ROUTE TO:

THE RHA REVIEW

Vol. 13, No. 4, Third Quarter 2007

A publication of Robert Hughes Associates, Inc., an international litigation support, actuarial, risk management and insurance consulting company.

RETHINKING THE FLOOD EXCLUSION: FURTHER COMMENTS ON KATRINA-RELATED COVERAGE DISPUTES

by Tim Ryles, Ph.D.

The flood waters of controversy in the wake of Hurricane Katrina refuse to recede. Upset with its treatment at the hands of Mississippi's legal system, State Farm says it will cease writing new policies in the Mississippi market; what normally would be a civil dispute has spilled over to criminal investigations of insurance company conduct; the insurance industry's anti-trust exemption is under attack in Congress; Mississippi's insurance commissioner, George Dale, is reminded that there are two ways an insurance commissioner can get into hot water: (1) by doing the job and (2) by not doing the job. Insurers, on the other hand, are wrestling with a couple of elementary Political Science 101 lessons: (1) the surest way to stimulate legislative action is to antagonize a legislator (or two), and (2) the insurer that fails to incorporate political risk into its rate filings greatly underestimates the risk assumed.

Meanwhile, the federal judiciary is struggling to fashion a centrist solution to a dispute among extremists. The court's task is magnified by heated rhetoric inside and outside judicial chambers. For example, the trade press has been as harsh defending insurers as consumer advocates and trial lawyers have been in attacking insurers and as insurers have been in attacking plaintiffs' lawyers. Generally, all parties recognize a central issue in the heated exchanges as "the" flood exclusion and an accompanying "concurrent causation" provision in homeowners' policies. Insurers seem somewhat surprised that these provisions are encountering so much misunderstanding. Industry critics, on the other hand, find the industry's position untenable. Even long-time Commissioner Dale, who is not known for stirring the political pot by attacking insurance companies, asserts that insurer application of a concurrent causation provision is inconsistent with how insurers presented it to his agency during form approval.

To date I have been involved in several Katrina cases, most of which involve State Farm, Allstate and Nationwide. During the work, I have reached certain conclusions about Katrina controversies, so in this article I will demonstrate that, as applied to Katrina cases, (1) there is no such thing as THE flood exclusion; (2) insurers have an overly simplified and incorrect view of concurrent causation; (3) by definition, concurrent causation concepts are inapplicable to the Mississippi claims; and (4) insurers follow a limited view of "wind" but an expansive interpretation of "water" that may undermine their duty to conduct thorough claims investigations.

INSURERS AND CAUSATION

Insurers have a love-hate relationship with causation. In underwriting and rating of policies, causation need not be proven; instead, mere correlation is sufficient. Thus, if an insurer finds a correlation between one's credit score and auto claims, credit scores are used to underwrite policies. The same is true for age, gender, type of vehicle, territory and other variables. Correlation simply means that two or more variables appear together. Correlation requires no causal linkages.

Insurers take a different view of causation at the claims stage, aided by certain policy provisions such as Proof of Loss statements, authority to conduct Examinations Under Oath and other "policy conditions." Here the relationship is transformed into one in which the insured must prove that a covered peril caused the loss. Simple correlation may be insufficient to effect payment. (In this regard, open perils policies are more consumer-friendly because they shift the burden of proving exclusions to the insurer.)

When courts, in reviewing insurer conduct in the claims process, construed policy language broadly to allow coverage when an excluded cause of loss combined with a covered cause, insurers cried foul and sought new ways to neutralize the judicial doctrine of proximate cause. Mississippi's attorney general, Jim Hood, described Mississippi's views on proximate cause as follows in his testimony before the U.S. House of Representatives on February 2, 2007:

> The proximate cause of an injury is that cause which in natural and continuous sequence is unbroken by any intermediate, controlling, and self-sufficient cause that produces the injury and without which the result would not have occurred. ... [I]f the proximate cause of a loss is a covered peril under a policy of insurance, the existence of or contribution by a non-governed (I think he means "non-covered") peril does not bar coverage. If the nearest efficient cause of the loss is not a peril which is insured against, recovery may nevertheless be had if the dominant cause is a risk or peril that is insured against.

The Insurance Services Office (ISO) introduced the first language to override liberal versions of proximate cause in 1991. It said:

> We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.

