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Insurance Bad Faith

# Katrina: Wind, Flood And Fire

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# Commentary

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### Katastrophe[1]

"The Big Easy:" Nothing can be further from the truth. Estimated insured losses from Hurricane Katrina exceed $30 billion. Adjusters have been forced to locate more than 100 miles away from the insured locations to motels that have no power, no air-conditioning and no hot water. In most catastrophes, adjusters move to the hardest hit areas first and then work their way toward less damaged outlying areas. However, due to the unique circumstances of Katrina, adjusters are being forced to start at the periphery and work their way in to the hardest hit areas. Such is the nature of this catastrophe that will challenge our fundamental constructs of claims handling.

### The Unimaginable

New Orleans remains in a state of unimaginable chaos and destruction, Biloxi has been obliterated, and the Gulf shore of Alabama has been severely damaged. The news reports are horrifying:

The second day brought more horror, greater despair. Two levees broke and sent water coursing into the street of the Big Easy, a full day after New Orleans appeared to have escaped wide-spread destruction from Hurricane Katrina. An estimated 80% of the below-sea level city was under water, 20 ft. deep in places, with miles and miles of homes swamped. — Brett Martel, The Associated Press, August 31, 2005.

No one knows how many were killed by Hurricane Katrina's floods and how many more succumbed waiting to be rescued. But the bodies are everywhere; hidden in attics, floating among the ruined city, crumpled on wheelchairs, and abandoned on highways. — Allen G. Breed, The Associated Press, September 4, 2005.

New Orleans turned much of its attention on Sunday to gathering and counting the dead across the ghastly landscape of wash and perhaps thousands of corpses. 'It is going to be about as ugly as a scene as I think you can imagine,' the Nation's Homeland Security Chief warned. — Robert Tanner, The Associated Press, September 5, 2005.

People living in the path of Hurricane Katrina's worst devastation were twice as likely as most Americans to be poor and without a car — factors that may help explain why so many failed to evacuate as the storm approached. An As-

> sociated Press analysis of census data shows that the residents in the three hardest hit neighborhoods in Louisiana, Mississippi, and Alabama also were disproportionately minority and had incomes $10,000 below the national average. "Let them know we're not bums. We have houses. Our houses were destroyed. We have jobs. It's not our fault that we didn't have cars to leave," Sahtonia Thomas, 27, said as she walked near New Orleans Convention Center five days after the storm, still trapped in the destruction with her children, ages 6 and 9. . .
>
> Money and transportation — two keys to surviving a natural disaster — were inaccessible for many who got left behind in the Gulf Region's worst squalor . . . The victims of Mississippi have much the same story. In one Pascagoula neighborhood, 30% of residents are minorities, more than 20% living in poverty. In Alabama, where Katrina wasn't as severe, one of the hardest hit areas was a downtown Mobile neighborhood where the median household income is barely $25,000 and one of every four residents lives below the poverty line. — Frank Bass, The Associated Press, September 5, 2005.

Thousands of insurance claims professionals are coordinating and managing resources to respond to this unprecedented American cataclysm.[2] This is and shall be anything but "The Big Easy."

The opportunities for claim handling missteps to occur resulting in moral, ethical, and financial regrets are innumerable. The focus of insurance "bad-faith" litigation is adjuster conduct. Mistakes in processing covered claims constitute the essence of "bad-faith." *See,* Michael Sean Quinn, *"The Ethical Habitat of Adjusters: Part I. Principles, Problems, and Practicalities,"* 10 Environmental Claims Journal 98 (1998). The opportunity for each and every insurance adjuster, independent adjuster, third-party administrator, supervisor, manager, examiner, director, and VP of Claims, to create an honorable legacy is upon us. Unfortunately, the opportunities to create one of shame and an exacerbated financial catastrophe may even be more evident. Now is the time for insurers and insurance claims professionals to educate and conduct themselves in such a manner so as to eliminate, or at least mitigate, extra-contractual exposure. The first step is to be aware of the applicable law in each of the affected states.

## Alabama

Understanding Alabama law on "bad-faith" requires a careful review of the Alabama Supreme Court's decision *State Farm Fire & Cas. Co. v. Slade*, 747 So. 2d 293 (Ala. 1999). Among other holdings and findings worthy of note, the *Slade* Court recognized that Alabama "bad-faith" law was anything but clear. The *Slade* Court's "clarification" of the law states:

1. There are two types of "bad-faith" in Alabama: "normal bad-faith" and "abnormal bad-faith."

2. "Normal bad-faith" is defeated if the insured does not obtain a "directed verdict" against the insurer on their breach of contract claim. That is, the denial of the claim or failure to pay the insured more insurance proceeds was "fairly debatable."

3. "Abnormal bad-faith" is where the insurer is in breach of the insurance contract and either failed to properly investigate the claim, failed to subject the results of the investigation to a cognitive evaluation and review, created its own debatable reason for denying the claim, or relied on an ambiguous part of the policy as a "lawful" basis to deny the claim. In such "abnormal bad-faith" cases the "directed-verdict-on-the-contract-claim" standard does not apply.

4. "Bad-faith" is not simply bad judgment or negligence, but rather requires a dishonest purpose and conscious wrongdoing.[3]

5. An insurer's duty to investigate does not extend only to those events that are not covered. An insurer has a duty to marshal all facts necessary in making a correct decision on a claim *before* it refuses to pay.

