

Temporal Requirements for Water Damage Exclusions in Homeowner Policies

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or

We don't live in glass houses so how the bleep are we supposed to know?

I. Introduction

There are few areas where homeowners and insurance companies disagree more often than on routine *non-flood* water damage claims. The disputes typically arise over whether water damage was caused by a “sudden and accidental” or by longer term “continuous or repeated seepage, leakage of water or the presence of condensation of humidity, moisture or vapor, **over a period of time greater than 14 days.**”ⁱ In other words, the central dispute between policyholders and insurers in *non-flood* water damage claims stems from whether the damage was from a sudden accident causing event like a burst pipe, or one that has lingered over a period of time, like a slow drip.

It's not surprising that water damage claims are a point of contention for insurance companies. According to industry sources, 2,296,570 residential water damage claims were reported between 2014-2015, accounting for approximately 33% of all homeowner's insurance claims.ⁱⁱ California leads the nation, followed by Florida, Texas, New York, and Pennsylvania.ⁱⁱⁱ By way of example, Citizens Florida, a state-run insurer-of-last-resort, obtained the approval of the state regulator to increase rates specifically

due to water claims having increased by 46% in the preceding five-year period.^{iv}

A major factor underlying this common dispute is how and when the homeowner discovers they have a water leak. In many cases, the water causes significant damage *before* the homeowner notices water on the kitchen floor, the presence of mold, etc. Given that most property insurance policies now contain exclusions for water damage claims that are not *immediately* identified, the fact that property owners cannot always readily appreciate water damage at its inception is problematic, to say the least. This article will survey the water damage landscape (coverage and exclusion), with an emphasis on California case law and a proposal for a delayed discovery rule that would reduce and resolve many disputes over when the damage-producing event occurred.

II. The coverage grant and the exclusion

Let's start with a typical water damage coverage grant and exclusion:

*[We cover] A sudden and accidental discharge, eruption, overflow or release of water does not include a constant or repeating, gradual, or slow release of water, or the infiltration or presence of water over a period of time. We do not cover any water, or the presence of water, over a period of time from any constant or repeating gradual or slow seepage, leakage, trickle, collection, infiltration or overflow of water from any source even if from the usage of those items described [in the specific sections listed or as stated above] **whether known or unknown to any insured.***^v

There you have it. Insurance companies, in an effort to minimize (or completely eliminate) their duty to pay for water damage claims, have imposed a temporal

requirement on coverage for water damage claims. This policy language mirrors most common policy forms and, as described above, some forms specify the number of days.

The insurance industry has gone away from offering an “all-risk” homeowner’s insurance policy, having carved out exclusions and exceptions ranging from pollution^{vi} to earthquake^{vii} to flood.^{viii} Water damage, of the non-flood event variety (e.g., burst pipe, dishwasher leak, etc.), on the other hand, has traditionally been covered under the HO 3 form. Under this industry standard form, water damage is typically covered when the water originates “inside the residence premises” as opposed to the result of a flood event.^{ix} Only a stand-alone flood insurance policy from the National Flood Insurance Program (or certain surplus lines carriers) will pay flood damage, and those policies have plenty of their own issues – a topic deserving of its own article.

However, coverage for routine water damage claims under the 2011 version of the HO 3 policy, for example, is excluded by the following boilerplate language:

*“...constant or repeated seepage or leakage of water or steam **over a period of weeks, months, years** from within the plumbing, heating, or air conditioning or automatic fire protective sprinkler system or from within a household appliance.”*

Both the HO 3 form as well as the language utilized by Farmers/Mid-Century in the above-cited *Brown v. Mid-Century* case demonstrate that the insurance industry has strategically tried to avoid covering water damage claims that *should be covered*, by focusing on the amount of time it takes for the homeowner to discover the loss. In other words, from the typical insurance company’s perspective, it does not matter when the homeowner learns about the water damage; all that matters is when the leak began.

This temporal requirement is incredibly problematic because, as the title suggests, we do not live in glass houses so we cannot see inside of the walls. It is only when the leak manifests in other ways (e.g. musty smells, peeling paint, or mold on the floor) that homeowners become aware that they have a water damage claim and need insurance benefits to pay for the cost of repairs.

