WHITE PAPER: HISTORIC SOUTH CAROLINA FLOODING AND COVERAGE ISSUES

OVERVIEW

South Carolina has been deluged with historic amounts of rain in early October 2015. The rains have caused extensive flooding, including the reported breaches of dams. There has and will be extensive property damage.

Flood insurance is typically provided pursuant to the National Flood Insurance Program, created by Congress by the National Flood Insurance Act of 1968. FEMA administers this program. Generally, private insurers do not provide flood coverage. Accordingly, insurance policies usually contain a water exclusion. Typically, the exclusion provides:

EXCLUSIONS

1. We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss.

Water

(1) Flood, surface water, waves, tides, tidal waves, overflow of any body of water, or their spray, all whether driven by wind or not;

(2) Mudslide or mudflow;

(3) Water under the ground surface pressing on, or flowing or seeping through:

(a) Foundations, walls, floors or paved surfaces;

(b) Basements, whether paved or not; or

(c) Doors, windows or other openings.

This paper will provide an overview of North and South Carolina first party property coverage legal principles involving:

- General rules of contract interpretation;
- The applicability of surface water and flood exclusions; and
- The enforceability of anti-concurrent cause language.

This paper will also refer to cases from other jurisdictions where courts have addressed the surface water and flood exclusions, as well as the application of the anti-concurrent cause language in light of the exclusions. It will also discuss cases where courts have applied the flood exclusion when water flows over or breaches dams and/or levees. The paper will conclude by providing some practical considerations and general rules.

NORTH AND SOUTH CAROLINA'S RESPECTIVE RULES OF POLICY INTERPRETATION

Under North Carolina law, an insurance policy is a contract, which is to be construed under the law applicable to other written contracts. *Integon Nat. Ins. Co. v. Philips*, 212 N.C. App. 623, 625 (2011). North Carolina follows "the plain meaning rule." *New NGC, Inc. v. ACE American Ins. Co.*, 2015 WL 2259172 *4 (W.D.N.C. 2015). "If the policy language is clear, courts are duty-bound to interpret it accordingly, without rewriting the contract or disregarding the express language used . . . ." *Id*. (internal citations omitted). If the policy is ambiguous, "North Carolina courts construe ambiguous terms and phrases in favor of the insured. . . . Further, coverage provisions are liberally construed and exclusions are strictly construed." Id.

South Carolina employs similar rules of policy interpretation. "[I]nsurance policies are subject to the general rules of contract construction." *M & M Corp. of S.C. v. Auto-Owners Ins. Co.*, 390 S.C. 255, 259, 701 S.E.2d 33, 35 (2010). "Where the contract's language is clear and unambiguous, the language alone determines the contract's force and effect." *McGill v. Moore*, 381 S.C. 179, 185, 672 S.E.2d 571, 574 (2009).

Whether the contract is ambiguous is a question of law for the court. Id. Ambiguous terms, as in North Carolina, are construed liberally in favor of the insured and strictly against the insurer. *USAA Prop. & Cas. Ins. Co. v. Clegg*, 377 S.C. 643, 655, 661 S.E.2d 791, 797 (2008).

SURFACE WATER: DEFINED IN SOUTH CAROLINA, BUT NOT IN NORTH CAROLINA

South Carolina

For over 100 years, South Carolina has consistently defined "surface water". In the South Carolina Supreme Court case of *Lawton v. S. Bound R.R. Co.*, the Court defined "surface water" as the following:

> [W]aters of a casual and vagrant character, which ooze through the soil or diffuse or squander themselves over the surface, following no definitive course. They are waters which, though customarily and naturally flowing in a known direction and course, have nevertheless no banks or channels in the soil, and include waters which are diffused over the surface of the ground, and are derived from rains and melting snows . . . . *Id.*, 61 S.C. 548, 552, 39 S.E. 752, 753 (1901).

