Understanding Vacancy Limitations on Vandalism and Theft Claims

By Mary Beth Sipos

Even in the hoped-for period of recovery from the recession, the volume of claims involving vacant or partially occupied buildings may generate more case law – and may offer broader consensus – on a number of significant insurance coverage issues.

From an underwriting perspective, it has long been understood that a vacant building presents a greater property damage risk than one that is occupied. The longer a building is vacant, the conventional wisdom goes, the greater the risk.

Mary Beth Sipos

The economic downturn created a virtual laboratory for testing that belief by providing a perfect storm of conditions for vacancy losses. The proliferation of vacant buildings provided opportunity, especially for theft. Joblessness, combined with a coincidental rise in the metals market, may have created a stronger than usual motive for such thievery.

Metal Theft from Vacant Buildings – a Hallmark of the Recession

There are several indications that property claims for vandalism and theft from vacant buildings increased in frequency and magnitude during the recession, even if the inquiry is limited to reported claims only. The National Insurance Crime Bureau reported that claims linked to metal theft in particular jumped 81 percent between 2009 and 2011, as compared to the three-year period between 2006 and 2008.[1]

And those are not penny ante claims. In February, a Caltrans spokesman reported the state spent $27 million over the last seven years replacing copper wire stolen from traffic signals, streetlights and freeway signs.[2] Copper now fetches as much as $4 per pound at salvage yards, or almost triple the price paid four years ago.[3] The same increase in price has raised the cost of replacing copper wiring, plumbing and air conditioner components, on top of the sometimes considerable damage to the structure caused by the thieves.

Even as the economy recovers, this remains a topic of concern. The NICB reported a 36 percent increase in metal theft claims for the two-year period ending December 31, 2012, compared to the preceding two-year period.[4] We will continue to see vacancy theft and vandalism issues developing legally as the losses that occurred during the worst of the recession are litigated and appealed.

It is not surprising then that, while there is still a market for insuring vacant buildings, restrictions on the coverage provided have also become more common. A November 13, 2012 article in the *Claims Journal* declared, "Theft & Vandalism Claims Have Carriers on Edge in Vacant Property Segment."[5] In many instances, policies impose higher deductibles, lower sublimits, or specific conditions including protective safeguards like alarms and on-site security or inspections to counter the increase in risk.

Coverage Pitfall for New Owners of Long-Vacant Buildings

The most recent California case on vacancy provisions highlights potential pitfalls for new owners of buildings that have long been vacant, even as those buyers begin remodeling or start occupying them.

In *Travelers v. Superior Court*, as in many policies, the vandalism coverage was subject to a specific limitation that entirely excluded coverage if the building was vacant more than 60 days prior to the loss.[6] In a case of first impression in California, the court enforced vacancy provisions limiting coverage where a building had been vacant more than 60 days prior to loss. In affirming

Mary Beth Sipos is a partner in the Risk Management & Insurance Law Practice Group of Haight Brown & Bonesteel LLP. Prior to joining Haight, Ms. Sipos was Senior Claims Counsel for Liberty Mutual Insurance. She can be reached at mbsipos@hbblaw.com.

summary judgment for the insurer, it held the vacancy conditions applied unambiguously, even though the loss occurred within 60 days of policy issuance.

The issue arose when the developer of an unfinished condominium project defaulted on its construction loan. Its builders' risk insurance had lapsed and, prior to the foreclosure, its agent obtained condominium association insurance from Travelers. After foreclosure by the project's note holder, and less than 60 days after inception of the Travelers policy, vandals damaged the property, including removal of all appliances and fixtures.

The new owner, as the loss payee under an assignment obtained in the foreclosure, made a claim against Travelers. When Travelers denied coverage in reliance on a 60-day vacancy limitation, the owner sued for bad faith. The new owner argued that the vandalism exclusion should not apply, since Travelers could not prove the policy had been in effect for 60 days when the loss occurred.

The property policy excluded coverage for vandalism and theft, "even if they are Covered Causes of Loss, if the building where loss or damage occurs has been 'vacant' for more than 60 consecutive days before that loss or damage occurs..." Based on that language, the Court of Appeal held that the exclusion applied if the building was vacant in the 60 days before loss, regardless of whether the policy was in force that entire time.

The court in *Travelers v. Superior Court* distinguished the pertinent clause from wording that excludes losses when the building is vacant "beyond a period of sixty days," explaining that "the use of 'beyond' is prospective-looking and must therefore commence at or after policy issuance. However, when the policy language is defined in terms of 'days before [the] loss,' the time period is clearly backward-looking from the date of the loss, and does not implicate policy issuance... There is no ambiguity in the instant policy; the period is backward looking from the date of the loss."[7]

That holding comports with the majority rule, calculating the period of vacancy from the date it begins, regardless of the inception date of the policy.[8] The minority of courts refusing to give effect to a vacancy clause largely cite ambiguity or vagueness of policy language which does not specify retrospective calculation of the vacancy period counting backward from the date of loss.[9]

Just How Vacant Is Vacant Enough?

