

**JUDICIAL REDRAFTING OF CONTRACTS:  
A “LEVEE” ON INSURANCE**

by

Randy J. Maniloff

*White and Williams, LLP*

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## **ABOUT THE AUTHOR**

**Randy J. Maniloff** is a Partner in the Business Insurance Practice Group at the law firm White and Williams, LLP in Philadelphia. He concentrates his practice in the representation of insurers in coverage disputes over primary and excess policy obligations for various types of claims. Mr. Maniloff writes frequently on insurance coverage topics for a variety of industry publications and his views on such issues have been quoted by numerous media, including *The Wall Street Journal*, *The New York Times*, *USA Today*, *Associated Press*, *Dow Jones Newswires* and *The National Law Journal*. The views expressed herein are solely those of the author and are not necessarily those of his firm or its clients.

# **JUDICIAL REDRAFTING OF CONTRACTS: A *LEVEE* ON INSURANCE**

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## **INTRODUCTION**

In a typical dispute between an insurance company and its policyholder over the availability of coverage, the insurer is about a seven-point underdog. That's not to say that the policyholder always has a better chance of winning because it is taking the more correct position. Rather, it is simply a recognition that, for various reasons, the insurance litigation playing field is tilted in its favor.

For starters – the most obvious: insurance companies are not viewed sympathetically by jurors. Of course, it is always dangerous to make sweeping generalizations, especially about something as diverse as the jury system and an industry as enormous as insurance. Not to mention doing so in the absence of any empirical evidence. But this may be one time when it is safe to stereotype. Indeed, despite the size of the industry, *Fortune* magazine's 2007 list of the top 20 most admired companies included only one insurer,<sup>1</sup> and a quasi one at that – Berkshire Hathaway (whose holdings include General Re, GEICO Auto and a few other insurance assets, but has many more

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<sup>1</sup>Available at <http://money.cnn.com/magazines/fortune/mostadmired/2007/index.html/>.

non-insurance companies in its portfolio).<sup>2</sup> It is so easy to generalize about the public's dislike for the insurance industry that, as GEICO's ads posit, even a caveman can do it.

Even if an insurance company were included in the *Fortune* list, or several for that matter, it is doubtful that it would change the public's view of the industry. Perception here is definitely reality. And while only a very small percentage of coverage disputes ever reach *voir dire*, the risk of jury bias no doubt plays a part in decisions by insurers to settle.

Next, insurers are perceived as better able to withstand the financial consequences of the decision on coverage. Here too, perception is reality – but this time legitimately so. A single decision in favor of coverage is unlikely to register even the slightest adverse blip on the insurer's income statement. On the other hand, a decision denying coverage could have devastating, even ruinous, financial consequences for the policyholder, not to mention the injured party in need of compensation. This dynamic is surely understood by courts and juries.

Third, many coverage disagreements involve the application of undisputed facts to policy language, often making them suitable for decision by Summary Judgment. In such a process, many courts apply the rule that if the insurance policy language is ambiguous, it is construed against the insurer as the drafter. Translation: insurer loses. Given the complex nature of insurance policies, the relative ease for lawyers to find two meanings, *at a minimum*, in any writing, and the inherently subjective nature of whether policy language is ambiguous, it can be easy for a court to quickly blow the whistle and declare the policyholder the winner by playing the ambiguity card.

For these reasons, while insurance litigation has its own version of the “Any Given Sunday” rule, and insurers still manage to win their share of cases, the fact remains that

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<sup>2</sup>See <http://www.berkshirehathaway.com/sqbs/sublinks.html>.  
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insurance companies pay plenty of claims that they did not believe were intended to be covered. While it causes consternation when it occurs, it does not cause shock. No matter how much time insurers spend agonizing over their policy language, in an attempt to achieve just the right balance between the extent of coverage afforded in exchange for the premium received, they are going to pay claims for which they do not believe that they received any remuneration. It is simply an inherent part of the business.

## **I. INSURANCE COVERAGE AND LEGAL GYMNASTICS**

Paying some uncovered claims may be a cost of doing business for insurers. But what insurers do not bargain for is having their policy language completely ignored in an effort by courts and legislators to ameliorate a large-scale problem by placing the bill for it in front of the insurance industry. Insurance companies and their policyholders are supposed to “go Dutch” (i.e. share) in the risk-sharing relationship. But sometimes the insurance industry finds itself being forced to pay more than its share to resolve a massive problem – not because they agreed to do so, but because they can.