6. Information received *after* the date of denial is irrelevant in determining whether the insurer denied the claim in bad-faith.[4]

The *Slade* Court, addressing "abnormal bad-faith," explained:

An insurer can be liable for the tort of bad-faith when it fails to properly investigate the insured's claim . . . Here, the [insureds] produced substantial evidence, in the form of expert testimony, indicating that the term "dwelling" did include their retaining wall. They also presented substantial evidence indicating that [the insurer] did not investigate their claim properly. The [insureds] produced evidence indicating that [the insurer] *never* in the course of its investigation, sent to their home someone who was qualified to conduct a lightning investigation . . . [and] *never* interviewed any of the witnesses present on the day lightning struck their retaining wall. The [insureds] presented expert testimony indicating that these omissions amounted to an improper investigation, on the basis that an investigation of a claim such as the [insureds] made required the use of a lightning expert. The [insureds] also presented evidence indicating that [the insurer] did not investigate lightning as a cause. The [insureds] produced evidence indicating that [the insurer] told its engineer . . . to investigate a "possible soil problem" and that it did not tell [him] about the lightning strike. This evidence conflicted with [the insurer's] "Good Faith Claims Handling" video, which was admitted into evidence and which contained a statement that [the insurer's] claim-handling policy was to attempt to find coverage . . .

This evidence, the [insureds] say, shows that [the insurer] never investigated the possibility that lightning directly struck their dwelling, a fact, which if proven, would negate the application of the earth-movement exclusion. The [insureds] maintain that this failure created a question of fact as to whether [the insurer] properly investigated their claim, and, therefore, that the trial court properly submitted this portion of their bad-faith claim to the jury. We agree.

*Slade* at 315 (*emphasis* in original).

*Slade's* major legacy is that an insurer better conduct a thorough, well documented investigation, followed by a thoughtful decision-making process before refusing to pay its insured more insurance proceeds. Otherwise, the insurer may be subject to an extra-contractual damages judgment for "bad-faith" claims handling. *Accord, Mutual Service Cas. Ins. Co. v. Henderson*, 368 F.3d 1309 (11th Cir. 2004) (under Alabama law there are two methods by which a party can establish a bad-faith refusal to pay an insurance claim); *Kervin v. Southern Guaranty Ins. Co.*, 667 So. 2d 704 (Ala. 1995) (the Alabama Supreme Court has consistently refused to recognize a cause of action for the negligent handling of insurance claims); *Adams v. Auto-Owners Ins. Co.*, 655 So. 2d 969 (Ala. 1995) (insurer had reasonable, arguable, and legitimate reasons for denying coverage for full amount of insured's claim for wind damage to roof and did not act in bad-faith where there were two independent on-site investigations indicating that almost all of the damage had resulted from deterioration due to age rather than wind); *Turner v. State Farm Fire & Casualty Co.*, 614 So. 2d 1029 (Ala. 1993) (insurer had duty to examine insured's property to determine cause of damage to basement wall, and, having fulfilled that duty, insurer was not guilty of "bad-faith"); *Thomas v. Principal Financial Group*, 566 So. 2d 735 (Ala. 1990) (exceptions to the "directed verdict" rule will undoubtedly arise); *Jones v. Alabama Farm Bureau Mutual Casualty Co.*, 507 So. 2d 396 (Ala. 1986) (issue of material fact precludes summary judgment on "bad-faith" denial of coverage); and, *Nat'l Security Fire & Cas. Co. v. Bowen*, 417 So. 2d 179 (Ala. 1982) (denying "bad-faith" recovery if there is ample debatable reason for refusing to pay the property damage claim).[5]

While the "bad-faith" law of Alabama appears fair and reasonable, the execution of such laws may be another story. Significantly, Alabama allows "bad-faith" litigation to proceed before resolution of the underlying breach of contract action. As a result, massive and intrusive "bad-faith" discovery may occur in an attempt to "leverage" a favorable settlement with the insurer on the underlying contract claim.[6]

### Louisiana

Louisiana law is based on the Napoleonic Code, which establishes, much like our criminal law, statutes as the

basis for all its civil laws and civil causes of action. In the context of claims handling, "bad-faith," and extra-contractual penalties, one should be cognizant of the following applicable statutes: La. R.S. 22:658 (payment and adjustment of claims); La. R.S. 22:651 (acts not constituting waiver); La. R.S. 22:1214 (Unfair Trade Practices); La. R.S. 22:1220(A) (duty to settle in good faith); and, La. R.S. 22:1220(C) (penalties).

In the recent case of *Urrate v. Argonaut Great Cent. Ins. Co.*, 881 So. 2d 787 (La. Ct. App. 2004), a Louisiana Appellate Court prophetically wrote:

