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### Summary of Federal Insurance Co. v. Coast Converters, Inc., 130 Nev. Adv. Op. 95

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## CONTRACTS – INSURANCE POLICY INTERPRETATION AND POLICY LIMIT APPLICATION

### Summary

In a dispute between an insured manufacturer and its insurer, the Supreme Court determined that contract interpretation is a question of law, which should be decided by the district court. Further, to determine which policy limit applies, the court must determine on what date the loss became manifest. The manifestation date is generally a question of fact to be decided by the jury, which the district court will apply and determine, as a matter of law, which policy limit applies.

### Background

Respondent Coast Converters, Inc. (hereinafter “Coast”) manufactured plastic bags in California. Coast moved its operation to Las Vegas in 2003. In June 2003, Coast obtained a commercial package all-risk insurance policy from appellant Federal Insurance Company (hereinafter “Federal Insurance”). The policy covered up to \$2 million in property damage (hereinafter “PD”), and up to \$1.75 million for business interruption/extra expenses (hereinafter “BI/EE”). On August 27, 2003, Coast requested and received an increase in the PD coverage from \$2 million to \$5 million.

Prior to moving the operation to Las Vegas, electrical modifications were made to the Las Vegas facility. The modifications were inadequate and caused voltage fluctuations. These fluctuations damaged machinery used in the manufacturing process and caused an increase in the amount of defective bags, or “scrap”.

Coast filed a claim with Federal Insurance to recover the costs related to the damaged machinery and the increased production of “scrap”. Coast asserted that it was unable to separate the defective bags from the quality ones, rendering the entire package of bags a total loss.

Federal Insurance made several payments to Coast, though did not communicate under which provision, PD or BI/EE, the payments were made. Federal Insurance later allocated a small portion of the payments related to the damaged machinery to the PD coverage. The majority of the payments were made under the BI/EE coverage. Federal Insurance ultimately made payments covering the increased scrap and other losses up to the entire \$1.75 million BI/EE policy limit.

Coast argued the scrap losses should have been covered under the PD provision, Federal Insurance disagreed and refused to make any additional payments. Coast alleged it ultimately went out of business as a result of Federal Insurance’s refusal to pay. Coast filed a complaint against Federal Insurance.

Federal Insurance asked the district court to determine (1) whether Coast’s loss fell under the policy’s PD provision or the BI/EE provision; and (2) if PD coverage was appropriate, whether the coverage limit was \$2 million or \$5 million. The district court declined to answer these questions and left them for the jury to decide. The jury found

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<sup>1</sup> By Christian Spaulding.

Federal Insurance liable in the amount of \$4,005,866 for breaching the insurance contract and in the amount of \$5,048,717 for violating the Nevada Unfair Claims Practices Act (UCPA).<sup>2</sup> The district court did not offset the judgment by the amount already paid on the increased scrap insurance claim, and awarded Coast attorney fees and prejudgment interest.

Federal Insurance appealed, arguing that (1) the district court erred in refusing to rule, as a matter of law, on the policy coverage and policy limit issues, as well as on the UCPA claims; (2) substantial evidence did not support the jury's findings on the breach of contract and UCPA claims; (3) the jury erred in finding it liable under the UCPA; (4) the district court erred in refusing to offset the judgment by the amount already paid on the claim; and (5) the district court erred in granting attorney fees as special damages.

## **Discussion**

### *Interpretation of the insurance policy*

In contract matters, the jury may be charged with deciding any factual disputes.<sup>3</sup> But “in the absence of ambiguity or other factual complexities, contract interpretation presents a question of law” for the district court to decide, “with de novo review to follow in this court.”<sup>4</sup>

The Supreme Court found that deciding whether the PD or BI/EE provision applies, is a question of contract interpretation, and thus, a question of law. As a question of law, the district court erred in sending this question to the jury.

A determination of which provision covers Coast's loss hinges on a question of fact for the jury to decide. The jury must determine on what date Coast became aware that continued use of its machines would result in the production of an increased amount of scrap? Once the jury determines when awareness occurred, the district court must then apply that fact and conclude, as a matter of law, that increased “scrap” produced after that date is covered under the BI/EE provision.

