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Testimony of Gilbert Randolph LLP
On Behalf of the Mississippi Center for Justice and
William Quigley, Professor of Law and Director of the Loyola Law Clinic and Gillis Long Poverty Law Center, Loyola University New Orleans College of Law

Presented to The United States House Financial Services Committee
Subcommittee on Oversight and Investigations

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Chairman Watt and members of the Subcommittee on Oversight and Investigations, thank you for the opportunity to provide written testimony today regarding concerns, raised by both Democratic and Republican Members of Congress, over whether private insurance companies have been properly paying claims for damage resulting from Hurricane Katrina.

This testimony will focus on providing the Subcommittee with concrete examples of the failure of the insurance industry to respond adequately to homeowners and small business owners following Hurricane Katrina. As the testimony below will show, policyholders throughout the region affected by Hurricane Katrina have been stymied in their recovery of needed insurance proceeds by systematic delays and other failures at virtually every stage of the claims handling process. These failures are not limited to a few ill-equipped or small regional insurance companies – these problems plague the insurance industry as a whole and typify its inadequate response following natural disasters such as Hurricane Katrina. These failures have not only undermined post-Katrina rebuilding efforts across the Gulf Coast region, but have unfairly shifted the costs of rebuilding to the policyholders – and ultimately the local, state and federal governments.

This testimony is submitted by Gilbert Randolph LLP[1] on behalf of the Mississippi Center for Justice ("MCJ")[2] and William Quigley, Professor of Law and Director of the Loyola

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[1] Gilbert Randolph LLP is a Washington, D.C. law firm that has extensive experience with insurance recovery on behalf of policyholders, and has handled, on a pro bono basis, insurance-related cases on behalf of homeowners and businesses impacted by Hurricane Katrina. After Hurricane Katrina, Gilbert Randolph LLP produced and distributed, free of charge, videos to help educate homeowners and business owners about their rights as policyholders. These videos may be viewed at http://www.gilbertrandolph.com. The following Gilbert Randolph LLP attorneys contributed to the drafting of this testimony: Rachel Kronowitz, Tina Hsu, Joshua Katz and Jackson Nichols. Michael McGinn also contributed to this effort.

[2] Created in 2002, the Mississippi Center for Justice is a nonprofit public interest law firm that provides legal advocacy to advance racial and economic justice statewide. To respond to the massive, hurricane-related legal needs of low-income and minority people and communities on the Mississippi coast, MCJ immediately opened a Katrina Recovery Office in Biloxi, where staff attorneys and volunteers provide legal advice and representation, coordinate the work of pro bono attorneys and law students from across the country, and advocate for recovery policies and practices that meet the needs of the low-income population.

Law Clinic ("Clinic") and Gillis Long Poverty Law Center ("Gillis Center"), Loyola University New Orleans College of Law.[3] These individuals and organizations have devoted substantial time and effort addressing the many insurance-related issues facing residents of the Gulf Coast region, and have had significant contact with individuals impacted by insurance company practices post-Katrina. Collectively, these groups have spoken with thousands of individuals with legal issues raised by Hurricane Katrina. Many of the policyholder experiences discussed in this testimony are based on accounts of employees or associates of the aforementioned organizations.[4]

I. BACKGROUND

On the morning of August 29, 2005, Hurricane Katrina made landfall on the Gulf Coast as a slow-moving Category 3 storm, causing catastrophic damage to large portions of Alabama, Mississippi and southeast Louisiana. Hurricane Katrina buffeted the coast with powerful winds, which were followed by a storm surge along the Mississippi Gulf Coast and on the north shore of Lake Pontchartrain in Louisiana, essentially sweeping homes off of their foundations. In New Orleans, levees separating Lake Pontchartrain and several canals from New Orleans were overwhelmed, causing flooding in 80% of the city that lasted for weeks.

Hurricane Katrina caused massive property damage to the Gulf Coast region and resulted in numerous deaths and injuries. Many of those who called the region home were displaced; to date roughly 1,700 people lost their lives as a result of the storm, and nearly three quarters of a million people were forced from their homes.[5] Recently, the House Financial Services Committee heard testimony discussing damage to property and housing in the areas affected by

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[3] The Gillis Long Poverty Law Center and the Loyola Law Clinic are both organizations housed at Loyola University Law School in New Orleans and directed by William Quigley, a law professor at Loyola and an expert on civil rights and poverty issues. The Gillis Center's many functions include promoting legal research and education concerning problems of poverty, and assisting attorneys practicing in this area of law. At the Loyola Law Clinic, law students supervised by experienced attorneys represent individuals in need of legal assistance in a number of areas of civil and criminal law. Following Hurricane Katrina, both the Clinic and the Gillis Center have assisted New Orleans citizens with a wide range of legal problems arising out of the storm and have conducted substantive research analyzing the resulting legal and social issues that affect the city and its residents. This testimony is also submitted on behalf of Bradley Black and Davida Finger, Katrina Staff Attorneys at Loyola University New Orleans College of Law. As Staff Attorneys, Bradley Black and Davida Finger supervised students in assisting hurricane victims with their hurricane-related legal issues.

[4] Examples and evidence referred to in this testimony will be cited as either Gilbert Randolph Example, MCJ Example, or Katrina Hotline Example. All of the examples from the Katrina Hotline have been provided by Gregory Johnson, an attorney working for the Katrina Call Legal Advice Hotline, who personally spoke with and counseled approximately 5,000 Katrina victims between September 2005 and February 2006.