> On September 26-27, 1998, Hurricane Georges made landfall near Biloxi, Mississippi and Brunings [, a seafood restaurant,] was severely damaged by the effects of the hurricane, with part of the building being swept away. At the time, Brunings was insured by two separate insurance policies, a flood policy issued by Omaha Property and Casualty (Omaha) and a commercial policy with property insurance coverage issued by Argonaut. Following the damage to Brunings from the hurricane, Brunings made claims against both insurers. The two policies complimented each other, providing full coverage to Brunings, but not overlapping coverage. Omaha covered damages from flooding and tidal waves. Argonaut excluded damage from flooding and tidal waves. Argonaut assigned adjuster William Moulton (Moulton) to the claim and Omaha assigned adjuster Andra Wilson (Wilson). Moulton believed that the major part of the damage to Brunings was caused by flooding and wave action, which was not covered by the Argonaut policy. He estimated that wind damage to the property, covered by the Argonaut polices was $1,763.80 less the deductible, and $9,591.21 for loss of business for three days while electricity in the area was out. Wilson, likewise, believed that most of the damage to the restaurant was caused by flooding and wave action, covered by the Omaha policy, and approved property loss of $314,493.93, for Replacement Cost Value (RCV) and replacement of inventory of $209,562.43 for (RCV). Brunings contends that Argonaut erred in its determination of covered losses under its policy and filed suit to recover for those additional covered losses.
>
> Following a bench trial, the trial judge ruled that glass breakage was covered by the Argonaut policy and awarded Brunings $35,372.15 based on an estimate for replacement cost of broken windows in the restaurant submitted by Binswanger Glass. The trial court found that Argonaut lacked a good faith defense to liability and awarded penalties of $70,744.32, double the insured loss. The trial court also concluded that Brunings suffered business loss for the last quarter of 1998, following the hurricane, of $80,000 and attributed 25% of that loss to wind damage which was covered by Argonaut and added penalties of $40,000. The trial court also found that Brunings had a business loss of $70,034 in 1999 and attributed 15% of that to covered wind damage, or $10,505 and added penalties of $21,010. . . Based on our review of the whole record in this case, we find no error in the trial court finding that the glass breakage was due to wind force. The record contains evidence of wind speed during the hurricane reaching between 46 and 55 miles per hour. Further, the claims adjusters noted at various times that the damage to Brunings was related to both water and wind. Thus, the broken window losses caused by wind force would be covered by the Argonaut policy and not the Omaha policy. It is also noted that there is no showing in the record that Brunings has been reimbursed for the full amount of its losses from Omaha. . . It was the consensus of the adjusters that the restaurant suffered both wind and water damages. The trial court found that the business loss attributable to wind damage in 1998 and 1999 was 25% and 15%, respectively. A large part of the back of the building was

gone, including the window wall across the back. Other windows in the restaurant were also broken. The roof was damaged and part of it was blown back over itself by wind force. The winds reached the 50 mile per hour range during the storm. Upon review of the record, we conclude that the trial court findings concerning the business losses attributable to wind damage are supported by the record. Although it might not have been the factual finding we would have made, we cannot say, based on the record that it was clearly wrong or manifestly erroneous . . .

The determination of whether Argonaut acted in an arbitrary and capricious manner or in bad faith in its refusal to fairly and quickly settle its insured's claim is a question of fact which will be reviewed on appeal under the manifest error standard of review. . . Considering the whole record in this case, we find that the record supports the trial court determination that Argonaut breached its duty to adjust and pay Brunings' claims fairly and promptly and in doing so acted in an arbitrary and capricious manner, without probable cause. Thus, Argonaut was liable to Brunings for penalties under La. R.S. 22:1220(C).

In assessing penalties against Argonaut, the trial court awarded double the amount due under the insurance policy for two separate breaches, the failure to pay for the glass loss caused by wind force and the failure to fairly pay for the loss of business for 1998 and 1999. However, the trial court did not award actual damages to Brunings resulting from the breach of the insurer's duty to settle the claims in good faith under La. R.S. 22:1220(A). [Citing *Gilpin v. State Farm*, 735 So. 2d 921 (La. App. 5th 1999), the Court restated]: "We hold that the total maximum penalty award, when there is no proof of damages caused by the breach of the insurer's duty to settle claims in good faith under R.S. 22:1220, is $5,000.00."

> Based on this Court's holding in *Gilpin,* and the trial court's failure to find damages due for the breach of the insurer's duty, we find that the two penalty awards for the two separate breaches of the insurer's duty, absent proof of damages caused by the breach, must be reduced from double the insurer's liability to $5,000 each.

Without question, *Urrate* will be cited often for years to come. *See also*, *Hebert v. Hill*, 855 So. 2d 768 (La. App. Ct. 2003) (applying La. R.S. 22:658) and *Gibson v. Allstate Ins. Co.*, 832 So. 2d 1209 (La. App. Ct. 2002) (addressing La. R.S. 22:1220 and 22:658).[7]

In *Gibson,* a Louisiana Appellate Court stated that the determination that an insurer's handling of a claim is "arbitrary and capricious" is a factual finding that may not be disturbed unless manifestly erroneous. The *Gibson* court described an insurer's action as "arbitrary and capricious" when its willful refusal of a claim is not based on a good faith defense or is unreasonable without probable cause. However, where the insurer has legitimate doubts about coverage, the insurer has the right to litigate those questionable claims without being subjected to damages and penalties. In any event, La.R.S. 22:658 "requires that the insurer take some substantive and affirmative step to accumulate the facts that are necessary to evaluate the claim." Thus, if an insurer has questions regarding the validity of a claim, the insurer must nevertheless investigate that claim within the statutory period (*in a catastrophe claim an insurer must initiate this investigation within 30 days of notification pursuant to La. R.S. 22:658(A)(3)*). *See also*, *Maurice v. Prudential Ins. Co.*, 831 So. 2d 381, 388 (La. App. Ct. 2002) ("statutory penalties are inappropriate when the insurer has a reasonable basis to defend the claim and was acting in good-faith reliance on that defense. . . [and] is especially true where there is a reasonable and legitimate question as to the extent and causation of a claim; 'bad-faith' should not be inferred from an insurer's failure to pay within the statutory time limits when such reasonable doubt exist[s]").

