

Uncrackable Construction Defects Exclusion

Law360, New York (December 01, 2011, 3:13 PM ET) -- Despite the significant burden insurers bear to prove exclusions to coverage, a recent decision from the United States District Court in Minnesota illustrates the power a well-drafted exclusion can have.

In *Friedberg v. Chubb & Son Inc.*, No. 08-6476, (D. Minn. Oct. 25, 2011), the insured homeowners sought insurance coverage for extensive damage to their home's exterior framing and insulation.

Water penetrating through defects in the house's exterior cladding system had caused most of the damage. The homeowners claimed that Chubb Indemnity Insurance Company had responsibility to cover the loss under the policy it issued covering the house.

But that policy excluded "any loss caused by [faulty] ... planning, construction or maintenance," but covered "ensuing loss" unless otherwise excluded.

Chubb moved for summary judgment, arguing that the claimed loss fit squarely within the plain language of this exclusion. The district court agreed and found no coverage was owed.

This case, one of first impression in Minnesota, follows the vast majority of cases across the country that hold that an "ensuing loss" must be a loss separate and distinct from the original excluded peril.

The court's opinion is also noteworthy for its discussion of concurrent causation.

What Lies Beneath

Plaintiff homeowners Joseph and Carolyn Friedberg built their home using an exterior insulation and finishing system (EIFS), also known as synthetic stucco.

According to both parties' experts, this system was defective because it allowed moisture to penetrate the exterior surface without providing a way for the moisture to escape once it got in. Moisture trapped beneath exterior cladding causes mold, rot and deterioration of the structural elements of a house.

The manufacturer of the EIFS system entered into a class action settlement in which these homeowners participated. But in the time following that 2002 settlement, these homeowners chose not to do any repairs. Instead, they claimed that they first became aware of the damage to their home following an attempt to repair a small hole in the side of their house in late 2006.

During that repair, the extensive damage to the house's exterior structure was discovered. The homeowners then made a claim to Chubb under their homeowners' policy.

Chubb's expert's inspection revealed multiple cracks in the cladding, and water damage and rot in the home's architectural beams, roof deck, sheathing and framing members. Chubb's expert concluded that the damage had occurred over time due to defects in the cladding as well as a defective roof.

Chubb denied coverage of the homeowners' claim. Chubb based its denial on exclusions within the policy, including the faulty planning, construction or maintenance exclusion, which the court called the "construction defects exclusion" in its opinion. That exclusion provided:

"Faulty planning, construction or maintenance. We do not cover any loss caused by the faulty acts, errors or omissions of you or any other person in planning, construction or maintenance. It does not matter whether the faulty acts, errors or omissions take place on or off the insured property. But we do insure ensuing covered loss unless another exclusion applies. ... 'Construction' includes materials, workmanship, and parts or other equipment used for construction or repair."

The policy defined "caused by" as: "The words 'caused by' mean any loss that is contributed to, made worse by, or in any way results from that peril."

The homeowners originally brought suit in a Minnesota state court, but Chubb removed to federal district court. Following discovery, both sides moved for summary judgment. On Oct. 25, 2011, Judge David Doty of the United States District Court for the District of Minnesota entered his decision granting summary judgment in Chubb's favor.

Just One Excluded Loss

At summary judgment, both sides agreed that the basic facts were undisputed and made multiple arguments for judgment as a matter of law. But for the court, the plain language of the Chubb exclusion covering construction defects controlled the case's outcome.

To begin its analysis, the court employed traditional rules regarding insurance policy interpretation.

Determining that the homeowners had satisfied their prima facie burden of establishing coverage by proving physical damage to covered property, the burden then shifted to Chubb to prove that its faulty construction exclusion applied.

While strictly construing that exclusion against Chubb as the insurer, the court nonetheless gave unambiguous language within the policy its plain and ordinary meaning.

Under this standard, the court found that the plain language of Chubb's faulty construction exclusion worked to prevent coverage of the homeowners' claim. To reach that conclusion, the court considered — and rejected — several arguments the homeowners made regarding how the operative exclusion should be construed.

First, the homeowners argued that term “loss” within the exclusion only means monetary loss and does not bar coverage for damage or physical loss.

Under this reading, the homeowners claimed the relevant exclusion barred coverage for expenses incurred to correct the faulty cladding, but not the amounts paid to correct ensuing water damage. The court disagreed and found instead that by using the term “any loss,” the plain language of the exclusion unambiguously includes both the faulty construction itself and any harm that resulted from that construction.

To reach that decision, the court distinguished the decision in *Buscher v. Economy Premier Assurance Co.*, No. 05-544, (D. Minn. Feb. 1, 2006).

In *Buscher*, the wording of the exclusion was limited to “loss to property ... caused by construction defects.” The court found that use of the term “any loss” in the Chubb exclusion expanded its application.

And, unlike the *Buscher* exclusion, the exclusion here covered ensuing losses. Adopting the interpretation the homeowners proposed would make surplusage of that language, enforcing the court’s conclusion that the suggested interpretation was improper.

The court also rejected the homeowners’ argument regarding concurrent causation. They argued that because Minnesota — the state of governing law — is a concurrent causation jurisdiction, if water damage was the overriding cause of the damage, the damage should be covered even if faulty construction also caused the harm.

But the court said that, in Minnesota, water infiltration is certain when not prevented by proper construction and that no jury could conclude that any other overriding cause but the construction defects caused the harm.

Using similar reasoning, the court also determined that the water damage did not qualify as an ensuing covered loss. Relying on *Bloom v. Western National Mutual Insurance Co.*, No. A05-2093, (Minn. Ct. App. July 3, 2006), review denied, No. A05-2093 (Minn. Sept. 19, 2006), the court determined that the deterioration, rot and mold that resulted from the water intrusion were not the “separate and distinct” perils needed to qualify as a covered ensuing loss.

Instead, the court concluded that the damage was the result of a single phenomenon — the faulty construction — without any other intervening cause but time.

Conclusion

For insurers, the evidentiary and factual burdens required for summary judgment often make it difficult to obtain complete resolution of a case at the end of discovery.

In the right case, however, insurers can persuade courts that the unambiguous language of the policy limits liability as a matter of law. To find the success that Chubb found here, insurers will need both a well-written exclusion and a discovery record that confirms that the disputed claim fits squarely within the language of that exclusion.

--By David E. Bland, Robins Kaplan Miller & Ciresi LLP

David Bland is a partner in the Minneapolis office of Robins Kaplan Miller & Ciresi.

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