[5] Michelle Roberts, *Families say stress of Katrina hastened deaths of loved ones*, The Boston Globe, Dec. 14, 2006, available at http://www.boston.com/news/nation/articles/2006/12/14/families_say_stress_of_katrina _hastened_deaths_of_loved_ones/; *Fox Facts: Hurricane Katrina Damage*, Fox News, Aug 29, 2006, available at http://www.foxnews.com/story/0,2933,210970,00.html.

the hurricane. It is sufficient to note here that such damage was broad and severe.[6] Katrina is estimated to have caused $96 billion in damage, making it the costliest natural disaster in United States history.[7] Much of the property that was damaged or destroyed carried insurance coverage. Insurance industry experts place the amount of insured loss at $40.6 billion, and estimate that about 1.7 million claims have been filed as a result of Katrina. The vast majority of these losses were attributable to homeowners and businesses in Louisiana (62.3%) and Mississippi (33.5%).[8] In these two states alone, over a million homeowner insurance claims have been filed since the storm.[9]

Despite the enormity of the destruction, the insurance industry was well prepared to handle the financial impact of a catastrophic event of this scale, even by its own admission. At the September 7, 2005 Keefe, Bruyette & Woods Insurance Conference in New York City, an insurance executive stated that "our loss will leave us with enough capital to really thrive in the market opportunity that's going to follow at January 1."[10] Another insurance industry executive remarked "[w]e think there's a lot of profitability left in the cycle, and we think that the hurricane will in fact extend that."[11] Recent favorable market conditions have allowed insurers to build up substantial reserves in preparation for a sudden spike in claims that would accompany an event like Hurricane Katrina. In addition, better risk management practices (such as diversifying lines of business) have improved the insurance industry's ability to absorb losses. Indeed, notwithstanding the devastation wrought by Hurricane Katrina and other storms in 2005, and the huge number of resulting claims, the insurance industry reported record profits in 2006. As such, there is no financial crisis that would prevent the fair compensation of losses caused by Hurricane Katrina.

While it is certainly better for everyone that the insurance industry as a whole remains robust and solvent, profits – especially record profits – should be earned through good business practices, not bad ones.[12] Moreover, past catastrophic events, including Hurricane Andrew and

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[6] Over 200,000 homes were destroyed by the storm. In New Orleans alone, 11 percent of the homes were destroyed, as were 18 percent of businesses in Louisiana. See Charles Herman, *Katrina's Economic Impact: One Year Later*, ABC News, Aug 25, 2006, at http://abcnews.go.com/Business/HurricaneKatrina/story?id=2348619&page=1.

[7] *Fox Facts: Hurricane Katrina Damage*, *supra* note 5.

[8] Robert P. Hartwig, *Louisiana Insurance: Market Overview*, Presentation to Louisiana Legislative Women's Caucus, Jan. 27, 2007, available at http://server.iii.org/yy_obj_data/binary/754699_1_0/louisiana.pdf.

[9] Becky Yerak, *Insurers say 95% of Katrina claims met: critics contend 'a lot still unhappy'*, Chicago Tribune, Aug. 23, 2006.

[10] *Looking past devastation, insurers see positive trends*, National Underwriter Property & Casualty, Sept. 12, 2005, quoting Jeff Radke, CEO of PXRE Group, during a presentation at the September 7th Keefe, Bruyette & Woods Insurance Conference.

[11] AIR Report at 17, quoting William Berkley, CEO of specialty insurer and reinsurer W.R. Berkeley Corp., at the September 7th Keefe, Bruyette & Woods Insurance Conference.

[12] In response to insurer practices following Hurricane Katrina, a bipartisan group of lawmakers introduced bills in the House and the Senate that would repeal the limited antitrust exemption provided to the insurance industry under

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the September 11 terrorist attacks, have provided the insurance industry with crucial opportunities to hone efficient processes for handling a massive influx of claims. While the insurance industry has touted the success of its response to Katrina-related claims, most policyholder experiences, including those presented below, tell quite a different story.[13]

II. INSURANCE COVERAGE BACKGROUND

Several types of coverage are available to property owners and business operators to provide protection from the impact of catastrophic events like a hurricane. The insurance disputes that have surfaced post-Katrina have involved the types of coverage described below.

Homeowners Insurance. The typical homeowners policy is considered a type of "all-risks" insurance. "All-risks" insurance extends to risks not usually covered under other insurance; recovery under an "all-risks" policy "generally allows recovery for all fortuitous losses, unless the policy contains a specific exclusion expressly excluding the loss from coverage."[14] While most homeowners policies cover damage caused by wind and wind-driven rain, the typical homeowners policy excludes coverage for flood damage.[15] The typical "all-risks" homeowners policy provides coverage for several types of loss, including:

- Dwellings and Other Structures: damage to homes and other structures on the property such as a shed or detached garage;

- Personal Property: reimbursement for household contents and personal belongings damaged or destroyed; and

- Additional Living Expenses ("ALE"): reimburses policyholders for costs of residing in a temporary location while the insured's home remains uninhabitable. Compensation for ALE includes, but is not limited to, reimbursement for items such as food and housing, and telephone or utility installation costs in a temporary residence. ALE coverage is only available when the insured property is uninhabitable because of a loss covered by the homeowners policy. Typically, insurance policies limit ALE coverage to 20 percent of the available insurance.

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the McCarran-Ferguson Act. These bills would retain state regulation of insurers but give the Justice Department and the Federal Trade Commission the authority to apply federal antitrust laws to insurers.

