

WHITE PAPER

ISO CHANGES WATER DAMAGE EXCLUSION IN HO3: IS THERE NOW COVERAGE FOR STORM SURGE UNDER THE 2000 VERSION?

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The exclusion for water damage in the most widely used homeowners' policy in the United States was recently changed. This white paper discusses the recent change and its implication for coverage under the prior version of the homeowners' policy, as well as what storm surge is and how it may have affected homes in the path of Hurricane Sandy. Based on this change, it may now be possible to argue that the water damage exclusion in effect before the recent change may provide coverage for storm surge damage.

In May 2011, the Insurance Services Office ("ISO") issued the new Homeowners 3 ("HO3") policy form.ⁱⁱ The HO3 is the most common residential policy form issued in the United States.ⁱⁱⁱ The International Risk Management Institute ("IRMI")^{iv} reports that the prior form, dated October 2000, "only applies to the HO3 October 2000 edition."^v Homeowners' policies in effect when Hurricane Sandy struck the east coast on October 29, 2012, may still have been written on the older HO3 2000 policy form.

The change from the 2000 HO3 to the 2011 HO3 policy form exclusion for water damage is significant. The "Water Damage" exclusion in the 2000 version of the HO3 policy defined water damage as "[f]lood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind."^{vi} In contrast, the 2011 HO3 "Water" exclusion defines water damage as: "Flood, surface water, waves, including tidal wave and tsunami, tides, tidal water, overflow of any body of water, or spray from any of these, all whether or not driven by wind, **including storm surge.**"^{vii} As is readily apparent in 2011, ISO added "storm surge" to the definition of water damage.

It has been suggested that the changes to the definition of water damage in the 2011 HO3 policy were made because of "conflicts arising from Hurricane Katrina," and that "ISO amended the water damage exclusion (now "water" exclusion) to provide greater clarity and to exclude more explicit types of water related losses. . . . Also added are explicit exclusions to losses arising from tsunamis and storm surge."^{viii} This justification, however, appears to be questionable with regard to the added term "storm surge." The insurance industry had previously contended, and courts had agreed, that the flood exclusion under the 2000 HO3 version included storm surge.^{ix} Indeed, in

Leonard v. Nationwide Mut. Ins. Co.,^x the Fifth Circuit went as far as to write that, “The [policy] explicitly exempts from coverage damage caused by ‘flood . . . waters. Tidal waves [and] overflow of a body of water . . . whether or not driven by wind.’ The phrase ‘storm surge’ is little more than a synonym for a ‘tidal wave’ or wind-drive flood, both of which are excluded perils.”^{xi} This analysis alone is now open to question, given ISO’s addition of “tidal wave” to the water exclusion. Certainly, the terms “tidal wave” and “storm surge” must now be viewed as referring to distinctly different events, and not, as the Court in *Leonard* held, merely as synonyms. Further, by adding “storm surge” to the water exclusion, insurers may have implicitly, if not explicitly, admitted that, despite their positions in *Tupeker* and *Leonard*, the 2000 version of the Water Damage exclusion did not include storm surge.^{xii}

Several courts have held that the interpretation of insurance policy language may be determined by looking to changes made by the insurers to their policies after the claim has been presented.^{xiii} For example, in *Pentair Water Treatment (OH) Co., et al. v. Continental Ins. Co., et al.*,^{xiv} the Court addressed Pentair’s request for discovery for documents relating to the pollution exclusion in the Continental policy issued to Pentair, and upon which Continental relied to deny coverage to Pentair arising out injury and related claims due to the alleged failure to Pentair’s whirlpool spa filter.^{xv} In granting Pentair’s motion, the Court observed as follows:

Contrary to Continental’s position, documents relevant to construing this clause are not limited to those relating to the use of this precise language. Information concerning other pollution exclusions employed by Continental—what it chose to include and how it might have altered the pollution exclusion from one policy to another—could well shed light on the meaning of the exclusion in this case.^{xvi}

Although there are decisions which hold that subsequent policy changes cannot be considered in the interpretation of an insurance policy, the better-reasoned decisions will allow it.^{xvii} The contrary position is often based on the idea that a party should not be penalized for making subsequent changes because “it would discourage remedial action and thereby violate public policy.”^{xviii} This analysis is based upon either federal or state rules of evidence, which preclude the admission of subsequent or remedial measures. But as at least one Court has pointed out, there is nothing in these rules that suggests that they “apply to changes in contract language.”^{xix}

Pursuant to the foregoing, it may now be possible to argue that the insurance industry’s inclusion of “storm surge” in the 2011 water exclusion supports the conclusion that the prior 2000 version was ambiguous, or that the insurance industry did not intend

to include storm surge in the 2000 version, and therefore, did not exclude coverage for storm surge.

