Insurance Coverage Rules for Inverse Condemnation Actions Involving Public Water Systems

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“A legal nexus of overlapping damages, liabilities and triggers”
Inverse condemnation is a complex legal theory presenting unique, opaque and expansive liability to public water systems. Its gravity is analogous to the Greek mythological Titan Atlas, who was condemned by Zeus to stand at the western edge of earth and hold up the sky on his shoulders. Public water systems face a similar fate, except their strain arises from the weight of a legal theory that is noble in concept yet predacious in practice. This nobleness reflects a constitutionally protected right against unlawful takings of private property by the government without just compensation. The predation represents acute liability from which its targets have few actionable defenses, no governmental immunities, and immense financial exposure.

Public water systems are vulnerable to inverse condemnation actions because unlawful takings encompass diminution in value to real and personal property proximately caused by physical and nonphysical injury from public improvements. Water delivery systems, which qualify as public improvements, are inherently prone to accidental and temporary takings involving uninvited water arising from breaks, leaks, backups, releases, and overflows. This paper encapsulates the problems owners of public water systems face from inverse condemnation. The first section of this article centers on the legal theory’s underlying mechanics, available protections, and emerging areas of liability, and the second section examines insurer defense and indemnity obligations for those insurance policies from which such action cloaks as a potential policyholder right.

I. Inverse Condemnation as Legal Theory

A. Constitutional Derivations

The principle of due process creates the risk of liability for those public water systems that violate the takings clause of the federal and state constitutions. The Fifth Amendment to the United States Constitution states “...no person shall be ... deprived of ... property, without due process of law ... nor shall private property be taken for public use, without just

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1 This paper focuses solely on public water systems purveying potable water through water delivery systems as opposed to public water systems engaging in flood control and irrigation operations. With respect to inverse condemnation, the operations of the latter are bound by the standard of reasonableness, as described in more detail herein.

2 Inverse condemnation affects any entity with public improvements that are designed and intended for the public use.
compensation.” Various State constitutions are even broader; Article I, Section 19 of the California Constitution affirms “private property may be taken or damaged for public use only when just compensation...has first been paid....”\(^3\) Due process functions as a constitutional lever for imposing strict liability on inverse condemnation actions for public improvements like water delivery systems that create damage to private property. Courts have frequently found that public water systems “may be liable in an inverse condemnation action for any physical injury to real property proximately caused by a public improvement as deliberately designed and constructed, whether or not that injury was foreseeable, and in the absence of fault by the public entity.”\(^4\)

Water delivery systems are deemed public improvements built for the public benefit. But these water systems are constructed in a way that anticipates tradeoffs. A trespass of uninvited water often occurs as a result of a deliberately designed and constructed water delivery system. In the event of such a trespass, physical injury to real property is a frequent byproduct. The resulting damage is often proximately caused by the trespass, rather than an intervening cause. Should the facts of trespass and damage be established, then inverse condemnation is reasoned to have occurred and strict liability levied. “[D]amage from invasions of water or other liquid effluents often provides the basis for inverse liability.”\(^5\) Inverse condemnation and the standard of strict liability extend beyond physical injury from the trespass of uninvited water and similarly comprise nonphysical injury to property, including loss of use, for other intrusive activities linked to water delivery systems. Common examples include nuisance (e.g., odors), existence (e.g., tanks), and land use (e.g., easements). Physical damage to property is not a prerequisite to compensation.\(^6\) The legal theory’s low burden of proof, malleable criteria for damages, and other reasons to be examined below have facilitated its widespread and weaponized use against public water systems whenever private

\(^3\) **CAL. CONST.,** art. I, § 19.

\(^4\) See, e.g., Holtz v. Superior Court, 3 Cal.3d 296, 303-304 (Cal. 1970); Albers v. County of Los Angeles, 62 Cal.2d 250, 263-264 (Cal. 1965); Pacific Bell v. City of San Diego, 81 Cal.App.4th 596, 96 Cal.Rptr.2d 897 (Cal. Ct. App. 2000). These cases affirm a water delivery system is deemed a public improvement as long as it is intended for community use and an improper plan of maintenance, as opposed to an operational failure to follow a plan, is grounds for inverse condemnation liability.


\(^6\) See id. at 296 (odors emanating from a sewage treatment plant is sufficient for inverse condemnation liability).
property is diminished in value via physical or nonphysical injury from a public improvement.\footnote{See Customer Co. v. City of Sacramento, 10 Cal.4th 368, 895 P.2d 900, 41 Cal.Rptr.2d 658 (Cal. 1995) ("...the property damage for which Customer seeks to recover bears no relation to a ‘public improvement’ or ‘public work’ of any kind. Instead, the damage was caused by actions of public employees having ‘no relation to the function’ of a public improvement whatsoever. As the foregoing cases demonstrate, property damage caused in such a manner never has been understood to give rise to an action for inverse condemnation in California, but rather has been treated as subject to the general tort principles applicable to governmental entities.“ id. at 383).}

\section*{B. Substantial Cause-and-Effect Rule}

Lack of proximate causation is the only defense for inverse condemnation actions filed against public water systems involving trespass of uninvited water or other intrusive activities linked to their water delivery systems. But in contrast to traditional tort law, the inverse condemnation doctrine requires a plaintiff seeking to prove proximate causation to simply show that the defendant’s undertakings set in motion a relatively short chain of events that could reasonably be deduced to lead to the plaintiff’s damages. The absence of fault and foreseeability involving water delivery systems has expanded proximate causation to encompass a “substantial cause-and-effect relationship which excludes the probability that other forces alone produced the injury.”\footnote{Souza v. Silver Development Co., 164 Cal.App.3d 165, 171, 210 Cal.Rptr. 146 (Cal. Ct. App. 1985).} This wide-ranging definition renders most loss scenarios involving water delivery systems as unlawful takings, since contributing factors are marginalized. \footnote{The following cases modified the proximate cause requirement found in Albers in the form of a substantial cause-and-effect relationship since foreseeability is no longer an element of inverse condemnation: Souza, 164 Cal.App.3d 165; Ingram v. City of Redondo Beach, 45 Cal.App.3d 628, 633-634 (Cal. Ct. App. 1975); Belair v. Riverside County Flood Control Dist., 47 Cal.3d 550, 559, 253 Cal.Rptr. 693, 764 P.2d 1070 (Cal. 1988); California State Automobile Assoc. v. City of Palo Alto, 138 Cal.App.4th 474, 559, 253 Cal.Rptr. 693, 764 P.2d 1070 (Cal. 1988); Blau v. City of Los Angeles, 32 Cal.App.3d 77, 85, 107 Cal.Rptr. 727 (Cal. Ct. App. 1973).} It is difficult for public water systems to avoid inverse condemnation liability unless there is a clear intervening break in the chain of causation, e.g., a mass inundation of rain preceding a water main break.\footnote{See Goebel v. City of Santa Barbara, 92 Cal.App.4th 549 (Cal. Ct. App. 2001) (inverse condemnation does not need to be foreseeable, but the public improvement must be a substantial cause of the injury; damage from massive rainfall was deemed to be an intervening chain in causation.}
C. Eminent Domain and Inverse Condemnation Governing Principles

The rationale for imposing strict liability against public water systems is based on dispersing the costs of water delivery systems across the entire community, so that no one property owner bears a disproportionate financial burden of the project. “[U]nderlying the concept of inverse condemnation is that the costs of a public improvement benefiting the community should be spread among those benefited rather than allocated to a single member of the community.”