III. The typical water damage claim scenario

How does this play out in the context of most water damage claims? If a kitchen pipe suddenly and accidentally begins releasing water and the homeowner immediately discovers the issue because the damage is readily visible in a location the insured has access to – there can be no question it is a covered claim. However, if the homeowner is away on a three-week vacation when the pipe bursts, the above exclusions purport to bar coverage. If the claim is denied, it not only goes against a policyholder's *reasonable expectations*^x of coverage – this is black letter insurance law - but it is contrary to common sense because, but for the unavoidable delay in discovering the loss, it would be covered under the terms of the contract. Similarly, if a pipe is leaking behind a wall, a homeowner may not discover it within the time required by most policies.^{xi}

Given that property insurance is supposed to provide coverage when the cause of loss is not itself excluded, it seems illogical that an exclusion can eviscerate coverage based only on the amount of time that passes between when the damage first occurs and the time the insured discovers it. This is especially true in the water damage context where it is difficult to pinpoint the exact date/time that a loss occurs. Obviously, the longer a leak goes unmitigated, the more expensive it is for the insurance company, but it goes

against the very purpose of insurance – which is to indemnify the policyholder in case of a loss – for homeowners to have to pay these losses out of pocket.

This leads to another problem: insurance company reliance on “expert” vendors to establish and prove the application of temporal exclusions. The first thing most homeowners do when they identify water damage is call their insurance company.

Typically, the insurance company will then send out a water damage vendor, perhaps a plumber, that is on its “approved vendor” list. The vendor then “evaluates” the cause and origin of the damage and reports his or her findings to the insurance adjuster.

But the vendor’s work does not stop there. There are many cases in which a policyholder will be forced to take the insurance company “expert’s” word that the leak has been going on longer than allowed by the policy. In the most egregious examples, adjusters may even ask their investigating plumber, engineer, or contractor to include in their reports an opinion regarding whether the damage appears to have existed for longer than 14 days or a month so that the adjuster can evaluate coverage. Given that these vendors get repeat business from insurers, this creates a problematic incentive for vendors to tell their insurance company clients what they want to hear (*i.e.*, that the damage is the result of a long, slow leak), especially on close calls.

Because most policyholders do not suspect that their insurance company is taking an adversarial posture so early in the claim investigation, they do not normally go to the effort of hiring their own independent “expert” when the evidence of water damage is fresh to evaluate the damage (and possibly dispute the insurer’s expert’s opinion on the time and duration of the water damage). It is also costly to do so, particularly when there

is no guarantee that the insurance company will give it much, if any, credence. This becomes extremely problematic for insureds. When their claim has been denied and their only option is to sue for breach of contract and bad faith, insurance companies in some jurisdictions are able to rely on the “genuine dispute” doctrine to defeat bad faith when they allege that they relied on their experts’ opinions in evaluating the claim.^{xii}

IV. How did we get here? Case law and industry evolution

Some decisions, in California and across the country, provide insurance companies with legal support to cite to and rely on these temporal exclusions. Courts uniformly find in favor of the insurance company’s citations to the exclusions. The opinions all focus on the duration that the water was leaking before the insured discovered it, *as opposed to when the insured discovered it*. In each decision insurers have cited to and relied on their vendors’ opinion evidence tending to show that the water damage was “long term damage.” Because the homeowners did not retain their own independent experts while the evidence was fresh (*i.e.*, before their insurer denied coverage and the walls and floors were still wet), they often do not have sufficient evidence to contradict the insurance company’s position that the duration of the leak was long term.^{xiii} Once some amount of remedial work has been performed or time has passed, water damage experts find it extremely difficult to evaluate the temporal component to a loss after the fact (which begs the question of whether an insurance company “expert” can really tell if the damage is long term?). As a result, homeowners are often without the tools necessary to dispute their insurance company’s denials based upon the temporal exclusions.

One California case does, however, present an interesting legal theory if applied to disputed water damage claims. In *Jones v. W. Home Ins. Co.*,^{xiv} the plaintiff argued that a “delayed discovery rule” should be read into the exclusion, but the court rejected this. In California tort law, the delayed discovery rule operates to toll the statute of limitations when the plaintiff is ignorant of the facts and could not have discovered the facts supporting a claim within the statute of limitations.^{xv} Were the delayed discovery rule to be applied in the water damage context, the insured would be able to challenge an insurance company’s denial of coverage when an insured reports the claim as soon as evidence is readily apparent. There is some precedent for application of the delayed discovery rule in the first party insurance context with regard to suit limitations, yet it has not, to the authors’ knowledge, been so applied.^{xvi}

It is worth noting that the insurance industry itself doesn’t (or didn’t use to) take such a hard-line view. When asked whether the HO-3 exclusion for “wet rot” (see fn. 8) bars coverage for hidden wet rot behind walls and cabinets, an author for FC&S/National Underwriter said the following when asked about that exact scenario:

