3d 81, 82 (2d Cir. 2005).
62. Id.
63. Id.
64. Id.
65. 304 F. Supp. 2d 758 (M.D.N.C. 2004).
66. Id. at 761–62.
67. Id. at 762.
68. Id. at 762–63.
69. Id. at 763.
“physical loss or damage” as required by the insuring clause of the property policy.\textsuperscript{70}

D. Business Interruption Coverage

Standard property coverage responds to the “brick and mortar” costs of replacing destroyed property. If the insured, however, uses the property in a commercial activity, it is quite likely that property loss will also cause business interruption damages. Valuing business interruption loss can be tricky. Claims of lost future profit may be attacked as speculative. Damages for lost profits cannot be based upon hypothetical or speculative forecasts of losses.\textsuperscript{71} Disputes over business interruption loss have a tendency to devolve into duels between financial experts making forecasts based upon past performance and industry indices.\textsuperscript{72}

\textsuperscript{70} Id. at 764-69. See also City of Burlington v. Indem. Ins. Co. of N. Am., 332 F.3d 38, 41–45 (2d Cir. 2003) (concluding coverage under a policy insuring “against risks of direct physical loss or damage to the property insured” did not extend to cover costs of repairing defective welds that had not yet failed); Trinity Indus., Inc. v. Ins. Co. of N. Am., 916 F.2d 267, 270-71 (5th Cir. 1990) (“The language ‘physical loss or damage’ strongly implies that there was an initial satisfactory state that was changed by some external event into an unsatisfactory state—for example, the car was undamaged before the collision dented the bumper. It would not ordinarily be thought to encompass faulty initial construction.”); Whitaker v. Nationwide Mut. Fire Ins. Co., 115 F. Supp. 2d 612, 615-17 (E.D. Va. 1999) (determining that an “all risks” policy’s coverage of fortuitous losses does not mandate coverage for the repair of construction defects as part of a “direct physical loss”); N. Am. Shipbuilding, Inc. v. S. Marine & Aviation Underwriting, Inc., 930 S.W.2d 829, 835 (Tex. App. 1996) (stating that “all risks” insurance policies need no express exclusion for damages due to faulty workmanship or faulty initial construction because “Trinity makes clear that these types of damage . . . are not covered to begin with.”); Wolstein v. Yorkshire Ins. Co., 985 P.2d 400, 407-08 (Wash. Ct. App. 1999) (concluding that coverage under a policy insuring against “all risks of physical loss of or damage” did not extend to cover costs to repair faulty workmanship or faulty initial construction).


\textsuperscript{72} See Blis Day Spa, LLC v. Hartford Ins. Group, 427 F. Supp. 2d 621 (W.D.N.C. 2006). The court concluded that plaintiff’s estimates were not unduly speculative so as to remove the issue from the jury:

Hartford contends that Blis’s estimates of lost profits as a matter of law are unduly speculative and therefore it is entitled to summary judgment because there is no competent evidence of additional business interruption losses. Specifically, Hartford points to the fact that: 1) Heil’s calculations assume that Blis would have increased its number of revenue producing hairdressers to sixty-six during the period of interruption when in fact there were only fifty-six hairdressers; and 2) Heil’s assumed revenue generated by each hairdresser, $6134, derived
Another WTC case, *Lava Trading, Inc. v. Hartford Fire Insurance Co.*, discussed the length of time an insurer must pay for business interruption losses. The insured maintained offices, including a functioning data center, on the eighty-third floor of One WTC. The insured sold computer programs to assist in the electronic trading of equities in various equity markets. In addition to its office in the WTC complex, the insured maintained a small, nearly-complete backup location at 75 Broad Street that was not destroyed in the terrorist attacks. Following the September 11, 2001, attack, the insured converted its Broad Street location into a functioning data center, and eventually to a more permanent location.

The insured asserted a claim under its business interruption policy. A dispute arose over the amount of the claim and the period of disruption. The business interruption policy provided reimbursement for actual loss of business income sustained during the period of restoration. The policy defined “period of restoration” as that period of time that begins with the date of direct physical loss and “ends on the date when the property at the described premises should be repaired, rebuilt or replaced with

from the industry average, grossly overstates the actual revenue generated before, during, and after the period of interruption. In response, plaintiffs argue Heil has provided ample support and explanation for his methodology, figures, and assumptions employed in reaching his estimates. Heil first examined Blis’s financial documentation and its business plan, and interviewed Blis’s management and its supplier, Jim Barr. He then utilized the following factors to calculate anticipated monthly business income: maximum available hours of service operation, the most used hourly service rate, available service providers, operational realization percentage, and Blis’s historical trends, including what he considered its upward trend towards profitability. Heil determined the maximum available hours of operation, and multiplied that by the “most used hourly service rate” of $71. Heil then multiplied this number by the anticipated number of service providers, based on the space available, for the six-month period of interruption. He then applied to that number a “realization number” of 40-55%, a number derived by starting from the “industry” figure of 70%, the assumed maximum efficiency rate for hairdressers, and then adjusting downward.

*Id.* at 630.


74. *Id.* at 437.

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.* at 438–39.

79. *Id.* at 436.

80. *Id.* at 439.
reasonable speed and similar quality.”  

The insured took the position that the period of restoration would not end until its new facility was completed.  

The court disagreed, finding that coverage terminated once the insured secured reasonable replacement space to conduct its operations.

E. Valuing Property Losses

Property policies may be written on a number of different reimbursement bases. For example, some policies pay the insured the actual cash value of the insured property. Other policies are written on a replacement basis. The Nebraska Supreme Court, in Olson v. LeMars Mutual Insurance Co. of Iowa, wrestled with determining the actual cash value of a loss to a grain storage building, where the policy did not define the term. The court explained:

As used in a property insurance policy, the phrase “actual cash value” is a limitation on the amount of recovery for the protection of the insurer. It is not a substantive measure of damages. Where, as here, the policy does not contain a specific definition, it has been noted that “[u]here is a priority of rules to determine actual cash value as follows. (1) where market value is easily determined, actual cash value is market value, (2) if there is no market value, replacement or reproduction costs may be used, (3) failing the other two tests, any evidence tending to formulate a correct estimate of value may be used.”

The insurer calculated the actual cash value of the loss based on the cost of repairing the partially damaged building and making
a deduction for depreciation from the cost of repair. While the court acknowledged that this approach might work for completely destroyed structures, it was inappropriate for partially damaged structures:

We agree with the district court that on the record presented, the policy did not permit the depreciation deduction claimed by Le Mars. As we have previously determined, the insured building had an actual cash value of $200,000 at the time of the loss. In its damaged condition, its value was reduced to $100,000, the price for which Olson sold it to Land. Le Mars elected to calculate its payment under the policy based upon the cost of repairing the partial damage, which was $95,040. There is no evidence that the repairs would cause the actual cash value of the building to exceed $200,000. Recovery of the full repair costs without a depreciation deduction will therefore restore the value of the insured property that existed immediately prior to the loss, but will not enhance that value. Accordingly, we conclude that under an actual cash value policy which does not expressly provide otherwise, an insurer may not deduct depreciation from the cost of repairing partial damage to insured property where the actual cash value of the property, as repaired, does not exceed its actual cash value at the time of the loss.

The Sixth Circuit, in Parkway Associates, LLC v. Harleysville Mutual Insurance Co., addressed the issue of whether a repair contractor’s overhead and profit was a proper constituent in calculating actual cash value of a loss. Parkway owned a hotel that was damaged by a tornado. The parties could not agree on proper valuation of the loss, and the district court ordered the

86. Id. at 456–57.
87. Id. at 460–61. See also Kane v. State Farm Fire & Cas. Co., 841 A.2d 1058, 1047 (Pa. Super. Ct. 2003) (“[I]n the absence of clear language to the contrary, an insurer may not deduct depreciation from the replacement cost . . . and the phrase ‘actual cash value’ may not be interpreted as including a depreciation deduction, where such deduction would thwart the insured’s expectation to be made whole.”). But see Ins. Co. of N. Am. v. City of Coffeyville, 630 F. Supp. 166 (D. Kan. 1986) (ruling that insurer was entitled to deduct depreciation from the cost of repairing a structure partially damaged by fire); Zochert v. Nat’l Farmers Union Prop. & Cas. Co., 576 N.W.2d 531 (S.D. 1998) (permitting deduction of depreciation from repair costs where policy differentiated between actual cash value and replacement cost coverage, and insured elected former).
88. 129 F. App’x 955, 957 (6th Cir. 2005).
89. Id.
parties to submit to the appraisal process required by the policy. The appraisers issued an award with two different valuations: $694,549, based on a replacement cost value, and $607,728, based on an actual cash value. Both values contained an amount for a general contractor’s overhead and profit. The district court determined that the policy permitted Parkway only to recover the actual cash value of its loss, and further concluded that the contractor’s overhead and profit should be deducted from the actual cash value. In disagreeing with the district court’s analysis, the Sixth Circuit stated:

    Parkway’s policy provides that it is entitled to recover the actual cash value of its loss. The actual cash value of a loss is equal to the repair or replacement costs less depreciation. The Tennessee courts have not determined what repair or replacements costs include. Other courts, however, have held that repair or replacement costs logically and necessarily include any costs that an insured reasonably would be expected to incur in repairing or replacing the covered loss. Although there are some types of losses where the services of a contractor would normally not be utilized, there are many instances where the insured reasonably would be expected to call a contractor, especially where there is extensive damage. If a contractor would reasonably not be required to repair an insured’s loss, then contractor’s overhead and profit would not be included in replacement costs. In the instant case, however, Parkway would reasonably be expected to hire a contractor to repair its property. Since the actual cash value of a loss is the repair or replacement costs less depreciation, and since the cost of a contractor would reasonably be incurred in repairing Parkway’s damaged property, then the costs of contractor’s overhead and profit would be included in the actual cash value of Parkway’s loss.

    In Assurance Co. of America v. Adbar, L.C., Missouri’s “value policy” statute, which prohibits property insurers from denying that “the property insured thereby was worth at the time of the issuing
of the policy the full amount insured” did not apply to a builder’s risk policy. As the Eighth Circuit noted:

A “builders risk” policy is a common form of fire insurance for buildings under construction in which the policy declares the completed value of the building but the insured pays a reduced premium in exchange for lesser amounts of coverage prior to completion. It is settled that the Missouri courts do not construe [Missouri Revised Statutes] section 379.140 as requiring a builders risk insurer to pay the declared completed value if the policy obligates the insurer to pay only a lesser amount for a fire loss that occurs prior to completion.

The boundaries of the valuation appraisal process called for under most property policies were examined in Kendall Lakes Townhomes Developers, Inc. v. Agricultural Excess & Surplus Lines Insurance Co. An insured suffered loss to its townhouse complex due to a windstorm. The insured’s appraiser estimated the covered loss at approximately $716,000, but the insurance carrier said that the damage to all nine buildings was less than $1000. Because of this, the deductibles did not cover the damage. Based upon the conflicts in the appraisals, the trial court appointed an umpire to determine the amount of loss. The court’s order expressly reserved for the court the determination whether the loss, in whole or in part, was caused by a covered cause of loss. The umpire, after reviewing the two appraisal reports and conducting a hearing, entered an award that the insured “did not carry the burden of proof to establish insurance coverage.”

The trial court confirmed the umpire’s award and the insured moved to vacate. The insured first argued—or at least the court of appeal so characterized the argument—that, under Florida law, the umpire had no authority to rule on the causation of the damage. The Florida Court of Appeal disagreed, as causation is a

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95. 129 F. App’x 334, 334–35 (8th Cir. 2005).
98. Id. at 13.
99. Id. at 14.
100. Id.
101. Id.
102. Id.
103. Id.
104. Id. at 15.
coverage question for the court when an insurer wholly denies that a covered loss exists. Where the insurer acknowledges that a covered loss exists, causation is an “amount-of-loss question” for the appraisal panel to determine. Nevertheless, the court vacated the award on the grounds that the umpire exceeded the authority granted by the trial court:

Contrary to the trial court’s order, the umpire did not do as directed as the umpire’s report did not state the total loss or “breakdown the amount of the loss by virtue of excluded causes.” While an umpire has the authority to resolve causation issues, since the trial court specifically reserved this issue for the court’s determination, the umpire in this case exceeded the authority granted to it by the trial court. The trial court’s order additionally and clearly states that “[t]he Court shall be the ultimate finder of fact on the issue of whether the loss, in whole or part, was caused by a covered cause.” In contravention of the trial court’s order, the umpire did not fulfill the tasks assigned to it and instead made factual findings as to coverage, an issue not in dispute and an issue it lacked authority to resolve; and causation, an issue which pursuant to the trial court’s order, the trial court had reserved for itself.

