Learning from Katrina, preparing for litigation over Irene

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Hurricane Irene is likely to spur substantial litigation along the East Coast, particularly in the flood-afflicted areas of the Northeast.

Accordingly, policyholders and insurers would be wise to heed the following lessons learned from Hurricane Katrina in analyzing losses caused by both flood and wind.

During Hurricane Katrina, thousands of homeowners along the Gulf Coast suffered damage caused by both hurricane winds and flooding — perils that generally are covered by separate insurance policies.[1]

Determining which insurer was primarily responsible became the source of considerable litigation, as the damage often was not attributable solely to wind or to flood but rather to a combination of both. Insurers fought over their respective liabilities with each other and with their insureds.

ANTI-CONCURRENT CAUSATION CLAUSES

A central issue in much of the litigation was the applicability of the anti-concurrent causation clauses generally found in homeowners insurance policies.

A typical ACC clause states that certain specified losses, including flood, are excluded "regardless of any other cause or event that contributes concurrently or in any sequence to the loss."[2]

Insurance companies added ACC clauses in an effort to thwart the "efficient proximate cause" doctrine espoused by cases around the country like *Wallach v. Rosenberg*, 527 So. 2d 1386 (Fla. 3d Dist. Ct. App. 1988).

Under the efficient-proximate-cause doctrine, a loss is covered "if it was predominantly caused by a covered peril, even though one or more excluded perils contributed to the loss."[3]

The first Katrina cases made apparent that many injured homeowners carried both limited flood insurance, often well below the value of the home, along with a general homeowners insurance policy that *excluded* any loss occasioned by flood.

Many homeowners who suffered flood and wind losses during Katrina filed claims under both their flood and homeowners policies, with the belief that their claims would be paid jointly by both insurers.

Many insurers initially refused to pay the claims because Katrina's losses involved flooding, they argued, and any wind-related damage occurred "concurrently or in any sequence" with the excluded flood loss.

Thus, the resulting "flood-and-wind loss" was excluded under the ACC clause, which barred coverage for any loss caused in part by an excluded peril. As a result, Katrina victims faced the prospect of being undercompensated.

Policyholders responded vigorously and contested the validity and scope of the ACC clauses in their homeowners policies.

The resulting litigation, most of which comes from the state and federal courts within the 5th U.S. Circuit Court of Appeals, has been extensive. Nevertheless, these cases provide guidance to parties trying to interpret ACC clauses in the aftermath of Hurricane Irene.

LESSON 1: ACC CLAUSES LIKELY UNAMBIGUOUS

First, most courts have found ACC clauses to be unambiguous. Thus, where applicable, ACC clauses will be enforced.

Leonard v. Nationwide Mutual Insurance Co., 499 F.3d 419 (5th Cir. 2007), represents the seminal Katrina case on this issue.

In *Leonard*, the district court had held that, despite an ACC clause, an insured was entitled to recover for wind damage "even if it occurred concurrently or in sequence with the excluded water damage" because that was the expectation of an insured who bought windstorm coverage.[4]

The 5th Circuit reversed, ruling that the district court's interpretation ran afoul of the "plain language" of the policy. "The [ACC] clause unambiguously excludes coverage for water damage 'even if another peril' — *e.g.*, wind — 'contributed concurrently or in any sequence to cause the loss,'" the opinion said.[5]

The 5th Circuit went on to explain that "the fatal flaw in the district court's rationale" was that there were "three discrete categories of damage" relevant to an ACC clause:

- Damage caused exclusively by wind.
- Damage caused exclusively by water.
- Damage caused by wind 'concurrently or in any sequence' with water."[6]

The first category was covered, the latter two excluded.

Accordingly, the ACC clause did not deny coverage that was granted elsewhere in the policy; rather, wind damage was expressly covered and joint flood and wind damage was expressly excluded.

This demarcation of coverage, the 5th Circuit reasoned, was clear, unambiguous and enforceable.

Subsequent 5th Circuit decisions have followed *Leonard,*[7] and its analysis may be persuasive outside the 5th Circuit.[8]

LESSON 2: COVERAGE FOR LOSSES CAUSED SOLELY BY WIND

Leonard provides the foundation for Katrina's second lesson, which is that ACC clauses do not preclude coverage for a loss caused solely by wind, *even if* a covered wind loss is followed by an excluded flood loss.

This may initially appear contrary to the language of an ACC clause, which, after all, purports to exclude any loss if it occurs "in any sequence" with an uncovered one.[9]

Nevertheless, several Katrina cases illustrate that reading ACC clauses so broadly is analytically incorrect.

For example, the Mississippi Supreme Court rejected this argument in *Corban v. United Services Automobile Association,* 20 So. 3d 601 (Miss. 2009).

