

Ninth Circuit Rules Flood Exclusion Unambiguously Bars Coverage for Storm Surge Damage From Hurricane Katrina

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On April 2, 2009, the U.S. Court of Appeals for the Ninth Circuit issued an order in *Northrop Grumman Corporation v. Factory Mutual Insurance Company* denying Northrop's Petition for Rehearing and for Rehearing en banc of the Court's August 14, 2008 decision. The order finalizes the court's holding that the flood exclusion in the Factory Mutual excess policy unambiguously bars coverage for storm surge damage to Northrop's subsidiary's shipyards from Hurricane Katrina. In its April 2 Order, the Ninth Circuit not only upheld its August 14, 2008 decision, but amended the decision providing further support for its initial ruling.

Northrop Grumman, a global defense contractor, brought this action in California, seeking \$1.2 billion in coverage under an "all risk" excess policy issued by Factory Mutual for hurricane damages allegedly sustained at its subsidiary's ship building operations in Mississippi and Louisiana. The Factory Mutual policy, which applied excess of \$500 million in underlying insurance, covered "all risks of physical loss or damage except as hereinafter excluded." The Factory Mutual excess policy expressly excluded, among other risks, "flood." The introductory language to the flood exclusion in the policy provided: "This Policy excludes loss or damage directly or indirectly caused by or resulting from any of the following regardless of any other cause or event, whether or not insured under this Policy, contributing concurrently or in any other sequence to the loss." The Factory Mutual excess policy defined "Flood" as:

Flood; surface waters; rising waters; waves; tide or tidal water; the release of water, the rising, overflowing or breaking of boundaries of natural or man-made bodies of water; or the spray therefrom; or sewer back-up resulting from any of the foregoing; regardless of any other cause or event contributing

concurrently or in any other sequence of loss. However, physical damage by fire, explosion or sprinkler leakage resulting from Flood is not considered to be loss by Flood within the terms and conditions of this policy.

On August 16, 2007, the district court granted Northrop's motion for partial summary judgment ruling that the flood exclusion in the Factory Mutual excess policy was ambiguous and did not bar coverage for water damage associated with hurricane storm surge. Factory Mutual filed a Rule 54(b) motion for entry of final judgment which was unopposed and the district court, finding no cause for delay, granted the motion allowing Factory Mutual to appeal the district court's summary judgment ruling to the Ninth Circuit. Factory Mutual also filed an unopposed motion for expedited appeal in the Ninth Circuit, which was granted.

In its appeal to the Ninth Circuit, Factory Mutual presented the following arguments as to why the district court's summary judgment grant in favor of Northrop should be reversed: (1) the Factory Mutual excess policy plainly and unambiguously excluded flood damage caused by hurricane storm surge; (2) the absence of the phrase "whether driven by wind or not" in the excess policy's definition of "Flood" does not create an ambiguity; (3) the primary policy's definition of "flood" did not render the excess policy's flood definition ambiguous; (4) the record evidence, including evidence of Northrop's treatment of the damage from Hurricane Isabel, confirms that Factory Mutual believed Northrop understood the flood exclusion encompassed flood from hurricane storm surge; and (5) Northrop cannot avoid the application of the excess policy's flood exclusion by asserting that wind was the efficient proximate cause of all of the damage to its shipyards caused by Hurricane Katrina. Factory Mutual further argued that it is irrelevant that the Factory Mutual excess policy, unlike some policies, did not include the phrase "whether driven by wind or not" in its flood definition. As Factory Mutual pointed out, a policy provision is not ambiguous simply because it could have been worded differently. The fact that the Factory Mutual primary policy, which had a specific sub-limit for flood, included the phrase "whether driven by wind or not" in its flood definition was irrelevant since the excess policy at issue was a stand-alone policy, rather than a following-form policy, and accordingly, its coverage depended on its own language, not the language of the primary

policy.

In its April 2 Order, the Ninth Circuit expanded its analysis regarding the general rules of contract interpretation under California law quoting its decision in *Evans v. Safeco Life Ins. Co.*, 196 F.2d 1437, 1441 (9th Cir. 1990) (*quoting Allstate Ins. Co. v. Ellison*, 757 F.2d 1042, 1044 (9th Cir. 1985)): “We will ‘not artificially create ambiguity where none exists. If a reasonable interpretation favors the insurer and any other interpretation would be strained, no compulsion exists to torture or twist the language of the policy.’” Citing to dictionary and legal definitions of “flood,” the Ninth Circuit concluded that the excess policy’s definition of “flood,” understood in its ordinary and popular sense, leads to the conclusion that the flood exclusion encompasses the storm surge damage to Northrop’s shipyards. The court noted in a footnote that contrary to the district court’s finding, it is appropriate to consider dictionary definitions in evaluating the ordinary meaning of terms in an insurance policy. The court further noted that the dictionary definition of “flood” comports with the lay understanding of that term, pointing out that “most individuals would describe the inundation caused by a hurricane as a ‘flood.’” (citation omitted)

The Ninth Circuit rejected Northrop’s contention that the differences between the language of the Factory Mutual primary policy and the language of the excess policy demonstrate that the flood exclusion in the excess policy is ambiguous. While the court acknowledged that the primary policy “must” be consulted in interpreting the excess policy (*citing* Cal. Civ. Code §1642), the court expressly declined to treat the two documents as a single contract. The court found that the different definitions of flood in the primary and excess policies did not create ambiguity. Nor was the court convinced that the absence of the phrase “whether driven by wind or not” renders the otherwise clear language of the flood exclusion ambiguous. As the court explained:

Here, because the other terms used to describe flood were merely descriptive of floods, or synonymous for flood, rather than separate exclusions, the absence of “whether driven by wind or not” is not rendered surplusage in the primary policy, nor is it necessary to the excess policy’s definition, where the term flood is sufficiently broad to encompass the damage Northrop suffered. (citations omitted)

While the court did preliminarily consider Northrop’s extrinsic evidence to determine whether it creates an ambiguity, it found that evidence “insufficient to render the contract susceptible to [Northrop’s] proffered interpretation of flood as excluding flooding caused by storm surge.”

The Ninth Circuit remanded for consideration by the district court Northrop’s argument that California’s efficient proximate cause doctrine demands coverage of the water damage notwithstanding the language of the contract, an issue that was briefed by the parties but not reached by the district court in the first instance.

Factory Mutual was represented in the district court and on appeal by attorneys from Zelle Hofmann’s Dallas and Minneapolis offices, Seattle’s Wilson Smith Cochran Dickerson, P.C., and San Francisco-based Carlson, Calladine & Peterson, LLP. Attorneys from Encino’s Horvitz & Levy LLP represented Factory Mutual on the appeal, which was argued by Peter Abrahams.