F. Collapse Coverage

The cases discussing collapse coverage under a property policy generally fall into one of three camps. The narrow view is that collapse coverage is limited to the actual falling down of a covered structure. The broad view is that any substantial structural impairment that threatens collapse falls within coverage. A third view is somewhere between these narrow and broad views and includes the threat of imminent collapse. The Pennsylvania Supreme Court, in 401 Fourth Street, Inc. v. Investors Insurance Group, adopted the third view—sometimes referred to as the “broad” view, depending upon the court’s perspective—and found

105. Id.
106. Id. at 16 (citing Johnson v. Nationwide Mut. Ins. Co., 828 So. 2d 1021, 1022 (Fla. 2002)).
108. 879 A.2d 166 (Pa. 2005).
that policy language insuring against “risks of physical loss involving collapse” provides coverage for the imminent collapse of a building or part thereof. The Indiana Supreme Court, in Monroe Guaranty Insurance Co. v. Magwerks Corp., determined that “collapse” for property insurance purposes means substantial impairment of the structural integrity of a building or any part thereof, and no requirement exists of a sudden and complete disintegration of the structure. In Hilton Head Resort Four Seasons Centre Horizontal Property Regime Council of Co-Owners, Inc. v. General Star Indemnity Co., damaged and deteriorating roofs, which included missing shingles and rotten wood without any sagging or drooping, were insufficient to trigger collapse coverage.

The competing theories over the scope of collapse coverage reflect competing policy concerns. Narrow coverage is justified on the grounds that to extend coverage for structural impairment short of collapse turns the insurance policy into a sort of maintenance agreement. Broader coverage is sometimes justified on the grounds that to restrict policy benefits to instances where the building actually falls down creates an incentive to forego repairs to avert imminent collapse.

Property coverage for losses incurred as a result of the collapse or partial-collapse of the insured structure can be a contentious matter due to a number of factors, including policy language. For example, in Assurance Co. of America v. Wall & Associates LLC of Olympia, the policy excluded loss or damage caused directly or indirectly by “collapse.” Nevertheless, the policy also stated that if the collapse results from a “Covered Cause of Loss,” the insurer

109. Id. at 174.
110. 829 N.E.2d 968 (Ind. 2005).
111. Id. at 972.
114. See Royal Indem. Co. v. Grunberg, 553 N.Y.S.2d 527, 529 (App. Div. 1990) (agreeing with the “numerical majority of American jurisdictions [that] a substantial impairment of the structural integrity of a building is said to be a collapse” because to require the building to fall down would be “unreasonable” in light of an insured’s duty to protect property from further damage). See also Assurance Co. of Am. v. Wall & Assoc., LLC of Olympia, 379 F.3d 557 (9th Cir. 2004) (holding that policy covered not only actual collapse, but also imminent collapse).
115. 379 F.3d 557, 560–63 (9th Cir. 2004).
would pay for the loss. Moreover, the policy responded to damages due to collapse caused by “hidden decay.” In this case, water infiltration caused deterioration of bricks and wallboard, which created a high risk of failure of structural support for the brick facing. The insured undertook repairs to the façade before it had a chance to collapse. The insured claimed that the policy responded to the loss because the building was in imminent danger of collapse due to “hidden decay.” The district court ruled against the insured, holding that “collapse,” under the policy, meant “a sudden falling down.” The Ninth Circuit disagreed:

The policy language at issue here comprehends a broader meaning than what the district court assigned. . . . The policy here states, “We will pay for loss or damage caused by or resulting from risks of direct physical loss involving collapse of a building or any part of a building caused . . . by . . . hidden decay.” The term “collapse” does not appear in the policy in isolation; instead, it is qualified by the terms “risks of direct physical loss” and “involving.” Certainly, as in Rosen, if the policy specified, “We insure only for direct physical loss to covered property involving the sudden, entire collapse of a building or any part of a building,” and, in turn, defined “collapse” as “actually fallen down or fallen into pieces,” the district court would have properly attributed to the word “collapse” the definition of “a sudden falling down.” However, . . . the clause here contains much more. To interpret the clause as a whole to mean that coverage extends only upon “a sudden falling down” impermissibly disregards the other aspects of the clause and renders them ineffective. . . . We therefore conclude that this policy language not only covers actual collapse but also imminent collapse.

116. Id. at 559.
117. Id.
118. Id. at 558–59.
119. Id.
120. Id.
121. Id. at 559.
122. Id. at 563. See also Sandalwood Condo. Ass’n at Wildwood, Inc. v. Allstate Ins. Co., 294 F. Supp. 2d 1315 (M.D. Fla. 2003) (holding that to recover for direct loss involving “collapse” caused by hidden decay or insect damage, the structure did not need to be in imminent danger of collapse, but damage to it had to substantially impair structural integrity of the building).
G. “Like Kind and Quality” Provision

Property policies may be drafted in such a way as to require the insurer to replace damaged property with one of “like kind and quality.” In Republic Underwriters Insurance Co. v. Mex-Tex, Inc., the insured’s roof was damaged by a hail storm. While the property insurer was undertaking its investigation, the insured retained a contractor to replace the roof for $179,000. The replacement roof was of the same kind as the prior roof, but was affixed to the building mechanically, rather than by ballast, as was the original roof. The property carrier issued a check for $145,460, representing the cost of an identical roof attached by ballast. The insured objected, arguing that the roof it paid for was “comparable” to its prior roof, and therefore the insurer should have paid $179,000. The Texas Supreme Court agreed with the insured, finding that the “like-kind and quality” provision in “the policy neither restricted nor required [the insured] to pay for the cost to replace the roof with an identical one.”

H. Inland Marine Coverage

Another form of property coverage sometimes encountered in the construction industry is “inland marine” coverage.

The term “inland marine” technically applies to transportation on the nation’s inland waterways . . . but by the turn of the 20th century, “inland marine” had come to signify insurance for property transported by land.

Today, most waterborne cargo is insured as “ocean” or “wet” marine, which has its own standards of liability, policy forms, and underwriting criteria.

123. 150 S.W.3d 423 (Tex. 2004).
124. Id. at 424.
125. Id. at 424–25.
126. Id. at 425.
127. Id.
128. Id.
129. Id.
Contractors transporting expensive pieces of equipment often insure against the risks of damage during the course of transit. Inland marine insurance “function[s] basically as a form of property insurance, even though the policy may explicitly contemplate that the value of the property will be payable to the owner rather than the insured.” The federal district court in Nebraska had occasion to discuss coverage under a “commercial inland marine coverage form” in connection with the collapse of a television tower. The opinion is somewhat frustrating because the facts are set forth in a separate memorandum and, therefore, difficulty arises in determining the factual background that the court actually applied to its coverage determinations. The commercial inland marine policy is described as covering a variety of property (i.e., materials, machinery, and equipment for which the insured has assumed liability and for which the insured has contracted to install or erect), and the duration of coverage is described as follows:

This policy attaches from the time the property is at risk of the Insured and, except as excluded elsewhere in the policy, covers continuously thereafter during transit, while awaiting and during installation, and terminates when:

a. the interest of the Insured in the property ceases, or
b. the installation or erection of the property is completed and accepted as satisfactory, or
c. this policy expires or is cancelled:

whichever of the foregoing conditions first occurs.

The court concluded that Fireman’s inland marine policy responded to the damages due to the tower collapse, although it is difficult to tell from the opinion what specific facts led to the conclusion. The court’s analysis treats the inland marine policy like a form of builder’s risk coverage.

131. See id.
134. Id.
135. Id. at 1027.
I. Boiler and Machinery Insurance

Boiler and machinery insurance coverage is another special type of property insurance designed to cover losses associated with equipment malfunction of pressurized, electrical, and electronic machinery. Typical equipment covered by this insurance includes boilers, generators, engines, pumps, compressors, and turbines. Refrigeration and air conditioning equipment is also the subject of this coverage. Common electrical objects such as transformers, reactors, circuit breakers and other items that might be critical for plant operation may be covered. This coverage is sometimes encountered in instances where the contractor is responsible for start-up and commissioning activities.

These policies usually require the equipment malfunction to result from an accident, which is defined as a “sudden” and “accidental” breakdown of the object or part of the object. Chronic failures of equipment attributable to age are typically not covered.136

J. Extra Expense Damages

After property loss, extra expense damages associated with maintaining the business enterprise and costs associated with repair and replacement that are not “brick and mortar” are another common “soft cost” property loss.137 The cost of renting other space to maintain the business is an “extra expense” item. Architectural fees and interest expense to rebuild are extra expenses.

It is not uncommon for property policies to contain a variety of sub-limits for soft cost items. The Georgia Court of Appeals, in RLI Insurance Co. v. Highlands on Ponce, LLC, found an ambiguity in the manner in which the property policy addressed soft and hard costs.138 A fire seriously damaged an apartment complex.139 The complex was insured through RLI in excess of $29 million for any one occurrence.140 In addition to this blanket limit of liability

136. See 515 Assoc. LLC v. Travelers Indem. Co. of Ill., 160 F. App’x 147, 151 (3d Cir. 2005) (holding that boiler and machinery policy did not respond to elevator breakdown that was neither sudden nor accidental).
139. Id. at 169.
140. Id.
provision, the policy also contained “additional limits of insurance” for soft costs and lost business income, each to $100,000 per occurrence.\(^\text{141}\) RLI took the position that the amount of coverage available for soft costs was $100,000 and a similar amount for business income loss.\(^\text{142}\) The insured took the position that these were “additional” limits and applied “in addition to” the blanket limit of $29 million.\(^\text{143}\) The court found an ambiguity, which precluded granting summary judgment in favor of RLI:

On the one hand, the contract could be interpreted to mean that soft costs and business costs are limited to $100,000 per occurrence, irrespective of the blanket limit of $29,507,000. On the other hand, however, given the clause that “additional limits” apply \textit{in addition to} the blanket limit of liability, and soft costs and business costs were identified as having additional limits of $100,000, the contract could also be interpreted to mean that once the blanket limit has been exhausted, there remained $100,000 for use to pay for liabilities in soft cost and business income over and above the blanket limit.

Moreover, the policy stipulates that “[t]he insurer shall not be liable for more than $29,507,000.00 for any one occurrence, \textit{except as hereinafter provided}.”

\ldots

\ldots [T]he agreement between the parties remains ambiguous as to whether the coverage for soft costs and business income exceeded $100,000. Thus, it is for a jury to consider the circumstances surrounding the transaction to determine the scope and effect of the policy between RLI and Highlands.\(^\text{144}\)

The court determined that after applying standard rules of construction—\textit{e.g.}, interpreting the contract as a whole and construing ambiguities against the drafter—the agreement remained ambiguous and a jury should resolve the issue.\(^\text{145}\) As is sometimes the case with these disputes, conflicting extrinsic evidence was placed before the court with respect to what the insured’s insurance agent knew about policy coverage.\(^\text{146}\)

\begin{footnotesize}
\begin{itemize}
\item \(^\text{141}\) \textit{Id.} at 170.
\item \(^\text{142}\) \textit{Id.}
\item \(^\text{143}\) \textit{Id.}
\item \(^\text{144}\) \textit{Id.} at 171–72 (alteration in original).
\item \(^\text{145}\) \textit{Id.} at 172.
\item \(^\text{146}\) \textit{Id.} \textit{See also} Blis Day Spa, LLC v. Hartford Ins. Group, 427 F. Supp. 2d 621,
\end{itemize}
\end{footnotesize}
K. Valuation Issues

Since 2001, a year has not gone by without at least one published insurance decision issued in connection with the WTC disaster. *SR International Business Insurance Co. v. World Trade Center Properties, LLC* involved a dispute over the amount of property insurance recoverable for tenant improvements affixed to the WTC complex.\(^ {147} \) The parties’ disagreement focused on how to value tenant improvements.\(^ {148} \) The developer argued “the improvements should be treated the same way as the buildings to which they were attached—that is, like the WTC’s ‘core and shell,’ they should be included in the replacement cost at their full appraised value.”\(^ {149} \) The insurers, noting that many of the tenants that occupied space on September 11, 2001, terminated or abandoned their leases, argued that the improvements cannot be valued at full replacement cost because they will never be “replaced.”\(^ {150} \) Instead, the improvements should be valued based upon “[the unamortized portion of the Port Authority’s original contribution to these improvements,’ [which] they claim[ed] constitute[d] the limit of the Insureds’ actual interest in the improvements.”\(^ {151} \)

This valuation disagreement is the basic difference between recovery under a “replacement cost” policy and recovery available under an “actual cash value” policy. As the court explained:

Replacement cost policies provide greater coverage than traditional “actual cash value” policies by permitting the insured to replace damaged or destroyed property with new property without any deduction. By paying an extra premium for replacement cost coverage, the insured can recover on a “new-for-old” basis instead of the “old-for-old” recovery provided by ACV [actual cash value] coverage. However, in order to collect this larger amount, the insured must actually replace the damaged property

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630-31 (W.D.N.C. 2006) (finding the property policy ambiguous with respect to whether it responds to advertising costs as language stated that insurer would provide “necessary” extra expenses incurred during the period of restoration and both parties disputed what were “necessary” expenses and the policy did not define the term “necessary”).

