IN THE COURT OF APPEALS OF IOWA

No. 0-220 / 09-1389
Filed May 26, 2010

CONTINENTAL WESTERN INSURANCE COMPANY, an Iowa Corporation,
Plaintiff-Appellee,

vs.

OAKS DEVELOPMENT COMPANY,
Defendant,

and

FOXFIRE TOWNHOMES OWNERS ASSOCIATION, INC.,
Defendant-Appellant.

Appeal from the Iowa District Court for Polk County, Richard G. Blane, Judge.

A homeowners association appeals from a declaratory judgment rendered in favor of an insurance carrier in a coverage dispute. **AFFIRMED.**

Kenneth Munro, Des Moines, for appellant.

Jeffrey Goodman, West Des Moines, and Vincent P. Tomkiewicz and Edward Ruberry of Bollinger, Ruberry & Garvey, Chicago, Illinois, for appellee.

Heard by Sackett, C.J., and Eisenhauer and Mansfield, JJ.

MANSFIELD, J.

This is an appeal from a ruling in favor of an insurer in an insurance coverage dispute. Unlike in the typical such case, we do not have to interpret the insurance policy itself. The parties largely agree as to what it means. However, we have to examine a separate agreement between the parties and determine what they meant therein by "alleged defectively constructed roof claims." Did those claims, so defined, fall within the coverage afforded by the insurance policy? Because we believe the district court correctly found they did not, we affirm its judgment and order.

I. Facts and Procedural Background.

This case concerns a development known as Foxfire Townhomes located in Urbandale. Construction of the townhomes was completed in 2002. Oaks Development Company was the construction manager. All the roofing work for the townhomes was performed by subcontractors.

It turned out that the roofing work was defective, and as a result the roofs began to leak. In 2005 and 2006, Foxfire Townhomes Owners Association had the roofs replaced at a cost of approximately $215,000.[1] Foxfire then sued Oaks, which in turn filed third-party claims against the subcontractors that had actually performed the substandard work.

Foxfire's amended and substituted petition stated that "[a]fter the buildings were constructed, defects were revealed with the construction of the roofs and installation of insulation in the Foxfire Townhomes buildings." Foxfire alleged

[1] Under the relevant covenants, conditions, and restrictions (CCR's), the association was legally responsible for the "roof" and "structural portion" of any townhome, but not for its interior.

that "[t]he damages include the cost to repair and shingle the roofs and the cost to add insulation in the Foxfire Townhomes."

Continental Western Insurance Company, the insurer of Oaks, provided a defense to it under a reservation of rights. However, on August 22, 2008, Continental filed the present declaratory judgment action, seeking a declaration that Oaks was not entitled to coverage for Foxfire's claims under the relevant Continental insurance policies.

Continental's primary policies during the relevant time period were commercial general liability (CGL) policies that provided coverage for "property damage" caused by an "occurrence." "Occurrence" was defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." "Property damage" was defined as "[p]hysical injury to tangible property, including all resulting loss of use of that property" and "[l]oss of use of tangible property that is not physically injured."

The policies also contained an exclusion for property damage to "[t]hat particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it." However, that exclusion did not apply if the property damage was included in the "products-completed operations hazard" and "the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor."

In approximately February 2009, the parties reached a partial settlement. The third-party subcontractor defendants paid $95,500 to Foxfire and were released from further liability. In addition, Continental and Foxfire entered into a "Declaratory Judgment Agreement" which provided in relevant part:

> Continental Western Insurance Company and Foxfire Townhomes Owners Association, Inc. shall proceed with the declaratory judgment action pending in the Iowa District Court for Polk County (Case No. CE 59882) to its final conclusion through the Iowa Courts, including any appeals. If the final decision of the Iowa Courts is that Continental Western Insurance Company had insurance coverage for the alleged defectively constructed roof claims alleged against The Oaks Development Company or Foxfire, L.C.,[2] Continental Western's named insureds, in the Iowa District Court (Law No. 101871), Continental Western Insurance Company shall pay $140,000 to Foxfire Townhomes Owners Association, Inc., a sum which includes in its total any amounts for legal interest, attorney fees, and court costs assessed in Law No. 101871. In no instance will Continental Western's liability for Foxfire Townhomes Owners Association's claims against The Oaks Development Company or Foxfire, L.C. exceed $140,000. If it is the final determination of the Iowa Courts that there was no insurance coverage for the alleged defectively constructed roof claims made in the Iowa District Court for the Polk County case against The Oaks Development Company and Foxfire, L.C. (Law No. 101871), Foxfire Townhomes Owners Association will receive nothing from Continental Western Insurance Company.

