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NEVER SAY NEVER AGAIN: SURVIVING THE SECOND STORM OF LITIGATION

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Never Say Never Again: Surviving the Second Storm of Litigation
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I. INTRODUCTION

On August 29, 2005, Hurricane Katrina changed the face of the insurance industry. Never before had such a large scale catastrophe caused legal and insurance scholars alike to challenge established principles and question basic fundamentals of law. The full effect of Katrina on the legal profession and the interpretation of insurance contracts will not be known for some time. Over the past two years, however, certain issues have repeatedly arisen in Katrina litigation, particularly issues involving the "flood" exclusion, the retroactivity of Louisiana Revised Statutes §22:1220 and 22:658, insurance discovery, and Louisiana's valued policy law. At least two of these key issues, the ambiguity of the "flood" exclusion, and the application of the amended version of Louisiana Revised Statutes 22:658 are presently pending before the Louisiana Supreme Court in *Sher v. Lafayette Insurance Company.* Another key issue involving the interpretation of Louisiana's valued policy law is also pending before the Louisiana Supreme Court in *Landry v. Louisiana Citizens Property Insurance Company*. The resolution of many cases is contingent on the resolution of these key issues by the Louisiana Supreme Court, and a final decision will either jumpstart further litigation over the application of these decisions or settlement discussions between the insurers and their policyholders. Regardless, many lessons have been learned from the insurance cases sparked by Hurricane Katrina, and today's panelists, who have been at the forefront of these key issues, will shed light on their experience with these issues and their advice for handling future catastrophes. The purpose of this article is to give a brief overview and background of the topics that will be discussed.

II. *SHER V. LAFAYETTE INS. CO.* AND *LANDRY V. LA. CITIZENS PROP. INS. CO.* – TWO LEADING CASES IN HURRICANE KATRINA LITIGATION

The *Sher* and *Landry* lawsuits are the models of Hurricane Katrina insurance litigation thus far. They involve, between the two, the most litigated and highly contested insurance issues addressed by Louisiana courts in recent history. Their outcome will affect thousands of Louisiana policyholders and change the face of the insurance industry for years to come.

A. *Sher v. Lafayette Insurance Company*

Joseph Sher is a 92-year-old Holocaust survivor who moved to the United States to start a new life for himself and his family as a tailor. He purchased the property at 1410 Broadway to establish his home — the first and only piece of real estate he purchased in this country after saving every cent he possibly could. It was this property that Hurricane Katrina so badly damaged and for which Mr. Sher's insurer, to whom he had paid premiums for over 15 years, refused to tender payment. Indeed, the jury found that Lafayette Insurance Company arbitrarily and capriciously violated Louisiana Revised Statutes §22:658 by refusing to pay Mr. Sher's claim, and that Lafayette was liable for all proceeds owed, including proceeds for water damage sustained from the broken levees, and the applicable penalties under the amended version of §22:658. On appeal, the Louisiana Fourth Circuit Court of Appeal upheld the district court's motion for summary judgment ruling regarding the ambiguity of the policy's water damage exclusion, but reversed the

award of the increased penalties under the new version of §22:658.[1] Both issues are pending before the Louisiana Supreme Court.

1. The Flood Exclusion.

In short, Mr. Sher argues that the flood exclusion in Lafayette's policy is ambiguous as it fails to distinguish between water damage resulting from natural events rather and water damage resulting from man-made events. Under Louisiana law, an ambiguity in an insurance contract must be construed against the insurer.[2] Exclusions from coverage are to be afforded a narrow construction, and, "a provision which seeks to narrow the insurer's obligation is strictly construed against the insurer, and, if the language of the exclusion is subject to two or more reasonable interpretations, the interpretation which favors coverage must be applied."[3] Specifically, because Mr. Sher's policy is an all-risks policy, his burden is a light one: to make a prima facie case for recovery he must show only that a loss has occurred. Upon Mr. Sher's making such a prima facie showing, the burden shifts to Lafayette to prove that the loss arose from a cause which is excepted from the policy or for which it is not liable."[4]

Moreover, every Louisiana judge to consider this issue has held that the purported flood exclusion is ambiguous and excludes from coverage only those damages caused by naturally occurring events.[5] In *Doerr v. Mobil Oil Corp.*,[6] the Louisiana Supreme Court considered whether a "total pollution" exclusion in a policy was applicable to damages resulting from the release of hydrocarbons into a water system. The exclusion applied to the "discharge, dispersal, seepage, migration, release or escape of pollutants at any time."[7] The court concluded that, if applied literally, absurd results would be achieved.[8] For example, it would cover "anything from the release of chlorine gases by a conglomerate chemical plant to the release of carbon monoxide from a small business owner's delivery truck" and even a slip and fall in a puddle of

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[1] *See* Exhibit A (posted online), *Sher v. Lafayette Ins. Co.*, 07-0757 (La. App. 4 Cir. 11/19/2007); 973 So.2d 39.

[2] *Crabtree v. State Farm Insurance Co.*, 632 So. 2d 736 (La. 1994).

[3] *See Reynolds v. Select Properties, Ltd.*, 634 So. 2d 1180, 1183 (La. 1994).

[4] *Walker v. Travelers Indem. Co.* 289 So.2d 864, 871 -872 (La. App. 1974).

