IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MARK D. SMITH and ELISSA C. SMITH,	:	CIVIL ACTION NO. 06-3077
Plaintiffs,	:	
v.	:	
WESTFIELD INSURANCE COMPANY,	:	
Defendant.	:	

M E M O R A N D U M

EDUARDO C. ROBRENO, J. JUNE 15, 2007

Plaintiffs Mark and Elissa Smith bring suit against Defendant Westfield Insurance Company based on Westfield's denial of the Smiths' homeowners' insurance claim. The parties agree that the builder's construction of the house was in some ways faulty; they dispute, however, whether any damages to the house resulting from the faulty construction are covered under the insurance policy.

I. BACKGROUND

The Smiths purchased their newly constructed home on January 8, 2003, from Windermere Farms, Inc. The home was constructed by

Gambone Brothers Construction Company.[1] The Smiths took out a homeowners insurance policy from Westfield. On June 1, 2003, about six months after moving into the house, the Smiths first noticed that water was penetrating the interior of the house.

Almost three years later, on March 15, 2006, the Smiths notified Westfield of the water infiltration damage and submitted a claim under their insurance policy. On May 16, 2006, Westfield denied the claim.

On June 22, 2006, the Smiths brought suit against Westfield in the Philadelphia County Court of Common Pleas. Westfield removed the case to this Court on the basis of diversity jurisdiction.[2]

The Court granted Westfield's motion to dismiss, with the Smiths leave to file an amended complaint, because the insurance contract required that suits against Westfield be brought within two years of the date of loss (doc. no. 5). To be timely, a suit stemming from a loss that allegedly occurred on June 1, 2003 (as alleged in the original complaint), must have been brought by May 31, 2005. The Smiths' original complaint was over a year tardy.

The Smiths filed an amended complaint, now asserting that the relevant date of loss was April 2, 2005 (doc. no. 9). The

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[1] This entity is alternately referred to as Gambone Brothers Development Company and Gambone Brothers Enterprises, Inc.

[2] On June 30, 2006, the Smiths brought suit against Gambone in the Montgomery County Court of Common Pleas. The current status of that litigation is unclear.

Smiths argue that a rainstorm on April 2, 2005, caused damage to different areas of the house than those caused by the June 2003 leak.

The Smiths assert two counts against Westfield. Count I is for breach of contract for Westfield's denial of the Smiths' homeowners' insurance claim. Count II is a claim for statutory bad faith by an insurer, under 41 Pa. Cons. Stat. § 8371.

II. DISCUSSION[3]

A. The breach of contract claim

There are two issues within the breach of contract claim. One is whether the date of the loss alleged in the amended

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[3] A court may grant summary judgment when "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). A fact is "material" if its existence or non-existence would affect the outcome of the suit under governing law. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). An issue of fact is "genuine" when there is sufficient evidence from which a reasonable jury could find in favor of the non-moving party regarding the existence of that fact. Id. at 248-49. "In considering the evidence, the court should draw all reasonable inferences against the moving party." El v. Se. Pa. Transp. Auth., 479 F.3d 232, 238 (3d Cir. 2007). "[S]ummary judgment is essentially 'put up or shut up' time for the non-moving party: the non-moving party must rebut the motion with facts in the record and cannot rest solely on assertions made in the pleadings, legal memoranda, or oral argument." Berckeley Inv. Group, Ltd. v. Colkitt, 455 F.3d 195, 201 (3d Cir. 2006).

The Court will apply the substantive law of Pennsylvania in this diversity action; the parties have not argued otherwise.

complaint is within the time period provided for in the suit-limitation clause. The other is whether the type of loss claimed is covered by the insurance policy.

1. Date of loss

The insurance contract contains a suit-limitation provision: "No action can be brought against us unless . . . the action is started within two years of the date of loss." Such suit-limitation provisions are routinely upheld under Pennsylvania law. See Gen. State Auth. v. Planet Ins. Co., 346 A.2d 265, 267 (Pa. 1975). Therefore, the Smiths can recover only for losses that occurred within two years prior to the date they originally filed the complaint (June 22, 2006), i.e., beginning on June 23, 2004.

The date of loss, which is a question of fact, is hotly contested by the parties and thus inappropriate for determination on summary judgment. If Westfield is correct, and the loss occurred on June 1, 2003,[4] then Westfield did not breach the contract and will prevail in the suit. If, however, the Smiths are correct, and the loss occurred on April 2, 2005,[5] then

[4] Westfield argues that on three prior occasions the Smiths put June 1, 2003, as the date of loss: (1) in their suit against Gambone; (2) in their claim to Westfield; and (3) in the original complaint filed in this case.

