

DOWNPOUR OR DOWNFALL? ACC CLAUSES ARE RAINING ON COVERAGE

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INTRODUCTION

As any property owner knows, damage rarely happens in a vacuum. When damage occurs, an adjuster's inspection might reveal faulty workmanship in the foundation or framing, poor choice in materials, improper grading or drainage, deferred maintenance, and a litany of other factors that might have contributed, either concurrently or sequentially to the damage. The emergence of the Anti-Concurrent Causation Clause ("ACC") in property insurance policies complicates matters further because there is rarely, if ever, one cause of the damage.

From the policyholder's perspective, the ACC defeats the purpose of insurance – to effectuate indemnity in case of loss. In these complex cases involving multiple perils, some covered and some excluded, the pressure is on hired experts to prove (or speculate on) the cause of the damage. Unfortunately, we have learned that many experts, particularly those retained by insurers are vulnerable to undue influences. Federal District Court Judge Brown's November 7, 2014 Memorandum and Order was a chilling expose of altered engineering reports used by flood insurers to deny coverage. *See In Re Hurricane Sandy Cases*.¹

Plaintiff side coverage and bad faith practitioners and their policyholder clients have endured some painful outcomes in recent decades as the political/judicial pendulum swung toward strict construction of policy exclusions and artificial caps on recoveries. The strict interpretation and enforcement of the ACC not only frustrates the purpose of insurance following property damage but has been harmful to the public's perception of the value of insurance.

For context, in New York and New Jersey, Sandy victims on average received only \$16,000 in payments for covered losses compared with an average claim amount of \$103,000. Most coverage disputes arose out of whether the damage was caused by wind-driven rain, storm surge, both, or a troublesome application of the earth movement exclusion. Homeowners are now questioning why they paid premiums in the first place and Community Block Grants have emerged as a necessary source of rebuilding financing. These grants were never intended to be a substitute for insurance, instead designed for... Many homeowners continue to struggle with the voluminous paperwork requirements necessary to receive these funds.

¹ *Raimey v. Wright National Flood Insurance* (E.D. N.Y. Case No. 14-mc-00041-CLP-GRB-RER) (<http://www.uphelp.org/sites/default/files/blog/Raimey-v-Wright-National-Flood-Insurance-Memorandum-and-Order.pdf>).

Judges should be reminded that allowing insurers to exploit their power to the detriment of coverage, through strict interpretation of the ACC is bad for our economy. Basic insurance principles demand an equitable analysis when coverage disputes involving the ACC result in litigation. Lest we not forget the rationale for enduring bedrock principles of insurance law such as *reasonable expectations* and *contra proferentem*.

THE ACC

A typical ACC reads:

“We do not cover loss to any property resulting directly or indirectly from any of the following...flooding, including storm surge and most water damage including sewer backup and overflow, earth movement, volcanic eruption...such loss or damage is excluded *regardless of any other cause or event that contributes concurrently or in any sequence to the loss.*”

Some have called it, a “tongue twister.” But to people who need their insurance to pay to replace a home or business that has been totaled due to a storm or hurricane, and the lawyers who represent them, there is nothing funny about these clauses. “[t]he ACC clause can put the kibosh on your entire claim.”² And for tens of thousands of Americans, it has.

Specifically, the ACC clause operates to exclude damage caused by an excluded event, such as flood, even if the flood was caused by wind or some other insured event. Untold numbers of people outside California have experienced financial devastation via this clause. United Policyholders’ staff and volunteers have battled it mightily in legislative, regulatory and court arenas with few successes.³ Our collective efforts are a work in progress.

Inside California, the ACC clause is inapplicable, due largely to California’s unique statutory provisions and the case law discussing efficient proximate cause. “Fire following earthquake? Covered. No problem. A retaining wall that fails due to a combination of flooding and tree-fall? Covered. No problem. But a series of decisions in recent years and one pending in the Court of Appeal are creating confusion for practitioners on both sides of the issue.

