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ESSAY

THE HURRICANE KATRINA INSURANCE CLAIMS

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THE insurance issues that arise in connection with mass torts have been studied with some care.¹ These issues most often involve corporate claims for coverage under Commercial General Liability (“CGL”) insurance policies. The insurance issues that arise in connection with what might be called “mass disasters,” however, have received less attention. These are natural and man-made disasters whose center of gravity is not tort, and therefore not liability insurance, but personal and property losses. The mass disaster that occurred on 9/11 did spawn a variety of non-liability insurance disputes. But even these disputes mostly involved different forms of corporate insurance, such as commercial property and business interruption coverage claims.²

The losses that arose out of Hurricane Katrina in August 2005, in contrast, heavily involve individual insurance issues. In particular, tens of thousands of homeowners whose residences were damaged or destroyed by the hurricane had standard homeowners in-

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¹ See, e.g., Kenneth S. Abraham, *The Maze of Mega-Coverage Litigation*, 97 *Colum. L. Rev.* 2102 (1997).

² See, e.g., *Duane Reade, Inc. v. St. Paul Fire & Marine Ins. Co.*, 411 F.3d 384 (2d Cir. 2005) (addressing a business interruption claim by the owner of a drug store doing business in the World Trade Center); *World Trade Ctr. Props., L.L.C. v. Hartford Fire Ins. Co.*, 345 F.2d 154 (2d Cir. 2003) (involving a commercial property insurance claim by the owner of the World Trade Center).

insurance. These policies insure the risk of direct physical loss to the policyholder's home and other property, subject of course to certain exclusions from and limitations on coverage. The key exclusion in this instance precludes coverage of loss resulting from "flood." The typical policy also contains an anti-concurrent causation clause, which provides that excluded losses (such as those caused by flood) are not covered "regardless of any other cause or event contributing concurrently or in any sequence to the loss."³ Claims made for Katrina-related losses under these seemingly simple policy provisions have spawned widespread litigation and controversy. This Essay briefly surveys these issues and comments on their implications for the availability of insurance coverage in the future.

I. WIND OR FLOOD

Most modern homeowners policies provide coverage on an "all-risk" (or "open-peril") basis. Under such policies, all direct physical loss to real property is covered unless an exclusion applies. Because there is no relevant wind exclusion in such policies, the Katrina losses are covered unless they were caused by "flood." Further, the conventional burden of proof in an insurance claim requires the insurer to prove that a claim that is otherwise covered falls within the terms of an exclusion. Thus, Katrina policyholders need not prove that their losses were caused by wind, nor must they prove how much of their losses were caused by wind. Rather, their insurers must prove that a loss was caused by flood, and if only some of a loss was caused by flood, how much of the loss was so caused.

The wind-or-flood question poses both factual and legal issues. The factual issue arises because a large number of claims involve the total destruction of property that occurred in the absence of any witnesses. Residents of the coastal areas of Louisiana and Mississippi evacuated their property as Katrina approached. As the hurricane winds came ashore, they brought with them a powerful storm surge that washed away buildings. But which buildings had been destroyed by wind, and which by storm surge, was not always

³ Kenneth S. Abraham, *Insurance Law & Regulation: Cases and Materials* 185–86 (4th ed. 2005).

clear. When residents returned after Katrina had passed, they simply found that their homes had been damaged or destroyed. If the damage or destruction was caused by wind, there was coverage. But if the damage or destruction was caused by flood, the insurer arguably had a defense. Vast numbers of claims were therefore dependent on efforts to determine what exactly had occurred while no one was present.

A second aspect of the wind-or-water issue is legal rather than factual. Suppose that the destruction of a particular property was caused by wind-driven ocean water resulting from the storm surge? Certain policies not only exclude coverage of loss caused by flood, but also of “waves” and “tidal water,” “whether or not driven by wind.”⁴ Whether damage from the storm surge is excluded depends on the meaning both of these policy provisions and of the anti-concurrent causation clause noted above, which precludes coverage of loss resulting from an excluded cause “regardless of any other cause or event contributing concurrently or in any sequence to the loss.” The first rule of insurance policy construction is that ambiguous policy language is interpreted against the drafter (“*contra proferentem*”), which in this and most instances is the insurer. As a consequence, it is not surprising that an important question for some courts adjudicating Katrina claims has been whether the policy provisions at issue are subject to this rule of construction and should therefore be interpreted in favor of coverage.⁵

Finally, it is quite possible that wind and flood were each responsible for a portion of the damage to some homes. For example, the roof might have been blown off of a home and then the storm surge may have damaged or destroyed what remained. Even where the flood exclusion applied, insurance payments for part of a home’s value would then be appropriate. The fact that many insurers offered their policyholders partial payments reflected this approach. But some policyholders have contended that the small portion of their losses that their insurers were willing to pay on this basis—given that the insurers had the burden of proving how much

⁴ Id. at 186.

