

Wisconsin Appellate Court Interprets Construction Defect Exclusion and Fungi Exclusion

Jan 10 2025

Posted By: Blayne Nicole Christy

Practice Area: Insurance Coverage and Risk Management

Cincinnati Insurance Company v. James Ropicky, et al., No. 2023AP588, 2024 WL 5220615 (Wis. Ct. App. Dec. 26, 2024)

On December 26, 2024, the Court of Appeals of Wisconsin issued its decision in *Cincinnati Insurance Company v. James Ropicky, et al.*, No. 2023AP588, 2024 WL 5220615 (Wis. Ct. App. Dec. 26, 2024), addressing whether an ensuing cause of loss exception to a Construction Defect Exclusion, Fungi Exclusion, and Fungi Additional Coverage endorsement contained in a homeowner's insurance policy issued by Cincinnati to its insureds precluded coverage for damage sustained by the insureds' home following a May 2018 rainstorm. A final publication decision is currently pending for this case.

Background Information

James Ropicky and Rebecca Leichtfuss (collectively "the insureds") submitted a claim to their homeowner's insurer, Cincinnati Insurance Company ("Cincinnati"), for alleged water and fungal damage that their home sustained as a result of a rainstorm that occurred on May 11, 2018. Based on Cincinnati's investigation and the opinions rendered by its expert following his inspections of the insureds' home, Cincinnati provided limited coverage for the insureds' claim based on the contention that a majority of the damage was the result of "design or installation deficiencies" that had allowed storm water to enter the interior wall structure. Therefore, Cincinnati concluded the subject damage was either excluded under the policy's Construction Defect Exclusion and Fungi Exclusion, or subject to the policy's Fungi Additional Coverage endorsement. As a result, Cincinnati paid \$10,000 under the policy's fungi-related coverage (Fungi Additional Coverage endorsement) and \$2,138.53 for other damages falling within the ensuing cause of loss exception to the Construction Defect Exclusion. Cincinnati denied coverage for costs associated with remedying and repairing the purported construction defects.

Eventually, Cincinnati filed a lawsuit against its insureds seeking declaratory judgment as to its coverage position. In response, Cincinnati's insureds disputed Cincinnati's coverage position and filed counterclaims against Cincinnati for breach of contract, declaratory judgment, and bad faith related to Cincinnati's handling of their claim. The circuit court ultimately granted Cincinnati's summary judgment motion as to coverage, agreeing that the Construction Defect and Fungi Exclusions contained in the applicable homeowner's policy barred any additional coverage under the policy's terms beyond that which Cincinnati had already paid with respect to the alleged May 2018 rainstorm damage. Further, because the circuit court ruled in Cincinnati's favor and held that Cincinnati had not breached its contract with the insureds, the court dismissed, *sua sponte*, the insured's bad faith claim as a matter of law. The insureds appealed the circuit court's decision.

Decision and Analysis

On appeal, the Court of Appeals of Wisconsin concluded the ensuing cause of loss exception to the policy's Construction Defect Exclusion reinstates coverage, and the policy's Fungi Additional Coverage endorsement renders the Fungi Exclusion inapplicable. Thus, the appellate court reversed the circuit court's decision, finding the circuit court erred in granting summary judgment in Cincinnati's favor, and remanded the case for further proceedings.

First, the appellate court held that even assuming the Construction Defect Exclusion applies, the damage to the insureds' home nevertheless constitutes an ensuing cause of loss under the policy's ensuing cause of loss exception and the authority of *Arnold v. Cincinnati Insurance Co.*, 2004 WI App 195, 276 Wis. 2d 762, 688 N.W.2d 707. Relying on *Arnold* as binding authority, the appellate court explained that an "ensuing loss" "is a loss that follows the excluded loss 'as a chance, likely, or necessary consequence' of that excluded loss[.]" and "in addition to being a loss that follows as a chance, likely, or necessary consequence of the excluded loss, an ensuing loss must result from a cause *in addition to* the excluded cause." *Id.* at ¶¶27, 29 (emphasis added). The appellate court then proceeded to apply the following three-step framework adopted in *Arnold* to determine whether the ensuing cause of loss exception applies: (1) first identify the loss caused by the faulty workmanship that is excluded; (2) identify each ensuing loss, if any – that is, each loss that follows as a chance, likely, or necessary consequence from that excluded loss; and (3) for each ensuing loss determine whether it is an excepted or excluded loss under the policy. *See id.* at ¶34. Based on the appellate court's application of this three-step framework, it concluded the rainwater at issue, *i.e.*, the May 2018 rainstorm, was an ensuing cause of loss within the meaning of the applicable policy's ensuing cause of loss exception to a Construction Defect Exclusion.

Second, the appellate court held that the policy's Fungi Exclusion and its anti-concurrent cause of loss clause did not exclude coverage for the damage to the insureds' home. Most significantly, in reaching this conclusion, the appellate court determined that the phrase "[t]his exclusion does not apply" in the Fungi Exclusion does not introduce an exception to the exclusion, but rather introduces two scenarios in which the Fungi Exclusion is *never triggered* in the first instance because its conditions for application are never satisfied. According to the appellate court, one of the circumstances enumerated in the Fungi Exclusion, wherein it states the exclusion "does not apply" "[t]o the extent coverage is provided for in Section I, A.5. Section I – Additional Coverage m. Fungi, Wet or Dry Rot, or Bacteria with respect to 'physical loss' caused by a Covered Cause of Loss other than fire or lightning," rendered the exclusion inoperative with respect to the subject loss. Notably, the concurring opinion explains how the majority's interpretation of the Fungi Exclusion's "this exclusion does not apply" language appears to depart from prior case law, wherein Wisconsin courts have repeatedly concluded that this language creates an exception to an exclusion that reinstates coverage. *See Neubauer, J. (concurring).*

Third, the appellate court held the policy's \$10,000 limit of Fungi Additional Coverage applies to the portion of subject home's damages that was at least partially caused by "fungi, wet or dry, or bacteria." However, the \$10,000 limit does not decrease or limit the coverage that was otherwise available for the home's damages caused solely by rainwater.

Based on its interpretation of the policy provisions set forth above, the appellate court additionally held: (1) genuine questions of material fact exist at least as to whether “fungi, wet or dry rot, or bacteria” caused any of the damage to the insureds’ home, and if so, what portion of the damage is attributable to “fungi, wet or dry rot, or bacteria”; (2) only after properly apportioning any damage caused by “fungi, wet or dry rot, or bacteria” can Cincinnati determine the extent of coverage it is obligated to provide under the terms of the homeowner’s insurance policy; and (3) because issues of material fact remain as to the cost to repair the construction defects (not the ensuing loss), this issue remains to be addressed on remand. The appellate court also reinstated the insureds’ bad faith claim asserted against Cincinnati in the underlying action, which had been dismissed by the circuit court when granting summary judgment in Cincinnati’s favor.

von Briesen & Roper Legal Update is a periodic publication of von Briesen & Roper, s.c. It is intended for general information purposes for the community and highlights recent changes and developments in the legal area. This publication does not constitute legal advice, and the reader should consult legal counsel to determine how this information applies to any specific situation.