BACKGROUND

The ACC clause emerged as a coverage killer after Hurricane Katrina. It had been showing up in homeowner policies since at least the 1980s, but it did not get much attention until 2005, when Hurricane Katrina walloped the Gulf Coast, costing insurers an estimated \$38 billion in claims.⁴ Suddenly the ACC became a devastating weapon for insurers to use to avoid paying claims. Policyholder attorneys mounted numerous challenges with some success. But overall, insurers prevailed in getting most courts to uphold and enforce the clause. Their public relations message

² Ed Leefeldt, Insure.com, *2 problems = Zero money: The anti-concurrent causation clause*, May, 2013.

³ See, e.g., United Policyholders’ *amicus curiae* brief in *Tuepkee v. State Farm Fire and Casualty Co.* (Case No. 06-61075 and 06-61076, S.D. Miss., 2007)

(<http://uphelp.org/tuepker-john-and-clare-vs-state-farm-fire-and-casualty>).

⁴ See David P. Rossmiller, *Interpretation and Enforcement of Anti-Concurrent Policy Language in Hurricane Katrina Cases and Beyond*, New Appleman on Insurance: Current Critical Issues in Insurance Law 43 (2007).

and rallying cry to courts and lawmakers: “If you rewrite our contracts after the fact and make us pay for claims we did not collect premiums for, we will go out of business.” The strategy worked - courts enforce these exclusions in most states.

In a recent decision, the New Jersey Appellate Division upheld an anti-concurrent/sequential causation clause that was used to preclude coverage for a Hurricane Irene loss. In the case, a covered peril (hidden decay on a pipe) led to an excluded peril (soil erosion due to inundation caused by pipe leaking stormwater) which caused damage to the insured structure. The court found that the trial judge properly granted summary judgment because the policy excluded coverage for such a sequential loss and was designed to contract out of any obligation to pay for losses that might be covered in the causal chain by applying of the efficient proximate cause doctrine. See *Ashrit Realty, LLC v. Tower National Ins Co.*, 2015 WL 248490, 2015 N.J. Super. Unpub, LEXIS 107 (N.J.Super.Ct., App.Div., Jan 20, 2015) (“Even if plaintiffs are correct in asserting that hidden decay was a cause of loss, plaintiffs do not dispute that water leaked from the collapsed culvert also causing soil erosion. Further, there is no dispute that soil erosion is excluded from coverage. Because these causes happened sequentially, the anti-sequential language in the policy excludes recovery. (emphasis added) [The trial judge properly granted summary judgment, finding that:] “The policy at issue that was drafted by the defendant was clearly drafted to eliminate the efficient proximate cause doctrine. Such an exclusion is not inconsistent...with public expectations, or commercially acceptable standards.”).

Like in the case above, “[w]hen disaster strikes it seems to happen all at once. Electric lines spark, windows shatter, roofs tear off, sump pumps stop and the lights go out. Homeowners see it this way. Insurance companies -- and often the courts -- see it differently.”⁵

JURISPRUDENCE

Many standard form homeowner’s policies provide coverage for “all-perils not specifically excluded.”⁶ [This means the policy pays for loss or damage resulting from any cause not specifically listed under the policy’s exclusions. However, the situation is much more complicated when, in the case of a hurricane, multiple perils contribute to the same loss.

After the San Francisco Earthquake of 1906, considered by many to be a turning point in the law of causation, many homeowners were shocked to find that their standard fire insurance policy excluded *both* the earthquake damage and the ensuing fire. Litigation ensued. *See, e.g., Pac. Heating & Ventilating Co. v. Williamsburgh City Fire Ins. Co.*⁷ The California legislature responded by enacting a series of reforms regarding ensuing loss provisions and ACC clauses.⁸

Now, a typical ensuing loss provision reads:

⁵ *Leefeldt, supra* note 3.

⁶ The most common form is published by the Insurance Services Office, called the Homeowner’s Standard Form Policy or HO 3. Most insurers use a version of the HO 3. *See* Robert H. Jerry, II & Douglas R. Richmond, *Understanding Insurance Law* 391 (4th ed. 2007); Roy C. McCullough, *Property Insurance*, 1963 Ins. L.J. 75, 84.

