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INSURANCE AND CATASTROPHE IN THE CASE OF KATRINA AND BEYOND

*Douglas R. Richmond**

I. INTRODUCTION

In insurance parlance, a "catastrophe" is an unusually severe disaster affecting many insurers and policyholders. Disasters may be either natural or man-made. Natural disasters include earthquakes, floods, hurricanes, tornados, tropical storms, tsunamis, wildfires, and winter storms, some of these obviously being more common than others.[1] Perhaps the best example of a man-made disaster is a terrorist attack.[2] Hurricane Katrina clearly qualifies as a catastrophe; indeed, it has been characterized as "the largest natural catastrophe ever to strike the United States"[3] and "the costliest natural disaster in U.S. History."[4]

Although the exact total of property insurance losses attributable to Katrina remains unknown, the amount is at least $38.1 billion[5] and perhaps as much as $55 billion.[6] Either figure reflects "an amount large enough to wipe out most of the estimated pretax operating profit of the entire insurance industry for the year."[7] As insurance goes, Hurricane Katrina dwarfs natural disasters such as Hurricane Andrew and the Northridge Earthquake, which cost the industry $21.6 billion and $16.5 billion, respectively.[8] Katrina likewise surpasses the worst man-made catastrophe—the terrorist attack on the World Trade Center of September 11, 2001—which produced $20.7 billion in property insurance losses.[9]

The wretched federal response to Katrina, the lingering hardships suffered by many storm victims, and the storm's long-term alteration of myriad aspects of business and life in the states which it struck heighten the level of concern otherwise accompanying forecasts of more numerous

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1. Ins. Info. Inst., *Catastrophes: Insurance Issues* 2 (Jan. 2006), http://www.iii.org/media/hottopics. Over the period 1985–2004, hurricanes and tropical storms accounted for 34.6% of all catastrophe losses; tornados made up 30.4%; winter storms accounted for 9.7%; earthquakes made up 8.4%; floods accounted for 3.4%; and fires made up 2.9%. *Id.*

2. *Id.* Terrorism accounted for 9.7% of total catastrophe losses during the period 1985–2004. *Id.*

3. Meg Green, *Not Business As Usual*, BEST'S REV., June 2006, at 27, 27.

4. Rawle O. King, *Hurricane Katrina: Insurance Losses and National Capacities for Financing Disaster Risk*, at CRS-4 (Congressional Res. Serv., Sept. 2005) (on file with author).

5. Ins. Info. Inst., *supra* note 1, at 1.

6. Jean-Pierre Berliet, *Katrina: Why Risk Management Failed*, BEST'S REV., June 2006, at 34, 34.

7. *Id.*

8. Robert P. Hartwig, *Hurricane Season of 2005: Impacts on US P/C Insurance Markets in 2006 & Beyond* (Ins. Info Inst., Mar. 2006) (on file with author).

9. *Id.*

hurricanes in the future.[10] Predictions of a $76 billion hurricane in Florida, a $21 billion hurricane in the Northeast, a $72 billion California earthquake, and a $101 billion earthquake along the New Madrid fault similarly add to the alarm.[11] Some prognosticators confidently predict a northeastern hurricane twice as costly as Katrina that could devastate the New York boroughs of Brooklyn and Manhattan and submerge nearby parts of New Jersey.[12] The type of storm surge that ravaged the Louisiana and Mississippi coasts could be replicated in Boston, Galveston, Houston, or Miami were hurricanes to strike those communities.[13] California's Central Valley, where at least forty percent of the nation's fruit and vegetable crops are grown, is protected by levees known to be woefully inadequate. The disastrous breaches of New Orleans's levees illustrate the danger flooding poses to California's agricultural economy.[14]

Catastrophe victims may in the first instance look to governments for help, but almost immediately thereafter they think of insurance. In some cases they may even think of insurance first and derive some comfort from the belief that they are protected whatever their loss may be. The insurance industry has historically responded well to catastrophes. Insurance companies dispatch legions of experienced, qualified adjusters to affected areas and efficiently and fairly resolve most claims. Using Hurricane Katrina as an example, within six months of the storm "insurers had paid most of the record volume of personal lines claims, and many took extraordinary steps to do so."[15] It now appears that homeowners' insurers have resolved roughly ninety-five percent of the claims attributable to Hurricane Katrina.[16] That does not mean, of course, that all insureds are satisfied with the way in which their carriers resolved their claims.[17] Yet, empirical data suggest that most homeowners are pleased with the treatment which they received from their insurers. According to one poll, eighty-nine percent of homeowners in Louisiana and ninety-three percent in Mississippi are content with their insurance companies.[18] That same poll also refutes critics' instinctive contention that satisfied insureds are only found inland (where most damage was wind-related and thus covered by standard homeowners' and property insurance policies), while policyholders in coastal areas feel

10. John Gibeaut, *Up Against the Seawall*, A.B.A. J., July 2006, at 45, 46.

11. J. David Cummins et al., *Can Insurers Pay for the "Big One?" Measuring the Capacity of an Insurance Market to Respond to Catastrophic Losses* 1 (Wharton Fin. Inst. Ctr., Working Paper No. 98-11-B, 1999) (on file with author).

12. Amanda Ripley, *Why We Don't Prepare,* TIME, Aug. 28, 2006, at 54, 57.

13. Munich Re Group, *Hurricanes—More Intense, More Frequent, More Expensive* 21 (Munich Re Group Knowledge Series, 2006) (on file with author).

14. *Id.* at 22.

15. Green, *supra* note 3, at 27.

16. Press Release, Ins. Info. Inst., Nearly 95 Percent of Homeowners Claims from Hurricane Katrina Settled and Tens of Billions of Dollars Paid to Affected Communities in Louisiana and Mississippi (Aug. 22, 2006), *available at* http://www.iii.org/media/updates/press.760032/.

17. *See* Becky Yerak, *Insurers Say 95% of Katrina Claims Met*, CHI. TRIB., Aug. 23, 2006, § 3, at 1 ("Just because claims are settled doesn't mean consumers have been treated justly, [insurance industry critics say].").

18. Press Release, Ins. Info. Inst., *supra* note 16, at 1.

mistreated by their insurers. "While satisfaction numbers are slightly higher inland, most residents in the hardest hit coastal areas describe themselves satisfied with the way their claim was handled."[19]

In any event, catastrophes and insurance are inextricably linked, and this Article will explain and examine several aspects of that linkage. Part II of this Article briefly discusses basic insurance economics, while part III examines some critical insurance law issues that Hurricane Katrina has spawned.

II. SOME INSURANCE FUNDAMENTALS

Insurance companies have two means of prospering financially: underwriting profit and investment income. Underwriting profit is simply an insurer's premiums collected, less claim payments and other expenses. Underwriting profit or loss is typically expressed in terms of a combined ratio. For example, a combined ratio of 90.0 would mean that for every dollar an insurer earned in premium income, it paid out $0.90 in claims and expenses (thereby making an underwriting profit). On the other hand, a ratio of 110.0 would mean that for every dollar earned in premium income, an insurer paid out $1.10 in claims and expenses (thus producing an underwriting loss). Underwriting losses are quite common. Between 1979 and 2005, property and casualty insurers as a whole turned an underwriting profit only once—in 2004.[20] How then has the industry not collapsed? The answer is investment income.

Insurers invest the bulk of the premiums they collect. This is possible because premiums are received before losses are paid, an interval sometimes extending over many years. Given the history of underwriting losses dating back to the late 1970s, recent industry-wide financial success is plainly attributable to insurers' investment income. Insurance companies that have turned underwriting profits—or at least have substantially minimized their underwriting losses—have fared better financially than those that have not. These companies are said to have "underwriting discipline," a term of somewhat varied meaning, but principally describing a willingness to accept only those risks the companies are able to properly evaluate and profitably price.[21] Companies possessing underwriting discipline also structure their business in a way that no aggregation of losses from a single catastrophe or series of catastrophes will threaten their solvency.

Before Hurricane Katrina struck, the property and casualty insurance industry was on track to record its highest level of profitability since 1987.[22]

19. *Id.*

20. Robert P. Hartwig, *Commentary on Full-Year 2005 Results* 1 (Ins. Info. Inst., Apr. 18, 2006) (on file with author).

21. Degrees of underwriting discipline vary, and even some generally disciplined companies will insure risks they might otherwise decline during periods of high investment returns as the price of obtaining money to invest.

22. Even so, insurers are less profitable than Fortune 500 companies as a whole. "Contrary to some media reports, the property/casualty insurance industry did not even come close to experiencing record profitability in 2005." Hartwig, *supra* note 20, at 1–2.

