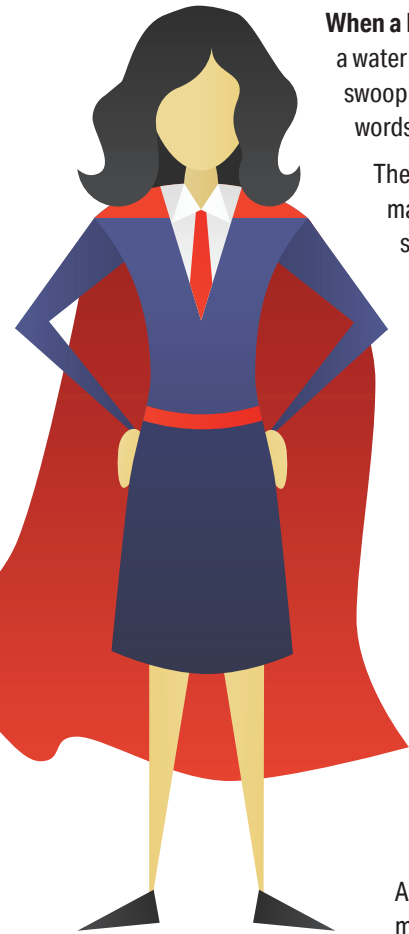


A silhouette of a superhero figure, likely Superman, is shown from the back, holding a large shield. The figure is set against a light blue background with a darker blue cape. The title text is overlaid on the shield and the figure's torso.

THE PERIL OF MISINTERPRETATION

BY CHANTAL M. ROBERTS

Insurance adjusters hold a position of responsibility: They must help homeowners after a loss, regardless of whether the loss is covered. To do this, an adjuster must first possess insight into the intricate workings of policy language as well as the ingenuity to find solutions where none seem apparent. This article discusses flood, surface water, backup, and overflow of water on the unendorsed HO 00 03 03/22 policy. There are a plethora of manuscript and commercial policies to also consider, but these definitions can often be extrapolated to the other policies with careful attention to wording.



When a homeowners policyholder sustains a water loss, they look for a superhero to swoop in and save the day. In other words, they call their insurer.

The carrier tasks adjusters with maintaining a delicate balance: ensuring fair claim resolutions while adhering to the policies that govern their decisions. This complex and challenging assignment requires more than just data entry skills from adjusters; it demands technical expertise, empathy, and a commitment to fairness.

KNOWLEDGE IS POWER

The policy is at the heart of every claim. Filled with conditions, exclusions, and exceptions, it is a complex document.

For example, the unendorsed HO 00 03 03/22 policy (HO3) provides open perils coverages for the dwelling and other structures (Coverage A and Coverage B, respectively); this means that everything is covered except exclusions listed in the policy. However,

Coverage C—Contents provides named perils coverage, meaning that only perils specifically listed are covered.

In the HO3, water is largely defined by what it is not rather than what it is. Accordingly, homeowners are often caught by surprise when they receive a coverage declination for their water claim.

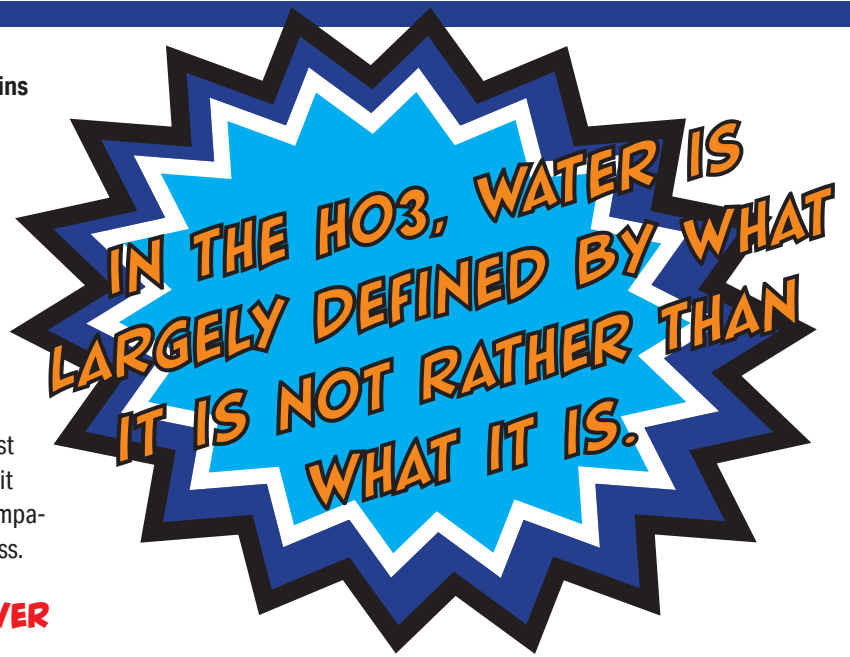
Contributing to this reaction is the varying placement of exclusions in homeowners policies. For example, some can appear in portions of the policy devoted to defining terms or, ironically, what is covered.