148. *Id.* at 326.
149. *Id.* at 331.
150. *Id.* at 331–32.
151. *Id.*
consistent with the RCE [replacement cost endorsement].\(^\text{152}\)

The court did not accept the insurer’s argument that replacement cost coverage was not available.\(^\text{153}\) Part of the court’s reasoning had to do with the jurisdiction and authority of the appraisal panel responsible for valuing the losses.\(^\text{154}\) As is common in property coverage disputes, the appraisal panel had limited jurisdiction, namely, to determine the extent of the insured’s loss.\(^\text{155}\) These panels do not typically get involved in coverage issues. Coverage determinations are for the court. In this case, the court held that, although actual replacement is a condition precedent to collecting replacement proceeds, it was not a condition precedent to valuing hypothetical replacement costs, which is all the appraisal panel was authorized to do.\(^\text{156}\) Moreover, the court was not convinced that, under the facts presented, the improvements would never be replaced.\(^\text{157}\) While it is true that the WTC was not going to be rebuilt, replacement is determined on a “functional similarity” basis and against this backdrop it is possible that the improvements will be replaced as the insureds have said that they intend to construct a new office and retail complex that will presumably include tenant improvements.\(^\text{158}\)

\textbf{L. Mold-Related Losses}

Coverage disputes over mold-related losses continued unabated in 2005. In 40 Gardenville, L.L.C. v. Travelers Property Casualty of America, the insured purchased a vacant building located in West Seneca, New York.\(^\text{159}\) Gardenville purchased an all-risk policy from Travelers for the property.\(^\text{160}\) Travelers’s underwriter did not inspect the building before issuing the policy, which contained a standard exclusion for “corrosion, rust or dampness.”\(^\text{161}\) Representatives of the insured, however, did inspect the building

\(^{152}\) Id. at 326 n.6 (alteration in original).
\(^{153}\) Id. at 332.
\(^{154}\) Id.
\(^{155}\) Id.
\(^{156}\) Id. at 333.
\(^{157}\) Id.
\(^{158}\) Id. at 334–35.
\(^{159}\) 387 F. Supp. 2d 205, 207 (W.D.N.Y. 2005).
\(^{160}\) Id. at 208.
\(^{161}\) Id.
before purchasing the policy. One testified that he “observed leaks in the roof and large holes on the exterior walls, water draining into buckets and leaking from the open valve of the sprinkler system, puddles of standing water, and wet carpeting throughout the building.” He also “observed a substance resembling dirt on the vinyl baseboards along the second floor that he later learned was mold.” Notwithstanding these observations, the court ruled that neither the “fortuitous loss” doctrine nor its counterpart, the “known loss” defense, operated to bar coverage at the summary judgment stage. While an insurer is not obligated to pay out policy benefits to an insured who is aware of a loss before it purchases the policy, in this case, while the insured certainly knew the building was in rough shape, it could not be held, as a matter of law, that the insured knew the property was contaminated with mold. Nevertheless, coverage did not exist because the policy’s “dampness” exclusion applied:

[T]his Court finds the water or dampness present in the building was the proximate cause of the mold contamination. As such, the unambiguous language of the policy excluding coverage for losses caused or resulting from dampness applies to Plaintiff’s claim for mold loss, and operates as a bar to Plaintiff’s recovery in this matter.

Property policies usually include a mold exclusion. Water damage, however, is a common cause of loss. Mold growth and water infiltration have a close causal tie, so a raging dispute exists in the industry over whether property policies respond to mold losses where water infiltration, a covered cause of loss, caused or contributed to the mold. The debate is complicated by fairly

162. Id.
163. Id.
164. Id. at 209.
165. Id. at 212.
166. See id. (reasoning that “[w]hile this admission certainly supports Defendant’s position that mold existed in the building prior to the inception of the policy, it does not compel the conclusion that Mr. Hickson was aware of the mold contamination at that time.”).
167. Id. at 214.
168. See id. at 213 (citing expert testimony on water damage to buildings).
common exclusionary language that incorporates an “ensuing loss” exception. The relevant language is as follows:

We do not cover loss caused by:

. . . .

(2) rust, rot, mold or other fungi.

. . . .

We do cover ensuing loss caused by collapse of the building or any part of the building, water damage, or breakage of glass which is part of the building if the loss would otherwise be covered under this policy.

Courts go back and forth on whether this “ensuing loss” language restores coverage for mold. Courts that found coverage usually concluded that mold was an ensuing loss of water damage. Courts that found no coverage often did so on the grounds that “ensuing loss” was loss that followed from some other cause. In other words, coverage applied only where the water damage ensued from some other non-covered loss, such as mold. The Texas Supreme Court resolved a long-running dispute within the state over this issue by concluding that the ensuing loss language did not restore coverage for mold loss:

To “ensue” means “to follow as a consequence or in chronological succession; to result, as an ensuing conclusion or effect.” An “ensuing loss,” then, is a loss which follows as a consequence of some preceding event


171. See Garza, 2005 WL 2388254 at *2. “This Court has specifically held that despite language in the Policy purportedly excluding coverage for mold damage, the Policy covers mold damage to a dwelling or personal property that ensues from an otherwise covered water damage event under the policy.” Id. (citation omitted).

172. Id. (stating the “general mold exclusion in the Policy precludes coverage for mold occurring naturally or resulting from a non-covered event.”).
or circumstance. . . . If we give to the language of the exception its ordinary meaning, we must conclude that an ensuing loss caused by water damage is a loss caused by water damage where the water damage itself is the result of a preceding cause.\footnote{Fiess, 202 S.W.3d at 749 (quoting Lambros v. Standard Fire Ins. Co., 530 S.W.2d 138 (Tex. Civ. App. 1975)).}

Of course, when a description of the “ordinary meaning” of insurance language is as complex as the above quote, the courts, not surprisingly scatter on this point. Moreover, the Texas Supreme Court was split with Justices Medina and O’Neill dissenting.\footnote{Id. at 753 (Medina, J., dissenting).} Others believe that neither party in \emph{Fiess} had the correct interpretation:

William J. Chriss, as amicus curiae, argues that neither party has it right. Amicus submits that the Feisses [sic] interpret water damage from the ensuing-loss provision too broadly, essentially ignoring \emph{Lambros} and reading “ensuing” out of the provision. The amicus further argues that State Farm’s circular interpretation of the provision ignores the meaning of the word “otherwise,” thus depriving the provision of virtually any meaning. Amicus submits that the correct and more reasonable construction of “otherwise be covered” is that it refers to the remainder of the policy other than the paragraph under consideration. Thus, according to the amicus, water damage including mold, which results from an excluded peril as \emph{Lambros} requires, would be covered because such loss is not excluded anywhere else in the policy other than in paragraph f.\footnote{Id. at 756. The dissent also pointed out that the Texas Department of Insurance read the “ensuing loss” language differently than the majority. \emph{Id.} The Texas Department of Insurance concluded that the “provision can only be read to mean that despite any exclusion language, it includes coverage for certain previously excluded damage which is caused by a covered water loss.” \emph{Id.}}

Thus, while the Texas Supreme Court apparently resolved the issue in the Lone Star state, the debate will likely continue elsewhere.\footnote{See \emph{Souza v. Corvick}, 441 F.2d 1013, 1016 (D.C. Cir. 1970) (holding that “earth sinking” exclusion did not exclude coverage for damage resulting from subsidence caused by something other than natural soil conditions); \emph{New Zealand Ins. v. Lenoff}, 315 F.2d 95, 95–96 (9th Cir. 1963) (holding that “settling” exclusion barred recovery for damage caused by house settling into soil unless immediate cause of settling was an unanticipated event rather than an inevitable occurrence); \emph{Church of the Palms-Presbyterian (U.S.A.), Inc. v. Cincinnati Ins. Co.}, 404 F. Supp.
M. E. coli Bacteria-Related Loss

In Motorists Mutual Insurance Co. v. Hardinger, homeowners fell ill with respiratory infections and skin problems shortly after moving into their new home.177 Their property insurer arranged for testing of the home and discovered that it was contaminated with *E. coli.*178 After a number of unsuccessful attempts to clean the property, the homeowners simply gave the property back to their bank.179 Their insurer notified them that it was denying coverage on the theory that the loss predated the policy and was excluded by the pollution exclusion.180 The trial court agreed with the insurer that, although the insureds gave up their home, they did not establish a "physical loss to property."181 The Third Circuit vacated the district court’s ruling, analogizing the situation to cases where an insured is denied the use of property because of asbestos contamination.182

177. 131 F. App'x 823 (3d Cir. 2005).
178. Id. at 824.
179. Id.
180. Id. at 825.
181. Id.
182. Id. at 826.
Affiliated FM Insurance Co., the Third Circuit remanded to the trial court for determination of whether the pollution exclusion applied. In a concurring opinion to Motorists Mutual Insurance, however, Justice Thomas L. Ambro opined that the exclusion was likely ambiguous under the facts of this case, and predicted that the Supreme Court of Pennsylvania would likely follow the Arizona precedent of Keggi v. Northbrook Property & Casualty Insurance Co., which found that a pollution exclusion did not apply to bacteria-related injury.

N. Policy Exclusions

1. Faulty Workmanship and Design Exclusion

Most property policies contain workmanship exclusions. One such exclusion was found to be ambiguous in Otis Elevator Co. v. Factory Mutual Insurance Co. The insured entered into a contract with the Metropolitan Airport Commission (MAC) to build an Automated People-Mover (APM) along the length of the new “C” Concourse at the Minneapolis-St. Paul Airport. During the testing of the APM, the tram crashed at the end of the tracks. The resulting damage to the tram, the buffer, and the terminal wall created repair costs of $2 million. In addition to these costs, Otis also paid $1.5 million worth of liquidated damages to MAC because of the delay in completing the project. Otis sought to recover its losses from the builder’s risk policy purchased by the MAC. The insurer denied coverage based on a policy exclusion that read:

This Policy excludes the following, but if physical damage not excluded by this Policy results, then only that resulting damage is insured:

1) faulty workmanship, material, construction or design from any cause.

2) loss or damage to stock or material attributable to

186. Id. at 276.
187. Id. at 277.
188. Id.
189. Id.
190. Id.
manufacturing or processing operations while such stock or material is being processed, manufactured, tested, or otherwise worked on.

The accident occurred because one of the insured’s subcontractors deviated from test protocol by failing to engage the secondary brakes while operating the tram. The insurer claimed that this failure amounted to “faulty workmanship” excluded under the builder’s risk policy. The court disagreed, finding that the term “faulty workmanship” did not encompass a breach of the testing protocol:

[T]he term “faulty workmanship” does not encompass the damage at issue. The tram itself was not faulty workmanship in the sense of a “flawed product” because it already had been completed at the time of the accident. The tram was not a “flawed process” because the construction of the tram already was complete, even if it had not actually been accepted by MAC, at the time of the accident. By either definition of “faulty workmanship,” defendant’s claim that the tram is faulty workmanship when sent at full speed, overloaded and without brakes, is forced. The accidental property damage to the tram cannot be termed “faulty workmanship.” It is simply accidental damage resulting from subcontractor negligence unrelated to the quality of any product or process.