This principle emanates from eminent domain, which is the contraposition of inverse condemnation. Both theories share the same constitutional safeguards of due process and just compensation arising from the taking or damaging of private property by a public water system. Their singular difference involves a role reversal of plaintiff and defendant.

Eminent domain (otherwise known as condemnation or direct condemnation) is the more common understanding of the takings clause and involves public water systems initiating takings as plaintiff by: (1) establishing public projects for public benefit requiring the acquisition of private property; (2) notifying potentially affected property owners that their property is needed for this purpose; (3) offering to purchase the private property or requesting it be dedicated; and, if necessary; (4) filing suit to acquire the private delivery system require a deliberate act from the governing body that is taken in furtherance of public purposes and a “use which concerns the whole community or promotes the general interest in its relation to any legitimate object of government.”


Eminent domain and inverse condemnation actions are both deemed takings, but the latter does not require the former powers. See Barham, 88 Cal.Rptr.2d at 432 (the power of eminent domain is not required for an entity operating a public improvement for public use to be sued under the theory of inverse condemnation).
property in exchange for just compensation.\textsuperscript{13} Inverse condemnation reverses the litigation whereby the property owner is plaintiff and the public water system is defendant. Proof of four rudimentary elements are required to establish inverse condemnation liability: (1) confirmation of interest in real or personal property by plaintiff; (2) the public water system substantially participated in the planning, approval, construction or operation of a public project or public improvement (i.e., its water delivery system); (3) plaintiff's property suffered damage; and (4) the public water system's project, act, or omission was a substantial cause of the damage.\textsuperscript{14}

\textbf{D. Legal Process for Physical Takings}

There are two types of unlawful takings: physical and regulatory. Our focus is the former since public water systems are more susceptible to this type of taking. Physical takings can be temporary or permanent. Public water systems are most vulnerable to claims of temporary takings resulting from trespass of uninvited water from their water delivery systems. Unlawful takings are constitutionally protected, precluding legislative or regulatory remedies. Takings also necessitate two trials. The first is a bench trial to determine if an unlawful taking occurred. Should a judge conclude an unlawful taking, then a second trial by jury establishes just compensation. The California just compensation formula is the same for inverse condemnation and eminent domain. Plaintiffs, however, can recover their attorney fees and expert witness fees, as well as prejudgment interest and appraisal fees in an inverse condemnation case. The only compensation recoverable under inverse condemnation is for damages to real and personal property. No other recovery, such as personal injury, is allowed. Since inverse condemnation involves strict liability as well as the attachment of fees and interest, litigation requires immediate review of the facts and determination of proximate causation. It is also important to promptly assess the plaintiff's damages, as early settlement may be prudent to mitigate the loss.

\textbf{E. Invited Water vs. Uninvited Water}

Public water systems are not subject to liability for inverse condemnation actions involving invited water (i.e., voluntary acceptance of water into private


\textsuperscript{14} Yamagiwa v. City of Half Moon Bay, 523 F. Supp.2d 1036, 1088 (N.D. Cal. 2007).
piping systems) that complies with statutory and regulatory standards, including regulations and other express government approvals. For example, there would be no liability under this theory for water provided to a property otherwise in conformance with state requirements, including any permits, for specified chemical usage associated with water treatment and distribution as long, as the act was expressly allowed by statute. In such situations, the alleged damage from the act or byproduct of said conformance will not trigger inverse condemnation liability. “The authorizing statute need not predict the precise nature of the damages. It need only authorize the governmental action.”

Case law has affirmed that regulatory compliance bars an inverse condemnation action, irrespective if the action involves property damage resulting from invited water distributed by a water delivery system. Similar to a public entity not being responsible under inverse condemnation liability (only tort liability) to compensate a property owner for alleged property damage resulting from the treatment and delivery of drinking water that is fully compliant with all state and federal clean drinking water standards. The public water system may be held liable, if at all, only in a tort action filed pursuant to the Tort Claims Act.

F. Emerging and Evolving Issues

There is clear legal precedent for unlawful takings arising from trespass of uninvited water and other intrusive activities linked to water delivery systems. Defenses are similarly ratified for invited water conforming to regulatory standards from water delivery systems. Inverse condemnation, however, is not a static legal theory. It is metastasizing to other operations tangentially connected to water delivery systems. The most pronounced is a public water system’s failure to protect property during a wildfire. In this scenario, plaintiffs have begun to argue inverse condemnation applies when a fire suppression system, which is deemed a public improvement, fails during a wildfire and property damage ensues as a result.

Plaintiffs assert strict liability as the legal standard for these actions


16 Farmers Ins. Exchange, 175 Cal.App.3d at 503.

17 See, e.g., Locklin v. City of Lafayette, 7 Cal.4th 336, 342 (Cal. 1994).
because fire suppression systems are embedded in water delivery systems. The fact that the wildfire was not started by the public water system or that the wildfire overwhelmed the fire suppression system is deemed moot. Plaintiffs focus their reasoning on the precise liability of inverse condemnation: physical injury to real property proximately caused by a public improvement as deliberately designed and constructed, whether or not that injury was foreseeable, and in the absence of fault by the public entity.\(^{18}\) If situational facts align with case law, plaintiffs argue strict liability must be the appropriate legal standard even though the resulting damage was from fire and not water. Such arguments stretch credulity, but a large, non-precedential judgment recently supported this logic and spurred copycat lawsuits involving similar fact patterns.

*Itani v. Yorba Linda Water District* involved the 2008 California Freeway Complex Fire.\(^{19}\) This wildfire was sparked by a disabled vehicle and destroyed hundreds of homes in Orange County, with the majority in a subdivision serviced by Yorba Linda Water District (YLWD). The affected homeowners sued YLWD under theories of negligence and inverse condemnation. Plaintiffs asserted the failure of YLWD’s fire suppression system, specifically lack of water and inadequate pressure from their hydrants, represented a substantial cause-and-effect of the loss. They argued the wildfire’s ignition by a third party and its subsequent overwhelming of YLWD’s fire suppression system as irrelevant. The plaintiffs further argued that it was irrelevant that it would have been unfeasible to augment the fire suppression infrastructure to defend against wildfires, as opposed to single structure fires. Plaintiff’s inverse condemnation argument was narrow: YLWD’s public improvement failed, and that failure was a substantial cause-and-effect of the loss. Since the fire suppression system was embedded in defendant’s water delivery system, plaintiffs stated strict liability should be the legal standard.

The trial judge dismissed the negligence cause of action based on California’s firefighting immunities\(^{20}\) but allowed the inverse condemnation action to proceed via its constitutionally protected status. The judge linked


\(^{19}\) *Id.*

\(^{20}\) (1) No liability for failure to provide fire protection service. *Cal. Gov’t Code* §850. (2) No liability for injury resulting from the condition of fire protection or firefighting equipment or facilities. *Cal. Gov’t Code* §850.4.
the failure of fire suppression systems to the failure of flood control facilities: “There is no reason why a flood case should not be applied to a fire case for inverse condemnation through the simple substitution of appropriate nouns in the foregoing quotation.” 21 The parties took the inverse condemnation action to binding arbitration where the judgment was split. The arbitrator ruled YLWD was not liable for the destroyed homes where its fire suppression system did not fail. However, the arbitrator ruled YLWD was liable for the destroyed homes where the fire suppression system did fail. The inverse condemnation binding arbitration judgment was $69 million.