And when this occurs, no amount of care in the drafting of policy language could have prevented it. While the outcome is portrayed as being within the confines of the policy language – it must be to maintain the appearance of legitimacy in the process – it is in fact a significant stretch of the language. It seems like some courts are bending so far backward to find coverage that they resemble *Cirque du Soleil* performers.

The latest example of the insurance industry being forced to play the role of unintended social safety net is the coverage litigation surrounding Hurricane Katrina. Despite government-approved flood exclusions in their homeowners policies, insurance commissioner warnings that such policies do not cover flood and the availability of flood

insurance specifically designed to fill this coverage void, it still was not enough to prevent courts and politicians from finding means to saddle the insurance industry with financial responsibility for property damage caused by Katrina's massive flooding. Never mind that the insurance industry paid over \$40 billion in Katrina claims.<sup>3</sup> When insurers' application of their flood exclusions still left many policyholders underinsured, courts and politicians pounded away with Category-5 force to eliminate such an exclusion.

Because they are so recent, Katrina coverage claims are the easiest example to cite of insurers' being too attractive to ignore when large amounts of money will go a long way toward solving a wide-scale incident of bodily injury or property damage. But it is certainly not the first time that the insurance industry has seen its policy language subject to contortion, or its right to assert coverage defenses met with political pressure, in an effort to prevent its capital from sitting on the sidelines when it is badly needed. Other examples abound.

When the asbestos litigation crisis hit, courts adopted the so-called "continuous trigger" to significantly maximize the insurance industry's share of the problem. This was accomplished by devising a method whereby *all* insurance policies in effect from the date of a plaintiff's first exposure to asbestos to the date of discovery of an asbestos-caused disease, are obligated to provide coverage<sup>4</sup> – hence the name "continuous trigger." In other words, even if such exposure was only to a single asbestos fiber, taking place 40 years before a person is diagnosed with an illness, 40 years worth of insurance policies are

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<sup>3</sup>"III's Dr. Robert Hartwig to Testify Before House Financial Services Committee on Katrina-Related Insurance Issues," Joint Statement of Various Insurance Trade Associations, February 26, 2007, available at [http://www.insurancenewsnet.com/print.asp?a=top\\_pc&id=76391](http://www.insurancenewsnet.com/print.asp?a=top_pc&id=76391).

<sup>4</sup>See *Keene Corporation v. Insurance Company of North America, et al.*, 667 F.2d 1034 (D.C. App. 1981).

financially liable. As a result of this nifty trick (a legal fiction if there ever was one<sup>5</sup>), the insurance industry's financial exposure for asbestos liabilities has been countless billions of dollars more than its policies were ever meant to provide. And needless to say, the easy availability of such huge amounts of insurance dollars is what fueled the fraud that is now so well-known to have surrounded asbestos litigation.

And when environmental claims involving CERCLA/Superfund came along, there was the continuous trigger again. This time courts concluded that *all* insurance policies in effect from the first date that a defendant contaminated the environment – with even a drop of hazardous material – to the date of discovery of property damage, are obligated to provide coverage. Here too, dozens of years of insurance policies are often-times financially exposed. The result, just as with asbestos, is the insurance industry's slice of the pie being significantly more than what was ever intended.

The insurance industry was lauded for not invoking the “war risk” exclusion following September 11<sup>th</sup>. Many would say that the accolades were unjustified since the exclusion had no applicability anyway. However, the insurance industry was never even given a chance to adequately analyze the exclusion's applicability or test it in court.

Less than one week after the attacks, Congressman Michael Oxley (R-Ohio), Chairman of the Financial Services Committee of the U.S. House of Representatives, sent a letter to the National Association of Insurance Commissioners asking for confirmation that insurers would not invoke the “war risk” exclusion to deny coverage. The Congressman's September 17<sup>th</sup> letter stated, in part: “Any attempt to evade coverage

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<sup>5</sup>There is no doubt that the continuous trigger is a fiction, which some courts readily admitted: “[T]he construction of policy terms in the context of long-term exposure, delayed manifestation cases is somewhat of a fiction[.]” *GenCorp Inc. v. AIU Insurance Company*, 104 F. Supp. 2d 740, 745 (N.D. Ohio

obligations by either primary insurers or reinsurers based on such legal maneuvering would not only be unsupportable and unpatriotic—it would tear at the faith of the American people in the insurance industry.”