Thereafter, the declaratory judgment action proceeded to a trial to the court on August 3, 2009. Continental took the position that the "alleged defectively constructed roof claims" asserted by Foxfire involved only damage to the roofs themselves, which damage was not covered under Continental's policies. Continental pointed out that when Foxfire was asked to itemize its damages in an interrogatory in the original lawsuit, it answered as follows:

> The Plaintiff is seeking $215,704.80 for work to repair and replace the roofs of the buildings. The Plaintiff is also seeking $24,099 necessary to bring the attic insulation up to Code.

As Continental pointed out, that interrogatory answer was never amended. Foxfire, by contrast, noted that the leaking roofs had also resulted in damage to

[2] Foxfire, L.C. was the contractor for the project and was named as a defendant in the association's original lawsuit. However, the only named insured under Continental's policies was Oaks.

the interior of the homes. Foxfire emphasized that its trial brief in the original action had also claimed "about $15,000 in work done to repair water damage to the interior of the buildings and to prevent additional water damage."

At trial, Continental offered testimony from its attorney and from one of its employees. The attorney, Thomas Henderson, described the background to the declaratory judgment agreement, which he drafted and negotiated with Foxfire's counsel, as follows:

> I said that rather than fight about laying evidence for all the damage claims, why don't we just have an all or nothing. If the replacement of the roofs is covered, it will be 140,000. If it isn't covered, you get zero. Both parties agreed to that. And I put in the letter a summary of that agreement, that they were only seeking damages solely for the roof replacement.

The "letter" reference was to Henderson's January 15, 2009 cover letter. In that letter, Henderson explained to Foxfire's counsel that the declaratory judgment agreement

> has been changed to reflect that *Foxfire Townhomes Owner's Association will be pursuing damages in the declaratory judgment action solely for the defectively installed roofs*, and will be anticipating a payment of $140,000 if it ultimately prevails in the declaratory judgment action.

(Emphasis added.) There is no dispute that the proposed declaratory judgment agreement language that accompanied Henderson's January 15 letter was the same language that appeared in the final version of the agreement signed by the parties.

Henderson also testified that he had a conversation around that time with Foxfire's counsel, Michael Jones, wherein Jones confirmed that he was not claiming "any resulting damage" because those portions of the townhome units

(i.e., the interiors) were owned by the various townhome owners rather than the association.

Continental's other witness was its own employee who had signed the declaratory judgment agreement drafted by Henderson. He testified to his understanding was that the "defectively constructed roof claims related solely to the cost and expenses related to replacing the roof" and that he would not have signed the agreement otherwise.

For its case, Foxfire put into evidence Michael Jones's deposition testimony. Jones disputed Henderson's account in some respects.

Following the completion of trial, the district court adopted Continental's proposed findings of fact and conclusions of law essentially word-for-word. The court found: (1) the Continental insurance policies did not provide coverage for repair and replacement of the allegedly defective roof work and (2) the term "alleged defectively constructed roof claims," as used in the declaratory judgment agreement, related only to the defective roofs themselves, and not to any interior damage to the townhomes. Accordingly, the court entered judgment in favor of Continental and against Foxfire. Foxfire now appeals.

