IN THE COURT OF APPEALS OF IOWA

No. 1-766 / 11-0309
Filed April 11, 2012

HOMETOWN PLUMBING & HEATING CO.,
Plaintiff-Appellee,

vs.

SECURA INSURANCE COMPANY,
Defendant-Appellant.

Appeal from the Iowa District Court for Scott County, Mary E. Howes, Judge.

Secura Insurance Company appeals a district court's declaratory judgment ruling interpreting the provisions of an insurance policy to find coverage for losses that were incurred during the testing of an air cooling system. **AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.**

Michael S. Jones of Patterson Law Firm, L.L.P., Des Moines, for appellant.

Steven J. Havercamp of Stanley, Lande & Hunter, P.C., Davenport, for appellee.

Heard by Danilson, P.J., and Tabor and Mullins, JJ.

MULLINS, J.

In this appeal, we are asked to determine whether Secura Insurance Company is obligated to provide coverage under an all risks insurance policy issued to Hometown Plumbing & Heating Co. for losses incurred when water pipes broke during three separate tests of an air cooling system. Secura appeals from the district court's declaratory judgment ruling finding Secura liable for the policy's limit. Secura argues the district court erred in finding coverage under the policy because the losses were not due to an "external cause," and the losses were excluded due to the insufficiency of the materials used or a defective design. In the alternative, Secura argues that even if there is coverage, then it is limited to the direct physical loss to the three sections of pipe that broke during testing. For the reasons stated herein, we find Secura is liable for coverage, but only for the three sections of pipe damaged during testing. Accordingly, we affirm in part, reverse in part, and remand for further proceedings consistent with this opinion.

I. Background Facts and Proceedings.

Hometown is a full-service mechanical contractor with a principal place of business in Davenport. Hometown specializes in heating, ventilation, and air conditioning systems. During the relevant time period, Hometown had a "commercial inland marine" policy with Secura for $150,000 in coverage and a $500 deductible. The policy included an "installation risks" floater with the following applicable provisions:

> **PERILS COVERED**
> We cover direct physical loss to covered property unless the loss is caused by a peril that is excluded. The loss must be due to an external cause.
> **PERILS EXCLUDED**
> We do not pay for a loss if one or more of the following excluded perils apply to the loss, regardless of other causes or events that contribute to or aggravate the loss, whether such causes or events act to produce the loss before, at the same time as, or after the excluded peril. We do not pay for a loss that results from:
> 1. Loss or damage due to or resulting from fault or omission or error or insufficiency in design or workmanship or materials used, whether due to negligence or not . . . .

In April 2008, Hometown contracted with Allsteel, Inc. to install an air cooling system at Allsteel's office furniture manufacturing facility in Muscatine. Allsteel's facility houses its offices, warehouse, and production lines, and is roughly 650,000 square feet in size (approximately 900 feet by 700 feet).

The air cooling system was designed as two piping loops, consisting of a supply line and a return line, running parallel to one another near the ceiling throughout the interior perimeter of Allsteel's facility. The two pipe lines circulate water to and from special chilling units, which in turn, cools the inside of the facility by reducing humidity. The project specifications required the installation of 8000 feet of primarily 8-inch schedule 40 CPVC pipe, and for forty-two degree water to be circulated through the pipes at forty to fifty pounds per square inch (psi). Each section of the schedule 40 CPVC pipe was approximately twenty feet in length and approved to handle up to one hundred and sixty psi.

Installation for the project was started on February 21, 2008, and was done in stages to ensure that Allsteel's production was not disrupted. The project took approximately eight weeks to complete.

On April 23, 2008, the air cooling system was tested for the first time. During testing, the pipes were going to be filled with water with all pressure values open in order to remove any air in the pipes. However, when only about half of the supply line (or 2000 feet of pipe) was filled and before any pressure was introduced, a piece of pipe along the western wall of the facility cracked resulting in a leak. The crack was in the middle of a twenty foot section of pipe, horizontal in nature, and approximately three feet in length. As a result, the pipes were drained, the cracked pipe was cut out, and a new piece installed.

After the new piece was installed, a second test was performed on April 25, 2008. The pipes were again filled with water, but when ten to fifteen psi was introduced, another pipe cracked. This crack occurred in the return line along the western wall of the facility. The crack was in the middle of a fifteen foot section of pipe, and again was horizontal in nature. This crack resulted in a couple hundred gallons of water leaking onto Allsteel's production floor, which forced Allsteel to shut down one of its production lines and send its workers home. The pipes were again drained of their water, and the cracked piece was again cut out and replaced.

The next day a third test was performed. The pipes were filled with water, and hydrostatic testing was performed. At about fifty to sixty psi, a twenty foot section of pipe in the supply line along the western wall of the facility completely sheered in half dumping 4000 gallons of water into Allsteel's warehouse.

