Hanover Insurance Co., 740 So.2d 603 (La.1999), that the "statutory scheme is intended to ... attach financial protection to the vehicle regardless of the purpose for which the vehicle is being operated."

Finally, the New Jersey Supreme Court held that the limit of coverage under the Proformance policy was the minimum required statutory amounts of $15,000 per person or $30,000 per accident, rather than the stated policy limit of $100,000. The business pursuits exclusion was contrary to public policy only to the extent that it denied an injured party the minimum coverage required by law, the court reasoned, and therefore the limits of statute rather than policy applied. // Holt

Bad Faith/Flood Insurance

Federal Flood Insurance Act Preempts State Law Claims

Department of Justice Files Amicus Brief

Gallup v. Omaha Prop. & Cas. Ins. Co., __ F.3d __, 2005 WL 3485890 (5th Cir. 2005)

Case at a Glance

Following its recent decision in *Wright v. Allstate Ins. Co.*, 415 F.3d 384 (5th Cir. 2005),[18] the Fifth Circuit again held that the National Flood Insurance Act preempted an insured's state law claims.

Summary of Decision

The Gallups purchased a Standard Flood Insurance Policy ("SFIP") from Omaha Property & Casualty Insurance Company ("Omaha") for their Covington, Louisiana home and its contents. On December 24, 2002, the insureds suffered a flood loss. After filing a claim for the $210,000—the replacement cost of the home—the carrier's engineer determined that the only damage caused by the flood was a loss of soil underneath the pilings. Omaha, a Write Your Own ("WYO") insurer under the National Flood Insurance Program, paid approximately $9,000 to replace the lost soil.

In June 2003, Tropical Storm Bill severely damaged the Gallups' home, causing part of the structure to sag and damage to the foundation. The Gallups again filed a claim for the full replacement cost of the home and Omaha denied this claim after unsuccessful attempts to settle for a nominal sum.

The insureds sued Omaha in December 2003, alleging (1) breach of contract under federal common law; (2) breach of the duty of good faith and fair dealing under federal common law; (3) bad faith breach of contract under LA. CIV. CODE ART. 1997; and (4) bad faith adjustment practices under LA. REV. STAT. 22:1220. Omaha moved to dismiss the state law claims, arguing that they were preempted due to the following regulation FEMA added to the SFIP in December 2000:

> IX. What Law Governs
>
> This policy and all disputes arising from the handling of any claim under the policy are governed exclusively by the flood insurance regulations issued by FEMA, the National Flood Insurance Act of 1968, as amended (42 U.S.C. § 4001, *et seq.*), and Federal common law.

44 C.F.R. pt. 61, App. A(1), Art. IX (2001).[19] The district court held that FEMA was not authorized to issue this regulation in its grant of authority from Congress, and therefore, it was not authorized to preempt state law extra-contractual claims. It did, however, grant the motion to dismiss as to the "bad faith adjusting practices" allegations under Louisiana law, holding that those claims were governed by federal common law.

18. Editor's Note: For an analysis of *Wright v. Allstate Ins. Co.*, *see National Flood Insurance Act Preempts Insured's Bad Faith Claims against Flood Insurer*, 27:15 INS. LITIG. REP. 725 (2005).

19. The *Wright* opinion noted this new provision, but did not rely upon it in reaching its decision. *Wright*, 415 F.3d at 390, n. 4 ("Allstate has not . . . argued that the policy amendment is applicable to the case before us. Accordingly, we analyze this case as a preamendment dispute.").

After the district court certified its decision for immediate appeal, the Fifth Circuit began its discussion by noting:

> The parties have presented the issue in this case as whether the National Flood Insurance Program authorizes FEMA to promulgate a regulation to preempt state law claims made against Write Your Own Insurance providers under the National Flood Insurance Program.

Following that prefatory note, the court quickly disposed of the rest of the case by relying on its recent decision in *Wright*, stating:

> Given this court's holding in *Wright*, that state law tort claims arising from claims handling by a WYO are preempted by the National Flood Insurance Act, it necessarily follows that the Act gives FEMA authority to promulgate regulations to that effect.

The court concluded:

> Based on our decision in *Wright*, the district court erred in concluding that state law claims against a WYO carrier are not preempted by the National Flood Insurance Act and related regulations.

