

NY COURT WEIGHS IN ON AMBIGUOUS DEDUCTIBLE TERMS

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Many property policies contain “all perils” deductibles and/or deductibles for specified perils. Frequently, these deductibles are written as fixed dollar amounts or percentages of the insured value. Insurers may construe these deductible provisions to avoid coverage, which is what Ace American Insurance Company tried to do after Castle Oil Corp. suffered nearly \$2.3 million in Superstorm Sandy flood losses. Fortunately for Castle Oil — and for New York policyholders — a New York court in *Castle Oil Corp. v. Ace American Insurance Co.* recently rejected Ace’s argument that the flood deductible in its policy should be calculated based on a percentage of the total value of the property instead of the value actually insured against flood loss.

Discussion of the Ruling

Castle Oil, the owner and operator of a New York City fuel oil terminal with a total insurable value of \$124.7 million, was insured by Ace at the time of Castle Oil’s flood loss in late October 2012. Ace’s all-risk commercial property policy had been endorsed with flood coverage subject to a \$2.5 million sublimit. An additional endorsement provided that the deductible for flood damage in special flood hazard areas would be “2 [percent] of the total insurable values at risk per location subject to a minimum of \$250,000.”

Ace contended that the appropriate calculation for the flood deductible was 2 percent of \$124.7 million of the total insurable value, which equaled approximately \$2.49 million. According to Ace, because this deductible amount exceeded Castle Oil’s \$2.28 million claim, Ace did not owe coverage for the loss. Castle Oil, however, argued that a policy endorsement expressly stated that the total insurable values provided are “for premium purposes only,” and contended that the flood deductible applies only to insurable values “at risk” of flood damage. The value of the property actually at risk of flood loss, according to Castle Oil, was the \$2.5 million flood sublimit. Because 2 percent of the flood sublimit is less than \$250,000, Castle Oil asserted that the proper deductible is the minimum deductible of \$250,000.

Westchester County Supreme Court Justice Mary Smith granted Castle Oil’s partial summary judgment motion for a declaratory judgment that the applicable flood deductible is 2 percent of the flood sublimit, subject to the \$250,000 minimum.

The court found three reasons to reject Ace’s position.

First, in order to give meaning to the phrase at risk, the “total insurable values at risk per location” must refer to the flood sublimit, rather than

the total insurable value of \$124.7 million. Ace's construction of the deductible, according to the court, would result in no coverage for Castle Oil's multimillion-dollar loss and thus render "the flood insurance plaintiff believed it had procured illusory," which the judge stressed "could not have been plaintiff's intent." Thus, the court agreed with Castle Oil that, to avoid rendering the flood damage sublimit "absolutely meaningless," the appropriate deductible for the flood loss claim was the minimum deductible.

Second, the term "values at risk" was not defined in the policy and that the endorsement expressly contained a "disclaimer" that the total insurable value was set forth "for premium purposes only." Because the policy did not indicate which values would be used to calculate the flood deductible, the court concluded that the deductible provision could be ambiguous, and any "ambiguities in insurance policy exclusionary clauses" are liberally construed in favor of the policyholder.

Finally, the court found support for its decision in *Terra-Adi International Dadeland LLC v. Zurich American Insurance Co. and Landscapes Unlimited v. Lexington Insurance Co.*, while rejecting Ace's reliance on *El-Ad Residences at Miramar Condominium Association v. Mt Hawley Insurance Co.* In *El-Ad Residences*, the Southern District of Florida had construed the policy's hail deductible of "3 [percent] of the total values at risk per building" to mean 3 [percent] of the total insured values, rather than the sublimit amount. Because the other deductible provisions in the policy at issue in *El-Ad Residences* expressly provided

that they applied to the corresponding sublimit, the *El-Ad Residences* court concluded that the absence of such a provision in the hail deductible indicated that the deductible was not intended to apply to the sublimit. In contrast, the policy in *Castle Oil* did not contain any percentage-based deductible provision other than the flood deductible.