Following the third test failure, Allsteel and Hometown met to discuss their concerns with the project. During the meeting, Allsteel expressed concern for

their workers' safety and the substantial costs incurred in shutting down production. Allsteel estimated that losing production could cost them two million dollars per day. Both Allsteel and Hometown expressed a lack of confidence in the schedule 40 pipes. Accordingly, Hometown agreed to replace all of the schedule 40 pipes with 8-inch schedule 80 CPVC pipes. Schedule 80 pipes are heavier and thicker than schedule 40 pipes, and are approved to withstand three hundred and thirty psi. Hometown subsequently submitted a change order, which Allsteel approved.

Following tear out and reinstallation with schedule 80 pipes, the air cooling system passed testing. There was no difference in the way the schedule 40 and the schedule 80 pipes were installed, and the same crew and technique was used to install the pipes.

The three cracked or broken pipes were sent to the pipe manufacturer and an outside laboratory for testing. The pipe manufacturer determined the pipes were not defective. The outside laboratory further found each of the pipes complied with the American Society for Testing and Materials (ASTM) standards and met the specifications for schedule 40 pipes. No precise explanation has been provided for why the pipes failed, although Hometown has maintained that it installed the pipes correctly.

On April 28, 2008, Hometown filed a notice of loss with Secura. Hometown later determined that the cost to remove and replace the schedule 40 pipes was $291,436.06 and sought to recover the policy limit of $150,000.

Secura issued a denial letter on May 7, 2008. The denial was based on the policy requirement that the loss be due to an external cause, that the loss was excluded under the insufficient materials used, design defect, or mechanical breakdown or derangement provisions, and that the direct physical loss was only to the three sections of pipe that failed to perform "to its manufactured specifications."

On February 3, 2009, Hometown filed a petition for declaratory judgment pursuant to Iowa Rule of Civil Procedure 1.1102 seeking a determination regarding coverage under the insurance policy. The petition was argued to the district court on August 24, 2010.

On December 15, 2010, the district court entered its ruling. The district court initially determined that based on the exclusion of an internal cause and the lack of evidence of other possibilities, Hometown sufficiently showed that the breaking of the pipes during testing was due to an external cause. The district court then found that the pipes breaking during testing was not due to any fault of Hometown's installation, workmanship, or any defect in the pipes themselves, and Secura's argument for coverage exclusion as a design flaw was not supported by expert testimony or other evidence. The district court proceeded to damages and determined that the direct physical loss was not limited to three sections of pipes because the entire "system" failed, and that the damages to the system exceeded $150,000. Thus, the district court ordered Secura to pay the policy limit. Secura appealed.

II. Standard of Review.

We review declaratory judgment actions according to the manner the case was tried to the district court. *Passehl Estate v. Passehl*, 712 N.W.2d 408, 414 (Iowa 2006). The parties agree that this case was filed and tried in equity; thus, our review is de novo. Iowa R. App. P. 6.907; *Owens v. Brownlie*, 610 N.W.2d 860, 865 (Iowa 2000). In a de novo review, we have the responsibility to examine the facts as well as the law and decide the issues anew. *SDG Macerich Props., L.P. v. Stanek, Inc.*, 648 N.W.2d 581, 584 (Iowa 2002). In doing so, we give weight to the district court's factual findings, but are not bound by them. *Id*.

III. Analysis.

The case of *West Bend Mutual Insurance Co. v. Iowa Iron Works, Inc.,* 503 N.W.2d 596, 598-99 (Iowa 1993), provides the starting point of our analysis:

> Well-settled general principles control the construction and interpretation of insurance policies.
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> > Construction of an insurance policy—the process of determining its legal effect—is a question of law for the court. Interpretation—the process of determining the meaning of words used-is also a question of law for the court unless it depends on extrinsic evidence or a choice among reasonable inferences to be drawn.
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> *A.Y. McDonald Indus. v. INA*, 475 N.W.2d 607, 618 (Iowa 1991). When an insurance policy is ambiguous, requires interpretation, or is susceptible to two equally plausible constructions, we adopt the construction most favorable to the insured. *Benzer v. Iowa Mut. Tornado Ins. Ass'n*, 216 N.W.2d 385, 388 (Iowa 1974). This principle of construction is necessary because insurance policies are in the nature of adhesion contracts. *A.Y. McDonald,* 475 N.W.2d at 619. Thus, "[a]n insurer, having affirmatively expressed coverage through broad promises, assumes a duty to define any limitations or exclusionary clauses in clear and explicit terms." *Benzer*, 216 N.W.2d at 388. The burden of proving that coverage is excluded by an exclusion or exception in the policy rests upon

> the insurer. *Brammer v. Allied Mut. Ins. Co.*, 182 N.W.2d 169, 174 (Iowa 1970).
>
> An insurance policy "should be interpreted from a viewpoint of an ordinary person, [a layperson,] not a specialist or expert." *Houselog v. Milwaukee Guardian Ins. Co.*, 473 N.W.2d 52, 54 (Iowa 1991). Thus "[w]hen words are left undefined in a policy [they will not be given] a technical meaning. Rather [they will be given] their ordinary meaning, one which a reasonable person would understand them to mean." *A.Y. McDonald*, 475 N.W.2d at 619.