The South Carolina Supreme Court recently upheld this definition in a significant opinion regarding both surface water and flood. The latter issue is discussed in the following section. *See M & M Corporation of South Carolina v. Auto-Owners Insurance Co.*, 390 S.C. 255, 701 S.E.2d 33 (2010). In *M & M*, the insured owned a hotel in South Carolina. The South Carolina Department of Transportation was widening lanes near the hotel, which included the installation of an underground stormwater drainage system. On a single day, 4 inches of rain fell. Water collected in the drainage system pipes, exiting at an exposed, above ground thirty-inch pipe, 50 feet from the edge of the hotel property line and 150 feet from the hotel building. Water, which discharged from the pipe, pooled in the hotel parking lot, entered the hotel and caused damage.

The policy at issue contained a surface water exclusion. The Supreme Court, per request of the U.S. District Court, was asked to determine whether the rainwater which collected and channeled in the stormwater system was "surface water". The Court held that it was not, reasoning as follows:

> While the water at issue was surface water before it was collected in the stormwater system, it then was concentrated and cast onto Plaintiff's property. Once surface water is deliberately contained, concentrated, and cast onto an adjoining landowner's property, it is no longer naturally flowing, diffuse water. Water spewing in an unnatural concentration from a stormwater drainage system lacks the identifiable characteristics of surface water the court approved in *Lawton*. *Id*. at 260.

Accordingly, the Supreme Court concluded that "[t]he water intruding upon Plaintiffs[']' property was not owing to fortuitous natural causes, but instead to the deliberate actions of another. We find that naturally falling water that has been intentionally concentrated and cast upon the insured's property is not surface water for the purposes of the Policy." *Id*. Thus, the Court ruled that the "surface water" exclusion was inapplicable.

North Carolina

Unlike South Carolina, North Carolina has not yet defined "surface water" in the context of a first party property insurance policy. However, North Carolina has discussed surface water in cases involving a nuisance action between property owners, when water from one property damages the property of another. *See, e.g., J.W. Pendergast v. Aiken*, 293 N.C. 201, 206, 236 S.E.2d 787, 790 (1977) (referring to "diffused surface water" as spring water, rain or snow melt spreading over the land without pattern or order, but stating that for purposes of analyzing drainage problems, the Court has, in the past, "combined diffuse surface waters, watercourse and overflow waters from the ocean into the broader category of surface waters.").

Definitions from Other States

Many other states in the country have defined "surface water" and their definitions are consistent with that of South Carolina. Some of these notable decisions include the following definitions of "surface water":

A. Surface water is water that derives from natural precipitation such as rain or melting snow, flows over or accumulates on the surface of the ground, and does not form a definite body of water or follow a defined watercourse. *Smith v. Union Auto. Indem. Co.*, 323 Ill. App. 3d 741, 752 N.E.2d 1261 (2d Dist. 2001);

B. Surface water consists of waters on the surface of the ground, usually created by rain or snow, which are of a casual or vagrant character, following no definite course and having no substantial or permanent existence. *T.H.E. Insurance Company v. Charles Boyer Children's Trust*, 455 F. Supp. 2d 284 (M.D. Pa. 2006) aff'd, 269 Fed. Appx. 220 (3rd Cir. 2008);

C. Surface water is natural precipitation diffused over the surface of the ground, until it evaporates, is absorbed by the land, or reaches channels where water naturally flows. *State Farm Lloyds v. Marchetti*, 962 S.W.2d 58 (Tex. Ct. App. 1997);

D. Surface water consists of waters from rain, melting snow, springs, or seepage, or floods that lie or flow on the surface of the earth and naturally spread over the ground but do not form part of a natural watercourse or lake. *Surabian Realty Co., Inc. v. NGM Insurance Co.*, 462 Mass. 715, 971 N.E.2d 268 (2012); and

E. Surface water is water from melted snow, falling rain, or rising springs, lying or flowing naturally on the earth's surface, not gathering into or forming any more definite body of water than a mere bog, swamp, slough or marsh. Surface water is not of a substantial or permanent existence, has no banks, and follows no defined course or channel. *Heller v. Fire Ins. Exchange*, 800 P.2d 1006 (Col. 1990).

