South Carolina's 1,000 Year Flood: Will the state's water worries extend to insurers?

March 14, 2016

Media Contact
Powers Tanis
Director of Strategic Marketing and Communications 803.221.4907
email@mgclaw.com

Total economic losses from October's historic flooding in South Carolina are expected to top $2 billion. According to Aon Benfield Group Ltd., insurers preliminarily reported roughly $350 million in commercial and residential property claims, and federally insured flood and crop insurance claims are expected to crest at $150 million. With the incredible amount of damage sustained in the state and the already mounting number of claims, the atmosphere is ripe for coverage-related causation disputes and litigation involving dam failures as residents and businesses scramble to fund their recoveries.

Beginning with coverage disputes, the flood-versus-covered-peril dichotomy threatens to impede the resolution of claims and lead to increased litigation and costs. While virtually all residential and commercial property policies cover damage from wind and wind-driven rain, flood insurance must be separately purchased and is more often than not purchased through the National Flood Insurance Program (NFIP), which is underwritten by the federal government.

To participate in the NFIP, businesses and residents must own property in participating communities and must have purchased their insurance before the likelihood of flood was apparent. Additionally, coverage afforded under the NFIP often is insufficient to support the work needed to rebuild affected homes and businesses. Consequently, because South Carolina's record flooding occurred in many areas that were not historically considered to be flood-prone, and because flood coverage often falls well short of realized damages, many South Carolinians (those who did and did not purchase flood insurance) will seek alternative ways to help recover from their catastrophic losses, including searching for more coverage in their traditional homeowners' policies.

Residential Repercussions

Courts in other jurisdictions have addressed cases in which insurers and insureds have disagreed on the cause of damage. For example, a New Jersey appellate court recently rejected a Superstorm Sandy claim that sought coverage under a standard homeowners' insurance policy for damage caused by toxic debris in floodwaters. The court held that flood loss encompasses both damage from water and from substances carried by the water and left behind when the water recedes. "To hold otherwise," the court remarked, "would provide coverage to homeowners who eschew the high cost of flood insurance and maintain only homeowners' policies, and would render the flood exclusion in those policies meaningless."

On the other hand, a U.S. district court in Washington disagreed with a nearly identical argument made by an insurer, finding that there is a distinction between damage from stormwater and damage from debris found in stormwater. The court held that the homeowners' policy at issue afforded coverage for damage caused by debris.

We surmise that as these coverage disputes are filed in South Carolina's state and federal courts, the judiciary will err on the side of finding coverage for damaged homeowners and businesses while not completely rewriting policies. Indeed, in an August 2015 decision involving a developer's taking claim based on allegedly unreasonable floodplain management regulations, the Supreme Court of South Carolina recognized the importance of floodplain management and the need for continued viability of the NFIP through proper floodplain management.

Commercial Effects

The cause-related disputes will not be limited to homeowners' policies, however, as the cause of loss also is important in commercial policies that include "named storm" deductibles, "civil authority" coverage, and business interruption coverage.

Policies containing named storm deductibles typically provide for higher deductibles where damage is caused by a named storm or hurricane. The linchpin of these clauses and deductibles is found within the specific policy language and its application to the specifics of the storms in question.

Similarly, civil authority and business interruption coverages also require a causal determination. Civil authority coverage typically is triggered when access to the insured premises is impaired by the action/order of a civil authority. This type of coverage affords relief when the insured's business is inaccessible and/or otherwise suffers due to physical damage to other property. Business interruption policies, on the other hand, usually require damage to the insured's property by a covered peril to create coverage for business loss.

In South Carolina, Hurricane Joaquin may have caused certain flooding on the coast in cities from Charleston to Georgetown, but was the hurricane responsible for the inland flooding in Columbia, Sumter, and other land-locked cities? How much of the rain that pounded the entire state was due to the hurricane as opposed to the unnamed rain storm that moved in from the south and west as the hurricane approached from the east? Where did the hurricane/wind damage stop and rainwater flooding begin? How will insureds or insurers prove the cause of damage?

We anticipate that for all of these types of coverage, insureds will bear the initial burden to prove that their losses stemmed from a potentially covered cause. If a cause potentially is covered, then we foresee the courts giving the insureds the benefit of the doubt and forcing carriers to rely on exclusionary language, possibly shifting the burden of proof. As that burden shifts, we foresee some situations in which carriers will need to not only evaluate insureds' property and alleged losses, but also losses and damage to surrounding properties. We also predict the need for meteorological evidence and expertise as disputes arise, and we anticipate challenges to whether in-house claims professionals and public adjusters—those typically tasked to document the extent of loss as opposed to cause—will possess such expertise.