Knowing where all the exclusions are in a policy is key to determining coverage. Even more important is knowing that there are exceptions to the exclusions in the Perils Insured Against section.

EXCEPTION TO THE EXCLUSION: A CASE STUDY

Several months ago, excessive rain damaged Gerardo and Paige Jefferson’s retaining wall, which did not support their home. The wall collapsed and damaged their patio, patio furniture, and shed.

The Jeffersons submitted the loss when they discovered mold and rot near the patio door. The adjuster found that the retaining wall was weakened due to age, wear and tear, and a lack of maintenance. So the Jeffersons received a coverage declination letter quoting the following policy language:



SECTION I – PERILS INSURED AGAINST

A. Coverage A – Dwelling And Coverage B – Other Structures

...

2. We do not insure, however, for loss:

...

c. Caused by:

...

(2) Freezing, thawing, pressure or weight of water or ice, whether driven by wind or not, to a:

- (a) Fence, pavement, patio or swimming pool;
- (b) Footing, foundation, bulkhead, wall, or any other structure or device that supports all or part of a building, or other structure;
- (c) Retaining wall or bulkhead that does not support all or part of a building or other structure; or
- (d) Pier, wharf or dock;

...

(5) Mold, fungus or wet rot. However, we do insure for loss caused by mold, fungus or wet rot that is hidden within the walls or ceilings or beneath the floors or above the ceilings of a structure if such loss results from the accidental discharge or overflow of water or steam from within:

- (a) A plumbing, heating, air conditioning or automatic fire protective sprinkler system, or a household appliance, on the “residence premises”; or
- (b) A storm drain, or water, steam or sewer pipes, off the “residence premises”.

For purposes of this provision, a plumbing system or household appliance does not include a sump, sump pump or related equipment or a roof drain, gutter, downspout or similar fixtures or equipment; or

(6) Any of the following:

- (a) Wear and tear, marring, deterioration;
 - (b) Mechanical breakdown, latent defect, inherent vice or any quality in property that causes it to damage or destroy itself;
 - (c) Smog, rust or other corrosion, or dry rot;
 - (d) Smoke from agricultural smudging or industrial operations;
 - (e) Discharge, dispersal, seepage, migration, release or escape of pollutants unless the discharge, dispersal, seepage, migration, release or escape is itself caused by a Peril Insured Against named under Coverage C. Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed;
 - (f) Settling, shrinking, bulging or expansion, including resultant cracking, of bulkheads, pavements, patios, footings, foundations, walls, floors, roofs or ceilings;
 - (g) Birds, rodents or insects;
 - (h) Nesting or infestation, or discharge or release of waste products or secretions, by any animals;
- or
- (i) Animals owned or kept by an "insured".¹

The insurer did not include the subsequent policy language, which outlines the exclusions, as part of its declination letter:

SECTION I – EXCLUSIONS

A. We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss. These exclusions apply whether or not the loss event results in widespread damage or affects a substantial area.

...

3. Water

This means:

a. 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;

...

c. Water below the surface of the ground, including water which exerts pressure on, or seeps, leaks or flows through a building, sidewalk, driveway, patio, foundation, swimming pool or other structure;

...