Further, there are a number of opinions from other states where courts have considered whether "surface water" lost it character as, or is no longer "surface water", once it enters a defined channel or watercourse. The *M & M* opinion, discussed above, is one of the cases. Additional examples include the following:

A. Surface water that entered the stormsewer lines lost its character as and was no longer surface water, as the lines were a defined watercourse or channel. *The Herrington, Inc. v. City of Geneva*, 2012 WL 6969046 (Ill. Ct. App. 2012);

B. Surface water that first hit the surface of the ground as rain, and then entered a sewer pipe, became surface water a second time after the pipe ruptured, and the water flowed down a slope and pooled in a low area next to a bowling alley. *T.H.E. Charles Boyer Children's Trust*, 269 Fed. Appx. 220 (3rd Cir. 2008);

C. Surface water exclusion applied where rainwater fell on the ground, entered a catch basin and drain pipe which was hampered by debris, water gushed back up from the drain pipe and into the basin, overflowed, and followed the terrain of the property to the outside stairwell of a basement. *Myers v. Encompass Indemnity Co.*, 169 Ohio App. 3d 545, 863 N.E.2d 1083 (Ohio Ct. App. 2006);

D. During heavy rains on campus, water that flowed into a domed stadium through loading dock doors, flooded the stadium, flowed through the underground steam pipes, flowed out and damaged a heating plant and building on campus was surface water; it did not lose its character as surface water by being diverted underground through man-made structures. *State v. North Dakota State University*, 694 N.W.2d 225 (N.D. 2005);

E. Surface water exclusion did not apply where rainwater went into a 13 foot deep pit, then into an underground sewer pipe which extended into a wall of an office space that was in the basement. *Selective Way Ins. Co. v. Litigation Technology, Inc.*, 606 S.E.2d 68 (Ga. Ct. App. 2004);

F. Water from rain and melted snow on the roof of a neighboring building, which flowed through an underground pipe and damaged a retaining wall, was not surface water. *Georgetown Square v. United States Fid. & Guar. Co.*, 523 N.W.2d 380 (Neb. Ct. App. 1994); and

G. Water from spring runoffs of melted snow which were diverted into man-made trenches and then onto the insured's property was not surface water. *Heller v. Fire Ins. Exchange*, 800 P.2d 1006 (Colo. 1990).

FLOOD

South Carolina

As mentioned above, another issue the Supreme Court in *M & M* was required to examine was whether a first party property insurance policy exclusion for "flood water" encompassed water that discharged from a stormwater collection system and thereafter entered a building. *M & M*, 390 S.C. at 261. Relying on the definition of "flood" from a 1965 Idaho case[1], the Supreme Court held that "[f]lood waters are those waters that breach their containment, either as a result of a natural phenomenon or a failure in a man-made system, such as a levee or a dam." Accordingly, the water in this case was "not flood water because it did not breach containment, but instead it was deliberately channeled and cast upon Plaintiff's land." *Id*.

1 *Milbert v. Carl Carbon, Inc.*, 89 Idaho 471, 406 P.2d 113, 117 (which defined flood water as "waters which escape, because of their height, from the confinement of a stream and overflow adjoining territory; implicit in the definition is the element of abnormality.")

North Carolina

There are no North Carolina cases which discuss flood in the context of a first party insurance policy exclusion.

Other States

There are a number of opinions from other states where courts have defined "flood" and then determined, based on the facts of the case, whether the flood exclusion applied. Some of the definitions include the following:

A. An overflowing or inundation of water over usually dry land. *Northrop Grumman Corp. v. Factory Mut. Ins. Co.*, 563 F.3d 777 (9th Cir. 2009);

B. Those waters above the highest line of the ordinary flow of a stream, and generally speaking they have overflowed a river, stream, or natural water course and have formed a continuous body with the water flowing in the ordinary channel. *T.H.E. Insurance Company v. Charles Boyer Children's Trust*, 455 F. Supp. 2d 284 (M.D. Pa. 2006), aff'd, 269 Fed. Appx. 220 (3rd Cir. 2008);

C. Water that escapes from a watercourse in large volumes and flows over adjoining property in no regular channel ending up in an area where it would not normally be expected. *Wallis v. Country Mutual Ins. Co.*, 309 Ill. App. 3d 566, 723 N.E.2d 376 (2000); and

D. When a body of water overflows its normal boundaries and inundates an area of land that is normally dry, the event is a flood. *In re Katrina Canal Breaches Litigation*, 495 F.3d 191 (5th Cir. 2007).