Damming Evidence

Beyond these coverage-related issues, a significant number of dam failures during the October events likely will complicate claims and litigation and, in some neighborhoods, spawn independent lawsuits. As of early November 2015, at least 75 dam owners received notices from the South Carolina Department of Health and Environmental Control that their dams failed during the storm and/or were in need of repairs resulting from the October floods. Many of these repairs become even more daunting because privately owned dams are not usually eligible for help from the Federal Emergency Management Agency, and they often are uncovered by private insurance for the costs of making repairs.

Private owners, however, may be covered for litigation spawned by damage to downstream property owners, and that litigation also is likely to involve individuals or entities tasked with the design, construction, maintenance, or operation of failed dams. These claims may include architects, engineers, designers, contractors, subcontractors, owners, operators, inspectors, and regulators. Additionally, because many of the failed dams form a string within the same general watershed, downstream properties may look to several uphill dams for the same loss.

In South Carolina, dam safety laws are found in the state's 1976 Code of Laws' Dams and Reservoirs Safety Act 49-11-110; and dam regulations are found in Dams and Reservoirs Safety Act Regulations section 72-1 through 72-9. South Carolina defines a dam as "any artificial barrier, together with appurtenant works, including but not limited to dams, levees, dikes, or floodwalls for the impoundment or diversion of water or other fluids where failure may cause danger to life or property." Any person who impounds water or other fluids in South Carolina may be liable for any damage caused by the failure of a dam or reservoir. Even if a house is built below a dam after the dam is constructed, the owner of the dam is not automatically free from liability.

Dam-failure defendants may be subject to claims sounding in negligence or strict liability. Claimants seeking to impose liability under a negligence standard will, of course, be forced to prove that the owner, designer, or builder of a failed dam neglected to act reasonably with respect to the cause of the dam's failure. Strict liability, on the other hand, will require proof that those individuals or entities engaged in an ultrahazardous activity involving a risk of serious harm to others' property or personal health. We anticipate multiple lawsuits making these claims, including some that may be couched as class-action matters.

Because of these claims, the October events also may lend themselves to the ordinarily unavailable "Act of God" defense. An Act of God is defined as "an unusual, extraordinary, sudden, and unexpected manifestation of the forces of nature, such as violent storms and extraordinary or unprecedented floods, which could not have been reasonably anticipated, guarded against, or resisted."

In determining whether a dam failure is defensible, courts have applied several standards to the design and maintenance, including "maximum experienced rainfall," "foreseeable peril," and "probable maximum flood." In South Carolina, the October flooding was described as a "1,000 year flood" that, while predicted in the days leading up to the event, could not be predicted in the ordinary course of operating, designing, or constructing a dam. Even if the event ultimately is determined by courts not to be an "Act of God," in the context of negligence claims, the circumstances could be used to demonstrate reasonableness on the part of the dam owner, designer, or builder. The ages of the dams will create yet another level of controversy regarding the appropriateness of their designs (most failed dams are decades old, and some exceed 100 years in age). Furthermore, questions of what entities were responsible for dam maintenance and/or testing will lead to finger-pointing from both those damaged and those accused of creating the damage.

The October storms and resultant flooding in South Carolina have already caused an expensive wave of insurance claims and losses. As first-party insurance claims are denied or as first-party insurance is insufficient to fully cover certain losses, we anticipate an increase in third-party liability claims and litigation, much of which will require a greater than normal reliance on expert review and testimony. Even those claims that are paid should create subrogation litigation as carriers seek to recover the significant losses incurred after such events. Given statutes of limitation applicable to these types of claims, the Palmetto State should expect to see an increase in litigation for years to come.

ABOUT THE AUTHORS

Brett Bayne's practice focuses on general litigation, including automobile negligence, premises liability, products liability and construction defects. He is located in the firm's Columbia office, and can be reached at 803.227.2281 or by email.

Jessica Tyndall's practice focuses on the defense of catastrophic personal injury matters, the defense of contractors and design professionals in construction disputes and the defense of insurers in insurance coverage disputes and litigation. She also focuses on professional liability and coverage and bad faith. Jessica is located in the firm's Raleigh office, and can be reached at 919.719.8253 or by email.

*This article first appeared in the Claims and Litigation Management's **Claims Management** magazine's December 2015 issue.*