For building owners, including those newly acquiring unoccupied property, and for agents, underwriters and claims professionals, an understanding of the potential restrictions of vacancy exclusion or condition is essential. Vacancy provisions can limit coverage to a percentage of loss or eliminate coverage altogether. They may apply to all causes of loss insured against or only specified causes of loss.

The starting point has to be understanding the term "vacant" and the factual variables underpinning it. There are usually two components to the limitation, (1) the nature of the vacancy and (2) its duration.

The defined term may vary depending on whether the policyholder is the owner of the building or a tenant. For example, in a policy issued to a tenant, the policy may state that "building means the unit or suite rented or leased to the tenant" and further provide that, "Such building is vacant when it does not contain enough business personal property to conduct customary operations."

When issued to the building owner, it usually requires consideration of the "entire building" and then specifies, alternatively, "Such building is vacant unless at least XX%? of its total square footage is: (i) Rented to a lessee or sub-lessee and used by the lessee or sub-lessee to conduct its customary operations; and/or (ii) Used by the building owner to conduct customary operations.

In either event, it's essential to understanding just what defines "customary operations."

One authority suggests that courts judge the degree of activity that makes a building occupied based on the nature of the building and its contemplated use. "For property to be considered vacant, it need not be totally free of any fixtures and furnishings; it is enough if the state of the structure's interior, combined with surrounding circumstances, indicate that the premises are not being used in any regular manner."[10]

Another suggests:

> Use and occupancy that will satisfy a policy condition that an insured building may not be vacant or unoccupied must be of such character as ordinarily pertains to the purpose to which the property is adapted or devoted. The condition should not have the same interpretation when applied to churches and schoolhouses as when applied to stores and dwellings...A store is unoccupied, even though certain fixtures or other property may be left in it. However, as such premises are frequently intended for rental, the customary use may permit renovation or preparation for tenants without constituting nonoccupancy, although a vacancy incident to change of tenants has been held by some authorities to avoid the policy.[11]

When a building is occupied by some combination of the owner and its tenants, customary use has to be considered *as to each of them.*

Similarly, when a policy covers more than one structure on the same premises, if policy language clearly applies the vacancy condition on a building-by-building basis, it should be applied as written. Throughout a property policy, in the declarations and elsewhere, distinctions are made between premises, location, and building. They should be applied consistently in the context of a vacancy clause.

That is to say that, if the coverage limitation states that it applies to loss, "if the building where loss or damage occurs" is vacant, then the applicable occupancy percentage should be calculated on the basis of that building alone.

Otherwise, there would be unfairness to claimant as well. For example, consider a policy insuring three buildings, and applying a vacancy penalty or limitation unless 30 percent of "the building where loss occurs" is occupied. There, if the tenant's loss occurred in a fully occupied building, but the two other buildings on the premises were vacant, ignoring the plain language of the policy would permit a carrier to deny coverage for the tenant. That is not a reasonable interpretation of the policy terms. Disregarding policy language is no more fair where it harms the carrier.

Careful reading and application of the policy as written is the only remedy. An annotation on point, notes:[12]

> There are many factual variables within the general framework suggested by the title. The policy may provide a single gross premium, or allocate premiums to the different buildings insured. The property covered may be tenement property, ordinary city residence property, or farm property. The occupied buildings may be the ones damaged, or the damage may have been confined to unoccupied buildings. And, of course, the possible variations in the language of the policy, both with respect to its provisions generally and with respect to the stipulations as to vacancy and unoccupancy, are limitless. In view of the foregoing considerations each of the cases within the scope of the annotation is largely sui generis, and little of a general nature can be deduced from them....

The same is true of the duration of the vacancy. As explored by the court in *Travelers v. Superior Court*, the only fair approach is to uniformly calculate the days of vacancy prospectively or retroactively depending on the approach prescribed by the policy language.

Exception for Buildings Under Construction or Renovation

Often, policies specify that buildings under construction and/or renovation are not considered vacant. Determining what is meant by each of the terms and when minor repairs or planning for future renovation do not fulfill the exception.

Some jurisdictions construe "construction" narrowly to refer to the original fabrication of a structure and do not read this word alone to extend to "renovation." In *Myers v. Merrimack Mut. Fire Ins. Co.*,[13] a court applying Illinois law held:

> Several state courts have held that in an insurance policy, the term construction does not include repairs, maintenance, reconstruction, renovation and the like to an already existing structure. [Citations.]...Such a clause balances a willingness to extend coverage through the construction period with a desire to guard against excessive vandalism that occurs when a dwelling is vacant, [citation] and the interpretation urged by plaintiff would intolerably alter this balance by greatly extending the "construction" period to include any time during which some repairs or renovations are being made. The "construction" period cannot go on forever.