The court also determined that the testing exclusion did not apply because the tram cars could not be considered “stock,” as that term is used in the exclusion. Stock is kept as inventory for use or sale to customers; the trams were custom-manufactured and installed as part of the airport’s APM system. Moreover, the trams were not “material” as used in the exclusion, “A tram is the complete machine and cannot be considered a component of itself; thus, it cannot be ‘material.’”

191.  Id. at 278.
192.  Id.
193.  Id.
194.  Id. at 281.
195.  Id. at 283.
196.  Id.
197.  Id. at 283. See also Allstate Ins. Co. v. Smith, 929 F.2d 447 (9th Cir. 1991) (distinguishing between “flawed product” and “flawed process,” finding that faulty workmanship only applies to the former); City of Burlington v. Hartford Steam Boiler Inspection & Ins. Co., 190 F. Supp. 2d 663, 672 (D. Vt. 2002) (holding that
The faulty workmanship exclusion was successful in eliminating coverage in *Andray v. Elling*. In *Andray*, an insured homeowner decided to make some electrical, plumbing, and structural changes to his new home. Unfortunately, he hired contractors who did not perform the work particularly well and the homeowner was required to hire other contractors to correct the resulting problems. When the homeowner turned the claim over to his homeowner’s insurance carrier, the claim was denied on the grounds that faulty workmanship was not covered under the policy. The insured sought to avoid this exclusion by claiming that a concurrent covered cause, namely the contractors’ acts of vandalism, contributed to the loss. The court rejected this theory on the ground that no evidence existed to prove the damages were anything more than the result of incompetence.

Property policies often exclude poor workmanship or design from the group of otherwise covered “causes of loss.” In *E.L. Rincon Supportive Services Organization, Inc. v. First Nonprofit Mutual Insurance Co.*, the court considered whether “excavation” activities fell within an exclusion for faulty “construction.” The insured’s property was not under construction. Rather, excavation activities on the adjacent property caused damage to the insured’s property. After consulting a number of dictionaries, which did not on their face appear to settle the issue, the court invoked the “reasonable person” analysis:


199. Id. at *1.
200. Id. at *1–2.
201. Id. at *3.
202. Id. at *4.
203. Id. at *5.
205. Id. at 534.
206. Id.
Based on the plain, ordinary meaning of the term “construction,” we conclude that a reasonable person would consider the construction process to encompass excavation activities. For instance, it is commonly understood that excavating activities are necessary to lay the foundation in the construction of a building. Since we conclude that the term “construction” includes excavation activities, the property damage resulting from the construction excavation operations on the adjacent property is excluded under the policy.  

In another case, a builders’ risk policy did not respond to damage to wood siding as a result of this exclusion.  

2. Ensuing loss exception

In National Union Fire Insurance Co. of Pittsburgh, Pa. v. Texpak Group, N.V., the faulty workmanship exclusion applied where insureds sought coverage for business interruption and extra expense losses due to a contractor’s defective design and installation of upgrades to a paper mill. The insureds argued that their business interruption and extra expense costs fell within the “ensuing loss exception” to the faulty workmanship/design exclusion. Under this exception, the policy does not respond to costs of making good defective designer specifications, “this exclusion shall not apply to loss or damage resulting from such defective design or specifications . . . .” The policy, however, expressly dealt with business interruption and extra expense losses, stating that these damages were covered when “resulting from loss

207. Id. at 538. See also Nat’l Hous. Bldg. Corp. v. Acordia of Va. Ins. Agency, Inc., 591 S.E.2d 88, 91 (Va. 2004) (holding that the design exclusion operated to bar coverage for defectively designed retaining wall that failed, and that the policy’s “Duties in the Event of Loss” provision requiring the insured to take steps to protect the covered property from further damage, i.e., fix the retaining wall, did not provide relief as such duties—and the insurer’s responsibility to reimburse the insured to fulfill these duties—is not triggered unless there is a covered loss).
208. Carney v. Assurance Co. of Am., 177 F. App’x 282, 283 (4th Cir. 2006) (“[T]he policy unambiguously excludes coverage for the damage at issue because it was caused by or resulted from faulty workmanship in the failure to properly stain and protect the wood.”). See also Elworthy v. Hawkeye-Security Ins. Co., 166 F. App’x 353 (10th Cir. 2006) (holding that damage to homeowner’s floors fell within policy exclusion for damage caused by faulty, inadequate, or defective materials used in repair, construction, renovation or remodeling).
209. 906 So. 2d 300, 301 (Fla. Dist. Ct. App. 2005).
210. Id.
211. Id. (emphasis omitted).
As the court noted:

Under the clear and unambiguous terms of this policy, business interruption and extra expense losses are covered only if "resulting from" damage or destruction of real or personal property caused by a covered peril. Since defective design or specifications are not perils covered by this policy, economic damage or loss resulting from these causes are excluded from coverage as well. 215

A California federal decision discussed at some length the "ensuing loss" language found in many faulty workmanship exclusions. In Sapiro v. Encompass Insurance, the exclusion in question excluded from "building losses incident to . . . inadequate or defective . . . workmanship." 214 However, the exclusion also stated "any ensuing loss not excluded or excepted . . . is covered." 215 In this case, the insured’s home was damaged due to water infiltration and mold growth due to a defective exterior stucco job. 216 The court found that the faulty workmanship exclusion unambiguously excluded the loss notwithstanding the "ensuing loss" provision:

California’s courts have long defined an “ensuing loss” as a loss “separate” and “independent” from [an] original peril. Plaintiffs’ losses are neither; they are, rather, abstrusely phrased reformations of the same “gap”-related losses-losses plaintiffs concede are excluded by Safeco’s “faulty workmanship” clause. In fact, none of the supposedly “ensuing losses” plaintiffs identify can be

212. Id. at 302.
214. 221 F.R.D. 513, 521 (N.D. Cal. 2004).
215. Id. at 522.
216. Id.
categorized as “ensuing losses,” if even losses at all. Plaintiffs’ alleged “moisture” and “fungal” losses are directly attributable to the initial negligent contracting. Plaintiffs’ “reconstruction” costs are neither separate nor “ensuing” by any legitimate measure; they are the price for repairing the predicate damage.217

3. Freeze/Thaw or Pressure/Weight of Water Exclusion

Another exclusion typically found in property policies involves damage caused by “freezing, thawing, pressure or weight of water or ice.” This exclusion sometimes operates to bar coverage for a partial collapse due to snow load.218

4. Latent Defect Exclusion

A common property insurance exclusion pertains to “latent defects.” This exclusion applied in Walker v. McKinnis, where the insureds’ home was damaged when water intruded into the basement during heavy rains because of the geometry of the home’s roof and gutter system.219 In applying the latent defect exclusion, the court reasoned:

The policy does not define “latent defect.” Webster’s Third New International Dictionary defines the adjective, “latent” as follows: “existing in hidden, dormant, or repressed form, but usually capable of being evoked, expressed, or brought to light; existing in posse; not manifest; potential.”

The report of appellants’ expert, an architect, stated that the water intrusion was caused by “the geometry of the roof and gutter system.” According to the expert, “[t]he vector of the roof valleys directs roof run off along the main A-frame gutters where there is no down spout outlet.” The expert stated in his report that during “very heavy rain events,” water overflowed from the gutters onto the ground and eventually into the basement through a window well. Appellants did not hire anyone to independently inspect the house prior to taking

217. Id.
occupancy. However, appellant, Christopher Walker, stated in an affidavit contained in the record that the house “did not have any visible defects” when he purchased it.

Based on the above facts and our review of the entire record, we find no error in the common pleas court’s determination that the defect in the “geometry of the roof and gutter system” was a “latent defect,” and that it caused the water intrusion and subsequent damage. Consistent with the ordinary meaning of “latent,” the defect in the roof and gutter system “existed in hidden form” and was “not manifest” at the time appellants purchased the property and entered into the contract with West American.

5. **Surface Water Exclusion**

Property policies often contain exclusions for loss caused by surface water runoff. In *State ex rel. State Fire & Tornado Fund of North Dakota Insurance Department v. North Dakota State University*, the university’s heating plant suffered damage when large amounts of rain water, which had collected on an adjacent sports facility site, entered the plant through a steam tunnel. The university’s property insurance carriers denied coverage on grounds that the water damage was excluded by the flood and surface water exclusions.

In agreeing with the insurers, the court acknowledged the difficulty of applying the “surface water” exclusion to a particular factual setting. The court determined that the exclusion applied even though the “surface water” was

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220. *Id.* at *1–2.
221. 694 N.W.2d 225, 227–28 (N.D. 2005).
222. *Id.* at 228.
223. *Id.* at 230, 235. *See also* Heller v. Fire Ins. Exchange, 800 P.2d 1006, 1009 (Colo. 1990) (explaining that the exclusion did not preclude coverage where water originated from natural runoff of melted snow, but was diverted into manmade trenches which were “defined channels” that prevented percolation, evaporation, or natural drainage); Smith v. Union Auto Indem. Co., 752 N.E.2d 1261, 1266–67 (Ill. App. Ct. 2001) (reasoning that the exclusion precluded coverage where rainwater filled homeowner’s basement, notwithstanding the fact that the flow was altered by such manmade objects as streets and other paved surfaces); State Farm Lloyds v. Marchetti, 962 S.W.2d 58, 61 (Tex. App. 1997) (noting that the exclusion did not preclude coverage for damage caused by sewerage backup after heavy rain, as the loss was proximately caused by sewage which was non-floodwater, even though the sewage invaded the home due to floodwater).
diverted underground through a steam tunnel. The water was merely following gravity and did not change its essential nature by flowing through an underground steam tunnel.

6. Rust and Corrosion Exclusion

Another common property policy exclusion pertains to damages caused by rust and corrosion. The exclusion applied in Gilbane Building Co. v. Altman Co., where Gilbane was hired as the construction manager on a new manufacturing plant. Gilbane hired Altman to provide cast-in-place concrete for the building. The contract called for Altman to “etch” the concrete floor, which essentially involved removing the concrete agents used to cure the concrete floor and to rough the surface of the floor so that it could receive the final sealant. The method selected to perform the etching process was to use a muriatic acid product called E-Z Muriatic Acid. Apparently, the process caused the stainless steel hardware, switch plates, and copper piping throughout the building to discolor. In contesting the application of the “rust and corrosion” exclusion, Altman claimed that, while the discoloration was due to rust and corrosion, the court should apply the common sense and ordinary understanding of the terms “rust” and “corrosion” and conclude that a fast-acting, acid-based chemical reaction, is not the type of rust and corrosion intended to be excluded under the policy. The court did not find Altman’s argument persuasive:

The ACE policy bars coverage for loss resulting from rust and corrosion. The policy does not qualify this exclusion to cover only gradual-forming rust and corrosion or fast-forming rust and corrosion. The parties have stipulated that the loss at issue here was due to corrosion and rust on the metal surfaces of the equipment.

224. State ex rel. State Fire & Tornado Fund, 694 N.W.2d at 232.
225. Id. at 233. See also Valley Forge Ins. Co. v. Hicks Thomas & Lilienstein, L.L.P., 174 S.W.3d 254, 258 (Tex. App. 2004) (concluding that the exclusion applied where heavy rains from a tropical storm caused a bayou to overflow its banks causing floodwater to flow into man-made underground structures causing damage to a law firm’s office).
227. Id.
228. Id.
229. Id.
230. Id.
231. Id. at *3.
and piping in the electrical/mechanical rooms and the UPS rooms in which the etching was performed. Therefore, this court finds that the “rust and corrosion” exclusion in the policy provided by ACE bars coverage. 232

7. Earth Movement Exclusion

Many property policies contain an earth movement exclusion. On occasion, the exclusion is also found in CGL policies. In Hoang v. Monterra Homes (Powderhorn) LLC, the CGL policy in question excluded coverage for property damage “arising out of, caused by, resulting from, contributed to, aggravated by, or related to earthquake, landslide, mud flow, subsidence, settling, slipping, falling away, shrinking, expansion, caving in, shifting, eroding, rising, tilting or any other movement of land, earth or mud.” 233

The insured claimed that the exclusion did not apply to movement of “artificial fill.” 234 In this case, a number of newly built residences were damaged because of soil problems and expansion of the artificial fill placed under the homes’ foundations. 235 The Colorado Court of Appeals rejected this interpretation of the exclusion because the policy language did not admit a distinction between natural and artificial causes, and to create one would rewrite policy language. 236

As a general rule, this exclusion is intended to eliminate coverage for earthquake damage, sink holes, and other earth


233. 129 P.3d 1028, 1035 (Colo. Ct. App. 2005), rev’d, 149 P.3d 798 (Colo. 2007). The Colorado Supreme Court reversed on the issue of whether the insurance proceeds covering the builder’s liability are available to a subsequent purchaser, holding “the proceeds of the CGL insurance policy at issue in this case are available through garnishment to satisfy the judgment of a subsequent purchaser . . . .” Hoang, 149 P.3d at 801.