Most commentators immediately pointed to *Pan American World Airways v. Aetna Casualty and Surety Co.*, 505 F.2d 989 (2d Cir. 1974) to support their conclusion that the “war risk” exclusion was inapplicable to September 11<sup>th</sup> claims. Yet, while the insurance industry faced pressure to take a position on the “war risk” exclusion within literally hours of the attacks, it took four years for the decision to be made in *Pan Am*.

Ironically, when the question of coverage for asbestos claims arose, it was acknowledged that the judicial decisions were being made to accommodate policies that had been outgrown: “[T]he policies were internally *unambiguous* when viewed through the lens of original expectations and the scheme the parties believed they were creating. In hindsight, however, the policies now reveal the fact that, at the time of the early policy agreements, neither party contemplated their future encounter with long-term exposure and delayed manifestation injury claims.” *GenCorp Inc. v. AIU Insurance Company*, 104 F. Supp. 2d 740, 745 (N.D. Ohio 2000), quoting *The Lincoln Electric Company v. St. Paul Fire and Marine Ins. Co.*, 210 F.3d 672, 685, n.13 (6<sup>th</sup> Cir. 2000) (emphasis added).

But when September 11<sup>th</sup> occurred, and the country quickly learned that a form of “war” now existed that no one had contemplated, there was no thought allowed, not even a fleeting one, to the possibility that the prior decisions interpreting the “war risk” exclusion had also been outgrown. As Judge Cardozo’s landmark decision, which forever changed the law of product liability, *MacPherson v. Buick Motor Company*, 217 N.Y. 382, 391

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2000), quoting *The Lincoln Electric Company v. St. Paul Fire and Marine Ins. Co.*, 210 F.3d 672, 685, n.13 (6<sup>th</sup> Cir. 2000).

(1916) states, “Precedents drawn from the days of travel by stage coach do not fit the conditions of travel to-day.”

Political pressure on insurers to pay September 11<sup>th</sup> claims was not limited to the days immediately after the attack. In late May 2007, seven insurers and the developer of the World Trade Center announced a \$2 billion settlement of the outstanding coverage litigation over the destruction of the Towers. The settlement was described this way by National Underwriter Editor-in-Chief Sam Friedman on his blog – *A View From the Press Box*: “New York Governor Eliot Spitzer apparently knocked some heads together and finally convinced seven insurers to cough up \$2 billion to settle all remaining property insurance claims over the destruction of the World Trade Center[.]”<sup>6</sup>

Immediately after the settlement was announced, SCOR, a reinsurer for Allianz Global Risks, one of the settling parties, requested arbitration over its reinsurance obligation, stating that the settlement “exceeds the contractual requirements and contains *ex gratia* elements.”<sup>7</sup> But, as noted by Mr. Friedman in the last sentence of his blog entry, “You don’t want to mess with Eliot Spitzer.”

## **II. IN RE: BREACH OF COMMON SENSE**

The massive damage caused by Hurricane Katrina in August 2005 has spawned an enormous amount of litigation between affected property owners and their insurers over the availability of coverage. While Katrina is usually associated with New Orleans, it also

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<sup>6</sup>Sam Friedman, “Spitzer Does it Again,” *A View From the Press Box*, *National Underwriter P&C*, May 23, 2007, available at [http://www.property-casualty.com/2007/05/spitzer\\_does\\_it\\_again\\_1.html](http://www.property-casualty.com/2007/05/spitzer_does_it_again_1.html).

<sup>7</sup>“SCOR Balks at World Trade Center Claims Settlement,” *Insurance Journal*, May 24, 2007, available at <http://www.insurancejournal.com/news/national/2007/05/24/80008.htm>.

caused wide-spread devastation in Mississippi. The Mississippi coverage litigation has been on a much faster track than Louisiana's.

In particular, the Southern District of Mississippi has been very active in moving its docket through bench trials, jury trials, settlements, attempted class action settlements, government-sponsored global settlements and mediations. As a result of several trial court opinions on key coverage issues and a taste of some jury awards, the parties on both sides have now likely concluded that they can predict the outcome of cases with some degree of reasonable certainty. No doubt this is fostering even more settlements as the media has recently reported several eve-of-trial settlements of Mississippi federal cases.