Despite Katrina—and her evil little sisters Rita and Wilma—the industry reported a 2005 operating profit of $41.5 billion.[23] Insurance companies weathered 2005 with an amazingly low combined ratio of 100.9.[24] Hurricane Katrina and the other storms of 2005 doubtless cut into insurers' earnings, but they did not impair capital.

The industry's resilience in the face of an exceedingly difficult 2005 is attributable in no small part to improved underwriting discipline across the board. In the first half of 2005, the industry-wide combined ratio was 92.7, down from 115.7 in 2001.[25] Over the past few years, insurers have better matched risks and prices, while also tightening coverage terms. They have also taken steps to reduce their exposures along the hurricane-prone Gulf and Atlantic Coasts, a market retreat further influenced by regulators' unwillingness to approve rate increases reflecting greater risks and reinsurance costs going forward.[26]

Insureds in catastrophe-prone areas are likely to feel the effects of insurers' underwriting discipline well into the future. Where they have been able to achieve property insurance rate increases, insurers have sharply raised rates in coastal areas.[27] These increases began in late 2005. At the same time, insurers have reduced capacity (i.e., the amount of risk they are willing to assume measured in dollars) through lower coverage limits and imposition of sub-limits.[28] Insurers have also insisted on higher deductibles and multiple deductibles. Some insurers have withdrawn from areas likely to be affected by hurricanes in the future.

Insurers were also able to withstand losses attributable to the storms of 2005 because of increased returns on their investments. Rising interest rates and small stock market gains allowed insurance companies to generate investment revenue of $59.2 billion in 2005.[29]

Finally, insurers were able to weather the storms of 2005 by spreading their risk through reinsurance. "Reinsurance is essentially insurance for insurance companies."[30] When procuring reinsurance, an insurance company—the "cedent" or "ceding company"—pays a premium to a reinsurer in exchange for the reinsurer's promise to indemnify it for some or all of the insurer's exposure on policies it has issued.[31] Among insurers with 2005 hurricane-related exposure, some companies may have ceded as much

23. Aon Risk Servs., *March 2006 Insurance Market Overview* 6 (Aon Corp. 2006) (on file with author).

24. Hartwig, *supra* note 20, at 1. "This means that for every dollar of premium income that came in the door in 2005, about $1.01 exited in the form of claim payments, claims reserves and expenses . . . ." Ins. Info. Inst., *supra* note 1, at 8–9. Hurricane Rita caused insured losses of roughly $5 billion, while Hurricane Wilma caused approximately $10.3 billion in insured losses. *Id.*

25. Hartwig, *supra* note 20, at 3.

26. *Id.*

27. Aon Risk Servs., *supra* note 23, at 10.

28. *Id.* at 11.

29. Hartwig, *supra* note 20, at 1.

30. Employers Reinsurance Corp. v. Mid-Continent Cas. Co., 358 F.3d 757, 761 (10th Cir. 2004); *accord* Covington v. Am. Chambers Life Ins. Co., 779 N.E.2d 833, 836 n.1 (Ohio Ct. App. 2002) ("Reinsurance is insurance for insurance companies.").

31. Cont'l Cas. Co. v. Nw. Nat'l Ins. Co., 427 F.3d 1038, 1040 (7th Cir. 2005).

as sixty percent of their risk to reinsurers, and industry experts estimate that reinsurance may reduce insurance companies' 2005 gross catastrophe losses from approximately $58 billion to $19 billion or less.[32] Unfortunately, reinsurers have suffered considerably because of the 2005 storms, which occurred on top of significant losses attributable to the 2004 storms. These events, coupled with predictions of increased hurricane activity in coming years, seem certain to ripple through the insurance industry.

Whatever the reasons that property and casualty insurers have profited in the face of Hurricane Katrina and other catastrophes, the fact that they have done so doubtless angers storm victims who have had their claims denied in whole or part, had their coverage cancelled, or have seen their insurance rates rise dramatically.[33] Such insureds care nothing about insurers' underwriting discipline, instead quite understandably focusing on their plights and those of their neighbors. More than a few policyholder advocates have invoked the image of Cuthbert Heath, a storied Lloyd's of London underwriter. Following the great San Francisco Earthquake of 1906, Heath cabled his company's United States lawyers to say: "Pay all our policyholders in full irrespective of the terms of their policies."[34]

But we live in different times and Mr. Heath would likely not send the same message today. Insurance is not welfare, and insurance companies are businesses—not aid societies. Shareholders expect insurers to profit regardless of catastrophes. In the insurance industry as elsewhere, investors' expectations drive business decisions. Additionally, only a few years ago wind claims attributable to Hurricane Andrew caused ten insurers to fail and imperiled the Florida Insurance Guaranty Association.[35] The "big one" or a "mega-catastrophe" (an earthquake or hurricane far costlier than Katrina, which many forecasters predict will occur) would cause a number of insurance company insolvencies and seriously disrupt the insurance market, perhaps even crippling it.[36] In sum, insurers' catastrophe-related financial decisions, though unpopular in storm-ravaged areas and dispiriting to those they negatively affect, are understandable when viewed through a wider lens.

III. INSURANCE LAW ISSUES RELATED TO KATRINA

Insurance-related legal issues surfaced immediately in Katrina's wake. Much of the damage the storm caused—unlike the damage from Hurricane

32. Hartwig, *supra* note 20, at 3–4.

33. *See, e.g.*, *Hurricanes Haven't Cut into Insurance Companies' Profits*, HATTIESBURG AM., Apr. 27, 2006, *available at* http://www.hattiesburgamerican.com (editorializing that "insurance companies have the ability to continue providing homeowners' insurance—at reasonable rates—throughout the hurricane zone").

34. *Outlook: Insurer's Honour*, THE INDEPENDENT (London), Oct. 24, 2001, at 17.

35. Ins. Info. Inst., *Insolvencies/Guaranty Funds*, (Nov. 2006), http://www.iii.org/media/hottopics/insurance/insolvencies/.

36. King, *supra* note 4, at CRS-5.

Andrew, for example—was attributable to flooding rather than wind.[37] Katrina's storm surge was overwhelming. Accordingly, controversy quickly centered on water damage exclusions in standard homeowners' policies. Standard homeowners' insurance policies "do not insure for loss caused directly or indirectly" by water damage to dwellings or other structures on insureds' residence premises, "regardless of any cause or event contributing concurrently or in any sequence to the loss."[38] As used in these policies, "water damage" means "[f]lood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind."[39] Water that is part of storm surge clearly qualifies as a flood, and storm surge may additionally be characterized as surface water, waves, or tidal water.[40] Standard policies' omission of "storm surge" when defining "water damage" is inconsequential, given their mention of flood, surface water, waves, and tidal water, and especially since "storm surge" is no more specific or descriptive than any of these terms.

Homeowners' policies also include a "combined causes" exclusion that bars coverage for "weather conditions" if they "contribute in any way" to causing a loss in concert with an excluded cause or event (such as water damage).[41] As for personal property, homeowners' policies include as covered perils windstorm or hail, but these perils do not include "loss to . . . property contained in a building caused by rain . . . unless the direct force of wind or hail damages the building causing an opening in a roof or wall and the rain . . . enters through this opening."[42]

Commercial property insurance policies include similar flood and combined causes exclusions.[43] Where commercial insurers agree to insure against flood damage, they typically impose sub-limits.[44] At least one large commercial insured has sued its property insurer for coverage for losses caused by storm surge and wind-driven rain from Hurricane Katrina.[45] Two universities in New Orleans have sued their insurers for their alleged unwillingness to pay valid flood and business interruption losses.[46]

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37. James A. Knox, Jr., *Causation, the Flood Exclusion, and Katrina*, 41 TORT TRIAL & INS. PRAC. L.J. 901, 903 (2006).

38. AUTO CLUB FAMILY INS. CO., PREMIER PLUS HOMEOWNERS POLICY 20 (on file with author).

39. *Id.* at 21.

40. *See* Leonard v. Nationwide Mut. Ins. Co., 438 F. Supp. 2d 684, 688–89 (S.D. Miss. 2006). The court explained that "storm surge is a type of flooding that is covered by flood policies sold under the National Flood Insurance Program and excluded under standard homeowners policies." *Id.* at 692.

41. AUTO CLUB FAMILY INS. CO., *supra* note 38, at 21–22.

42. *Id.* at 17–18

43. *See, e.g.*, HANOVER INS., HANOBUSINESS BUSINESSOWNERS INSURANCE POLICY 6–7 (on file with author).

44. Vincent J. Vitkowsky, *Reinsurance Issues Arising from the 2005 Hurricane Season*, 41 TORT TRIAL & INS. PRAC. L.J. 999, 1000 (2006).