By placing wet rot in this longer list of things that occur over a long period of time, it is clear that the [under]writers’ intent was to exclude wet rot that happens over a long period of time—like on the underside of wooden steps leading down into a damp basement. In that case there has been no intervening peril—the wet rot just happened. And that’s what is meant to be excluded. It is important not to confuse resulting wet rot damage with loss caused by wet rot. When a pipe breaks, gets the covered property wet, and wet rot then occurs, we have resulting wet rot damage, which is covered, because the peril that caused it is plumbing discharge. The HO 00 03 does not contain the exclusion for “repeated seepage or leakage,” nor does it state that a loss must be “sudden and accidental.” In this case, the water damage, the wet rot damage, and the cost to tear out and replace the pipe are all covered. We should add, though, that had the insured seen signs of the leak—stained wallpaper, for example—and done

nothing, the loss would not have been covered by virtue of the duty of the insured at the time of loss to protect the property and prevent further loss."^{xvii}

Further, typical water damage exclusions used to include the following qualifier:

*...unless such seepage or leakage of water or the presence or condensation of humidity, moisture or vapor and the resulting damage is **unknown to all insureds and is hidden within the walls or ceilings or beneath the floors or above the ceilings of a structure.** (emphasis added).*

There is some logic to imposing a temporal requirement that is consistent with an policyholder's duty to timely report a claim and mitigate further damage. But insurance policies are not warranty contracts intended to incentivize property owners to stop maintaining their properties and shift the cost of doing so to their insurance companies. But it seems illogical to apply exclusions for water damage claims that place the burden of triggering coverage on an issue (determining when the event that caused water damage first occurred) that is at its core subjective, inherently susceptible to dispute, and places the insurer and insured at odds with one another too early in the investigative stage of a claim. This is especially so where, here in California (where the authors are based and practice), water damage claims are one of the most prevalent types of claims that occur.^{xviii} In reality, homeowners truly need coverage for water damage claims that are caused by accidental events. However, through the use of these temporal exclusions, they are finding it more and more difficult to get the coverage they need.

V. Conclusion – adopt a delayed discovery rule

A win-win solution that would benefit insurance companies and policyholders would be exceptions to the temporal exclusion (such as the one identified above) where the damage is of a type that is previously unknown to the insured or takes place in a location that it is hidden from the insured, OR for policyholder advocates to begin fighting to have the delayed discovery rule applied in this context. The result would be that insurance companies would only provide coverage where the evidence demonstrates (1) that the water damage causing event occurred suddenly and accidentally, and (2) that the policyholder is either able to immediately appreciate the damage, OR could not do so due to circumstances out of their control. This result would protect insurance companies from paying for claims that should not be covered by placing the burden of proof on the policyholders to establish the exception to the exclusion (or as it called in tort law - the “delayed discovery rule”).

Such a rule would also protect policyholders by not placing them in the patently unfair position where the outcome of their entire claim could ride on the opinion of an “expert” vendor – whose opinion on the duration of a leak may not be objectively accurate, and who may be motivated by the desire to please their client (the insurer) to obtain repeat business. This proposal would, in effect, level the playing field in the context of water damage claims. Given that numerous exceptions already exist in first party property damage insurance and tort law to exclusions for damage that is not readily apparent or easily appreciated, it only makes sense to apply them in the context of routine water damage claims as well.

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ⁱ This language is found in the 1999 and 2005 ISO forms.

ⁱⁱ See THOMAS MANASEK, NATIONAL INSURANCE CRIME BUREAU, WATER DAMAGE REPORT, 2014-2015 (2016) (“For the purpose of this study, water damage can be defined as property damage due to accidental discharge, leakage, or overflow of water from plumbing systems, heating, air conditioning, and refrigerating systems, rain or snow through broken doors, open doors, windows, and skylights resulting in damage or destruction of the property scheduled in the policy.”); See also <http://www.iii.org/fact-statistic/homeowners-and-renters-insurance>.

ⁱⁱⁱ *Id.* (NICB report)

^{iv} Amy O’Connor, *Florida Regulators Approve Rate Increase for Citizens Policyholders*, Insurance Journal Sept. 19, 2016, <http://www.insurancejournal.com/news/southeast/2016/09/19/426822.htm>.

^v *Brown v. Mid-Century Ins. Co.*, 156 Cal.Rptr.3d 66 (Ct. App. 2013).