Other jurisdictions apply the same narrow construction and will not read it as meaning original construction only unless the term "renovation" is also used.[14]

At the other end of the spectrum, at least one court, construed "construction" broadly as implying renovation and mere preparation for renovation as well. In *TRB Investments, Inc. v. Fireman's Fund Ins. Co.*,[15] the court mandated a broad reading of the term, holding that "the term 'under construction' as used in the vacancy exclusion was meant to be the functional equivalent of 'construction, renovation or addition' as used in the cancellation endorsement. It reasoned that, "If a building is regularly occupied during normal business hours, as is usually contemplated for commercial structures, then an insurer can assess risk based upon such occupancy. When there is substantial construction activity on the premises, the risk of loss becomes roughly equivalent to that of an occupied building, thus giving the insurer the benefit of its prior risk assessment."

Therefore, it held the same standard applies to preparation for construction activity as for renovation or building that is in full swing: "The question remains

the same no matter what stage of a construction project is at issue, i.e., are there 'substantial continuing activities' on the premises by those involved in the construction endeavor?"[16]

A handful of out of state cases have considered a variety of construction or renovation activities that might or might not be substantial enough to suffice to keep a building from being considered vacant. These range from minor repairs that were found not to rise to the level of a "renovation",[17] to others where the premises were fully stocked with equipment and so close to occupancy that they were held not vacant.[18] Some cases report only the existence of material fact with respect to vacancy.[19]

It is also important to remember that the extent of construction may be unavailing in this context if the element of continuity of activity is missing. In a noteworthy case out of the Eighth Circuit, *Vennemann v. Badger Mut. Ins. Co.*,[20] even though the insured spent $5,000 on a new roof, that project was completed many weeks before the subject fire loss. The court held that the other projects taking place in the intervening period involved only discrete, non-structural changes to the property that did not constitute "continuing" activity; the smaller projects were that arise to the level of "being constructed" exception.

It may be somewhat disheartening for the practitioner in this area that so few hard and fast rules determine what is or is not construction or renovation. On the other hand, the existing flexibility acknowledges the potential factual variables while permitting courts to apply standard principles of policy construction to attain fair outcomes.

Conclusion

As foreclosures and other transactions in distressed properties start to slow, the frequency of theft and vandalism claims of every sort may diminish.

The last challenge in this area may be discerning among various causes of loss that invoke vacancy limitations. When strangers strip a building of valuable copper fixtures, it is safe to bet that theft is involved as that merely consists of a taking without right of ownership. The distinction between theft and vandalism blurs however,[21] when soon-to-be dispossessed owners and tenants damage property.[22]

Whether such damage is covered as vandalism in the first instance is usually based on whether the evidence demonstrates the requisite mental state to fall within such coverage. "Although, here again, the distinction between property damaged and property merely taken by the occupants upon departure can be decisive as to whether recovery is allowed."[23]

Even in the hoped-for period of recovery from the recession, the volume of claims involving vacant or partially occupied buildings may generate more case law on all of these issues and may offer broader consensus on the main coverage issues discussed here.