The battle over coverage for Katrina claims in Mississippi has taken place as much outside the courtroom as in. Political maneuvering has surrounded the litigation, no doubt in an effort to influence it. For example, the Katrina coverage disputes gave rise to a Mississippi Grand Jury investigation into one insurer's claims handling. A suit was brought by the Mississippi Attorney General seeking to declare insurers' flood exclusions invalid. Katrina coverage issues prompted legislation to be introduced in Washington to repeal the insurance industry's 65 year-old limited anti-trust exemption under the McCarran-Ferguson Act. The Department of Homeland Security was tasked to investigate the manner in which claims under the National Flood Insurance Program were handled. Senator Trent Lott (R-Mississippi), himself a Katrina flood victim and plaintiff in a now-settled coverage action, has become the loudest political critic of the insurance industry, stating, "I'm like a woman scorned. I'm prepared to continue to kick their [the insurance industry's] fanny until the last day I'm alive on this Earth because they have mistreated

too many people.”<sup>8</sup> Coverage decisions are supposed to come from the bench, but politicians with a muscle to flex in the situation have not missed an opportunity to do so.

While Mississippi’s coverage cases have grabbed the headlines, Louisiana courts have not been completely silent. The case receiving the most attention is *In re Katrina Canal Breaches Consolidated Litigation v. Encompass Insurance Company, et al.*, 466 F. Supp. 2d 729 (E.D. La. 2006), in which Judge Stanwood Duval, Jr. of the Eastern District of Louisiana addressed coverage for flooding caused by the New Orleans levee breaches. The court ruled that because several insurers’ flood exclusions did not distinguish between man-made and naturally occurring floods, they were ambiguous and unenforceable.

The decision was a stunner when it was issued in November 2006. The insurance industry – after first picking itself up off the floor – predicted that it would not be upheld on appeal.<sup>9</sup> The industry will know soon enough, as the U.S. Court of Appeals for the Fifth Circuit heard oral argument in the case on May 6<sup>th</sup> in a courtroom packed with 120 lawyers, paralegals and law clerks.<sup>10</sup> The court promised a quick decision, with Judge King stating: “This case is not just going to take its place in the queue. It’s going to the head of the list.”<sup>11</sup> The exact dollar amount at stake is probably difficult to know at this point, but the number that has been floated is one billion.<sup>12</sup>

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<sup>8</sup>Brian Faler, “Lott, ‘Scorned’ After Katrina Targets State Farm, Allstate,” *Bloomberg News*, May 20, 2007, available at [http://news.yahoo.com/s/bloomberg/20070520/pl\\_bloomberg/ayjjigypeita](http://news.yahoo.com/s/bloomberg/20070520/pl_bloomberg/ayjjigypeita).

<sup>9</sup>Joseph B. Treaster, “Judge Upholds Policyholders’ Katrina Flood Claims,” *The New York Times*, Nov. 29, 2006.

<sup>10</sup>Rebecca Mowbray, “What makes a flood a flood?,” *The Times-Picayune*, June 7, 2007.

<sup>11</sup>Michael Kunzelman, “Appeals court tackles Katrina levee lawsuits,” *The Associated Press*, June 6, 2007.

<sup>12</sup>Michael Kunzelman, “Appeals court to hear arguments in Katrina levee breach lawsuits,” *The Associated Press*, June 6, 2007.

While *Katrina Canal Breaches* is very lengthy and procedurally complex, as it is the umbrella case for four individual cases,<sup>13</sup> it nonetheless resembles many coverage decisions. The case involves disagreement over the meaning of a term – flood – in an insurance policy. The court strives to discern the meaning – with the policyholder all the while arguing that the term is ambiguous and must be construed against the insurer as the drafter.

But the decision involves much more than a typical coverage case. It is, plain and simple, an example of a court torturing policy language to find coverage that clearly did not exist, in an effort to bring much-needed financial resources to a wide-scale problem. The flood exclusion at the heart of the brouhaha is as follows:

(1) We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.

(c) Water Damage, meaning: Flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind;

*Katrina Canal Breaches* at 741.