235. Id. at 1032, 1035–36. The district court “found that the damage here was caused by water pressure associated with clay soils and the fill materials underlying the homes.” Id. at 1036.

236. Id. at 1036. The court stated, “Colorado courts, however, have refused to rewrite policies to create a distinction between natural and artificial causes where no language in the policy supports such a distinction.” Id.
movement caused by natural phenomena. In *Travelers Personal Security Insurance Co. v. McClelland*, an examination of the concurrent causation doctrine was undertaken in the context of damages to a home from movement of the foundation.\(^{237}\) Under Texas law, if the insurer pleads an exclusion, the insureds are obligated to introduce evidence sufficient to prove that the damage was caused solely by a covered risk or sufficient to allow a jury to segregate the damage caused by the insured peril from that caused by the excluded peril.\(^{238}\) The *McClelland* court upheld a jury verdict in favor of the insureds, finding that expert testimony to the effect that eighty percent of the foundation damage was caused by plumbing leaks was sufficient for a jury to render a verdict in favor of the homeowners.\(^{239}\)

8. **Vacancy Exclusion**

Many property policies contain a vacancy exclusion. In general terms, this exclusion eliminates coverage if a building is vacant for a certain number of consecutive days prior to the occurrence resulting in the loss or damage. A common exception to the vacancy exclusion pertains to buildings under construction. The California Court of Appeal, in *TRB Investments, Inc. v. Firemen’s Fund Insurance Co.*, ruled that the “under construction” exception applies to a building that is being built and is not yet ready for occupancy.\(^{240}\) The exception, however, did not apply to completed commercial buildings that are ready for occupancy, but being renovated to meet the needs of a particular tenant.\(^{241}\) It is unclear why the court found “renovation” to be sufficiently different from “construction” so as to evade the exception’s grasp. The court relied on dictionary definitions and, not surprisingly, found that the term “construction” is not equivalent to “renovation.”\(^ {242}\) Yet, from a functional viewpoint, little significant difference exists between constructing a building and undertaking a major

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\(^{237}\) 189 S.W.3d 846 (Tex. App. 2006).

\(^{238}\) Id. at 849 (quoting Travelers Indem. Co. v. McKillip, 469 S.W.2d 160, 162 (Tex. 1971)).

\(^{239}\) 189 S.W.3d at 851–52. See also Hudson v. Allstate Ins. Co., 809 N.Y.S.2d 124 (N.Y. App. Div. 2006) (holding that subsidence damage to plaintiff’s home from a plumbing pipe leak was not excluded by insurance policy’s earth movement or collapse exclusion).

\(^{240}\) 31 Cal. Rptr. 3d 384 (Ct. App. 2005), rev’d, 145 P.3d 472 (Cal. 2006).

\(^{241}\) *TRB Investments, Inc.*, 31 Cal. Rptr. 3d at 392.

\(^{242}\) Id. at 391.
renovation. In either case, it is not possible to occupy the structure while the activities are taking place.\textsuperscript{243}

The case was appealed and the “under construction” exception was the focus of the California Supreme Court’s 2006 decision in \textit{TRB Investments, Inc. v. Fireman’s Fund Insurance Co.}\textsuperscript{244} In a matter of first impression, the highest court of California examined whether the “under construction” exception to the vacancy exclusion was limited to the erection of a new structure or whether it extended to all building endeavors, no matter if they were classified as new construction, renovations, or additions, all of which required the substantial and continuing presence of workers at the premises.\textsuperscript{245} In reversing the Court of Appeal, the California Supreme Court ruled in favor of the insured:

The Court of Appeal’s focus upon whether the term “under construction” encompasses only the erection of new structures or also includes renovations thus fails to take into account the rationales underlying the vacancy exclusion and the construction exception. We believe the proper inquiry for determining whether a building is “under construction” for purposes of defining an exception to the vacancy exclusion is whether the building project, however characterized, results in “substantial continuing activities” by persons associated with the project at the premises during the relevant time period. Under that test, “sporadic entry” would be insufficient to find a substantial continuing presence of workers required for a finding of “construction.” We believe this test better serves the purposes underlying the vacancy exclusion and more accurately reflects the reasonable expectations of an insured than any test turning upon technical distinctions between “construction” on the one hand and “renovation” or “remodeling” on the other.

Defendant contends the building here was not “under construction” because, at the time of the loss, contractors were engaged in only “preparatory” activities in

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{244} 145 P.3d 472 (Cal. 2006).
\item \textsuperscript{245} \textit{Id.} at 473–74.
\end{itemize}
\end{footnotesize}
contemplation of future construction. The characterization of the activities here as “preparatory” is no more helpful than characterizing the building endeavor as a “renovation” or remodeling.” Whether the construction activity at issue is performed in contemplation of, or in preparation for, a building endeavor of even greater scope involving more workers is beside the point. The question remains the same no matter what stage of a construction project is at issue, i.e., are there “substantial continuing activities” on the premises by those involved in the construction endeavor?246

9. Non-Permanent Property Exclusion

In *Ajax Building Corp. v. Hartford Fire Insurance Co.* damage to a crane was not covered as the policy contained an exclusion for “equipment or other property which will not become a permanent part of the structure(s) . . . .”247

10. Vandalism Exclusion

In *American States Insurance Co. v. Rancho San Marcos Properties, LLC*, a “vandalism” exclusion did not operate to exclude arson damages.248

11. Law and Ordinance Exclusion

Many property policies contain an exclusion or restrictive endorsement that eliminates coverage for certain losses sustained by an insured to comply with building codes and other regulatory requirements. The exclusion has been held not to restrict recovery for increased costs of replacing a damaged structure due to new or more stringent code requirements where the cause of loss is otherwise covered.249 More agreement seems to exist that the exclusion bars recovery where the insured seeks recovery for the costs of having to upgrade undamaged portions of a structure due

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246. *Id.* at 478–79 (citations omitted).
247. 358 F.3d 795, 798 (11th Cir. 2004).
249. See *Fire Ins. Exch. v. Superior Court*, 10 Cal. Rptr. 3d 617, 636 (Ct. App. 2004) (stating that the exclusion operates to defeat coverage only if the cause of loss is an ordinance or law).
to regulatory requirements triggered because of the need to repair
the damaged portions.250 The Third Circuit’s decision in Regents of
the Mercersburg College v. Republic Franklin Insurance Co. is a twist on
the more common coverage question presented by this exclusion.251
In Mercersburg, the property policy contained an ordinance and law
endorsement that actually expanded coverage.252 The endorsement
read:

1. Coverage A—Coverage For Loss to the Undamaged
Portion of the Building. If a Covered Cause of Loss
occurs to covered Building property[,] . . . we will pay for
loss to the undamaged portion of the building caused by
enforcement of any ordinance or law that: (a) requires
demolition of parts of the same property not damaged by
a Covered Cause of Loss; (b) regulates the construction or
repair of buildings, or establishes zoning or land use
requirements at the described premises; and (c) is in
force at the time of the loss.

. . . .

3. Coverage C—Increased Cost of Construction
Coverage. If a Covered Cause of Loss occurs to covered
Building property[,] . . . we will pay for the increased cost
to repair, rebuild or construct the property caused by
enforcement of building, zoning or land use ordinance or
law. If the property is repaired or rebuilt, it must be
intended for similar occupancy as the current property,
unless otherwise required by zoning or land use
ordinance or law.

The college claimed that the insurer was responsible for
upgrades to the undamaged portions of the building to bring them
into compliance with the International Mechanical Code, the
National Electrical Code, and the International Plumbing Code.254
The Borough of Mercersburg, however, did not adopt any of those
building codes.255 Therefore, the question became whether the law
and ordinance endorsement was triggered under these
circumstances. The Third Circuit ruled against the college, finding that the “loss of undamaged portions” was not “caused by enforcement of any” of the codes:

Unlike the [Americans with Disabilities Act (ADA)] and [Pennsylvania Handicapped Act (PHA)], Mercersburg fails to point out any provisions of the building codes that mandated or required it to do any upgrades, renovations, etc., to the undamaged portions of Keil Hall. Certainly, Mercersburg’s discretionary decision to renovate undamaged portions of Keil Hall triggered the application of the building codes as to that renovation, but critically important is that the building codes themselves did not trigger those renovations. This distinguishes Mercersburg’s building codes claims from its ADA and PHA claims. As a result, we affirm the District Court’s determination (albeit on different grounds than the District Court) that the Ordinance and Law Endorsement does not provide coverage for renovations it made to undamaged portions of Keil Hall in hypothetical compliance with codes not mandating those renovations.

A common rendition of this exclusion eliminates coverage for loss caused by the “enforcement of any ordinance or law regulating construction, repair or demolition of a building or other structure, unless endorsed to this policy.” The California Court of Appeal, in *Fire Insurance Exchange v. Superior Court*, ruled that this exclusion does not restrict recovery for the increased costs of replacing a damaged structure due to new or more stringent building code requirements where the cause of loss is otherwise covered. Instead, the exclusion operates to defeat coverage if the cause of the loss is an ordinance or law.

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256. *Id.* at 172.
257. *Id.* (first alteration in original).
259. 10 Cal. Rptr. 3d 617, 629 (Ct. App. 2004).
260. *Id.* at 632. Quoting the Alaska Supreme Court, the California court noted:

As we read this provision, it does not limit [the insurance company’s] obligation for the cost of repair or replacement of the building when a loss has occurred that is covered by the policy, but merely states that if the loss itself is caused by an ordinance or law, there is no coverage. For instance, if some safety improvement of a building to which no other loss had occurred were required by an ordinance or law, [the insurance
12. Water Without Roof Damage Exclusion

Some property policies contain a limitation that excludes damage to the building’s contents due to rain, snow, or sleet unless the building structure first sustains damage by a covered cause of loss to its roof or walls through which the rain, snow, or sleet entered. The meaning of this exclusion was examined in a situation where renovations to an apartment were stalled due to regulatory problems. At the time renovation ceased, the roof was completely removed and a series of tarps covered the structure. Due to high winds, rainwater penetrated the tarps causing damage. The court determined that the temporary tarp structure was not a “roof” within the meaning of the policy provision permitting coverage for rain damage to interior contents where the roof sustained damage.

13. Rotting Exclusion

Common exclusionary language bars coverage for damage due to “rotting.” In Topor v. Erie Insurance Co., an insured’s building parapet collapsed because of rotting mortar joints in the brick company] would not be liable. However, when the cost of repairing or replacing a building that had been damaged by fire is increased by the requirements of an ordinance or a law, [the insurance company] is not relieved of that cost. Id. at 632–33 (quoting Bering Strait Sch. Dist. v. RLI Ins., 873 P.2d 1292, 1296 (Alaska 1994) and Garnett v. Transamerica Ins. Servs., 800 P.2d 656, 666 (Idaho 1990)) (alterations in original). See also Dupre v. Allstate Ins. Co., 62 P.3d 1024, 1029–30 (Colo. Ct. App. 2002); Farmer’s Union Mut. Ins. Co. v. Oakland, 825 P.2d 554, 555 (Mont. 1992); Commonwealth Ins. Co. of Am. v. Grays Harbor County, 84 P.3d 304, 308 (Wash. Ct. App. 2004) (finding where Commonwealth drafted the policy “in broad terms, covering reconstruction of undamaged parts of the facility if required by enforcement of a law or ordinance,” and where other limitations were not included, any ambiguity in Commonwealth’s language is construed in favor of coverage because Commonwealth could have limited the coverage or written other restrictions). But see Chattanooga Bank Ass’n v. Fidelity & Deposit Co. of Md., 301 F. Supp. 2d 774, 779 (E.D. Tenn. 2004) (agreeing with Fidelity that “it is not liable for the cost of upgrading code violations which were discovered in areas not affected by the fires” under the “Demolition and increased cost of construction” clause, and that “discovery of code violations in non fire affected areas, even when the inspection would not have taken place in the absence of fires, fails to create liability under the terms of the insurance contract”).