Providing coverage for storm surge damage arising from Hurricane Sandy may result in significant additional policy benefits for homeowners in New York and New Jersey. The National Oceanographic and Atmospheric Administration ("NOAA") describes storm surge as "water that is pushed toward the shore by the force of the winds swirling around the storm."^{xx} A storm surge is *not* a giant wave. Rather, it is a "rise in sea level along a coastline **caused by the combination of a hurricane's surface winds and the physical geography of a coastline.**"^{xxi} Hurricane Sandy's storm surge caused extensive damage. For example, Battery Park had a water surge of 13.88 feet.^{xxii} The storm surge that hit New York City on October 29, 2012, flooded streets, tunnels, and subway lines and cut power in and around the city.^{xxiii} IRMI has reported that Swiss Re indicated that the "record storm surge" caused widespread damage.^{xxiv}

Given the extent of storm surge damage from Hurricane Sandy, any practitioner should seriously consider the following:

- (1) Does the homeowners' policy form in effect at the time of the storm expressly exclude coverage for storm surge?
- (2) If not, what damage can be attributed to the storm surge and claimed under the policy?
- (3) Consider retaining an expert on insurance industry standards for the interpretation of insurance policies to testify regarding the significance of the ISO change in the Water Damage exclusion.^{xxv}

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ⁱⁱ ISO is an insurance industry organization which issues uniform insurance policies that are used by most insurance companies throughout the United States. According to the testimony of Michael L. Averill, the manager of the Commercial Casualty Division of ISO in New York, in his December 18, 1985, testimony before the New Jersey Department of Insurance, "ISO is a not-for-profit corporation which provides a variety of rating and advisory and statistical services to the PC [property casualty] industry. We are a voluntary organization made up of companies who choose to associate with us to receive any or all of our services. One of the services we do provide is the development of policy forms and endorsements that are made available to our companies" (Transcript of testimony, pp. 8-9).

ⁱⁱⁱ Insurers may modify the form before using it. Indeed, some insurers, such as State Farm, commonly do this. Commonly, the altered forms are still substantially the same as the original ISO HO3 form.

^{iv} The International Risk Management Institute (“IRMI”) publishes several volumes on various types of insurance policies, including commercial liability, commercial property, and personal property policies. These volumes are also widely used in the insurance industry to assist claims personnel in the interpretation and application of insurance policies. As pointed out in the IRMI volume regarding personal property, which is quoted above in the text, “[t]he overall objective of the PRMI [Personal Risk Management and Insurance] is to provide a comprehensive and broad reference source on personal risk management and insurance. It is designed to be used by those with a working knowledge of insurance—insurance agents and brokers, customer insurance representatives, underwriters, adjusters, and attorneys—to give them detailed and practical information about specific topics on which they have questions. The research for IRMI involved a thorough review of insurance literature, legal research, and interviews with many underwriters, agents, attorneys, and adjusters. Virtually all of the text was written by IRMI staff and has been extensively reviewed by insurance professionals not affiliated with the firm” (Id., Preface).

^v IRMI, “Homeowners 3, Sec. 1—Exclusions-Water Damage/Water.”

^{vi} ISO Form HO 99 93 10 00—2000 Version.

^{vii} ISO Form HO 00 03 05 11—2011 Version (emphasis added).

^{viii} IRMI, “Homeowners 3—Sec. 1—Exclusions--Water Damage/Water,” p. 2 of 5.

^{ix} See *Tupeker v. State Farm Fire & Cas. Co.*, 507 F.3d 346 (5th Cir. 2007).

^x 499 F.3d 419 (5th Cir. 2007).

^{xi} Id.