[5] The Smiths allege in their amended complaint, and Mr. Smith states in his deposition testimony, that some losses

Westfield did breach the contract and the Smiths will prevail.

It is up to the trier of fact to determine when the loss occurred.[6]

2. Type of loss

The burdens in this insurance action are familiar. The Smiths, as the insureds, first bear the burden of showing that a loss has occurred. Westfield, as the insurer, then bears the burden of showing that the loss falls within a particular policy exclusion. See Miller v. Boston Ins. Co., 218 A.2d 275, 277 (Pa. 1966). If the insurance contract's language is unambiguous, the Court will simply apply it; if, however, a provision of the contract is ambiguous, it is construed against the insurer, the drafter of the agreement. See Standard Venetian Blind Co. v. Am. Empire Ins. Co., 469 A.2d 563, 566 (Pa. 1983).

The determination of coverage here involves four steps. The first step is whether there has been a loss. Westfield does not dispute that there has been. The second step is whether the loss falls within a policy exclusion. The relevant exclusion here is

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occurred on April 2, 2005.

[6] Of course, there is a very real possibility that the loss "occurred" on more than one date. Water might have seeped into the house over a period of months or years. Different rainstorms might have caused damage to different areas of the house--or even different damages to the same area of the house. The parties will need to present evidence on this issue to the trier of fact.

for faulty construction. By the contract's plain terms, losses that are faulty construction (i.e., the cost of replacing the stucco, windows, etc.) are not covered, while "ensuing losses," or those that result from the faulty construction (i.e., water damage to the interior of the house), are covered. The third step is whether the ensuing loss is itself excluded by a specific policy provision. Here, the contract specifically excludes recovery for mold and wet rot. The fourth step is whether there is an exception to the mold exclusion. There is "additional coverage" for mold or wet rot if, but only if, the mold or wet rot is caused by one of six named perils (faulty construction is not one of the named perils).

The faulty construction exclusion provides that there is no coverage for "faulty, inadequate or defective planning, zoning, development surveying, siting; design, specifications, workmanship, repair, construction, renovation, remodeling, grading compaction; materials used in repair, construction, renovation or remodeling; or maintenance." However, the faulty construction exclusion provides that there is coverage for an "ensuing loss" due to faulty construction. In other words, losses that are faulty construction are not covered; losses that result from faulty construction are covered. This is more easily seen with an example. The contractor did not properly install the stucco on the exterior of the house. Due to this faulty

construction, rainwater seeped into the house and damaged the flooring. The insurance policy covers the cost of replacing the damaged flooring but not the stucco.[7]

There is an important caveat to the "ensuing loss" provision, though: the "ensuing loss" itself must not be specifically excluded elsewhere in the policy. See Banks v. Allstate Ins. Co., 1993 WL 40113, at *4-5 (E.D. Pa. Feb. 12, 1993) (holding that the "ensuing loss" clause does not provide coverage for a loss that is specifically excluded elsewhere in the policy).

Here, the policy specifically excludes coverage for "mold, fungus, wet rot, bacteria and other biological contaminants" (which the Court will refer to collectively, for the sake of brevity, as "mold or wet rot"). So, if the damage to the interior of the house is itself mold or wet rot, even if the damage is an "ensuing loss" from the faulty construction, is it

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[7] A federal court that was confronted with an almost identical factual scenario recently came to the same conclusion:

> [T]he policies are clear that faulty construction losses are excluded, but losses taking place afterward, or as a result of faulty construction, are covered. The exclusions still apply despite the applicability of the ensuing loss provision. For example, water damage ensuing from a defective roof is covered as an ensuing loss, but the exclusion for faulty construction excludes coverage to repair the roof.

Eckstein v. Cincinnati Ins. Co., 469 F. Supp. 2d 455, 463 (W.D. Ky. 2007).

not covered by the policy.

The fourth step is a possible exception to the mold or wet rot exclusion. The policy provides for "additional coverage" of up to $10,000 if, but only if, the loss caused by the mold or wet rot is the "direct result" of one of six named perils, which include "windstorm or hail" (but not faulty construction). However, the peril of "windstorm or hail" "does not include loss to the property contained in a building caused by rain, snow, sleet, sand or dust unless the direct force of wind or hail damages the building causing an opening in a roof or wall and the rain, snow, sleet, sand or dust enters through this opening." Here, the Smiths have presented no evidence that wind or hail from the April 2, 2005, storm damaged the house and caused an opening in the roof or walls. As a matter of law, then, any loss to the interior of the house caused by mold or wet rot is excluded under the policy, because it was not a "direct result" of a windstorm or hail.