262. Id.
263. Id.
264. Id. at 1234–36.
226  WILLIAM MITCHELL LAW REVIEW  [Vol. 34:1

The court determined that the rotting exclusion did not apply because it was limited to the rotting of organic materials such as wood. 266

O. Mixed Causation: The Efficient Proximate Cause Doctrine

While courts take the same basic interpretive approach to exclusions, regardless of whether they are contained in first-party (property insurance) or third-party (liability insurance) policies, differences exist. Many of the exclusions contained in property policies are tailored around specific “causes of loss” or “named perils.” Flood, surface water, landslide, weather conditions, and earth movement are common “causes of loss” exclusions. Where a loss is the result of a confluence of events, i.e., the interaction of more than one “cause of loss,” some of which fall within coverage and others not, a coverage dilemma can arise. Some jurisdictions deal with this situation by applying what has come to be known as the “efficient proximate cause” doctrine:

The efficient proximate cause doctrine is the universal method for resolving coverage issues involving the occurrence of covered and excluded perils. The efficient proximate cause is not necessarily the last act in the chain of events, nor necessarily is it the triggering cause, and the efficient proximate cause looks to the quality of the links and the chain of causation and is considered the predominating cause of the loss. 267 Nevertheless, an insured cannot bring an otherwise uncovered event into coverage merely by recharacterizing the cause of loss by breaking it down into its various constituents. 268 The Washington Supreme Court explained this principle:

The efficient proximate cause rule applies only where two or more independent forces operate to cause the loss. When, however, the evidence shows the loss was in fact occasioned by only a single cause, albeit one susceptible to various characterizations, the efficient proximate cause analysis has no application. An insured may not avoid a contractual exclusion merely by affixing an additional

266  Id. at 633.
label or separate characterization to the act or event causing the loss.  

Insurers have attempted to avoid the “efficient proximate cause” doctrine by adopting policy language designed to circumvent the doctrine. A common approach, implicated in Howell v. State Farm Fire & Casualty Co., was to draft an introductory clause to the exclusion section of the policy stating that the policy does not provide coverage if the loss would not have occurred in the absence of the excluded loss, regardless of whether “other causes acted concurrently or in any sequence with the excluded event to produce the loss . . . .” In jurisdictions where the doctrine is grounded in public policy concerns, this introductory language proved ineffective. To avoid this result, some insurers began drafting multiple cause exclusions designed to avoid disputes over whether the efficient proximate cause or predominant cause was a covered or an excluded peril. Instead, these exclusions preclude coverage resulting from a combination of specified causes regardless of whether one of the specified causes is a remote cause of loss. The California Supreme Court enforced such a multiple-cause exclusion in Julian v. Hartford Underwriters Insurance Co. The exclusion in question precluded coverage for losses caused by weather conditions that “contribute in any way with” an excluded cause or event such as earth movement, including a landslide. Because the policy was an “all-risk” form, most weather conditions were covered causes of loss and damages.

269. Id. (citations omitted) (internal quotation marks omitted). See also Pieper v. Commercial Underwriters Ins. Co., 69 Cal. Rptr. 2d 551, 558 (Ct. App. 1997) (finding arson and brush fire were not separate and distinct perils that caused loss); See also Pieper v. Commercial Underwriters Ins. Co., 69 Cal. Rptr. 2d 551, 558 (Ct. App. 1997) (determining arson and brush fire were not separate and distinct perils that caused loss); Chadwick v. Fire Ins. Exch., 21 Cal. Rptr. 2d 871, 874 (Ct. App. 1993) (stating builder’s negligence and defective framing were not separate perils, because “[t]o say builder negligence ‘caused’ the defective framing is, in this context, to indulge in misleading wordplay”).


271. Id. at 715 n.6 (“If we were to give full effect to the State Farm policy language excluding coverage whenever an excluded peril is a contributing or aggravating factor in the loss, we would be giving insurance companies carte blanche to deny coverage in nearly all cases. . . . Since, in most instances, an insurer can point to some arguably excluded contributing factor, this rule would effectively transform an ‘all-risk’ policy into a ‘no-risk’ policy.”)

272. 110 P.3d 903 (Cal. 2005).

273. Id. at 904.
proximately caused by them fell within coverage.  Yet, the weather conditions exclusion operated in such a way that, if any specific excluded cause of loss “contributes in any way” along with weather conditions, even if the weather conditions were the efficient proximate cause of loss, no coverage exists. In Julian, heavy rains caused a slope to fall above the insured’s home, triggering a landslide that caused a tree to crash into the insured’s home.

California has statutorily adopted the efficient proximate cause doctrine. The weather conditions clause in Julian was not in conflict with the statute. The statute did not preclude an insurer from excluding some manifestations of weather conditions, but not others. Nevertheless, where the excluded peril makes only a minor, remote contribution to the loss, a coverage denial "would raise troubling questions regarding the clause’s consistency with the efficient proximate cause doctrine. Denial of coverage for such a loss would suggest the provision of illusory insurance against weather conditions, raising concerns similar to those implicated in Howell."

IV. SUBROGATION REMEDIES

After an insurance company has paid out monies under its policy, it may attempt to recover some or all of its payments from a third party on the grounds that it is subrogated to the rights of its insured. Subrogation is the equitable right of an insurer to be put in the position of its insured so that it may pursue recovery from any third party legally responsible to the insured for the loss paid by the insurer. Property carriers bring many subrogation actions because payment is triggered not on the fault of the insured, but on the existence of a covered cause of loss. As a consequence, property insurers often have cleaner subrogation rights than liability insurers. Nevertheless, no automatic prohibition against liability carriers seeking subrogation from third parties exists. An

274. Id. at 905.
275. Id. at 909–10.
276. Id. at 905.
278. See Julian, 110 P.3d at 912.
279. Id.
280. Id. at 911.
insurer, however, may not seek subrogation from one of its policyholders. In addition, if the insured has not been completely compensated for its loss, its claim to be “made whole” may interfere with the insurer’s subrogation claims. Moreover, an insurer’s rights to subrogation may be compromised or eliminated through a provision in a construction contract whereby the insured waives its subrogation rights.

It is not uncommon for one insurance company to seek reimbursement from another insurer for losses paid out due to a construction-related injury. Under Illinois law, the grounds upon which one insurer can seek equitable subrogation from the other are:

(1) the defendant carrier must be primarily liable to the insured for a loss under a policy of insurance; (2) the plaintiff must be secondarily liable to the insured for the same loss under its policy; and (3) the plaintiff carrier must have discharged its liability to the insured and at the same time extinguish the liability of the defendant carrier. 282

In one case, the plaintiff insurer was denied equitable subrogation because it provided additional insured coverage to the general contractor for liability arising out of the work of one subcontractor; whereas, it sought subrogation from an insurer that provided additional insured coverage to the general contractor for liability arising out of a different subcontractor’s liability. 283 Therefore, the two insurers did not insure the same risk. 284

In Hartford Casualty Insurance Co. v. Mt. Hawley Insurance Co., 285 the differences between equitable subrogation and equitable contribution were discussed:

The right of subrogation is purely derivative. An insurer entitled to subrogation is in the same position as an assignee of the insured’s claim, and succeeds only to the rights of the insured. The subrogated insurer is said to “stand in the shoes” of its insured, because it has no greater rights than the insured and is subject to the same defenses assertable against the insured . . . . Equitable contribution is entirely different. It is the right to recover,

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283. Id. at 999.
284. See id.
285. 20 Cal. Rptr. 3d 128 (Ct. App. 2004).
not from the party primarily liable for the loss, but from a co-obligor who shares such liability with the party seeking contribution. In the insurance context, the right to contribution arises when several insurers are obligated to indemnify or defend the same loss or claim, and one insurer has paid more than its fair share of the loss or defended the action without any participation by the others.\textsuperscript{286}

These legal principles formed the context within which a subcontractor’s insurer was denied equitable contribution from the general contractor’s insurer due to the indemnity agreement contained in the insureds’ contract.\textsuperscript{287} The indemnity provision required the subcontractor to indemnify the general contractor for loss except that occasioned by the general contractor’s sole negligence.\textsuperscript{288} Under the circumstances, the court concluded that to require the general contractor’s insurer to contribute to the loss paid by the subcontractor’s insurer when the general contractor was not liable to the subcontractor for the loss would be inconsistent with “equitable principles designed to accomplish ultimate justice.”\textsuperscript{289}

An insurer’s subrogation interest can complicate an insured’s ability to settle with a tortfeasor. Unless the insured can give the

\textsuperscript{286} Id. at 135 (quoting Fireman’s Fund Ins. Co. v. Md. Cas. Co., 77 Cal. Rptr. 2d 296, 303 (Ct. App. 1998)).

\textsuperscript{287} Id. at 140.

\textsuperscript{288} Id. at 136.

\textsuperscript{289} Id. at 139. Courts have held that where two or more insurers cover loss, no right of contribution exists for the insurer that paid the loss on behalf of an insured that owed broad indemnity to the insured of the non-contributing insurer. See, e.g., St. Paul Fire & Marine Ins. Co. v. Am. Intern. Spec. Lines, 365 F.3d 263 (4th Cir. 2004); Am. Indem. Lloyds v. Travelers Prop. & Cas. Ins. Co., 335 F.3d 429 (5th Cir. 2003); Wal-Mart Stores, Inc. v. RLI Ins. Co., 292 F.3d 583 (8th Cir. 2002); Continental Cas. Co. v. Auto-Owners Ins. Co., 238 F.3d 941 (8th Cir. 2000). See also Home Ins. Co., 801 N.E.2d at 1003 (“In Illinois, an excess insurer cannot seek equitable contribution from a primary insurer because excess and primary carriers insure different risks. The rationale for such a holding is that the protections under an excess policy do not begin until those under a primary policy have been exhausted. Therefore, even if both Home and Cincinnati could be said to insure Allied for the same loss, Home’s status as an excess insurer precludes it from seeking equitable contribution from Cincinnati, a primary insurer.”) (citations omitted); Land v. Tall House Bldg. Co., 602 S.E.2d 1 (N.C. Ct. App. 2004) (holding that construction contractor’s insurer could not bring contribution claim against stucco manufacturer, where contractor could be liable to home purchasers for construction defects based only on breach of contract and not tort and, thus, contractor was precluded from being a joint tortfeasor who could recover from another joint tortfeasor under contribution statute).
tortfeasor assurance that its insurer will not pursue any subrogation interest, a tortfeasor may be reluctant to participate in a partial settlement. Jurisdictions have developed different ways to deal with this situation. Minnesota, for example, distinguishes between first-party automobile insurance disputes and those involving first-party property insurance disputes. 290 The automobile losses, governed by the state’s No-Fault Insurance Act, require the insured to give notice to the automobile insurer before reaching a settlement with the tortfeasor so as to permit the insurer the right to preserve its subrogation rights by matching the tortfeasor’s offer. 291 This same mechanism, however, does not apply in the property insurance context. The property insurance context is governed solely by contract terms agreed to by the parties. 292 Under these circumstances, the insurer’s denial of coverage benefits permits the insured to freely settle with a tortfeasor and compromise the insurer’s subrogation rights:

Thus, if the [Insurer’s] denial of coverage was erroneous, such denial will have relieved Owner of the obligation to protect [Insurer’s] subrogation rights and will have authorized Owner to accept the Rule 68 offer of judgment without the consent of [Insurer]. In so concluding, we are mindful that an insurer such as [Insurer] must be allowed a reasonable time to investigate the claims of its insured before it can be found to have materially breached the contract by the denial of coverage. But the present facts show that [Insurer] had ample time to investigate Owner’s claim and even to have its coverage defenses determined by a declaratory judgment action if it did not want to be confronted with the prospect of a settlement between the Owner and the tortfeasors. 295