[13] Yerak, *supra* note 9.

[14] Jane Massey Draper, Coverage Under All-Risk Insurance, 30 A.L.R. 5th 170.

[15] Typically, homeowners insurance policies contain a specific exclusion prohibiting recovery for damage caused by "flooding." Standardized policies used throughout the insurance industry (known as "ISO Policies") contain a specific exclusion that bars coverage for any loss "caused directly or indirectly by any of the following…..water damage, meaning: flood…." ISO Form Number HO 00 02 04 91.

Business Insurance. In addition to providing "all-risk" property damage coverage similar to that afforded by homeowners policies, the typical business insurance policy also provides a range of additional coverages, including:

- Accounts Receivable: recovery of money that cannot be collected due to the destruction of accounts receivable records through a covered event;

- Business Interruption: protection against loss of business income when covered property damage results in a necessary suspension of operations;

- Extra Expenses: reimbursement for extra expenses incurred (to cover rebuilding or relocation costs, for example) as a result of such property damage; and

- Clean-up: funds for cleaning up pollution and removing debris resulting from a covered event.

Flood Insurance. Flood insurance is purchased from the National Flood Insurance Program ("NFIP"). The NFIP is a federally funded program that enables property owners to purchase insurance protection against losses from flooding. While underwritten by the federal government, flood insurance is generally sold through the private insurance market. Likewise, any claims against a flood policy are handled by the private insurer and their adjusters. Flood insurance is meant to fill the gap created by the flood exclusion in typical homeowners and business policies. It is estimated that about 15 percent of Mississippi and 40 percent of New Orleans homeowners carry flood insurance.[16]

III. THE INSURERS' INADEQUATE RESPONSE

In the typical claims handling process, once there has been a covered loss, the policyholder files a claim with their insurance carrier. In filing the original claim, a policyholder includes information to establish proof of loss. The insurance company is either obligated to pay the claim or to send an adjuster to investigate the claim and determine the extent and cause of damage. After factoring in any provisions or exclusions that may affect coverage, the insurer provides an estimate of covered damage and, if accepted by the policyholder, the claim is paid. In the event that a claim is not covered or an exclusion applies, the claim is denied. The policyholder is then left to appeal the decision through the adjudication process outlined in the policy, or can seek redress by filing suit against their insurance carrier.

What follows is an accounting of systemic problems that pervaded the claims handling process in the Gulf Coast region following Hurricane Katrina.

[16] Kevin G. Hall, *Tens of thousands in Gulf Coast may be without flood insurance,* Knight-Ridder/Tribune News Service, Sept. 3, 2005.

Problem 1: Contacting the Insurer

In the months following Katrina, many policyholders experienced a great deal of difficulty in the initial and simplest step of the claims handling process – contacting their insurance company. When policyholders needed their insurers the most, the insurers were often unreachable or simply refused to respond to their policyholders at all. Policyholders were unable to contact a representative of their insurance company by telephone to file their initial claim, or after having filed a claim, were unable to inquire about the status of their pending claims or provide an update of an existing claim.[17]

For example, a woman from Hammond, Louisiana spent two weeks trying to contact Third Millennium, her insurance carrier, by telephone. Because wind damage had caused the collapse of her roof, she was forced to spend most nights during that period in a tent on her front lawn.[18] Similarly, a New Orleans woman who lived in her home for over 30 years before it was destroyed by Hurricane Katrina was unable to contact her insurer to check on the status of her claim despite nearly three months of repeated telephone calls.[19] Far from being isolated experiences, such stories are echoed in the complaints of numerous policyholders who found their insurance carriers completely unavailable in their time of need.

For those policyholders fortunate enough to actually reach a representative of their insurer by telephone, there were frequently additional impediments to obtaining much needed assistance. Many policyholders were forced to plod through a tangled web of operators and transfers to speak with someone who was servicing their claim. One elderly New Orleans woman repeatedly attempted to call her insurance carrier, United Fire, but had her calls continually transferred for weeks without getting any answers. Unable to contact her insurer and obtain the "additional living expenses" that should have been provided under her policy, this elderly woman was forced to live in a shelter for over a month, during which time she became extremely ill and ran out of the meager savings she possessed.[20]

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[17] The failure of the insurance companies to respond to telephone calls from policyholders compounded the already difficult situation involved in contacting insurers as policyholders could not rely on other methods of communication, such as mail service, following Katrina.

[18] Americans for Insurance Reform, *The Insurance Industries Troubling Response to Hurricane Katrina*, Jan. 2006, at 9-10, available at http://www.insurance-reform.org/pr/KATRINAREPORT.pdf (hereinafter AIR Report).

[19] *Id.* at 15. This claimant obtained her insurance through Louisiana Citizens Property Insurance Corporation (LCPI), a state sponsored "insurer of last resort" who provides coverage for those homeowners who are unable to obtain insurance from the private market. Audubon Insurance, a subsidiary of American International Group held the contract to administer LCPI policies and handle claims through Hurricane Katrina. The claims handling failures typical of the insurance industry as a whole after Katrina were even worse for LCPI. In anticipation of the termination of their contract to administer LCPI policies and handle claims, Audubon began scaling down operations, thereby impairing their ability to respond to the claims of policyholders.

[20] *Id.* at 10.

This phenomenon is not an isolated event limited to certain insurance carriers. Rather, this problem typifies the insurance industry's mismanagement of the claims handling process in the wake of Katrina.