The court explained that once a covered loss occurs, coverage cannot be negated by the chance happening of a subsequent uncovered event.

"The right to be indemnified," the court wrote, "attaches at that point in time when the insured suffers [a covered loss]."[10]

Consequently, "an insurer cannot avoid its obligation to indemnify ... based upon an event which occurs subsequent[ly]," the court concluded.[11]

Applying this framework to ACC clauses, the court in *Corban* concluded "the [ACC] exclusion applies [to exclude coverage] only in the event that the perils act in conjunction, *as an indivisible force*, occurring at the same time, to cause direct physical damage."[12]

In situations where damage occurs in quick succession but results from distinct covered and uncovered causes, the insured is entitled to indemnification for the covered portion of the loss.[13]

As a Mississippi federal court put it, the ACC clause does not apply where wind and flood act "sequentially but separately" to cause distinguishable losses.[14]

The *Corban* decision has triggered a heightened effort by litigants to segregate hurricane losses into damages caused by flood and those caused by wind. For example, homeowners have increasingly argued, with great success, that wind losses occurred distinct from and often well before floodwaters reached their property.[15]

LESSON 3: BURDEN OF SEGREGATING LOSSES IS KEY

In turn, these arguments have brought to light an evidentiary problem: when a home is a complete loss, such as where only a concrete foundation remains, there is often scant evidence of whether flooding or hurricane-force winds caused the loss.[16]

In cases like these, the issue of which party bears the burden of proof becomes the single most important factor in determining the outcome.

Thus, the third lesson of Katrina is that because ACC clauses incentivize parties to segregate flood damage from wind damage, the question of *which party* bears the burden of segregating losses is fundamentally important.

The 5th Circuit's opinion in *Broussard v. State Farm Fire & Casualty Co.,* 523 F.3d 618 (5th Cir. 2008), is particularly instructive.

In *Broussard*, the home had been reduced to "the foundation slab." The policy at issue contained "all risks" insurance (for the structure itself) and "named perils" coverage (for personal property) and also included an ACC clause that applied to both sections of coverage. The district court granted summary judgment to the policyholder, finding coverage under both sections.

The 5th Circuit reversed, holding that the burden of segregating covered from uncovered damage depended on whether the policy was "all risks" or "named peril."

Although both types of policies oblige the insured to meet an *initial* burden of proving coverage under the policy, in the case of an "all risks" policy, the burden shifts back to the insurer to prove an applicable exclusion once this initial burden is met.[17]

The policyholder argued that this failure to segregate entitled him to summary judgment in light of the insurer's burden of proof at trial.

The district court disagreed, and the 5th Circuit affirmed.

The burden of proof at trial, the 5th Circuit explained, differs from the burden of production at summary judgment: "[Once] Allstate adduced evidence sufficient to establish that flood, not wind, caused any uncompensated ... damage ... the burden of production shifted to [the insured] to offer rebuttal evidence sufficient to create a genuine issue of material fact."[22]

In situations where damage occurs in quick succession but results from distinct covered and uncovered causes, the insured is entitled to indemnification for the covered portion of the loss.

This is not the case for "named peril" policies, where the burden stays with the insured.[18]

Accordingly, where an ACC clause potentially excludes coverage under an "all risks" policy, the court noted that the burden of proving uncovered damages, and hence the burden of segregating uncovered portions of a loss, rests with the insurer.[19]

In this regard, apportionment is an affirmative defense no different from any other exclusion the insurer must prove to avoid coverage.[20]

In contrast, under a "named peril" policy, the insured bears the burden of proving allocation to the extent the argument is raised by the insurer.[21]

It should be noted that *Broussard* concerned the burden of proof *at trial,* as distinguished from the parties' burdens of production at summary judgment.

On this issue, *Bayle v. Allstate Insurance Co.,* 615 F.3d 350 (5th Cir. 2010), offers a particularly illuminating analysis.

In *Bayle,* a Katrina victim sought coverage for wind damage to his home and moved for summary judgment on the basis of an expert affidavit that stated that the entire loss resulted from wind.

The insurance company responded with evidence that flooding, not wind, caused the damage, but the insurer did not attempt to segregate the specific items claimed by the policyholder as being lost "due to wind" or "due to flood."

This the insured had not done.

Consequently, even though the insured bought an "all risks" policy, and the burden of proof for allocation rested on the insurer, the court upheld summary judgment against the insured.

CONCLUSION

As the preceding summary illustrates, the application of ACC clauses to combined flood and wind losses is an emerging issue in insurance law.

Fortunately, many of the arguments that practitioners are likely to face in the wake of Hurricane Irene have precedents in Hurricane Katrina litigation.