II. Standard of Review.

This case was tried in equity, and the parties agree that it is subject to a de novo standard of review. *See* Iowa R. App. P. 6.907. We give deference to the district court's findings, but are not bound by them. *See* Iowa R. App. P. 6.904(3)(*g*). However, because the district court adopted Continental's proposed findings verbatim, "we must scrutinize the record more carefully when conducting our appellate review." *Nevadacare, Inc. v. Dep't of Human Servs.*, ___ N.W.2d

___, ___ (Iowa 2010). As we discuss below, some aspects of those proposed findings were inaccurate.

III. Analysis.

As we have noted at the outset of this opinion, this appeal does not really involve a disagreement about what a CGL policy covers. In its reply brief, Foxfire concedes that under Iowa law, "defective workmanship standing alone, resulting in damages only to the property itself, is not an occurrence under a CGL policy." *See Pursell Constr., Inc. v. Hawkeye-Sec. Ins. Co*., 596 N.W.2d 67, 71 (Iowa 1999) (setting forth that rule). Without an occurrence, it is not even necessary to decide whether the "your work" exclusion applies. There is simply no coverage under Iowa law. *See Norwalk Ready Mixed Concrete, Inc. v. Travelers Ins. Cos.*, 246 F.3d 1132, 1137 (8th Cir. 2001) (applying Iowa law) (holding that "defective workmanship, regardless of who is responsible for the defect, cannot be characterized as an accident under Iowa law").

Foxfire argues, however, that some interior damage resulted from the defective roofing, thereby giving rise to an "occurrence." In other words, according to Foxfire, this is not just a defective workmanship case.

However, we need to consider the language of the declaratory judgment agreement. According to the agreement, the critical question to be decided was whether the Continental policies afforded coverage for the "alleged defectively constructed roof claims made in [the Foxfire/Oaks lawsuit]," *not* all the claims that could possibly have been made against Oaks by any party. If there is coverage for the "alleged defectively constructed roof claims," then Continental owes $140,000. Otherwise, Continental owes nothing. The declaratory judgment

agreement in effect established an all-or-nothing bet, the outcome of which turns on the interpretation of the phrase, "alleged defectively constructed roof claims."

Foxfire notes that prior to settlement, it had filed a trial brief in the Oaks lawsuit. In that trial brief, Foxfire disclosed that it was also seeking a relatively small recovery from Oaks of about $15,000 for the interior water damage, in addition to repair/replacement of the roofs themselves. Thus, Foxfire contends that "alleged defectively constructed roof claims" must include interior water damage claims, which are covered under the CGL policies. However, Continental responds that no claim for resulting interior damage was set forth in Foxfire's petition, nor in Foxfire's answer to an interrogatory where it was asked to itemize its damages. Continental also points out that even if such interior damage "claims" had been properly asserted, they would not constitute "defectively constructed roof claims."

We believe that Foxfire's argument establishes, at most, that the phrase "alleged defectively constructed roof claims" is ambiguous, and that its ultimate interpretation was for the district court to decide, after hearing all the extrinsic evidence. That of course was what happened in this case.

After reviewing the record, we agree with the district court that the term "alleged defectively constructed roof claims" encompasses only the claims for repair and/or replacement of the roofs themselves. Extrinsic evidence, including both Henderson's January 15, 2009 letter and his testimony about a conversation with Foxfire's attorney, supports this interpretation. *See Kroblin v. RDR Motels, Inc*., 347 N.W.2d 430, 432-33 (Iowa 1984) (authorizing consideration of written and oral communications between the parties as an aid to contract

interpretation). In our view, Henderson's January 15 letter is particularly persuasive. There, he explained that he had revised the agreement "to reflect that *Foxfire Townhomes Owner's Association will be pursuing damages in the declaratory judgment action solely for the defectively installed roofs*, and will be anticipating a payment of $140,000 if it ultimately prevails in the declaratory judgment action." (Emphasis added.) Unlike after-the-fact testimony about unvoiced intentions, this letter is a concrete demonstration of what the parties believed when the agreement was made. And, it clearly supports Continental's position that the phrase "allegedly defectively constructed roof claims" refers only to claims for repair and/or replacement of the roofs themselves.