[5] *See* Exhibit B (posted online) *In re Katrina Canal Breaches Consol. Litig.*, 466 F. Supp. 2d 729 (E.D. La. 2006)(reversed); *Historic Restoration, Inc. v. RSUI Indemnity Company and Essex Insurance Company*, No. 06-4990, Div. D-16-11, Civil District Court, Parish of Orleans, State of Louisiana, Judgement dated December 5, 2006; *White III, L.L.C. v. Travelers Property & Cas. Co.,* No. 06-9607, Div. G-11, Civil District Court, Parish of Orleans, State of Louisiana, Judgement dated July 26, 2007; *White v. Louisiana Citizens Prop. Ins. Corp.,*No. 06-7975, Civil District Court, Parish of Orleans, State of Louisiana, Judgment dated July 26, 2007; *Townsend v. Louisiana Citizens Prop. Ins. Corp.,* No. 06-6780, Civil District Parish Court, Parish of Orleans, State of Louisiana, Judgment dated August 29, 2007.

[6] 00-0947 (La. 12/19/00), 774 So. 2d 119.

[7] *Id.* at 122.

[8] *Id.* at 124-25.

spilled gasoline would not be covered.[9] Accordingly the policy was ambiguous and was interpreted narrowly to effect, not deny, coverage.[10] Other jurisdictions have echoed similar concerns. In *Murray v. State Farm Fire and Casualty Co.*,[11] the court recognized that an earth movement exclusion was ambiguous because the term did not reference its source. The court noted:

> On the one hand, the exclusions cited in the defendants' policies could bar coverage for solely natural events such as earthquakes, volcanic eruptions, and sinkholes. On the other hand, the same exclusions refer to events which could be man-made, such as subsidence or earth movement caused by equipment or a broken water line. Or, as alleged in this case, earth movement could be caused by both man and nature over a period of time, such as landslides, mudflows, or the earth sinking, shifting, or settling. ***Because the policy language is reasonably susceptible to different meanings, we believe that the earth movement exclusions in the insurance policies at issue are ambiguous, and must have a more limited meaning than that assigned to it by the defendants.***[12]

In *Peach State Uniform Service, Inc. v. American Insurance Co.*,[13] heavy rains washed away uncompacted fill dirt under the foundation of its building and when the dirt washed away, the building collapsed. The insurer denied coverage, in part, on the basis of a provision that excluded coverage for damage resulting from "'[e]arthquake, volcanic eruption, landslide or other earth movement.'" Plaintiff contended that the exclusion was inapplicable because it did not apply to earth movement caused by external sources. The district court disagreed, and entered judgment in favor of the insurer. The U.S. Fifth Circuit reversed, noting:

> There is no clear manifestation here of an intent not to limit the general term other earth movement in this policy to events of the same nature as earthquakes, volcanoes, and landslides. . . . ***[W]e read other earth movement as referring only to phenomena related to forces operating within the earth itself, and not to the merely superficial effects of external forces, such as erosion by run-off rainwater***.[14]

Further, various courts have found that water escaping from a broken water main does not constitute a "flood" for the purposes of a water damage exclusion.[15] These broken water main cases and Mr. Sher's

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[9] *Id.* at 124.

[10] *Id.* at 124-25.

[11] 509 S.E.2d 1 (W.Va. 1998).

[12] *Id.* at 9 (emphasis added).

[13] 507 F.2d 996 (5th Cir. 1975).

[14] *Id.* at 999-1000 (emphasis added).

[15] *Change, Inc. v. Westfield Insurance Co.*,542 S.E.2d 475 (W. Va. 2000); *Ebbing v. State Farm Fire & Casualty Co.*,1 S.W.3d 459 (Ark. Ct. App. 1999); *Popkin v. Security Mutual Insurance Co. of New York*, 367 N.Y.S.2d 492 (N.Y. App. Div. 1975). Interestingly, in at least one case an insurer took a position consistent with these cases by claiming a broken water main was not a "flood." *Mateer v. Reliance Ins. Co.,*

losses share a similar factual basis. In both instances, the insured sustained water inundation when man-made structures designed to contain the flow of water – water mains and the levees and walls along the 17th Street and London Avenue drainage canals – failed. Just like the water mains and pipes in these cases, the levees and canal walls in the present case failed. The greater scope of damages from the levee failures does not alleviate the insurer of its obligations under an "all risks" policy. Rather, Mr. Sher argues that there are two potential interpretations of the word. It either applies to natural events or to both natural and man-made events. Consistent with long-standing principles of insurance policy interpretation, the term should be given its most narrow meaning, and the term "flood" should apply only to naturally occurring events.

2. Application of the Amended Version of §22:658.

Another key issue in the *Sher* matter is whether the amended version of §22:658 applies retroactively. Mr. Sher first contends that the amendment applies retroactively because of the amendment is remedial in nature as it effects only the means of enforcing a violation of §22:658 rather than changing an insured's rights under the statute itself. Further, the Louisiana Legislature intended for the amendment to §22:658 to apply retroactively as evidenced by the comments of Senator Edward Murray regarding Senate Bill 620. Senator Murray declared that the "penalties were not enough to encourage these insurers to be more timely in getting adjusters to these people's homes so that these claims can be settled."[16] In arguing in support of an attorneys' fees provision, Senator Murray stated that it would be wrong to force insureds who have "to deal with costs associated with a disaster" to "pay for an attorney in order to get their claims settled."[17] Plainly, the legislature enacted Act 813 to provide consequences for insurance companies who did not timely and in good faith handle claims related to Hurricane Katrina (and Rita), regardless of when these claims were filed. Thus, the Louisiana Legislature intended for Act 813 to apply retroactively to increase the penalties to all bad faith insurance claims related to Hurricanes Katrina and Rita. The claims for bad faith already existed. The amendment simply increased the remedy. Thus, the amendment should apply retroactively.