CONCURRENT CAUSATION AND THE ANTI-CONCURRENT CAUSE LANGUAGE

Overview

Insurance policies typically contain anti-concurrent cause language as a preamble to their water exclusions. Generally, the language states:

> We will not pay for "loss" caused directly or indirectly by any of the following. Such "loss" is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the "loss".

South Carolina and North Carolina law uphold the anti-concurrent cause language. Although there are no South Carolina or North Carolina cases applying the language to a flood or surface water exclusion, many courts around the country have enforced it in connection with those exclusions.

South Carolina

South Carolina courts have enforced anti-concurrent cause language. *South Carolina Farm Bureau Mut. Ins. Co. v. Durham*, 380 S.C. 506 (2009) (applying anti-concurrent cause language as to an exclusion for underground water pressure, where it was "a cause of loss", even though it was not the sole cause or even the efficient proximate cause).

North Carolina

North Carolina courts have also enforced anti-concurrent cause language. *Builders Mutual Ins. Co. v. Glascarr Properties, Inc.*, 202 N.C. App. 323, 326, 688 S.E.2d 508, 511 (2010) (applying anti-concurrent cause language as to a mold exclusion); *Magnolia Mfg. of N.C., Inc. v. Erie Ins. Exch.*, 361 N.C. 213, 639 S.E.2d 443 (2007) (per curiam), 179 N.C. App. 267, 278, 633 S.E.2d 841, 847-848 (2006) (Tyson, J. dissenting) (applying anti-concurrent cause language as to a collapse exclusion). *But see Dodd v. Automobile Ins. Co. of Hartford*, 2007 WL 203983 (W.D.N.C. 2007) (refusing to uphold the anti-concurrent cause language because it was contrary to North Carolina law; the Dodd opinion was issued 3 days prior to the South Carolina Supreme Court opinion in Magnolia).

Other States

Generally, most courts have enforced the anti-concurrent cause language in cases involving surface water and/or flood. Some of the cases include the following:

A. Rainwater that overflowed and diverted from a drainage ditch onto the insured's property was flood water and excluded, even though the water had been diverted because someone placed large cylinders across the ditch. *George v. State Farm Lloyds*, 2014 WL 2481894 (Tex. Ct. App. 2014);

B. Heavy rain that flowed over a parking lot and into the building was surface water and excluded, even though the water did not enter the parking lot drain because it was clogged. *Surabian Realty Co., Inc. v. NGM Insurance Co.*, 971 N.E.2d 268 (Mass. 2012);

C. Rainwater that rushed off a road, down a hill and through a hole in the wall of a basement was surface water and excluded, even though the insured claimed that the cause was construction activities, as workers had removed a curb and sidewalk which allowed the water to flow. *Legal Services Plan of Eastern Michigan v. Citizens Ins. Co. of America*, 2009 WL 1175514 (Mich. Ct. App. 2009);

D. Pool of rainwater that had accumulated at the bottom of basement stairs during a storm and then entered the basement when a glass door broke was surface water and excluded. The court rejected the insured's argument that the loss should be covered because the predominant cause of the loss was the wind that blew an object into and broke the glass door. *Bao v. Liberty Mutual Fire Ins. Co.*, 535 F. Supp. 2d 532 (D. Mary. 2008);

E. During a rainstorm, water that flowed into a bowling alley when a door on the side of the building collapsed was surface water and excluded. In light of the anti-concurrent cause language in the policy, the court rejected the insured's claim that there was coverage because the proximate cause was a ruptured pipe in an embankment, which led to the collapse of the embankment and a mud pile that disrupted the drainage and diverted water into the bowling alley. *T.H.E. Charles Boyer Children's Trust*, 455 F. Supp. 2d 284 (M.D. Pa. 2006), aff'd 269 Fed. Appx. 220 (3rd Cir. 2008);