^{vi} See ISO 1991 Form, HO 03 04 91. ([we do not cover loss caused by] “(5) 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 under Coverage C of this policy. 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.)

^{vii} See INSURANCE INFORMATION INSTITUTE, EARTHQUAKES: RISK AND INSURANCE ISSUES (2016) (“The California Earthquake Authority (CEA) was created in 1996 two years after the devastating Northridge Earthquake caused huge losses for homeowners insurers in the state. The California Legislature established the CEA as a publicly managed, largely privately funded entity.”).

^{viii} See https://www.fema.gov/media-library-data/20130726-1447-20490-2156/nfipdescrip_1.pdf (National Flood Insurance Program created to address the financial infeasibility of the private insurance market providing flood coverage and federal recognition of increased costs in the form of disaster assistance).

^{ix} “[We do not cover] Water Damage, meaning 1. Flood, surface water, waves, title water, overflow of a body of water, spray from any of these, whether or not driven by wind and storm surge. 2. Water which backs up through sewers or drains or which overflows from a sump; or 3. Water below the surface of the ground, including water which exerts pressure on or seeps or leaks through a building, sidewalk, driveway,

foundation, swimming pool or other structure – caused by or resulting from human or animal forces or any act of nature. Direct loss caused by fire, explosion, or theft resulting from water damage is covered.”

^x See, e.g., Robert E. Keeton, *Insurance Law Rights At Variance With Policy Provisions: Part One*, 83 HARV. L. REV. 961(1970) See also Keeton, *Insurance Law Rights At Variance With Policy Provisions: Part Two*, 83 HARV. L. REV. 1281 (1970) and Eugene R. Anderson & James J. Fournier, *Why Courts Enforce Insurance Policyholders' Objectively Reasonable Expectations of Insurance Coverage*, 5 CONN. INS. LJ. (1998).

^{xi} The HO-3 also excludes coverage for: (1) Wear and tear, marring, deterioration;(2) Inherent vice, latent defect, mechanical breakdown;(3) Smog, rust or other corrosion, **mold, wet or dry rot.**” (emphasis added).

^{xii} See, e.g., *Chateau Chamberay Homeowners Ass'n v. Assoc. Intl. Ins. Co.* (2001) 90 Cal.App.4th 335

^{xiii} See, e.g., *Brown v. Mid-Century*, *supra*; *Jones v. W. Home Ins. Co.*, No. B155742, 2003 WL 393781 (Cal. Ct. App. Feb. 21, 2003); *Finn v. Continental Ins. Co.* (1990) 218 Cal.App.3d 69; *Raschkovsky v. Allstate Ins. Co.*, No. CV1500216RGKJPRX, 2015 WL 9463882, at *9 (C.D. Cal. Dec. 21, 2015).

^{xiv} *Jones v. W. Home Ins. Co.*, B155742, 2003 WL 393781 (Cal. Ct. App. Feb. 21, 2003).

^{xv} See, e.g., *Fox v. Ethicon Endo-Surgery, Inc.*, (2005) 35 Cal.4th 797, 809; *Casualty Ins. Co. v. Rees Investment Co.* (1971) 14 Cal.App.3d 716; *Kirby v. Albert D. Seeno Const. Co.*, (1992) 11 Cal. App.4th. 1059. See also Paul Eisner, *DELAYED DISCOVERY AND ACCRUAL: For Whom the Statute of Limitations Does Not Toll*, The San Francisco Attorney, The Bar Association of San Francisco (Winter 2011).

^{xvi} *But see*, e.g., *Prudential-LMI Commercial Ins. v. Superior Court* (1990) 51 Cal. 3d 674, 685 (“Under Insurance Code, section 2071, the limitation period commences to run from the *inception of the loss*. That term has been construed to mean “that point in time when appreciable damage occurs and is or should be known to the insured, such that a reasonable insured would be aware that his notification duty [i.e., the duty to notify the insurer of a covered loss] under the policy has been triggered.”) (emphasis added).

^{xvii} See May 2003 Question and Answer, discussed at length by Chip Merlin at: <http://www.propertyinsurancecoveragelaw.com/2009/06/articles/insurance/the-dirty-secret-of-exclusions-some-major-insurance-companies-like-state-farm-allstate-nationwide-and-even-usaa-do-not-want-you-to-think-about/>

^{xviii} *Id.* at fn. 3 (From 2014 through 2015, California had a total of 327,648 water damage claims, 45% more than the second highest state of Florida which had 225,222 water damage claims).