45. Leslie A. Platt, *First Party Coverage for Catastrophic Risks*, INSURANCE COVERAGE 2006: CLAIM TRENDS & LITIGATION 198 (PLI Litig. & Admin. Practice Course, Handbook Series No. H-742, 2006).

46. Katherine Mangan & Jeffrey Selingo, *2 Universities Sue Insurers over Katrina Damage*, CHRON. HIGHER EDUC., Sept. 1, 2006, at A53.

A. *Flood Versus Wind*

Flood insurance is available through the National Flood Insurance Program ("NFIP"), which is administered through the Federal Emergency Management Agency ("FEMA") under the National Flood Insurance Act of 1968 ("NFIA").[47] In an effort to reduce future flood damage, the NFIP makes flood insurance available for commercial and residential properties in communities that voluntarily adopt and enforce floodplain management ordinances.[48] About 20,000 communities currently participate in the program. Property owners in NFIP communities may purchase flood insurance even if their properties are outside a floodplain. Coverage comes in the form of a Standard Flood Insurance Policy ("SFIP"), with coverage limits of $250,000 for structural damage and $100,000 for contents.[49] FEMA dictates SFIP terms.[50]

For years, flood insurance was available only through insurance agents who dealt directly with the Federal Insurance Administration ("FIA"). The FIA was placed under FEMA's control in 1983, and since then the "direct" flood insurance program has been augmented by what has come to be known as the Write-Your-Own program ("WYO"). Almost all flood insurance policies today are issued through the WYO program.[51] Distilled to its essence, the WYO program works in the following way. Participating property and casualty insurers enter into contracts with the FIA. These companies are known as "WYO insurers," and they are fiscal agents of the United States.[52] They issue flood insurance policies in their own names. These insurers charge nearly the same premium as the federal government charges for policies issued through the direct program.[53] The carriers adjust, defend, settle, and pay all flood claims arising under the policies they issue. The companies receive small administrative fees for policies written and claims processed, but they remit the remainder of the premiums they collect to the government.[54] The government reimburses WYO insurers for claims they pay and bears all underwriting losses.[55]

The NFIP is self-supporting; losses as well as operating and administrative expenses are paid out of collected policy premiums.[56] Additionally, the NFIP is authorized to borrow up to $1.5 billion from the United States Treasury, though it must repay any loans with interest. WYO insurers never lose money through the NFIP.[57] If it appears that the program is

47. 42 U.S.C. §§ 4001–4129 (2006).

48. Robert P. Hartwig & Claire Wilkinson, *The National Flood Insurance Program (NFIP)* 2 (Ins. Info. Inst., Oct. 2005) (on file with author).

49. BusinessInsurance.com, *Flooding from Hurricanes Pushes Wave of Claim Reform* 2 (Apr. 17, 2006), http://www.businessinsurance.com.

50. Wright v. Allstate Ins. Co., 415 F.3d 384, 386 (5th Cir. 2005).

51. *Id.*

52. *Id.*

53. Hartwig & Wilkinson, *supra* note 48, at 4.

54. BusinessInsurance.com, *supra* note 49, at 2.

55. *See* Hartwig & Wilkinson, *supra* note 48, at 4.

56. *Id.*

57. BusinessInsurance.com, *supra* note 49, at 3.

going into the red, FEMA instructs the insurers to temporarily halt claims payments.[58] Claims payments are suspended until FEMA receives congressional authorization to borrow additional funds. FEMA has done that only once—in November 2005.[59]

Nationally, only about twenty percent of homeowners living in flood-prone areas purchase flood insurance.[60] Many eligible homeowners living in areas vulnerable to hurricanes do not purchase flood insurance. The reasons for this are poorly understood. Agents and brokers typically receive the same commissions for selling flood insurance that they do for selling other types of policies, so they have no economic reason to discourage customers from purchasing flood coverage. Certainly many Mississippians did not have flood insurance when Hurricane Katrina hit.[61] As of September 2005, less than one in five businesses or homes in Mississippi were insured against flood loss.[62] In some of the hardest hit areas of the state, fewer than one in ten homeowners had flood insurance.[63] Mississippi homeowners generally did not purchase flood insurance because their mortgage companies did not require it or because their properties were not located in designated flood plains.[64] The picture in other affected states is murky. In the most severely affected area of Louisiana, for example, some reports indicate that only two in five households were insured against damages due to flooding.[65] Other reports indicate that of the thousands of single-family homes in Louisiana that sustained hurricane-related flood damage, almost sixty-five percent were covered by flood insurance.[66]

Storm victims without flood insurance who became homeless or had their lives otherwise devastated still may have thought they were protected under their homeowners' policies. Unfortunately, many policyholders who neglected to purchase flood insurance found their claims denied in whole or part on the basis that their losses were caused by water damage. Some carriers routinely insisted that storm surge rather than wind destroyed dwellings.[67] Other insurers struggled with whether structures were damaged by wind before the storm surge arrived and, if so, what percentage of any given loss should be paid as being caused by wind or denied as being

58. *Id.*

59. Kathy Chu, *FEMA Halts Flood Insurance Payments*, USA TODAY, Nov. 16, 2005, at 1B .

60. Ripley, *supra* note 12, at 58.

61. Rick Cornejo, *Searching for a Cause*, BEST'S REV., Feb. 2006, at 22, 23.

62. Aon Re Inc. & Leboeuf, Lamb, Greene & MacRae LLP, *Report on Legal Precedents Relevant to Hurricane Katrina Losses* 1 (Sept. 2005) (on file with author).

63. Knox, *supra* note 37, at 911.

64. Cornejo, *supra* note 61, at 23.

65. Knox, *supra* note 37, at 911. *See also* Green, *supra* note 3, at 28.

66. Green, *supra* note 3, at 28.

67. Cornejo, *supra* note 61, at 24. Just before the Symposium, two State Farm Insurance Co. employees, Cori and Kerri Rigsby, publicly alleged that State Farm supervisors pressured outside engineers to alter reports so that it appeared that homeowners' damages were caused by water rather than wind. The Rigsby sisters claim that such fraud was "widespread" at State Farm offices in Biloxi and Gulfport, Mississippi. *Employees Allege Katrina Fraud*, CHI. TRIB., Aug. 26, 2006, § 2, at 2. The merit of these accusations is still uncertain.

caused by flooding. These determinations are difficult generally and impossible where a structure is totally destroyed.[68]

The potential for insurance disputes accompanying Katrina-related losses is obvious and the difficulty in resolving many of these disputes is equally apparent. It is settled insurance law that the insured bears the burden of establishing that a particular loss falls within a policy's coverage.[69] The burden then shifts to the insurer to show that the loss falls within a policy exclusion.[70] With respect to dwellings and other structures, homeowners' policies afford all-risk coverage, meaning that they insure against direct physical loss caused by all risks except those that are specifically excluded. It will be easy for insureds to demonstrate direct physical loss to their homes, thus shifting to insurers the burden of proving that the loss was caused by storm surge or the like.[71] Water damage exclusions are "valid and enforceable."[72] But how will insurers carry their burden of proof in cases where the property is totally destroyed? What of the many losses where there are no witnesses? Is reliable scientific evidence available?

Of course, there will be many instances where an insurer will be able to demonstrate that storm surge or some other form of flooding at the very least contributed to causing the loss. For example, a building may bear a water line—thus allowing the insurer to exclude all damage below it on the basis that such damage was caused by flooding, while paying for all damage above it on the theory that such damage must be attributable to wind. Historically, policyholders facing multiple causes of loss, some of which are covered and some of which are not, have been able to obtain coverage under the concurrent causation doctrine. The concurrent causation doctrine varies between states. Under the majority approach in first-party insurance cases, "if multiple concurrent causes exist and if the dominant, most significant or most important cause is a covered peril, coverage exists for the entire loss; otherwise the loss is not covered."[73] This is an efficient proximate cause analysis. Mississippi takes the efficient proximate cause approach.[74] Thus, where storm victims can show, for example, that their homes were destroyed by wind before storm surge swept over their property, their losses will be covered.[75] The problem, again, is one of proof—especially with total losses.

When it comes to damage to personal property, the analysis is flipped. Personal property coverage in a standard homeowners' policy extends only

68. Cornejo, *supra* note 61, at 24.

69. Am. Family Mut. Ins. Co. v. Co Fat Le, 439 F.3d 436, 439 (8th Cir. 2006); Nelson v. Hartford Underwriters Ins. Co., 630 S.E.2d 221, 229 (N.C. Ct. App. 2006) (quoting Hobson Constr. Co. v. Great Am. Ins. Co., 322 S.E.2d 632, 635 (N.C. Ct. App. 1984)).

70. *Co Fat Le*, 439 F.3d at 439; *Nelson*, 630 S.E.2d at 229.

