

## Insurance Coverage Lessons From Katrina: Insurance Companies Should Be Protecting Policyholders, Not Insurance Companies

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Much of the Northeast was not fully prepared for Superstorm Sandy, and its effects will linger for some time. But one industry largely headquartered in the Northeast had been preparing for the storm for years: the insurance industry.

Since Hurricane Andrew in 1992, the insurance industry has been taking steps to reduce its exposure to catastrophe losses – ironic, considering that insurance companies are supposedly in the business of insuring them. As a result, insurance com-

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panies made record profits in the immediate aftermath of Hurricane Katrina and in recent years have kept enormous surpluses, despite 9/11 and the overall economic landscape.<sup>1</sup>

The ultimate lesson from Katrina accordingly is simple. The time has come for consumers, courts and state regulators to stop insurance companies from protecting *themselves* from catastrophe losses. It is time for them to start protecting their policyholders instead.

### Two Views Of The World

To put coverage issues into perspective, one must view the world through an insurance company lens. To most of us, a hurricane is a singular event – a swirling shape, with an eye in the center. Not so, however, for the insurance industry. Insurance companies see a hurricane as a series of unrelated events – wind, rain, high water, waves, storm surges and so on.

The same applies to the hurricane's consequences. To the "untrained" eye, the flooding of cities, the power failures that render businesses inoperative and the evacuation orders all are caused by the storm. To the insurance industry, however, each is a separate loss that might or might not be covered.

There is a reason for the insurance

industry to draw such distinctions. By parsing storms into multiple parts, it becomes easier to deny all or part of a claim. But the entire system is confusing to policyholders. Somehow, it turns the insurance policies they thought would cover their losses into denial letters when they make claims.

### What Does Your Policy Say?

Insurance policies are drafted by insurance companies. The insurance companies define the key terms (i.e., "flood"), draft the exclusions and even include draconian language that purports to eviscerate coverage in certain circumstances. The insurance companies then interpret the provisions that they drafted, leaving the policyholders with the relatively undesirable option of arguing against a fait accompli.

Property insurance policies generally fall into two types: (1) "all risks," that cover "all risks of direct physical loss or damage," except those specifically excluded;<sup>2</sup> and (2) "named perils," that cover damage or loss caused by listed perils (i.e., fire, wind, hail or vandalism) but also contain exclusions, including for weather conditions.<sup>3</sup>

A typical commercial policy covers buildings and structures, personal property inside or on them and personal property that is nearby or in a vehicle.<sup>4</sup> Coverage then is modified by a section called "Covered Causes of Loss": "We insure for direct physical loss to the covered property caused by windstorm or hail unless the loss is excluded in the Exclusions."

The most important section for purposes of this article sets forth the exclusions:

The following exclusions apply to loss

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to covered property:

1. Flood. “We will not pay for loss or damage caused by or resulting from flood, surface water, ...”<sup>5</sup>

2. Power Failure. “We will not pay for loss or damage resulting from the failure of power or other utility service ... [unless] ... on the described premises if caused by windstorm or hail.”

3. 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 ...”

Such policy language places causation directly into question – yet causation often is difficult to assess. Superstorm Sandy, for instance, involved a wide variety of perils, including wind, wind-driven water, storm surge, flooding, sewage overflows, power failures, explosions, government-ordered evacuations, transportation shut-downs and fires.

The courts have developed various tests for determining the cause of a loss. Most prominent among them is the doctrine of “efficient proximate cause,” which focuses on the dominant cause. If the dominant cause is a covered peril, there is coverage under this doctrine; if not, then (usually) not.<sup>6</sup> In states that have adopted this doctrine, such as New Jersey and Connecticut, it supports the argument that storm-related damages ultimately were caused by wind (which is covered), rather than by excluded floods.<sup>7</sup>

An alternative view is the doctrine of concurrent causation. This doctrine finds coverage if *any* of the causes are covered, even if only one cause fits the bill and even if that cause played a minor role in the loss. This doctrine is the most helpful to policyholders of all, but is followed by a minority of states.

Still other courts apply a strict interpretation of policy language, no matter the consequence.<sup>8</sup> This approach often is unfavorable for policyholders, as many insurance policies include hidden coverage-defeating provisions.