When an insured who has experienced loss seeks coverage under an insurance policy, the burden of proof initially is on the insured to prove that both the property and the peril were covered by the terms of the policy. *See*, *e.g.*, *Henschel v. Hawkeye-Security Ins. Co.*, 178 N.W. 2d 409, 418-20 (1970); 17A Lee R. Russ & Thomas F. Segalla, *Couch on Insurance* § 254:11, at 254-25 to 254-28 (3d ed. 2001) [*Couch on Insurance*]; 46 C.J.S. *Insurance* § 1525, at 422-23 (2007). It is then that the burden shifts to the insurer to prove any claimed exclusion or exception to the coverage. *W. Bend Mut. Ins.*, 503 N.W.2d at 598-99; *Long v. Glidden Mut. Ins. Ass'n*, 215 N.W.2d 271, 274 (Iowa 1974); *accord* 17A *Couch on Insurance* § 254:12, at 254-28 to 254-32; 46 C.J.S. *Insurance* § 1525, at 423. In the absence of a statutory requirement for a higher standard of proof, the burden is the same as any civil case, by a preponderance of the evidence. Iowa Code § 619.9 (2009); *Natalini v. Nw. Fire & Marine Ins. Co.*, 219 Iowa 806, 809, 259 N.W. 577, 578-79 (1935); 17A *Couch on Insurance* § 254:14, at 254-35 to 254-36; 46 C.J.S. *Insurance* § 1525, at 423.

The policy at issue in this case is known as an "all risks" policy, covering "direct physical loss to covered property unless the loss is caused by a peril that is excluded. The loss must be due to an external cause." *See generally* 46

C.J.S. *Insurance* § 1523, at 419-20; 5 *New Appleman on Insurance Law Library Edition* § 41.02[1][a], at 41-15 (2011).

The policy does not define "external cause." Iowa case law provides that an

> "[e]xternal cause . . . is concerned with the outward source or origin of an instigating agent. A cause which has an external source or origin is not rendered internal by the fact that its effect is internal, since it is the means and not the injury itself to which the phrase refers."

Connie's Const. Co., Inc. v. Continental W. Ins. Co., 227 N.W.2d 204, 206 (Iowa 1975) (quoting *Dubuque Fire & Marine Ins. Co. v. Caylor*, 249 F.2d 162, 164-65 (10th Cir. 1957)).

Having found no controlling Iowa authority on the proof necessary to establish coverage under an all risks policy, we have looked to other jurisdictions for guidance. The policy language in this case is very similar to that found in a Fifth Circuit case in which the court was concerned with a policy that protected against "all risks of physical loss or damage to property from any external cause." *Morrison Grain Co., Inc. v. Utica Mut. Ins. Co.,* 632 F.2d 424, 427 (5th Cir. 1980). That court explained the burden of proof as follows:

> As has been recognized in other circuits, "it would appear that all risks insurance arose for the very purpose of protecting the insured in those cases where difficulties of logical explanation or some mystery surround the (loss of or damage to) property." It would seem to be inconsistent with the broad protective purposes of "all risks" insurance to impose on the insured, as Insurer would have us do, the burden of proving the precise cause of the loss or damage. It is not surprising, therefore, that courts which have considered claims under insurance policies with essentially the same insuring language as the policy before us have consistently refused to require the insured to demonstrate that the loss or damage was

> occasioned by an external cause. We similarly refuse to impose such a burden in this case.

Id. at 430 (footnotes omitted).

In the present case, Hometown carried its burden to prove that there was "direct physical loss to covered property." Hometown did not prove the precise cause of the loss, but presented evidence to rule out installation, workmanship, or faulty pipes as potential causes of loss. In other words, Hometown sought to prove an external cause by exclusion, i.e. by showing the breaking of the pipes was not caused by their negligence, ordinary wear and tear, or a latent or inherent defect.

> While it is generally accepted that the loss must have been caused by an external event, it has been noted that courts that have considered claims under all-risk insurance policies have consistently refused to require the insured to demonstrate that the loss or damage was occasioned by an external event, apparently giving the insurer the duty to show that the loss or damage was not caused by an external event.

