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Split On Calif. Code Upgrade Coverage Remains Unresolved

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Law360, New York (March 18, 2013, 1:17 PM EDT) -- California's Fourth Appellate District Court recently interpreted the law and ordinance exclusion to preclude coverage when the enforcement of a law or ordinance is the actual cause of the loss itself rather than a covered peril. Reichert v. State Farm Gen. Ins. Co., 212 Cal. App. 4th 1543, 152 Cal. Rptr. 3d 6 (2012). Additionally, the court held that even if the law or ordinance is being enforced due to a third party's negligence, the loss may still be precluded under the exclusion. Id. at 1549-50, 152 Cal. Rptr. 3d at 10-11.

The court did not, however, resolve the current conflict in California relating to code upgrade coverage.

In Reichert, the insureds owned a home in Huntington Beach, Calif., which sat in a designated flood zone. During a remodel of the home, it was discovered that the home was remodeled in violation of a Federal Emergency Management Agency regulation. Id. at 1546, 152 Cal. Rptr. 3d at 8. A stop order was immediately issued, halting all construction, and the building was subsequently demolished. Id.

The insureds submitted a claim under their homeowners insurance policy, which contained a provision stating, "We do not insure under any coverage for any loss which is caused by one or more of the items below, regardless of whether the event occurs suddenly or gradually, involved isolated or widespread damage, arises from natural or external forces, or occurs as a result of any combination of these: a. Ordinance or Law, meaning enforcement of any ordinance or law regulating the construction, repair or demolition of a building or other structure." Id. at 1547, 152 Cal. Rptr. 3d at 9.

The court ultimately determined that when a loss is caused by the enforcement of a law or ordinance, rather than from a covered peril such as fire, it is precluded under the law or ordinance exclusion. Id. at 1549, 152 Cal. Rptr. 3d at 10. Here, because the loss was due to the enforcement by the city of FEMA floodplain regulations, it came under law or ordinance policy exclusion, and the insurance policy provided no coverage. Id. at 1550, 152 Cal. Rptr. 3d at 11.

In affirming summary judgment in favor of the insurers and finding no coverage for the loss, the court recognized the split in authority related to code upgrade costs. The court stated:

Courts have struggled with the question of whether a party whose house was noncompliant before the loss deserves a code-compliant house after the loss. The cases may be divided into two camps — 'antiwindfall' versus 'procompliant' — and in California the battle over the possible 'windfall' is how the two sides have characterized their approach to the exclusion.

Id. at 1547-48, 152 Cal. Rptr. 3d at 9.

The court further noted, however, that the conflicting case law interpreting law or ordinance exclusions arises in cases where the loss is caused by a covered peril, rather than solely by the enforcement of the law or ordinance as it did here. To demonstrate, the court compared Bischel v. Fire Ins. Exchange, 1 Cal. App. 4th 1168, 2 Cal. Rptr. 2d 575 (1991) and Fire Ins. Exchange v. Superior Court (Altman), 116 Cal. App. 4th 446, 10 Cal. Rptr. 3d 617 (2004).

But because the loss in Reichert was caused by the enforcement of a law or ordinance, rather than a covered peril, the court did not have to apply either line of cases to the current matter. Additionally, there is a consistent line of cases that support the holding in Reichert, and as far back as 1900, courts have "routinely applied the law or ordinance exclusion (or its predecessor, the civil authority exclusion) to losses caused by the enforcement of a local building ordinance or law." Reichert, 212 Cal. App. 4th at 1549; see also Hawaii Land Co. v. Lion Fire Ins. Co., 13 Haw. 164 (1900).

Since that holding, numerous states have continued to interpret the law or ordinance exclusion in the same way. These states include New York (61 Jane St. Tenants Corp. v. Great Am. Ins. Co., No. 00 Civ. 1049 (GEL). (S.D.N.Y. Jan. 12, 2001)), Connecticut (Dlugokenski v. Hartford Ins. Co., No. HHBCV095012898, (Conn. Super. Ct. Dec. 14, 2010)), Louisiana (Sweeney v. City of Shreveport, 584 So. 2d 1248 (La. Ct. App. 1991)) and Washington (Hocking v. British Am. Assurance Co., 62 Wash. 73, 113 P. 259 (1911)).