71. *See* Buente v. Allstate Ins. Co., 422 F. Supp. 2d 690, 696 (S.D. Miss. 2006).

72. *Id.*

73. ROBERT H. JERRY, II, UNDERSTANDING INSURANCE LAW 587 (3d ed. 2002).

74. Grace v. Lititz Mut. Ins. Co., 257 So. 2d 217, 224 (Miss. 1972).

75. *Id.* (discussing destruction of building during Hurricane Camille).

to specified perils.[76] Thus, and by way of example, it is the insured's burden to prove that loss to property contained in a home caused by rain is attributable to the direct force of wind or hail causing an opening in the roof or a wall that allowed the rain to enter. This can be done in some cases, but presumably not in all.[77]

Hurricane Katrina will doubtless spawn all sorts of other coverage issues, including disputes over the application of different or multiple deductibles[78] and situations in which ambiguities in policies may allow insureds to successfully argue for coverage even where hurricane rains are the efficient proximate cause of their losses.[79] Perhaps most interesting is the lawsuit filed against a number of insurance companies by Mississippi Attorney General Jim Hood.[80] The allegations in the Hood complaint are so vague as to make them difficult to evaluate on the merits. Several points, however, bear mention.

First, Mr. Hood alleges that wind-driven rain exclusions are "void and unenforceable as violations of the public policy of the State of Mississippi" because they offend Mississippi concurrent causation law.[81] What Mr. Hood appears to be referring to is the windstorm or hail peril found in the personal property coverage of standard homeowners' insurance policies. Again, personal property coverage in standard homeowners' policies is specified-peril coverage, and while policies insure against direct physical loss caused by windstorms or hail, these perils do not include loss to property in a building caused by rain "unless the direct force of wind or hail damages the building causing an opening in a roof or wall and the rain . . . enters through this opening."[82] It is unlikely that an insurer's decision to structure its windstorm or hail peril in this way violates public policy in general,[83] but it is especially difficult to see how this language is contrary to public policy on the ground that it defeats Mississippi's concurrent causation doctrine.

When it comes to a homeowner's personal property loss, it is clear that a windstorm and hail are each a covered peril, and it is equally clear that

76. AUTO CLUB FAMILY INS. CO., *supra* note 38, at 17–20.

77. *See, e.g.*, Commercial Union Ins. Co. v. Byrne, 248 So. 2d 777, 778–81 (Miss. 1971) (finding for insured in case arising out of Hurricane Camille).

78. *See, e.g.*, Turner Constr. Co. v. ACE Prop. & Cas. Ins. Co., 429 F.3d 52 (2d Cir. 2005) (involving dispute over whether wind deductible or lower general deductible applied to damages caused by rain where rain entered building through wind-created openings).

79. *See, e.g.*, Buente v. Allstate Ins. Co., 422 F. Supp. 2d 690, 696–97 (S.D. Miss. 2006) (discussing hurricane deductible and combined causes exclusion).

80. Complaint and Motion for Temporary Restraining Order, Hood *ex rel.* State of Miss. v. Miss. Farm Bureau Ins., Civ. Action No. G2005-1642R1 (Hinds County, Miss. Ch. Ct. 2005) [hereinafter Hood Complaint] (on file with author).

81. *Id.* at 7.

82. AUTO CLUB FAMILY INS. CO., *supra* note 38, at 17–18.

83. Fla. Windstorm Underwriting v. Gajwani, 934 So. 2d 501, 507 (Fla. Dist. Ct. App. 2005) (finding that language does not violate Florida public policy).

rain is not.[84] Where wind or hail is the peril "to which legal liability attaches"[85] or which sets other causes of loss (such as water damage from rain) in motion,[86] then it is the efficient cause of the insured's loss, and the insured's loss will be covered even if property contained in the home is destroyed because it is waterlogged. That is essentially what the windstorm or hail peril in a standard homeowners' insurance policy provides. On the other hand, assume that rain enters an insured's home not because hail or wind blows out windows or blows off the roof, but because the roof leaked as a result of aging or normal wear-and-tear or because the insured left windows open in her haste to evacuate. In those cases, wind or hail would not be the efficient proximate cause of the water damage inside the insured's home, and the insurer ought not to have pay for the associated loss. Again, this is what a standard policy provides. How then does such a policy provision abrogate Mississippi concurrent causation law? The short answer is that it does not. How does this policy language violate Mississippi public policy? Again, it does not.

Another possibility is that Mr. Hood is referring to exclusions in homeowners' policies that exclude from coverage direct physical loss to a dwelling or structure caused by flood, surface water, waves, tidal water, overflow of a body of water, "or spray from any of these, whether or not driven by wind."[87] Coverages for dwellings and other structures in a homeowners' policy are all-risk, meaning that buildings to which they apply are insured against all perils other than those specifically excluded. Windstorm and hail losses are therefore covered, but flooding and other forms of water damage are specifically excluded (hence the need for flood insurance). Thus an insured will have coverage where wind or hail was the efficient proximate cause of the loss, as where wind obliterates a building before storm surge hits.[88] On the other hand, a home that is inundated by storm surge instead of being blown to smithereens by hurricane winds is not covered by a standard homeowners' policy. Again, standard policy provisions appear to be entirely consistent with Mississippi concurrent causation law, and therefore any related public policy arguments seem dubious at best.

Second, but more fundamentally, if the insurance policy provisions about which Mr. Hood's lawsuit complains are against public policy, then Mississippi's insurance regulatory scheme has utterly failed. If these provisions violate public policy, the Mississippi Insurance Department never should have allowed insurers admitted to do business in the state to include them in their policies. Because the Department did permit them, however,

84. AUTO CLUB FAMILY INS. CO., *supra* note 38, at 17–20.

85. Kemp v. Am. Universal Ins. Co., 391 F.2d 533, 535 (5th Cir. 1968) (discussing windstorm loss and efficient proximate cause under Mississippi law).

86. Sabella v. Wisler, 377 P.2d 889, 895 (Cal. 1963).

87. AUTO CLUB FAMILY INS. CO., *supra* note 38, at 20–21.

88. *See, e.g.*, Grace v. Lititz Mut. Ins. Co., 257 So. 2d 217, 224 (Miss. 1972) (finding coverage because office building was destroyed by wind from Hurricane Camille before storm surge hit); Lititz Mut. Ins. Co. v. Boatner, 254 So. 2d 765, 766–67 (Miss. 1971) (finding coverage where wind from Hurricane Camille obliterated dwelling before tidal wave hit).

these provisions presumably respect Mississippi public policy. Mississippi Deputy Commissioner of Insurance Lee Harrell's balanced remarks at a recent legal symposium on Hurricane Katrina confirm this conclusion.[89] Furthermore, it is reasonable to assume that Mr. Hood does not believe the Department erred or that the Commissioner of Insurance committed some related malfeasance, since in his press release trumpeting his lawsuit the Attorney General mentioned nothing about the Department or the Commissioner—he attacked only the insurance industry.[90]

Third, the Hood lawsuit and others making similar allegations (such as those filed by Mississippi trial lawyer Dickie Scruggs) potentially carry with them serious and unintended consequences. Regional insurers could be forced into insolvency if these suits are successful.[91] If the insurers are so affected, responsibility for paying claims under their policies will pass to the Mississippi Insurance Guaranty Association. Even if they are not driven into insolvency, insurers that lose these lawsuits or that pay extortionate settlements may withdraw from the Mississippi insurance market. As one knowledgeable insurance economist observed, "[t]he certain outcome of a victory by [Scruggs] or Hood would be the virtual overnight disappearance of insurance in [Mississippi]."[92] Skeptics may consider that prediction exaggerated (especially given the result in *Leonard v. Nationwide Mutual Insurance Co.*,[93] discussed later,[94] and Mississippi federal district courts' present reluctance to certify some homeowners' cases as class actions or to consolidate them[95]), but the fact remains that the withdrawal of but one or two major insurers from the Mississippi market would have significant adverse consequences for consumers. If Mr. Hood is duty-bound "to protect the interests of the general public" as he alleges in his lawsuit, how exactly does he satisfy that duty by materially impairing the Mississippi insurance market in the best case and obliterating it in the worst?[96]

Messrs. Hood and Scruggs argue that these concerns are invalid because (1) the insurance industry made a profit exceeding $40 billion in 2005, so it has plenty of money to pay Mississippians' claims;[97] (2) insurers

89. Mississippi Deputy Comm'r of Insurance Lee Harrell, Remarks at *Hurricane Katrina: A Legal Symposium*, Mississippi College School of Law (Aug. 29, 2006) (on file with the *Mississippi College Law Review*).

90. Press Release, State of Miss., Attorney General Jim Hood Files Complaint and Motion for Temporary Restraining Order Against Insurance Industry to Protect Mississippi's Victims of Hurricane Katrina (Sept. 15, 2005) (on file with author).

