

THOUGHT LEADERSHIP

News

TEXAS SUPREME COURT TACKLES CONCURRENT CAUSATION AND UPHOLDS EXCLUSION IN A HURRICANE IKE PROPERTY DAMAGE CASE

Newsbrief

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Last Friday, April 24th, in *JAW The Pointe, LLC v. Lexington Insurance Co.* 2015 WL 1870054 (Tex. 2015) the Texas Supreme Court affirmed the Fourteenth Court of Appeals and refused to reinstate a \$3.7 million trial verdict against Lexington Insurance Co. for losses stemming from property damage from Hurricane Ike.

The dispute involved losses the insured incurred as a result of city ordinances triggered by damage to an apartment complex during Hurricane Ike. The parties agreed the insurance policy covered the costs of complying with city ordinances, but only if the policy covered the property damage that triggered the enforcement of the ordinances. In this case the property damage resulted from wind, which the policy covers, and flooding, which the policy expressly excludes. Lexington provided the primary coverage layer, limited to \$25 million per occurrence. Hurricane Ike damaged about 135 other complexes also covered by the same policy. The insured initially planned to repair the apartments, but the City of Galveston ordinance required that all apartment complexes that were “substantially damaged” (meaning they sustained damage equal to or exceeding 50% of their market value) must be brought into compliance with current code requirements, which included raising the structures to a base flood elevation. Two months after the hurricane, the insured submitted a permit application to the city and included a third-party consultant’s estimate that it would cost \$6,256,887 to repair all of the damage the building had sustained. The estimate did not distinguish between damage caused by wind and damage caused by flooding. The city determined that the building was in fact “substantially damaged” because the cost of the damage “equals or exceeds 50 percent of the market value.” The city also found that because the building was “substantially damaged,” city ordinances also required the insured to elevate the apartments three additional feet.

Lexington’s building consultant submitted a report estimating the building sustained wind damage totaling approximately \$1,278,000 and flood damage of approximately \$3.5 million. Subsequently the insured submitted a proof of loss to Lexington, requesting payment of \$817,940, which represented the \$1,278,000 in wind damage less an applicable deductible. Lexington promptly paid this claim, but did not pay the additional amounts the insured had claimed as costs incurred to demolish and rebuild the building pursuant to the city’s ordinances. The insured claimed that Lexington never formally denied the claims for these ordinance-compliance losses.

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The insured filed suit in July of 2009 asserting claims for breach of the insurance contract and violations of the Texas Insurance Code and the Texas Deceptive Trade Practices Act. Despite the lawsuit, Lexington and the adjuster continued working on the claim. In September 2009, Lexington notified the insured by letter stating it would not pay for flood damage or for costs to comply with the city ordinances. Meanwhile, Lexington continued paying claims associated with the other apartment complexes that its policy covered, and in January 2010 it notified the insured that the policy's \$25 million per-occurrence limit had been exhausted.

Prior to trial, Lexington filed two motions for partial summary judgment, one seeking dismissal of the breach of contract claim on the ground that Lexington had exhausted the policy limits, and the other seeking dismissal of any claims based on flood damage on the ground that the policy expressly excluded coverage for such damage. The insured did not oppose these motions, and the trial court granted them, leaving only the insured's statutory claims for trial. On the remaining claims, the jury returned a verdict finding that Lexington had engaged in "unfair or deceptive acts or practices in the business of insurance" by failing to (a) "attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim when the insurer's liability had become reasonably clear;" (b) provide a reasonable explanation for its coverage denial; and (c) affirm or deny coverage within a reasonable time, and that Lexington had engaged in this conduct "knowingly." The jury found actual damages and expenses of \$1,230,000 and awarded additional statutory damages of \$2.5 million. Based on the jury's verdict, the trial court entered a judgment awarding these damages plus \$170,000 in attorney's fees.

The court of appeals reversed and rendered a take-nothing judgment concluding the policy excluded coverage for the code-compliance losses and therefore Lexington could not be liable for Insurance Code and DTPA violations. Relying on the policy's anti-concurrent-causation clause, the court of appeals held the policy excluded coverage of costs to comply with the city's ordinances because the necessity of compliance resulted at least in part from flooding, expressly excluded from the policy.

In its analysis last Friday, the Texas Supreme Court began by reiterating that, as a general rule, there can be no claim for bad faith when an insurer has promptly denied a claim that is not covered, unless there was some "extreme" conduct causing damages unrelated to the policy claim. For that reason, the Court confined its inquiry to whether or not the policy provided coverage for the claimed costs. The Court found: first, the policy expressly excludes coverage for any "loss or damage caused directly or indirectly by any of the" listed causes, "regardless of any other cause or event that contributes concurrently or in any sequence to the loss." Second, the policy specifically lists "flood" as an excluded cause, and the parties agreed the policy does not cover losses caused by flooding. And third, even though the policy expressly excludes coverage for any losses that result "directly or indirectly" from "[t]he enforcement of any ordinance or law," there were two endorsements that the parties agreed provided coverage for such losses, despite the exclusion.

The Court acknowledged that it had not previously addressed an anti-concurrent-causation clause but listed decisions from federal courts and lower courts of appeals that have interpreted and upheld the applicability of virtually identical clauses under Texas law and other states' laws. They concluded the evidence conclusively established that "Hurricane Ike caused both wind damage and flood damage, in a sequence of events, which combined to cause the city to enforce the ordinances against The Pointe". The Court further agreed with the Fifth Circuit that, under Texas law, the anti-concurrent-causation clause and the exclusion for losses caused by flood,

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“read together, exclude from coverage any damage caused by a combination of wind and water.” The high court ultimately said because the evidence established that flood damage triggered the enforcement of the city ordinances and thus ‘directly or indirectly’ caused the insured’s losses, the policy excludes coverage for such losses “regardless of the fact that wind damage ‘contribute[d] concurrently or in any sequence to the loss.” The court affirmed and found the policy did not cover the insured’s losses, thus the insured cannot recover for the insurer’s bad faith failure to effectuate a prompt and fair settlement of the claim.