Moreover, the Fourth Circuit erred in failing to even address the argument that Lafayette's post-amendment conduct subjected it to the increased penalties provided by the amended version of §22:658, which became effective August 15, 2006. Louisiana Revised Statute §22:1220 and §22:658 impose a duty of good faith and fair dealing on an insurer, specifically to "adjust claims fairly and promptly and to take reasonable steps to settle valid claims."[18] In Louisiana, this duty is a continuing duty of good faith and fair dealing on the part of the insurer.[19] Accordingly, Mr. Sher argues that Lafayette's duty to adjust his claim in good faith continued beyond the August 15, 2006 effective date of the amended version of §22:658.

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233 A.2d 797 (Ma. Ct. App. 1967).

[16] *See* House Committee on Insurance, Minutes of Meeting, 2006 Regular Session, May 31, 2006, p. 2.

[17] *Id.* at p. 3.

[18] *Chargois v. Guillory*, 97-439 (La. App. 3 Cir. 10/29/1997), 702 So. 2d 1068, 1069.

[19] *See Conlee v. Fireman's Fund Ins. Co.*, No. 07-660, 2007 WL 2071860 (E.D. La. 9/18/2007); *See also Kodrin*, 2007 EL 4163437; *See also Robert C. Evans,* 2007 WL 4365386.

Indeed, in *Theriot v. Midland Risk Ins. Co.*, this Court held that the duties of good faith and fair dealing imposed on insurers by §22:658 "continue throughout the litigation."[20] Further, in *Harris v. Fontenot* , the court found that nowhere in either §22:1220 or §22:658 is there an express distinction limiting the application to the pre-litigation conduct of the insurer."[21] The court reasoned that the "requirements [of good faith and fair dealing] are no less important after litigation has begun."[22] The *Harris* court also noted that in *McDill v. Utica Mutual Insurance Co.,* this Court imposed penalties on an insurer for post-litigation conduct.[23] Thus, because an insurer's duty of good faith and fair dealing continues beyond the effective date of the amended version of §22:658 and throughout the litigation, Mr. Sher argues that Lafayette should be subject to the increased penalty of 50% and attorneys' fees.

At least two judges from the United States District Court of the Eastern District of Louisiana have acknowledged an insurer's continuing duty to adjust a claim under Louisiana law in applying the amendment to §22:658 prospectively. Recently, in *Kodrin, et al v. State Farm Fire Insurance Company, et al*, Judge Carl J. Barbier, acknowledging the Fourth Circuit's ruling that the amended version of §22:658 is not retroactive, held that because the insurer had a continuing duty to adjust the claim in good faith post-amendment, the insurer was subject to the increased penalties.[24] Specifically, Judge Barbier recognized that "in Louisiana an insurer owes its insured a continuing duty of good faith and fair dealing."[25] Judge Barbier further recognized that because State Farm had a continuing duty to adjust the plaintiffs' claims, State Farm's bad faith conduct occurred both before and after the effective date of the amended version of §22:658, and thus, the plaintiffs were entitled to recover attorneys fees incurred after the effective date of the amendment.[26] Indeed, Judge Barbier stated:

> While the Court is aware that other cases have held that only the version of the statute in effect at the time of the original breach can apply, this interpretation of the amendments does not seem to be justified by the obvious purpose of the legislative amendments increasing the penalty and providing for recovery of attorneys fees. **If the notion of a "continuing duty" has meaning, then an insurer who initially denies a claim cannot simply ignore its continuing obligation to its own policyholder to further investigate or review the pending claim. Continuing to act unreasonably by failing to pay a legitimate claim**

[20] 664 So. 2d at 550, *rev'd on other grounds*, 694 So. 2d 184 (La. 1997).

[21] 606 So. 2d 72, 74 (La. App. 3 Cir. 1992) (emphasis added).

[22] *Id.* (emphasis added).

[23] 475 So. 2d 1085 (La. 1985).

[24] 2007 WL 4163437 (E.D. La. 11/21/2007).

[25] *Id.* at *1.

[26] *Id.*

> **even after the legislature acted to increase the penalties for such behavior seems to be precisely the conduct that the legislature sought to address.**[27]

Further, in *Robert C. Evans d/b/a Evans & Company and Breadfruit Tree, LLC v. Lafayette Ins. Co,* Judge Mary Ann Vial Lemmon adopted Judge Barbier's decision in *Kodrin*, holding that the insurer, ironically also Lafayette, continued to act in bad faith post-amendment and was thus, subject to increased penalties and attorneys' fees.[28] Similarly, Mr. Sher argues that Lafayette's duty to adjust claims fairly and promptly extended beyond August 15, 2006, and continues to this day, thus subjecting it to the increased penalties provisions set forth in Act 813. Therefore, Mr. Sher contends that the Fourth Circuit incorrectly held that the amended version of §22:658 did not apply to his claim against Lafayette, and incorrectly reduced the award of damages.