G. Common Enemy Doctrine

This non-precedential decision applied the legal standard of strict liability by correlating fire suppression systems with water delivery systems. Fire suppression systems are embedded within water delivery systems, but their operational purposes are fundamentally different. The former is an ancillary and regulatory mandated service intended to assist emergency response providers with fire protection. The latter is a core service involving potable water purveyance. The failure to protect during a wildfire does not involve an unlawful taking of uninvited water trespassing from a water delivery system. It arises from the failure of a fire suppression system to provide sufficient water flow during a wildfire. The physical injury to real property is fire and not water; the same logic applies to nonphysical injury. Moreover, fire suppression systems are operationally aligned with flood control facilities in that they both protect the public against a common enemy, with one defending against fire and the other against water.

The common enemy doctrine22 is the impetus to affording flood control facilities a legal standard of reasonableness for inverse condemnation actions.23 This standard of reasonableness associated with flood control facilities). Besides promoting the common good that flood control facilities bestow, they are subject to the “unique context of water law and derived from upper riparian private landowners’ limited common law privilege to defend themselves against the common enemy of floodwaters.” citing Archer v. City of Los Angeles, 19 Cal.2d 19, 24–25, 119 P.2d 1 (Cal. 1941); Albers, 62 Cal.2d at 262; Holtz, 3 Cal.3d at 304–306.

21 Itani, No. 30-2009-00124906.
22 Under the common enemy doctrine, as an incident to the use of his own property, each landowner has an unqualified right, by operations on his own land, to fend off surface waters as he sees fit without being required to take into account the consequences to other landowners, who have the right to protect themselves as best they can.
23 Bunch v. Coachella Valley Water Dist., 15 Cal.4th 432, 935 P.2d 796, 63 Cal.Rptr.2d 89 (Cal. 1997) (codifying the rationale for the
standard is akin to negligence and based on just, rational, appropriate, ordinary, or usual actions or activities. It was purposely established to elevate the burden of proof for inverse condemnation actions against flood control facilities. Case law stipulates “... a public agency that undertakes to construct or operate a flood control project clearly must not be made the absolute insurer of those lands provided protection ... [but] it must at least act reasonably and non-negligently.” Accordingly, plaintiffs must demonstrate the flood control facility's design, placement, construction, maintenance or funding posed an unreasonable risk of harm to the plaintiff's property, and the preceding governing body's decisions represented a substantial cause-and-effect of the damage.

The standard of reasonableness applicable to flood control facilities is fundamentally different than strict liability. It provides meaningful defenses, similar to a tort, for public water systems when defending an inverse condemnation action involving their flood control facilities. The courts apply the following factors when assessing liability from this standard: (1) the overall public purpose being served by the public improvement; (2) the degree to which the plaintiff's loss is offset by reciprocal benefits; (3) the availability of feasible alternatives with lower risks; (4) the severity of the plaintiff’s damage in relation to risk-bearing capabilities; (5) the extent to which damage of the kind the plaintiff sustained is generally considered a normal risk of land ownership; and (6) the degree to which similar damage is distributed at large over other beneficiaries of the public improvement or is peculiar only to the plaintiff. These factors favorably line-up with the operations of fire suppression systems and their purpose to protect the public against the common enemy. The similarities with flood control facilities are likewise accentuated. As the law applicable to inverse condemnation in fire suppression cases develops, the standard of reasonableness should apply.

H. Evolving & Emerging Issues – Recap

Inverse condemnation is an evolving exposure intensifying in regularity, gravity, and consequence. The impact on public water systems and its insurers is notably adverse because water delivery systems align perfectly with the precise liability imposed by this legal theory. With overwhelming financial ramifications, inverse condemnation represents an existential threat to public water systems and may soon be deemed

24 Belair, 47 Cal.3d at 565; Holtz, 3 Cal.3d at 307 n. 12.

25 Locklin, 7 Cal.4th at 368-369.
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an uninsurable exposure. The situation will irreparably deteriorate should the standard of strict liability, as opposed to reasonableness, be imposed for failure to protect claims arising from fire suppression systems. Litigation similar to the *Itani* case is underway from the 2017 and 2018 California wildfires and will invariably impact the legal standards on this open question. Meanwhile, the Governor’s Office of Planning and Research has formed a Commission on Catastrophic Wildfire Cost and Recovery to examine the issue from a public policy perspective. Their findings are due July 2019 and may shape judicial adjudication of the appropriate liability standard to apply in these pending cases.

The Commission’s final report recommends the replacement of strict liability with the standard of reasonableness for water and electric utilities as it relates to inverse condemnation actions involving the failure of their public improvements during a wildfire. The nonbinding con-version is intended to apply a consistent liability standard for common enemy claims involving floods and wildfires and coherently articulate legislative-and-executive branch intent to the judicial branch when deciding inverse condemnation cases. The proposed standard balances rights of private property owners with rights of the populace for reliable, affordable, and available fire suppression services. Equally important, it preserves the option for public water systems to transfer this risk via properly structured insurance policies under pre-agreed terms and pricing.

II. Insurance Solutions for Inverse Condemnation

The first section of this article presented the derivations and exposures of inverse condemnation as well as its seamless liability alignment with public water systems. Insurance can serve as an effective risk transfer solution for this legal theory but is not a panacea. Most insurers do not wittingly offer inverse condemnation coverage or fully comprehend its impact. The legal theory is problematic for public water systems, as their

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26 In September 2018, the California legislature passed and then-Governor Brown signed SB 901. Among other things, the bill created a Commission on Catastrophic Wildfire Cost and Recovery to provide recommendations to the governor and legislature on how to manage the long-term costs and liabilities associated with utility-caused wildfires.


28 This article limits its review to public water systems purveying potable water through water delivery systems, as opposed to public water systems engaging in flood
water delivery systems 29 intrinsically comport to its complex liability. Insurers have different but no less vexing challenges of interpreting insurance policies against a convolution of overlapping damages encapsulating economic and physical injury, as well as intersecting liabilities comprising wrongful acts and system operations.

The theory’s compositional incongruence presents confusion and inconsistency within the insurance industry regarding the proper adjustment of such actions. The situation is exacerbated by the doctrine of adhesion contracts by which insurance policies are governed. This doctrine sets forth specific rules of insurance policy interpretation that bestows rights to policyholders for reasonable coverage expectations and ambiguous policy provisions. Those rights, coupled by the unwieldy and obfuscated attributes of inverse condemnation actions, necessitate a careful evaluation by insurers to properly assess their defense and indemnity obligations in order to abate policyholder conflict and unintended extracontractual damages.

