BATTLE ROYALE

OVER HURRICANE CLAIMS

BY RHONDA D. ORIN

When hurricanes Katrina and Rita swept along the Gulf Coast, each one looked like a cohesive whole, a single tragic event. But unfortunately for those in the affected areas, insurers viewed the disasters much differently.

Some insurers saw each hurricane as a series of wholly separate and unrelated events. One event was wind. Another was rain. Still others were high water, waves, storm surges and so on. By parsing hurricanes into the smallest possible parts, insurers can find grounds for denying coverage. Sometimes, this approach enables insurance companies to deny coverage for the entirety of a claim. Other times, this approach enables them to deny coverage for various parts of a claim—after first placing the burden on policyholders to prove which parts are covered.

This is fundamentally unfair. When policyholders buy insurance products that cover hurricanes, they think that if a hurricane roars through their area and leaves physical and economic devastation in its wake, all of the resulting damages from that hurricane will be covered.

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Certainly, there are checks and balances in this system. One of them is the role played by state insurance departments, which typically are empowered to review and approve the policy forms that the insurance companies propose to sell in their states. Another is the role played by state attorneys general and the courts in reviewing insurance company denials.

In this regard, the responses of state insurance departments, state attorneys general and the courts to Hurricanes Katrina and Rita have been informative. Many of these entities have made clear, through public statements and actions, that the parse-and-deny approach of the insurance industry is not going to work here.

The Texas Department of Insurance (TDI) and the Texas attorney general, for example, have made clear that they are not going to allow insurance companies to deny insurance coverage to Texas residents who have been deprived of access to their property due to power failures.

The Mississippi Attorney General's office has made it clear that it believes that insurance coverage provisions that attempt to exclude damage caused by water are unenforceable. On September 15, Attorney General Jim Hood filed a lawsuit in Hinds County, Mississippi, First Judicial District, alleging that insurance companies are interpreting their policies in an overly restrictive manner; that they are taking advantage of policyholders who do not understand their rights; and that they are selling insurance policies that are so difficult to understand as to be unconscionable and therefore void.

A related situation has arisen in Louisiana, where some 160,000 property and business owners have filed a class action lawsuit against Commissioner of Insurance Robert Wooley as well as a number of insurance companies. (Similar class actions have been filed in Louisiana and Mississippi and more are anticipated.) There, the plaintiffs are asking the court for an order requiring the insurance commissioner to nullify the exclusions for damage caused by rising water. They take the position that the flooding in New Orleans was caused by negligence in the construction and maintenance of the levees, rather than an excluded "act of God." Accordingly, they contend that the high-water exclusions were not intended to apply to the flooding.

Standard-Form Policy Language

Insurance for losses caused by hurricanes typically is provided under property policies, which are available to businesses as part of comprehensive or package policies, and to residents in such forms as homeowners' policies and renters' policies.

Commercial property insurance policies generally fall into two types. The first type covers losses caused by "all risks of direct physical loss or damage," except risks that are specifically excluded in the policy. In these broad policies, known as "all risk" policies, once an insured proves that it has suffered a loss, the insurance company has the burden of proving that the loss is not covered.

The other type of commercial property policy takes the opposite approach. It covers property damage or loss caused by specified perils, such as fire, wind, hail or vandalism. Known as a "named perils" policy, it typically contains a wide variety of exclusions, including exclusions for many different types of weather conditions. The policyholder typically is found to have the burden of overcoming these exclusions, in accordance with basic principles of insurance law.

Both types of property insurance policies contain provisions insuring personal property. This usually provides coverage for specified types of personal property contained within the covered premises. Often, the coverage extends to property found within a certain distance from the covered premises.

Useful examples of this policy language can be found in the standard commercial policy of the Texas Windstorm Insurance Association (TWIA). With regard to buildings, labeled "Coverage A," the policy expressly states that it covers:

- Building or structure, meaning everything that is legally part of the building or structure described in the declarations. However, machinery not used solely in the service of the building is not covered.

- Personal property used for the service of and located on the described location.

Next, with regard to personal property, labeled "Coverage B," the policy expressly states that it covers "business personal property located in or on the building described in the declarations, or in the open on the described location, or in a vehicle or rail-

road car located within 100 feet of the described building."