B. *Landry v. Louisiana Citizens Property Insurance Company*

The key issue before the Louisiana Supreme Court in the *Landry* matter is the application of Louisiana's valued policy statute, which requires an insurer to pay the face value of a insurance policy in the case of a total loss.[136] In *Landry*, the plaintiffs argue that the insurer is liable for the full policy limits in the event of a total loss if the total loss was caused only partially by wind, a covered peril, and the remaining damage was caused by flood, an excluded peril.[137] The Louisiana Third Circuit Court of Appeal held that once the factual determination is made that a covered peril was the efficient or proximate cause of the loss, an insurer cannot rely on any clause, condition, or exclusion in the insurance contract to reduce or nullify its obligation to pay the full value of the policy:

> We find the Louisiana Valued Policy Law clearly provides in the event of a total loss *caused* by a *covered peril,* the insurer "shall compute and indemnify or compensate any covered loss of, or damage to, such property which occurs during the term of the policy" at the valuation it placed upon the covered property and used for the purpose of determining the premium charged. Therefore, once a factual determination is made that the covered peril was the "efficient or proximate cause" of the total loss, the insurer is prevented from relying on any clause, condition, or exclusion in the insurance contract to reduce, nullify, or offset its obligation to pay the "full face value" of the policy unless another " *valuation* " method, i.e., cash value, was set forth in the application and the policy. The "offset" or "opt out" clause, as commonly referred to by the parties, in the VPL (when read conjunctively) again only speaks *to the method for calculating the value of the property at the time the policy was issued;*[FN18] it does not address *coverage* or *causation.* Resolution of these matters requires

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[27] *Id.* (emphasis added).

[28] No. 06-6783 (E.D. La. 12/11/2007).

[136] *See* La. Rev. Stat. §22:695.

[137] 2007-247(La. App. 3 Cir. 2007); 964 So. 2d 463.

> an interpretation of the policy coverage provisions and a causation determination by the fact-finder.[138]

Louisiana Citizens has appealed this ruling to the Louisiana Supreme Court, which heard oral argument on this issue and those issues raised in the *Sher* matter on February 26, 2008. A decision is pending.

III. DISCOVERY ISSUES IN HURRICANE KATRINA LITIGATION

A. Discoverability of Other Sources of Funding.

One of the most litigated discovery issues in Hurricane Katrina litigation is whether an insurer is entitled to discover information regarding other funding obtained by the insured to recover from its losses, i.e, funding from other sources of insurance or governmental sources such as the National Flood Insurance Program and FEMA. Magistrate Joseph C. Wilkinson of the United States District Court for the Eastern District of Louisiana has addressed this issue in the *In Re Katrina Canal Breaches* litigation, and has ultimately ruled that such information is discoverable, with the exception of charitable donations and gifts.[139] Judge Wilkinson originally ruled, however, that information regarding an insured's claim with FEMA, specifically, an insured's classification of damages as flood or non-flood, is entirely irrelevant to its claim against its insurer. Judge Wilkinson reversed his ruling, however, after a decision was rendered by the United States Fifth Circuit regarding the ambiguity of the "flood" exclusion.[140] As discussed above, the Louisiana Supreme Court has yet to rule on the "flood" exclusion issue; thus, the discovery question has not yet been resolved.

Insureds strongly contend that an insurer is not entitled to any credit or offset for funds received from FEMA or any other government-related entity because the documents provided to FEMA constitute an inadmissible collateral source. The collateral source rule is a common law concept that has become "well-established" in Louisiana.[141] Louisiana courts summarize the effect of the collateral-source rule as follows:

> [A] tortfeasor generally is not entitled to a credit for a payments made to the plaintiff through collateral sources independent of the wrongdoer's procuration or contribution. Generally, payments to a tort victim from a collateral source do not reduce the victim's recovery against

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[138] *Id.* at 480.

[139] *See In re Katrina Canal Breaches Consolidated Litigation*, 2007 WL 2480422 (E.D. La. 8/28/2007).

[140] *See In re Katrina Canal Breaches Consolidated Litigation*, 2007 WL 2480422 at *1-2.

[141] *Louisiana, DODT v. Kansas City So. R.R.,* 2002-2349 (La. 5/2/2003), 846 So. 2d 734, 739 (hereinafter, "*Kansas City Southern*"). Louisiana law will apply to this motion. *See* November 27, 2006 Opinion, pp. 4-5.

the tortfeasor. Thus, the collateral source rule applies to situations where the victim receives compensation for his damages from a source independent of the tortfeasor.[142]

The Louisiana Supreme Court has rejected the suggestion that the collateral-source rule narrowly applies to tort suits only. In *Kansas City Southern*, the Louisiana Department of Transportation ("DOTD") expended several million dollars to remove environmental pollution at a state construction site. The United States government, through the Federal Highway Administration ("FHWA"), reimbursed the DOTD ninety percent of the remediation costs. The DOTD then sued several defendants as the parties responsible for the clean-up costs pursuant to Louisiana Environmental Quality Act ("LEQA").[143] The defendants contended that the DOTD's maximum recovery against them would be the ten percent of clean-up costs that the DOTD actually paid. The defendants claimed that any damages owed by them under the LEQA had to be offset by the amount covered by the FHWA. According to defendants, permitting the DOTD to recover more than ten percent of the clean-up costs would result in an "impermissible double recovery."[144] The district court agreed with the defendants and the Louisiana First Circuit Court of Appeals affirmed, finding that the collateral-source rule did not apply because it was a "tort based concept."[145]