91. Patricia Vowinkel, *Katrina's Lawsuit Surge: A Legal Battle to Force Insurers to Pay for Flood Damage from Hurricane Katrina Could Cost the Industry Billions*, http://www.findarticles.com/p/articles/mi_m0BJK/is_15_16/ai_n15930125 (last visited June 21, 2006) (quoting Robert P. Hartwig).

92. *Id.*

93. 438 F. Supp. 2d 684 (S.D. Miss. 2006).

94. *See infra* notes 112–42 and accompanying text.

95. *See infra* notes 143–45 and accompanying text.

96. Hood Complaint, *supra* note 80, at 1–2.

97. Mississippi Attorney General Jim Hood, Remarks at *Hurricane Katrina: A Legal Symposium*, Mississippi College School of Law (Aug. 29, 2006) (on file with the *Mississippi College Law Review*).

will not withdraw from the Mississippi market because there is too much money to be made in the state;[98] and (3) insurers who withdraw will violate antitrust laws.[99] None of these arguments are persuasive.

First, the fact that the United States insurance industry as a whole made a $40 billion profit in 2005 is meaningless, since that figure encompasses all companies, all types of coverage, and all jurisdictions. States individually regulate the insurance industry. By law, insurance rates in each state must reflect the loss experience in that state alone.[100] As a result, each line of insurance must stand alone in any profitability analysis.[101] Insurers cannot use profits generated by their professional liability or auto insurance units, for example, to subsidize homeowners' insurance losses attributable to catastrophes. Insurers cannot use homeowners' insurance profits generated in Iowa or Wisconsin to subsidize hurricane-related homeowners' losses in Louisiana or Mississippi.[102] Industry-wide profitability is therefore irrelevant to Mississippians' insurance coverage for losses from Hurricane Katrina. Besides, the mere fact that an industry is profitable is no basis for reforming contracts lawfully entered into by its members. The idea of arbitrarily redistributing private wealth to accomplish patently political goals is repugnant.

Second, the argument that the Mississippi property insurance market represents too much money for insurers to forego is belied by the preceding discussion of insurer profitability, but it is flawed in other ways as well. For one thing, insurers do not have to withdraw from the state for consumers to suffer long-term economic disadvantage from plaintiffs' attempts to broadly reform their policies. All insurers have to do is reduce their policy limits or require higher deductibles for consumers to be adversely affected by these lawsuits. For another thing, insurers could stop writing property insurance in the state through admitted companies and instead offer it on a surplus lines basis,[103] meaning that the Mississippi Insurance Department would no longer approve the language of insurers' policies or regulate their rates. This would allow insurance companies to charge higher rates and impose policy terms arguably less favorable to policyholders. Moreover, not all insurers are equal. The fact that there are premiums to be collected in Mississippi does not mean that if one established carrier withdraws from the market, it will be replaced by a company of equal financial strength.

98. Richard F. Scruggs, Remarks at *Hurricane Katrina: A Legal Symposium*, Mississippi College School of Law (Aug. 29, 2006) (on file with the *Mississippi College Law Review*).

99. Hood, *supra* note 97.

100. Hartwig, *supra* note 20, at 2.

101. *Id.*

102. *Id.*

103. Insurers are fundamentally classified as either admitted or non-admitted. An admitted insurer is licensed to do business in the insured's home state, while a non-admitted insurer is not. Admitted insurers' policy forms and the rates they intend to charge for coverage are approved by the admitting state's insurance department; not so with non-admitted insurers. Non-admitted insurers are referred to as surplus lines insurers. Most insurance holding companies write business through both admitted and surplus lines companies. Douglas R. Richmond, *Surplus Lines Insurance and Wholesale Brokers*, 25 INS. LITIG. REP. 261, 261 (2003).

Finally on this point, why even risk long-term harm to a key industry and the resulting harm to consumers? Instead, why not craft a plan to persuade more Mississippians to buy flood insurance? Why not enact a statewide building code that would lead to the construction of more storm-resistant structures?[104]

Third, a single insurer's withdrawal from the state would likely raise no antitrust issues. The same is true if several insurers withdraw for independent, economically justifiable reasons. But if just one withdrawing insurer is a major player in the Mississippi market—such as Allstate or State Farm—the consequences for consumers could be considerable.

In the same vein, it is no answer to say that these suits will have no material effect on insurers doing business in Mississippi because they will be settled and reinsurers will ultimately bear those costs under the "follow the fortunes" or "follow the settlements" doctrine.[105] First, not all affected insurers may have reinsured their Katrina-related losses, and few (if any) were entirely reinsured. Second, the "follow the fortunes" doctrine and related provisions in reinsurance agreements do not override all other conditions, terms, and limits in those agreements.[106] If coverage that would not otherwise exist is created by agents' misrepresentations, the "follow the fortunes" doctrine may not apply.[107] Third, it seems probable that many reinsurers would decline to indemnify their cedents for these settlements on the ground that any associated payments were clearly outside the scope of coverage and therefore were made *ex gratia* (i.e., as favors or to enhance goodwill rather than as legal obligations).[108] London market reinsurers are almost certain to argue that any settlements are not covered under their reinsurance treaties.[109]

In summary, insurance policies are contracts and insurers have to be able to accurately price their contractual obligations. Their ability to do so depends on the terms of those contracts being enforced. Some insurers have perhaps drafted policies that will prove ambiguous. Others may have added endorsements or charged multiple deductibles that have created ambiguity where none would have existed otherwise. These insurance companies will pay a price for such errors, and those carriers which deny claims in

104. *See* Ripley, *supra* note 12, at 56 (discussing the benefits of statewide building codes and noting that Mississippi still has no such code).

105. These clauses obligate a reinsurer to indemnify its cedent for good faith payments made in connection with claims reasonably appearing to be within the coverage afforded by the underlying insurance policy. JOHN S. DIACONIS & DOUGLAS W. HAMMOND, REINSURANCE LAW § 3:2, at 3–28 (2005).

106. Vitkowsky, *supra* note 44, at 1019.

107. *Id.* at 1025.

108. *See* DIACONIS & HAMMOND, *supra* note 105, § 1:9.1, at 1–18.

109. *See* Commercial Union Assurance Co. v. NRG Victory Reinsurance Ltd., [1998] 2 LLOYD'S REP. 600 (involving settlement following the *Exxon Valdez* disaster).

bad faith will face resulting liability. But Attorney General Hood's attempt to void standard policy provisions on a widespread basis and similar efforts by private lawyers are misguided.[110]

B. Litigation to Date

Most, if not all, of the Katrina-related lawsuits against insurers have been initiated by insureds who opted not to purchase flood insurance.[111] At the time this Article was prepared, only one case involving a homeowners' policy had gone to trial. That case, *Leonard v. Nationwide Mutual Insurance Co.*,[112] turned out well for the insurance industry.[113] The insureds in *Leonard,* Paul and Julie Leonard, purchased a homeowners' policy with Nationwide from Jay Fletcher, a Nationwide agent in Pascagoula, Mississippi.[114] The policy contained a standard water damage exclusion and a combined causes exclusion.[115] The Leonards did not purchase flood insurance for their home.[116] Paul Leonard asked Fletcher whether he needed flood insurance and Fletcher told him that he did not because he did not live in a flood zone.[117] Fletcher's conduct in this regard was a mystery to the trial court:

> Fletcher did not carry flood insurance on his own property, and his office assistant, Cindy Byrd Collins, did not carry flood insurance on her property.
>
> Fletcher sometimes discouraged his clients from purchasing flood insurance policies . . . . There was enough evidence on this point to warrant the conclusion that Fletcher, as a matter of habit and routine, expressed his opinion, when he was asked, that customers should not

110. The rhetoric surrounding the Attorney General's lawsuit serves no valid purpose. Mr. Hood freely admits saying that insurers "are in lockstep like Nazis locking arms, coming at those people down there on the coast." Insurance Group, *Miss. Attorney General in Spat over "Nazi" Remark*, http://www.badfaithinsurance.org/reference/general/0518a.htm (last visited June 21, 2006). That assertion is demonstrably false. When challenged on his Nazi analogy, Mr. Hood responded: "If they [meaning the insurers he has sued] are so confident in their policies, why don't they quit with the delay tactics and meet me in court?" *Id.* That statement defies all reason. Does Mr. Hood really mean to suggest that insurance companies, merely by virtue of their business, ought not be allowed to pursue a litigation strategy they believe is most likely to lead to a favorable outcome? That removal to federal court should simply be denied them? The answer to these questions, based on Mr. Hood's remarks at the Symposium, is "yes." Mr. Hood's indignation is especially difficult to understand given his early public statements about wanting his case and others like it in state courts, where he expected that insurers would be less likely to receive fair trials. Walter Olson, *Insurers Can Breathe Easier over Katrina Lawsuits*, TIMES ONLINE, Aug. 30, 2006, http://www.timesonline.co.uk/article/0,,200-2334835,00.html. Any objective observer would expect that insurers aware of those remarks would attempt to avail themselves of federal jurisdiction.