These cases can therefore provide guidance to practitioners, and the courts, as they grapple with the aftermath of Irene. WJ

NOTES

[1] After the Mississippi River flooded in 1927, many insurers stopped offering flood insurance to homeowners in coastal markets. As a result, the federal government created the National Flood Insurance Program, which today is the principal insurer of flood risks nationwide. John DiMungo, *Cat Claims: Insurance Coverage for Natural and Man-Made Disasters,* Section 4:26 (May 2011).

[2] 37 Am. Law Reports, 6th 657 § 3 (2008).

[3] 37 Am. Law Reports, 6th 657 (2008). *See also Preferred Mut. Ins. Co. v. Meggison,* 53 F. Supp. 2d 139, 142 (D. Mass. 1999) (discussing the origin of ACC clauses).

[4] *Id.* at 426.

[5] *Id.* at 430.

[6] *Id.*

[7] *See Tuepker v. State Farm Fire & Cas. Co.,* 507 F.3d 346 (5th Cir. 2007) (ACC clause enforceable). *Cf. Stewart Enters. v. RSUI Indem. Co.,* 614 F.3d 117 (5th Cir. 2010) (noting that ACC clauses are generally unambiguous but finding clause inapplicable to the facts of the case).

[8] *See, e.g., Colo. Intergov't Risk Sharing Agency v. Northfield Ins. Agency,* 207 P.3d 839 (Colo. Ct. App. 2008); *Subrabian Realty Co. v. NGM Ins. Co.,* No. WO-CV-2009-02358A, 2011 WL 915544 (Mass. Super. Ct. Jan. 24, 2011). But *see Corban v. United Servs. Auto. Ass'n,* 20 So. 3d 601 (Miss. 2009) (finding ACC clause enforceable but ruling that the prepositional phrase "in any sequence" was ambiguous and should be construed against an insurer).

[9] For example, Nationwide Mutual Fire Insurance Co. argued in *Politz v. Nationwide Mut. Fire Ins. Co.,* No. 1:08CV18 LTS-RHW, 2009 WL 909261 (S.D. Miss. Mar. 27, 2009), that an ACC clause precluded coverage "for any property ... that was ultimately damaged by storm surge flooding. ... [w]hether the insured property sustained damage from a covered cause ... before being further damaged by [the] storm surge." *Id.* at *2. The U.S. District Court for the Southern District of Mississippi rejected this argument. *See also Dickinson v. Nationwide Mut. Fire. Ins. Co.,* No. 1:06-CV-198 LTS-RHW, 2008 WL 1913957 (S.D. Miss. Apr. 25, 2008) (same).

[10] *Id.* at 613.

[11] *Id.*

[12] *Id.* at 614.

[13] *Accord Maxus Realty Trust v. RSUI Indem. Co.,* No. 06-0750-CV-W-ODS, 2008 WL 2098084 (W.D. Mo. May 16, 2008) ("[T]o the extent that wind caused damage that was separate and apart from any damage caused by water, even if the same portions of the property were previously or subsequently damaged by water, the wind damage is recoverable.").

[14] *Dickinson*, 2008 WL 1913957, at *2. "Wind and flood were separate and not concurrent causes of damage to the insured property, and the wind damage that precedes the storm surge does not contribute, sequentially or concurrently, to 'the excluded loss' caused by storm-surge flooding and referred to by the ACC [clause]." *Id.* at *4.

[15] *La Louisiance Bakery Co. v. Lafayette Ins. Co.,* 61 So. 3d 17 (La. Ct. App. 2011) (upholding verdict that entire Katrina-related loss was due to covered wind damage that took place before flooding occurred); *cf. Maxus Realty Trust v. RSUI Indem. Co.,* No. 06-0750-CV-W-ODS, 2007 WL 4468697 (W.D. Mo. Dec. 17, 2007) (existence of waterline in building did not preclude factual dispute on what wind-related damage occurred below the waterline prior to flooding); *Penthouse Owners Ass'n v. Certain Underwriters at Lloyd's, London,* No. 1:07-CV-568-HSO-RHW, 2011 WL 96514 (S.D. Miss. Jan. 11, 2011) (denying insurer's motion for summary judgment where policyholder argued property was a total loss due to wind damage before flooding reached it).

[16] *See, e.g., Broussard v. State Farm,* 523 F.3d 618 (5th Cir. 2008).

[17] *Id.* at 625-26.

[18] *Id.; Accord Tuepker,* 507 F.3d at 356-57; *Corban,* 20 So. 3d at 619.

[19] *Broussard,* 523 F.3d. at 626.

[20] *Id.* at note 2.

[21] *Id. Accord Corban,* 20 So. 3d at 619 (under a named-peril policy that includes an ACC clause, the insured bears the burden of proving that damage was caused by wind alone).

[22] *Bayle*, 615 F.3d at 360-61.

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