The Louisiana Supreme Court reversed the rulings of the lower courts, finding that it was "**mere happenstance** that the collateral source rule has been applied chiefly in the context of a conventional [Article 2315] tort."[146] Scanning jurisprudence from across the country, the Court held that the collateral-source rule had been applied in "a range of situations where the collateral source is provided to the plaintiff by a **<u>government agency</u>** or even a gratuitous source."[147] Once the Louisiana Supreme Court ruled that the collateral-source rule *could* apply to the DOTD's claim against the defendants, it held that the rule *should* apply to prevent any offset of the amounts paid to the DOTD by the FHWA.[148] The Court reasoned that, even if its decision resulted in a "windfall" for the DOTD, it was preferable to "**<u>allowing the liability of the potential wrongdoer under the LEQA to be reduced by the 90 percent federal share</u>**."[149] In other words, as between the victim and the wrongdoer, any windfall should go to the victim. Accordingly, the

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[142] *Suhor v. Lagasse*, 2000-1628, (La.App. 4 Cir. 9/13/2000); 770 So. 2d 422, 423.

[143] *See id* at 736.

[144] *Id.* at 737.

[145] *Louisiana, DOTD v. Kansas City Southern R.R.*, 36,002 (La.App. 2 Cir. 8/8/2002), 827 So. 2d 443, 461.

[146] *Louisiana, DOTD*, 846 So. 2d at 741 (emphasis added).

[147] *Id.* at 740 (emphasis added). The Louisiana Supreme Court observed that, considering the origin of the collateral-source doctrine, decisions from other states on the collateral source rule were "persuasive." *Id.* at 742.

[148] *Id.* at 744.

[149] *Id.* (emphasis added).

Court held that any judgment against defendants "should not be reduced by the ninety percent of the federal share of the remediation funded by the FHWA."[150]

Even if the collateral-source rule is inapplicable, however, it does not follow that insurers are thereby entitled to a credit or offset. As noted by a court in California:

> [a] court's decision not to grant a defendant collateral source credit does not rely on the same legal basis as the decision to apply the collateral source rule. [Even though] the collateral source rule has never [in California] been extended to breach of contract . . . not granting the [defendant] collateral source credit is well within the judge's discretion. In California, there is no statutory or common law precedent in a breach of contract action to give defendants collateral source credit for income tax benefits which plaintiffs may have received.[151]

Similarly, Louisiana has no precedent allowing for the type of credit sought by many insurers.

B. Discoverability of Reserves and Reinsurance Information

Another contested discovery issue is whether an insured is entitled to discover information from his insurer regarding reserves and reinsurance. Several Louisiana courts have ruled that reserve and reinsurance information is discoverable and relevant in Hurricane Katrina insurance litigation and have ordered insurers to produce said information. In *Historic Restoration, Inc. v. RSUI Indemnity Company*, for example, Judge Lloyd Medley of the Civil District Court for the Parish of Orleans ordered the defendant insurer to produce all responsive reserve and reinsurance information in granting a similar motion to compel.[152] Moreover, upon being ordered to produce the reserve and reinsurance information by the district court, the defendant insurer applied for supervisory writs to the Louisiana Fourth Circuit Court of Appeal on this very issue, and said **writ was denied**.[153]

Further, it is well-settled that since Louisiana's discovery rules were obtained from the federal rules, Louisiana courts may look for guidance to the federal decisions which have interpreted the issues in question.[154] For example, in *Children's Hospital et al v. Continental Casualty Company*, Judge Carl J. Barbier of the Eastern District of Louisiana ordered the defendant insurance company to produce its reserve and reinsurance information where the case involved similar allegations of bad faith violations of § 22:1220

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[150] *Id.* at 745.

[151] *Depalma v. Westland Software House,* 225 Cal.App.3d 1534, 1539 (Cal. 2 Dist. Ct. App. 1990).

[152] *Historic Restoration, Inc. v. RSUI Indemnity Company, et al*, No. 06-4990, Civil District Court for the Parish of Orleans, Division "D".

[153] *See* March 13, 2007 Judgment in *Historic Restoration, Inc. v. RSUI Indemnity Company, et al*, No. 07-C-0311, Louisiana Fourth Circuit Court of Appeal; March 14 , 2007 Judgment, *Historic Restoration, Inc. v. RSUI Indemnity Company, et al.*,No. 07-C-0305,Louisiana Fourth Circuit Court of Appeal.

[154] *See Williams v. Smith*, 576 So. 2d 448, 450 (La. 1991); *Madison v. Travelers Ins. Co.*, 308 So. 2d 784, 786 (La. 1975).

and § 22:658 regarding the adjustment of plaintiff's Hurricane Katrina claims.[155] Similar rulings followed in *Harborside, LLC. v. Pacific Insurance Company*,[156] *Royal Cosomopolitan LLC v. Scottsdale Insurance Company*,[157] and *Hurwitz Mintz Finest Furniture Store South, L.L.C. et al v. United Fire & Casualty Co.*[158]