⁷ 111 P. 4 (Cal. 1910). For an in-depth discussion of the San Francisco Earthquake and the history of the “ensuing loss” doctrine in California and elsewhere, *see generally*, Christopher C. French, *The Ensuing Loss Clause in Insurance Policies: The Forgotten and Misunderstood Antidote to Anti-Concurrent Causation Exclusions*, 13 Nev. L.J. 215 (2012).

⁸ Cal. Ins. Code §§ 2081, 10088, and 10088.5 forced insurers to include ensuing loss provisions in policies.

In the event an excluded cause of loss...results in a covered cause of loss, the [insurance] company will be liable only for such resulting loss or damage.

By including the ensuing loss provisions, policies were reformed to provide coverage for fire following earthquake. *See, e.g., Acme Galvanizing Co. v. Fireman's Fund Ins. Co* (“...[coverage] where there is a ‘peril,’ i.e., a hazard or occurrence which causes a loss or injury, separate and independent but resulting from the original excluded peril, and this new peril is not an excluded one, from which loss ensues.”); *but See Loughney v. Allstate Ins. Co.* (“ensuing loss” provision is only applicable when an insured alleges damage resulting from a secondary peril which is covered).⁹

The ensuing loss provision is the easy part. But an ACC clause can cause confusion when multiple perils contribute to the same loss and occur either simultaneously or in close proximity. For example, if both wind and flood damage property as a result of a storm, like in the Hurricane Sandy example discussed above, application of the ensuing loss provision in conjunction with an ACC clause causes confusion for both homeowners and reviewing courts.

At the time Hurricane Katrina hit the Gulf Coast, only 15 states enforced ACC clauses.¹⁰ That’s changing. Courts in Alabama, Alaska, Arizona, Colorado, Indiana, Louisiana, Massachusetts, Michigan, North Carolina, New Hampshire, Nevada, New Jersey, New York, Pennsylvania, South Carolina, South Dakota, Tennessee, and Texas have expressed their approval of the ACC.¹¹ The ACC has only been formally rejected by courts in California, North Dakota, Washington, and West Virginia.

Some courts, such as in Mississippi, have enforced ACC clauses but have refused to extend them to loss or damage caused by a covered peril. *See, e.g., Leonard v. Nationwide Mut. Ins. Co* (“If wind blows off the roof of the house, the loss of the roof is not excluded merely because a subsequent storm surge later completely destroys the entire remainder of the structure; such roof loss did occur in the absence of any listed excluded peril.”).¹²

CALIFORNIA

California, as a minority jurisdiction with unique statutory protections, has traditionally rejected the ACC. *See, e.g., State Farm Mut. Auto. Ins. Co. v. Partridge* (“Under certain circumstances, an [insurer] may be liable for coverage so long as the covered peril was one of two or more independent, concurrent proximate causes of harm, even if the covered peril was not the efficient proximate cause.”).¹³ California instead applied the “Efficient Proximate Cause” (“EPC”) doctrine for nearly half a century. *See, e.g., Sabella v. Wisler*. (“a]n insurer is liable for a loss of which a peril insured against was the proximate cause, although a peril not contemplated by the

⁹ 465 F. Supp. 2d 1039, 1042 (S.D. Cal. 2006)

¹⁰ *See* Michael C. Phillips & Lisa L. Coplen, *Concurrent Causation Versus Efficient Proximate Cause in First-Party Property Insurance Coverage Analysis*, 36 Brief 32 (Winter 2007).

¹¹ Bill Kreckstein and Emmett McGowan, *Anti Concurrent Causation Clauses in Property Insurance Policies: Deconstructing Judicial Construction and What It Means for Insurers*, Gen Re Research (2014).

¹² 499 F.3d 419, 431 (5th Cir. 2007).