While it seems clear enough – there is no coverage for flood – Judge Duval disagreed. In a nutshell, he held as follows:

It is the considered opinion of this Court that because the policies are all-risk, and because “flood” has numerous definitions, it reasonably could be limited to natural

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<sup>13</sup>*In re: Katrina Canal Breaches Consolidated Litigation*, C.A. No. 05-4182 is the umbrella for all cases which concern damages caused by flooding as a result of breaches or overtopping in the areas of the 17<sup>th</sup> Street Canal, the London Avenue Canal, the Industrial Canal, and the Mississippi Gulf River Outlet, specifically, *Vanderbrook, et al. v. State Farm Fire & Cas. Co., et al.* C.A. No. 05-6323; *Xavier University of Louisiana v. Travelers Property Ca. Co. of America*, C.A. No. 06-516; *Chehardy, et al. v. State Farm, et al.*, C.A. No. 06-1672, 06-1673, and 06-1674; and *Humphreys v. Encompass Ins. Co.*, C. A. No. 06-169. *Katrina Canal Breaches* at 733.

occurrences. Simply put, the language of the ISO<sup>14</sup> Water Damage Exclusion chosen by the insurer is unclear. ...

Under the principles of Louisiana law, the Court is constrained to find the language ambiguous. To find otherwise, leads to absurd results. Once this finding is made, the Court is further constrained to interpret it against the insurer. “If there is any doubt or ambiguity as to the meaning of a provision in an insurance policy, it must be construed in favor of the insured and against the insurer. *See* La. C.C. art. 2056. When the ambiguity relates to an exclusionary clause, the law requires that the contract be interpreted liberally in favor of coverage.”

*Katrina Canal Breaches* at 757.

Suffice to say, between Judge Duval’s 85-page opinion and the numerous Fifth Circuit briefs of the parties and *amici*, much can be written about the case and its many competing arguments. But since the purpose here is not to analyze the flood exclusion, but, rather, make the case that *Katrina Canal Breaches* follows in the tradition of courts that have reached outcome determinative decisions to avoid leaving a large source of funds unavailable to solve a massive problem, a lengthy point-counterpoint is not necessary. Rather, the case will be examined through the lens of the relevant rules of insurance policy interpretation and whether they were followed. That is the mandate that all courts, in all coverage cases, state that they are obligated to follow.

To his credit, Judge Duval did not attempt to hide from Louisiana’s rules of insurance policy interpretation. He set them out in length, in part as follows:

Words and phrases used in an insurance policy are to be construed using their plain, ordinary and generally prevailing meaning, unless the words have acquired a technical meaning. *An insurance contract, however, should not be*

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<sup>14</sup>“ISO’ is an acronym for ‘Insurance Service Office, Inc.’ which provides products and services help to the insurance industry to measure, manage and reduce risk. It provides standardized insurance policy language such as the policies noted herein.” *Katrina Canal Breaches* at 742, quoting ISO’s homepage at [www.iso.com](http://www.iso.com).

*interpreted in an unreasonable or strained manner under the guise of contractual interpretation to enlarge or to restrict its provisions beyond what is reasonably contemplated by unambiguous terms or achieve an absurd conclusion. The rules of construction do not authorize a perversion of the words or the exercise of inventive powers to create an ambiguity where none exists or the making of a new contract when the terms express with sufficient clearness the parties' intent. . . .*

If the policy wording at issue is clear and unambiguously expresses the parties' intent, the insurance contract must be enforced as written. Courts lack the authority to alter the terms of insurance contracts under the guise of contractual interpretation when the policy's provisions are couched in unambiguous terms. The determination of whether a contract is clear or ambiguous is a question of law.

*Katrina Canal Breaches* at 737 (citations omitted and emphasis added).

In reaching the conclusion that the term "flood," as used in the ISO exclusion, could reasonably be limited to natural occurrences only, Judge Duval inked approximately 30 pages, which included examination of four dictionaries and case law from numerous state and federal courts.

Under Louisiana law, and many states for that matter, if the policy language is ambiguous, it is construed against the insurer as the drafter. However, as the court also readily acknowledged, it may not reach this conclusion by interpreting the policy "in an unreasonable or strained manner under the guise of contractual interpretation to enlarge or to restrict its provisions beyond what is reasonably contemplated by unambiguous terms or achieve an absurd conclusion." *Id.* Further, "[T]he rules of construction do not authorize a perversion of the words or the exercise of inventive powers to create an ambiguity where none exists or the making of a new contract when the terms express with sufficient clearness the parties' intent." *Id.*

With that said, it is difficult to imagine a clearer example of a court interpreting an insurance policy in a strained manner to enlarge its provisions, or exercising inventive powers to create an ambiguity where none exists, than here -- devoting approximately 30 pages and resorting to four dictionaries and case law from numerous state and federal courts to define a word that, according to a U.S. Department of Education study, appears on fourth grade vocabulary lists.<sup>15</sup>