A. Liability and Damage Misperceptions

The confusion and inconsistency of inverse condemnation actions center on a misunderstanding of proximate loss and resulting damage. To systemize the proper evaluation method for assessing defense and indemnity obligations, insurers must fully comprehend the derivations, purpose, and framework of inverse condemnation as well as the source for its constitutional protections bestowed to private property owners. This knowledge will ensure appropriate and uniform loss adjustment handling across the insurance industry. Procedural standardization will enhance coherent codification by insurers of their obligations for those insurance policies structurally equipped to plausibly encompass coverage.

These policies—commercial general liability and public officials’ liability— are fundamentally different in scope and intent. The former comprises property damage arising from operations of the public water system’s water delivery system, 30 whereas the latter includes monetary damages arising public improvements subject to their public use by the community.

30A general liability policy includes defense and indemnity obligations for bodily injury, property damage, personal injury, advertising injury, fire legal liability, and medical payments. Since inverse condemnation only applies to real and

29Pacific Bell, 81 Cal.App.4th 596. Pacific Bell held water delivery systems are deemed

control and irrigation operations. As of this writing, inverse condemnation actions filed against the former are subject to strict liability, whereas actions against the latter are bound by the standard of reasonableness.

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from the wrongful acts of the public water system’s governing body. Although one of the policies is patently better equipped to cover inverse condemnation actions than the other, they both require careful inspection due to the complexity of damages and liabilities frequently specified as well as the influence of the adhesion doctrine on divining insurer obligations for policies that were not intended to cover such actions.

B. Governing Body
Wrongful Acts vs. Operational Property Damage

An inverse condemnation action requires damage from a public improvement that was deliberately designed and constructed. Case law has defined *deliberately designed and constructed* to mean deliberate decisions and acts from the public water system’s governing body. Governing law attributes the personal property, our discussion is limited to the property damage coverage grant of this policy. The International Risk Management Institute, Inc. (IRMI), defines a public officials’ liability policy as providing coverage for wrongful acts (i.e., powers, policies, decisions, plans, and funding) to the board of trustees and its executive officers in the governing of a public entity. Wrongful acts are commonly defined as actual or alleged errors, omissions, misstatements, negligence, or breaches of duty in the capacity as a trustee, officer, and executive of a public entity that results directly but unexpectedly and unintentionally in monetary damages to others. A public officials’ liability and directors & officers’ liability policy are structurally similar. The distinction is based on corporate formation. Public water systems that are public entities or nonprofit mutual benefit corporations purchase the former, whereas investor owned utilities procure the latter. See *Albers*, 62 Cal.2d at 260. *Albers* further states “[a]ny definite physical injury to land or an invasion of it cognizable to the senses, depreciating its market value, is damage in the constitutional sense...” *Id.*
current fair market value of the affected property. "Restoring the deprived property owner's pre-taking financial position involves compensating the property owner for the fair market value of the property lost as a result of the taking." 33

Inverse condemnation liability distinguishes water delivery system operations from decisions of the governing body as it relates to design, placement, construction, maintenance, and funding of the public water system. The act of initiating a public improvement derives from the deliberate and intentional decisions made by the governing body to approve its existence and purpose. "So long as the entity has made the deliberate calculated decision to proceed with a course of conduct, in spite of a known risk, just compensation will be owed." 34 The right of a public water system to operate a water delivery system is based on their charter bestowed to it by the local, state or federal government. That right, and the attendant powers, is conferred to the governing body to make deliberate and intentional decisions regarding the design, placement, construction, maintenance, and funding of its water delivery system. "The destruction or damaging of property is sufficiently connected with 'public use' as required by the Constitution, if the injury is a result of dangers inherent in the construction of the public improvement as distinguished from dangers arising from the negligent operation of the improvement." 35 The governing body's deliberate and intentional damage under predictable circumstances may later be judicially described as 'negligently' drawn; yet, in the original planning process, the plan or design with its known inherent risks may have been approved by responsible public officers as being adequate and acceptable for non-legal reasons. "The governmental decision...to proceed with the project under these conditions thus may have represented a rational (and hence by definition non-negligent) balancing of risk against practicability of risk avoidance." citing Van Alstyne, supra note 34, at 490. The Bunch case involved a flood control facility where the standard of reasonableness versus strict liability applied. Notwithstanding, it underscores the point that decisions or wrongful acts of the governing body and not the operations of the flood control facility trigger inverse condemnation liability.

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35 Paterno v. State of California, 74 Cal.App.4th 68, 87, 87 Cal.Rptr.2d 754 (Cal. Ct. App. 1999); Bauer, 45 Cal.2d 276, 284–285; see also Hayashi v. Alameda County Flood Control, 167 Cal.App.2d 584, 334 P.2d 1048 (Cal. Ct. App. 1959) (plaintiffs had not stated a cause of action for inverse condemnation because, although the defendant's failure to repair a levee within 10 to 21 days was negligence, it was not "a deliberate plan with regard to the construction of public works." Id. at 590–592). See Van Alstyne, supra note 34, at 489–490; see also Bunch, 935 P.2d 796 which states: "[p]lan or design characteristics that incorporate the probability of property
decisions associated with its water delivery system are, without equivocation, the basis of all inverse condemnation actions. Any resulting property damage is peripheral to the economic injury prompted by the unlawful taking.

Negligence of employees falls outside the scope of inverse condemnation. Private property that is taken or damaged in this context requires an act or decision by the public water system’s governing body. “The focus is on the acts of the public entity, which decides where, when and how to construct public improvements. In making policy choices, the entity must consider the effect of the improvement on property owners and be prepared to pay for taking or damaging property, either by condemning it or by paying a takings judgment. Where damage results from the acts of employees, and not from a policy decision, there is no taking. Recovery, if any, lies in a tort action, such as negligence.”

Conversely, inadequate plans of maintenance, which are distinct from the failure to follow prescribed plans of maintenance, qualify under the deliberate decision requisite of a governing body. “[I]t is the plan of maintenance which must be unreasonable to establish a taking. Poor execution of a maintenance plan does not result in a taking.”

The same takings criteria applies when plans set forth by the governing body are not followed by employees or independent contractors. “An injury resulting from a violation of the project plans is not a result of the ‘public use’ for which the project was created.” Inadequate implementation of said plans qualifies as a general tort liability.

The same methodology applies to funding decisions by the governing body as it relates to design, placement, construction, and maintenance of a water delivery system. The act of funding comprises the governing body’s legal power to set policies, enact plans, and make decisions on behalf of the public water system. “The governmental decision to proceed with the project without incorporating the essential precautionary modifications in the plan thus represents more than a mere determination that effective damage prevention is not expedient. It is also a deliberate policy decision to shift the risk of future loss to private property owners rather than to absorb such risk as a part of the cost of the improvement paid for by

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36 Paterno, 74 Cal.App.4th at 87; see also Customer Co., 10 Cal.4th at 382; Bauer, 45 Cal.2d at 285–286.
38 Paterno, 74 Cal.App.4th at 86.
the community at large.” Courts have deemed insufficient funding of a water delivery system as grounds for an inverse condemnation action should the funding be a contributing factor in physical injury to private property. Liability centers on the governing body’s failure to anticipate the probability of damage to private property arising from funding decisions influencing the design, placement, construction, and maintenance of its water delivery system.

