

Property Insurance Issues: COVID-19 and the Vacancy Exclusion

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The COVID-19 pandemic has changed the practice of law. Attorneys in well-established practice areas are encountering completely novel issues, even as familiar problems develop new, pandemic-related elements. Property insurance is no exception. One such issue to watch for is the “vacancy exclusion” found in standard property insurance policies. Under the standard formulation, the vacancy exclusion applies when an insured property is “vacant” for a certain period of time. If the exclusion applies, an insurance company can deny coverage for property damage claims.

Expect to see this exclusion included more in policies as the hardships caused by the pandemic spread through the economy. Economists have predicted vacancy rates will increase for both commercial and residential properties. As courts have noted, vacant properties are magnets for the sort of property damage ordinarily covered by insurance. This article examines how courts have interpreted the vacancy exclusion.

Background

Early in the pandemic, lawyers were busy dealing with matters directly attendant to the virus. Articles examined whether the pandemic was an “act of God” that excuses nonperformance of a contract under the obscure, boilerplate, force majeure clause. Travis S. Hunter & Renée Mosley Delcollo, *Is the Force Majeure with You?*, ABA Commercial & Bus. Litig. Comm., July 6, 2020. Clients wanted to know if the pandemic changed the terms of a lease. Michele Lerner, *Breaking Your Lease During the COVID-19 Pandemic*, [Boston.com](https://www.boston.com) (May 6, 2020), <https://bit.ly/2MKEt08>.

Although the vacancy exclusion likely never topped any pre-pandemic issues checklists, the devastating economic impacts of the pandemic should prompt practitioners to take notice. Such effects have been severe and may get worse before they get better. Economists have been predicting a significant spike in real estate foreclosures and evictions because of the coronavirus pandemic since before states began issuing lockdown orders in March 2020. Widespread civil unrest over the summer months made the situation more precarious for some businesses. The effects have been somewhat muted by government action, but property markets are feeling the downturn. Konrad Putzier, *Commercial-Property Foreclosures Are Poised to Rise as Covid-19 Lingers*, Wall St. J., Oct. 6, 2020.

This is primarily a consequence of the economic contraction associated with the pandemic. Over 20 million Americans lost their jobs this past year, numbers not seen since the Great Depression. Paul Davidson, *Unemployment Soars to 14.7%, Job Losses Reach 20.5 Million in April as Coronavirus Pandemic Spreads*, USA Today, May 11, 2020. Millions of those now-jobless people are facing long-term and potentially permanent unemployment. Jeanna Smialek, Ben Casselman & Gillian Friedman, *Workers Face Permanent Job Losses as the Virus Persists*, N.Y. Times, Oct. 3, 2020.

Census data indicate that third quarter 2020 vacancy rates for housing units are slightly lower than for the same period in 2019 (albeit with far less data due to reduced collection efforts). While this may

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come as a surprise, it is likely the result of now-lapsing eviction moratoria and cash assistance programs. Although additional stimulus and other government action may be on the horizon, the staggering jobless numbers have already led to missed mortgage and lease payments, foreclosures, and evictions. Increased vacancies will follow. And where there is vacant insured property, there is a vacancy exclusion issue.

The Vacancy Exclusion

Standard commercial and residential property insurance policies contain a provision that severely restricts coverage for certain kinds of property damage to buildings that have been vacant for an extended period of time, often 60 days. This exclusion is commonly called the vacancy exclusion (or vacancy provision, or vacancy clause). The purpose of the vacancy exclusion is to limit insurance liability for vacant properties, which face higher risk of loss for vandalism, theft, and neglect. *TRB Investments, Inc. v. Fireman's Fund Ins. Co.*, 145 P.3d 472, 473 (Cal. 2006).

A 1962 California case stands out as an early example of the exclusion and its severe effects. It is also a fine example of the idiosyncratic judicial reasoning that governs the application of the exclusion.

In *Belgrade v. National American Insurance Co.*, the Belgrade brothers had “acquired . . . property, which was residential in nature, as the result of a foreclosure of an encumbrance thereon.” 22 Cal. Rptr. 21 (Ct. App. 1962). Less than two months after the brothers took possession on June 29, 1958, vandals entered the house and caused damage worth \$9,000 (in 1958 dollars) to the residence and its “expensive” carpets and drapes. The Belgrades sued for insurance coverage but lost at the trial and appellate court levels. According to the *Belgrade* court, the vacancy exclusion applied because there were not enough furnishings in the house. *Id.* at 23. This was odd because according to extensive testimony from Jules Belgrade, the house seemed to have been rather well-appointed.

The court quoted at length from Belgrade’s testimony describing the furnishings and belongings in the house. Although there was no stove (perhaps the fatal missing element), the ten-room house was equipped with a private soda fountain. There was a freezer unit for their milk. There was furniture, too: a chaise longue (aluminum, according to the opinion), two beds (the opinion takes care to mention they were on the floor), a breakfast table, multiple stools and chairs, and a radio. The Belgrades had blankets and clothing on hand, as well as all the toiletries necessary for daily washing. There were garden implements, a vacuum cleaner, silverware, plates, cups, and even a decorative statue. *Id.* at 22.