292. See Schwickert, 680 N.W.2d at 83.
293. Id. at 86; see also Youell v. Grimes, 217 F. Supp. 2d 1167, 1175 (D. Kan. 2002) (holding that erroneous denial of coverage in third-party liability insurance relieves the insured of the obligation to protect the insurer’s subrogation rights); Great Divide Ins. Co. v. Carpenter ex rel. Reed, 79 P.3d 599, 609–10 (Alaska 2003) (holding that a settlement agreement by the insured with the tortfeasor without the consent of the insurer did not relieve the insurer of its obligations under a commercial general liability policy even where the insurer had provided a defense but materially breached the policy by unreasonably refusing to consent to the settlement); Home Ins. Co. v. Nat’l Union Fire Ins. of Pittsburgh, 658 N.W.2d 522, 534 (Minn. 2003) (holding that third-party liability insurer’s erroneous denial of
Disputes can sometimes arise between insureds and insurers over the sharing of recoveries from third-party tortfeasors. Where an insured has not been fully reimbursed for its loss by the insurer, potential exists for disagreement over just when the insurer’s subrogation interest gets paid. Many jurisdictions adopt the “make whole” principle, which holds that the insurer does not begin to recover on its subrogation interest until the insured’s loss is paid in full.\footnote{294} Sometimes insurance policies will contain provisions that essentially give the insurer a contract right to subrogation, in addition to whatever equitable rights of subrogation might arise by virtue of its paying a loss under the policy. These “subrogation provisions” should be distinguished from “reimbursement provisions,” which require the insured to pay over to the insurer any settlements received from third parties.\footnote{295} As a general rule, subrogation provisions are subject to the “make whole” principle, and, therefore, the insurer’s contract subrogation rights will not permit recovery until the insured is paid in full.\footnote{296} Reimbursement provisions, on the other hand, are not subject to the “make whole” limitation and, therefore, may require an insured to pay all settlement proceeds over to an insurer even though the insured has not fully been reimbursed for its loss.\footnote{297} Not surprisingly, courts tend to interpret policy provisions entitling the insurer to third-party recoveries as “subrogation” provisions, where possible.\footnote{298}

One of the greatest impediments to an insurer’s subrogation rights is a contract provision whereby the insured waives its right of subrogation. These provisions are common in construction contracts. Moreover, they are generally enforced. This may be the case even where the tortfeasor against whom subrogation is sought was grossly negligent.\footnote{299} As a general rule, most construction

\footnote{295} Id. at 375–76.
\footnote{296} Id. at 375.
\footnote{297} But see id. at 376 n.7.
\footnote{298} See id. at 372.
contract waivers of subrogation are triggered upon the existence of property coverage. In essence, they leave the loss with the property insurer. For example, in *Gray Insurance Co. v. Old Tyme Builders, Inc.*, a property insurer claimed that a subcontractor waived the subcontract’s waiver of subrogation by voluntarily undertaking to repair its defective work. The insurer sought to recover for the consequential losses incurred by its insured. The court rejected this argument, finding that repairing one’s defective work does not constitute a waiver of a contract right to be free from subrogation claims. Similarly, the Missouri Court of Appeals decision in *Nodaway Valley Bank v. E.L. Crawford Construction, Inc.* discussed whether the presence of an indemnity clause lessened or eliminated the scope of coverage under a waiver of subrogation clause. The property carrier seeking subrogation from a general contractor and subcontractor argued that the broad indemnity clauses contained in their contracts, running in favor of the insured, did not limit the protection afforded by the contract’s waiver of subrogation provision. The court disagreed:

Under the plain language of the clauses, the waiver of subrogation clause prevents Bank [insurer was suing in the insured’s name] from pursuing a claim against Crawford & Crane for the fire damage to the extent that such damage is covered by property insurance that contract required Bank to obtain. Under the plain language of the indemnification clause, Crawford agreed to indemnify Bank for all property damage caused by any act or omission of anyone who performs services under the agreement. The indemnification clause is silent as to whether the agreement to indemnify applies to damage covered by property insurance. In interpreting the waiver of subrogation and indemnification provisions, however, this court cannot merely look at the two clauses in a vacuum. The clauses must be read in the context of the entire contract. A reasonable interpretation of the indemnification clause that is in harmony with the insurance procurement requirement and the waiver of subrogation clause is that the indemnification clause

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301. *Id.* at 605.
302. *Id.* at 608.
304. *Id.* at 823.
refers to compensation and liability for losses not covered by the property insurance policy, that is, compensation and liability to third parties.

A. Contractual Waivers of Subrogation

An insurer that pays out a loss on behalf of its insured is subrogated to the rights of its insured to pursue those responsible for the loss. A number of themes recur in subrogation cases. Frequently, disputes arise between an insured and insurer over priority where the insured has not been fully reimbursed for its loss. In the construction business, parties often waive rights to seek recovery from one another to the extent property insurance covers the loss. The scope and enforceability of these waivers, however, can be the subject of dispute.

Contractual waivers of subrogation rights are also common features of commercial lease agreements. One such waiver played a pivotal role in determining who bore the ultimate risk of loss of one of the WTC buildings. In addition to the collapse of buildings One and Two of the WTC, building Seven was also lost as a result of the terrorist attacks of September 11, 2001. Portions of the collapsing twin towers fell onto Seven WTC “causing the fires to spread to that building, where they created another inferno,” resulting in the building’s collapse. The building’s lessee, Silverstein Properties, Inc. (Silverstein), received a substantial payment from its property insurer, Industrial Risk Insurers (IRI).

305. Id. at 826–30. See also Chubb Ins. Co. v. DeChambre, 808 N.E.2d 37, 42 (Ill. App. Ct. 2004) (holding that under terms of property policy, subcontractor was additional insured and, therefore, the anti-subrogation doctrine precluded insurer’s claim against subcontractor); Midwestern Indem. Co. v. Sys. Builders, Inc., 801 N.E.2d 661, 668 (Ind. Ct. App. 2004) (holding that waiver of subrogation provision applied to losses incurred after the building was complete); S. Tippecanoe Sch. Bldg. Corp. v. Shambaugh & Son, Inc., 395 N.E.2d 320, 327 (Ind. Ct. App. 1979) (holding that the insurance procurement clause alone established that the parties had contracted away the risk of first-party property loss under the all-risk carrier and that the contract did not require the presence of a waiver of subrogation clause to accomplish this risk allocation scheme).

306. See generally 4 BRUNER & O’CONNOR ON CONSTRUCTION LAW, supra note 27, § 11:102; 16 COUCH ON INSURANCE, supra note 85, § 222:14.

307. 2 BRUNER & O’CONNOR ON CONSTRUCTION LAW, supra note 27, § 7:154.


309. Id. at 301.

310. Id.

311. Id.
In turn, “IRI sued the airlines, the airport security companies, and the airline manufacturer for allowing the terrorists to board and hijack the planes.” The insurer also “sued the Port Authority of New York and New Jersey . . . , the owner of 7 WTC, and Citigroup, Inc.,” a sublessee of a substantial portion of the building. IRI alleged that Citigroup was grossly negligent in designing and installing an “emergency generator system that utilized an unreasonable amount of diesel fuel and that continuously pumped that fuel unreasonably close to critical structural supports in the building without proper safeguards.” IRI alleged that the building’s collapse was due, in part, to this system catching fire and weakening critical structural supports.

Citigroup defended on the grounds that its lease with Silverstein contained a waiver of subrogation provision. IRI countered by claiming that it would be against public policy to shield Citigroup from liability for its gross negligence. While New York law does invalidate waivers purporting to exonerate a party for willful or grossly negligent acts, one needs to do more than simply make the allegation:

The purpose, then, of excepting claims of gross negligence from the rule permitting the release of claims for negligence, is to ensure that parties will have legal recourse for injuries from particularly malicious behavior. The rule exists to protect parties in positions of weaker bargaining power from unknowingly agreeing in advance to allow the other party to recklessly disregard its rights in broad and unforeseeable ways. However, parties, especially those of equal bargaining power, should be able to rely upon the general New York rule that enforces contracts for the release of claims of liability. If a party needs only to add gross negligence as a theory of liability to force litigation to proceed through discovery and a trial, contracting parties would be stripped of the

312. Id.
313. Id. at 302.
315. Id.
316. Id. at 304.
317. Id. at 306.
substantial benefit of their bargain, that is, avoiding the expense of lengthy litigation.\(^{318}\) Simply misdesigning a generator system without more did not rise to the level of "reckless disregard."\(^{319}\) The Second Circuit, applying New York law, came to a similar conclusion in a case involving a waiver of subrogation clause contained in a construction contract. In *St. Paul Fire & Marine Insurance Co. v. Universal Builders Supply*, the owner sought to erect a building in Times Square, New York City.\(^{320}\) The construction contract required the owner to secure Builder’s Risk insurance policy, which contained a broad waiver of subrogation clause.\(^{321}\) On a more unusual note, the contract also required the contractor to obtain “similar waivers, each in favor of all parties enumerated above.”\(^{322}\) Notwithstanding this obligation, the contractor’s liability insurers reserved their right to seek subrogation for any covered loss.\(^{323}\) A forty-nine story scaffolding, designed and built by the contractor, collapsed, causing extensive damage to the site and surrounding area, and resulting in the death of one person.\(^{324}\) The owner’s builder’s risk carrier paid $19 million to satisfy the property claims arising out of the collapse.\(^{325}\) The insurer then brought a subrogation claim against the contractor, alleging,

\begin{thebibliography}{9}
\bibitem{id} {Id. at 307.}
\bibitem{id} {Id. at 309–10. See also Great N. Ins. Co. v. Paino Assocs., 364 F. Supp. 2d 7 (D. Mass. 2005) (raising questions of joint liability where tenant’s property insurer brings subrogation action against landlord for negligent supervision of employee that started fire in restroom); Middlesex Mut. Assurance Co. v. Vaszl, 873 A.2d 1030 (Conn. App. Ct. 2005) ("insurer had right of subrogation, in light of lease language making the tenant liable for damage caused to premises"); Burns Int’l Sec. Servs., Inc. v. Phila. Indem. Ins. Co., 899 So. 2d 361 (Fla. Dist. Ct. App. 2005) (holding that where tenant’s property insurer brought subrogation action against landlord’s security contractor to recover for theft loss, comparative fault statute applied and permitted apportionment among security contractor, tenant, and non-party landlord); Rausch v. Allstate Ins. Co., 882 A.2d 801 (Md. 2005) (discussing at length the "no subrogation per se" rule between landlord and tenants, explaining that even in the absence of a contractual waiver in the lease, the landlord’s insurer has no subrogation right against tenant as both are considered co-insureds under the policy); McEwan v. Mountain Land Support Corp., 116 P.3d 955 (Utah Ct. App. 2005) (holding that where lease did not require tenant to obtain separate property insurance, landlord’s insurer could not seek subrogation as tenant was a co-insured under the policy).}
\bibitem{id} {409 F.3d 73, 77 (2d Cir. 2005).}
\bibitem{id} {Id.}
\bibitem{id} {Id. at 83.}
\bibitem{id} {Id. at 78.}
\bibitem{id} {Id.}
\bibitem{id} {Id. at 78.}
\end{thebibliography}
among other things, a claim of gross negligence. The insurer argued that well-established New York law did not permit exculpatory provisions to be enforced where the loss was the result of gross negligence. The Second Circuit, however, rejected this argument, finding that a “waiver of subrogation” provision is different than an exculpatory clause. Waivers of subrogation agreements, like indemnity provisions, “shift the source of compensation without restricting the injured party’s ability to recover.” By contrast, exculpatory clauses deprive the victim of compensation. With respect to the contractor’s obligation to obtain similar waivers, the court found that this promise extended only to property coverage—which the contractor did not secure—and did not require waivers from the contractor’s liability carriers.

B. Equitable Subrogation vs. Equitable Contribution

The Supreme Court of Illinois issued an interesting decision in Home Insurance Co. v. Cincinnati Insurance Co., where it denied an insurer the right to seek equitable contribution from another insurer because the carriers did not insure the same risk.