Additionally, the court found that the negligence of a third party would not necessarily preclude the application of the law or ordinance exclusion, and the exclusion would apply even when the enforcement of the law or ordinance "has arisen out of some gaffe by a local government official." Reichert, 212 Cal. App. 4th at 1549, 152 Cal. Rptr. 3d at 11.

In Reichert, the insured argued that it was either the contractor's or architect's negligence that caused the loss. Id. at 1550, 152 Cal. Rptr. 3d at 11. The court found that the undisputed facts show that the property was demolished pursuant to the city enforcing FEMA regulations, and therefore the exclusion "plainly applies." Id.

The court noted that this finding was consistent with the other courts' interpretations of similar provisions. See Hawaii Land Co. v. Lion Fire Ins. Co., 13 Haw. 164, 173 (1900) ("The loss must be regarded as caused by the order of the Board of Health and not by the bubonic plague. Whether the Board was justified in issuing the order is a question not before us."); Conner v. Manchester Assurance Co., 130 F. 743, 746 (9th Cir. 1904) (applying California law) ("The facts that the loss was the result of a fire started on other property, and that the property of the plaintiff in error was not ordered to be burned, do not render the exemptions of the policy inapplicable. There was but one fire. It was ordered by civil authority. It indirectly caused the loss, and there was no intervening cause."); Hocking, 62 Wash. 73, 76 (negligence of the health officer in causing a fire during the fumigation of a building did not preclude the application of the exemptions of the policy.).

The court further noted that more recently, in Sweeney, 584 So. 2d 1248, Sweeney purchased a house that she let fall into disrepair. A city code enforcement officer provided notice that the city sought to demolish the residence but sent the required notices to the wrong address.

After the residence was demolished, Sweeney filed a claim with her insurance company to cover the

loss, which the insurer denied pursuant to the ordinance or law exclusion. The court found that while "it may be true that the negligence of city employees resulted in Mrs. Sweeney not getting notice and that this negligence contributed to the demolition of the house, however, the exclusion by its own terms still applies." Id. at 1251, 152 Cal. Rptr. 3d at ___.

In Dlugokenski, the insured owned a building that was vacant, unsecured and in severe disrepair. The chief building official for the city inspected the property, issued a condemnation order and sent a letter to the owner of the property. After the building was demolished, the owner submitted a claim on his insurance policy, which was denied pursuant to the ordinance or law exclusion.

The insured argued that the city did not follow the appropriate procedures in condemning the property. The court found that "for the Ordinance or Law exclusion in the insurance policy to apply, the insurance policy does not require that all lawful procedures be followed by the governmental entity carrying out the demolition. The policy does not even say that the condemnation order must be lawful. The policy exclusion merely says that that the damage must be 'caused directly or indirectly' by an ordinance or law regulating the demolition of property." Id. at *7-8.

The holding of these courts demonstrate that the focus in determining whether a law or ordinance exclusion applies to preclude coverage is whether the loss was the result of the enforcement of the law or ordinance. It is not determinative whether a party's negligence or other factors cause the enforcement of the law or ordinance or if the tactics used to enforce the law or ordnance is flawed in any way. As long as the enforcement of the law or ordinance is the cause of the loss, coverage for the loss will be precluded.

Additionally, the court in Reichert was able to avoid making a determination on the split of authority in California relating to code upgrade coverage. While the court did specifically recognize the anti-windfall versus pro-compliant code upgrade coverage dispute, it found that the loss in Reichert was caused by the enforcement of a law or ordinance rather than a covered loss.

As a result, the claim did not come under the purview of this split of authority, and a resolution did not have to be found. Therefore, the split of authority in California remains, and it will be up to another court at a later date to resolve this conflict.

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