Notably, courts have ruled that reserve and reinsurance information is relevant to claims involving allegations of an insurer's bad faith in litigation preceding Hurricane Katrina. In *Silva v. Fire Insurance Exchange*, the District Court for the District of Montana explicitly stated that **a plaintiff in a first-party bad faith action is entitled to discover the *entire* claims file kept by the insurer**.[159] In fact, the court in *Silva* aptly observed that "[u]nder ordinary circumstances, a first-party bad faith claim can be proved only by showing the manner in which the claim was processed, and the claims file contains the sole source of much of the needed information."[160]

Further, the United States District Court for the Eastern District of Louisiana has specifically held that reserve information is discoverable in cases involving allegations of bad faith on behalf of an insurance company. In *Culbertson v. Shelter Mutual Insurance Company*, plaintiffs filed a motion to compel responses to requests for production including reserve information from the defendant insurance company.[161] The court held that reserve information is discoverable where a claim of bad faith is asserted, stating:

> The information sought may demonstrate or lead to admissible evidence with respect to the thoroughness with which defendant investigated and considered plaintiff's loss of income claim. **It is therefore discoverable and may be relevant to the good or bad faith of defendant in denying the claim**.[162]

Additionally, in *First National Bank of Louisville v. Lustig*, the District Court for the Eastern District of Louisiana concluded that "[r]eserve information, including any post-litigation reserve information, is relevant to show the insurer's state of mind in relation to its claims settlement practices" and that

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[155] *Children's Hospital et al vs. Continental Casualty Company*, Civil Action No. 06-3548, Section J(4).

[156] *Harborside, LLC. v. Pacific Insurance Company*, Civil Action No. 06-5319, Section K(3).

[157] *Royal Cosomopolitan LLC v. Scottsdale Insurance Company*, Civil Action No. 06-4557, Section B(5).

[158] *Hurwitz Mintz Finest Furniture Store South, L.L.C. et al v. United Fire & Casualty Co.*, Civil Action No. 06-4817, Section J(3).

[159] 112 F.R.D. 699, 699 (D. Mont. 1986)(emphasis added).

[160] *Id.* at 699.

[161] 1998 WL 743592 (E.D. La. Oct. 21, 1992).

[162] *Id.* at *1 (emphasis added).

"examination with respect to the reserve may develop evidence on the issue of the defendant's bad faith."[163] Of course, in Hurricane Katrina cases, insureds are alleging that their insurers, in bad faith, did not thoroughly investigate and consider their claimed losses as a result of Hurricane Katrina. Therefore, the insurers' reserve and reinsurance information is discoverable as it may be relevant to the good or bad faith of the insurers in failing to pay all proceeds owed under their policies.

In one fully-researched decision, Pain Clinic, Inc. v. Banker Ins. Co., Magistrate Judge Wilkinson expressed the opposite view — that reserves information is not discoverable.[164] However, the portion of his decision concerning reserves information was reversed in the *Pain Clinic* case by Judge Barbier, Record Doc. No. 41,[165] and since the other district judges in the Eastern District who have considered the issue have not accepted his view, Magistrate Judge Wilkinson now defers to the majority view expressed by the district judges of his court, although he respectfully disagrees.[166]

C. <u>The Katrina Canal Breaches Umbrella</u>

The Katrina Canal Breaches umbrella was implemented by the United States District Court for the Eastern District of Louisiana to better oversee the extensive amount of litigation arising out of the failure of the New Orleans levee system during Hurricane Katrina. Specifically, the umbrella was created to avoid conflicting decisions among various sections of the court, particularly for purpose of pretrial discovery and motion practice. The umbrella's website specifically states that the umbrella consists of "all cases which concern damages caused by flooding as a result of breaches or overtopping in the areas of the 17th Street Canal, the London Avenue Canal, the Industrial Canal, and the Mississippi Gulf River Outlet. The common factor among all of the claims in this umbrella is that the recourse sought involves a determination as to whether the failing of a specific levee or levees was caused by negligent design, construction or maintenance. A corollary to this issue is whether the water damage exclusion in all-risk insurance policies apply to these damages."[167]

There are seven sub-categories of the Katrina Canal Breaches umbrella: Levee, MRGO, Insurance, Responder, St. Rita, Barge, and Dredging Limitation. The court has appointed liaison counsel for each sub-category to oversee the filing of motions, hearings before the court, etc. The umbrella not only consists of cases brought by insureds against their insurers, but also cases against the United States Army Corps of Engineers arising out of its purported negligence in designing and building the levee system.

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[163] No. 87-488, 1991 WL 236839, *2 (E. D. La. Oct. 30, 1991); *see also American Med. Sys., Inc. v. National Union Fire Ins. Co.*, No. Civ. A. 98-1788, 1999 WL 781495 (E. D. La. Sept. 29, 1999) (concluding that, given that there was an issue of whether the defendant insurer acted in bad faith, the reserve information could show how that insurer's evaluation of the case impacted its decision to deny coverage).

[164] *See* Exhibit C (posted online), No. 06-4572-J(2), Record Doc. No. 25 (E.D. La. April 5, 2007)

[165] *See* Exhibit D (posted online), No. 06-4572-J(2), Record Doc. No. 41 (E.D. La. March 19, 2007)

[166] *See* Exhibit E (posted online) *Whitney Place Condominium Ass'n v. James River Ins. Co.*, C.A. No. 06-4154, Record Doc. No. 81.

[167] "Introduction," http://www.laed.uscourts.gov/CanalCases/Intro.htm.