These coverage agreements are followed by sections that delineate what types of personal property are and are not covered. Then comes a section called "Covered Causes of Loss," in which the policy specifies that they "insure for direct physical loss to the covered property caused by windstorm or hail unless the loss is excluded in the exclusions."

The next section—and the most important one, for purposes of this article—includes, but is not limited to, the following exclusions, which apply to loss to covered property:

Flood: "We will not pay for loss or damage caused by or resulting from flood, surface water, waves, tidal water of tidal waves, overflow of streams or other bodies of water or spray from any of these whether or not driven by wind."

Power Failure: "We will not pay for loss or damage resulting from the failure of power or other utility service supplied to the described premises, if the failure occurs away from the described premises. However, we will pay for loss resulting from physical damage to power, heating or cooling equipment located on the described premises if caused by windstorm or hail."

Rain: "We will not pay for loss or damage caused by or resulting from rain, whether driven by wind or not unless wind or hail first makes an opening in the walls or roof of the described building. Then we will only pay for loss to the interior of the building, or the insured property within, caused immediately by rain entering through such openings."

The structure of this policy places causation directly into question. The problem is that, while some events are covered and others are not, damages often arise after a series of events take place. Hurricane Katrina is a perfect example. It involved a wide variety of perils, including wind, wind-driven water, flooding, levee breaches, sewage overflows, power failures, court-ordered evacuations, fire, looting, pollution and mold.

The courts have developed various tests for determining whether there is coverage when a covered peril and an excluded peril combine in some proportion to cause a loss. Most prominent among them is the doctrine of "efficient proximate cause," which has been adopted by the highest courts of both Louisiana and Mississippi. This doctrine provides for coverage if the covered cause is what sets the loss into motion. It is applied most commonly where a loss was caused in part by a covered peril and in part by an excluded or noncovered peril, it is equally applicable where different limits of liability and deductibles may apply depending on what is determined to be the cause of the loss.

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The "efficient proximate cause" doctrine looks simple on paper, but in practice, it is complicated to apply. One helpful explanation of "efficient proximate cause" and followed by many courts, is that it is the "risk [that] set[s] the other causes in motion which, in an unbroken sequence, produced the result for which recovery is sought."

This definition of "efficient proximate cause" may be helpful in arguing that the damages at issue with respect to Hurricanes Katrina and Rita were caused by wind, and not by flood, since it was the hurricanes that set in motion all the other events that led to the property damage at issue. Policyholders will argue (and insurance companies no doubt will disagree) that all subsequent events, including the breaches of the levees in New Orleans, were set in motion, in an unbroken sequence, by the hurricanes.

The insurance company's response to this coverage-friendly doctrine seems to be the addition of language designed to defeat coverage. Although not used by the TWIA in the sample policy highlighted earlier in this article, many insurance policies contain a prefatory clause to the exclusions section, generally known as the "anti-concurrent causation" provision.

As published by the Insurance Services Offices (ISO), a typical anti-concurrent causation lead-in provision states as follows:

> "We will not pay for loss or damage caused directly or indirectly by any of the following. Such loss or damage is excluded regardless of any other cause or event that contributes concurrently or in any sequence to the loss." [*Causes of Loss—Special Form (CP 10 30 04 02), accompanying ISO's Building and Personal Property Coverage Form (CP 00 10 04 02)*]

This provision is significant because, if enforceable, it has the capacity to substantially alter the scope of coverage under a policy. Accordingly, many challenges have been raised to its enforceability. The lawsuit filed last September by Mississippi's Attorney General is one example.

Mississippi business owners and homeowners can take heart in the knowledge that the issues raised in that lawsuit have prevailed in other courts. The highest court in Washington State, for example, has held that as a matter of public policy, insurance companies may not use such provisions to avoid the efficient proximate cause doctrine (*Safeco Ins. Co. of Am. v. Hirschmann*). Likewise, West Virginia's highest court has held that anti-concurrent causation clauses are ambiguous and that it offends the reasonable expectations of a policyholder to read them as precluding coverage for damage proximately caused by a covered peril (*Murray v. State Farm Fire & Cas. Co.*).