The Supreme Court concluded that increased “scrap” produced *before* awareness is covered by the PD provision, and increased “scrap” produced *after* awareness is covered by the BI/EE provision. The BI/EE provision applies to the “scrap” produced *after* awareness because it fits the policy definition of an extra expense, and the scrap cannot be categorized as property under the implied requirement of fortuity.

Insurable loss of or damage to property must be occasioned by a fortuitous, noninevitable, and nonintentional event.<sup>5</sup> A loss occasioned by the insured's own decision to act in a way that will predictably result in a loss is not fortuitous; and thus, such a loss is generally not covered.<sup>6</sup> Therefore, if Coast was aware that continued use of their machines would produce a higher amount of scrap, such a loss would not be covered by the PD provision.

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<sup>2</sup> NEV. REV. STAT. § 686A.310 (1991)

<sup>3</sup> State, Univ. & Cmty. Coll. Sys. v. Sutton, 120 Nev. 972, 983; 103 P.3d 8, 15 (2004).

<sup>4</sup> Galardi v. Naples Polaris, L.L.C., 129 Nev. \_\_, \_\_; 301 P.3d 364, 366 (2013) (quoting Ellison v. Cal. State Auto Ass'n, 106 Nev. 601, 603; 797 P.2d 975, 977 (1990).

<sup>5</sup> See City of Burlington v. Indem. Ins. Co. of N. Am., 332 F.3d 38, 47-48 (2d Cir. 2003); Univ. of Cincinnati v. Arkwright Mut. Ins. Co., 51 F.3d 1277, 1281 (6th Cir. 1995).

<sup>6</sup> See, e.g., Univ. of Cincinnati, 51 F.3d at 1281.

*Determining which PD policy limit applies was a question of law for the district court to decide*

Coast received an increase in the PD policy limit on August 27, 2003. The court must determine whether the applicable policy limit is the original \$2 million, or the amended \$5 million. Determining which PD policy limit applies is a question of law.

In Nevada, to determine whether an insurance policy applies to ongoing property damage the “manifestation rule” must be used.<sup>7</sup> Under the “manifestation rule,” an insurer is only liable under the policy if it was in effect when the loss became manifest.<sup>8</sup> A loss becomes manifest when appreciable damage occurs and is or should be known to the insured, such that a reasonable insured would be aware that his notification duty under the policy has been triggered.<sup>9</sup> Generally, the manifestation date is a fact to be determined by the jury, but a court may decide the date where the undisputed evidence establishes that no damage had been discovered before a given date.<sup>10</sup> To determine the applicable policy limit, the jury must decide when manifestation occurred, and the district court must then apply that fact and determine which policy limit applies.

*Coast's UCPA claim is dependent on a proper interpretation of the contract*

Coast’s UCPA claim depends on the district court’s determination of how the excess scrap should be categorized under the policy pending the jury’s finding of when Coast became aware that continued production would lead to an increase in “scrap”. As such, the jury’s verdict regard Federal Insurance’s liability under the UCPA is vacated, and the issue is remanded for a new trial.

## **Conclusion**

Contract interpretation and determination of which policy limit applies are questions of law for the district court to decide. The district court erred in submitting these questions to the jury. The Supreme Court determined that under a proper interpretation of the policy, losses incurred *after* Coast became aware that increased scrap would be produced, are covered under the BI/EE provision. The losses incurred *before* Coast became aware are covered under the PD provision and should be valued as “finished stock.”

To determine the applicable PD policy limit, the jury must use the manifest rule to determine what date the loss became manifest. The district court must then apply that fact and determine which policy limit applies. The court found that because the jury’s verdict on Coast’s UCPA claim was influenced by an improper interpretation of the contract, the verdict must be vacated. Therefore, the court vacated in part, and reversed and remanded for further proceedings.

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<sup>7</sup> See *Jack v. State Farm Fire & Cas. Co.*, 108 Nev. 504, 509; 835 P.2d 786, 789 (1992).

<sup>8</sup> *Id.* at 506.

<sup>9</sup> *Id.* at 509.

<sup>10</sup> *Id.*