The court also noted that, in interpreting the policy, it was bound to follow the so-called “reasonable expectations” doctrine, which it defined as follows: “Ambiguity will also be resolved by ascertaining how a reasonable insurance policy purchaser would construe the clause at the time the insurance contract was entered. The court should construe the policy to fulfill the reasonable expectations of the parties in the light of the customs and usages of the industry.” *Katrina Canal Breaches* at 738-39, quoting *Louisiana Insurance Guaranty Association v. Interstate Fire & Casualty Co.*, 630 So. 2d 759, 764 (La. 1994).

Incredibly, however, the court then omitted the very next line from *Louisiana Insurance Guaranty Association*, which went on to further define the reasonable expectations doctrine: “Yet, if the policy wording at issue is clear and unambiguously expresses the parties’ intent, the insurance contract must be enforced as written. LSA-C.C. Art. 2046 (providing that when the words of a contract are clear, no further interpretation may be made to determine the parties’ intent)[.]” *Id.* at 764 (emphasis added).

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<sup>15</sup>Robert Marzano, John Kendall, Diane Paynter, “The Analysis and Identification of Basic Words in Grades K-6; Appendix: A List of Essential Words by Grade Level,” U.S. Dept. of Education, Office of Educational Research and Improvement, Educational Resources Information Center (1991).

The “reasonable expectations” doctrine is frequently misinterpreted to somehow mean that the test for insurance availability is simply whether the insured reasonably expected to be covered for a loss that has already taken place. Needless to say, if that were the standard, insurers would have an impossible burden for placing any constraint on the scope of their obligations. The difficulty that such “Monday morning quarterbacking” by policyholders would present for insurers was aptly noted by the Alabama Supreme Court not long ago: “If ... all that was required to defeat the operation of a policy exclusion under the reasonable expectation doctrine was a provision attempting to qualify or limit the scope of policy coverage, then every policy exclusion would be invalid as contrary to the insured’s reasonable expectation of coverage.” *Federated Mutual Ins. Co. v. Abston Petroleum, Inc.*, 2007 Ala. LEXIS 65, \*28 quoting *State Farm v. Slade*, 747 So. 2d 293 (Ala. 1999), quoting *Millar v. State Farm Fire & Cas. Co.*, 804 P.2d 822, 826-27 (Ariz. App. 1990), *review denied*, 811 P.2d 1081 (Ariz. 1991). For this very reason, “expectations that contradict a clear exclusion are not ‘objectively reasonable.’” *Id.* at \*27, quoting *Slade, supra* quoting *Wellcome v. Home Ins. Co.*, 849 P.2d 190 (Mont. 1993).

It is odd that people living in as hurricane-prone an area as New Orleans could have had a reasonable expectation that their homeowner’s policy covered flood. The Louisiana Insurance Department’s “Consumer’s Guide to Homeowner’s Insurance” states as follows under the heading Flood Insurance: “Because homeowners policies in Louisiana do not provide coverage for damage due to floods, it is important to look into getting a separate flood insurance policy, no matter where you live. Ask your producer/agent if your insurance provider offers flood insurance policies that will provide coverage for your house and its contents, or contact the National Flood Insurance Program (NFIP) at 1-888-

CALL-FLOOD, ext. 314.”<sup>16</sup> If people living in New Orleans had an expectation that their homeowner’s policies covered flood, it certainly was not a *reasonable* one.

The court in *Katrina Canal Breaches* addressed the argument that the existence of the National Flood Insurance Program establishes that homeowner’s policies do not provide coverage for flood. The court’s response was brief: “If an insurer wanted to exclude coverage for damages covered by a national insurance program, it could so state in the relevant exclusion. Furthermore, [i]t is the reasonable interpretation of an insured that governs the legal effect of language in an insurance contract, and not whether the language chosen by an insurer may constitute a legal term of art in another context.” *Katrina Canal Breaches* at 760.