The brothers looked after their acquisition diligently. They hoped to sell the property for \$79,500 in 1958 dollars, equivalent to over \$700,000 today after adjusting for inflation. They went to the property every day to make it available for showings at a moment’s notice. They arrived as early as 8 a.m. and left as late as midnight. The home was not their primary residence, but one of them slept in the house on four occasions during the two months prior to the vandalism, including three nights during the month the vandalism occurred. The Belgrade brothers ate all of their meals there. *Id.*

To evaluate the vacancy exclusion, courts primarily consider the property that was in the building and how the building was used at the time the damage occurred. The *Belgrade* court applied these lists of property that was in the house and activities that occurred there to these two factors. In *Belgrade*, there was property in the house, and the Belgrades were at the house frequently. Yet, the court allowed the vacancy exclusion to apply and the insurance carrier to deny coverage for the vandalism because the property was vacant.

To be clear, the Belgrades’ policy covered losses caused by vandalism unless “the described property has been vacant beyond a period of thirty (30) consecutive days immediately preceding the loss.” *Id.* at 21.

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The policy also defined “vacant” to mean a building that does not contain “the furnishings ordinarily contained therein to enable the use of said building for the purpose for which it is adapted.” But the policy also drew a distinction between “vacant” and “unoccupied.” A building is “unoccupied (but not vacant) if such building contains the furnishings ordinarily contained therein to enable the use of said building for the purpose for which it is adapted, but no lawful occupant is residing therein.” This concept is reiterated in a footnote:

The term “vacant” is associated with removal of inanimate objects from a dwelling; the term “unoccupied” is associated with the abandonment of that dwelling as a customary abode by its former occupants.

Id. at 22 (internal citations omitted).

The distinction between vacant and unoccupied is another way courts evaluate whether a building is sufficiently “vacant” to be subject to the vacancy exclusion. The strange thing about the *Belgrade* decision is that the court acknowledged this distinction but did not examine the facts in light of it. The coverage issue seems to turn on whether the house is vacant or merely unoccupied, but the court barely discusses this. According to the trial court, as affirmed by the appellate court, the Belgrades’ house simply “did not contain furnishings ordinarily contained in such a building to enable the use of said building for the purpose for which it was adapted, which was for use as a place of residence by human beings.” *Id.* (internal quotations omitted). The court offers no hints about why the house was vacant and not merely unoccupied, especially with daily use by the owners and the presence of furniture and some modern conveniences like a freezer. The court instead observed “how sparsely the house was furnished” in support of its conclusion that “it is obvious that the record amply supports [the] determination of the trial court.” *Id.*

Let the Belgrade brothers’ misfortune, and the *Belgrade* court’s odd reasoning, be a lesson to proceed with *extreme caution* when dealing with property that could be found “vacant” or even “unoccupied.” As is the case with all property insurance issues, interpretations of the vacancy exclusion vary heavily by jurisdiction. While modern courts tend to interpret coverage exclusions—including the vacancy exclusion—narrowly, the *Belgrade* case illustrates the severity of its effect. And even though modern courts have generally favored a narrower interpretation of the vacancy exclusion, the provision is still included in most property insurance policies.

Some courts are happy to apply the exclusion in cases of apparent fraud or arson, such as in *Botee v. Southern Fidelity Insurance Co.*, 162 So. 3d 183 (Fla. Dist. Ct. App. 2015). In *Botee*, an intentionally set fire destroyed Raziya Botee’s home after it had been vacant for more than 30 days. *Id.* at 185. Her policy excluded coverage for “vandalism or malicious mischief” to a property vacant for more than 30 days. Unlike *Belgrade*, there was no dispute whether the property was actually vacant. Rather, the issue in *Botee* was whether an act of arson (the intentionally set fire) was “vandalism or malicious mischief.” More precisely, the dispute was over whether there was insurance coverage for damage caused by an intentionally set fire at a vacant property. The *Botee* court notes there is a split of opinion over whether arson is “vandalism or malicious mischief” for the purposes of applying a vacancy clause. Citing the dictionary, the *Botee* court determined that vandalism and malicious mischief unambiguously included “arson” and was therefore excluded. *Id.* at 186–88. Straightforward enough, but other jurisdictions have reached the opposite conclusion.

Southern Trust Insurance Co. v. Phillips is a Tennessee case involving a similar vacancy clause but with the opposite outcome. 474 S.W.3d 660 (Tenn. Ct. App. 2015). In *Southern Trust*, the insurer sought a declaratory judgment that it owed no coverage to Phillips for an act of arson to a vacant dwelling. The

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insurer did not suspect Phillips was involved in the arson, but, as in *Botee*, the parties agreed the dwelling was vacant for the purposes of the vacancy clause. The dispute, also like *Botee*, centered on whether the act of arson was “vandalism or malicious mischief” and therefore an excluded cause of loss for vacant properties. The *Phillips* court concluded that the arson was not vandalism or malicious mischief, and therefore not excluded under the vacancy clause. The court notes that “the policy clearly makes a distinction between ‘fire’ and ‘vandalism or malicious mischief,’ listing these as separate perils. The average policy holder or layman would conclude that arson falls within the class of ‘fire.’” *Id.* at 667. In other words, arson at a vacant building was covered because a policyholder would consider it a fire loss, not “vandalism or malicious mischief.”