On the other hand, this favorable response has not been universal. The highest court of Utah held that provisions like the anti-concurrent causation provision are enforceable, as insurance companies are entitled to contract around any applicable causation rule (*Alf v. State Farm Fire & Cas. Co.*).

Notably, there is no state law yet in Texas, Louisiana and Mississippi as to the enforceability of this provision, as the highest courts of these states have not had occasion to examine it.

Applicable Doctrines and Statutes

Historically, the courts have considered a number of additional matters when called upon to decide insurance coverage disputes. Principal among these is the doctrine of *contra proferentem*. This doctrine requires ambiguities in insurance policies to be interpreted in favor of coverage and against the insurance companies that drafted the policies.

Courts typically agree that ambiguities are proved when courts adopt different interpretations of the same provision. Thus, the mere existence of a dispute over the meaning of the flood, rain and water exclusions, and the citation of supportive—yet contrary—authority by both policyholder and insurance company, should be sufficient to prove ambiguity and tip the scales in favor of coverage.

Another important resource for the courts has been state statutes, which often are policyholder-friendly. For example, Texas, Louisiana and Mississippi all have statutes designed to protect policyholders against bad faith practices by insurers, particularly including unfair settlement and late payment practices. As mentioned previously, these statutes have been used affirmatively in protecting hurricane victims from insurers' attempts to shortchange them. These statutes are likely to prove useful and important in the battles over Katrina and Rita.

Another particularly important state statute, in the context of hurricane losses, is the Louisiana Valued Policy Law. This statute essentially provides that when there is a total loss, the insurance company must pay to the policyholder the actual cash value of the policy, namely the policy limits.

Mississippi also has a Valued Policy Law, which provides "when buildings and structures are insured against loss by fire and, situated within this state, are totally destroyed by fire, the company shall not be permitted to deny that the buildings or structures insured were worth at the time of the issuance of the policy the full value upon which the insurance is calculated, and the measure of damages shall be the amount for which buildings or structures were insured."

Texas, while lacking an equivalent statute, comes close, through the existence of Texas Insurance Commissioner's Bulletin No. B-0045-98. That bulletin addresses the calculation of actual cash value under the Texas Standard Homeowners' Policy. It was directed to all property and casualty insurance companies doing business in Texas, and holds that:

> "the Department has concluded that an insurer providing property coverage under replacement cost residential policies that allow for the adjustment of covered losses to structures on an actual cash value basis may not calculate actual cash value on the basis of replacement cost with proper deduction for depreciation, less contractor's overhead and profit, nor may the insurer deduct sales tax on building materials. Any insurer that determines actual cash value on this basis may be subject to disciplinary action for violations of the Texas Insurance Code, including unfair claims practices pursuant to Article 21.21 Section 4(10)(a) and Article 21.21-2."

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A celebration about the Louisiana statute and the Texas directive is not necessarily in order, though. For 106 years, Florida residents and business owners used to enjoy the benefits of a substantially similar statute, known as the "valued policy law." That statute required insurance companies to pay the full amount of an insurance policy if a property is deemed a total loss.

In the aftermath of Hurricane Irene, an appellate court in Florida ordered insurers to pay their full claims, based on this statute (*Mierzwa v. Florida Windstorm Underwriting Ass'n*). It overruled an argument by the insurance company that the statute must yield to contrary language in the policy's anti-concurrent causation clause. In that case, the evidence showed that the loss was only partially caused by a covered peril, yet the court ordered full coverage regardless.

The insurance industry responded by lobbying the Florida state legislature to change the law. They threatened that rates would skyrocket and homeowners policies would become difficult to obtain without the change. The Florida legislature changed the law just a few months ago; now the insurance industry perceives the new law as limiting their obligations to only a proportionate share of the loss.

Ultimately, the principle of "buyer beware" extends all the way through the claims process. Policyholders must remain wary until their claims are fully and finally paid in the correct amounts. There are many possible slips in recovering insurance coverage for Hurricanes Katrina and Rita. But for policyholders who are vigilant about asserting their rights and have a clear sense of what their rights are, they ultimately should succeed in recovering their just due. ■

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