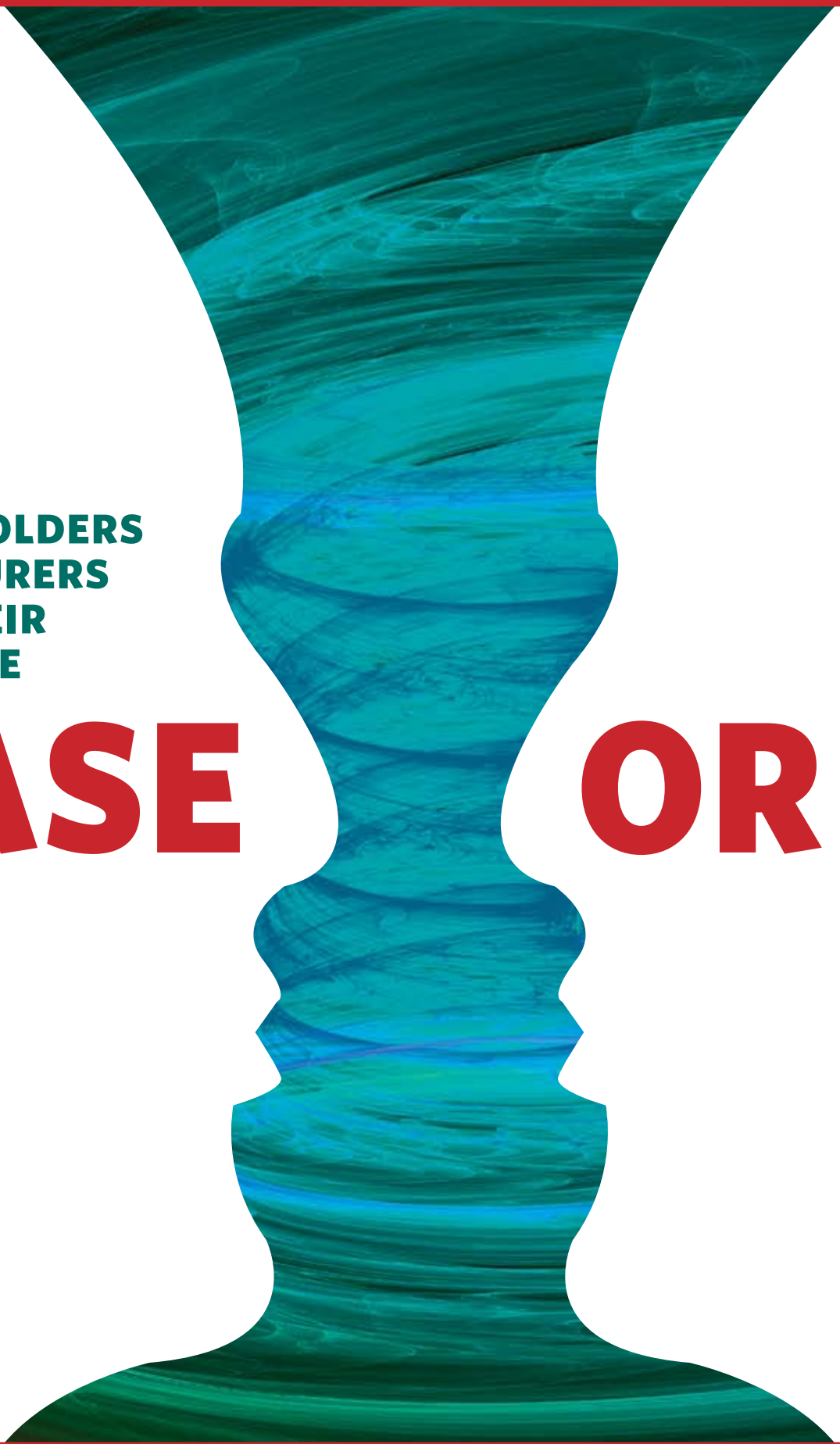
POLICYHOLDERS AND INSURERS VIEW THEIR COVERAGE

VASE OR



Even the most carefully drafted insurance policies aren't always clear about what's covered and what's not. In the conflict between policyholder and insurer, it's often the courts that decide. BY RHONDA D. ORIN

A DANISH PSYCHOLOGIST NAMED EDGAR RUBIN BECAME FAMOUS around the turn of the 20th century for designing a vase/profile illusion, a picture that can be perceived as either a white vase against a black background or as two black faces against a white background. Since the picture's been around since 1915, you've probably seen it by now. ■ As with Dr. Rubin's illusion, policyholders and insurance companies can look at the same circumstance and come to completely opposite conclusions. ■ One of the clearest examples of these differing viewpoints can be seen in the 2005 hurricane season when Hurricanes Katrina and Rita swept along the Gulf Coast. On television news, each one looked like a cohesive whole to policyholders. The swirling shape with an eye in the center was a single event—a hurricane.

TWO FACES?

But not so for the insurance industry. Insurance companies saw each hurricane as a series of wholly separate and unrelated phenomena. One was wind, another was rain. Still others were high water, waves, storm surges, and so on.