Analysis of Cases Involving Similar Deductible Language

Among the handful of published decisions on the proper interpretation of values at risk when the term is not defined in the policy, most were issued by Florida federal district courts after Hurricanes Katrina and Wilma struck the region in 2005.

In *Terra-Adi International Dadeland LLC v. Zurich American Insurance Co.*, Zurich had issued a builder's risk policy for two real estate projects in Miami-Dade County, Fla. The policy provided coverage for property damage due to windstorm and other perils.

The windstorm deductible provision provided: "From the amount of each claim for insured loss or damage arising out of one occurrence, there shall be deducted the applicable amount shown below ... 5 [percent] of the total insured values at risk at the time and place of loss subject to a minimum deduction of \$250,000, as respects the peril of WINDSTORM."

The policy's earthquake and flood deductibles contained virtually identical language concerning "total insured values at risk." After Hurricanes Katrina and Wilma inflicted millions of dollars in damages and delays to the two projects, Zurich contended that

"total insured values at risk" meant the insured value of the entire construction project. In contrast, the policyholders argued that "total insured values at risk" referred to the \$10 million sublimit for windstorm losses because the total insured value for windstorm damage was reflected in the windstorm sublimit.

In its 2007 ruling, the Southern District of Florida held that the windstorm deductible contained an ambiguity, and although both parties' interpretation of the deductible was reasonable, the court construed the ambiguity in favor of the policyholder and applied the deductible to only the \$10 million windstorm sublimit. The court distinguished this case from one in which it had issued an opposite ruling just a month earlier, *Beverly Hills Condominium 1-12 Inc., et al v. Aspen Specialty Insurance Company*.

In *Beverly Hills*, the court rejected the policyholder's interpretation of "total insurable values" for the purposes of calculating the 5 percent hurricane deductible, because the policy provided that the "application of a 'per location' deductible ... is intended to apply to the total insurable values of the entire premises, inclusive of all buildings." Unlike the policy in *Beverly Hills*, the *Terra-Adi* policy's deductible language contained the term "as respects the peril of windstorm," which served as a modifier of the term total insured values.

The inclusion of the modifying language created enough ambiguity for the court to grant summary judgment in favor of the policyholder on that issue.

And just a few months before the Florida courts' decisions, a Nebraska district court had reached a similar conclusion in *Landscapes Unlimited v. Lexington Insurance Co.* to that in *Terra-Adi*. The court examined an all-risk commercial property policy issued to Landscapes Unlimited, which is comprised of two Nebraska companies that design and construct golf courses.

Addendums to the policy provided for a \$500,000 sublimit "per occurrence for each peril of flood" and a deductible of "5 [percent] of the values at risk for the peril of flood (minimum \$25,000)." In 2003, after Landscapes had contracted to construct golf courses and facilities at a site in Maryland, the property

sustained about \$407,000 in flood damage. The insurer, Lexington, calculated the deductible as 5 percent of the value of the property insured, while Landscape asserted that the appropriate definition of "values at risk" is the actual value at risk as reflected in the flood sublimit. The court found that because both interpretations of "values at risk" were reasonable, the policy provision was ambiguous, and the court construed the provision in favor of the insured.

Implications of Castle Oil

As *Castle Oil* and prior case law suggest, policies that fail to define key terms in their deductible provisions, such as "values at risk," are likely to be found ambiguous because they are susceptible to conflicting interpre-

tations. Because courts in New York and other jurisdictions are inclined to construe ambiguities in deductible provisions against the insurer, they may increasingly find that insurers' calculations of deductibles are improper where the policy does not explicitly provide that deductibles are calculated from the total insurable values of the entire premises.

Policyholders should carefully review their policies' deductible provisions and endorsements at renewal and certainly before a loss occurs so that they understand fully how the deductibles will apply. And after a loss, policyholders should carefully ensure that they — and their insurer — are calculating deductibles appropriately.