This Exclusion A.3. applies regardless of whether any of the above, in A.3.a. through A.3.d., is caused by an act of nature or is otherwise caused.²

Although this still seems to be a cut-and-dried case of coverage denial, hope remains for the Jeffersons—because this is where our hero steps in, with knowledge of the exception to the exclusion. Turning their attention back to the Perils Insured Against section, the adjuster notices this language:

Section I – Exclusion A.3. Water, Paragraphs a. and c. that apply to surface water and water below the surface of the ground do not apply to loss by water covered under c.(5) and (6) above.

Under 2.b. and c. above, any ensuing loss to property described in Coverages A and B not precluded by any other provision in this Policy is covered.³

The adjuster, when examining coverage language, must proceed one step at a time. In this instance, the adjuster sees that the Jefferson's retaining wall is excluded because it doesn't support "all or part" of the Jefferson's structure and was damaged by "pressure or weight of water." Plus, exclusions apply for surface water and water that "exerts pressure on" another structure, which in this case is the retaining wall.

The carrier can issue a coverage denial for the retaining wall for the above reasons.

Next up is the mold and rot damage, which is not covered, unless (the exception to the exclusion) the damage was hidden within the walls, floors, and ceiling and came from an accidental discharge from an appliance at the Jefferson's premises or a backup/overflow of a storm drain off the premises.

The Jeffersons did not know about the mold and rot at the time of the initial rainstorm. And while the damage was hidden, the loss did not occur from the exception to the exclusion, so this portion of the coverage denial can stand for the above reasons.

The adjuster goes on to quote that the claim is denied because wear, tear, and deterioration contributed to the loss. However, there is coverage for surface and below-the-surface water damage under Perils Insured Against, 2.c.(5)



and 2.c.(6). In other words, the policy contains contradictory language, through a giveback of coverage, all in the same section! Therefore, the carrier cannot deny the Jefferson's mold and rot damage.

Further, the second paragraph under the exception to the exclusion discusses coverage for ensuing losses—namely, that such coverage exists as long as the loss is not excluded elsewhere. For the Jeffersons, the ensuing loss was the patio furniture, patio, and shed.

Because the adjuster believes the cause of loss was the pressure of water and the wear, tear, and deterioration of the retaining wall, coverage could very well exist for this portion of the claim. However, some might argue that the water exclusion still applies. Put a pin in this for now.

PRACTICAL ADVICE

Reading a policy and adjusting a claim may seem like easy tasks, but exclusions may be located several pages apart from exceptions to the exclusions, making careful study of the full policy imperative.

An insurance professional should never say that "everything is covered" merely because the policyholder has an open perils policy. Moreover, the adjuster should not include superfluous policy language in the coverage declination letter. For example, the content in 2.c.(6), (c-i) has nothing to do with the Jefferson's claim and should not, therefore, be included in the letter.

FLOOD AND SURFACE WATER

It's an easy leap to equate surface water with flood, or to surmise that water seeping through walls or foundations falls under the same category. Policyholders, when describing such loss and damage, use the words, "My basement is flooded." This paints a picture of straightforward water damage, yet the reality is far more nuanced.

The distinctions between "surface water" and "flood water" are essential to understand, despite being listed in the exclusion of water in Section I—Exclusions, 3. Water.

FLOOD

Sometimes, an adjuster will rush headfirst into a situation without taking the time to assess it. This is how a claim can end up with an improper denial or in a bad-faith lawsuit. The claims supervisor's attention to detail is what saves the day when the adjuster has overlooked an important fact.

According to the National Flood Insurance Program (NFIP), flood is defined, in part, as:

A general and temporary condition of partial or complete inundation of two or more acres of normally dry land area or of two or more properties (at least one of which is your property) from:

- Overflow of inland or tidal waters;
- Unusual and rapid accumulation or runoff of surface waters from any source....⁴

This distinction is fundamental, because it draws a line between common misconceptions and the stark reality of policy definitions—or a lack of definitions, which will be discussed later. The adjuster must dissect the policy language with precision, separating each strand of meaning to reveal the true nature of the loss.

Flood is not defined in the policy, but the NFIP definition states that water inundates "normally dry land." One New Jersey appellate court, in considering if a broken water main constituted "flood," "surface water," or "ground water," found that if a broken municipal water main caused inundation to a home, it could not be considered a "general... condition..." because "(u)se of the word 'general' conveys that the water-related condition was 'not limited in scope, area, or application.'"⁵

This interpretation, and reversal of the trial court's ruling, signaled that the scope of a flood transcends the confines of a singular event.