In *Calogero v. Safeway Ins. Co. of Louisiana*, 753 So. 2d 170 (La. 2000), the Louisiana Supreme Court stated

than an insurer's actions are "arbitrary and capricious" when a willful refusal to pay is not in good faith, is unreasonable, or is without probable cause. It held that "arbitrary and capricious" actions subject the insurer to liability under two statutes, La.R.S. 22:658 and La.R.S. 22:1220. The Court held that when 22:1220 provides for a greater penalty, it supercedes the penalty provided for in 22:658 so that an insured cannot collect penalties under both statutes. When an insurer is liable under both statutes and a higher penalty is payable under 22.1220, the insurer can still be held liable for the attorney's fees provided for in 22:658 because, unlike the penalties in 22:1220, the penalties and attorney fees in 22:658 are mandatory. *See also, Becnel v. Lafayette Ins. Co.*, 773 So. 2d 247 (La. App. Ct. 2000) (Where the insurer was dissatisfied with the costly recommendation of its first adjuster and hired a second adjuster who recommended only the replacement of 13 shingles, the insurer's decision to ignore the recommendation of its own adjuster was found to be without a good faith explanation and thus arbitrary and capricious.).

In sum, Louisiana case law has a long history of addressing wind and flood claims. Ignorance of such history, both the law and the events, has and will result in repeating the same mistakes. *See, Ebert v. Pacific Nat. Fire Ins. Co.*, 40 So. 2d 40 (La. App. Ct. 1949) (damage by the hurricane of September 19, 1947). Also, the authors note, albeit cynically, as some insureds realize the limitations of their flood insurance, New Orleans will begin to burn. Louisiana does have a Valued Policy Law for fire losses. *See,* La. R.S. 22:695.[8]

### Mississippi

Correctly, Mississippi law holds that "there is no fiduciary relationship or duty between an insurance company and its insured in a first-party insurance contract." *Gorman v. Southeastern Fid. Ins. Co.*, 621 F.Supp. 33, 38 (S.D. Miss. 1985) *aff'd*, 775 F.2d 655 (5th Cir. 1985); *Accord, Tipton, III v. Nationwide Mut. Fire Ins. Co.*, 2003 W.L. 24133045 (S.D. Miss. 2003) ("[A] fiduciary duty does not exist between the agent for the insurer [e.g., independent adjuster] and the insured in first-party insurance contracts");[9] *Bass v. California Life Ins. Co.*, 581 So. 2d 1087, 1090 (Miss. 1991) ("The relationship between an adjuster and the insured is a purely contractual one. The adjuster does not owe the insured a fiduciary duty nor a duty to act in good faith, as the plaintiff claims . . . [Although,] an adjuster has a duty to investigate all relevant information and must make a realistic evaluation of a claim . . . However, an adjuster is not liable for simple negligence in adjusting a claim. [The adjuster] can only incur independent liability when his [or her] conduct constitutes gross negligence, malice, or reckless disregard for the rights of the insured."); and, *Hill v. Giuffrida, Director of FEMA*, 608 F.Supp. 648 (S.D. Miss. 1985) (discussing the duty owed by an adjusting firm that was hired independently by the insurance company for adjustment of an insured's claim). On the other hand, an insurer is liable for the "bad-faith" conduct of its TPAs and IAs. *See,* John J. Pappas, *"An Insurer's Liability For The Bad-Faith Conduct Of Its Third-Party Administrators And Independent Adjusters,"* Mealey's Litigation Report: Insurance Bad-Faith, Vol. 18, #16 (December 12, 2004) ("an insurer cannot shield itself from 'bad-faith' extra-contractual exposures by delegating claims handling to third-parties").

In *Gipson v. Fleet Mortgage Group, Inc.*, 232 F.Supp.2d 691, 699 (S.D. Miss. 2002) the Federal Court, applying Mississippi law, wrote:

> Plaintiff suggests that a jury could find [the insurer] to have acted in bad-faith based on the patent inadequacy of its investigation and adjustment of his claim for benefits, and in support of this assertion offers a lengthy list of acts and/or omissions which he maintains exemplify the gross inadequacy of the company's investigation and handling of his claim.

The Court found, however, each of the assertions were without merit as a matter of law, except the assertion that the insurer acted in complete derogation of its duty in failing to ascertain the circumstances of the air conditioners, including the manner in which they were installed, whether they were in the house when it was purchased and plaintiff's intentions with respect to them. Although arguably negligent, the Court concluded that the failure to have inquired into these matters cannot be said to have amounted to "a willful or malicious wrong, or gross or reckless disregard for [its] insured's rights."

The Mississippi Supreme Court, in *Mississippi Farm Bureau Mut. Ins. Co. v. Todd*, 492 So. 2d 919 (Miss. 1986) addressed the issue of punitive damages against

an insurer. The majority, citing *State Farm and Cas. Co. v. Simpson*, 477 So. 2d 242 (Miss. 1985), opined:

> [T]he standard to be applied in determining whether punitive damages will lie is whether the insurance company had an arguable reason for failing to pay a claim, "and the evidence in each particular case will decide whether a punitive damage instruction must be granted or refused." *See, State Farm Fire and Casualty Co. v. Simpson* at footnote 2.