The same is true for the consequences. To the untrained eye, the flooding of New Orleans, the power failures that rendered businesses inoperative, the evacuation orders that closed down entire communities, and the looting and thefts that followed the physical devastation all arose from single events: the hurricanes.

Here again, the insurance industry disagreed. It viewed each of the above as a separate event, rather than a collective consequence of the hurricanes.

Concurrent Causation

There is a reason insurance companies draw such distinctions. By parsing the hurricanes into separate parts, and especially by including "anti-concurrent causation" provisions that purport to justify the complete denial of coverage whenever there is a single uncovered part, insurance companies increase the likelihood of denying coverage for claims.

Policyholders find this entire system confusing. Often, when they buy insurance policies that cover property damage and other losses that might follow in the wake of hurricanes, policyholders think they've purchased all the coverage they need. They think that if a hurricane roars through their area and leaves physical and economic devastation in its wake, the damages that result from that hurricane will be covered.

But insurance policies are drafted by the insurance companies. They define the key terms, such as "flood." They draft the exclusions, even including Draconian language that purports to exclude coverage whenever an excluded peril is among many causes of alleged harm. Finally, the insurance companies interpret the provisions they've drafted, leaving the policyholders with the relatively undesirable option of arguing against a *fait accompli.*

Certainly, there are checks and balances in this system. One of them is the role played by state insurance depart-

ments, which typically are empowered to review and approve the policy forms the insurance companies use to sell in their states. Another is the role played by state attorneys general and the courts in reviewing insurance company denials. Still another is the role of the courts in reviewing policyholder challenges to denials of coverage and in using state bad-faith law to deter insurance companies from wrongful and bad-faith denials.

Activity in the courts following Hurricane Katrina was substantial. A brief review of Westlaw shows that in Louisiana alone, approximately 70 decisions regarding Hurricane Katrina were handed down by the end of 2006. Mississippi ran a close second, with approximately 50 such decisions.

Standard-Form Policy Language

Insurance for losses caused by hurricanes is typically provided under comprehensive or package policies for businesses, and homeowners' and renters' policies.

Commercial property insurance policies generally fall into two types. The first type covers losses caused by "all risks of direct physical loss or damage," except risks that are specifically excluded in the policy. In these broad policies, known as "all-risk" policies, once an insured proves it has suffered a loss, the insurance company has the burden of proving that the loss isn't covered.

The other type of commercial property policy takes the opposite approach. It covers property damage or loss caused by listed perils, such as fire, wind, hail, or vandalism. Known as a "named perils" policy, it typically contains a wide variety of exclusions, including exclusions for many different types of weather conditions. The policyholder typically is found to have the burden of overcoming these exclusions, in accordance with basic principles of insurance law.

Both types of property insurance policies contain provisions insuring personal property. This coverage usually provides coverage for specified types of personal property contained within the covered premises. Often the coverage extends to property found within a certain distance from the covered premises.

Useful examples of this policy language can be found in the standard commercial policy of the Texas Windstorm Insurance Association (TWIA). With regard to buildings labeled "Coverage A," the policy expressly states that it covers:

> *1. Building or structure, meaning everything that is legally part of the building or structure described in the declarations. However, we do not cover machinery that is not used solely in the service of the building.*
>
> *2. Personal property owned by you that is used for the service of and located on the described location . . . .*

Next, with regard to personal property, labeled "Coverage B," the policy expressly states that it covers:

> *Business personal property located in or on the building described in the Declarations, or in the open on the described location, or in a vehicle or railroad car located within 100 feet of the described building. . . .*

These coverage agreements are followed by sections that delineate what types of personal property are and aren't covered. Then comes a section called "Covered Causes of Loss," in which the policy specifies:

> *We insure for direct physical loss to the covered property caused by windstorm or hail unless the loss is excluded in the Exclusions.*

The next section—and the most important one, for purposes of this article—includes, but is not limited to, the following exclusions:

> ***Flood.***
>
> *We will not pay for loss or damage caused by or resulting from flood, surface water, waves, tidal water of tidal waves, overflow of streams or other bodies of water or spray from any of these whether or not driven by wind.*
>
> ***Power Failure.***
>
> *We will not pay for loss or damage resulting from the failure of power or other utility service supplied to the described premises, if the failure occurs away from the described premises. However, we will pay for loss resulting from physical damage to power, heating or cooling equipment located on the described premises if caused by windstorm or hail.*
>
> ***Rain.***
>
> *We will not pay for loss or damage caused by or resulting from rain, whether driven by wind or not unless wind or hail first makes an opening in the walls or roof of the described building. Then we will only pay for loss to the interior of the building, or the insured property within, caused immediately by rain entering through such openings.*

Efficient Proximate Cause

The structure of this policy places causation directly into question. The problem is that while some events are covered and others aren't, damages often arise after a series of events take place. Hurricane Katrina is a perfect example. It involved a wide variety of perils, including wind, wind-driven water, flooding, levee breaches, sewage overflows, power failures, court-ordered evacuations, fire, looting, pollution, and mold.