^{xii} One author has noted that, despite *Tupeker* and *Leonard*, policyholders “remain free to raise public policy challenges to the breadth of the flood exclusion and to proffer factual support for their contention that the proximate cause of storm surge is wind. Factual support can take the form of testimony by law witnesses regarding what transpired at the insured premises and expert climatological or meteorological evidence regarding the storm surge phenomenon. Such expert testimony would show that storm surge cannot occur independently of a cyclonic storm, such as a hurricane, and the height of the storm surge at any particular location is directed related to the speed of the storm’s wind” (CAT Claims/Insurance Coverage for Natural and Man-Made Disasters, Dimugno, John K., et al. [West, 2012], pp. 206–207 [footnotes omitted]).

^{xiii} See *State Automobile Mut. Ins. Co. v. Flexdar, Inc. and RTS Realty*, 964 N.E.2d 845, 852 (Ind. 2012); *Williston Basin Interstate Pipeline Co. v. Factory Mut. Ins. Co.*, 270 F.R.D. 456, 463 (D. ND. 2010); *Kilroy Industries v. United Pacific Ins. Co., et al.*, 608 F.Supp. 847, 854 (CD Calif. 1985); *Colt Industries, Inc., et al. v. Aetna Cas. and Surety Co.*, 1989 WL 147615, p. 5 of 6 (ED Penn. 1989); *Lebas Fashion Imports of USA, Inc. v. ITT Hartford Ins. Group*, 50 Cal.App.4th 548, 565-566, *Modified on Denial of Rehearing* Nov. 27, 1996, *Rev. Denied* Jan. 22, 1997 (Cal. App. 1996).

^{xiv} 2009 WL 3817600 (S.D.N.Y. Nov. 16, 2009); and see *Trilegiant Corp. v. Sitel Corp.*, 272 F.R.D. 360, 364 (S.D.N.Y., Nov. 15, 2010), “anything that might further the interpretation of [the manual] provision—including information on other contracts, SOW’s, and manuals utilized by Trilegiant in other transactions—is relevant and subject to discovery”; and *Bridgeport Music, Inc. V. UMG Recordings, Inc.*,

No. 5 Civ. 6430, 2007 WL 441405, at *3 (S.D.N.Y. Dec. 17, 2007), that allows discovery of “similar” contracts to aid interpretation of contract at issue.

^{xv} *Id.*

^{xvi} *Id.*, p. 3.

^{xvii} *McKee v. State Farm Fire & Cas. Co.*, 145 Cal. App. 3d 772 (Cal. App. 1983); *Fu-Kong Tzung v. State Farm Fire & Cas. Co.*, 873 F.2d 1338 (9th Cir. 1989); *State Farm Fire & Cas. Co. v. Eddy*, 218 Cal. App. 3d 958 (Cal. App. 1990); *Lenscrafters, Inc. v. Liberty Mut. Ins. Co.*, 2005 U.S. Dist. LEXIS 22709 (N.D. Cal. Oct. 6, 2005).

^{xviii} *Tzung v. State Farm Fire and Cas. Co.*, 873 F.2d 1338, 1341 (9th Cir 1989).

^{xix} *Williston Basin v. Factory Mut.*, 270 F.R.D. at 463-464.

^{xx} www.nhc.noaa.gov/HAW2/english/storm_srg.shtml (emphasis added).

^{xxi} *Id.* (emphasis added). This is important because it would appear that storm surge damage can be distinguished from other types of flood damage, such as flood damage directly from waves. This distinction underscores the need to separately identify flood and storm surge, as is done in the 2011 HO3 water exclusion, but not done in the 2000 water damage exclusion.

^{xxii} "Water, Fire and Darkness: NYC after the Superstorm." TheState.com.

^{xxiii} "Superstorm Sandy causes at least 9 U.S. deaths as it slams East Coast", CNN. See also "Eli Manning deals with Superstorm Sandy flooding." *National Football League*. 2012-10-31.

^{xxiv} IRMI, "Risk Management Notes #242," p. 2.

^{xxv} See "The Scope of Expert Testimony in Insurance Bad Faith Cases: Can the Expert Testify on the Meaning of the Insurance Policy," 15 *Conn. Ins. Law Journal* 1 (2008-2009).