SURFACE WATER

A "contract of adhesion" is when a contract, such as an insurance policy, is written in a "take-it-or-leave-it" manner. This means that the insured has only two options: to

accept the contract or reject it in its entirety.

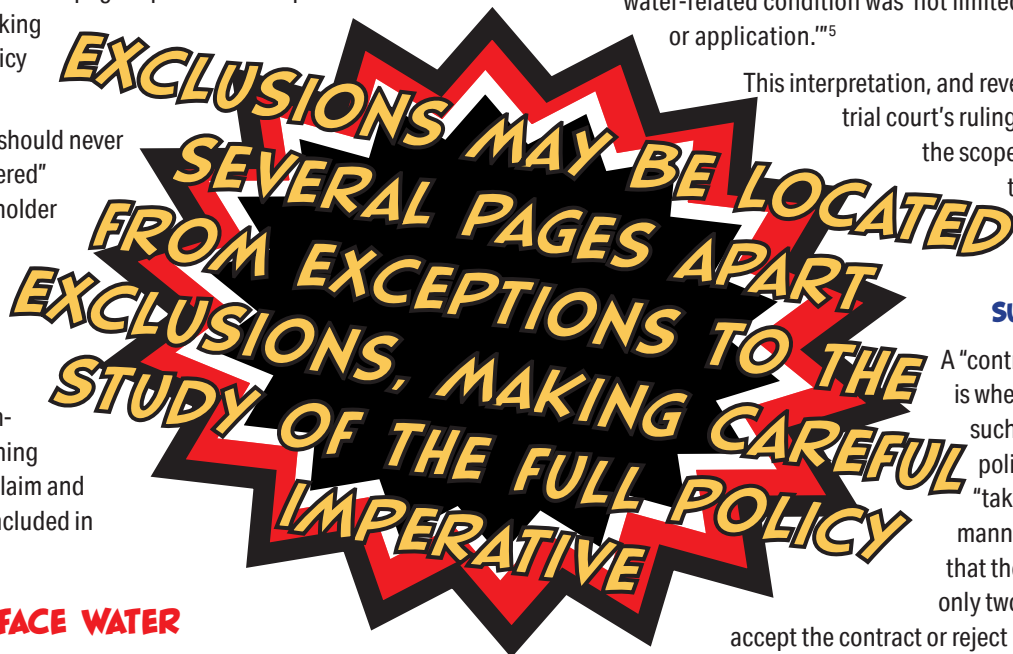
However, when the insured cannot reword or rewrite the contract language with more favorable terminology, and a word or phrase is unclear, courts will often find coverage for the party who did not write the contract (the insured).⁶

With that in mind, the New Jersey court found the term "surface water" to be ambiguous. The state's administrative code defined "surface water" to be a permanent body of water, such as a lake or stream, while judicial opinions countered that it's rainwater or snow melt. The policy did not define the phrase.

When equally logical definitions muddy the waters (pun intended), and definitions create conflict, the adjuster's path is clear: Grant coverage to the insured in the face of ambiguity, honoring the contract's spirit and ensuring that the policyholder's trust remains unbroken.

PRACTICAL ADVICE

Carriers are aware they are ultimately responsible for accurately and adequately defining terminology in the insurance policy. This is why courts opine that if two (or more) equally logical definitions of a term are plausible, the carrier is mandated to extend coverage to the policyholder. Otherwise, the insurer would have defined the word or phrase in the policy.



Adjusters can avoid bad-faith lawsuits brought from improper denials after an insured or their representative or agent point to a different interpretation of a term. For instance, they can perform the same exercise as the New Jersey appellate court in *Sosa v. Massachusetts Bay Ins. Co.* The three judges in that appellate case considered the word "general" to help define flood; because it was not defined in the policy, they used *Webster's II New College Dictionary* (3rd ed. 2005) to define the term.

In the instance of the Jefferson's patio furniture and shed loss—where coverage may be ambiguous and dependent on how an adjuster interpreted the exception to the exclusion and the water exclusion—a coverage opinion from an attorney may be necessary if the carrier wants more information about which policy language would be applicable.

