ISO's Flood Exclusion Amendments and Hurricane Ian Claims

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I understand that it may seem early to be addressing possible coverage issues, under homeowner's policies, for the devastation in Florida caused by Hurricane Ian. At the moment, those affected are dealing with a major catastrophe and possibly life-altering situation.

But I'm a realist. While we all have those impacted in our thoughts and prayers, that's not going to rebuild the state or people's lives. Money is. And when it comes to the source of money to do so, insurance will be far and away the first and principal place that people turn.

Indeed, even before it started to rain, Florida Governor DeSantis was discussing the availability of insurance for his citizens, as well as plenty of articles written forecasting how significant the insurance impact could be. If Covid-19 taught us anything about the pursuit of insurance, the discussion begins the second the need arises.

When it comes to insurance coverage for hurricanes, the starting place is always the same. Homeowner's [and commercial property] policies generally cover wind damage and exclude flood damage. For flood coverage, a flood policy is needed, offered by the National Flood Insurance Program or the private market.

There will of course be coverage disputes over the cause of property damage – wind, water or a combination of both (a significant issue in Katrina litigation). The Florida Supreme Court's 2016 decision in *Sebo v. American Home Assurance Co.*, 208 So. 3d 694 (Fla. 2016) will provide important guidance on the issue. [As in Katrina coverage litigation, expect to see much discussion of "anti-concurrent causation" clauses in policies and how they impact damages caused by a combination of wind and flood.]

It is clear from current news reports that a substantial amount of Ian claims will be for flooding caused by storm surge. Such damages are excluded by the flood exclusion. But with so much at stake, and a Florida plaintiffs' bar that has long been as attracted to insurance companies as a bee to honey, the pursuit of coverage for flood damage can be anticipated, a steep climb notwithstanding.

Indeed, a September 28th article in *The Washington Post* cites this jaw-dropping statistic from Florida's insurance regulator: "In the last half of the 2010s, Florida accounted for about 8% of all homeowners' claims in the U.S. but almost 80% of all homeowners' lawsuits against insurers in the U.S."

ISO's Amendments to its Flood Exclusion

When it comes to the pursuit of coverage for flood damage, expect to see arguments made by policyholders that Insurance Services Office's ("ISO") 2011 amendments to the flood exclusion, contained in the organization's homeowner's policies [as well as being amended in 2012 in its commercial property policies], affects certain claims. This issue was addressed in a 2017 article by Bob Russin, of Cleveland law firm Rutter & Russin, LLC, posted on the firm's website. I'll let Mr. Russin explain the issue:

> In May 2011, the Insurance Services Office (ISO) issued a new standard HO3 policy form. The HO3 is the most commonly used residential policy form in the United States. This edition of the HO3 expanded the water damage exclusion by explicitly exempting coverage for "storm surge." Prior editions of the HO3, many of which are probably still in use, did not specifically exclude storm surge, so policyholders sometimes successfully argued that

> damage caused by storm surge was not excluded, and was therefore covered, under their version of the HO3 form. This argument is now bolstered by the new HO3 form. A policyholder can argue that if the prior HO3 form already clearly excluded storm surge, then why did ISO amend the form to list it separately. This may be enough to convince a court that since the old version of the HO3 form does not specifically exclude storm surge, it must not be excluded. Not being excluded equals being covered under "all-risk" property insurance policies.

Rutter and Russin are not the only ones to argue that ISO's amendments to the flood exclusion could mean that, what's now excluded was, by implication, intended to be covered under earlier policies. A undated white paper by California attorney Charles Miller – posted on the website for United Policyholders (an insurance consumer-advocacy group) – posits that ISO's addition of "storm surge" to the flood exclusion in 2011 gives rise to an argument that the earlier flood exclusion was ambiguous or the industry did not intend to exclude storm surge from earlier policies.

An argument about the meaning of the change in the flood exclusion was also raised by a policyholder, but not addressed by the court, in *Five Towns Nissan, LLC v. Universal Underwriters Ins. Co.*, 2016 N.Y. Misc. LEXIS 4347 (Sup. Ct. N.Y., N.Y. County Nov. 22, 2016).

ISO, for its part, writing in its 2010 filing circular for its 2011 homeowner's policy, described the impact of the flood exclusion amendments succinctly: "There is no change in coverage relative to the intended design of the above referenced water exclusion endorsements."

By way of background, ISO's changes to its flood exclusion in fact date back to 2008, specifically acknowledged in a filing circular to have been on account of certain decisions in Katrina coverage cases. ISO discussed these cases and noted that appeals courts found the flood exclusions to be unambiguous. Nonetheless, ISO stated that it was amending the flood exclusion to "reinforce the scope of the provision."

Specifically, in 2008, ISO introduced endorsements that amended its "water damage" exclusion, including changing its name to "water" exclusion. These amendments included such things as adding "storm surge" to the list of excluded types of water.

The now-named "water" exclusion was also amended to state that it applies regardless of whether excluded water "is caused by an act of nature or is otherwise caused." In addition, the exclusion was amended to state that it "applies to, but is not limited to, escape, overflow or discharge, for any reason, of water or waterborne material from a dam, levee, seawall or any other boundary or containment system." Among other things driving these changes were disputes in Katrina litigation whether "flood" included man-made flood, since so much damage was caused by the levee breaches is Louisiana.