The courts have developed various tests for determining whether there is coverage when a covered peril and an excluded peril combine in some proportion to cause a loss. Most prominent among them is the doctrine of "efficient proximate cause." This doctrine provides for coverage if the covered cause is the efficient and dominant cause, the one that sets the loss into motion.

The highest courts of two of the states most affected by Hurricanes Katrina and Rita—Louisiana and Mississippi—have adopted the doctrine of efficient proximate cause. The Texas Supreme Court has no clear authority on this question.

The "efficient proximate cause" generally is defined as the "dominant" cause. If the dominant cause of the loss is a covered peril, there is coverage; if the dominant cause of the loss is an excluded peril, there is no coverage or, in some instances, reduced coverage. Although the "efficient proximate cause" doctrine most commonly has been applied where a loss was caused in part by a covered peril and in part by an excluded or non-covered peril, it is equally applicable where, as here, different limits of liability and deductibles

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may apply depending on the determined cause of the loss.

The "efficient proximate cause" doctrine sounds simple on paper. In practice, though, it's complicated to apply. One helpful explanation of "efficient proximate cause" offered in a respected treatise on insurance, and followed by many courts, is that it's the "risk [that] set[s] the other causes in motion which, in an unbroken sequence, produced the result for which recovery is sought."

This definition may be helpful in arguing that the damages at issue with respect to Hurricanes Katrina and Rita were caused by wind and not by flood, since it was the hurricanes that set in motion all the other events that led to the property damage. Policyholders will argue (and insurance companies no doubt will disagree) that all subsequent events, including the breaches of the levees in New Orleans, were set in motion, in an unbroken sequence, by the hurricanes.

The insurance company's response to this coverage-friendly doctrine seems to be the addition of language designed to defeat coverage. Although not used by the TWIA in the sample policy highlighted above, many insurance policies contain a prefatory clause to the exclusions section, generally known as the "anti-concurrent causation" provision.

As published by the Insurance Services Offices (ISO), a typical anti-concurrent causation lead-in provision states as follows: "We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss."

This provision is significant because, if enforceable, it has the capacity to alter substantially the scope of coverage under a policy. Accordingly, many challenges have been raised to its enforceability.

The most recent decisions in this area found anti-concurrent causation clauses to be ambiguous and unenforceable as a matter of law in the context of hurricane damage. The ruling said that enforcement of such language "would mean that an insured whose dwelling lost its roof in high winds and at the same time suffered an incursion of even an inch of water could recover nothing under his Nationwide policy. Read literally, this provision would exclude all coverage when a windstorm did damage to both an insured dwelling (a covered loss) and adjacent 'screens, including their supports, around a pool patio or other areas.' (an excluded loss). I do not believe this is a reasonable interpretation of the policy."

Notably, there is no state law yet in Texas, Louisiana, and Mississippi as to the enforceability of this provision, as the highest courts of these states have not had occasion to examine it. The highest court in Washington state has held that as a matter of public policy, insurance companies may not use so-called anti-concurrent causation provisions to avoid the efficient proximate cause doctrine. West Virginia's highest court similarly has held that anti-concurrent causation clauses are ambiguous and that it offends the reasonable expectations of a policyholder to read them as precluding coverage for damage proximately caused by a covered peril.

On the other hand, this favorable response hasn't been universal. The highest court of Utah held that provisions like the anti-concurrent causation provision are enforceable, as insurance companies are entitled to contract around any applicable causation rule.

Applicable Doctrines and Statutes

Historically, the courts have considered a number of additional matters when called upon to decide insurance coverage disputes.

Principal among these is the doctrine of *contra proferentem*. This doctrine requires ambiguities in insurance policies to be interpreted against the insurance companies that drafted the policies, and in favor of coverage.

Courts typically agree that ambiguities are proved when courts adopt different interpretations of the same provision. Thus, the mere existence of a dispute over the meaning of the flood, rain, and water exclusions, and the citation of supportive yet contrary authority by both policyholder and insurance company, should be sufficient to prove ambiguity and tip the scales in favor of coverage.

Another important resource for the courts has been state statutes, which often are policyholder-friendly. For example, Texas, Louisiana, and Mississippi have statutes designed to protect policyholders against bad-faith practices by insurance companies, particularly including unfair settlement practices and late payment practices. Also relevant are the valued policy laws found in many states, which can lead to 100 percent recovery by policyholders in certain circumstances. Such statutes are likely to be studied carefully by both sides in the battlefields over hurricane coverage.

Conclusion

The principle of "buyer beware" extends all the way through the claims process for policyholders. As shown above, there are many possible reasons that policyholders may not receive the coverage they believe they purchased. But the inverse principle of "seller beware" applies to insurance companies. The developing precedent of Hurricane Katrina appears to be that ambiguous language in insurance policies will be "outed" by courts deciding hurricane cases. Insurance companies that sell ambiguous provisions may

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find themselves with serious legal problems, extending far beyond the particular framework of Katrina-related liabilities. ●

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