*Mississippi Farm Bureau* at 932.

Worthy of note is Justice Hawkins' dissenting comments:

> [S]urely an insurance company in a dubious case has a right at any time to raise the question of whether there was an insurable interest without the Damocles sword of bad faith hanging over it by so doing . . . . To hold, as the majority does, that this is a punitive damages case (except on this one narrow issue restricted solely to the Todds) will, I fear, convey to the public that any claim against an insurance company carries with it also a claim for punitive damages. *Id.* at 945-947.

Hopefully Justice Hawkins fears will not become reality.

In *Stewart v. Gulf Guaranty Life Ins. Co.*, 846 So. 2d 192 (Miss. 2002), the Mississippi Supreme Court stated that before punitive damages may be recovered from an insurer, the insured must prove by a preponderance of evidence that the insurer acted with (1) malice *or* (2) gross negligence or reckless disregard for the rights of others. If the insurer had a legitimate or arguable reason to deny payment of the claim, then the trial judge, after reviewing the evidence, should refuse to grant a punitive damage instruction. The *Stewart* Court instructed:

> "Arguably-based denials are generally defined as those which were rendered upon dealing with the disputed claim fairly and in good faith." . . . .These principles, however, are not ironclad . . . Even in the absence of an arguable basis for the denial or breach of a policy claim, submission of the punitive damages issue may not be warranted . . . "Indeed, 'the fact that an insurance company lacks a legitimate or arguable reason for denying a claim *does not automatically lead to the conclusion that the issue of punitive damages should be submitted to the jury.*'". . . Where an arguable reason for denying a claim is absent, the trial court still must determine whether there is a jury issue as to the insurer's having committed a willful or malicious wrong, or acted with gross or reckless disregard for the insured's rights . . . If not, the question of punitive damages should not go to the jury . . . .Conversely, this Court has recognized that the issue of punitive damages may be submitted, notwithstanding the presence of an arguable basis, where there is a question that the mishandling of a claim or the breach of an implied covenant of good faith and fair dealing may have reached the level of an independent tort. (citations omitted).

*Stewart* at 200-201 (*emphasis* in original).

Viewing the evidence in the light most favorable to Stewart, the Mississippi Supreme Court found there was a question of fact for the jury as to whether the insurer acted with, at a minimum, gross negligence or reckless disregard for Stewart's rights. Specifically, the Court held:

> Though Stewart makes arguments in the context of asserting that [the insurer] lacked an arguable reason for denial of his claim, in our view they more aptly demonstrate a breach of an implied covenant of good faith and fair dealing that may have reached the level of an independent tort . . . .
>
> *This Court has held that the denial of a claim without proper investigation may give rise to punitive damages* . . . . Fur-

> thermore, there was evidence presented which would support a conclusion by the jury that [the insurer] attempted to engage in post-claims underwriting in dealing with Stewart's claim. Post-claim underwriting occurs when an insured pays premiums and operates under the assumption he [or she] is insured against a specific risk, only to learn after he [or she] submits a claim that he [or she] is not insured. (citations omitted).

*Id.* at 202-204 (*emphasis* supplied).[10]

Given the obstacles facing insurance claims professionals in the wake of hurricane Katrina, an insurer's "failure" to promptly and fully investigate will be an issue in any subsequent "bad-faith" claim. *Accord, Langston v. Bigelow*, 820 So. 2d 752 (Miss. App. Ct. 2002) (The insurer denied the property insurance claim as a result of storm because it could not find evidence of damage. In granting the insurer's Motion for Summary Judgment on the bad faith count, the court said that punitive damages are not recoverable for breach of contract unless there is an intentional wrong, insult, abuse, or gross negligence. The court found that the evidence showed that the insurer had ample reason to deny the claim so that granting of Summary Judgment was affirmed.); *Sobley v. Southern Natural Gas Company*, 302 F.3d 325 (5th Cir. 2002) (The Court held that the proper way to determine whether the insurer had a legitimate reason for denying coverage was to consider only those exclusions specifically mentioned to the insured as a reason for denial. The insurer cannot rely on an applicable exclusion that was discovered after the claim was denied because the insurer did not consider that exclusion as a basis for denying coverage.); and, *Hans Construction Co., Inc. v. Phoenix Assurance Co. of New York*, 995 F.2d 53 (5th Cir. 1993) (In light of *Universal Life Ins. Co. v. Veasley*, 610 So. 2d 290 (Miss. 1992), Mississippi will allow extra-contractual damages for failure to pay on an insurance policy only when there is *no arguable reason* for such failure. An "arguable reason" shields the insurance company from liability for both punitive damages and extra-contractual damages.).

## Preparation And Prevention

The specific first-party and third-party coverage issues that Katrina creates will be a long and developing list. There will be disputed issues of causation,[11] concurrent-causation,[12] anti-concurrent-causation policy language,[13] "efficient-proximate cause,"[14] flood vs. wind,[15] mold,[16] contaminants, pollutants, order of civil authority, law and ordinance, insurrection, arson, contingent liability, off-premises coverage, application of deductibles, other insurance clauses, co-insurance penalties, "period of restoration" for business interruption claims, the measure of business interruption loss, actual cash value vs. replacement cost, the application of the Valued Policy Law, vandalism and vacancy,[17] demands for appraisal,[18] demands for policy limits,[19] denial letters, demands for mediation, and, of course, the inevitable litigation and "bad-faith" claims.[20] Each claims professional, field adjuster, supervisor, manager, director, Vice President of Claims, and, in fact, CFO and CEO, will be required to swiftly identify, analyze, and decide — while literally standing in a cesspool of decay and devastation.