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Industry sources and commentators dubbed ISO's work and provisions adopted by other sources to achieve the same objective as "concurrent causation" provisions. The term "concurrent cause" does not appear in insurance policies, including those discussed in this article. This oversight, however, did not forestall industry acceptance of the view that "concurrent causation" is "A single loss caused by two or more perils, acting either simultaneously or in succession." (A peril is a cause of loss.) As one source adds, the industry's position on concurrent causation is that "a loss is excluded if caused by an excluded cause, whether or not that excluded cause is the predominant one." (Popow, 134) As the quotation emphasizes, industry thinking is focused on perils. Since perils are things insurers insure against, they get independent listing in insurance policies and industry publications. In the insurance mind-set, each peril may serve as a separate cause of loss. Given this mental paradigm, the next step is to infer that two perils occurring together represent "concurrent causes" of loss. Unfortunately, the industry's position is at odds with court interpretations of concurrent cause and with research specialists who apply scientific methods in their work. A Florida court in *Jeno F. Paulucci vs. Liberty Mutual Fire Insurance Company, 190 F. Supp. 1312 (2002)* offers the following observation:

> The concurrent cause doctrine and efficient proximate cause doctrine are not mutually exclusive. Rather, they apply to distinct factual situations. The concurrent cause doctrine applies when multiple causes are independent. The efficient proximate cause doctrine applies when the perils are dependent. Causes are independent when they are unrelated such as an earthquake and a lightning strike, or a windstorm and wood rot. Causes are dependent when one peril instigates or sets in motion the other, such as an earthquake which breaks a gas main that starts a fire.

Social, behavioral and medical-science researchers would concur with the court's distinctions regarding concurrent cause. Concurrent causation occurs when two independent, unrelated causal or explanatory variables contribute to the same effect.

In a hurricane, there are multiple perils: varieties of wind (described below), rain, wind-blown objects, waterborne objects and storm surge. These perils are not independent; rather, they are all interactive as components of a massive weather system called a hurricane. Wind drives the water; the water's surface temperature interacts in reciprocal causation to drive the wind. The causes, therefore, are dependent in nature. Logically, therefore, the concurrent cause concept is inapplicable to Katrina claims because the causes involved are not independent.

WHAT THE POLICY FORMS PROMISE: INSURING AGREEMENTS

The water-exclusion provision in the three companies' policies are unique to the company. Additionally, all of the homeowner policies I have reviewed are "open perils" forms with two important features: (1) if a peril is not excluded, a property loss is covered, and (2) the burden of proof rests with the insurer to demonstrate that an exclusion negates coverage.

> State Farm's introductory Insuring Agreement for Coverage A – Dwelling states: "We insure for *direct physical loss* to the property described in Coverage A, except as provided in SECTION I – LOSSES NOT INSURED." (Note: This includes "Other Structures.")

> Allstate says, "We will cover **sudden and accidental** *direct physical loss* to property described in Coverage A – Dwelling Protection and Coverage B – Other Structures Protection except as limited or excluded in this policy."

> Nationwide states under "COVERAGE A – DWELLING and COVERAGE B – OTHER STRUCTURES" that "We cover *direct physical loss* to property described in Coverages A and B except for losses excluded under Section I – Property Exclusions."

As the language indicates, all policies cover *direct physical loss*. These are undefined terms. "Direct" means "by the shortest way, without turning or stopping; not round about; not interrupted; straight." (Webster's Dictionary) The dictionary definition of "physical" is "of nature and all matter; natural; material." The insurance industry's take on the term is that it covers only that which is "tangible." It does not include intangibles (money and securities) or loss of use. "Loss" is given an insurance definition by Webster's as "death, injury, damage, etc., that is the basis for a valid claim for indemnity under the terms of an insurance policy." Some insurance sources describe Loss as "reduction in value." Black's Law Dictionary, 7th Edition describes loss as "The amount of financial detriment caused by an insured person's death or an insured property's damage for which the insurer becomes liable."

Under all policies, then, a claimant is responsible for demonstrating the occurrence of a "direct physical loss" to trigger the insurer's duty to investigate the claim, and, as the bold words indicate, only Allstate demands that the direct physical loss be "sudden and accidental." This wording, of course, has been the subject of much analysis under commercial general liability policies. So far as I can determine, though, Allstate has not opined that a hurricane is not a sudden and accidental occurrence.