Foxfire maintains that Continental's interpretation of "alleged defectively constructed roof claims" is implausible because insurance companies do not typically agree, even contingently, to pay more than the amount of the loss. Foxfire points out that when the $140,000 is added to the $95,500 in subcontractor payments, this comes to $235,500, which is more than the $215,704.80 for the roof repair/replacement. Therefore, Foxfire argues, Continental must have contemplated that interior damage was part of the claim. Why would Continental expose itself to possible payment in excess of what Foxfire had actually lost? However, our review of the e-mails in the trial record indicates that this issue was considered and resolved internally within the Continental camp at the time. When Henderson's co-counsel "raised a concern as to whether the Plaintiffs have provable damages in excess of the potential settlement sums," Henderson pointed out that Foxfire's damages "could have been well in excess of $300,000," taking into account the costs of roof

repair/replacement, the costs of bringing the attic insulation up to code, and interest on those items. None of the Continental representatives referred to interior damage as part of the relevant damages. Foxfire's position actually suffers from a greater implausibility than Continental's: Why would Continental knowingly allow a mere $15,000 worth of interior damage to serve as the trigger for an obligation to pay $140,000?[3]

Foxfire also urges us to rely on a prior November 2008 draft of the declaratory judgment agreement. The November 2008 draft did not establish an all-or-nothing bet, but simply provided that the declaratory judgment action would proceed and if there was coverage for "some or all of the claims" for the "alleged defectively constructed roofs and insulation," Continental's liability would not exceed $140,000. Not surprisingly, this was not acceptable to Foxfire, since it was getting nothing in return for capping liability; it still had to prove up damages. Thus, in the final February 2009 version of the agreement, it was agreed that damages would be fixed at $140,000, but only if there was coverage for the "alleged defectively constructed roof claims."

We do not think the November 2008 draft supports Foxfire's position. It still begs the question of what are the "alleged defectively constructed roof

[3] As noted, in its reply brief, Foxfire now acknowledges that "defective workmanship standing alone, resulting in damages only to the property itself, is not an occurrence under a CGL policy." However, from reviewing the record, it appears Foxfire did not have that view prior to this appeal. Previously, it appears Foxfire was banking on the "subcontractor" exception to the "your work" exclusion as taking this case outside the *Pursell* rule. Thus, we believe both parties at the time viewed the declaratory judgment agreement as a gamble on the legal question whether the roof repair/replacement costs were covered or not. If a court found they were covered, Continental was prepared to pay $140,000. If they were not, Foxfire was prepared to absorb the loss itself. Foxfire believed it had valid arguments for the repair/replacement costs to be covered.

claims." On this point, we believe Henderson's January 15 letter provides the best guidance.

Nonetheless, we do not agree with the district court's findings that there was "no pleading or testimony by representatives of Foxfire as to the existence of claims for damage to property other than the roof replacement claim," and that "no contrary evidence" was presented by Foxfire on the intent of the agreement. These statements are not supported by the record, and their presence illustrates the potential hazards of adopting a party's proposed findings of fact wholesale. In fact, Foxfire's attorney Michael Jones testified by deposition that he learned during the course of the Foxfire/Oaks lawsuit that Foxfire had paid to repair some of the interior damage to the units. That was why he mentioned the point in his trial brief. He also testified that he provided the relevant documentation concerning the payments for interior damage to the other counsel and advised them informally that Foxfire would also be seeking recovery of those amounts. In addition, he testified that his understanding of the term "alleged defectively constructed roof claims" was that it included "the resulting damage to the interior of those units."

However, Jones's testimony does not alter our ultimate view of the merits of this case. Jones admits he saw Henderson's January 15 letter at the time, but he cannot satisfactorily explain it. According to Jones's deposition testimony, Henderson's reference to "damages . . . solely for the defectively installed roofs" actually *includes* interior damage. We cannot accept this illogical reading of Henderson's letter. In short, Henderson's January 15 letter is an important clue

to the meaning of the declaratory judgment agreement, and we believe it fully supports Continental's interpretation of that agreement.

In a final effort to salvage its position, Foxfire argues essentially that the *events* in question included interior damage, and that this means there was an occurrence regardless of the specific meaning one attaches to the phrase "alleged defectively constructed roof claims." But the problem here is that events do not trigger an obligation to pay; only claims do. As the policies state, "We [i.e., Continental] will pay those sums that the insured becomes legally obligated to pay as damages . . . ." Here the only damage claims within the scope of the declaratory judgment agreement were for the property that was defectively installed (i.e., the roofs). Thus, there was no occurrence and *Pursell* controls.

For the foregoing reasons, we affirm the judgment of the district court.

AFFIRMED.