Problem 2: Insurer Follow-up and Adjuster Inaction

Those policyholders that actually managed to reach their insurers and file claims encountered a number of additional roadblocks to recovering on their claims. Under typical policy terms, an insurance company must provide an adjuster to inspect the damaged property before the policyholder can expect to be reimbursed for making repairs. Louisiana law provides that "in the case of a catastrophic loss, the insurer shall initiate loss adjustment of a property damage claim within thirty days after notification of loss by the claimant."[21]

Following Katrina, many policyholders languished, waiting weeks (and many even months) for an adjuster to arrive, despite repeated requests. Policyholders who were unable to wait for their insurer to send an adjuster were forced to pay for the repairs themselves. Many of the policyholders who waited for their adjusters to arrive incurred further damage to their properties in the interim because no repairs were made.

For example, a Harvey, Louisiana woman's home sustained severe roof damage during Hurricane Katrina, rendering her home uninhabitable. As she was unable to get Allstate to provide the necessary funds for her to make repairs to her roof, her home was further damaged by Hurricane Rita. If her insurer had responded earlier she could have prevented the additional water damage caused by Hurricane Rita.[22] Similarly, a New Orleans woman whose home was damaged by Katrina was forced to wait for over three months before her insurer sent an adjuster – a clear violation of Louisiana law. The storm had left her house with significant water damage, which resulted in the accumulation of mold in the interior of her home. Because her insurer continued to stall and delay in processing her claim, she was unable to repair her home for months after Hurricane Katrina. While her house sat unrepaired, the mold problem got progressively worse.[23] The insurers' inadequate response left those insured vulnerable to further damage and destruction.

These problems were not limited to homeowners. An owner of a damaged apartment building in New Orleans waited months for an adjuster to arrive to survey the damage. More than a year after Hurricane Katrina, he had not been able to get anyone at his insurer, Allianz, to provide him with his adjuster's report, nor had anyone bothered to return his repeated calls to follow up on his claim. Unable to get insurance proceeds for rebuilding, the apartment building

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[21] L.R.S. 22:658.3(A)(3).

[22] AIR Report at 11.

[23] *Id.* at 15-16.

owner has not been able to repair his building.[24] In another case, a New Orleans business waited until February 2006, almost six months after Hurricane Katrina struck, for an adjuster to assess the damage. In the meantime, expensive equipment on-site was exposed to further damage from the elements because it could not be moved until the adjuster had completed his inspection and the insurer, Zurich, rendered payment (which could be used to fund moving costs).[25]

Compounding the aforementioned problems, insurers refused to provide additional living expenses for those homeowners in need until an adjuster was sent to survey the property. Gregory Johnson, an attorney who has heard the complaints of many beleaguered policyholders through his work on the Katrina Hotline, recounts many instances in which homeowners were forced to go without the living expenses they desperately needed (and to which they were entitled) for months on end.[26]

Unable to obtain an adjustment, many policyholders ran out of options. Some were forced to move back into their homes despite structural damage. One Terrytown, Louisiana family with a newborn baby was forced into this drastic course of action because an adjuster was not sent to inspect their house for over three months.[27] Those policyholders that tried to take matters into their own hands and make early repairs, rather than wait in vain for an adjuster to come, had their requests for reimbursement denied by the insurers, who insisted that their failure to wait for an adjuster violated the terms of their policy.[28]

Problem 3: Improper Assessment of Damage

In numerous instances, adjusters sent by their insurance company failed to properly carry out their duties, either through incompetence or sheer lack of effort. In many cases, adjusters would conduct "drive by inspections" where it was obvious that no inspector had actually seen the home up close. There have been numerous accounts of policyholders whose inspectors failed to undertake the necessary steps to assess the damage, refusing to enter homes or climb onto roofs, and sometimes refusing even to get out of their car.[29] If a home had flooded, many adjusters simply assumed that all the interior damage to the home was caused by the flooding without seeking any confirming evidence.[30] One Mississippi resident who had flood insurance

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[24] Gilbert Randolph Example.

[25] *Id.*

[26] Katrina Hotline Example. Under the typical homeowners insurance policy, policyholders have a right to additional living expenses if their home has been made uninhabitable by a covered loss. *See supra* § II.

[27] AIR Report at 15.

[28] *Id.* at 10-11.

[29] Katrina Hotline Example; Gilbert Randolph Example.

[30] On September 7, 2005, immediately after Katrina hit, the Mississippi Insurance Commissioner issued Bulletin 2005-6, which required that an adjuster on a homeowner policy not summarily determine the cause of property

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was told by their insurer, State Farm, that because all of the damage was due to flooding, they could not recover any amounts on their homeowners policy. State Farm refused to pay without bothering to investigate whether any damage was caused by wind.[31] Another Mississippi resident got the same response from Liberty Mutual, and obtained coverage only after media reports and intervention by an attorney.[32]

Cori and Kerry Rigsby, two former adjusters employed by E.A. Renfro to provide adjuster services for State Farm, have exposed the unscrupulous tactics that they were ordered to carry out by their superiors. According to the Rigsby sisters, they were instructed to pay National Flood Insurance Program claims as quickly as possible, and to refuse to acknowledge evidence of wind damage.[33] Inspection reports were sent in citing “no wind damage” where trees had clearly been driven through the house by hurricane force winds, or where the backs of homes had been blown clean off. In fact, many independent adjusters quit because of the instructions they were getting from their insurance companies to deny or otherwise falsify claims.[34] This practice allowed insurers to minimize the liability for themselves while at the same time shifting the burden onto both policyholders and the federal government, which subsidizes the NFIP.