The conclusion is that the insurance policy provides coverage for an ensuing loss to the interior of the house that is not mold or wet rot.[8]

[8] In their response to the motion for summary judgment, the Smiths argue that the damage to the interior of the house is not wet rot or dry rot, but rather "water damage to the walls, floors, insulation and supporting timbers." Pls.' Resp. at 19.

3. Breach of contract conclusion

The Smiths can recover for any loss that occurred after June 23, 2004, that resulted from the faulty construction, so long as the loss was not itself excluded under the policy (i.e., mold or wet rot). The Smiths cannot recover for the faulty construction itself (i.e., the cost of replacing the stucco, windows, and exterior stone).

At this stage of the litigation, the Court is not in a position to determine which losses occurred when and were caused by what. Summary judgment will be denied on the breach of contract claim, because these are genuine issues of material fact.[9]

2. Statutory bad faith

The Smiths have asserted a claim for bad faith in insurance

[9] The Smiths have not pointed to any useful list of the alleged damages. They attached an estimate from a contractor on what it would cost to repair the outside of the home (i.e. fix Gambone's mistakes), but, as noted above, these damages are not recoverable. They have referred to damages to the interior of the home, see Pls.' Resp. at 18-19, but the only evidence for these assertions are citations to Mr. Smith's deposition testimony, where he spoke about water damage in the basement. See Mark Smith Depo. at 36-40. Surprisingly, it appears that the parties did not take discovery on this issue.

In short, because the Smiths failed to itemize their damages, it is impossible at this time to determine which damages are recoverable (and thus for which damages did Westfield breach the contract) and which damages are not recoverable (and thus for which damages did Westfield not breach the contract).

dealings. The statute reads:

> In an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions:
>
> (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3%.
> (2) Award punitive damages against the insurer.
> (3) Assess court costs and attorney fees against the insurer.

42 Pa. Cons. Stat. § 8371.

The Pennsylvania Superior Court has defined "bad faith" in the insurance context as follows:

> "Bad faith" on part of insurer is any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (i.e., good faith and fair dealing), through some motive of self-interest or ill will; mere negligence or bad judgment is not bad faith.

Terletsky v. Prudential Property & Cas. Ins. Co., 649 A.2d 680, 688 (Pa. Super. Ct. 1994) (quoting Black's Law Dictionary 139 (6th ed. 1990)). A claim of "bad faith" must be proven by the heightened standard of "clear and convincing evidence." Id. Further, "the plaintiff must show that the defendant did not have a reasonable basis for denying benefits under the policy and that defendant knew or recklessly disregarded its lack of reasonable basis in denying the claim." Id. "Courts repeatedly have held that an insurance company's substantial, thorough investigation,

based upon which the insurance company refuses to make or continue benefit payments, establishes a reasonable basis that defeats a bad faith claim." Cantor v. Equitable Life Assur. Society of U.S., 1999 WL 219786, at *3 (E.D. Pa. Apr. 12, 1999) (applying § 8371).

Here, the Smiths' claim for statutory bad faith plainly has no merit. After the Smiths notified Westfield of the claim, Westfield promptly sent an inspector to the house. The inspector inspected both the inside and outside of the house, took Mr. Smith's statement, and received an expert report prepared by Jerry Yedinak on behalf of the Smiths. Westfield's denial letter cited the insurance policy at length and referred to Yedinak's report. The position that Westfield took--that the damages were not covered by the policy--is perfectly reasonable, especially given the fact that (1) the alleged date of loss was almost three years prior, and therefore on its face excluded under the suit-limitation provision, and (2) Yedinak's report detailed damages only to the exterior of the home, which are plainly excluded under the faulty construction provision. Westfield did a thorough investigation and made a reasonable finding. That the determination may turn out to be incorrect does not mean that it had a dishonest purpose or was made with reckless disregard for the truth.

Therefore, Westfield will be granted summary judgment on the

Smiths' claim for statutory bad faith.

III. CONCLUSION

Westfield's motion for summary judgment will be granted in part and denied in part. The motion will be granted as to the statutory bad faith claim and denied as to the breach of contract claim.

An appropriate Order follows.

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O R D E R

AND NOW, this **15th** day of **June 2007,** for the reasons stated in the accompanying Memorandum, it is hereby **ORDERED** that Westfield Insurance Company's motion for summary judgment (doc. no. 25) is **GRANTED IN PART** and **DENIED IN PART**.

The motion is granted as to Count II, Plaintiffs' claim for statutory bad faith.

The motion is denied as to Count I, Plaintiffs' claim for breach of contract.

AND IT IS SO ORDERED.

S/Eduardo C. Robreno
EDUARDO C. ROBRENO, J.