One of the most interesting aspects of the court’s decision was that, despite all of the flaws it found to exist in the ISO flood exclusion, it concluded that the flood exclusions in State Farm’s and Hartford’s policies were adequately drafted to preclude coverage for both man-made and naturally occurring floods. The State Farm policy contained the following flood exclusion:

SECTION I - LOSSES NOT INSURED

2. We do not insure under any coverage for 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*

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<sup>16</sup>“Consumer’s Guide to Homeowner’s Insurance,” Louisiana Department of Insurance (2006), at 4 (available at [http://www.ldi.state.la.us/consumers/misc\\_pubs/Consumers%20guide%20to%20homeowners%20insurance.pdf](http://www.ldi.state.la.us/consumers/misc_pubs/Consumers%20guide%20to%20homeowners%20insurance.pdf)).

natural or external forces, or occurs as a result of any combination of these:

- c. (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;

*Katrina Canal Breaches* at 762 (emphasis in original).

The court held: “The State Farm policy does precisely what the ISO Water Exclusion Policy fails to do. It makes it clear that regardless of the *cause* of the flooding, there is no coverage provided for any flooding ‘regardless of the cause.’ Such language is clear to the Court and as such, the Court must find that the State Farm policy as written excludes coverage for all flooding.” *Katrina Canal Breaches* at 762-63 (emphasis in original).

It seems a strange conclusion that the State Farm flood exclusion is superior to the ISO flood exclusion on the grounds that the State Farm policy makes it clear that there is no coverage provided for any flooding “regardless of the cause.” After all, as set out above, the ISO flood exclusion provided as follows: “We do not insure for loss caused directly or indirectly by any of the following [Flood]. Such loss is excluded *regardless of any other cause* or event contributing concurrently or in any sequence to the loss (emphasis added).”

By concluding that the State Farm policy excluded flood, the court was no doubt giving itself cover against any charge that its decision was result-driven (especially given State Farm’s huge market share). Of course, the effectiveness of this is questionable when you compare the State Farm flood exclusion and the ISO flood exclusion.

**CONCLUSION:  
JUDGE DUVAL, THE FLOOD EXCLUSION  
AND TROPICAL STORM ALLISON**

Not surprisingly, given his location, Katrina was not Judge Duval's first foray into the world of insurance coverage for a major storm. It's worth taking a brief look at how the judge addressed another coverage dispute involving a storm and man-made flood.

In *Costanza, et al. v. Allstate Insurance Company, et al.*, 2005 U.S. Dist. LEXIS 36607 (E.D. La.), Judge Duval addressed coverage for damage to a home that was flooded by Tropical Storm Allison. The resultant repairs revealed major structural damage to the home, including a defective exterior stucco system. Mold was subsequently discovered which rendered the home uninhabitable.

The homeowners acknowledged that the flood exclusion precluded coverage for the damage caused by the tropical storm. But they contended that the majority of the damage was the result of long-term and previously unknown water leakage caused by the home's defective exterior, which is not within the exclusion.

The flood exclusion at issue, while not quoted in the decision, is cited in Allstate's Motion for Summary Judgment and is substantially the same as the ISO flood exclusion.

Allstate's Motion for Summary Judgment stated:

As is well known in South Louisiana, homeowner's insurance policies do not cover damage from rising water due to excessive rain or other sources of rising water. Rather, these damages are covered by policies issued pursuant to the National Flood Insurance Act, 42 USC 4001, et seq. The specific exclusion in the homeowner's policy is found on page 8, exclusion #1, which excludes coverage for Flood, including but not limited to, surface water, waves, tidal water, or overflow of any body of water, or spray from any of these, whether or not driven by wind.

*Costanza, et al. v. Allstate Insurance Company, et al.*, United States District Court, Eastern District of Louisiana, No. 02-1492, Allstate's Motion for Summary Judgment at III.

The flooding at issue in *Costanza* was seemingly of the man-made variety. The plaintiffs' complaint alleged that it was the negligence of certain construction companies that enabled rainwater and floodwater to enter the home. *Costanza, et al. v. Allstate Insurance Company, et al.*, United States District Court, Eastern District of Louisiana, No. 02-1492, Complaint at XIX.

Judge Duval concluded that Allstate was not entitled to summary judgment because "there is a material question of fact as to what extent the damage claimed by the plaintiffs is excluded under the homeowner's policy as flood water damage." *Costanza* at \*8. Implicit in such decision is that the flood exclusion would apply to some of the damage.

While *Costanza* is not a detailed decision, it is curious that Judge Duval took the flood exclusion's applicability to a man-made flood for granted, yet devoted 30 pages to the issue in arriving at a contrary conclusion in *Katrina Canal Breaches*.

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