C. Correlating Inverse Condemnation to Insurance Policies

An insurance-related analysis of inverse condemnation, including its refined principles and relevant case law, clearly places this complex legal theory within a public officials’ liability policy. The fundamental covenant of a public officials’ liability policy is to cover monetary damages arising from the wrongful acts of a governing body. That subtle but important distinction between governing decisions and economic injury versus operations and property damage is the decisive demarcation line. Inverse condemnation liability does not arise out of general tort liability, such as negligent acts in day-to-day maintenance or operations of a public improvement.

those costs should be recognized as planned costs inflicted in the interest of fulfilling the public purpose of the project.”

39 Van Alstyne, supra note 34, at 491.

40 Frustuck v. City of Fairfax District, 212 Cal.App.2d 345, 28 Cal.Rptr. 357 (Cal. Ct. App. 1963). As stated in Paterno, “[a]n injury resulting from a violation of the project plans is not a result of the ‘public use’ for which the project was created.” 74 Cal.App.4th at 87. See also Van Alstyne, supra note 34, at 491-492. The magnitude of the public necessity for the project at the particular location, with the particular design or plan conceived for it, must be assessed in comparison to available alternatives for accomplishing the same underlying governmental objective with lower risk, but presumably higher costs.” Paterno continues: “[a] deliberate policy decision to shift the risk of future loss to private property owners rather than to absorb such risk as a part of the cost of the improvement paid for by the community at large, meaning private damages, should be treated as a deferred cost of the project as a whole. If and when they materialize, however, the present analysis suggest that

41 Unlawful

takings are the result of wrongful acts bestowed by the powers, policies, and decisions of the governing body.\textsuperscript{42}

Prescribed plans of maintenance and funding levels of a water delivery system are acts of the governing body. These decisions qualify as wrongful acts in the context of an inverse condemnation action if the governing body took a calculated risk that private property may be damaged by a substantial cause-and-effect relationship from a plan of maintenance that is not all-encompassing.\textsuperscript{43} Inverse condemnation actions are uniquely founded in the deliberate and intended decisions of the governing body as it relates to the design, placement, construction, maintenance, and funding of its water delivery system. Any resulting property damage is peripheral to economic injury from the wrongful act.

Unlawful takings are not deemed intentional or disqualifying under the precepts of insurance. Decisions by the public water system’s governing body related to design, placement, construction, maintenance, and funding of their water delivery system are intentional and deliberate. These decisions, however, are not made with foreseeability to intentionally damage private property. Frequently, inverse condemnation damage occurs without an actual intention on the part of the government to harm private property.\textsuperscript{44} Hence, inverse condemnation actions conform to the insurance code for insurability and contingency.\textsuperscript{45}

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\textsuperscript{43} Yox v. City of Whittier, 182 Cal.App.3d 347, 355, 227 Cal.Rptr. 311 (Cal. Ct. App. 1986); Youngblood v. Los Angeles County Flood Control Dist., 56 Cal.2d 603, 607, 15 Cal.Rptr. 904, 364 P.2d 840 (Cal. 1961); see also Van Alstyne, \textit{supra} note 34, at 491, proceeding with a public project without incorporating necessary prevention measures for known risks is a “deliberate policy decision to shift the risk of future loss to private property owners rather than to absorb such risk as a part of the cost of the improvement paid for by the community at large.”

\textsuperscript{44} See \textit{Belair}, 47 Cal. 3d at 574; Van Alstyne, \textit{supra} note 34, at 493-495.

\textsuperscript{45} California Insurance Code, Section 22 defines insurance as “a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event.” Cal. Ins. Code § 22. Section 250 limits insurability to events which are “contingent or unknown, whether past or present.” Sections 22 and 250 coalesce in what has come to be known as the “loss-in-progress” or “known loss” rule. See Montrose Chem. Corp v. Superior Court, 10 Cal.4th 645, 689-690 (Cal. 1995). “[T]he loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer
D. Insurance Policies as Contracts of Adhesion

Even though the principles of inverse condemnation structurally align with a public officials' liability policy, policyholders may also find unintended defense and indemnity relief within their commercial general liability policy. The reasons are two-fold. First, many inverse condemnation actions also include general tort liability claims such as nuisance, dangerous condition, and trespass within their complaint. These torts are based on negligence and align with the fundamental coverage compact of property damage arising from a public water system’s operations. Accordingly, defense and indemnity obligations may exist for those specific actions within the commercial general liability policy, regardless whether inverse condemnation is the overarching action. Second, insurance policies follow the doctrine of adhesion contracts and have specific rules for interpretation that benefit the policyholder. Consequently, a commercial general liability policy may be deemed ambiguous and confusing to the policyholder regarding an inverse condemnation action. Should a finding of ambiguity occur, courts will interpret the equivocality in favor of the policyholder and require the insurer to fulfill the policy's basic obligation of defense and indemnity for property damage claims.

Insurance policies are contracts that are governed by the rules of construction applicable to contracts. They also qualify as adhesion contracts, which necessitate specific principles of insurance policy interpretation to govern construction of contested provisions. As a general matter, “the mutual intention of the parties at the time the contract is formed governs [contract] interpretation.”

entered into the contract of insurance with the policyholder, that the insured had a legal obligation to pay damages to a third party in connection with a loss.” Id. at 693. This rule is now largely obsolete as the insurance industry has attached manifestation language to restrict claims that metastasize in prior policy periods. Courts have ruled inverse condemnation claims that have not stabilized are insurable.

46 See Gray v. Zurich Ins. Co., 65 Cal.2d 263, 419 P.2d 168 (Cal. 1966); see also Edwin Patterson, The Interpretation and Construction of Contracts, 64 Colum. L. Rev. 833, 858 (1964): “The doctrine of the adhesion contract encompasses standardized contracts written by the more powerful bargainer to meet its own needs and offered to the weaker bargainer on a take or leave it basis. Since insurance contracts are deemed contracts of adhesion, it affords more rights to the weaker bargainer than ordinary judicial contract evaluation. The most critical right is ascertaining the meaning of the insurance policy beyond the words in the contract but rather by what the insured would reasonably expect.”

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California, the following four rules, the first three of which are to be applied in sequence, are followed to discern the mutual intent of the parties in an insurance contract:\textsuperscript{48} Rule 1: The Plain Meaning: a court must attempt to put itself in the position of a layperson and understand how he or she might reasonably interpret the language. Rule 2: The Insured’s Objectively Reasonable Expectation: if a provision has no clear and explicit meaning, then ambiguity is resolved by interpreting the ambiguous provisions in the sense the insurer believed the insured understood them at the time of formation. Rule 3: The Contra-Insurer Rule: if application of the first two rules does not eliminate the ambiguity, then the ambiguous language is construed against the party who caused the uncertainty to exist. Rule 4: Exclusions Must Be Conspicuous, Plain & Clear: finally, when examining coverage limitations (e.g., exclusionary clauses), courts must apply a fourth rule as an overlay to the general rules of contract interpretation. Any provision that limits coverage must be conspicuous, plain and clear to be enforceable.\textsuperscript{49}

E. Duty to Defend vs. Duty of Indemnify

The rules of insurance policy interpretation logically form the basis in determining an insurer’s obligation of defense and indemnity. The duty to defend is much broader than the duty to indemnify. To assess an insurer’s obligation or duty to defend, one must compare the allegations of the underlying complaint with the terms of the policy. Any doubt as to whether there is a duty to defend must be resolved in favor of the insured.\textsuperscript{50} “[W]hen a suit against an insured alleges a claim that ‘potentially’ or even ‘possibly’ could subject the insured to liability for covered damages, an insurer must defend unless and until the insurer can demonstrate by reference to ‘undisputed facts’ that the claim cannot be covered.”\textsuperscript{51} As such, the

\textsuperscript{48} See generally H. WALTER CROSKEY, et al., CALIFORNIA PRACTICE GUIDE: INSURANCE LITIGATION, Ch. 4-A (The Rutter Group 2005). Details of each rule were abbreviated for purposes of brevity.