Tragically, it was not uncommon for homeowners to go through several adjusters over a period of months without ever receiving a final report or an offer of settlement from the insurance company. Many homeowners were informed by their insurer that the company had “never received his report,” and would have to send out another adjuster, thereby starting the cycle of frustration over again.[35]

Problem 4: Arbitrary Denial of Claim

Insurance companies have embarked on a campaign to shift the costs associated with insuring policyholders in the Gulf Coast region to the state and federal governments. Because private insurance polices cover damage associated with wind, but exclude damage associated with flood, private insurers had a perverse incentive to routinely make determinations that any damage resulting from Katrina was caused by flooding. Thus, every dollar allocated to a flood policy is paid using federal funds instead of depleting the insurers’ reserves. United

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damage without first inspecting the property itself. Adjusters were instructed to “fully inspect any damaged property before a coverage decision is made.”

[31] MCJ Example. MCJ attorneys noted that in most cases that they reviewed, there was generally some evidence of wind damage, but that insurers often refuse to acknowledge such damage.

[32] Gilbert Randolph Example.

[33] Anita Lee, *State Farm Underpaid on Purpose*, The Sun Herald, Aug. 26, 2006.

[34] Katrina Hotline Example.

[35] *Id*.; Gilbert Randolph Example.

States Congressman Gene Taylor labeled this incentive "one of the biggest Katrina frauds of them all," and suggested that adjusters hired by insurance companies have an inherent conflict of interest because they calculate losses for both their own companies and the federal flood program.[36]

For thousands of destroyed properties in the Gulf Coast region covered by both flood and homeowners insurance, owners were compensated up to the policy limits of their flood policy and were provided no compensation under their homeowners policy.[37] The clear purpose of this allocation was to have claims compensated with federal funds and not the insurance company's own money. The allocation to the homeowner's flood policy was done regardless of what actually caused the damage.[38] It is evident that as long as insurance companies have the ability to assign damages to the NFIP rather than to themselves, the conflict of interest that this creates will allow insurers to avoid financial responsibility while the federal government is left holding the bag.

One of many people falling victim to this perverse incentive was a woman in Lake Shore, Mississippi who lived in a house elevated on 16-foot posts that was completely destroyed by Katrina. Despite the absence of any signs of water or previous flooding on her property, she was informed by her insurer, Countrywide Homeowners, that her claim would be denied because the damage was caused by flooding.[39] In fact, many policyholders who were in their homes when they were destroyed by wind or tornado hours before the flooding were told by their insurer that their claims had been denied because all of the damage to their homes was the result of flooding.[40]

Several residents holding homeowners policies with United Fire Insurance[41] were informed by their insurer that the damage and forced evacuations in New Orleans resulted solely from flooding. Similarly, a New Orleans woman whose home was not damaged by flooding was told by a Lafayette Insurance Company official that due to the "fact" that her home was damaged solely by flooding, the company would refuse her claim for additional living expenses.[42] The

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[36] Letter from Representative Taylor to Chairman Frank, January 5, 2007. Representative Taylor's observations come in part from his own experience in trying to show his adjuster the wind damage to his home.

[37] The Mississippi coast suffered several hours of destructive hurricane force winds before inundation by the storm surge. Insurers paid billions of dollars of wind claims inland, where no possible flooding could be claimed, but rejected claims on the coast assuming, for the most part incorrectly, that all the damage near the coastline was caused by flooding.

[38] Katrina Hotline Example.

[39] AIR Report at 4.

[40] Katrina Hotline Example.

[41] United Fire Insurance's subsidiaries include Lafayette, Addison, American Indemnity, and United Fire Lloyd's.

[42] AIR Report at 5.

arbitrary denial of claims under homeowners policies violates La. Stat. Ann. § 658(B)(1), which provides that the "failure to make a written offer to settle any property damage claim, including a third-party claim, within thirty days after receipt of satisfactory proofs of loss of that claim…when such failure is found to be arbitrary, capricious, or without probable cause, shall subject the insurer to a penalty…."

According to the Center for Justice & Democracy, which took calls from a hotline staffed by Patrick Buckley and Basel Hamdam, some of the most reprehensible conduct exhibited by the insurance industry is attributable to Allstate and its representatives.[43] For example, a Bay St. Louis, Mississippi resident had the damage to his home declared to be entirely due to flooding, despite the fact that two separate inspections of his house showed a waterline of only 8 and 10 inches, respectively, and further despite the sizable hole in his roof caused by a tree that had fallen on it.[44]

Commercial claims are also subject to arbitrary denials, leading to delays in re-opening businesses, which can hinder the overall recovery of a region. A New Orleans business had been denied crucial extra expense funds to rebuild, based on an erroneous reading of the policy provisions. Only after a lawyer for the business intervened and pointed out the error did the insurer, Zurich, relent and agree to make extra expense payments.[45] Businesses without legal representation may not be so lucky.

As was revealed in a recent legal battle against State Farm, the insurance industry seems to have adopted an outcome-oriented approach to claims handling. This approach often ends in the mistreatment of policyholders and swollen coffers for insurance companies. According to reports from the case, *Watkins et al. v. State Farm Fire & Casualty Co. et al.*, the linchpin of this strategy is hiring adjusters who the insurers know will provide a report that justifies the denial of the policyholders' claims. While insurance executives represent that policyholders get a fair assessment of their claims, what they actually receive is quite the opposite. In May 2006, the jury in the above-mentioned case found that State Farm "intentionally and with malice breached its duty to deal fairly and act in good faith" with policyholders through the use of two companies, Haag Engineering Co. and E.A. Renfro, hired to adjust claims. The two companies were both hired by State Farm to provide adjustments in the Gulf Coast region after Hurricane Katrina, and were complicit with State Farm in improperly denying wind claims. The assessments conducted by firms such as these two adjusters demonstrate how the current claims handling process is not only flawed, but has an enormous potential for corruption.[46]

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[43] *Id*. at 2.

