

CASE OVERVIEW: LESSONS FROM THE GREAT FIRE OF 1906

California Wine Association v. Commercial Union Fire Insurance Company of New York

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December 2010 marks the centennial of the landmark California Supreme Court decision that resolved the critical insurance coverage dispute arising from the 1906 San Francisco earthquake and fire. The earthquake and ensuing fires laid waste to the city, destroying 28,000 buildings and causing the nation's second largest death toll in history with up to 6,000 killed.

Immediately after the fires were extinguished, the city's real estate board convened to pass a remarkable resolution that "the calamity should be spoken of as 'the Great Fire' and not as 'the Great Earthquake.'" Why? Many fire insurance policies issued to San Franciscans contained exclusions for losses caused by earthquake. As British consul general Walter Courtney Bennett put it, "If the insurance is not paid, the city is ruined. If it is paid, many of the insurance companies will break."

Many policyholders were forced to sue their property insurers when they invoked earthquake exclusions to deny coverage. Policyholders won some cases and lost others, but the decisions helped set the ground rules for how courts around the country would resolve insurance disputes arising out of such catastrophes up to the present day. Addressing the perplexing issue of coverage when

loss is caused by two perils—one that is insured and one that is excluded—most courts held that there was coverage for the ensuing fires unless the insurance policies unambiguously excluded fires caused by earthquakes. Even where the policies excluded losses "caused directly or indirectly by earthquake," most courts found for the claimants if any covered cause independent of the earthquake—an explosion, backfiring or even wind—contributed to the fire damage.

These early decisions helped establish the now nearly universal rule of "concurrent causation" or "efficient proximate causation." In layman's terms, this means that when a loss is caused by a combination of excluded causes (earthquake, flood) and covered causes (fire, hurricane), the insured is entitled to coverage.

The 1906 case illustrates how these rules work in the hands of skilled policyholder lawyers and was filed by the California Wine Association, which stored millions of gallons of wine in San Francisco warehouses. After fire consumed these buildings, the Wine Association submitted to its insurers a property damage claim that included loss of inventory. Commercial Union Fire Insurance Company of New York denied

coverage, invoking the exclusion in its policy for “loss caused directly or indirectly by earthquake.” The insurance company’s lawyers argued that the fire had been started by the earthquake and travelled “continuously and uninterruptedly” to the plaintiff’s warehouses, destroying them.

The Wine Association’s attorneys obtained the judge’s approval to ask the jury specific questions in the form of special verdicts. One asked whether, of all the fires that began on April 18, some were “not caused directly or indirectly by the earthquake.” Another asked whether it was necessarily one of these latter fires that destroyed the Wine Association’s warehouses.

The jury answered these questions in favor of the Wine Association after its lawyer showed, to the jury’s satisfaction, that the losses were caused by fires from the quake that were legally distinguishable. (Hours after the quake struck, for example, someone making breakfast on a stove sent sparks through a cracked chimney and launched what is known as the “Ham and Eggs Fire.”) The insurer appealed, but to no avail. On December 28, 1910, the California Supreme Court held that the jury’s factual finding made the only potential legal issue in the case moot, namely, whether the fire had been caused by the earthquake or had independent origin.

The California legislature later enshrined the decision in *California Wine Association v. Commercial Union Fire Insurance Company of New York*, amending the state’s insurance code to mandate that property insurers must cover fire damage ensuing from earthquakes regardless of whether those fires are “caused” by earthquakes or merely “follow” them. Across the country, insurers sought to protect themselves from a repeat of the massive losses they had incurred in the wake of the 1906 San Francisco catastrophe by inserting so-called “anti-concurrent causation clauses” into nearly all of their property insurance policies. Those clauses say, in essence, that if damage occurs even partly by an excluded cause, there is no coverage even if a covered cause also contributes to the loss. In California, such clauses remain unenforceable to this day.

The concurrent causation issue has continued to rear its head in almost every dispute over insurance coverage for natural disasters. Indeed, the issue became critical nearly 100 years later in the litigation over coverage for property damage resulting from Hurricane Katrina. While most property insurance policies excluded flood damage, windstorm loss was generally covered. Many Katrina claims have yet to be resolved, but most Gulf state courts have found anti-concurrent causation clauses to be

enforceable, denying policyholders coverage for billions of dollars in windstorm damage that was exacerbated by ensuing floods.

In contrast, partly as a result of the tragic events a century ago, California remains one of only a handful of states that refuse to recognize and enforce such anti-concurrent causation provisions. As companies contemplate the potential hazards presented by natural and manmade disasters, it is worthwhile to revisit the issue of concurrent causation and the tragedies that can result when coverage is not available for such perils.

During the past year, this issue has been presented in stark relief, with a Haitian earthquake, Pakistani flood and a three-month drought in Russia. For the majority of policyholders, deleting anti-concurrent causation clauses from their policies will remain a matter requiring hard-knuckled negotiation. Fortunately, at least for now, California policyholders retain the protection granted by the State Supreme Court in 1910.