On November 26, 2007, as a result of the decision of the Louisiana Fourth Circuit Court of Appeal in the *Sher* matter, Judge Duval, the district court judge presiding over the umbrella, entered an order staying all proceedings in the Insurance sub-category pending a final decision from the Louisiana Supreme Court.

IV. THE ROAD HOME LITIGATION

Recipients of Road Home funds had to assign rights against their insurance company to the State of Louisiana. The State has filed suit against over 200 insurance companies, alleging that the insurers failed to pay what they actually owed under the homeowners' policy by relying on a flawed interpretation of the flood exclusion, among other issues. Complication arose because, at the time of suit, thousands of people hadn't received Road Home funds, and thus hadn't assigned rights to the State. To solve this problem, the State filed a class action as the sole class representative. Filing as a class action, though, enabled the insurers to remove the suit pursuant to the Class Action Fairness Act ("CAFA"), which was the culmination of years of tort reform efforts. A key element of CAFA is that, in large class action cases, there just needs to be minimal diversity between class member and one of the main defendants for federal courts to have jurisdiction. The State moved to remand and lost; thus, the jurisdictional issue is pending before the United States Fifth Circuit. Regardless, resolution of the flood exclusion issue in *Sher* will likely resolve many of the issues in the Road Home lawsuit because the State seeks to recover amounts not paid to Louisiana insurers because of an insurer’s reliance on the flood exclusion.

One issue arising out of the Road Home litigation is whether a settlement agreement reached between an insured and his insurer should be subject to a protective order. This is because the Subrogation Agreement that assigns the State the right to pursue claims against the recipient's insurer also gives the State the authority to approve or disapprove of a recipient's settlement with the insurer. There is presently a dispute between the State and the insurers over the extent to which information provided to the State as part of the settlement approval process should be subject to a protective order. The State contends that the scope of the Protective Order should be restricted to information about coverage limits, prior payments, and payments to be made in connection with the proposed settlement. The insurers argue that those three categories are much too narrow and "leave unprotected a large amount of insurer proprietary information and virtually all of the insureds' private personal and financial information." The insurers contend that, while individual bits of information about the insureds and their coverages may not be proprietary, this information, complied together into lists and databases, is very valuable to insurers looking for ways to market policies to potential insureds. The State has responded that much of the alleged proprietary information, which includes the insured's personal information, policy numbers, info on other policies and apportionment, is disclosed to the State by the insured during the Road Home application process. The State and the insurers also disagree on the confidentiality of settlement terms, e.g., settlement amounts. While the parties have reached agreement on some issues, they have been unable to resolve all the issues.

Notably, the State's lawsuit has been separated from the other umbrellas before Judge Duval in the Katrina Canal Breaches litigation. In many respects, the State's Road Home lawsuit raised the same issues as other class actions in the Insurance umbrella. Several factors, though, convinced the court to set up a separate umbrella for Road Home - the magnitude of the lawsuit, which involves nearly every insurer to issue a policy in this State, unique jurisdictional issues, and privacy concerns expressed by both the State

(on behalf of the recipients), and the insurers. Put simply, the Road Home is sui generis, and litigation stemming from it is unlike any other lawsuit before Judge Duval.

V. MORTGAGE AND BANKING ISSUES FOLLOWING HURRICANE KATRINA

The Times Picayune reported in May 2007 that insurance companies are dropping wind, hail and tornado coverage from standard homeowner's policies, forcing residents to purchase supplemental policies to protect against these risks. The practical (or impractical) reality is that property owners will now most likely be required to obtain at least three policies (standard, flood, and supplemental wind) to obtain peace of mind that they are covered for hurricane risks. In addition to skyrocketing premiums and coverage limits, insurers have also raised deductibles on Hurricane policies, creating a gap in coverage that could have serious consequences in the event another storm strikes.

The stakes are considerably higher and more complex for owners of high-end commercial property. Mortgagees – many of whom are located out of state – can demand coverage (full replacement coverage on a $180-million high rise, for example) that is, at best, astronomically expensive and, more often, unavailable. Insurance coverage post-Katrina has become a hotly negotiated provision in Louisiana mortgages.

The proliferation of securitized debt has, in part, intensified the struggle between Louisiana borrowers and lenders. Securitization occurs when a lender bundles hundreds or thousands of mortgages into a security that investors can purchase on the open market. For the investor, this pooling of debts offers an attractive investment option: the debt service payments provide a reliable stream of revenue, while the number of mortgages involved in the securitization mitigates the risk if a particular borrower defaults. As a consequence of securitization, major institutional lenders demand uniformity in the mortgages securing the underlying debts and fiercely resist any attempts to negotiate standard terms. The practical effect of this tension is only beginning to unfold.