111. Yerak, *supra* note 17, at 4 (quoting Robert Hartwig).

112. 438 F. Supp. 2d 684 (S.D. Miss. 2006).

113. *Id.* at 696. The case was dismissed, as "Nationwide . . . met the burden of proving . . . that all other damage to the Leonard's property was caused by water and waterborne materials . . . ." *Id.*

114. *Id.* at 687.

115. *Id.* at 687–88.

116. *Id.* at 691.

117. *Id.* at 690.

> purchase flood insurance unless they lived in a flood prone area . . . where flood insurance was required in connection with mortgage loans. But between 2001 and the time of Hurricane Katrina, Fletcher sold approximately 187 flood insurance policies in the Pascagoula area. Fletcher sold 12 flood insurance policies in the neighborhood where the Leonards live. There was no testimony from which [the court] can discern the reason Fletcher discouraged some of his clients from purchasing flood insurance policies, the reason Fletcher did not have flood insurance on his own property, or the reason he did sell 187 flood policies in the Pascagoula area and a dozen flood policies in the Leonard neighborhood.[118]

Leonard inferred from Fletcher's statement that he did not need flood insurance because his homeowners' policy would cover water damage caused by a hurricane.[119] "This was an erroneous inference and one that might have been avoided had either party to the conversation been more articulate in his inquiry or his response."[120] Regardless, it was undisputed that Fletcher did not misrepresent the terms of the policy, nor did he say anything that could be reasonably understood to alter the policy's terms.[121] "In fact, Fletcher and Leonard never had any discussion of specific policy provisions and coverages."[122]

Hurricane Katrina extensively damaged the Leonards' home.[123] "Almost all of the damage . . . [was] attributable to [storm surge]."[124] The Leonards' home was inundated by five feet of water.[125] Wind damage was relatively minor.[126] Following an inspection of the home, a Nationwide adjuster issued the Leonards a check for just over $1600 for wind-damaged items.[127] The Leonards contended that they suffered total storm damages of over $130,000, of which over $47,000 was attributable to wind.[128] They hired Dickie Scruggs's law firm to sue Nationwide on their behalf and the battle was joined. The case was tried to Senior Judge L.T. Senter of the United States District Court for the Southern District of Mississippi.[129]

The court in *Leonard* determined that almost all of the plaintiffs' damages were caused by water incursion, not wind.[130] This was significant,

118. *Id.* at 690–91.
119. *Id.* at 691.
120. *Id.*
121. *Id.* at 691–92.
122. *Id.* at 693.
123. *Id.* at 687.
124. *Id.* at 695.
125. *Id.* at 689.
126. *See id.* at 689, 695.
127. *Id.* at 690.
128. *Id.*
129. *Id.* at 687.
130. *Id.* at 695.

because the court also resolved that "[t]he provisions of the Nationwide policy that exclude coverage for damages caused by water are valid and enforceable terms of the insurance contract."[131] The court did find the combined causes exclusion in the Nationwide policy to be unenforceable.[132] Nationwide had never invoked the combined causes exclusion to deny coverage, apparently agreeing with the court that the exclusion, read literally, rendered illusory the windstorm protection that its policy clearly provided.[133] Ultimately, the court entered judgment for the Leonards for just over $1200, a figure reflecting window damage and cleaning expenses that the plaintiffs proved were caused or necessitated by wind, for which Nationwide had not originally paid.[134]

The decision in *Leonard* drew national attention.[135] Although some observers contend that neither side won in *Leonard*—Nationwide spent huge sums of money in its defense and the Leonards remain uncompensated for the loss of their home—the case was actually a victory for the insurance industry. The outcome was a triumph for insurance companies because the justice system worked as it should have: the parties disagreed over coverage, the case was tried to an unbiased judge, and one party carried its burden of proof while the other did not. The court did not invalidate clear policy language regarding water damage on amorphous public policy grounds or manufacture ambiguity where there was none. Instead, the court fairly decided the case on the narrowest grounds possible. Other cases may turn out differently, but that is the nature of our system of justice, where different trials yield different outcomes because they involve different facts. Of course, the court's enforcement of the water damage exclusion in the Leonards' policy generally bodes well for insurers.[136]

Parties increasingly litigate big cases in the press, and, not surprisingly, Mr. Scruggs and his clients publicly proclaimed victory in *Leonard*.[137] Mr. Scruggs had announced before trial that if he lost the *Leonard* case, he would have to "spin it the best way" he could.[138] This he did, despite recovering just over $1200 of the approximately $130,000 the Leonards claimed to be owed and seeing the court uphold the water damage exclusion that appears in every policy that will be litigated in future cases.[139] The plaintiffs' hollow claim of victory is premised on the fact that the court struck down the combined causes exclusion in the Nationwide policy.[140] That ruling is insignificant, however, since it afforded the Leonards no meaningful relief and few insurers are likely relying on it to deny coverage.

131. *Id.* at 693.
132. *Id.* at 694.
133. *Id.* at 695.
134. *See id.* at 696.
135. *See, e.g.*, Becky Yerak, *Plaintiffs Lose on Katrina*, CHI. TRIB., Aug. 16, 2006, § 3, at 1 (characterizing the decision as positive for the insurance industry).
136. *Id.*
137. *Id.*
138. Olson, *supra* note 110 (quoting Richard Scruggs).
139. *Id.* (quoting Richard Scruggs and Paul Leonard).
140. Scruggs, *supra* note 98.

In the *Leonard* case, Nationwide conceded that the combined causes exclusion did not operate to exclude coverage for wind damage.[141]

Additionally, Mr. Scruggs has acknowledged the Leonards' weak case, but he insists that they pressed to trial because if the court had voided the water damage exclusion in the Nationwide policy it would have been "game over," since all standard policies include this exclusion.[142] That rationalization is suspect. Had the court thrown out the exclusion, Nationwide certainly would have appealed and would have continued to vigorously defend every case against it until it received an unfavorable appellate ruling. Only then would Nationwide have considered settlement on a widespread basis. The same is true for all other insurers. In other words, if the court had thrown out the water damage exclusion in the Nationwide policy, then the situation would have remained "game on" rather than becoming "game over."

More recently, Mississippi federal courts have declined to certify class actions aimed at collectively litigating homeowners' insurance claims,[143] and they have similarly declined to consolidate homeowners' suits against their insurers.[144] These rulings are clearly correct, inasmuch as each insured's purchase of coverage was a separate transaction involving distinct and different communications. Hurricane Katrina caused different types of damage in different places in different times, causing common questions of fact and law to be dwarfed by questions affecting individual litigants. These claims or cases are simply not suitable for class action treatment or anything like it.[145]

C. *Insurance Agent and Broker Liability*

In addition to insurance companies themselves, insurance agents and brokers are likely litigation targets when insureds discover that they do not have the coverage that they thought or wished they had purchased. Nationwide agent Jay Fletcher's conduct was obviously scrutinized in the *Leonard* case.[146] While several lawsuits have been filed against intermediaries thus far,[147] these actions are relatively few in number.[148] The volume of cases of this nature is likely to increase if policyholders' lawyers see that

141. Leonard v. Nationwide Mut. Ins. Co., 438 F. Supp. 2d 684, 694 (S.D. Miss. 2006).

142. Scruggs, *supra* note 98.

143. *See, e.g.*, Guice v. State Farm Fire & Cas. Co., 2006 WL 2359474, at *5 (S.D. Miss. Aug. 14, 2006).

144. Becky Yerak, *Katrina Ruling Favors Allstate*, CHI. TRIB., Sept. 12, 2006, § 3, at 3; Michael Kunzelman, *Judge Rules Katrina Lawsuits Against Insurers Must Be Filed Separately*, Sept. 8, 2006, http://www.clarionledger.com/apps/pbcs.dll/article?AID=/20060908/NEWS/60908023&G.

145. *See* FED. R. CIV. P. 23 (governing class actions).

146. *Leonard*, 438 F. Supp. 2d at 690–92.

147. *See, e.g.*, Leboeuf v. State Farm Fire & Cas. Co., 2006 WL 1615980 (S.D. Miss. June 6, 2006); Tuepker v. State Farm Fire & Cas. Co., 2006 WL 1442489 (S.D. Miss. May 24, 2006); Buente v. Allstate Ins. Co., 422 F. Supp. 2d 690 (S.D. Miss. 2006).