Accordingly, it reversed the district court's judgment denying Omaha's Motion to Dismiss.

Comment

The court's decision in this case, following *stare decisis* and the new choice-of-law provision incorporated into the SFIP, is not surprising. What is interesting, however, is that the United States Department of Justice filed an amicus brief in this case—something it did not do in *Wright*. Though it is only speculation, the implications for the National Flood Insurance Program arising out of the aftermath of Hurricanes Katrina and Rita may have triggered the government's involvement in this case. // Morgan

Bad Faith/Parties

Insured's Spouse Has Standing to Assert Claim Bad Faith Based on Denial of Medical and Family Benefits

Spouse Lack Standing to Allege Bad Faith under Policy's Liability Coverage

Gillette v. Estate of Gillette, 163 Ohio App.3d 426, 837 N.E.2d 1283 (Ohio App., 10th Dist., 2005)

Case at a Glance

The spouse of an insured under an automobile policy has standing to assert a claim for bad faith denial of medical payments and family compensation benefits, which provide coverage for her own losses and expenses. However, bad faith claims were barred with respect to denial of liability coverage because the insurer did not owe the spouse a duty as to that coverage, but owed the duty only to the named insured.

Summary of Decision

Joseph Gillette was driving his minivan when he had an accident that seriously injured his wife, who was a passenger. Gillette had automobile insurance through Nationwide Insurance. The policy named the minivan as the only insured vehicle, and Gillette as the only named insured. Gillette conceded that, as the spouse of the named insured, the wife was an insured under the policy. Nationwide made $10,000 in payment of the wife's medical expenses, under a policy benefit for "Family Compensation" coverage. The wife's attorney sought further benefits equal to the full limits of the insurance policy. Nationwide offered to settle for $100,000, but the wife rejected the offer and sued Nationwide for bad faith. Nationwide moved for summary judgment, asserting that the wife was precluded from asserting a bad-faith claim because, by seeking benefits via the liability coverage Nationwide provided to her husband, she stood in the shoes of a third-party claimant. The trial court ruled for Nationwide, finding that the wife, as a third-party

claimant, could not assert a bad faith claim against Nationwide.

An Ohio Court of Appeal reversed and remanded, concluding that a third-party claimant who is also an insured may bring a claim of bad faith against an insurer for denial of promised medical payments and family compensation. The spouse could not claim bad faith for denial of liability coverage, however. Although no Ohio court had addressed the issue, the court noted that at least five courts in other jurisdictions had concluded that an insured spouse must be treated as a third-party claimant when seeking benefits based upon a coinsured's liability coverage. In those cases, the insured spouse sought benefits based upon the duty the insurer owed to the coinsured to pay for damages for which the coinsured was liable. Because the insurer did not owe any contractual duty to the insured spouse to pay her liability benefits, the insurer did not owe any overlying duty of good faith in handling the insured spouse's claims for liability benefits. Requiring the insurer to owe a duty of good faith to an insured spouse would also create a conflict of interest for the insurer, who would simultaneously owe inconsistent duties to both the insured spouse and the coinsured. The Ohio court agreed with the reasoning in those cases and concluded that the spouse was barred from asserting a claim for bad faith for Nationwide's delay in paying her benefits pursuant to the "Auto Liability" section of the policy.

However, the Court of Appeal reached a different result for the spouse's claims that Nationwide acted in bad faith when it delayed payment pursuant to the "Medical Payments" and the "Family Compensation" sections of the policy. As to both of these coverages, the spouse was a first-party claimant because Nationwide agreed to provide "Medical Payments" and "Family Compensation" benefits to her, as an insured, for her own losses and expenses. Therefore, Nationwide not only owed her a duty to provide the benefits promised pursuant to these coverages, but it also owed her a duty to exercise good faith in handling her claims pursuant to these coverages. If the spouse could prove that Nationwide delayed payment, without reasonable justification, for the benefits she alleges she was entitled pursuant to the "Medical Payments" and "Family Compensation" coverages, she could recover damages for Nationwide's breach of its duty of good faith. // Holt

Builders Risk Insurance/ Causation

The "Wind Deductible" Endorsement Does Not Apply unless Wind Is the Direct, i.e., Immediate, Cause of an Otherwise Insured Loss

Texas Law Applied

Turner Construction Co. v. Ace Property & Casualty Ins. Co., 429 F3d 52 (2d Cir. 2005)

Case at a Glance

An endorsement creating a higher deductible for wind damage than for other types of covered losses is ambiguous. Thus, the "wind deductible" does not apply to property damage caused by the rain, which came through the hole in the roof caused by the wind.

