

THE WALL STREET JOURNAL.

Paying for Flood Damage Looms as Big Challenge **Many in Gulf Coast Region Had Little or No Insurance; A New Compensation Fund?**

By: Theo Francis in Tampa, Fla., John D. McKinnon in Washington, and Peter Sanders in Mobile, Ala. -- Staff Reporters of The Wall Street Journal
September 8, 2005

As the cleanup from Hurricane Katrina begins, a big fight could be brewing among insurers, policyholders, lawyers and regulators over who will shoulder the enormous cost of damage to thousands of homes.

Most homeowners in the hardest-hit Gulf Coast states lacked any flood insurance at all, even in flood-prone neighborhoods. Standard homeowners' policies exclude flood coverage, which generally must be bought from the federal government and is capped at \$250,000. Katrina also sent flood waters deep into areas that hadn't flooded before, in which many homeowners thought they didn't need coverage.

Consequently, many who lost their homes in devastated areas -- including much of New Orleans and large chunks of Biloxi, Pascagoula and Gulfport, Miss. -- could find themselves without any insurance proceeds to help rebuild demolished homes and businesses.

Yesterday, insurance commissioners from the Gulf Coast states met in Atlanta to assess the challenges, while some civil-rights groups and others suggested creating a victim-compensation fund, similar to one established after the Sept. 11, 2001, terrorist attacks.

Intensifying the emerging debate will be the sheer logistical challenge of assessing hundreds of thousands of ruined structures. That process is certain to stir up a series of thorny questions, such as whether flood or wind -- which is covered under many homeowners' policies -- caused damage to homes. Determining whether wind-driven rain or rising floodwaters caused damage can be tricky, especially in areas that suffered both.

Though home-insurance providers face little or no exposure to flood damage, some are calling for them to step in, given the widespread, costly scale of damage. Among them is Richard Scruggs, a well-known class-action attorney who made his name suing the tobacco and asbestos industries -- and whose own beachfront house in Mississippi, which had flood insurance, was partly destroyed by Katrina.

Mr. Scruggs said he plans to urge Mississippi Attorney General Jim Hood to try to override flood-exclusion clauses in homeowners' policies in that state in the interest of public policy, a move that could force insurers to pay many billions more toward

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rebuilding costs. Through a spokesman, Mr. Hood said: "I'm reviewing these contracts to determine if there are unconscionable provisions."

Insurers are likely to resist any such effort, though a fight could be a costly public-relations nightmare. Industry officials argue that they can't afford to take on flood risks because they haven't been paid to do so.

"Where does that money come from?" said Allstate Corp. spokesman Mike Trevino. "We didn't collect any premiums that contemplated flood as an exposure that we would have to cover."

Said Stephen Cozen, a Philadelphia attorney whose firm does extensive work for the insurance industry: "This is not a public-policy issue. This is simply an insuring agreement between two parties in plain English where there's plenty of notice."

So far, estimates for Katrina's damage top \$100 billion, with private-sector property-casualty insurers expected to pay anywhere from \$14 billion to \$35 billion of that. At the high end, that would make the hurricane the nation's costliest natural disaster, topping Hurricane Andrew in 1992 by more than 50% in dollars adjusted for inflation. Still, \$35 billion is a manageable amount for an industry that has had several profitable years and currently has more than \$400 billion in assets to cover claims nationwide.

For homeowners, anxiety over flood exclusions is mounting as they return to their neighborhoods.

"I know when I file a claim, the insurance company is going to say the house was destroyed by flood," said Wayne Woodall, a 49-year-old lawyer whose 6,000-square-foot house in Gulfport was reduced to scattered bricks by Katrina. Just yards from the sea, his property wasn't covered by a separate flood-insurance policy.

"A neighbor down the street saw our roof and furniture flying by his house long before the deluge, so I know it was the wind that knocked the place down," he said.

In nearby Pascagoula, Melanie Bosarge last week saw her condominium, in a development called Spinnaker Point, badly damaged. "Everybody is insured to the hilt here, but nobody has flood insurance," she said, looking up at the almost intact second story of her home, which was perched high on stilts above a gutted first story.

In their meeting yesterday, regulators from Louisiana, Mississippi and Alabama huddled with more than 200 insurance-industry representatives in an effort to head off potential problems and ensure that claims are handled efficiently and uniformly. Among other things, they said they had reached a tentative agreement to prevent cancellation of policies for displaced customers who don't pay their bills on time.

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The parties reached no conclusions about whether insurers might pay for some flood damage, Louisiana Insurance Commissioner J. Robert Wooley said by phone from Atlanta. He called the industry's "level of cooperation and interest" unprecedented, with many insurers writing checks for policyholders' temporary living expenses even without clear damage reports.

He also drew parallels to the aftermath of the 2001 terrorist attacks, when insurers didn't try to exclude claims as acts of war. "Whether that is going to translate into payments above and beyond the contract, I don't know," he said.

Since at least the mid-1900s, insurers generally have refused to insure against flood damage. They argue that only property owners most at risk buy the coverage, and that damage is so devastating when floodwaters rise that it is too costly for the private sector. In 1968, the federal government established the National Flood Insurance Program.

In some cases, vague policy language may allow property owners to argue that flooding in New Orleans was caused not by rising water itself; for instance, some New Orleans policy owners could argue that the ultimate cause of damage wasn't flooding, but breaches of the city's levees from other causes. That arguably might be covered under some policies, said Finley Harckham, a partner at law firm Anderson, Kill & Olick PC, which primarily represents policyholders.

In cases in which there is both wind damage and flooding, homeowners who lack the specialized federal coverage might face challenges from insurers over how much they will pay, insurance-industry attorneys said. "It will be an expert-driven process, on a case-by-case basis," said Mark J. Bunim, Director of Risk Management for Fortress Global Investigations & Security Corp. in New York and a former insurance attorney.

In all, the combination of widespread flooding and wind damage "creates an enormous gray area, which provides the insurance companies with an opportunity to delay or deny coverage, and it's going to create a battleground for lawyers for years to come," said Mr. Harckham.

Some civil-rights groups and others say a victim-compensation fund is the best solution, despite big differences from the 9/11 attacks. With the 9/11 fund, about 98.5% of eligible plaintiffs elected to take a payout rather than sue the airlines and security firms. In return, they received an average of about \$2 million with minimal delay.

Marc Moller, chairman of the plaintiffs' executive committee for the 9/11 compensation fund, endorsed the concept. "The disastrous initial response to the Katrina situation by the federal government itself is a reason for the federal government to step in on an individual basis," said Mr. Moller, of Kreindler & Kreindler LLP.

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He said he generally opposes compensation funds when there's a viable litigation alternative. But in this case, he said, there's little chance that victims of Katrina can successfully sue the government because of protection offered by the legal doctrine of sovereign immunity.

Kenneth Feinberg, the lawyer and mediator who ran the 9/11 compensation fund, pointed out significant differences between the terrorist attacks and the hurricane, including the fact that the attacks left both the airline and insurance industries exposed to potentially devastating losses. Still, he said: "From the perspective of the nation, I think there's ...no convincing difference between the victims."

Source: Wall Street Journal