Notwithstanding, as unfair as it might be, we must accept the fact that four years from now, while sitting in an air-conditioned courtroom *(no doubt completely rebuilt and refurbished with Federal tax dollars)*,[21] neither the local judge nor local jury *(all of whom suffered severely from Katrina)* are going to empathize with any insurer or claims professional who did not handle the subject plaintiff's claim swiftly or with sufficient funds. A battery of questions will surface. *You took how many months to adjust Mrs. Thomas' claim? How long did it take you to inspect the insured's premises? How long did it take you to advance any additional living expenses to Mrs. Thomas and her two children?*[22] *And you only paid Mrs. Thomas how much money?*

Every insurer who is presently organizing, training, deploying and supervising CAT Teams must now dedicate sufficient talent and resources necessary to eliminate, or at least mitigate, the inevitable extra-contractual tail that is sure to come. Each and every insurer and insurance claims professional *presently* has an opportunity to be proud of its, his, or her contributions and actually look forward to sharing their side of the Katrina story in response to the unavoidable litigation that shall result. Now is the time to ensure that you have the story you will be proud to share.[23]

Of course, in order to have such a story, you must be sure not just to comply with the laws, your own

insurance policy, and all applicable Codes of Ethics,[24] but also you must be able, four years from now, to convey such a story to judge and jury in such a way that these judges and jurors in Alabama, Louisiana, and Mississippi are at least willing to listen. The essentials to even be given the opportunity to be heard are as follows:

(1) **Delay.** Each day the "tennis ball" is on the insurance company's side of the net is not a good day. Under the unique circumstances of this unimaginable catastrophe, such may not be fair, but we can assure you, four years from now while defending yourself in a "bad-faith" lawsuit before judge and jury in New Orleans, Biloxi, or Mobile, you will be called upon to account for each and every day the "tennis ball" was on your side of the net. Either it was simply impossible to move the "tennis-ball," which under present circumstances no doubt accounts for much of the present delay, or it is reasonable in waiting for further information from the insured or some other third-party before the insurer must decide upon a claim or make additional insurance payments. However, an insurer or insurance claims professional whose testimony is that delay or the "tennis ball" was on its side of the net simply because it, he, or she could not get to it, is not the story you wish to tell. Certainly any insurer whose employees, adjusters, independent adjusters, third-party administrators, managers, directors, or Vice Presidents will testify in such a "bad-faith" trial that the reason why he or she couldn't get to Mrs. Thomas' property, couldn't reach a decision on Mrs. Thomas' claim, couldn't issue a payment for additional living expenses for Mrs. Thomas and her two children for eight months was because they simply did not have the resources to do so, we can assure you, will not be a "story" your multi-billion dollar insurance company will wish to tell.

(2) **Communication.** Clear, accurate, truthful, knowledgeable and competent communication *within* the insurance company and its representatives, and, more importantly, *without* the insurance company, specifically with the insured and its, his, or her representatives, including public adjusters, is vital. It is vital to ensure that you shall have a "story" that not only you are not ashamed to tell, but that you, in fact, enthusiastically and proudly tell and, hopefully, corroborate. Miscommunication and false representations, whether intentional or not, are the fuel by which all extra-contractual claims are fed.

(3) **Document.** No doubt, while wading in four feet of sewage, gasoline, and debris (and other unmentionables) as the Southern sun beats down upon you and the mosquitos bite, documenting your claim files will be difficult. Nevertheless, unless you want the extra-contractual tail of Katrina to match the indemnification dollars, *document* you must. Especially document the location of the "tennis-ball." *On whose side of the net is it on today? Why is it on our side? What can we do to get it moving productively toward a swift and just resolution of the claim?* Especially document all oral communications with the insured, the insured's representatives, including the insured's public adjusters and/or attorneys. Be detailed and accurate when memorializing commentary. Do not be pejorative or judgmental. Be declarative and factual. Without such documentation, there will be gaps. Your "story" in the bad-faith trial will lack corroboration and appear incomplete. Absent detailed documentation, we can assure you the benefit of the doubt will fall firmly in favor of the victim — which, notwithstanding your great efforts, will be the insured.

(4) **Triage.** The CAT Team must identify losses and claims that have a greater likelihood of resulting in litigation along with the commensurate increase in exposure to extra-contractual liability. Those so identified will require *different*, not necessarily more, attention. At any rate, the identified claims will demand more than normal documentation, and, unfortunately, *legal oversight*. Those insurers who accurately triage, and, thus assemble the right team in place for each claim, shall unequivocally be in a much better position to share an accurate "story" with the judge and jury in defense of the inevitable "bad-faith" claim. The story should not be fictitious. Rather, the story should be real, truthful, accurate, and, most importantly,

corroborated within the claim file, the correspondence, and other documentation. It is a shame that under these catastrophic conditions an insurer and its personnel must concern itself with such an allocation of talent and resources, but, unfortunately, failure to document can trigger unnecessary risk as well as leave the insurer exposed to substantial and wholly unwarranted "extra-contractual" claims.