¹³ 10 Cal.3d 94 (1973)

contract may have been a remote cause of the loss; but is not liable for a loss of which the peril insured against was only a remote cause.”¹⁴

California’s application of the EPC is based on its statutory Insurance Code, which states, in relevant part: “[a]n insurer is liable for a loss of which a peril insured against was the proximate cause, although a peril not contemplated by the contract may have been a remote cause of the loss; but he is not liable for a loss of which the peril insured against was only a remote cause.”¹⁵

In Garvey v. State Farm Fire Cas. Co., the California Supreme Court held:

...whether a claim is covered or excluded under the terms of the policy turns not on whether the alleged cause of the loss was a concurrent cause of the damage, but whether it was the ‘efficient proximate cause’ of the loss.¹⁶

Despite these directives, California courts continue to confront the EPC/ACC issue with mixed results.¹⁷ Some recent decisions suggest that the EPC doctrine is intact, while others suggest that insurers are free to contract around it, thus upholding a version of the ACC. *See* Julian v. Hartford Underwriters Ins. Co. (“[a]n insurer is liable for a loss of which a peril insured against was the proximate cause, although a peril not contemplated by the contract may have been a remote cause of the loss; but he is not liable for a loss of which the peril insured against was only a remote cause.”)¹⁸ *But See* De Bruyn v. Sup. Ct. ([EPC] does not preclude an insurer from providing coverage for some, but not all, manifestations of a peril, as long as the policy makes clear which perils are and are not covered.”)¹⁹

Vardanyan v. AMCO Ins. Co., a case with potentially far-reaching impacts, is pending in a California Court of Appeal.²⁰ In the case, the trial judge refused the plaintiff’s request for a jury instruction on predominant cause (*i.e.*, EPC):

You have heard evidence that the claimed loss was caused by a combination of covered and excluded risks under the insurance policy. When a loss is caused by a combination of covered and excluded risks under the policy, the loss is covered only if the most important or predominant cause is a covered risk.

The judge instead relied upon a policy provision that excludes coverage unless the covered peril was the *sole* cause of loss.²¹ In other words, the trial court held that there was no coverage when any unnamed condition, no matter how remote in time or effect, was in the causal chain. This

¹⁴ 59 Cal.2d 21 (1963).

¹⁵ Cal. Ins. Code §530.

¹⁶ 48 Cal.3d 395, 401-404 (1989) (discussing section 530, citing *Howell v. State Farm Fire & Cas. Co.* (1990) 218 Cal.App.3d 1446; Cal. Civ. Code, § 1667 (That is not lawful which is: 1. Contrary to an express provision of law; 2. Contrary to the policy of express law, though not expressly prohibited).

¹⁷ For an extensive discussion of EPC and the ACC clause, *see* Jacqueline Young, Notes - *Efficient Proximate Cause: Is California Headed for a Katrina-Scale Disaster in the Same Leaky Boat?* 758 *Hastings L.J.* 62 (2011).

¹⁸ 2014 U.S. Dist. LEXIS 142870 (C.D. Cal. Oct. 7, 2014).

¹⁹ 158 Cal.App.4th 1213 (2008).

²⁰ Case No. 11CECG02112, from a judgment by the Fresno Superior Court.

²¹ California Civil Jury Instruction (CACI) 2306. Covered and Excluded Risks—Predominant Cause of Loss (2003).

case is pending appeal and many insurance professionals on both sides of the aisle are anxiously waiting for the outcome.

CORE PRINCIPLES

In summary, the authors urge that the following principles, should always be part of a court's analysis in coverage and bad faith cases involving the ACC:

- Insurance policies are contracts of adhesion; consumers have no power to alter their terms.²² *See, e.g., D'Ambrosio v. Pa. Nat. Mut. Cas. Ins. Co.*²³
- “Courts carefully scrutinize adhesion contracts and sometimes void certain provisions because of the possibility of unequal bargaining power, unfairness, and unconscionability. Factoring into such decisions include the nature of the assent, the possibility of unfair surprise, lack of notice, unequal bargaining power, and substantive unfairness. Courts often use the “doctrine of reasonable expectations” as a justification for invalidating parts or all of an adhesion contract: the weaker party will not be held to adhere to contract terms that are beyond what the weaker party would have reasonably expected from the contract, even if what he or she reasonably expected was outside the strict letter of agreement.” *The Legal Information Institute at Cornell Law School*.
- Many of the exclusions in property policies today were never analyzed or formally approved by a regulatory agency. Regulators do not have the resources or authority to scrutinize policy wording in every policy sold in their state. In many cases, you will find that coverage is illusory through cleverly worded clauses and exclusions.²⁴
- The business of insurance is different, not like a radio, television or car. It is affected with the public interest and a quasi-utility.²⁵ *See, e.g., U.S. v. South-Eastern Underwriters* (U.S. Supreme Court).²⁶
- The purpose of an insurance contract is to effectuate indemnity in case of loss. “Delayed payment based on inadequate or tardy investigations, oppressive conduct by claims adjusters seeking to reduce the amounts legitimately payable, and numerous other tactics

