SANDBERG PHOENIX

BAD FAITH BLOG

Bad Roof - Bad Faith?

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Drury Company was a subcontractor which added a commercial roofing product to the Jackson R-2 School District school building. Missouri United School Insurance Counsel (MUSIC) issued an all risk “special property coverage” policy which included “automatic builders risk” insuring the School District, its prime contractor, and all levels of subcontractors. MUSIC denied the claim of subcontractor Drury Company, but the trial court denied MUSIC’s Motion to Dismiss while granting Drury’s Motion for Summary Judgment, which included a statutory vexatious award. The Missouri Appellate Court affirmed.

The School District entered into a prime contract with Penzel Construction Company to build an addition at the high school campus. The prime contract required the School District to purchase and maintain property insurance “written on a builder’s risks ‘all risk’ or equivalent policy form to include the interests of the owner, contractor, subcontractors and sub-subcontractors in the Project.” Penzel and Drury entered into a subcontract which required Drury to install a roof deck product called Tectum. The prime contract (which was incorporated by reference into the subcontract) required the School District to obtain the policy of insurance referred to above. The policy provided that whenever a contract required, “this insurance shall include the interests of the member [School District], the contractor, all subcontractors, and sub-subcontractors.” One of the exclusions in the policy was for “faulty workmanship or materials, unless lost by a peril not otherwise excluded in this document ensues” and then MUSIC shall be liable only for such ensuing loss.

Drury began its work in October 2007. Rain, ice storms, and other precipitation fell during the next several months and the Tectum suffered moisture damage. Drury submitted a claim to MUSIC which was denied “on the basis that the damage was excluded from coverage under the faulty workmanship provision, among others.”

Drury sued multiple defendants including MUSIC contending that MUSIC had breached the insurance contract by denying the claim and Drury also asserted a vexatious refusal to pay claim under Section 375.296 seeking statutory penalties, interest, and attorney’s fees.

After the trial court entered summary judgment in favor of Drury Company against MUSIC, MUSIC appealed raising multiple points. The first point was a lack of standing. The court brushed that position aside with little difficulty. The contract documents required "the member [School District], the contractor, all subcontractors and sub-subcontractors" to have "automatic builder's risk" coverage. The insurance policy issued by MUSIC did so. Accordingly the court found Drury had standing.

Having brushed the standing argument aside, the appellate court next addressed whether it was proper to enter summary judgment for Drury despite MUSIC's contention that 1) the loss was excluded under the policy; and 2) the trial court had "erroneously interpreted and applied the 'ensuing loss' clause in the faulty workmanship exclusion." The court first noted that the basic property coverage section of the policy covered "all risks of direct physical loss… to the property covered from any external cause except as hereinafter excluded." The court next pointed to the builder's risk section of the policy which covered "all materials… installed or to be installed… and supplies or materials on site… to be used in the construction or installation at a member building project." The same builder's risk section specifically provided coverage for "rain, snow, sleet… to covered property in the open."

Tectum was "covered property" because it was material installed or to be installed as part of the building project. It was also "in the open" because it was on the project's roof. Drury's statement of material facts pointed to "several significant precipitation events" over the winter that included "rain, snow, sleet and ice" which resulted in damage to the Tectum. MUSIC had admitted that "weather conditions were wet that winter" to include "ice storms and winds." The court ruled that "the plain language of the policy" provided coverage for "the damage to the Tectum resulting from 'rain, snow, [or] sleet.'"

MUSIC argued that "All Risk Policies" cover only fortuitous events and that Drury's loss was not fortuitous. Distinguishing a Sixth Circuit case, the Missouri Appellate Court noted that it was undisputed that "Drury attempted to protect the Tectum from the weather while claiming "that Drury's actions were inadequate." Accordingly, MUSIC had asserted the faulty workmanship exclusion [as well as others] to support its coverage denial. The court quoted the exclusion which provided that "MUSIC does not cover loss due to… faulty workmanship or materials, *unless loss by a peril not otherwise excluded in this document ensues* and then MUSIC shall be liable only for such ensuing loss." The Appellate Court in Missouri found that the ensuing loss exception provided coverage because "Drury sustained an ensuing loss from the precipitation" which was clearly a covered peril no matter whether "Drury's workmanship was faulty."

Despite MUSIC's contention (relying upon another Sixth Circuit case) that the "'ensuing loss' language is subordinate to and dependent on the faulty workmanship exclusion and should not be interpreted to abrogate the exclusion,", the Missouri Appellate Court distinguished that case (governed by Michigan law) and all other cases MUSIC cited. The court then noted that if MUSIC had truly wanted to accomplish its goal of a broad exclusion, it should have employed the language found in a different exclusion. There MUSIC's exclusion applied "*regardless of any other cause or event* that in any way contributes concurrently or in sequence to the loss…."

Having found coverage, the court turned to the vexatious refusal to pay points. MUSIC first contended that Drury had no standing to bring a vexatious refusal claim. Since the court had already rejected such a contention, the court stated it did not have to address it again. MUSIC then contended "it had a reasonable basis to believe and did believe there was no coverage under the policy and it had a meritorious defense to Drury's claim."

Citing to the earlier case of *Legg v. Certain Underwriters at Lloyd's of London*, the appellate court noted that the vexatious refusal statutes in Missouri "allow penalties to be assessed against an insurer when it refuses to make payment, upon demand and in accordance with the policy, vexatiously, willfully and without reasonable cause." It also cited the Supreme Court of Missouri decision in *Overcast v. Billings Mut. Ins. Co.,* noting that the vexatious refusal statutes were enacted "to make the contracting party whole in a practical sense and to provide an incentive for insurance companies to pay legitimate claims without litigation." An insurance company has the right to litigate an open question of law or fact relating to claims under the insurance policy. In addition the question of reasonableness is usually a question for a jury rather than a question of law for the court. However, where the facts are undisputed, it can become a question of law for the court.

MUSIC's reasonable basis argument was based upon findings by the project architect and an engineer MUSIC had hired to investigate the claim who had determined that it was Drury's faulty workmanship which caused the loss. However, the court noted that "there is no evidence in the record that MUSIC's review of the claim involved consideration of the full text of the faulty workmanship exclusion, which provides coverage irrespective of workmanship when a covered peril ensues. Instead, from the record it appears that MUSIC focused its review of the claim on gathering evidence that Drury's workmanship was faulty. In the letter denying Drury's claim, MUSIC quoted the faulty workmanship exclusion in full, but provided no explanation for why the exclusion would apply despite the ensuing loss language. Given MUSIC's failure to consider the plain language of its policy, it did not have a reasonable basis to believe it had no liability. That "plain language of the policy" caused the appellate court to reject MUSIC's position that there was an open question of law that it was entitled to litigate without being penalized.

It would appear that the plain language of MUSIC's policy defeated its arguments that the ensuing loss exception to the faulty workmanship exclusion did not apply and it was entitled to litigate because there was no Missouri case law directly on point. MUSIC was not entitled to litigate the issue because the plain language of MUSIC's policy provided coverage. The Drury Company case demonstrates that appellate courts in Missouri are not going to go beyond Missouri for guidance if the "plain language of the policy" either provides or does not provide coverage. Furthermore, if that plain language provides coverage, almost no claim denial will be deemed to be reasonable such that any vexatious award entered will be affirmed on appeal.

By Anthony L. Martin

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