

Function Over Form: Eighth Circuit Narrows Application of Cosmetic Damage Exclusion

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Introduction

In a significant decision for policyholders, the United States Court of Appeals for the Eighth Circuit adopted a narrow interpretation of an exclusion for cosmetic roof damage caused by wind or hail.[1] The court held that for a cosmetic damage exclusion to apply, an insurer must prove that the roof's ability to function as a barrier to the elements is not impaired as compared to its functionality prior to the loss or damage.

Background

In April 2022, a hailstorm struck the insured school buildings causing indentations in the buildings' metal roofs. The hail did not puncture the roofs' metal, and no leaks were reported. The insurer denied the claim based on the policy's cosmetic damage exclusion, which precluded coverage for "cosmetic damage to roof surfacing caused by wind and/or hail." Cosmetic damage was defined as "superficial damage that altered the appearance of the roof surfacing, but such damage does not prevent the roof from continuing to function as a barrier to entrance of the elements to the same extent as it did before."

The insured filed suit, and both parties moved for summary judgment. Applying Minnesota law, the district court ruled in favor of the insurer, holding that the exclusion applied because the roofs could still act as a barrier to the elements, even if the roofs' lifespans had been shortened or the roofs had been weakened. The insured appealed.

Whether Damage is Cosmetic is Determined by Functionality

On appeal, the court considered whether the hail damage: (1) shortened the lifespan of the roof, and (2) impaired the roof's functionality.

The court rejected the shortened lifespan argument. Focusing on the exclusion's present-tense language, the court concluded that the exclusion considers whether damage to a roof prevents it from keeping out the elements, not whether a roof will degrade quicker in the future.

However, with respect to functionality, the court held that a roof being unable to withstand the same weight of snow and same windspeed as before the damage, constitutes impaired functionality because the roof can no longer function as a barrier to the elements to the same extent as before. The court rejected the district court's interpretation that coverage is precluded unless a roof leaks or otherwise admits the elements. The court held that the determinative inquiry is whether the hail damage results in "diminished barriers."

Notably, the court held that damage to non-structural or decorative features, or insubstantial, unmeasurable, or inconsequential damage, remains excluded as cosmetic damage. While the key inquiry is functionality, the inquiry does not extend to non-integral parts of the roof.

Policyholders May Overcome Cosmetic Damage Exclusions Even if the Damage Appears Superficial

Critically, the Eighth Circuit's decision may expand coverage for roof damage, and potentially beyond. Insureds need only show that there is a loss, hence, coverage is available. However, as the burden of proof to exclude coverage is on them, insurers may face an uphill battle to deny coverage based on a cosmetic exclusion. Insurers may not be able to simply rely on the absence of non-superficial damage like water leaks or holes in the roof. Regardless of whether the damage appears superficial, an insurer will now have to establish that the functionality of the roof is not impaired.

Additionally, while this decision interprets a cosmetic damage exclusion only with regards to hail or wind damage to a roof, the rationale could potentially apply to various structures of a building. Insureds may now argue that a cosmetic damage exclusion cannot preclude coverage until the insurer establishes that the functionality of the damaged structure is not impaired.

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