\textsuperscript{49} MacKinnon, 31 Cal.4th at 647.


\textsuperscript{52} Modern procedural rules expand this defense obligation by requiring insurers to focus on the facts of a case rather than the theory of recovery in the complaint. That point is especially critical in inverse
duty to defend frequently results in defense obligations from which no damages ultimately are awarded.

In contrast, the test of whether there is a duty to indemnify is whether there is actual coverage, not merely a potential for coverage. Courts have deemed insurers can assert previously reserved noncoverage arguments to protect themselves from an uncovered judgment through an adequate reservation of rights. This weighty leverage against insurers in favor of policyholders goes back to insurance policies qualifying as an adhesion contract. It is the primary reason why inverse condemnation actions must be evaluated under both the commercial general liability and public officials’ liability policies. The former would grant coverage by interpretational technicality, whereas the latter would afford coverage by explicit intent.

F. Hypothetical Inverse Condemnation Action – Commercial General Liability Policy

Based on the rules of insurance policy interpretation, let’s review a hypothetical inverse condemnation scenario. Plaintiff sues public water system under an inverse condemnation action arising from a temporary taking via uninvited water from defendant’s water delivery system that results in physical injury to plaintiff’s private property. There are no subsequent causes of action for general tort liability such as nuisance, trespass, or dangerous condition. This scenario requires we follow the rules of insurance policy interpretation. We first review defense and indemnity obligations under the commercial general policy. The policy provides coverage for: (1) loss; (2) which the insured is legally obligated to pay by reason of liability imposed by law; (3) for property damage; (4) caused by an occurrence; (5) arising out of your operations; (6) to which the policy applies; and (7) occurs during the policy period. The preceding language is clear and unambiguous with respect to the insurer’s underlying obligation of defense and indemnity for losses involving property damage arising from operations to which the policy applies.

These obligations, without further clarification, would lead the policyholder to reasonably expect

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54 Gray, 65 Cal.2 at 269-270.
their insurer to provide defense and indemnification for such damages unless there is clear language restricting or removing said obligations, or the loss falls outside the scope of the conditions set forth above. Should there not be any inverse condemnation exclusion, then the basic promise of the commercial general liability policy would support the policyholder's reasonable expectation that defense and indemnity obligations apply for a suit of property damage arising from an inverse condemnation claim.55 "Whereas coverage clauses are interpreted broadly so as to afford the greatest possible protection to the insured, exclusionary clauses are interpreted narrowly against the insurer."56 "[A]ny exception to the performance of the basic underlying obligation must be so stated as clearly to apprise the insured of its effect."57

The preceding scenario meets the requisite for a loss which the insured is legally obligated to pay by reason of liability imposed by law. It was caused by an occurrence, which is commonly defined as an accident, and arose from the policyholder's operations resulting in property damage that occurred during the policy period. We must now look for policy provisions that could restrict or remove said obligations. There are three provisions an insurer may argue to extricate itself from its obligations. The first provision is a property damage exclusion arising from physical injury that is expected or intended from the standpoint of the policyholder. As previously discussed, inverse condemnation actions are predicated on the governing body's decisions as it relates to the deliberate and intentional design, placement, construction, maintenance, and funding of a water delivery system. Those decisions were intentional, but the resulting private property damage was not intended or foreseeable by the governing body. Hence, the provision is inapplicable to the illustrated scenario and will not extricate the insurer from its obligations.

The second provision is the insuring agreement that limits coverage to property damage arising from the public water system's operations. This position fits neatly within the theory that inverse condemnation damages are economic and founded on the governing body's decisions as opposed to property damage arising from operations. Any property

damage, as asserted by the insurer, is peripheral to the unlawful taking of private property without just compensation from a deliberately designed and constructed water delivery system intended for community use. The argument is logically sound and structurally correct. However, it could be challenged under Rule 1 (the plain meaning) since the coverage portion of the commercial general liability policy would lead a policyholder to reasonably interpret the language to include property damage coverage for the claim purportedly excluded. The provision has legitimacy to disclaim coverage under the illustrated scenario should the court apply a literal interpretation of an inverse condemnation action and its inherent divergence with the basic coverage obligations of a commercial general liability policy. An insurer’s argument would be strengthened by referencing professional liability case law where wrongful acts were the proximate cause of loss but resulted in property damage. This parallel accentuates the scope and intent of professional liability policies, which are structurally similar to public officials’ liability policies, and their variance from commercial general liability policies, irrespective if an action (i.e., wrongful act) involves peripheral property damage.

The third provision is an inverse condemnation exclusion that reads simply and clearly such as the following: “any and all damages arising from inverse condemnation are excluded in the policy.” This exclusion meets Rule 4 (exclusions must be conspicuous, clear, and simple) and “… indisputably applies to the city’s liability involving inverse condemnation - as long as inverse condemnation is the only basis on which a liability imposed by operation of law rests.” The subordinating conjunction as long as would not bar the duty to defend against allegations of trespass, nuisance, or dangerous condition arising from the same damages alleged. A simple and clear inverse condemnation exclusion will extricate an insurer from its defense and indemnity obligations under the illustrated scenario as it relates to the inverse condemnation action.

Defense and indemnity obligations would similarly be disclaimed for inverse condemnation actions alleging diminution in value within the commercial general liability policy irrespective if the result of such malpractice was property damage.

58 Gray, 65 Cal.2d at 272–273.
59 Shaw v. Freeman, AC 31658, 38 A.3d 1231 (Ct. App. Ct. 2012) (property damage exclusion within a professional liability policy is inapplicable where the proximate cause of loss was legal malpractice).
60 See, e.g., City of Laguna Beach, 226 Cal.App.3d at 827.
61 Id. at 831.
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should private property not be physically injured. The definition of property damage within a commercial general liability policy includes loss of use for tangible property not physically injured. The intent of that language is to provide compensation when an occurrence prevents the use of undamaged property. It does not contemplate diminution in value resulting from the inability to use property as it was intended or for a property's fair market value debasement. An example where this type of inverse condemnation action would be disclaimed includes diminution in value of property from a failure of a water delivery system (e.g., fire suppression system that is overwhelmed in a wildfire or an infrastructure leak that contributed to hillside subsidence) resulting in monetary damage to said property but without physical injury. “Diminution in value does not necessarily constitute property damage as defined in the [commercial general liability] policy.” Under California law, “diminution in value to the housing projects does not constitute property damage as defined by the [commercial general liability] policy” because it is not physical damage to tangible property. “Such diminution in value, therefore, is a harm that is distinct from physical damage to, or loss of use of the property.” This conclusion comports with a common-sense reading of the commercial general liability policy and meets the standard of Rule 1 (the plain meaning).