1. https://www.nicb.org/newsroom/news-releases/metal-theft-report.
2. http://www.mercurynews.com/crime-courts/ci_22552163/invisible-culprit-traffic-gridlock-copper-thieves.
3. *Id*
4. https://www.nicb.org/newsroom/news-releases/2013-metal-theft-report.
5. http://www.claimsjournal.com/news/national/2012/11/13/217357.htm.
6. *Travelers Property Casualty Company of America v. Superior Court*, 215 Cal.App.4th 561, --- Cal.Rptr.3d ----, 2013 WL 1638157 (2013).
7. *Id., citing Gas Kwick, Inc. v. United Pac. Ins. Co.*, 58 F.3d 1536 (11th Cir. Fla. 1995).
8. *See Gas Qwick v. United Pacific*, supra [vacancy exclusion applies retrospectively from the date of the loss, and the issue of when the vacancy period began with respect to the effective date of the policy is irrelevant]; *Estate of Higgins v. Washington Mut. Fire Ins. Co. of Lawrence County, Pa.*, No. 203 WDA 2003, 2003 WL 22881975, --- A.2d --- (Pa. Super. 12/08/03) [60-day vacancy period was calculated from the day the building first became vacant, not the day the renewal policy took effect]; *Babandi v. Allstate Indem. Ins. Co.*, No. 1:07CV329, 2008 WL 906116 (N.D.Ohio 3/31/08) [rejecting insured's argument that 90-day vacancy period should begin on the date the policy was issued]. But see *Pappas Enterprises, Inc. v. Commerce & Indus. Ins. Co.*, 661 N.E.2d 81 (Mass. 1996) [vacancy prior to the policy period did not preclude coverage under a vacancy exclusion unless the current policy continues a substantially identical prior policy].
9. *See Old Colony Insurance Co. v. Garvey*, 253 F.2d 299, 302 (4th Cir.1958) (addressing prospective policy and stating that "[i]f it had been intended that existing vacancy be taken into account, language to that effect should have been used ..."); *Bledsoe v. Farm Bureau Mut. Ins. Co.*, 341 S.W.2d 626, 629 (Mo.App.1960) (provision that company not liable for loss occurring while building "is vacant or unoccupied beyond a period of sixty consecutive days"); *Home Mut. Fire Ins. Co. v. Pierce*, 240 Ark. 865, 402 S.W.2d 672 (1966) (exclusion for vacancy "beyond a period of thirty days").
10. *Couch on Insurance* (3d ed.), section 94:132.
11. 45 C.J.S. Insurance § 1003, *What Constitutes Vacancy or Nonoccupancy* [citations omitted].
12. 51 A.L.R.2d 1366, Vacancy or unoccupancy within fire insurance policy which covers several buildings only some of which are or become vacant or unoccupied.
13. *Myers v. Merrimack Mut. Fire Ins. Co.*, 788 F.2d 468 (7th Cir., Ill. 1986).
14. *See also Travelers Indemnity Co. v. Wilkes County*, 102 Ga.App. 362, 116 S.E.2d 314, 317 (1960); Crescent Co.

of Spartenburg, Inc. v. Insurance Co. of North America, 266 S.C. 598, 225 S.E.2d 656, 658 (1976); Rogers v. Aetna Casualty & Surety Co., 601 F.2d 840, 844 (5thCir.1979).

15. *TRB Investments, Inc. v. Fireman's Fund Ins. Co.*, 40 Cal.4th 19, 145 P.3d 472 (Cal., 2006.)
16. *Id.*, Cal.4th at 40; P.3d at 479.
17. *See, e.g., Catalina Enterprises, Inc. Pension Trust v. Hartford Fire Ins. Co.*, 67 F.3d 63 (4th Cir. Md., 1995)[Two minor repairs did not constitute renovation]; *Rojas v. Scottsdale Ins. Co.*, 267 Neb. 922, 678 N.W.2d 527 (Neb., 2004) [Workers present on the property approximately 3 days per week to make improvements following eviction of tenants did not continuous enough to prevent finding of vacancy.]
18. *Rockford Ins. Co. v. Wright*, 39 Ill.App. 574, 1890 WL 2496 (1890) [Tenant in possession in process of having the premises cleaned prior to use, with cleaning tools in place and a full storeroom of stock, was in "practically the same condition as there was so far as actual occupancy was concerned.".
19. *Knight v. U. S. Fidelity & Guaranty Co.*, 123 Ga. App. 833, 182 S.E.2d 693 (1971) [Where restaurant being renovated for reopening, and insured, within two weeks to one month prior to fire, had purchased and installed new refrigerator on premises, installed music box, had electrical service reconnected and had kitchen area of insured restaurant painted, and that restaurant equipment was on premises at time of fire, issues of material fact existed as to whether insured restaurant premises were unoccupied.]; *Brighton Mfg. Co. v Reading F. Ins. Co.*, 33 F. 232(1887, CC Ill) [Where a cotton-manufacturing company temporarily stopped work in order to repair its machinery, but the night and day watchmen were on duty all the time that the machinery lay still, the superintendent remained in charge of the premises, and the retained employees were at the factory, there were still enough people about to retain possession, and keep watch against intrusion, and to give notice if a fire should break out or other danger arise to the property involving the risk under the policy.]
20. *Vennemann v. Badger Mut. Ins. Co.*, 334 F.3d 772, 774 (8th Cir. 2003).
21. "Vandalism is usually defined as the willful and malicious destruction of property but, "malice may be inferred from the act of destruction." 11 *Couch on Ins.* § 155:92 [citations omitted].
22. *See, e.g., St. Paul Fire and Marine Ins. Co. v. Pensacola Diagnostic Center and Breast Clinic*, 505 So. 2d 513 (1987) [seller's repossession and removal of equipment from the insured constituted "theft" where repossession was impermissible and constituted conversion]; *Intermetal Mexicana v. Insurance Co. of N. Am.*, 866 F.2d 71 (3rd Cir. Pa. 1989) [non-fortuitous loss occurred when a creditor took possession of a debtor's property pursuant to a valid court order].
23. 56 A.L.R.5th 407, What constitutes "vandalism" or "malicious mischief" within meaning of insurance policy specifically extending coverage to losses from such causes.