(5) **Educate.** An insurer must constantly educate its CAT Team, including its independent adjusters and third-party administrators, not only about the laws of Alabama, Louisiana, and Mississippi, but also, and even more importantly, about the particular insurance company's demands from its own employees and representatives. Each insurer has its own culture, *standards*, (both written and unwritten), and guidelines for the just and fair treatment of its insureds and members. These policies, standards, and guidelines must be communicated to each and every adjuster involved in the investigation and the adjustment of the claims (*even more so for those who are not employees, such as independent adjusters and third-party administrators*). Note, this is not a prescription for rhetoric, but rather, for actual substantive conduct and belief. The insurer's conduct and tone must evidence its belief and demands – otherwise, mere rhetoric, without more, will be unmasked. If unmasked, form over substance will be recognized. If recognized, the falsified beliefs and demands will be counterproductive to any defense when exposed to extra-contractual liability.

## Tomorrow's Judges And Jurors

There is much work to be done and much more to be said — which no doubt will be done and said in the upcoming months and years. But one thing each and every insurer and claims professional should keep in mind, especially those Vice Presidents, CFO's, CEO's, and Boards of Directors, who are in charge of the purse strings and the vast talent pool and resources that such allows, is that the insured(s) you communicate with in Alabama, Louisiana, and Mississippi will be your judges and jurors of tomorrow. As you read this article, you are presently communicating with those who will judge you tomorrow. What mark and memory you presently make upon such judges and jurors will determine the mark and memory they make upon you in the years to come.

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## Endnotes

1. The word "catastrophe" is a derivation of the Greek word "katastrophe" meaning any great and sudden calamity, disaster, or misfortune. Katrina certainly constitutes a "katastrophe," and we recommend no future hurricane be given a name beginning with the letters "K-A-T," which should preclude such names as "Kathleen" or "Kathren."

2. "It was not a normal hurricane, and the normal disaster relief system was not equal to it." — President George W. Bush, September 15, 2005.

3. John J. Pappas, *Willful and Wanton*, Mealey's Litigation Report: Insurance Bad-Faith, Vol. 19, #6 (July 19, 2005) ("[W]hether the language used is 'fairly debatable,' 'reasonable justification,' 'unfounded and frivolous,' 'reckless disregard,' or 'willful and wanton,' these semantical constructs require *'knowing intent.'*").

4. As a claims handling practice point, you should note the *Slade* Court also found that the term "dwelling" in the policy was ambiguous, the earth-movement exclusion was not, and an insured's "reasonable" expectations cannot be "reasonable" if in conflict with the unambiguous terms of the insurance contract.

5. John J. Pappas, *"The Duty to Investigate And Disclose,"* Mealey's Litigation Report: Insurance Bad-Faith, Vol. 15, #6 (July 18, 2001) ("an insurer who refuses to investigate or disclose better have cogent justification"). *See, Phillip Rosamond Drilling Co., Inc. v. St. Paul Fire & Marine Ins. Co.*, 305 So. 2d 630 (La. App. Ct. 1974) (without consultation with expert was arbitrary and capricious).

6. John J. Pappas, *Bifurcating Bad-Faith*, Mealey's Litigation Report: Insurance Bad-Faith, Vol. 19, #2 (May 17, 2005) ("it is folly not to immediately bifurcate and stay the 'bad-faith' case until the coverage case is fully and finally resolved").

7. *Compare, Southern Hotels Limited Partnership v. Lloyd's Underwriters at London Companies*, 1997 WL 325972, *6 (E.D. La. 1997)(In a diversity case following Hurricane Andrew, the District Court, noting general rules for assessing and quantifying property damages, articulated: "The plaintiff has the burden of proving both the damage and the causal connection between the damage and the covered loss. This proof must be shown by a preponderance of the evidence, and with some detail and specificity. A mere possibility of causation and damage are insufficient . . . 'In fixing the amount of damages due to a plaintiff, [if any], a trier-of-fact is given much discretion, which will only be disturbed if there is an abuse of discretion.'")(citations omitted); and, *Loyola University v. Sun Underwriters Ins. Co. of New York*, 93 F.Supp. 186, 190 (E.D. La. 1950)(While acknowledging it is plaintiff's burden to establish the facts necessary to support relief, the court stated: "These facts may be established by direct and circumstantial evidence and the opinions of expert and skilled witnesses.").

8. Note, there is an issue as to whether the Valued Policy Law applies only to loss due to fire or only to fire policies.

9. Lee Craig, *Why A First Party Insurer Is Not A Fiduciary*, Mealey's Litigation Report: Insurance Bad-Faith, Vol. 13, #14 (November 16, 1999) (a first-party contract creates a debtor-creditor relationship not a fiduciary relationship); *But* see, *Gourley v. Prudential Property and Cas. Ins. Co.*, 734 So. 2d 940 (La. App. Ct. 1997) (the statute codified law arising from a fiduciary relationship).

10. John J. Pappas and John V. Garaffa, *Piece Of Mind: The Utah Supreme Court's Response to Campbell*, Mealey's Litigation Report: Insurance Bad-Faith, Vol. 18, #18 (January 18, 2005) (some courts use semantical gymnastics to justify large punitive damage awards in light of *Campbell* constraints).

11. *See, Milton v. Main Mut. Ins. Co. of Ill.*, 261 So. 2d 723, 725 (La. App. Ct. 1972) ("direct result" and "direct loss" in windstorm insurance policies are interpreted essentially the same as "proximate cause" in negligent cases).