G. A Hypothetical Inverse Condemnation Action – Public Officials’ Liability Policy

Based on the rules of insurance policy interpretation, let’s review the same hypothetical inverse condemnation scenario as referenced above. Plaintiff sues public water system under an inverse condemnation action arising from a temporary taking via uninvited water from defendant’s water delivery system that results in physical injury to plaintiff’s private property. There are no subsequent causes of action for general tort liability such as nuisance, trespass, or dangerous condition.

We will follow the same rules of insurance policy interpretation, which necessitate a review of the defense and indemnity obligations under the public officials’ liability policy. The policy provides coverage

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64 New Hampshire Ins. Co., 930 F.2d at 701.
for: (1) claims; (2) which the insured is legally obligated to pay by reason of liability imposed by law; (3) for monetary damages; (4) caused by a wrongful act; (5) arising from your governing body; (6) to which the policy applies; and (7) occurs during the policy period. The preceding language is clear and unambiguous with respect to the extent of the insurer’s underlying defense and indemnity obligations for losses involving monetary damages arising from wrongful acts of the governing body to which the policy applies. These obligations, without further clarification, would lead the policyholder to reasonably expect, and courts to concur, that its insurer provides defense and indemnification for damages unless there is clear language restricting or removing said obligations, or the loss falls outside the scope of the conditions set forth above.

The referenced scenario meets the requisite for a claim which the insured is legally obligated to pay by reason of liability imposed by law. It was caused by a wrongful act, which is commonly defined as an act that results directly but unexpectedly and unintentionally in monetary damages to others and occurs during the policy period. A public officials’ liability policy is explicitly designed to cover monetary damages arising from the wrongful acts of your governing body (i.e., directors, officers, and executives). We have demonstrated the basis of inverse condemnation actions as economic injury arising from the taking of private property without just compensation. Such takings are based on the deliberate and intentional decisions of the public water system’s governing body in the design, placement, construction, maintenance, and funding of its water delivery system. Any resulting property damage is peripheral to the root claim of a wrongful act by the governing body. Inverse condemnation actions can involve two types of economic losses arising from a water delivery system: (1) diminution in value whereby the property owner does not suffer physical injury to tangible property; or (2) diminution in value whereby the property owner sustains physical injury to tangible property.

We must now look for policy provisions that could restrict or remove these obligations. There are three provisions that an insurer may argue to extricate itself from its obligations. The first provision falls within the definition of “wrongful act”, which stipulates acts must not unexpectedly and intentionally result in monetary damages to others and occurs during the policy period. A public officials’ liability policy is explicitly designed to cover monetary damages arising from the wrongful acts of your governing body (i.e., directors, officers, and executives).
which might restrict the water system's ability to recover. Those decisions were intentional, but the resulting private property damage was not foreseeable by the governing body. Hence, the provision is inapplicable to the illustrated scenario and will not extricate the insurer from its obligations.

The second provision is an exclusion predicated off the limitation that damages were based upon, attributed to, arising out of, in consequence of, or in any way related to property damage. The intention of this exclusion is to disclaim traditional property damage losses involving operations and maintenance of a water delivery system. These claims are excluded within the public officials' liability policy because they are explicitly contemplated within the commercial general liability policy. This interpretation is incorrect, as inverse condemnation actions are predicated off economic injury arising from the wrongful acts of the governing body as opposed to property damage arising from operations. Any resulting property damage, as asserted by the insurer, is peripheral to the fundamental taking of property without just compensation, based on a water delivery system that was deliberately and intentionally designed and constructed for public use. Courts have also held that diminution in value does not trigger the loss of use description within the property damage definition of the eponymous exclusion. As such, insurers will have no basis to disclaim a claim based on the property damage exclusion. Any attempt to disclaim an inverse condemnation action based on the property damage exclusion violates Rule 1 (the plain meaning) and Rule 2 (the insured's objectively reasonable expectations).

A policyholder can additionally cite professional liability case law (explained above in the commercial general liability policy hypothetical example) as grounds for enforcing an insurer's defense and indemnity obligations for inverse condemnation actions. Three examples highlight the inapplicability of the property damage exclusion: (1) an engineering firm improperly designs a bridge (i.e., wrongful act), and it collapses. The proximate cause of loss was the engineering firm's faulty design versus property damage from its operations; (2) a flood certification company improperly designates a residential neighborhood as low flood hazard when it should be high flood hazard, and a flooding event destroys the neighborhood. The proximate cause of loss was property owner's reliance of certification company's faulty flood zone designation versus property damage from its operations; and (3) a homeowner's association inadequately
establishes reserves for the upkeep of its common area, and assessments are subsequently levied to address the neglect.\textsuperscript{66} The proximate cause of loss was the inadequate reserves versus property damage from the neglect.

The third provision is an inverse condemnation exclusion that reads simply and clearly as the following: “any and all damages arising from inverse condemnation are excluded in the policy.”\textsuperscript{67} The exclusion meets Rule 4 (exclusions must be conspicuous, clear, and simple) and “...indisputably applies to the city’s liability involving inverse condemnation - as long as inverse condemnation is the only basis on which a liability imposed by operation of law rests.”\textsuperscript{68} This conclusion comports with a common-sense reading of the public officials’ liability and meets the standard of Rule 1 (the plain meaning). A simple and clear inverse condemnation exclusion will extricate an insurer from its defense and indemnity obligations under the illustrated scenario as it relates to the inverse condemnation action.

III. Inverse Condemnation Modifications – Public Officials’ Liability Policy

The complexity of inverse condemnation actions necessitates written affirmation within the public officials’ liability policy. The recommended structure is to endorse coverage by endorsement without restriction or limitation. Silence is imprudent since many inverse condemnation actions involve cloudy fact patterns and loss triggers. Additionally, these actions frequently encompass overlapping allegations of wrongful taking, economic injury, willful decisions, and property damage. Any failure to codify intent will invariably lead to misinterpretations between insurer and policyholder, as well as disagreements with resultant reservation of rights or outright coverage disclaimers. Although the doctrine of adhesion contracts and rules for insurance policy

\textsuperscript{66} Pulliam v. Travelers Indem. Co., 743 S.E.2d 117 (S.C. Ct. App. 2013) (a property damage exclusion within a directors & officers’ liability policy does not nullify defense and indemnity obligation for breaches of duty arising from the failure to establish a reserve fund: “The duty to establish a reserve fund, while related to the property damage, did not result in physical damage to tangible property as required by the policy. The failure to establish a reserve fund resulted in Respondents having to expend more from their own pockets to make the repairs than they might have otherwise had to expend — economic damage.”). See Builders Mut. Ins. Co. v. Lacey Constr. Co., No. CIV.A. 3:11–cv–400–CMC, 2012 WL 1032539, (D. S.C. Mar. 27, 2012) (“To the extent damages sought in the [underlying action] are for inadequate reserves or failure to record a deed, they do not involve physical injury and, consequently, cannot satisfy the definition of property damage.”).

\textsuperscript{67} See supra note 60.