⁵ See *In re Katrina Canal Breaches Consol. Litig.*, 466 F. Supp. 2d 729, 751 (E.D. La. 2006) (holding that the term “flood” is ambiguous); *Leonard v. Nationwide Mut. Ins. Co.*, 438 F. Supp. 2d 684, 693 (S.D. Miss. 2006) (holding that the anti-concurrent causation clause is ambiguous).

damage was caused by flood—constituted bad-faith behavior by the insurers. Some policyholders therefore sued their insurers for punitive damages. A prominent verdict for punitive damages in the amount of \$2.5 million (reduced by the trial court to \$1 million)⁶ against State Farm then prompted that company to make a mass-settlement offer.⁷

II. THE ROLE OF THE AGENT

Most individuals purchase their insurance through agents and depend at least to some extent on these intermediaries' expertise in deciding what kind and how much insurance to purchase. In some Katrina claims the role played by the agent has been an important ingredient in the coverage dispute. For example, some agents are alleged to have told applicants that they "did not need" flood insurance⁸ or that "they would have full and comprehensive coverage for any and all hurricane damage."⁹ As noted above, standard homeowners policies exclude coverage for loss caused by flood, but flood coverage is available through the Federal Flood Insurance program administered by FEMA. About twenty percent of coastal Mississippi residents whose property was damaged or destroyed by Hurricane Katrina are said to have purchased such coverage.¹⁰

Of course, to the extent that the agent in these situations represented the policyholder as a principal rather than the insurer, the policyholder's cause of action, if any, should be against the agent and not the insurer, for negligent performance of the agent's duties. But even setting that issue to the side, the black letter rule governing representations made by the insurer's agents is pretty clear. In the absence of fraud, the insurer cannot be estopped by

⁶ *Broussard v. State Farm Fire & Cas. Co.*, No. 1:06-CV-00006, 2007 WL 268344 (S.D. Miss. Jan. 31, 2007).

⁷ State Farm offered to settle the Mississippi class action litigation for \$50 million. Press Release, State Farm Insurance, Mississippi Litigation: The Broussard Case, <http://www.statefarm.com/about/litigation.asp> (last visited July 10, 2007).

⁸ *Leonard*, 438 F. Supp. 2d at 690.

⁹ *Buente v. Allstate Ins. Co.*, 422 F. Supp. 2d 690, 693 (S.D. Miss. 2006).

¹⁰ In contrast, upwards of sixty to eighty percent of homes in certain Louisiana parishes had flood insurance. Press Release, Insurance Information Institute, Insurers Paid More than \$40 Billion in Hurricane Related Claims; Majority Settled Without Dispute (Feb. 28, 2007), <http://www.iii.org/media/updates/press.768752/>.

representations made by an agent prior to the issuance of an insurance policy.¹¹

That rule makes some sense in light of the policy underlying the parol evidence rule, which is to give the written, subsequent agreement of the parties priority over precontractual understandings. And this rule has special appeal in insurance disputes, where policies often are renewed annually on a virtually automatic basis over a period of years. The agent's alleged precontractual representations may therefore have been made at the time the policyholder purchased the initial policy, typically many years before the year when the loss at issue occurred.¹² As such, the memories of both policyholders and agents about the agents' representations regarding the policy's contents, or about what coverage it was in the policyholder's interest to purchase, are likely to be especially unreliable in this setting.

Nevertheless, the circumstances to which certain Katrina policyholders testified were sufficiently sympathetic that the courts have not ignored the role played by agents in the selection of these policyholders' coverage. Applying Mississippi law, one federal court has held that the black letter no-estoppel-by-representation rule does not apply if the agent made "misrepresentations concerning issues of coverage."¹³ Whether these misrepresentations must be fraudulent is unclear. Thus, while the black letter rule may operate well in sporadic circumstances, it will not necessarily apply where there has been a systematic failure on policyholders' part to purchase what appears, in retrospect, to have been an essential form of coverage.

III. THE TENSION BETWEEN POLICY LANGUAGE AND POLICYHOLDER EXPECTATIONS

These disputes regarding the role of the agent and the legal force of agents' representations about coverage are representative of a broader dilemma. Ordinarily a contract's terms are binding on the parties, notwithstanding one party's unilateral understanding of the meaning of the contract. But where one party has reason to believe

¹¹ See Robert L. Jerry, II, *Understanding Insurance Law* 416 (3d ed. 2002).

¹² The conversations between the policyholder and the agent in *Leonard*, for example, took place in 1999. *Leonard*, 438 F. Supp. 2d at 690.

¹³ *Buente*, 422 F. Supp. 2d at 697.

that the other party would not agree to the contract if that other party knew the contract contained a particular term, then the contract is construed not to contain that term.¹⁴ Conceivably, this rule could apply to the flood exclusion in some policyholders' policies.

Applying some version of this approach to the interpretation of insurance policies, however, poses a distinctive problem. Insurance policies are standard form contracts. A policy's meaning will vary to the extent that an individual policyholder's expectations are held to trump the policy language's objective meaning. Standard form policies will contain uniform language, but that language will not have a uniform meaning. This tension between policy language and policyholder expectations can in theory be reconciled, however, where policyholders' expectations are themselves largely the same, but are also in conflict with the objective meaning of their policies' language. In such a situation, policyholders' expectations can trump policy language and still result in a policy having a uniform meaning.