The crown jewel for denying coverage is what is generally known as the “anti-concurrent causation” clause. Such clauses often are found as lead-ins or preambles to Exclusion sections. They typically contain language to the effect that: “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.”<sup>9</sup>

In short, this clause is designed to obliterate coverage whenever there is a single

non-covered event, no matter how insubstantial or indirect.<sup>10</sup> In the words of one district court judge, who rejected the clause as ambiguous and unenforceable:

[It] would mean that an insured whose dwelling lost its roof in high winds and at the same time suffered an incursion of even an inch of water could recover nothing under his Nationwide policy. Read literally, this provision would exclude all coverage when a windstorm did damage to both an insured dwelling (a covered loss) and adjacent “screens, including their supports, around a pool patio or other areas.” (an excluded loss). I do not believe this is a reasonable interpretation of the policy.<sup>11</sup>

Some states have held that anti-concurrent causation clauses are not enforceable. In Washington, for example, the state’s highest court ruled that insurance companies cannot circumvent the state’s “efficient proximate cause” rule by contract.<sup>12</sup> Rulings by the highest courts in West Virginia, California and North Dakota are to the same effect.<sup>13</sup> Other states have ruled that additional coverage for water provided by endorsement is not subject to exclusion by anti-concurrent causation clauses.<sup>14</sup> More states can be expected to follow in the wake of Superstorm Sandy.

#### Other Insurance Company Tactics

Aside from the insertion of anti-concurrent causation clauses into insurance policies, dramatic increases in insurance premiums and non-renewals of insurance policies have become commonplace in recent years. But they are not the only tactics that insurance companies have developed to protect themselves from the risk of loss. One reasonably new tactic is the addition of “hurricane deductibles.”

Hurricane deductibles have become widely used since Katrina. The deductible amounts are percentages of the claimed loss rather than fixed dollar amounts. In New York and New Jersey, such deductibles range between one and five percent. They apply only when hurricanes caused the damage.

Another tactic used by insurance companies is to shift coverage of certain perils to government-backed programs – meaning, to the tax-paying public. Taxpayer-sponsored coverage – such as for flooding – ends up as a hedge for the insurance industry (as insurance companies collect fees for servicing government policies).<sup>15</sup>

Yet another tactic made obvious by

Katrina is delay in paying claims. Especially under the National Flood Insurance Program (“NFIP”), policyholders can expect delays in claim resolution followed by prolonged court battles. Insurance companies benefit from slowing claim payments and engage in delay tactics, if left unchecked.

#### Government Intervention

Fortunately, there are checks and balances in this system. One of them is the role played by state governments. Immediately following Superstorm Sandy, for example, the governors of New York, New Jersey and Connecticut each issued an Executive Order stating that hurricane deductibles are inapplicable because Sandy was a tropical storm – not a hurricane – when it made landfall.<sup>16</sup> Similarly, in 2006, Louisiana Governor Blanco extended various legal deadlines that were deemed impossible to meet after Katrina.<sup>17</sup> The Louisiana Legislature also extended the prescriptive period within which citizens were to file certain claims.

Another check on insurance companies comes from state attorneys general and courts. After Katrina, the Louisiana attorney general filed suit on behalf of the state and obtained a ruling upholding certain legislative acts as constitutional.<sup>18</sup> The Texas Department of Insurance (“TDI”) and the Texas attorney general obtained a court order against Allstate Insurance Company, preventing it from denying insurance coverage to Texas residents who had been deprived of access to their property due to power failures.<sup>19</sup>

Courts also reviewed policyholder challenges to coverage denials and used state bad-faith law to deter improper denials. While post-Sandy cases have barely begun to be filed, similar decisions can be expected.

#### Conclusion

The ultimate lesson from Katrina is that it is time to bear down on insurance companies that put themselves ahead of their policyholders and avoid the losses that they were paid substantial premiums to absorb. Policyholders should do their part by challenging coverage denials that are wrongful and manipulative. With diligent oversight by policyholders, governmental entities and courts, insurance companies that engage in wrongful tactics will find themselves with serious legal problems, extending far beyond the details of any single claim.

1 Hunter, J. Robert, *The Insurance Industry's Incredible Disappearing Weather Catastrophe Risk: How Insurers Have Shifted Risk and Costs Associated with Weather Catastrophes to Consumers and Taxpayers*, *Consumer Federation of America*, (Feb. 17, 2012) (noting that insurance industry has reported record profits and been grossly overcapitalized since 2000, despite the occurrence in those years of the nation's largest and most costly weather catastrophes); compare *Insurance Information Institutes Media Advisory, Insurers Paid Out \$41.1 billion to 1.7 Million Policyholders, Mostly in Louisiana and Mississippi* (Aug. 23, 2010). Hunter demonstrates that through price increases and coverage reductions, insurance companies paid approximately 30 percent less in coverage in response to Katrina than they would have if they had provided the same level of coverage as they did for Andrew. *How Insurers Have Shifted the Risk*, at 3. He shows that the property-casualty insurance industry is so overcapitalized that the industry surplus would be huge even if Katrina claims had been paid out at 64 percent, like Andrew claims, rather than at 50 percent. In fact, had the top ten catastrophes since 1989 all taken place in 2010 and been paid in that year, the industry surplus would still exceed \$418 billion. *Id.* at 8-9.

