


Contracts Under Pressure

A Look at Insurance Liability
Issues after Hurricane *Katrina*

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Outline

- Definition of Terms
 - Flood Exclusion
 - Valued Policy Provision
 - How Contract Law Differs from Tort
 - Mississippi AG Hood's Case
 - Mr. Scruggs Led Class Action
 - Likely Outcome?
- 

Terms: Flood Exclusion

“Losses Not Insured

1. We [the insurance company] do not insure under any coverage for any loss which would not have occurred in the absence of one or more of the following excluded events. We do not insure for such loss regardless of: (a) the cause of the excluded event; or (b) other causes of the loss; or (c) whether other causes acted concurrently or in any sequence with the excluded event to produce the loss; or (d) whether the event occurs suddenly or gradually, involves isolated or widespread damage, arises from natural or external forces, or occurs as a result of any combination of these:

...

- c. **Water Damage**, meaning:
- (1) flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, all whether driven by wind or not;...”

Terms: Valued Policy Provision

- If a dwelling is a total loss, the insurer must pay the stated policy value of the dwelling.
- Insurers believe the VPP law to mean insurers are responsible for a total loss on a covered property only for the amount of damage caused by something their policies covered.
 - For example, if wind is twenty percent responsible for destroying a home and flooding caused the remainder of the damage, then insurers pay claims for just the twenty percent portion of home's value.
- In Florida, the 4th DCA* held in a case like the example above, the homeowner's insurance carrier was responsible for the value of the home even if the loss causing the condemnation of the house was excluded.

* *Mierzwa v. Fla. Windstorm Underwriting Assn*, 877 So. 2d 774 , (Fla. 4th DCA., June 23, 2004)

Contract v. Tort

- Contracts are arranged **prior** to an event to allocate **future** risk between parties.
- Tort law allocates risk after the fact to parties that generally have no previous contractual relationship.
- Court decisions which change expectations about *a priori* risk allocation or *ex ante* duties can upset markets, but we generally do not like them for either tort or contract.

Contract

- Terms provides expectations about behavior.
- Price (or premium collected) for service depends upon these terms
- However, insurance contracts are often treated “specially.”
 - Policy holder expectations
 - Ambiguity is solved by providing coverage.
 - But exclusionary contract language was approved by the State of Mississippi and most other states too.
- Insurance policy language is a result of a litigation and regulatory processes, it is not part of a spur of the moment contract.
- Mississippi like many other states approves both the policy language and the underlying pricing assumptions of the contract.

Outline of AG Hood's Lawsuit

➤ Violation of Public Policy

- Exclusions are void as against public policy
- Exclusions violate Mississippi's common law which he believes says that losses should be covered if "proximate cause" of loss is covered even if other causes are not.
- This sounds like VPP.

➤ Exclusion is unconscionable because the contracts are

- unreasonably complex,
- are not subject to negotiation,
- "and are unreasonably favorable to insurers and oppressive to the policy holder and bear no reasonable relationship to the risk and needs of the insurers. ."

AG Hood's Lawsuit (*Part II*)

- Water damage exclusion is ambiguous.
 - When read in conjunction with other clauses
 - And expressly contradict other clauses
- Violates MS Consumer Protection Act
 - Exclusion of coverage is an unfair deceptive trade practice
- Irreparable Injury
 - Insurers “purportedly” provided coverage in past that they are now denying to Katrina’s victims.
 - Property-owners are suffering and the suffering will be greater unless the court acts to stop the insurer’s practices.
 - Insurers are also requiring policy-owners to waive rights.

Other Potential Suits

- To early to tell what exactly Mr. Scruggs' theory will be
 - Deception
 - Valued Policy Provision (like Florida's)
 - Both Mississippi and Louisiana have VPP type provisions in their law.

What is Likely Result?

- AG looking for other help...
- Rep. Taylor's *Ex Post* Flood Insurance Proposal.
- But if the AG wins what are the likely effects?
(Note: this is not a worst case scenario)
 - Insurance industry will stop in its tracks temporarily
 - Possibly some insurer bankruptcies
 - Massive short to intermediate term availability problems
 - Massive short to intermediate term insurance pricing problems
 - Potential contagion to other states/other lines
 - Call for greater regulation and possible Federal intervention.