²² Kessler, Friedrich, *Contracts of Adhesion-Some Thoughts About Freedom of Contract* (1943). Yale Law School Faculty Scholarship Series. Paper 2731 (43 Colum. L. Rev. 629).

²³ 396 A.2d 780, 785 (Pa. Super. Ct, 1978)

²⁴ Regulatory Brief: State Insurance Regulation: History Purpose and Structure, National Association of Insurance Commissioners (only half the states require insurers to submit property-casualty forms for prior approval).

²⁵ “The insurers' obligations are ... rooted in their status as purveyors of a vital service labeled quasi-public in nature. Suppliers of services affected with a public interest must take the public's interest seriously, where necessary placing it before their interest in maximizing gains and limiting disbursements ... [A]s a supplier of a public service rather than a manufactured product, the obligations of insurers go beyond meeting reasonable expectations of coverage. The obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary. Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibility consonant with that trust.” (Goodman & Seaton, Foreword: Ripe for Decision, Internal Workings and Current Concerns of the California Supreme Court (1974) 62 Cal.L.Rev. 309, 346-347.)

²⁶ 322 U.S. 533 (1944).

may breach the implied covenant [of good faith and fair dealing] because they frustrate the insured's right to receive the benefits of the contract in "prompt compensation for losses." Waller v. Truck Ins. Exch., Inc.²⁷

- The financial security that insurance policies provide is essential to economic health of policyholders and the economy at large. When insurers don't pay, the results can be catastrophic. Individuals fall down one or two rungs on the economic ladder. Businesses close. Bad news all around. *See, e.g., Amerigraphics v. Mercury Casualty Co.*²⁸
- "The obligations of insurers go beyond meeting reasonable expectations of coverage [and] ... encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary." Egan v. Mutual of Omaha.²⁹
- The duty of good faith extends to the drafting of the contract itself. If an exclusionary clause operates to defeat the reasonable expectations of indemnity, an insurer acts in bad faith by enforcing that clause.

As Professor Williston said:

The fundamental reason which explains [contra proferentem] and...judicial predisposition toward the insured is the deep-seated often unconscious but justified feeling or belief that the powerful underwriter, having drafted its several types of insurance contracts with the aid of skillful and highly paid legal talent, from which no deviation desired by an applicant will be permitted, is almost certain to overreach the other party to the contract. The established underwriter is magnificently qualified to understand and protect its own selfish interests. In contrast, the applicant is a shorn lamb driven to accept whatever contract may be offered on a 'take-it-or-leave-it' basis if he or she wishes insurance protection...insurance policies, while contractual in nature, are certainly not ordinary contracts, and should not be interpreted or construed as individually bargained for, fully negotiated agreements, but should be treated as contracts of adhesion between unequal parties. This is because...insurance contracts are generally not the result of the typical bargaining and negotiating processes between roughly equal parties that is the hallmark of freedom of contract.³⁰

²⁷ 11 Cal. 4th 1 (1995) (citing *Love v. Fire Ins. Exch.*, 221 Cal. App. 3d 1136 (1990)).

²⁸ 182 Cal.App.4th 1538 (2010) (when considering a punitive damages award, the court's reprehensibility analysis focused on the fact that the insurer's failure to pay caused the insured company to go out of business).

²⁹ 598 P. 2d 452, 24 Cal. 3d 809 (1979).

³⁰ Williston on Contracts, 49:15.