Summary of Decision

The loss arose out of a hotel construction project undertaken at the Houston Construction Center in Texas. Ace provided Turner, the general contractor on the project, with "Builders Risk" insurance.

There was no dispute as to the facts. The construction project sustained wind damage to a roof. Rain came in through an opening in the damaged roof. The internal-to-the-building rain damages were $1.3 million, as both sides stipulated. This number did not include damage to the roof itself.

The policy covered "risks of direct physical loss to Covered Property," except for those to be found in exclusions. There was an exclusion for losses "caused by or resulting from" rain, "whether driven by rain or not[.]" There was, however, an explicit exception to the "Rain Exclusion:" there was coverage for damage caused by rain if it was "located within a fully enclosed structure and then only for such loss that is caused by or resulting from rain ... entering through an opening caused by a Covered Cause of Loss not otherwise excluded."

How an area could be "fully enclosed" and there be an "opening" in a roof was not an issue in the case.

One can see why easily enough.

The policy contained several deductibles. One was quite large. It was not defined and was simply called a "wind deductible." It was in an added endorsement and one suspects that not only was there no definition, explanation, or specification of the idea, but the endorsement was created specially and without serious review of the draft. Thus, it was a manuscript endorsement.

The district court had held that wind was a cause of the loss for which compensation was sought and also held that the "wind deductible" endorsement applied. After all, wind caused the hole in the roof without which the water damage from rain could not have taken place. Wind was therefore part of the causal chain.

The United States Court of Appeals for the Second Circuit undertook *de novo* review. This is true for two reasons. First, policy interpretation was at stake, so it was not facts that were at issue but a matter of law. Second, summary judgment was an issue. The circuit court reversed the district court.

The policy did not define the phrase "wind deductible." The deductible certainly applies to damage directly caused by wind. However, it was not clear whether the deductible should apply to property damage "directly caused by rain, and only indirectly caused by wind." To be sure, in this case, wind caused a physical situation which permitted rain to cause property damage, but it was the rain that caused the damage. Thus, "although wind created the opening through which the rain entered, it was the rain *alone* that caused the damage at issue." (Italics added.)

Of course, there is a sense in which the rain "alone" did not cause the property damage. After all, the wind was in the causal chain that set up the situation. Hence, said Chief Judge Walker, who wrote the majority opinion, in which the famous Judge Calabresi—a Yale Law School Professor—silently joined, the policy is ambiguous, and while the insurer's interpretation is "plausible," it is "not compelling." Under Texas law, observed the opinion, genuine ambiguities are resolved against the party that drafted the insurance contract, which is—almost always—the insurer itself. Thus, ambiguous terms are interpreted in favor of coverage. (Although not noted in this opinion, under Texas law, this rule applies with extra strength to exclusions and hence probably to deductibles; after all, they reduce or eliminate payment which is—practically speaking—substantially like the impact of an exclusion.)

Judge Straub wrote a dissent disagreeing with the majority's view that the application of the deductible must be based on the direct cause of loss. His opinion contained three significant themes.

First, Judge Straub interpreted the terms of the policy to mean that rain can never, by itself, be a covered cause of loss. Rather, rain damage is covered only if it arises from wind damage. Hence, the wind deductible must apply.

Second, the judge reasoned from how the term "windstorm" has been interpreted under Texas law. The dissenter recounted parts of a few policies specifically covering windstorms discussed in Texas court decisions. In light of these decisions, the wind would have been regarded as a cause of the internal damage to the building immediately caused by rain.