148. *Few Big Players in the Agent/Broker E&O Market*, BEST'S REV., June 2006, at 24, 24.

claims against carriers on other theories are unlikely to succeed.[149] *Buente v. Allstate Insurance Co.*[150] is a representative case.

Plaintiffs John and Sheila Buente bought a home in Gulfport, Mississippi.[151] They insured the dwelling with Allstate by purchasing a homeowners' policy from agent Brenda Pace,[152] who allegedly told them that "they would have full and comprehensive coverage for any and all hurricane damage, including any and all damage proximately, efficiently and typically caused by hurricane wind and 'storm surge' proximately caused by hurricanes."[153] The Buentes further contended that they asked Pace whether they should purchase flood insurance, and that her employee told them that they did not need the protection because their home was not in a flood plain and their policy afforded hurricane coverage.[154] The plaintiffs allegedly relied on these representations and "their own subjective expectations" when deciding not to buy flood insurance.[155] The Buentes' property was damaged by "'hurricane wind, rain, and/or storm surge from Hurricane Katrina.'"[156] Allstate gave the Buentes a check for just over $2600, apparently reflecting the Allstate adjuster's determination of damage attributable to wind rather than water.[157] The plaintiffs claimed to have suffered covered losses of between $50,000 and $100,000. The Buentes sued both Allstate and Pace, and Allstate moved to dismiss the complaint.

The Buentes alleged that Allstate was bound by Pace's coverage representations and that she negligently misrepresented the scope of Allstate's coverage. The court noted that an agent can sometimes bind an insurer, and in certain circumstances both the insurer and agent may be liable for the agent's misrepresentations concerning coverage.[158] Although Pace "was under no duty to advise the plaintiffs what coverages were necessary for the protection of their property," she and her employees were obligated to answer accurately if the plaintiffs specifically asked them about the need for flood insurance.[159] Furthermore, at the motion to dismiss stage, the court was obligated to accept as true the Buentes' allegation that they reasonably relied on the assurances they received from Pace and her employees.[160] For these reasons and others related to Allstate's policy language, the court denied Allstate's motion to dismiss.[161]

149. Rick Cornejo, *Katrina's Next Wave*, BEST'S REV., June 2006, at 22, 22.
150. 422 F. Supp. 2d 690.
151. *Id.* at 692.
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.* at 693.
156. *Id.* (quoting plaintiffs' complaint).
157. *Id.*
158. *Id.* at 697 (citing Nichols v. Shelter Ins. Co., 923 F.2d 1158 (5th Cir. 1991)).
159. *Id.* at 697–98.
160. *Id.* at 698.
161. *Id.*

Turning now to some insurance law basics, the term "agent" is commonly understood to describe an intermediary who is employed by an insurance company "to represent it in dealings with third parties on insurance matters."[162] The term "[a]gent also may refer to an intermediary who sells only one insurance company's products and who, though an independent contractor compensated on commission paid by the insurer, is identified and treated as" the insurer's agent.[163] A "broker," on the other hand, is not linked to a particular insurer. Brokers have relationships with several insurers and are compensated by way of commissions paid by the insurers with which they place coverage. "Brokers are sometimes . . . [described] . . . as independent agents and are generally considered to be the insured's agent."[164]

The relationship between insurance companies and their agents is controlled by agency law principles, and agents can bind the insurance companies for which they work under several traditional agency theories.[165] The same is not true for brokers. If a broker is functioning as an insured's agent, his knowledge or conduct cannot be imputed to the insurer with which he places coverage.[166]

Both agents and brokers have no duty to advise insureds about the adequacy of insurance coverage they purchase, about the scope of that coverage, about the suitability of a policy, or about optional coverages that might be available.[167] Their duty is to attempt to procure the coverage the insured specifically requests and to tell the insured if they are unable to obtain the coverage.[168] The fact that agents and brokers often do advise insureds about desirable coverages, the availability of differing coverage limits, the wisdom of purchasing optional coverages, and so forth means only that they think their business interests will be served thereby and that they are willing to assume any legal duties which may arise. This does not mean that they otherwise have a duty to render such advice. Of course, where an insured asks an agent or broker about the coverage provided by the policy he is purchasing, the intermediary must answer the questions honestly.[169]

There are several issues that courts will have to confront in suits against insurance agents and brokers.[170] First, when insureds allege that

162. Douglas R. Richmond, *Insurance Agent and Broker Liability*, 40 TORT TRIAL & INS. PRAC. L.J. 1, 3 (2004).

163. *Id.*

164. *Id.* at 5.

165. JERRY, *supra* note 73, at 255–56.

166. Douglas R. Richmond, *Liability Issues in the Sale of Life Insurance*, 40 TORT TRIAL & INS. PRAC. L.J. 877, 889 (2005).

167. *See, e.g.*, Owens v. Miss. Farm Bureau Cas. Ins. Co., 910 So. 2d 1065, 1074 (Miss. 2005). The court rejected the argument that the agent had a duty to explain to insured his right to purchase uninsured motorist coverage "over and above amount of coverage required by statute." *Id.* at 1076.

168. Richmond, *supra* note 162, at 16–22.

169. *See* Buente v. Allstate Ins. Co., 422 F. Supp. 2d 690, 697–98 (S.D. Miss. 2006).

170. Because insurance agents work for a disclosed principal (the insurance company they represent), they cannot be individually liable for breach of contract if the insurer wrongfully denies coverage. Likewise, they cannot be liable for breach of the covenant of good faith and fair dealing found in

they relied to their detriment on their agents' or brokers' representations that their standard homeowners' policies insured them against hurricane-related flooding or storm surge, they will be hard pressed to prevail on such claims in light of the crystal clear language in standard policies excluding coverage for water damage.[171] Mississippi law imputes knowledge of policy contents to insureds even if they do not read their policies.[172] Insureds may attempt to escape this rule by arguing that they did not have copies of their policies at the time of the alleged misrepresentations and therefore could not discover them.[173] Once insureds accept policies for a reasonable time without complaining about the coverage afforded, however, they are bound by the terms of the policies regardless.[174] Thus, insureds making misrepresentation claims are likely to prevail only where they had copies of their policies for a very short time before Hurricane Katrina struck or where they complained about the water damage exclusion or hail and windstorm peril coverage when they received their policies.[175]

Second, insureds' requests for "full coverage," the "best policy available," "adequate protection," and the like do not trigger a duty for intermediaries to advise insureds about coverage needs or optional coverages.[176] Thus, for example, insureds who did not have flood insurance cannot reasonably allege that their statements along these lines should have obliged their agents or brokers to advise them about its availability and importance.

Third, if insureds allege that their agents or brokers negligently misrepresented the terms of policies, the misrepresentations must have been material.[177] If the insureds would have purchased the same policies had the truth been told, the misrepresentations cannot have been material.[178] Since most homeowners' policies are standardized, most negligent misrepresentation claims probably will be linked to flood insurance. In those cases, insureds will have to prove that they would have obtained flood insurance but for the misrepresentations of their agents or brokers. Of course, even commercial insureds that purchased flood coverage may claim misrepresentation because flood insurance policies do not provide business interruption coverage (which they will surely claim was important to

all insurance policies, nor are they liable for ordinary negligence in performing their duties. They can be independently liable if their conduct amounts to a separate tort, such as fraud. Jabour v. Life Ins. Co. of N. Am., 362 F. Supp. 2d 736, 740–41 (S.D. Miss. 2005) (interpreting Mississippi law).

171. *See* Stephens v. Equitable Life Assurance Soc'y of the U.S., 850 So. 2d 78, 82 (Miss. 2003) (reciting the general rule that a person will not "'be heard to complain of an oral misrepresentation the error of which would have been disclosed by reading the contract'") (quoting Godfrey, Bassett & Kuykendall Architects, Ltd. v. Huntington Lumber & Supply Co., 584 So. 2d 1254, 1257 (Miss. 1991)).

172. Cherry v. Anthony, 501 So. 2d 416, 419 (Miss. 1987).

173. *See* Reed v. Am. Med. Sec. Group, Inc., 324 F. Supp. 2d 798, 802 (S.D. Miss. 2004).

174. *See* Atlas Roofing Mfg. Co. v. Robinson & Julienne, Inc., 279 So. 2d 625, 629 (Miss. 1973); *see also Reed*, 324 F. Supp. 2d at 802 (citing *Atlas Roofing* for this proposition).

175. *See Reed*, 324 F. Supp. 2d at 802–03 (illustrating the importance of insureds' complaining about policy terms in misrepresentation cases).

176. Richmond, *supra* note 162, at 30.

177. *Id.* at 13.