THE CLAIMS CONTEXT: WIND AND WATER

All three companies define "water damage" (which they seek to exclude) but do not define "wind," a nonexcluded cause of loss. Since there is no attempt to exclude wind, this is not necessarily a shortcoming; however, failure to acknowledge the variety of forms wind may take can compromise claims investigations. While my experience is that Katrina insurers tend to focus on the straight-line form of wind in assessing damages, a broader view of "what is wind?" may lead to different conclusions from those proffered by insurers. To illustrate, "wind" may be distinguished by direction of movement and velocity. With regard to direction of movement, straight-line winds move along the surface of the earth, and tornadic winds move in a counterclockwise direction in our hemisphere. Hurricane winds also move in a counterclockwise direction around an identifiable eye, shifting their direction as the hurricane moves from one position to another.

Straight-line winds also appear as gusts of varying strength. In what meteorologists

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call **subsidence**, a condition associated with cold temperatures aloft, winds move in a downward direction. In subsidence, as air cools, it becomes denser and moves toward the ground. Relatively small downbursts are called microbursts while more extensive downbursts are macrobursts. Once a downburst contacts the earth in a straight downward movement, it then spreads out from the center horizontally. In extreme form a downburst produces damage similar to that associated with a tornado.

Changes in velocity also result in differing ways of characterizing wind. Light wind of 4 to 31 miles per hour is a breeze; a velocity of 32 to 63 miles per hour is a gale; tropical storms move faster than a gale but more slowly than a hurricane; a hurricane is wind in excess of 73 miles per hour. The Saffir-Simpson scale ranks hurricanes according to their maximum sustained wind at 33 feet above the surface of the earth for a duration of one minute, as follows:

Category 1	74-95 mph
Category 2	96-110 mph
Category 3	111-130 mph
Category 4	131-155 mph
Category 5	155+ mph

Insurance policies use "windstorm" but do not define the term. Nevertheless, the courts have come to the rescue, defining it as "a wind of sufficient violence to be capable of damaging the insured property, either by its own unaided action or by projecting some object against it." Courts, then, see "windstorm" as a form of wind.

The different wind types – straightline, gusts, tornadic and subsidence – all occur within and are important potential causes of loss from a hurricane; consequently, simple reliance upon the maximum sustained winds of a hurricane to estimate damage is highly likely to result in an incomplete investigation of a hurricane claim.

STATE FARM, ALLSTATE, NATIONWIDE AND CONCURRENT CAUSE

STATE FARM'S CONCURRENT-CAUSE TERMINOLOGY

State Farm's homeowners policy reads:

2. We do not insure under any coverage for any loss *which would not have occurred in the absence of* one or more of the following excluded events. We do not insure for such loss regardless of: (a) the cause of the excluded event; or (b) other causes of the loss; or (c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss; or (d) whether the event occurs suddenly or gradually, involves isolated or widespread damage, arises from natural or external forces, or occurs as a result of any combination of these:

c. Water damage, meaning:
flood, surface water, waves, tidal water, tsunami, seiche, overflow of a body of water, or spray from any of these, all whether driven by wind or not.

To restate the language, State Farm says, "We do not insure under any coverage for any loss which would not have occurred in the absence of flood, surface water, waves, tidal water, tsunami, seiche, overflow of a body of water, or spray from any of these, all whether driven by wind or not." This provision essentially requires State Farm adjusters to ask the following question before invoking the water-damage exclusion: "If we control for the effects of water, would wind have been sufficient to cause the loss?" If State Farm cannot muster a preponderance of evidence to show that wind would not have caused the damage, it cannot deny coverage based upon the water exclusion. Unambiguously, the language does not say the company will not pay if water and wind combine in a loss.

ALLSTATE'S POLICY: BACK TO PREDOMINANT CAUSE

Allstate's policy language states:

We do not cover loss to covered property described in COVERAGE A-DWELLING or COVERAGE B-OTHER STRUCTURES PROTECTION when:
a) there are two or more causes of loss to the covered property; and
b) the predominant cause(s) of loss is (are) excluded under LOSSES WE DO NOT COVER, items 1 through 22 above.

This section of the policy is in the conjunctive.