2 13A George J. Couch, *Couch on Insurance 2d* § 48:142 (2d ed. revised 1982).

3 *Id.*

4 See T.W.I.A. Commercial Policy/Windstorm and Hail, available from the Texas Windstorm Insurance Association, 5700 South MoPac Expressway, Building C, Suite 300, Austin, Texas 78749. Comparable lan-

guage can be in the T.W.I.A. Dwelling Policy/Windstorm and Hail, available from the same association.

5 There are many other standard-form flood exclusions. For example, the standard form published by the Insurance Services Office has one subsection similar to the exclusion above, then includes other subsections pertaining to sewer back-up and below-ground seepage.

6 See Sidney I. Simon, *Proximate Cause in Insurance*, 10 Am. Bus. L.J. 33, 37 (1972).

7 *Franklin Packaging Co. v. California Union Ins. Co.*, 171 N.J. Super. 188, 408 A.2d 448, (N.J. Super. 1979); *Frontis v. Milwaukee Ins. Co.*, 242 A.2d 749 (Conn. 1968). New York has no clear authority on this question.

8 See e.g., *Alf v. State Farm Fire & Cas. Co.*, 850 P.2d 1272, 1277 (Utah 1993).

9 See ISO's Causes of Loss – Special Form (CP 10 30 04 02), accompanying ISO's Building and Personal Property Coverage Form (CP 00 10 04 02), cited in *Unraveling Insurance Coverage for Hurricane Katrina: No Big Easy Task* at 2, The National Underwriter (October 2005) (reprinted at: [http://www.uphelp.org/disaster/tip\\_katrina\\_articles.html#Unraveling](http://www.uphelp.org/disaster/tip_katrina_articles.html#Unraveling)).

10 Lower courts in New York and New Jersey previously have allowed insurance companies to deny coverage based on anti-concurrent causation clauses. See *Kosich v. Metropolitan Prop. & Cas. Ins. Co.*, 214 A.D.2d 992 (4th Dep't. 1995); *Simmonetti v. Selective Ins. Co.*, 859 A.2d 694 (N.J. Super. 2004).

11 *Leonard v. Nationwide Mut. Ins. Co.*, 438 F. Supp. 2d 684, 694 (S.D. Miss. 2006); *aff'd but criticized*, 499 F.3d 419 (5th Cir. 2007), *cert. denied* 552 U.S. 1310 (2008). Notably, the Fifth Circuit anticipated that a Mississippi court would allow an anti-concurrent causation clause to override state law. *Id.* at 431.

12 *Safeco Ins. Co. of Am. v. Hirschmann*, 773 P.2d 413, 416 (Wash. 1989).

13 *Murray v. State Farm Fire & Cas. Co.*, 509 S.E.2d 1 (W. Va. 1998); *Garvey v. State Farm Fire & Cas. Co.*, 770 P.2d 704 (Cal. 1989). See also *Western Nat. Mut. Ins. Co. v. University of N. D.*, 643 N.W.2d 4 (N.D. 2002).

14 *Bishops, Inc. v. Penn Nat. Ins.*, 984 A.2d 982 (Pa. Super. 2009).

15 *The Insurance Industry's Incredible Disappearing Weather Catastrophe Risk*, *supra*, at 3.

16 New York: <http://www.governor.ny.gov/press/10312012Hurricane-Deductibles>; New Jersey: <http://www.nj.gov/infobank/circular/eocc107.pdf>; <http://www.state.nj.us/health/news/2012/approved/20121102a.html>; Connecticut: <http://www.governor.ct.gov/malloycwp/view.asp?Q=513366&A=4010>.

17 Executive Order Nos. KBB 2005-32, KBB 2005-48 and KBB 2005-67.

18 *State of Louisiana v. All Property and Casualty Insurance Carriers Authorized and Licensed to do Business in the State of Louisiana*, 937 So.2d 313 (2006).

19 [http://www.consumeraffairs.com/news04/2005/tx\\_rita\\_allstate.html](http://www.consumeraffairs.com/news04/2005/tx_rita_allstate.html).