Finally, given the way windstorm coverage is "usually" thought of in Texas, the dissenting judge reasoned that "a reasonable observer knowledgeable of insurance practices in Texas would view damage caused by rain entering through a wind-blown opening as windstorm damage and would view a 'wind deductible' as applying to the windstorm-protection aspects of the policy." An advantage of such an approach, the dissenting judge reasoned, is that it avoids a finding of ambiguity. To avoid declaring an ambiguity, "[c]ourts should ... consider the commercial context of the transaction, including the customs and usage in effect in the industry.... In light of the scope and nature of windstorm insurance in Texas, I would find that the policy in this case has a definite and certain legal meaning and that the application of the wind deductible to loss caused by rain entering through a wind-created opening is clear and consistent with the parties' intent as expressed in their written agreement."

The majority opinion explicitly disagreed with the dissenting opinion. "The policy in this case is not a windstorm policy, and the deductible at issue is a 'wind' deductible, not a 'windstorm' deductible. Why should a wind deductible apply to damages not directly caused by wind?" In particular, whatever kind of storm originally damaged the building, it is not what is classically called a "windstorm." It was not a hurricane; it was not a cyclone; it was not a tornado; and so forth.

Comment

The majority also utilized the contents of an elementary symbolic logic textbook published by the prestigious Oxford University Press to "refute" the dissent. Hardly any publisher is better to cite. The court's opinion goes this way. The language of the insurance policy, in effect, is as follows: "'Rain is not a covered cause of loss, unless it enters a building as the result of a different covered cause of loss.'" According to Judge Walker, this sentence is equivalent to the following: "'If rain enters a building as a result of a different covered cause of loss, rain is a covered cause of loss.'" The court draws a significant inference on the basis of the following proposition: "[A]s a matter of elementary logic, the proposition 'not A, unless B' is exactly equivalent to 'if B, then A.'"

The alleged exact logical equivalence just quoted is dead wrong. The word *unless* is a statement of necessary not sufficient condition. To assert "if B, then A" is to say that B is a sufficient condition for A. The sentence "not A, unless B" asserts that B is a necessary condition for A; it does not assert that B is a sufficient condition for A.

The dissenting opinion also contains a significant error. Judge Straub asserts that terms should be understood in terms of industry custom before they are declared ambiguous. He is right under Texas law. What industry custom might be—however—hinges upon how the construction industry risk managers and the building risk insurance underwriters used and understood the term "wind" and the phrase "wind deductible." This is a factual matter. There was no relevant evidence as to industry custom before the district court below, or before the circuit court deciding the appeal. Consequently, it was error to grant any summary judgment at all. Therefore, the summary judgment favoring the insured should be reserved, if Judge Straub is right, not affirmed. That would be a concurring section of Judge Straub's opinion. He should then "hold" that the case should be returned to the district court for further review and action. That would be the only portion of his opinion to dissent. // Quinn

The majority's reasoning has implications for Hurricane Katrina-related claims and other claims arising out of multiple causes, only some of which are covered. In the Hurricane Katrina context, insurers will no doubt invoke the majority's reasoning to argue that coverage depends on the direct cause of loss—usually flooding, which is typically excluded—rather than the indirect cause of loss—wind, which is covered under most homeowners policies. Policyholders will point out that the *Turner* decision is about construing ambiguities against insurers in favor of coverage, not which causation doctrine should apply to a different set of facts. // DiMugno

Damages

Indiana Court of Appeals Recognizes Third Party Litigation Exception to American Rule That Attorney Fees Are Not Recoverable by Prevailing Party

Court Permits Insured to Recover Legal Fees Incurred to Sue Construction Contractors Due to Insurer's Breach of Insurance Contract

Masonic Temple Association of Crawfordsville v. Indiana Farmers Mutual Insurance Co., 837 N.E.2d 1032 (Ind.App. 2005)

Case at a Glance

Attorney fees and expenses an insured incurs in litigation against construction contractors whose excavation of an adjacent property damaged the insured's property were recoverable as an element of damages in the insured's breach of contract action against its property insurer where the insurer denied coverage for damage caused by the contractors.

Summary of Decision

The insured, a Masonic Temple, was located adjacent to a construction site for a new Police Department building. Following excavation of the construction site, cracks developed in the walls and ceilings of the Temple, forcing the Temple's membership to implement emergency procedures to prevent further deterioration and collapse.

Indiana Farmers Insurance Company, the Temple's property insurer, denied coverage for the Temple's loss. In so doing, the Indiana Farmers relied on its policy's earth movement exclusion. The insurer