F. Enforcing the anti-concurrent cause language when damage was caused by a combination of water, an excluded loss, and wind, a covered loss. *Leonard v. Nationwide Mut. Ins. Co.*, 499 F.3d 419 (5th Cir. 2007) (applying Mississippi law);

G. Heavy rainstorm which resulted in water damage to a car dealership was surface water and excluded, even though the insured argued that the proximate cause was a drain which was partially blocked by a piece of wood. *Sunshine Motors, Inc. v. New Hampshire Ins. Co.*, 530 N.W.2d 120 (Mich. Ct. App. 1995);

H. Damage to a theater during a rainstorm from water that went from a parking lot into a building was surface water and excluded, even though partially blocked pipes in the underground storm sewer caused the system to overflow. *Front Row Theatre, Inc. v. American Mfrs. Mut. Ins. Cos.*, 18 F.3d 1343 (6th Cir. 1994); and

I. Heavy rainstorm which resulted in water damage to a basement was surface water and excluded, even though a clogged rain contributed to the loss. *Casey v. General Accident Ins. Co.*, 578 N.Y.S.2d 337 (N.Y. Ct. App. 1991).

WATER OVERFLOWING DAMS AND LEVEES

Reports from South Carolina have stated that, following Hurricane Joaquin, water has overflowed certain dams and/or the dams have been breached in some way, with water flowing downstream and damaging property. Generally, courts have held that the flood exclusion applies when water overflows or breaches a dam or levee.

A. Water that flowed through levees broken by Hurricane Katrina was "flood" water within the meaning of the flood exclusion. *Sher v. Lafayette Ins. Co.*, 988 So. 2d 186, 194-195 (La. 2008);

B. Flood exclusion applied where water overflowed three canals running through New Orleans and the levees failed to hold back the water; "[t]hat a levee's failure is due to its negligent design, construction or maintenance does not change the character of the water escaping through the levee's breach; the waters are still floodwaters, and the result is a flood." *In re Katrina Canal Breaches Litigation*, 495 F.3d 191, 214 (5th Cir. 2007);

C. Flood exclusion applied where property was damaged by released water and debris as a result of the failure of a dam. *Bartlett v. Continental Divide Ins. Co.*, 697 P.2d 412 (Colo. Ct. App. 1984) aff'd, 730 P.2d 308 (1986); and

D. Flood exclusion applied where the failure of a dam caused water flow downhill and damaged the insured's restaurant, motel, condominium complex and resort. *Kane v. Royal Ins. Co. of America*, 768 P.2d 678 (Colo. 1989).

PRACTICAL CONSIDERATIONS AND GENERAL RULES

South Carolina and North Carolina case law is limited on what constitutes flood and surface water under a policy exclusion. Further, the facts of each claim must be analyzed to determine whether there is coverage. There are, however, some practical lessons and broad rules to apply in analyzing a claim that may involve flood or surface water.

First and foremost, you must determine the source of the water that entered the building or structure. You also have to determine how the water entered the building or structure. If the water that entered the building came from rainwater that hit the roof, and then went directly into the building, it is probably not surface water. If the water that entered the building came directly from a pipe that fed into the basement, it is also probably not surface water. If the water that entered into the building came from rainwater that flowed on the ground, pooled next to, and then entered the building, it is probably surface water. If the water that entered the building came from the overflow of a river, stream or lake, it is probably flood water.

Second, as *M & M* and similar cases teach, you have to take the analysis a step further. You have to examine the flow of the water, and see if, at some point prior to entering the building, it flowed through a pipe, canal, ditch or other structure which an insured would argue is a defined watercourse or channel. If it did, the insured may argue that the water lost its character as surface water, and the exclusion does not apply.

Third, if you determine that surface water or flood is "a" cause of the loss or damage, you should be able to enforce and apply the anti-concurrent cause language. We caution, however, to make sure your investigation is thorough and complete, and consider all possible sources of the water.