Only a minority of states have adopted this "reasonable expectations" approach, however, and Mississippi and Louisiana are not among them.¹⁵ At least part of the reason is that it is unclear how to determine the majority of policyholders' expectations. The expectations of the individual policyholder making a claim may be a question of fact. But as a practical matter, it is hard to see how the expectations of the majority of policyholders can be treated as a question of fact. Rather, what the majority of policyholders reasonably expects seems more like a mixed question of fact and law, similar to the questions of what constitutes reasonable care under all the circumstances in a negligence case or of whether a product is defectively designed in a products liability action. Yet in insurance coverage disputes in which the reasonable expectations test governs, that test is applied by courts rather than by juries. The fact that it is a somewhat anomalous process helps to explain why the majority of courts have not adopted the reasonable expectations doctrine in this form.

¹⁴ See Restatement (Second) of Contracts § 211.

¹⁵ See, e.g., *LeBlanc v. Babin*, 786 So. 2d 850 (La. Ct. App. 2001) (applying the reasonable expectations approach only to construe ambiguous policy language); *Brown v. Blue Cross & Blue Shield of Miss.*, 427 So. 2d 139 (Miss. 1983) (same).

A second difficulty with the majority-of-policyholders'-expectations approach arises in a particular way in the Katrina setting. Some twenty percent of the relevant policyholder universe in Mississippi, and upwards of sixty to eighty percent of the policyholders in certain Louisiana parishes, chose to purchase separate flood insurance.¹⁶ For this reason, the contention that the majority of policyholders expected this coverage under their homeowners policies is, at the least, contestable. So a policyholder-by-policyholder inquiry into expectations would seem to be the only available avenue of approach, and that approach entails the risk of creating non-uniform meaning, as described above.

IV. LEGAL RESCUE AND ITS CONSEQUENCES

Most mass tort and mass disaster claims stress the capacity of the court system; trying hundreds or thousands of individual claims is unrealistic at the least and sometimes impossible. Partly for this reason, most mass claims end in settlement. That is where the Katrina insurance claims are heading, but with a push in favor of coverage from a number of sources. There have been class action suits in both Louisiana¹⁷ and Mississippi,¹⁸ a "request" by the Louisiana Commissioner of Insurance that State Farm reevaluate all claims it had previously denied,¹⁹ threats to revoke the insurance industry's exemption from the U.S. antitrust laws,²⁰ and (as noted above) at least one award of punitive damages against an insurer for mishandling a Katrina claim. All of these efforts seem designed to provide the insurance industry with an incentive to settle Katrina claims rather than to force the courts to confront head-on the legal issues these claims pose. Hard cases make bad law, the

¹⁶ See Press Release, Insurance Information Institute, *supra* note 10.

¹⁷ *In re Katrina Canal Breaches Consol. Litig.*, 466 F. Supp. 2d 729, 729 (E.D. La. 2006).

¹⁸ *Woullard v. State Farm Fire & Cas. Co.*, No. 1:06CV1057(LTS-RHW), 2007 WL 208519 (S.D. Miss. Jan. 26, 2007).

¹⁹ Press Release, Donelon Announces Settlement with State Farm on Disputed Hurricane Katrina and Rita "Slab" Claims (May 10, 2007), http://www.ildi.state.la.us/public_affairs/most_recent_releases.htm (follow "May 10, 2007" hyperlink).

²⁰ Press Release, Senator Lott Advocates Repeal of Insurance Industry's Antitrust Exemption (March 7, 2007), available at http://www.virginialareview.org/inbrief/2007/08/06/lott_release.pdf.

authors of these varying forms of pressure seem to be saying, so why not settle your Katrina claims and avoid the establishment of precedents that will apply in undesirable ways to future, non-Katrina claims?

The fact that major insurers are in the process of accepting this invitation and settling claims en masse suggests that the threat of adverse consequences for insurers who do not cooperate has created strong incentives to settle. But as in any multiple move game, the insurers have not simply taken their medicine and moved on. Rather, their next move has been to cease selling homeowners insurance on coastal properties. This development was at least partly in prospect regardless of how the insurers were treated in the courts. Harsh legal treatment (or the prospect of it), however, undoubtedly exacerbated insurers' reluctance to continue writing coverage on coastal property.

In the field of insurance, legal rescue of this sort is thus a double-edged sword. The price that is paid to ensure that current policyholders have insurance for their losses may be that future policyholders find it difficult or impossible to obtain coverage at current levels or for current premiums. As a result, coverage becomes scarce and premiums skyrocket. This phenomenon occurred in the 1980s in connection with insurance against liability for pollution, and now it is occurring again in the homeowners insurance market. The whole phenomenon poses a public policy dilemma, for it pits the interests of those who have current losses against the interests of those who need coverage in the future. Yet as so often happens in our system, that dilemma is being addressed obliquely, in the language of rules governing the interpretation of insurance policies and by threatening legislation that will address broader or different issues. This is how the seemingly simple question of whether the Katrina losses were caused by wind or flood has been transformed into a far more complex problem.

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