178. *Id.*

them).[179] Likewise, individual insureds who purchased flood insurance may be surprised to learn that it does not cover living expenses, and they may accuse their agents or brokers of misrepresentation as a result.[180]

Fourth, many cases against agents and brokers probably will be ill-suited for resolution by summary judgment. The parties will have different recollections of what was said and there will be other genuine disputes over material facts.[181] These cases will therefore strain judicial resources if, in fact, a significant number of them are filed.

Fifth, plaintiffs must be prepared to offer expert testimony as to the standard of care for insurance intermediaries when it comes to recommending flood insurance.[182] Brokers and agents clearly have no duty to suggest that customers purchase flood insurance, but how should they respond when customers ask whether they should? When asked, an agent might say, "the company will probably take the position that its policy does not cover flood damage, so you may want flood insurance" or "it depends on how risk averse you are" or simply "yes." An agent or broker probably will not say "I am unwilling to answer that question because I do not want to assume a duty to advise you on coverage where one would not otherwise exist," nor will he say "read your homeowners' policy and decide whether you need flood insurance."

But what if an agent or broker tells an inquiring insured that he does not need to purchase flood insurance because his home is not located in a flood plain? Does that answer meet the standard of care applicable to insurance intermediaries? The court in *Leonard* specifically noted the lack of evidence "to establish the standard of care applicable to an insurance agent who is asked about the advisability of purchasing flood insurance."[183] The lack of such evidence did not help the Leonards' case.[184] At the very least, the court's comment should alert other litigants to the potential need for expert testimony on agents' and brokers' duties in this regard.

Insurance agents and brokers will, in the future, want to think carefully about the advice they give insureds who inquire about the need for flood insurance. They will also seek to settle on appropriate methods of documenting such communications.

Finally, it is reasonable to believe that some insureds will not testify truthfully about their dealings with agents and brokers. A disturbing number of Americans believe that it is acceptable to lie to obtain increased insurance benefits.[185] With respect to Hurricane Katrina, many insureds

179. *See* Cornejo, *supra* note 149, at 24.

180. *See id.* at 23.

181. *Id.* (quoting policyholders' attorney on fact-specific nature of these disputes).

182. *See generally* Douglas R. Richmond, *Expert Testimony in Insurance Agent and Broker Litigation*, 28 INS. LITIG. REP. 317 (2006) (discussing the need for expert testimony in cases against insurance agents and brokers).

183. Leonard v. Nationwide Mut. Ins. Co., 438 F. Supp. 2d 684, 692 (S.D. Miss. 2006).

184. *See id.*

185. William P. Barrett, *Fighting Insurance Fraud*, http://www.forbes.com/2003/09/22/cz_wb_0922 fraud.html (last visited Jan. 8, 2007) (reporting that 25% of all people surveyed "thought that pumping up the value of a claim submitted to an insurer was OK").

are so crippled by their losses that it seems reasonable to predict that sheer desperation will drive them to lie.[186] Yet more insureds will convince themselves that they *did* ask about flood coverage or *did* complain about policy exclusions, not because they are naturally dishonest, but because their lives have been shattered and they simply cannot believe that (given their usual good judgment) they would not have protected themselves and their families against the calamity that befell them. None of this should be read to mean that all insureds will testify falsely to obtain policy benefits (the Leonards apparently testified truthfully) or even that most insureds will do so. What it does suggest is that insurance fraud is a concern after Hurricane Katrina, just as it is after most catastrophes.

D. Business Interruption Coverage

Property insurance compensates an insured for the value of property that is damaged or destroyed, or for the cost of repairing or replacing such items.[187] In the case of a business, damage to its property may force it to suspend operations and lose income. Because property insurance does not protect a commercial insured against this risk, businesses may purchase "business income" or "business interruption" coverage.[188] Business interruption coverage may be included in commercial "package" policies providing both third-party and first-party coverages. In any event, business interruption coverage is intended to indemnify the insured against lost income caused by the suspension of its normal business operations due to a covered cause of loss.[189] A typical policy affording business interruption coverage might provide:

> We will pay for the actual loss of Business Income you sustain due to the necessary suspension of your "operations" during the "period of restoration". The suspension must be caused by direct physical loss of or damage to property at the described premises . . . caused by or resulting from any Covered Cause of Loss.
>
> We will only pay for loss of Business Income that occurs within 12 consecutive months after the date of direct physical loss or damage . . . .[190]

186. Coalition Against Insurance Fraud, *Katrina's Winds Breeding Record Fraud?*, http://www.insurancefraud.org/katrina_fraud.htm (last visited June 22, 2006).

187. William T. Barker, *Business Income Insurance in a Disrupted Economy: New Orleans After Hurricane Katrina*, 28 INS. LITIG. REP. 49, 49 (2006).

188. *Id.*

189. United Air Lines, Inc. v. Ins. Co. of the State of Pa., 439 F.3d 128, 131 (2d Cir. 2006) (quoting N.Y. JUR. INSURANCE § 539 (2005)).

190. HANOVER INS., *supra* note 43, at 4.

"Business income" means the insured's net income (pretax net profit or loss) that would have been earned or incurred and continuing normal operating expenses, including payroll.[191]

In addition to lost business income tied to a direct loss, policies may provide "contingent" business interruption coverage, which extends coverage to include losses suffered by the insured that result from damage to property of suppliers of goods or services to the insured.[192] The description of this extension of business interruption coverage as "contingent" is "something of a misnomer," since it means only that "the insured's business interruption loss resulted from damage to a third party's property."[193] In any event, companies that have been spared direct physical losses attributable to Hurricane Katrina may submit contingent business interruption claims. Contingent business interruption losses may span the country—they certainly will not be confined to insureds along the Gulf—and they will affect all corners of industry.[194]

Business interruption coverage may insure against lost income and extra expense attributable to the actions of civil authorities that prevent the insured's access to its property, subject to some time limitation. For example:

> "Civil Authority. We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss. This coverage will apply for a period of up to two consecutive weeks from the date of that action."[195]

Business interruption claims are likely to be asserted by businesses along the Gulf Coast. Katrina hit the hospitality and tourism industries hard, battered the chemical industry, and devastated the energy industry. Hospitals and universities were closed. Loyola University in New Orleans has sued its business interruption insurer for its allegedly arbitrary and capricious failure to pay the school's $22.5 million business interruption claim.[196] Katrina-related claims will also come from states far from the

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191. *Id.*

192. *See* Pentair, Inc. v. Am. Guarantee & Liab. Ins. Co., 400 F.3d 613, 614 (8th Cir. 2005) (quoting policy); Archer Daniels Midland Co. v. Hartford Fire Ins. Co., 243 F.3d 369, 371 (7th Cir. 2001) (discussing business disruptions caused by flooding).

193. *Pentair, Inc.*, 400 F.3d at 615 n.3.

194. Arnold F. Mascali, Jr., *Contingent Business Interruption Coverage*, 41 TORT TRIAL & INS. PRAC. L.J. 843, 844 (2006).

195. S. Hospitality, Inc. v. Zurich Am. Ins. Co., 393 F.3d 1137, 1139 (10th Cir. 2004) (quoting Zurich policy).

196. *University Sues over Katrina Payments*, CHI. TRIB., Aug. 8, 2006, § 3, at 2. Loyola additionally alleges that its insurer has wrongfully refused to pay at least some portion of its $6 million property damage claim. *Id.*

Gulf of Mexico because business in those states will experience business interruptions attributable to damage suffered by their distributors and suppliers along the Gulf Coast. Of course, in order to be covered, an insured's business interruption must be caused by direct physical loss or damage to property resulting from a covered cause of loss, again implicating policies' water damage exclusions.[197]

IV. CONCLUSION

Hurricane Katrina was a catastrophe of incomprehensible proportion. Large areas of the Gulf Coast remain decimated today. Many insurance issues remain to be resolved, chief among them the scope of coverage provided by homeowners' and commercial property insurance policies. Most policies are clear and unambiguous; they simply do not provide coverage for losses attributable to the devastating flooding and storm surge that ruined the lives of so many people. Unfortunately, lessening the immediate loss by invalidating key policy provisions is no answer. Indeed, the post-Katrina restructuring of the insurer-insured bargain has the potential to seriously impair insurance markets in affected states. These and other issues doubtless will play out over time. What will we learn? And, based on what we learn, what will the insurance industry and insurance consumers do in response before catastrophe strikes again? We can hope that more consumers purchase flood insurance. We can hope that agents and brokers document well their customers' specific coverage requests and instructions. But the truth of the matter is that the insurance industry traditionally handles catastrophes better than other industries and, in light of Katrina, clearly better than the states and the federal government. Popular anger with the insurance industry is, for the most part, misdirected.

197. Platt, *supra* note 45, at 201.