The steps insurers take when underwriting the risk on the policy can also affect how courts interpret vacancy provisions. In *West Bend Mutual Insurance Co. v. New Packing Co., Inc.*, the insured meat packing company purchased a new warehouse and vacated its former location. 2012 IL App (1st) 111507-U, ¶ 4 (Nov. 30, 2012) (unpublished opinion used for illustrative purposes, not to be cited as precedent). The insured wisely obtained an endorsement to provide coverage for the new warehouse. More than 60 days after the original warehouse was vacated, but only a few days after the endorsement for the new location was added, the old warehouse sustained over \$1,000,000 in vandalism damage. *Id.* ¶ 5.

The insurer denied the claim under the vacancy exclusion, which precluded coverage for acts of vandalism that occur after 60 days of vacancy. The insured sued for coverage, claiming that the 60-day period did not begin until the endorsement for the new location was added and also that the vacancy provision was ambiguous and therefore unenforceable. *Id.* ¶ 6.

At trial, the insured was awarded summary judgment in favor of coverage, and the decision was affirmed by the Illinois Appellate Court. “Prior to issuing an endorsement to the policy adding the warehouse as an insured property, West Bend had an opportunity to inspect the premises to determine if it was vacant. Thereafter, West Bend could have chosen not to underwrite the risk, or it could have chosen to provide coverage at an additional premium.” *Id.* ¶ 18.

In other words, the insurer could not deny coverage under the vacancy exclusion because it had an *opportunity* to determine whether the property was vacant by conducting an inspection. Because the insurer issued the policy and accepted the premium without finding out whether the property was vacant, it effectively waived its right to deny coverage for the vacancy. By the court’s reasoning, if the insurer truly did not want to cover losses to vacant properties, it should have made some attempt to find out whether it was insuring one.

As is often the case, careful policy drafting and tighter policy language can make the exclusion much harder to get around, even in policyholder-friendly courts, and even in the context of a foreclosure. In *Community Bank v. United States Liability Insurance Co.*, the vacancy exclusion applied to property that was “vacant or unoccupied.” No. 13-P-1748, 2014 WL 2720339, at *1 (Mass. App. Ct. June 17, 2014). Following a foreclosure, the plaintiff bank initiated eviction proceedings to evict the former owner and named insured from the premises. Shortly after the eviction proceedings began, the named insured reported to police a break-in at the insured premises. *Id.*

Furniture, stereo equipment, and part of the heating system were stolen, and there was apparently also vandalism damage. The insurer denied coverage for theft damage citing the vacancy exclusion and arguing that the insured premises were unoccupied at the time of the loss. The bank sued for coverage under the mortgage clause, arguing that the term “unoccupied” was ambiguous. The claims investigation and discovery revealed the insured had stopped living at the insured premises and had no intention of

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returning, but was merely storing some of her belongings there. *Id.*

The Massachusetts Court of Appeals upheld the denial of coverage. It found the term “unoccupied” was not ambiguous under Massachusetts law. It further found the insured premises were unoccupied because it was no longer used as “a customary place of abode” since the insured had moved out. The presence of the insured’s personal property was not sufficient to establish “occupancy” for the purpose of the vacancy exclusion analysis. *Id.* at *2.

These cases demonstrate the considerable variation in judicial decisions regarding the vacancy exclusion. *Belgrade* illustrates the salient factors used to analyze vacancy issues (the property in the building, and how the building is used) and highlights a common policy distinction between vacant and unoccupied buildings. *Botee* and *Southern Trust* demonstrate a split of opinion as to whether arson is excluded for vacant properties. *New Packing* shows that the vacancy exclusion can sometimes be overcome if an insurer fails to inspect a property to determine whether it fits its risk profile for the premiums charged. Coming full circle, *Community Bank* emphasizes the factors used to analyze vacancy issues but collapses the distinction between vacant and unoccupied buildings seen (but ignored) in *Belgrade*.

Conclusion

As stated above, where there is vacant insured property, there is a potential vacancy exclusion issue. It is an unfortunate likelihood that the economic consequences of the pandemic will give rise to vacancies and the associated vacancy exclusion issues. In addition to the potentially significant economic exposures, professionals must evaluate the human cost of this crisis. Professionals, whether they are lawyers, insurance claims adjusters, or business owners, should treat people with respect and dignity. This is as true for those who are experiencing economic hardships like eviction and foreclosure as it is for those who are not. As the economic fallout from the COVID-19 pandemic spreads, attorneys will do well to remember their responsibility to treat people fairly, whatever their circumstances. Much like the vacancy exclusion itself, things are not always as they appear.