\textsuperscript{68} See supra note 61.
interpretation shift ambiguities and uncertainties in favor of the policyholder, there is substantial uncertainty and expense when challenging an insurer's interpretation of a complex, opaque, and evolving legal theory with corresponding damages, liabilities, and loss triggers. The prudent course is to take the preventative approach of securing written affirmation of inverse condemnation coverage via endorsement prior to policy activation.

Inverse condemnation is commonly grouped in an exclusion titled Public Use of Property. The exclusion comprises eminent domain, condemnation, adverse possession, dedicated use, and inverse condemnation. The first four exclusions within this grouping are acceptable, as the public water system would serve as plaintiff and control the litigation incursion. Inverse condemnation reverses the plaintiff-and-defendant roles. The recommended inverse condemnation endorsement should be conspicuous, clear, and simple. The endorsement's title should crystalize intent and state: *Public Use of Property Exclusion – Inverse Condemnation Exception*. The endorsement's verbiage should be a restatement of the original exclusion except for the words *inverse condemnation* purposely removed. An overt endorsement confirms the insurer's intent to cover inverse condemnation actions that occur during the policy period while retaining its right to deny other types of taking where the public water system initiated the litigation.

Policy-holders should also be mindful of any restrictions to the inverse condemnation coverage grant. An example would be coverage for unintended takings but an exclusion for deliberate takings. The restriction requires confirmation from the insurer that easements (e.g., loss of use), code violations (e.g., fixed equipment), project prioritizations (e.g., one neighborhood over another), and insufficient infrastructure (e.g., investments below an arbitrary level of protection or expedience) are not deemed deliberate takings. Such restrictions can also lead to legitimate misunderstandings between policyholder and insurer, as the line of demarcation between unintended and deliberate takings is unclear and subject to interpretation. Moreover, some insurers may exclude the attachment of attorney fees, expert witness fees, appraisal fees, and pre-judgment interest. Others may affirm inverse condemnation but only for resulting property damage and not diminution of property value where the alleged taking does not encompass physical injury to property. There may even be limitations to negligence only, which is a hollow affirmation since
condemnation actions involving water delivery systems are not torts but represent strict liability arising from a constitutional violation of due process. Any restriction or limitation to inverse condemnation must be thoroughly analyzed, with insurer intent coherently codified. Insurers must also be cognizant of extracontractual damages arising from intentionally deceptive restrictions that nullify almost all scenarios from which coverage could be activated from the inverse condemnation affirmation.

A few ancillary, but important, policy provisions warranting clarification include date of loss; manifestation-and-prior-awareness of claims; retroactive date parameters; and caps on limits and defense expenses. The date of loss definition is important when dealing with an inverse condemnation claim involving diminution in property value for nonphysical injuries. Common examples include nuisance claims involving odor or existence, as well as easements that compromise property values. In such situations, one needs to carefully review the fact pattern and assess if the loss goes back to the date of operations or construction as it relates to the nuisance, the date of the easement recording, the date of the lawsuit, or the date the governing body is aware of the conflict. Prior notice of claims and manifestation provisions are intended to prevent a claim from triggering the policy when the policyholder had previous knowledge or awareness of the claim. These provisions similarly avoid a stacking of policy limits should a claim occur or manifest itself over several policy periods. The provision can disqualify a legitimate claim should there be a fact pattern that spans several years and coverage is not affirmed in each policy period.

The retroactive date provision is applicable to claims-made policies and requires the claim to occur and be reported on or after the retroactive date and during the policy period. The reporting of the claim can be extended after the policy period expiration should a policyholder purchase the supplemental extended reporting period. A claims-made policy also subjects the public water system to forfeiture of all past inverse condemnation coverage should the public officials’ liability policy be nonrenewed or renewed without said coverage. Other issues to guard against are limit and defense expense caps. Inverse condemnation actions have catastrophic and vertical judgment extended reporting period. The claim itself must occur on or after the retroactive date and before policy period expiration to comply with notification requirements.

69 The reporting of a claim in a claims-made policy can be filed after the policy period and the basic extended reporting period should a policyholder purchase a supplemental extended reporting period. The claim itself must occur on or after the retroactive date and before policy period expiration to comply with notification requirements.
potential. Limits should follow the policy, and defense expenses should not be capped. Equally important, inverse condemnation coverage should extend into the umbrella or excess liability policy. These policies are designed to provide additional limits of protection for the scheduled underlying policies. Similar to the public officials’ liability structure, written affirmation via endorsement is critical on the umbrella or excess liability policies, as inverse condemnation actions necessitate high limits without restrictions or misinterpretations. Insurer intent should be coherently codified for each of the referenced policy provisions.

VI. Conclusion

Inverse condemnation is a complex legal theory for insurers and policyholders to evaluate. Its intricacy regularly manifests in claims of overlapping damages encapsulating economic and physical injury, as well as intersecting liabilities comprising wrongful acts and system operations. The principle underlying this confusion is a constitutionally protected right against unlawful takings of private property by a public water system without just compensation. Injury is economic and based on diminution in value of private property that is physically injured or otherwise impaired by a water delivery system. Strict liability pertains to inverse condemnation actions involving public water systems, and the historical defense of proximate cause has been narrowed to one of a substantial cause-and-effect relationship.

Notwithstanding the legal theory’s embodiment of economic injury and appropriate placement within a public officials’ liability policy, the most common fact patterns in which inverse condemnation arises and the adhesion doctrine can trigger unintended defense and indemnity obligations under the commercial general liability policy. Insurers intending to grant such coverage should apply a clear and plain meaning endorsement affirmation on their public officials’ liability policy while concurrently applying a clear and plain meaning endorsement exclusion on their commercial general liability policy. If inverse condemnation coverage is not intended, then clear and plain meaning endorsement exclusions should apply to both policies.

Affirmation aside, there must be clarity of expectations between policyholder and insurer to avoid defense and indemnity miscalculations. Any restrictions or limitations must be clearly codified to ensure maximum alignment and avoidance of unreasonable or ambiguous verbiage. Insurers should review their conformance to the aforementioned claims
evaluation protocol and policy interpretation rules as well as address their defense and indemnity obligations to the previously examined scenarios. Such adherence will mitigate confusion and obfuscation when an inverse condemnation action is tendered and an examination is necessitated.

Policyholders should validate insurer fluency, as well as the fitness of their defense attorneys. The latter should have trial experience in inverse condemnation litigation and have a clear understanding how the legal theory ties back to water delivery systems. A review of the policy provisions is similarly important so that insurers and policyholders thoroughly understand and correctly enforce loss triggers, event manifestation, and reporting requirements. Finally, insurers and policyholders should confirm there are adequate limits and defense expenses. The former requires a carry forward of coverage and limits within the public officials' liability policy to the umbrella or excess liability policy. The latter reduces the risk of unlimited defense expenses while providing for proficient attorney representation within this genre of law.

The foregoing offers an effective and coherent risk transfer strategy to manage inverse condemnation actions. Success entails a fastidious focus on policy details and proper defense panel selection. It also demands written insurer documentation, including endorsement affirmation, of defense and indemnity obligations as it relates to inverse condemnation actions occurring within the policy period. Only then will policyholder and insurer be aligned on the scope of defense and indemnity afforded for this most unusual, complex, and vertical exposure.