[44] *Id*. at 12.

[45] Gilbert Randolph Example.

[46] Anita Lee, *The Perfect Insurance Storm*, The Sun Herald, Feb. 18, 2007, available at http://www.sunherald.com/mld/sunherald/16725585.htm; see also *Watkins et al. v. State Farm Fire & Cas. Co. et al.*, No. CJ-2000-303, *verdict returned* (Okla. Dist. Ct., Grady County May 25, 2006).

Problem 5: Inadequate Payment

After dragging out the claims handling process, exacerbating the pain and suffering that Katrina victims were forced to endure, the insurance industry demonstrated a systematic pattern of offering inadequate compensation for the policyholders' insured losses. An elderly Pass Christian, Mississippi couple whose home was completely wiped out by the storm was forced to move into temporary residence, placing them under substantial financial strain. After months of waiting, the couple was offered one quarter of the amount of their total homeowners and flood policies. This was in spite of the fact that their home was completely destroyed by the hurricane. Desperate for money and having already been driven to the limits of their patience, the couple gave in and decided to accept the reduced payment.[47]

One New Orleans woman's struggle to receive adequate compensation for her covered loss provides further insight into how the insurance industry failed its policyholders when they needed them most. This woman, whose home was severely damaged by Hurricane Katrina, filed a claim for the damage to her home and its contents that were also destroyed by the storm. As the typical insurance policy covers both damage to the physical structure of the home and its contents, she had a right to compensation for damage to both her home and the personal possessions that were inside. To her dismay, she was informed by her insurer that it was disputing her claim and she would only be compensated for the damage to her home. Even worse, the compensation she was awarded would not cover the cost of a new roof.[48]

Insurance companies forced policyholders to choose between accepting reduced compensation or face both protracted litigation and further delays in receiving their money. For example, an elderly New Orleans woman who attempted to contest the "lowball" offer given to her by her claims handler, Audubon, was told that contesting the offer would only further delay her payments.[49] In another case, a Mississippi family had $78,000 worth of damage done to their house a result of Katrina. However, after a dispute with their insurer, Allstate, over how much damage was caused by wind, the family was forced to accept only $13,000 for the contents of their home and only $18,000 for repairs. Shockingly, the family was not even provided any money for out of pocket living expenses incurred while displaced.[50]

A former Allstate adjuster, Shannon Brady Kmatz, has explained how this strategy is not just an incidental business practice, but a directive handed down by insurance company

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[47] AIR Report at 12.

[48] *Id*. at 14.

[49] *Id*. at 15.

[50] MCJ Example. The MCJ has recorded numerous similar instances where insurers forced Mississippi homeowners to accept reduced payouts. Offending insurance companies include Z.C. Sterling Insurance, State Farm, Nationwide Insurance, National Security Fire and Casualty Company, and Guide 1 Insurance.

executives. Kmatz, who left Allstate in 2000, says that she felt constant pressure to "fast-track" claims by settling them quickly and for as little as possible. Kmatz referred to the process as "throwing them [policyholders] a bone." She elaborated, "[y]ou offer them $500 and hope they go away." Kmatz said that she was evaluated on how successful she was at convincing policyholders to accept the company's lowball offer rather than try to get more money by hiring an attorney. This pressure was even incentivized through the award of thousands of dollars in free dinners and bonuses to every adjuster meeting performance criteria in this area.[51] As demonstrated above, this tactic was employed even prior to the problems with insurers in the aftermath of Katrina, and as a business practice has been central to Allstate's claims handling process for quite some time.

Faced with the choice between receiving some money now or the prospect of a protracted court battle, many policyholders settled for drastically reduced payments. Those with limited financial means and less education are more likely to have little recourse and are often forced to accept being shortchanged by their insurers. Their savings are insufficient to cover repairs to their home or legal costs to go after their insurers. Similarly, those with lower levels of education may lack the sophistication to overcome the hurdles to receiving additional funds. In the case of Hurricane Katrina, it also appears as though African-Americans were less likely to pursue additional insurance funds after initially receiving an inadequate settlement.[52] As an example, Louisiana residents who felt they had not received adequate compensation for their insured losses could file a complaint with the state insurance regulators who would then seek additional compensation through a settlement with the offending insurance companies. (The fact that this process was even necessary supports the contention that the insurance industry's response to hurricane losses were insufficient and unacceptable.) An Associated Press analysis shows that Louisiana residents living in white neighborhoods have been three times as likely to seek help from this agency than residents from black neighborhoods. Income also appeared to be a factor, as those seeking this assistance tended to be from neighborhoods with higher median household incomes than those who did not seek assistance.[53]

Even those who could afford representation or were savvy enough to maneuver through the claims dispute process sometimes accepted inadequate settlements as they could not wait for the legal system to run its course. Insurers can take advantage of policyholders desperate for funds to rebuild. For example, a New Orleans company waited nearly six months for an adjuster to survey its damage, only to be told by its insurer, Zurich, that it would be paid only 32 weeks of lost business income under the company's business interruption coverage. In other words,

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[51] Walter Updegrave and Kate Ashford, *Insurers Playing Rough*, Money Magazine, Feb. 13, 2007, available at http://money.cnn.com/2007/02/12/magazines/moneymag/insurance_sv.moneymag/. Kmatz provided evidence of such bonuses in a 2003 affidavit that is part of a class action suit filed against Allstate.

