Case Alert

Florida Supreme Court Denies Review of Chinese Drywall Case

A recent Florida Supreme Court decision could create a hurdle for policyholders pursuing first-party coverage in the construction defect realm. On August 22, 2016 the Florida Supreme Court denied review of the Second District Court of Appeals' pro-insurer decision, leaving intact a narrow interpretation of the commonly used ensuing loss exception.

The Peeks were forced to leave their home due to noxious, sulfuric fumes from Chinese drywall, and sought coverage from their all-risk homeowners' insurance policy. American Integrity Insurance Company ("American Integrity") denied coverage, citing the exclusions for latent defects, corrosion, pollutants, and faulty, inadequate, or defective construction materials.[1] The trial court granted American Integrity's motion for a directed verdict, and the Peeks appealed. The Second District Court of Appeal affirmed, and the Florida Supreme Court denied further appeal.[2] Thus, the Second District's decision stands, and the Peeks are left without coverage.

The Peeks argued that the damage occasioned by the sulfuric emissions to their home should qualify under an "ensuing loss" exception to the latent defect exclusion. Though the Peeks' all-risk insurance policy excluded coverage for latent defects and defective construction, it provided coverage for covered losses ensuing from excluded losses. The Peeks conceded that the drywall itself was excluded, but argued that humidity was the ensuing loss that made their home uninhabitable.[3] The Second District disagreed, adopting a narrow interpretation contrary to many other jurisdictions.[4] The Second District found that the Peeks failed to meet their burden of establishing a covered loss resulting subsequent to the defective drywall, an excluded peril.[5] The Second District noted that the loss caused by the release of sulfuric gases originated from the Chinese drywall; thus, these losses were not "ensuing," but were, instead, part of a single, excluded loss.[6]

Similar issues have arisen in the context of asbestos cases, where the presence of asbestos, without more, was ruled insufficient to establish a covered loss unless the asbestos caused the structure to become unusable.[7] In the context of Chinese drywall, although incorporation of defective drywall into a building may constitute a physical loss because the building itself is damaged,[8] that loss would likely fall within the "defective construction" exclusion.[9] Likewise, the resulting noxious fumes likely fall within the pollution exclusion. Due to the potential applicability of these exclusions, a policyholder seeking to obtain coverage for loss due to Chinese drywall would have to prove a subsequent covered loss, which ensued from the previous excluded losses.

Evidence of an ensuing loss is crucial to the policyholder's success. Under Florida law, "[e]nsuing-loss exceptions are not applicable [] if the ensuing loss was directly related to the original excluded risk."[10] Chinese drywall cases stem in great part from the sulfuric odors emanating from the drywall, which Florida law does not recognize as a separate risk. Unless the loss can somehow be separated from the exclusions for drywall itself, policyholders will continue to lose out to defective construction, pollution, and latent defects.

In the construction realm, policyholders should be sensitive to the challenge that Florida's treatment of "ensuing loss" creates in evaluating coverage. The same principles that exclude coverage for Chinese drywall and asbestos could also apply in other contexts, such as mold, lead paint, or other defective materials that could potentially damage the property's use or value without creating identifiable, physical damage to that property. Unfortunately, as Florida law currently stands, a construction project affected by faulty materials (such as Chinese drywall, asbestos, lead paint, etc.) could leave owners and contractors liable for the costs of repair, with insurers able to hide behind the exclusions under which these defects have been classified.

For further information, or to discuss the possible ramifications of this case, please contact C. Lily Schurra at cls@sdvlaw.com or 203-287-2138.

1. *Peek v. Am. Integrity Ins. Co.,* 181 So. 3d 508, 509 (Fla. Dist. Ct. App. 2d Dist. 2015) (hereinafter, "Peek I").
2. The Florida Supreme Court gave no reason for its denial of the Peeks' petition, except for a short statement that the Court determined it should not accept jurisdiction. *Peek v. Am. Integrity Ins. Co.,* 2016 Fla. LEXIS 1838 (Fla. 2016) ("…the Court having determined that it should decline to accept jurisdiction").
3. *Peek I*, 181 So. 3d at 510.
4. Courts are split as to the proper interpretation of the ensuing loss provision. Some, like Florida, have adopted the position that the ensuing loss must be completely separate and independent from the initial excluded loss. See, e.g., *GTE Corp. v. Allendale Mut. Ins. Co.,* 372 F.3d 598, 613-14 (3d Cir. 2004) (cost of correcting design defects not covered as ensuing loss); *Wright v. Safeco Ins. Co. of Am.,* 109 P.3d 1, 7 (Wash. Ct. App. 2004) (mold damage not covered as ensuing loss because caused by faulty construction). Others find that this interpretation contradicts the plain meaning of the provision, which provides coverage for losses consequently following an excluded loss, but does not have to be completely separable. See e.g., *Arnold v. Cincinnati Ins. Co.,* 688 N.W.2d 708, 719 (Wis. Ct. App. 2004) (coverage under ensuing loss provision for claim for water damage caused by rain leaking through damaged caulking resulting from faulty workmanship and materials); *Dawson Farms, LLC v. Millers Mut. Fire Ins. Co.,* 794 So. 2d 949, 952-53 (La. Ct. App. 2001) (damage to stored sweet potatoes caused by condensation from faulty construction covered as ensuing loss).
5. *Id*. at 512.
6. *Id*.
7. See 23-41 MEALEY'S LITIG. REP. INS. 11 (2009) (quoting *Port Auth. of New York and New Jersey v. Affiliated FM Ins. Co.,* 311 F.3d 226 (3d Cir. 2002) ("[I]f asbestos is present in the components of a structure, but is not in such form or quantity as to make the building unusable, the owner has not suffered a loss.")
8. This is in contrast to asbestos cases, in which the building itself remains physically intact and usable, despite the presence of asbestos.
9. 23-41 MEALEY'S LITIG. REP. INS. 11 (2009).
10. *Liberty Mut. Fire Ins. Co. v. Martinez,* 157 So.3d 486, 488 (Fla. Dist. Ct. App. 5th Dist. 2015); see also *Swire Pac. Holdings, Inc. v. Zurich Ins. Co.,* 845 So.2d 161, 168 (Fla. 2003) (holding that a building owner could not obtain coverage for the cost to repair the structural defects caused by his engineer) (costs to repair a design defect qualify as a part of that defect, not as an ensuing loss; "[t]o hold otherwise would be to allow the ensuing loss provision to completely eviscerate and consume the design defect exclusion").

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