Claims departments do not need to keep dictionaries in the office, as many are located online. And while they may not automatically need to incur the expense of coverage opinions, researching ambiguous terms and conflicting coverages is often well worth the effort by vastly improving customer satisfaction and reducing litigation costs.

BACKUP AND OVERFLOW

Policyholders use the word "flood" when the actual cause of loss is a "back up" or an "overflow" of water. Although these two words are used interchangeably, each has different definitions:

- A backup is when water that originates outside the plumbing system flows backward into the property. The backup of water is not a covered cause of loss, per Section I-Exclusions, 3. Water, b.(1).
- An overflow happens when a blockage or clog is present and water cannot escape the plumbing system. Water then overflows from the system onto the property.

While water overflow and discharge are generally covered through the exceptions to the exclusions previously mentioned, Section I-Exclusions, 3. Water, b.(2) states that overflows from sumps, sump pumps, and other related equipment, including roof drains and gutters, are not a "plumbing system" or a "household appliance."

The unendorsed HO 00 03 03/22 policy extends protection for water-related damage that stems from the accidental discharge or overflow of water from within a plumbing, heating, or air-conditioning system or household appliance on the property, such as leaking pipes concealed within walls or when appliances like washing machines or toilets leak, back up, or overflow. Coverage is afforded for the accidental discharge or overflow of water from a storm drain or a water, steam, or sewer pipe situated off the property. See the exception to the exclusion 2., c.(6), (i-ii).



Most homeowners, however, have endorsements to provide limited coverage in the event of these losses, which can cause significant damage in the home.

Adjusters cannot determine coverage solely from the notice of loss. First, the policyholder may not use the correct words when describing the loss. Second, it would be, in most states, a violation of the Unfair Claims Settlement Practices Act to determine coverage without an investigation. And third, as shown above, sometimes coverage can be extended through an exception to the exclusion.

PRACTICAL ADVICE

Insurance professionals from agents to adjusters must listen carefully to the description of the loss, extending the policyholder every benefit of the doubt to find coverage while still adhering to the policy and the interests of other insureds.

CONCLUDING THE CASE

In addition to the retaining wall damage, the Jefferson's basement was "flooded." However, the adjuster's methodical investigation will help determine the ultimate cause of loss through observation.

For example, the adjuster finds that dust on the basement windowsills is undisturbed, the walls under the windows show no sign of water damage, and a watermark along the floor molding gradually recedes the further away the bathroom becomes. There is evidence of water on the outside of the toilet bowl. And finally, a watermark appears in the basement shower, but no water or residue is visible in the shower threshold.

These observations clearly indicate that the water from the shower did not combine with the water from the toilet. They serve as evidence that the cause of loss was a backup because the sewers could not remove the water quickly enough due to the excessive rain.

An unendorsed policy would therefore provide no coverage for this loss. But notifying the Jeffersons early of the coverage issue is a way to extend customer service to the insured. Imagine how angry and upset the Jeffersons would be if they were told "everything is covered," then received a declination letter.

The case of the Jeffersons shows how the policy is the carrier's commitment to pay covered losses—and that, when a loss occurs, the adjuster can be a hero for the insured.

Reading, understanding, and explaining policy language is difficult. So a sound investigation is important to meet the demands of claims handling.

And while no insurance professional should assure a policyholder with an open perils policy that "everything is covered," they should also remain diligent in seeking coverage, particularly by combing through the exceptions to the exclusions. In this manner, insurers can live up to their superhero status, handling each insured's claim with fairness and care. ■

1. Insurance Services Office, Inc. HO 00 03 03/22. 2021.
2. Ibid.
3. Ibid.
4. FEMA, "National Flood Insurance Program Summary of Coverage."
5. *Sosa v. Massachusetts Bay Ins. Co.*, No. A-5349-16T3, 2019 WL 1780983 (N.J. Super. Ct. App. Div. Apr. 24, 2019). Quoting *Webster's II New College Dictionary* (3rd ed., 2005), p. 438.
6. The Institutes, "Decoding Insurance Policies," CPCU 530—*Applying Legal Concepts to Insurance*, 1st ed., 2023, Assignment 2, p. 11.