[52] Richard Callamachi, *Whites Pursued Katrina Insurance Complaints More Than Blacks in La.*, Insurance Journal, Oct. 25, 2006, available at http://www.insurancejournal.com/news/southcentral/2006/10/25/73574.htm.

[53] *Id*.

despite the fact that the insured location was no longer fit for use and the company would have to relocate, the company would be expected to rebuild and re-open within 10 weeks – an impossibility, especially in post-Katrina New Orleans. Only after intervention by a lawyer was the business awarded the full policy limits of one year of lost business income.[54]

The insurance companies' tactics of throwing policyholders a "bone" has allowed the insurance industry to increase profits and produce deceptively high statistics regarding how many claims have been settled. Faced with the aforementioned options, it is no surprise that so many policyholders have settled with their insurance carriers. Far from suggesting that the insurance industry's claims handling process has provided an effective solution, these statistics may only illustrate the insurers' manipulation of a flawed system.

Problem 6: Delayed Payment

Many policyholders were promised that they would receive compensation, either for their covered loss or in the interim to cover "additional living expenses," only to be left in the lurch for months waiting for their promised compensation. Louisiana law provides that "[a]ll insurers issuing any type of contract…shall pay the amount of any claim due any insured within 30 days after receipt of satisfactory proofs of loss…."[55] Nevertheless, it is common to hear stories of policyholders who were repeatedly told by their insurers that their "check was in the mail," only to wait for months for their checks to finally be sent. A New Orleans woman's struggle to obtain the check she was repeatedly promised by her insurer provides an example of what so many policyholders were forced to go through to finally obtain compensation for their losses. An Allstate policyholder residing in New Orleans was repeatedly told by Allstate representatives that she had been sent her check. However, the check never came. She attempted to contact Allstate numerous times to inquire about the status of her check. Each time she called Allstate she was given a different date when the check was supposedly mailed to her. This game was played by Allstate for over two months before she finally received her check.[56]

Many policyholders were instructed that in order to obtain their check they would have to drive to a local office of their insurer. Louisiana resident Shawna Balding tells how her mother, a 78-year-old New Orleans woman whose home was flooded, was told by a Travelers representative that she would have to travel to Baton Rouge, Louisiana or Gulfport, Mississippi to pick up the check she was owed for additional living expenses.[57] Another frustrated policyholder who waited four months for her compensation gave voice to what has been

[54] Gilbert Randolph Example.

[55] L.R.S. 22:658.3(A)(1); Mississippi law does not contain any provision to this effect.

[56] AIR Report at 11.

[57] *Id*. at 9.

weighing on many policyholders' minds: Why have I paid those premiums for all these years to be left starving, struggling and homeless?[58]

Businesses are also harmed by delayed payments. Without insurance funds, many businesses cannot reopen (and thereby provide needed jobs and services), to the detriment of the local economy. Funds critical to the recovery of the region are held up for a variety of reasons: allegedly lost FedEx packages, indifferent or even hostile claims handlers, poor caseload management (such as files that fall between the cracks when claims representatives quit or are fired), or deliberate delay.[59] As time passes, policyholders are more and more likely to accept unconscionably small settlements.

Mississippi Attorney General Jim Hood has publicly suggested the motive that drives these high-pressure tactics: the longer cases are delayed, the greater the number of policyholders who will accept payments amounting to little or nothing, so that they can avoid the extra hassle and get on with their lives. This ploy could have dire effects for local economies. Rick Sharga, a vice president at RealtyTrac, a company that tracks foreclosure rates, suggests that the delayed insurance payments on homeowners and businesses could lead to higher foreclosures along the Gulf Coast because people cannot afford to repair their properties. Indeed, according to RealtyTrac, foreclosures have been rising in recent months in the areas of the Gulf Coast region hardest hit by Hurricane Katrina.[60]

IV. <u>THE NEED FOR REFORM</u>

More than merely a tragic account of the suffering experienced by a few victims of Hurricane Katrina, these stories reveal the widespread and systemic failure of the insurance industry's claims handling process. The current claims handling process allows insurers to exploit policyholders through deliberate neglect, purposeful incompetence, and outright manipulation of the system. Thus, insurance companies improperly delay compensating policyholders, seriously undervalue claims, and even arbitrarily deny claims, knowing full well that many policyholders lack any viable recourse.

Many of the failures of this process are similar to those identified more than a decade ago in the aftermath of Hurricane Andrew in 1992. Andrew raised many of the questions that are again before this Subcommittee today regarding the inability of the insurance industry to adequately compensate policyholders following a large-scale disaster. But now the insurance

[58] *Id*. at 12.

[59] Gilbert Randolph Example.

[60] Kathy Chu and Larry Copeland, *Homeowners decked by Katrina still wait for insurers to pay up*, USA Today, Aug. 25, 2006, available at http://www.usatoday.com/money/perfi/insurance/2006-08-24-katrina-insure-usat_x.htm.

industry comes before Congress while reaping record profits on the basis of those same failures.[61]

The failure of the claims handling process has allowed the insurance industry to thrive financially while inaccurately claiming to be enveloped in a crisis of mounting liability. In fact, a study by Robert Hunter, a former insurance commissioner of Texas and now the insurance director of the Consumer Federation of America, shows that property and casualty insurers are actually paying out less in claims relative to the premiums they collect than at any time in the past twenty years.[62] While some of this is attributable to the insurers' refusal to insure high risk areas, thereby forcing the local and federal governments to absorb a larger portion of the coastal insurance program, this increase in retained premiums is, to a large extent, due to insurers forcing policyholders to accept smaller payouts on claims.