12. *See, Loyola University v. Sun Underwriters Ins. Co. of New York* at 190 ("If the cause of the damage or destruction [is] not the direct result of the wind alone, but the damage or destruction [is] caused by a combination of wind and water, and the damage by either cannot be separated, then, there can be no recovery under the burden of proving the cause of the damage, and if it fails to make that proof, it cannot recover.").

13. *See, Burke v. Foremost Insurance Company*, 2004 WL 3152179, *4 (Mass. Supp. 2004)("Anti-concurrent causation provisions have appeared in recent years in response to the concurrent causation doctrine under which some courts have found that insurers are obligated to pay for damages resulting from a combination of covered and excluded perils, if the efficient proximate cause is a covered peril... 'Anti-concurrent causation provisions in insurance contracts avoid application of the doctrine by expressly stating that a loss is excluded from coverage if it results from a combination of covered and excluded perils.'")(citations omitted); *Preferred Mutual Insurance Co. v. Meggison*, 53 F.Supp.2d 139, 142 (Mass. Dist. Ct. 1999) (stating the "vast majority of states" uphold anti-concurrent causation clauses); *Dahlke v. Home Owners Insurance Company*, 2003 WL 23018291, *3 (Mich. Ct. App. 2003)("The language of the exclusion is typically referred to as 'anti-concurrent causation' because it expressly excludes coverage for losses directly or indirectly caused in whole or in part by one of the listed causes of loss. As applied in this case, the 'anti-concurrent causation' language of the policy excludes coverage for damages resulting from mold even though the mold itself may have formed as the result of a covered event."); and, *Boteler v. State Farm Casualty Insurance Company*, 876 So. 2d 1067 (Miss. Ct. App. 2004)(denying coverage based on an earth movement exclusion in the policy).

14. *Compare, Lorio v. Aetna Insurance Company*, 232 So. 2d 490 (La. 1970)(denying coverage for a horse that died as a result of overeating wheat and stating hurricane Betsy was too remote to be the efficient cause of the loss).

15. *See, Riche v. State Farm Fire and Cas. Co.*, 356 So. 2d 101 (La. App. Ct. 1978) (finding damage caused by windstorm (or resulting waves) over a body of water, such as a lake or a reservoir, does not come within the scope of flood exclusion).

16. John J. Pappas and Charles E. Reynolds, *Mold, Mildew and Marco*, Mealey's Litigation Report: Insurance Bad-Faith, Vol. 16, #4 (June 19, 2002) ("once the potential for mold proliferation has been recognized, which today is simply any water damage claim, a question arises as to the existence of any possible duties to warn the insured").

17. *See, Mintz v. Jefferson Ins. Co. of New York*, 537 So. 2d 1241 (La. App. Ct. 1989) (fire during vacancy excluded from coverage).

18. John J. Pappas and Matthew W. Peaire, *Appraising Windstorm Claims*, Mealey's Litigation Report: Insurance Bad-Faith, Vol. 17, #4 (June 18, 2003) ("if appraisal cannot be avoided and a property insurer wants to be heard on coverage (causation) issues, it better appoint an appraiser who is persuasive in making such arguments to the umpire").

19. *See, Sanders v. Int'l Indem. Co.*, 708 So. 2d 772 (La. App. Ct. 1998) (insurers can avoid "bad-faith" penalties and attorney fees by timely paying undisputed amounts that are reasonably determined).

20. "Even with the full extent of the losses caused by Hurricane Katrina still unknown, a battle over what insurance companies will cover is taking shape around one pivotal question: How much of the damage was due to strong winds and how much due to flooding? . . . For insurers, the answer could mean a difference of billions of dollars in liabilities." — Jennifer Bayot, The New York Times, September 8, 2005.

21. "To carry out the first stages of the relief effort and begin the rebuilding at once, I have asked for, and the Congress has provided, more than $60 billion. This is an unprecedented response to an unprecedented crises, which demonstrates the compassion and resolve of our nation . . . . In the life of this nation, we have often been reminded that nature is an awesome force and that all life is fragile. We are the heirs of men and women who lived through those first terrible winters at Jamestown and Plymouth, who rebuilt Chicago after a great fire, and San Francisco after a great earthquake, who reclaimed the prairie from the dust bowl of the 1930s . . . . Every time, the people of this land have come back from fire, flood, and storm to build anew and to build better than what we had before. Americans have never left our destiny to the whims of nature, and we will not start now." — President George W. Bush, September 15, 2005.

22. *See, Broussard v. Nat'l Union Fire Ins. Co. of La.*, 653 So. 2d 816, 817 (La. App. Ct. 1995) ("Mrs. Broussard and her four children could not live in their home from August 25, 1992 until January 31, 1993").

23. John J. Pappas, *Institutional Bad-Faith: The Exponential Exposure Of Portability And The Mother Standard,"* Mealey's Litigation Report: Insurance Bad-Faith, Vol. 16, #8 (August 21, 2002) ("have a story to tell, and be prepared to tell it").

24. *See,* Michael Sean Quinn, *"The Ethical Habitat of Adjusters: Part 2. Principles, Problems, and Practicalities,* Environmental Claims Journal, Vol. 10, No. 3 (Spring 1998) (the Chartered Property Casualty Underwriters (CPCU) examines its candidates on their "Code of Professional Ethics"). ■