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# Sandy Plaintiffs Get Boost From PSEG Insurance Ruling

By **Martin Bricketto**

*Law360, Jersey City (March 26, 2015, 7:38 PM ET)* -- A ruling that insurance policy limits on flooding don't apply to more than $500 million in Hurricane Sandy damages suffered by Public Service Enterprise Group Inc. could aid the legal arguments of other insureds seeking bigger recoveries and lessen the storm's impact on ratepayers, experts say.

Tackling an issue which no reported case in the state has addressed, Monday's decision from Judge Thomas Vena in Essex County, New Jersey, relied on the language of property policies that together provided PSEG with $1 billion in coverage, out-of-state court decisions on storm surge losses, rules of contract interpretation, the parties' practices and New Jersey's efficient proximate cause doctrine — known as "Appleman's Rule" — to conclude that the company's losses from hurricane-driven water don't fall under sublimits for flooding.

PSEG and utility subsidiary Public Service Electric & Gas Co. successfully argued that the storm surge from the October 2012 hurricane fell under coverage for "named windstorms," which don't have a sublimit for New Jersey purposes. On the other hand, the flood sublimits cap such coverage at $250 million per occurrence and also restrict payouts to $50 million in particular flood zones. The policies define "named windstorm" to include "storm surge," while the flood provisions don't mention that term.

It will be useful for Sandy-impacted insureds and others with all-risk property coverage policies to have a written decision that separates the peril of storm surge from flooding when it's not included in a policy's flood definition, according to Daniel J. Healy, a partner with Anderson Kill PC.

"A decision like this would demonstrate that the insurance companies do break out the perils when they assess the risk at the underwriting phase," Healy said. "It is important for policyholders who are at the claims end of the process trying to get coverage."

Healy pointed to extrinsic evidence on which Judge Vena relied, specifically the deposition testimony of an underwriter with defendant Energy Insurance Mutual Ltd. In the view of Judge Vena, that underwriter testified that storm surge is not subject to the flood sublimits.

Insurance litigation hinges on the specific contractual language at issue, but the ruling shows that courts are willing to look at the true intentions behind a policy, according to Christopher C. Loeber, a partner with Lowenstein Sandler PC.

“Insurance carriers are more than capable of drafting very clear provisions in their policies and they don't do it, and they don't do it so they can market very broad coverage on the one hand when they're selling and renewing their policies and then go back and deny claims or restrict claims to smaller sublimits when they are faced with the prospect of paying an extremely large loss,” Loeber said.

The ruling will attract a lot of attention and coax parties to re-examine how flood limits in their policies would operate, but they will likely have to wait until the state Appellate Division weighs in before making a final decision, according to James W. Carbin, a partner with Duane Morris LLP.

An attorney for the insurers declined comment Thursday on their next steps, but Carbin said he would be shocked if there isn't an appeal.

“I don't think the insurers could accept this rationale,” Carbin said. “I think they almost have to appeal it.”

No such appeal notice was filed as of Thursday, according to the state judiciary. PSEG spokeswoman Karen Johnson said the company is continuing to negotiate with its insurance carriers.

Elements of Judge Vena's legal analysis could prove useful for policyholders in other litigation, including his interpretation of Appleman's rule, according to Sherilyn Pastor, the practice group leader for McCarter & English LLP's insurance coverage group.

The rule applies when a loss stems from multiple covered and uncovered events that occur sequentially in a chain of causation, the judge explained in the decision. Under the rule, “the loss is covered if a covered cause starts or ends the sequence of events leading to the loss,” according to the judge, who quoted another decision.

While PSEG contended that wind was the “efficient proximate cause” of the storm surge damages and the flood sublimits don't come into play, the insurers said among other arguments that Appleman's rule doesn't apply outside of disputes that essentially involve coverage versus no coverage. The judge disagreed and said the rule has been applied in other contexts.

“The insurers in the causation context have sometimes argued that you don't look to Appleman's Rule on causation unless what you're looking at is a policy exclusion, and here the court said that, although it has been applied in the context of exclusions, it's not limited to that application and includes, what in this case was, sublimits,” Pastor said.

Also important is the court's application of the specific-over-general rule, according to Pastor. Under that general rule of contract construction, “when two provisions dealing with the same subject matter are present, the more specific provision controls over the more general,” according to Monday's decision. The insurers said that rule only applies when two provisions present a clear conflict.

“The court found there was a conflict, and that the rule’s application was not as narrow as the insurer claimed,” Pastor said. “This is important to policyholders because their specific intent on a particular matter — like what sublimit applies — should not be thwarted and the parties’ contract should not be made muddy by resort to general provisions that were never intended to apply or control in a specific circumstance.”

PSEG's suit isn't the only court battle over the applicability of flood sublimits.

In October, New Jersey Transit Corp. slapped seven insurers with a lawsuit seeking $300 million in coverage for Sandy damage, claiming a $100 million flood sublimit should not apply because the damage was caused by a named windstorm. The agency's named storm coverage includes the term "storm surge," while a definition for flood doesn't, according to the complaint.

An NJ Transit spokesman declined comment Thursday on whether the PSEG decision helps the agency's case.

PSEG has said it's premature to say how the decision may impact ratepayers. However, a stipulation last year with the New Jersey Board of Public Utilities spells out how insurance money would affect the storm-related costs that PSEG customers may bear.

The stipulation covered more than $240 million in operations and maintenance costs and nearly $125.8 million in capital expenditures from major storms including Sandy that PSE&G could seek to recover as part of a future base rate proceeding with the BPU. However, those amounts would be reduced by any insurance proceeds that PSE&G receives from a storm-related claim over its distribution assets, according to the stipulation.

“To the extent that there is insurance coverage for the storm costs that the board allowed them to recover in their next rate case, the insurance part of it would come off the top, and the ratepayer would only be on the hook for the portion that isn't covered by insurance,” explained Stefanie Brand, director of the New Jersey Division of Rate Counsel.

Johnson, PSEG's spokeswoman, said the bulk of the costs from damaged facilities are associated with power generating plants, which aren't recoverable from ratepayers. The utility is tied to $88 million in property damage expenses, while PSEG Power LLC facilities are tied to $476 million in expenses, according to Johnson.

Still, the more insurance money that PSE&G and its parent collect, the smaller any impact on ratepayers, according to Brand.

“There will be some division between the utility and the generating side,” Brand said. “Right now, nobody knows what that would be, but certainly some of it would fall on the utility side, which would benefit the ratepayer.”

The case is Public Service Enterprise Group Inc. v. Ace American Insurance Co., case number L-4951-13, in the Superior Court of New Jersey, Essex County.

--Additional reporting by David Siegel. Editing by John Quinn and Philip Shea.

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