326. Id.
327. Id.
328. Id. at 86.
330. Id. at 85.
332. 821 N.E.2d 269, 316 (Ill. 2004).
contractor, they did so for different named insureds.\footnote{Id. at 310.} Under the facts of this case, the plaintiff insurer was deemed to be excess and the defendant insurer primary.\footnote{Id. at 317.} Under well-settled Illinois law, an excess carrier does not insure the same risk as a primary carrier and, therefore, no right of equitable contribution existed.\footnote{Id.} The plaintiff insurer, however, was entitled to seek equitable subrogation, except for the fact that it waived its right by failing to seek full reimbursement from defendant insurer during the underlying litigation.\footnote{Id. at 326–27.}

C. Anti-subrogation Rule

Contractors and subcontractors may have an additional avenue of protection against the subrogation claims of property insurers beyond an express contractual waiver of subrogation contained in many standard form construction contracts. A well-established rule of insurance law exists that an insurer may not subrogate against its own insured.\footnote{Andrew B. Downs et al., Recent Developments in Property Insurance Law, 34 TORT & INS. L.J. 619, 636 (1999).} Therefore, if the contractor is deemed an insured under the builder’s risk policy, the carrier may not be entitled to subrogate against it. This is sometimes referred to as the “anti-subrogation rule.” The trick, of course, is to be deemed an insured under the policy. In \textit{Tri-State Insurance Co. of Minnesota v. Commercial Group West, LLC}, a subcontractor was unsuccessful in obtaining insured status under a builder’s risk policy sufficient to invoke the anti-subrogation rule.\footnote{698 N.W.2d 483, 492 (N.D. 2005).} The court rejected the subcontractor’s analogy to the landlord/tenant case law, holding that a tenant is a co-insured under the landlord’s property policy unless the lease expressly states otherwise.\footnote{Id. at 488.} The privity of a landlord/tenant relationship is closer than the privity that exists between an owner and a subcontractor.\footnote{Id.} Thus, where the policy does not name the subcontractor as a co-insured under the policy, the status of its relationship as a subcontractor does not give it blanket immunity from the property carrier’s claims, merely
because the property insurance covered some of the subcontractor’s property.\textsuperscript{341}

An insurer that pays a loss under its policy is usually subrogated to the rights of its insured to recover some or all of its payment from third parties who are responsible for the loss in the first instance. Property insurers are fairly diligent at pursuing their subrogation rights against contractors and design professionals responsible for property losses. Perhaps the greatest impediment to the exercise of this remedy in the construction industry is the common practice of insureds waiving their subrogation rights. Most standard form contracts contain a “waiver of subrogation” provision by which the owner waives its subrogation rights against contractors, subcontractors, and design professionals to the extent its losses are covered by property insurance.\textsuperscript{342} These waivers are routinely upheld.\textsuperscript{343}

Other impediments can exist to pursuing subrogation

\textsuperscript{341} Id. at 492. See also Transamerica Ins. Co. v. Gage Plumbing & Heating Co., Inc., 433 F.2d 1051, 1055 (10th Cir. 1970) (finding that where property policy covered unnamed subcontractor’s property, it was a co-insured); Travelers Indem. Co. v. Losco Group, Inc., 150 F. Supp. 2d 556, 561–62 (S.D.N.Y. 2001) (stating that an unnamed contractor is not co-insured because there was nothing in the language of the policy to show an intention to benefit the contractor); Richmond Steel, Inc. v. Legal & Gen. Assurance Soc’y, Ltd., 821 F. Supp. 793, 799 (D.P.R. 1993) (noting that an unnamed subcontractor is not co-insured, because policy language is not sufficiently expansive to cover subcontractor absent a “property of others” clause); Baugh-Belarde Const. Co. v. Coll. Utils. Corp., 561 P.2d 1211, 1216 (Alaska 1977) (applying the anti-subrogation rule in the context of a builder’s risk policy for an unnamed party); La. Fire Ins. Co. v. Royal Indem. Co., 38 So. 2d 807, 808 (La. Ct. App. 1949) (re-inforcing the same principle expressed in \textit{Transamerica}); Willis Realty Assocs. v. Cimino Const. Co., 623 A.2d 1287, 1289 (Me. 1993) (reasoning that a contractor is not impliedly co-insured under policy because coverage does not extend to personal property of others within the control of the named insured); Factory Ins. Ass’n v. Donco Corp., 496 S.W.2d 351, 392–34 (Mo. Ct. App. 1973) (finding that an unnamed contractor was co-insured under policy which contained an “also covers” provision that included similar property of others); McBroom-Bennett Plumbing, Inc. v. Villa France, Inc., 515 S.W.2d 32, 35 (Tex. Civ. App. 1974) (stating that an unnamed subcontractor that did not pay for insurance premiums and only had interest in certain tools on property was not co-insured under builder’s risk policy).

\textsuperscript{342} See \textit{Bruner & O’Connor on Construction Law}, supra note 27, § 11:100.

\textsuperscript{343} See Factory Mut. Ins. Co. v. Citizens Ins. Co. of Am., 709 N.W.2d 82, 84 (Wis. Ct. App. 2005) (finding that a subrogation waiver in contract between contractor and manufacturing facility was enforceable and thus waiver precluded insurer from pursuing contractor or its general liability insurer for subrogation). But see Reed & Reed, Inc. v. Weeks Marine, Inc., 431 F.3d 384, 388 (1st Cir. 2005) (noting that the waiver of a subrogation clause contained in “idiosyncratic” contract documents did not apply to post-construction activities).
remedies. In some jurisdictions, an insurer’s right to subrogate against non-participating insurers is limited to insurers assuming the same risks as the carrier seeking subrogation. The Illinois Supreme Court had occasion to address this issue in *Home Insurance Co. v. Cincinnati Insurance Co.*, 344 where it explained in detail the differences between contribution, indemnification, and subrogation rights in the context of multiple insurers:

The terms “contribution,” “indemnification,” and “subrogation” are often used interchangeably, but there are distinct differences between [sic] them. The remedies of contribution and indemnity are mutually exclusive, and contribution is prohibited where a party has a right to indemnity. Contribution, as it pertains to insurance law, is an equitable principle arising among coinsurers which permits one insurer who has paid the entire loss, or greater than its share of the loss, to be reimbursed from other insurers who are also liable for the same loss. Contribution applies to multiple, concurrent insurance situations and is only available where the concurrent policies insure the same entities, the same interests, and the same risks. These elements must be met before the insurance can be considered concurrent or double. Accordingly, when two insurers cover separate and distinct risks, there can be no contribution among them.

In contrast to contribution, subrogation and indemnification are devices for placing the *entire* burden for a loss on the party ultimately liable or responsible for it and by whom it should have been discharged. Indemnification differs from subrogation in that the entity seeking indemnification does so in its own right, while in the latter the subrogee succeeds to another’s right to payment.

It is well settled that the doctrine of equitable contribution is not applicable to primary/excess insurer issues. This is because by definition the policies do not cover the same risks—the protections under the excess policy do not begin until those of the primary policy cease.

*344.* 821 N.E.2d 269 (Ill. 2004).

*345.* Id. at 276–77 (citations omitted) (holding that plaintiff excess insurer was not entitled to equitable contribution from primary carriers but was entitled to pursue that portion of equitable subrogation it had not waived). *See also* Safeco Ins. Co. of Am. v. Superior Court, 44 Cal. Rptr. 3d 841, 842 (Ct. App. 2006)
Another restriction on an insurer’s ability to secure a subrogation remedy is the superior equities doctrine. This restrictive principle prevents an insurer from recovering against a party whose equities are equal or superior to those of the insurer. This doctrine is usually invoked in the context where the insurer is seeking to subrogate against third parties who are not other insurers. In some jurisdictions, the application of this doctrine depends on whether the source of the insurer’s right to subrogation arises by operation of law (legal or equitable subrogation) or by contract (conventional subrogation). Jurisdictions that make this distinction usually limit its application to instances where the insurer seeks to enforce the terms of a separate contract between its insured and a third party. In *State Farm General Insurance Co. v. Wells Fargo Bank N.A.*, State Farm argued that a fire on its insureds’ property was the result of respondents’ negligence in failing to provide proper fire-safe equipment and its failure to keep combustible items away from one another. The court determined that the superior equities doctrine applied and remanded the matter for determination of whether the defendants were in a better position to avoid the loss than the insurer or its insured:

Contrary to the extreme positions advanced by the parties, we conclude the issue is whether respondents were in a better position to avoid the loss than State Farm or its insureds. State Farm alleges that respondents negligently permitted the fire to spread to its insureds’

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(stating that in an action for equitable contribution, the settling insurer meets its burden of proof when it makes a prima facie showing of coverage under the non-participating insurer’s policy and the burden then shifts to the recalcitrant insurer to prove the absence of actual coverage); Liberty Mut. Ins. Co. v. Am. Home Assurance Co., Inc., 858 N.E.2d 530, 533 (Ill. App. Ct. 2006) (finding owner’s insurer not entitled to equitable subrogation from subcontractor’s insurer due to policy exclusion; the "mend the hold" doctrine did not apply as subcontractor’s insurer did not materially change its coverage position once litigation ensued).


348. 49 Cal. Rptr. 3d 785 (Cl. App. 2006).
property by failing to provide non-combustible metal trash cans, failing to promulgate and post rules establishing a system for the safe disposal of fireplace ashes, and failing to keep combustible materials (i.e., trash cans) a safe distance away from other combustible materials (i.e., wood fencing and siding). The failure to provide the safe disposal of ashes arguably could be characterized as promoting or encouraging the spread of fire. Moreover, the implementation of a method for safe disposal of fire ashes, including appropriate trash cans, possibly could have prevented the fire from occurring.

The gravamen of State Farm’s subrogation claim in the present case is that respondents negligently permitted a fire to occur and to spread to its insureds’ property. It seems inequitable to bar State Farm from pursuing its claim against respondents solely because they did not place the ignition source in the trash can [they did not actually start the fire]. Subrogation advances an important policy rationale underlying the tort system by forcing a wrongdoer who helped to cause a loss to bear the burden of reimbursing the insurer for payments made to its insured as a result of the wrongdoer’s acts and omissions.

In the case at bench the contest is between an innocent insurance company (which admittedly received premiums for the very loss that occurred) and alleged tortfeasors (who did not physically start the fires but whose negligence allegedly permitted the fire to be started and to spread by failing to provide for the safe disposal of fireplace ashes). On this record, we cannot say that respondents are entitled to a judgment as a matter of law based on the doctrine of superior equities.349

D. Assignment of Remedies

Whereas subrogation arises by operation of law, a party’s assignment rights arise out of contract. Where an insurer declines to provide a defense or indemnification, thereby leaving its insured exposed to direct loss from a third-party claim, the insured may be inclined to settle the lawsuit by assigning its rights under the

349. Id. at 800–01 (citations omitted).
insurance policy to the claimant. Many insurance policies contain an anti-assignment clause. These clauses generally restrict the insured from assigning the policy without the prior written consent of the company. Unless the clause is expressly drafted to apply to post-loss situations, the majority position is that the limitation applies only in a pre-loss context:

The Vermont Supreme Court has not addressed whether a post-loss assignment violates the anti-assignment clause of an insurance policy. When state law is not clear, this court must predict how the highest court would rule. . . . This court may consider decisions in other jurisdictions on the same or analogous issues. . . . [T]he majority rule developed in many states that an anti-assignment clause is valid with respect to transfers that were made prior to, but not after, the insured-against loss has occurred.

The reasoning behind the development of this rule is premised on the nature of the contract. An insurer has bargained to accept the risk presented by the particular insured with whom it has contracted. The insurer's exposure to risk is altered if the insured assigns the policy to another before there is a covered loss. Hence, this rule protects the insurer's interest in insulating itself from unforeseen risk. However, once the loss occurs, the insurer is obligated to cover the loss agreed to under the terms of the policy. This obligation is not altered when the claimant is not the party who was originally insured. The accrual of an insurance claim extinguishes the insurer's interest in the risk profile of the insured, thereby converting the claim into, in effect, a chose in action. Hence, after the loss occurs there is no additional risk to the insurance company if the insured assigns its right to any claims or proceeds under the policy to another. After the loss the anti-assignment clause serves only to limit the free assignability of the claims, which is not favored by law.350

V. CONCLUSION

Managing risk in the construction industry is a complex web of contract allocation, mitigation techniques, and third-party products. Property insurance forms the nucleus of all third-party products, which include a variety of insurance products and, on occasion, payment security devices such as payment bonds, letters of credit, and performance guarantees, like performance bonds. Property insurance is intended to respond to such major risks as fire, wind, and water, and their effects of the elements on the project. Property coverage plays a central role in any risk management matrix. Unlike liability coverages, which are offered through relatively standard policies, property coverage is more varied. Many issues, however, recur. It is critical for construction law practitioners to understand basic property coverages and the common legal issues that arise in connection with this crucial risk management product.