The insurance industry posted record profits in 2006. According to industry filings with state regulators, the insurance companies that provide homeowner and automobile insurance posted record profits of $44.8 billion last year, even after accounting for the claims of policyholders impacted by Hurricane Katrina and other big storms of 2005. These profits represent an 18.7 percent increase over the previous year. Not only has the industry increased its profits, it has also raised its surplus by more than 7 percent to nearly $427 billion, according to an analysis of company filings by the National Association of Insurance Commissioners, which represents regulators from all fifty states.[63] The insurance industry's remarkable performance in the face of an estimated $40.6 billion in disaster losses reflects a long-term effort by insurers to insulate themselves from the extreme financial consequences associated with catastrophic events.[64] By diversifying its risks, the insurance industry has kept itself in good health, and has absorbed a significant increase in claims while remaining profitable. Thus, the industry has the necessary reserves to provide fair compensation for the claims arising out of Hurricane Katrina.

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[61] The insurers' ability to absorb the influx of claims generated by a catastrophic event like Hurricane Katrina and still increase profits has grown since Hurricane Andrew and other past catastrophic events. For example, when Hurricane Andrew hit the coast of Florida in 1992, Allstate Chief Executive Edward M. Liddy told a Washington audience that, "it wiped out all of the profits Allstate ever made in the state from all lines of insurance over the course of our history…. [a]nd when four hurricanes hit in 2004, they wiped out all the profits from 1992 to 2004." An Allstate spokesperson later clarified Mr. Liddy's statement, saying that what he meant to say "is that…the four hurricanes wiped out all the profits Allstate earned from our homeowners lines of business," not all lines. Peter G. Gosselin, *Insurers Saw Record Gains in Year of Catastrophic Loss*, L.A. Times, April 5, 2006, available at http://www.latimes.com/news/nationworld/nation/la-na-insure5apr05,0,3061059.story?coll=la-home-headlines.

[62] Updegrave and Ashford, *supra* note 51.

[63] Gosselin, *supra* note 61.

[64] Allstate's Vice President summed up how his company has isolated itself against an influx of claims when he said "[i]f last year's hurricane season had occurred 10 years ago, it would have been devastating for the company,… [l]ast year, it was merely disappointing." This comment and the statistics cited above directly contradict the insurance industry's inaccurate and overblown comments regarding the financial effect of Katrina-related claims on the insurance industry. Moreover, these comments are part of a larger attempt by insurers to force "a risk shifting strategy of moving risks off their books onto government and policyholders." Gosselin, *supra* note 61.

But, as detailed in this testimony, the way in which insurers have been paying claims has been anything but fair.

Reform and leadership will have to come from the federal government. The insurance industry has shown no willingness to self-regulate since these same failings were identified over a decade ago. State agencies charged with overseeing and regulating insurance companies are discouraged from taking aggressive positions with insurers, lest insurers follow through on threats to pull out from the state altogether. As a case in point, State Farm recently announced that it would no longer write policies in Mississippi, where Attorney General Jim Hood has been locked in a highly publicized fight with State Farm. Notwithstanding Hood's aggressive actions against State Farm, even he acknowledged that he pursued a settlement of his lawsuit against State Farm in the hopes of keeping the insurer writing homeowner policies in Mississippi.[65] Nor can legislative action be relied upon to resolve these issues. When these battles are decided in state legislatures, the insurance industry lobby has had success in beating back stiffer regulations.[66]

Moreover, at a time when insurers are using global warming as the basis to stop writing policies as far north as Long Island, New York, these issues are no longer confined to a single state or even to the Gulf Coast region. Nationally, important questions about who can build a home or business and where they can build – previously the sole province of government – are now being decided by private insurers. Further, the costs of these decisions are borne by policyholders, and especially in the case of the uninsured or uninsurable, state and federal government.

This situation cries out for Congressional intervention. The importance of the insurance industry in rebuilding efforts following a disaster cannot be overstated. When a disaster occurs, productive resources in the affected area are crippled; the degree to which the storm disrupts the affected area's economy depends not only on the magnitude of the storm, but also to a large extent on the insurance industry's responsiveness to such disasters. Compensation for insured losses provides a key source of revenue to stimulate and facilitate recovery. The inability, and in many cases unwillingness, of the insurance industry to respond properly post-Katrina demonstrates the shortcomings of the current system. Without reform, the victims of future catastrophes will continue to face the same injustices presented in this testimony.

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[65] *Mississippi fires back at State Farm*, Reuters, Feb. 16, 2007, available at http://money.cnn.com/2007/02/16/news/companies/state_farm/index.htm?postversion=2007021616.

[66] For instance, following Hurricane Andrew in 1992, the insurance industry successfully lobbied the Florida Legislature to repeal Fl. Ann. Stat. § 627.702, Florida's Valued Policy Law. This statute held insurers responsible for the total loss if just a portion of the loss was caused by a covered peril, regardless of any loss limiting provisions in the policy. As a result of these lobbying efforts, the insurance industry was able to insulate itself from the potential onslaught of claims that would result if the Florida law remained in effect.