FARMER SMITH & LANE LLP

CASE LAW UPDATE:
ERIC REICHERT, ET AL. V. STATE FARM GENERAL INSURANCE CO.

2012 WL 6721116
California Court of Appeal, Fourth Appellate District
December 28, 2012
(Pub. Order 1/24/13)

In *Reichert*, the Court of Appeal held the demolition of the insured's home as a result of non-conformity with the City of Huntington Beach's floodplain regulations was excluded by a provision in the insured's homeowner's policy precluding coverage for loss caused by the enforcement of any law or ordinance. Moreover, the policy's code upgrade coverage did not restore coverage taken away by the law or ordinance exclusion.

Eric and Lisbeth Reichert purchased a two story home in Huntington Beach, which sits in a designated flood zone, intending to do a substantial remodel. They hired an architect and a general contractor. The first set of plans depicted what amounted to a "substantial" remodel, triggering the City's "in-fill" requirement that neighbors sign off on the placement of windows and a federal FEMA requirement that the ground floor be constructed above the base flood level. The first set of plans would cause significant cost and headache, so the Reicherts went back to the drawing board. The second set of plans was similar to the first, but left in place several existing walls to just barely avoid the City's in-fill requirement.

The plans were approved by the City, and the general contractor commenced demolition. The on-site project manager, however, noticed that the second set of plans still called for 10-foot ceilings in upstairs and downstairs rooms, but in order to get the City to sign off on the second set of plans, the Reicherts agreed to leave in place several existing walls which only supported 8-foot ceilings. The project manager contacted the general contractor and architect – the Reicherts were allegedly on vacation at that time – and was instructed to tear down the existing walls.

During the next City inspection, it was discovered that the Reicherts had exceeded the scope of the permit issued, triggering a requirement that they comply with the FEMA regulation. A stop work order was issued, and eventually the City ordered the demolition of the home. The Reicherts sued their architect and general

contractor, and submitted a claim to State Farm under their homeowner's policy. After State Farm denied the claim, the Reicherts sued.

The trial court granted summary judgment in favor of State Farm on two theories: "The demolition could not be an accidental loss as required under the insurance contract and the exclusion of losses for enforcement of any ordinance or law was 'fairly obvious'."

The Court of Appeal side-stepped the issue of whether the demolition was an accidental loss, noting that the insureds may not have intended or expected the damage to occur because they were on vacation at the time the decision was made to tear down the extra walls. (See *MRI Healthcare Center of Glendale, Inc. v. State Farm General Ins. Co.* (2010) 187 Cal.App.4th 766, 781; See also *Home Savings of America v. Continental Ins. Co.* (2001) 87 Cal.App.4th 835 [purposeful demolition by an owner to redevelop property was "accidental" from the standpoint of the mortgage company].)

As to the law or ordinance exclusion, the Court of Appeal first noted a split in California authority as to the application of the exclusion when the loss itself is caused by a covered peril. One line of cases suggests that the insurer is only obligated to pay for damages to bring the property to preloss condition. (See *Bischel v. Fire Ins. Exch.* (1991) 1 Cal.App.4th 1168 [insurance is not intended to put insured in a better position]; See also *McCorkle v. State Farm Ins. Co.* (1990) 221 Cal.App.3d 610, 614-615; *Breshears v. Indiana Lumbermens Mut. Ins. Co.* (1967) 256 Cal.App.2d 245, 248.) The other line of cases provides that inherent in the idea of "replacement cost coverage" is that the insured will receive a usable replacement for property damaged by a covered peril, even if replacement requires compliance with local codes or ordinances. (*Fire Ins. Exch. v. Superior Court* (2004) 116 Cal.App.4th 446; See also *Dupre v. Allstate Ins. Co.* (Colo. App. 2002) 62 P.3d 1024; *Bering Strait School Dist. v. RLI Ins. Co.* (Ala 1994) 873 P.2d 1292; *Farmers Union Mut. Ins. Co. v. Oakland* (Mont. 1992) 251 Mont. 352; and *Garnett v. Transamerica Ins. Servus* (Idaho 1990) 118 Idaho 769.)

The Court of Appeal drew from those cases the principle that the law or ordinance exclusion was intended to preclude a loss when it is the "law or ordinance itself – as distinct from, say, a fire – that is the cause of the loss." The loss to the Reichert's home was caused by the enforcement of the FEMA requirement, not a fire, earthquake or other covered peril. Accordingly, the State Farm policy did not apply.

The Reicherts also argued that the policy's Option OL Endorsement "provides coverage for losses resulting from building, zoning or land use ordinances." The

Option OL coverage provides an additional sum for increased costs associated with the enforcement of any code or ordinance. Under the terms of the Endorsement, however, a *covered peril* is a prerequisite to obtaining the increased limits. Because there was no covered peril associated with the code enforcement, the Option OL coverage did not apply. Stated another way, Option OL restores coverage which the law or ordinance exclusion otherwise removes.

The Reicherts final argument was a riff on the efficient proximate cause principle. The negligence of the Reicherts' architect and contractor was the cause of the loss, not the enforcement of the code provision. However, the court correctly noted that the policy – likely in response to *Garvey v. State Farm Fire & Cas. Co.* (1989) 48 Cal.3d 395, 408 [third-party negligence was itself a covered peril]. – specifically excludes this circumstance.