ISO's flood exclusion endorsements were incorporated into the terms and conditions of its homeowner's and property policies in 2011 and 2012, respectively. So clearly the significance of this issue will be tied to the extent that policies, in effect today, contain a form issued prior to the change. In other words, how many policies today use a prior form that did not expressly include "storm surge" in the list of excluded types of water? This is hard to know. In general, it is not unusual for insurers to issue policies that do not include the most current edition of a form.

Impact of ISO's Amendment on Hurricane Ian Flood Claims

In Mr. Miller's paper, written in response to so-called Superstorm Sandy, he addresses the principal issue that will be at the heart of determining the impact, or not, of these ISO flood exclusion amendments on clams. Specifically, will courts adopt the argument that, by changing a policy exclusion, insurers must have meant that, whatever is now being excluded, had previously been covered?

Courts nationally have addressed this issue and cases go both ways. Mr. Miller acknowledges as much. He concludes that the "better-reasoned decisions" are those that allow a court to consider a subsequent policy provision when interpreting a prior version of it. However, Mr. Miller cites no reasons for his conclusion.

On one hand, the issue should be stopped before it even starts. If a court determines that the flood exclusion in a pre-2011 or 2012 policy form is unambiguous – as several appeals courts did in Katrina cases – then resort to extrinsic evidence, such as the changes made in the later form, should be impermissible off the bat.

However, if the question needs to be answered, the decisions that have addressed the impact of subsequent changes in policy forms will be carefully scrutinized. Of these decisions, expect to see *Pastor v. State Farm*, 487 F.3d 1042 (7th Cir. 2007) get much attention. Not only is the Seventh Circuit influential, but the decision was written by Judge Richard Posner, whose opinions have long been respected by other jurists.

At issue in *Pastor* was a provision in a State Farm automobile policy that provided that the insurer will "pay you $10 per day if you do not rent a car while your car is not usable." If you do rent a car, then State Farm pays a portion of the rental charge. A State Farm insured sought to represent a class of all State Farm insureds who, during a certain period, received payments for damage to their cars but, despite not renting a car, did not receive payment pursuant to the $10 per day clause.

At issue in the class certification process was the manner in which State Farm defines a "day." Pastor argued that a "day" meant any part of a day. Her own car had been out of use for about an hour while she had its windshield repaired. State Farm argued that a "day" means 24 hours. In support of her interpretation, Pastor argued that, because State Farm made explicit in a subsequent version of the clause that "day" means 24 hours, the insurer made a "confession" that her interpretation of the original clause was correct. State Farm, on the other hand, maintained that the change was simply a clarification.

Judge Posner saw no "confession" by State Farm's change in its form. Moreover, he held that:

> [T]o use at a trial a revision in a contract to argue the meaning of the original version would violate Rule 407 of the Federal Rules of Evidence, the subsequent repairs rule, by discouraging efforts to clarify contractual obligations, thus perpetuating any confusion caused by unclarified language in the contract. Rule 407 is not limited to 'repair' in the literal sense. (several citations omitted). It was applied to the meaning of an insurance clause in *Hickman v. GEM Ins. Co.*, 299 F.3d 1208, 1213-14 and n. 9 (10th Cir. 2002). . . . Pastor wants to use the evidence that State Farm, to avert future liability to persons in the position of the plaintiff, changed the policy, to establish State Farm's 'culpable conduct.' That is one of the grounds that evidence of subsequent corrective action may not be used to establish."

Id. at 1045.

Hickman v. GEM Ins. Co., the decision cited by Posner, involved claims that a medical benefits insurer wrongfully refused to fully pay certain hospital room and board charges. The Tenth Circuit declined to consider evidence of an insurer's later handling of hospital room and board charges on the basis that it was inadmissible as a subsequent remedial measure under Rule 407 of the Federal Rules of Evidence.

In *Reynolds v. University of Pennsylvania*, 483 Fed. Appx. 726 (3rd Cir. 2012), the Third Circuit addressed a dispute over the characterization of a degree from the University of Pennsylvania. A student in Penn's Executive Masters in Technology Program was denied the right to claim the status of a Wharton School alumni. At the time that the student enrolled, the EMTP website stated that he was entitled to do so. The trial court declined to admit evidence that Penn made changes to the website to state that EMTP graduates

are "honorary" members of the Wharton alumni network. In affirming, the appeals court relied on both *Hickman* and *Pastor* to conclude that the website changes were inadmissible under Rule 407.

More recently, this issue was addressed in *Crescent Plaza Hotel Owner, L.P. v. Zurich Am. Ins. Co.*, 20 F.4th 303, 311 (7th Cir. 2021), where the court, citing *Pastor*, stated that "revising language in an insurance policy does not constitute an admission that an alternative interpretation of the original language was correct. . . .More fundamental, though, such belt-and-suspenders modifications to policy language simply do not compel the inference that prior policy language did not require the same result."

The argument, that ISO's change to the flood exclusion altered its meaning should be a non-starter based on the pre-2011 and 2012 flood exclusion being unambiguous. If not, the impact of the change is an issue that is likely going to be addressed in certain flood claims. But ISO's statement, that it intended no change in coverage, and the purpose of FRE 407, shuts it down.

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