On the litigation front in the Eastern District of Louisiana, two developments bear noting. First, informal discussions before Magistrate Judge Wilkinson have occurred in which counsel for insureds/plaintiffs, the State of Louisiana Road Home Program and various banking and mortgage interests have met and discussed ways in which a "priority" issue concerning insurance settlement proceeds might be brought to decision. Specifically, plaintiffs' counsel assert that the plaintiff's attorney's fee has first priority for payment from insurance settlements. Many mortgage and banking interests assert that they are named loss payees on any insurance settlement, and their interest should have first priority for payment from any insurance settlement. Similarly, the State of Louisiana Road Home Program asserts that it has first priority (or at least second behind the attorney's fee, but before any mortgage interest) for payment from insurance settlements, up to the amount of its payment to an insured/plaintiff of any Road Home grant. Thus far, the issue has been raised only in the discussion stage in the federal court, and no actual litigation has been commenced. In the state court, however, plaintiffs' counsel have won a decision in the Louisiana 4th Circuit that the attorney's fee outranks the mortgage interest.[168] Second, about 50 lawsuits filed by Chase Home Finance LLC and another half dozen or so filed by Midland Mortgage against various insurance

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[168] *Irons v. U.S. Bank, Inc.* 966 So.2d 646 (La. App. 4th Cir. 2007).

companies have been brought together for group handling before Judge Fallon. All of the cases assert claims that the plaintiff mortgage interests were named loss payees under insurance policies held by their debtors, but that their names were not included on insurance settlement checks issued by the defendant insurance companies. The cases are very much in the early pleading and organizational stages, but it appears that they will be handled and administered together in some fashion in the Eastern District by Judge Fallon.

VI. AN INSURER BEARS THE BURDEN OF PROVING AN EXCLUSION

An "all risks" policy is defined as one that "creates a special type of coverage that extends to risks not usually covered under other insurance; recovery under an all-risk policy will be allowed for all fortuitous losses not resulting from misconduct or fraud unless the policy contains a specific provision expressly excluding the loss from coverage."[169] The insurer must specifically plead the exclusions to coverage. The burden of proving an exclusion from coverage rests on the insurer.[170]

Further, Louisiana Code of Civil Procedure article 1005 provides that a defendant's answer must affirmatively set forth all affirmative defenses. Affirmative defenses are required to be specifically pleaded to give a plaintiff fair notice of the defense and to avoid surprise.[171] Affirmative defenses raise matters for judicial resolution outside of issues raised by plaintiff's petition, plaintiff must be made aware of these matters so that plaintiff can prepare an opposition to the defense and adjust his case, if necessary, in light of the new facts and issues raised by the affirmative defense.[172]

The Fourth Circuit Court of Appeal has specifically held that reliance on an insurance contract is considered an affirmative defense which must be specifically pleaded.[173] In *Pendleton v. Smith*, the defendant's answer did not contain any references to the exclusion sought to be applied by defendants. The Fourth Circuit Court of Appeal held that where the pleadings fail to refer to the exclusion, the defendants were precluded from offering any proof regarding the exclusion: "where the pleadings fail to include this defense, defendant is precluded from offering proof in connection with this exclusion."[174]

Further, courts have held that pleading policy terms "in extenso" is insufficient. For example, in *Dixie Savings & Loan Association v. Pitre*, the Louisiana Fifth Circuit Court of Appeal addressed this exact issue and held that no proof could be offered in connection with the proposed affirmative defense because

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[169] *Dow Chem. Co. v. Royal Indem. Co.*, 635 F2d 379, 386 (5th Cir. 1981); *see also Trinity Indus., Inc. v. Ins. Co. of N. Am.*, 916 F.2d 267, 269 n.11 (5th Cir. 1990).

[170] *See Doerr v. Mobil Oil Corp.*, 2000-0947 (La. 12/19/2000); 774 So. 2d 119, 124; *Dawson Farms, L.L.C. v. Millers Mutual Fire Ins. Co.*,34,801 (La. App. 2d Cir. 8/1/2001); 794 So. 2d 949, 951.

[171] *Sessions, Fishman, Rosenson, Boisfontaine, & Nathan v. Taddonio,* 490 So. 2d 526, 527 (La. App. 4 Cir. 1986).

[172] *Hebert v. ANCO Insulation, Inc.*, 2000-1929 (La. App. 1 Cir. 7/31/2002), 835 So. 2d 483.

[173] *Pendleton v. Smith*, 95-1805 (La. App. 4 Cir.,1996), 674 So. 2d 434, 437.

[174] *Id.*

the defendant failed to specifically plead the affirmative defense at issue.[175] In *Dixie Savings*, the defendant attempted to amend its answer to specifically plead the affirmative defense at issue, but the trial court did not allow the defendant to file an amended answer. The Louisiana Fifth Circuit Court of Appeal refused to consider the defendant's purported affirmative defense or any proof in connection with that defense.[176]

Moreover, the Fourth Circuit recently affirmed the decisions of *Pendleton* and *Dixie Savings* in its November 19, 2007 ruling in the *Sher* matter. In *Sher*, the Fourth Circuit specifically relied on *Pendleton* and *Dixie Savings* in affirming the district court's finding that Lafayette Insurance Company's Answer was insufficient to assert various defenses to coverage. Thus, under Louisiana law, if an insurer fails to specifically plead an exclusion or limitation of coverage, the insurer is precluded from offering any evidence related to these un-pled exclusions or limitations on coverage. Again, this issue is currently pending before the Louisiana Supreme Court.

VII. CONCLUSION

Hurricane Katrina will not only impact insurance litigation in Louisiana, but will have a lasting effect on the insurance industry and insurance law nationwide. The nation's largest natural disaster has led attorneys, the courts, insurance companies, and insureds alike into unchartered waters. In the wake of the catastrophe that was Katrina, however, there are lessons to be learned regarding all of the key post-Katrina insurance litigation issues discussed above.

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[175] No. 99-154 (La. App. 5th Cir. 7/27/99), 751 So. 2d 911.

[176] *Id.*