Jane Massey Draper, Annotation, *Coverage under All-Risk Insurance*, 30 A.L.R.5th 170 § 2[b], at 222 (1995) (footnote omitted); *see also Goodman v. Fireman's Fund Ins. Co.*, 600 F.2d 1040, 1042 (4th Cir. 1979) ("If the loss did not result from inherent defect, ordinary wear and tear, or intentional misconduct, its cause was necessarily external."); *Standard Structural Steel Co. v. Bethlehem Steel Corp.*, 597 F.Supp. 164, 193 (D. Conn. 1984) ("A cause is external if damage which arises from it does not result wholly 'from an inherent defect in the subject matter or from the inherent deficient qualities, nature and properties of the subject matter.'" (citation omitted); *Avis v. Hartford Fire Ins. Co.*, 195 S.E.2d 545, 548-49 (N.C. 1973) ("The loss or damage must not result wholly from an

inherent quality or defect in the subject matter. In other words, the damage must result from at least one extraneous cause."); 4 *Law & Prac. of Ins. Coverage Litig.* § 45:30 ("[C]ourts have found the loss in question to be the result of external causes or forces where it was shown that such loss was not due to ordinary wear and tear, latent defect or inherent vice within the insured property."). Based on the record, we find Hometown provided sufficient evidence showing the loss was due to an "external cause" by discrediting internal causes. *See*, *e.g.*, *Long*, 215 N.W.2d at 274 (holding insured did not have to prove the identity of the thief in order to show coverage for theft under an insurance policy, but could meet its burden through circumstantial evidence).

We further find Secura failed to meet its burden to show the use of insufficient materials or a design defect necessary for enforcement of the policy exclusions. The pipe manufacturer found the pipes were not defective, and an independent outside laboratory determined the pipes complied with industry standards. In addition, Secura's argument that coverage should be denied because of a design defect was only a theory and was not supported by expert testimony or any other evidence. *See* 11 *Couch on Insurance* § 155:46, at 155-67 (observing the question of whether an exclusion for loss caused by faulty materials or workmanship or error in design or latent defect "are the types of issues generally resolved through a battle of the experts"). Accordingly, we find the direct physical loss to physical property is covered by the insurance policy.

The question now becomes, what was the extent of the direct physical loss? Secura claims the direct physical loss was limited to the three sections of

pipe that actually cracked or broke. On the other hand, Hometown claims the direct physical loss was for the entire cooling system and that once the business decision was made that risk of failure of additional sections of pipes was too great, that replacement of all the pipes in the system should be covered by the policy.

The evidence is undisputed that after the first pipe failed, the section was removed and replaced. After the second pipe failed, the section was removed and replaced. After the third failure, a business decision was made that in order to mitigate future pipe failures the whole system should be replaced. Hometown argues that once the pipes were glued together they were no longer individual pipes but were part of a "system." But there is no dispute that after the first pipe failed, it was not a system failure, as the broken pipe was replaced. After the second pipe failed, it was not a system failure, as the broken pipe was replaced. After the third pipe failed, all the pipes were replaced with stronger, heavier pipe, in response to a business decision to mitigate future risk of failure.

Hometown placed itself in a "catch-22."[1] In order to show an external cause and to prevent Secura from meeting their burden on exclusions, Hometown had to argue that the materials used were sufficient and the design was not defective when the three pipes broke. However, a natural consequence of that argument, and a lack of any evidence or argument to the contrary, is a finding that the unbroken pipes in the cooling system were also sufficient and not

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[1] The term "catch-22" was coined by Joseph Heller in his novel Catch-22. It refers to a paradoxical situation in which an individual cannot avoid a problem because the seemingly alternative solutions are logically invalid. The American Heritage Dictionary 247 (2nd Coll. ed. 1985).

defective, thus preventing Hometown from showing "direct physical loss" or damage to them. 10A *Couch on Insurance* § 148:46, at 148-80 ("As with any insurance, property coverage is 'triggered' by some threshold concept of injury to the insured property."). Hometown in effect seeks insurance coverage for the risk of future physical loss instead of only seeking coverage for actual current physical loss. There is no coverage for risk of future loss, only actual physical loss. There is no evidence of a system failure, only evidence that individual pipes failed. Accordingly, the pipes fall within the policy loss limitation:

> 5. **Loss to Parts.** If there is a loss to a part of an item that consists of several parts, we will pay only for the loss to that part. A loss to a part is not considered to be a loss to the whole item.

Hometown has carried its burden of proof as to the direct physical loss of the sections of pipe that cracked or broke, but failed to prove there was a "system" failure or a "direct physical loss" to additional sections of pipe. Therefore, we affirm the district court's ruling finding coverage for the damage to the three broken sections of pipe, but reverse the district court's determination to the extent it awarded damages beyond those three sections. We remand for further proceedings consistent with this opinion.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.