Allstate's policy recognizes examples of multiple causation, i.e., the conjunction of more than one cause of a loss. Instead of adopting a concurrent-cause position, though, the Allstate policy actually incorporates proximate cause, as reflected in *Garvey v. State Farm Fire and Casualty Company*, 770 P.2d 704 (Cal. 1989). Invoking its water/flood exclusion dictates that its claims procedure demonstrate that "the predominant cause of loss is flood, including, but not limited to surface water, waves, tidal water or overflow of any body of water, or spray from any of these, whether or not driven by wind."

"Predominant" means "having ascendancy, authority, or dominating influence over others; superior." (Webster's New World College Dictionary, 4th Edition)

Stating the exclusion differently, if inquiry demonstrates that the predominant cause of loss is a covered peril, Allstate must pay the entire claim. Claims are not excluded just because they involve water.

NATIONWIDE'S POLICY: NO AMBIGUITY HERE, EITHER

The Nationwide policy exclusion states:

1. We do not cover loss to any property resulting directly or indirectly from any of the following. Such a loss is excluded even if another peril or event contributed concurrently or in any sequence to cause the loss.

b) Water or damage caused by waterborne material. Loss resulting from water or waterborne material damage described below is not covered even if other perils contributed, directly or indirectly, to cause the loss. Water and waterborne material damage means:

(1) flood, surface water, waves, tidal waves, overflow of a body of water, spray from these, whether or not driven by wind.

Nationwide's policy is the only one of the three purporting to exclude "waterborne material." Apparently, this is an attempt to circumvent *Sterling v. City of West Palm Beach et al.*, 595 So.2d 295 (Fla. Dist. Ct. App. 1992), which held that since the policy at issue did not mention raw sewage in its

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definition of water damage, sewage backup was a covered peril.

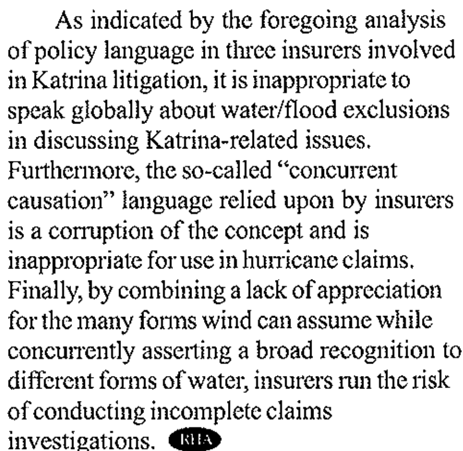
As indicated by the policy language, Nationwide, like State Farm, incorporates an alleged concurrent-cause exclusion, although it is different from State Farm's policy. Nationwide states that "Such a loss is excluded even if another peril or event contributed concurrently or in any sequence to cause the loss." The court in *Leonard v. Nationwide* (Memorandum Opinion, U.S. District Court, Southern District of Mississippi, No. 1:05CV475 LTS-RHW, 08/15/2006) explained why this provision failed to limit coverage to the insurance industry's most restrictive interpretation of concurrent causation (if water damage is present, there is no coverage) as follows:

The "loss," "such a loss" and "the loss" referred to in this paragraph, are, in this instance, damage caused by rising water during Hurricane Katrina. These three terms refer to this particular excluded loss, i.e., damage caused by rising water, but this paragraph does not affect the coverage for other losses (covered losses), i.e., damage caused by wind, that occur at or near the same time. Thus, this language does not exclude coverage for different damage, the damage caused by wind, a covered peril, even if the wind damage occurred concurrently or in sequence with the excluded water damage. The wind damage is covered; the water damage is not.

I agree. The language unambiguously supports the court's interpretation.

CONCLUSION

As indicated by the foregoing analysis of policy language in three insurers involved in Katrina litigation, it is inappropriate to speak globally about water/flood exclusions in discussing Katrina-related issues. Furthermore, the so-called "concurrent causation" language relied upon by insurers is a corruption of the concept and is inappropriate for use in hurricane claims. Finally, by combining a lack of appreciation for the many forms wind can assume while concurrently asserting a broad recognition to different forms of water, insurers run the risk of conducting incomplete claims investigations.



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THE RHA REVIEW

Publisher .... Robert N. Hughes
Editor .... John R. Oakley
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