UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

INQUIRY INTO INSURANCE CLAIMS PAYMENT PROCESSES IN THE GULF COAST AFTER THE 2005 HURRICANE

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Hurricane Katrina: What about the wind?

Introduction and Summary

Mr. Chairman and members of the Subcommittee:

I am Jim Hood, Attorney General for the State of Mississippi. I appreciate the opportunity to testify before the Subcommittee today on the insurance industry's response to Hurricane Katrina.

Hurricane Katrina slammed into the Mississippi Gulf Coast on August 29, 2005. Eighteen months later, thousands of residents remain displaced or homeless, not as is commonly believed, as a result of their failure to buy flood insurance, but because the wind policies they purchased were not honored. Those Mississippians who did purchase flood insurance soon learned that while flood claims were paid relatively quickly, courtesy of the federal government, claims against privately-written wind policies were denied with little or no explanation and apparently erratic or nonexistent investigation. The long-term consequences for an already over burdened National Flood Insurance Program and for a private insurer pretending that Katrina was a windless hurricane remain to be seen. The Mississippi Attorney General' s Office is indebted to the residents of the Gulf Coast who have given generously of their time and information to assist in the investigation of the man-made aspects of this disaster.

This report will focus on the following topics:

I: The efforts made by the Mississippi Attorney General's Office to protect the citizens of Mississippi from apparent civil and criminal fraud; the obstacles encountered as part of these efforts; and analysis of the mechanisms available in Mississippi to protect both policyholders and the National Flood Insurance Program from future abuse by insurance providers;
II: A sampling of the pre-textual and legal tactics used by State Farm to avoid responsibility for wind damage caused by Hurricane Katrina; and
III: Concerns for the continued economic viability of coastal regions and the insurance industry.

I. Protective measures

A. The Attorney General's challenge of the anti-concurrent causation clause. Less than a month after the storm, a civil action was brought in Hinds County Chancery Court by the Mississippi Attorney General' s Office (hereinafter "MSAG's Office") against five named insurance providers; the action sought to make the insurance companies honor their policies and pay for damage caused by Hurricane Katrina, including storm surge, consistent with long-standing Mississippi law on proximate causation and contract interpretation. The MSAG's Office asked the Court to prohibit insurance companies from enforcing the ambiguous and misleading anti-concurrent causation clauses and water damage exclusions to unlawfully deny claims. Examples of anti-concurrent causation clauses used by Allstate, Nationwide and State Farm are attached as Exhibits A, B and C, and are discussed in detail below.

The proximate cause of an injury is that cause which in natural and continuous sequence is unbroken by any intermediate, controlling, and self sufficient cause that produces the injury and without which the result would not have occurred. Mississippi follows the doctrine of efficient proximate cause, which provides that if the proximate cause of a loss is a covered peril under a policy of insurance, the existence of or contribution by a non-governed peril does not bar coverage. If the nearest efficient cause of the loss is not a peril which is insured against, recovery may nevertheless be had if the dominant cause is a risk or peril that is insured against.

The Defendants promptly removed the matter to federal court, where it languished until its remand on March 8, 2006. Defendants filed a motion to reconsider, which was denied on December 26, 2006, and only then, after a fifteen month delay, was the matter sent back to the Hinds County Chancery Court. On January 23, 2007, a Settlement Agreement with State Farm only was filed with the Hinds County Chancery Court. The proposed settlement was intended to resolve the MSAG's civil suit against State Farm, and included language requiring State Farm "to establish an administrative procedure to reevaluate claims of State Farm policyholders in Hancock, Harrison, and Jackson Counties who had residential or commercial policies in effect on August 29,2005,_ ..._[that] will establish an orderly, fair and prompt resolution of claims_..._based upon criteria and guidelines approved by the United States District Court for the Southern District of Mississippi."

On January 26, 2007, the U.S. District Court denied preliminary approval of State Farm's proposed class settlement. State Farm's failure to establish an acceptable procedure for the reevaluation of claims as described above violates its Settlement Agreement with the MSAG's Office. As a result, the MSAG's Office has petitioned the U.S. District Court to enforce the state court Settlement Agreement and to allow the MSAG to either intervene in the federal action or participate in a hearing on the matter. At the time of this writing, the Court has not issued a response to these requests.

B. Launching the criminal investigation into the conduct of State Farm and its

selected vendors for adjusting and engineering services

1. Citizen complaints. After the storm, the MSAG's Office continued to field and investigate complaints from policyholders, and a pattern soon emerged. Some policyholders were frustrated that their property damage was inspected by one adjuster after another, with each adjuster offering contradictory and/or incomplete information about coverage and the assessment of the cause(s) of damage. Most complaints were directed at State Farm, which at the time seemed explainable by the fact that State Farm was the largest residential insurer in Mississippi. Residents began receiving denial letters from State Farm informing them that, "based on our investigation" coverage was denied; however, neither the State Farm agents nor members of the State Farm Catastrophe Team (hereinafter "CAT team") were willing and/or able to explain to policyholders what steps were taken in the investigation of their claim(s). Some policyholders were informed over the telephone that an engineering report or weather data had been used to exclude coverage, but they were not allowed to see the reports or data or to learn of the exact contents or persons responsible for creating them. The MSAG's Office announced publicly on March 20, 2006, that a formal criminal investigation would be conducted to determine whether or not any violations of Mississippi law had been committed by insurance providers handling Hurricane Katrina claims.

In certain instances, mistakes were made and policyholders ended up with copies of the engineering reports that State Farm never intended for them to see. For example, Rimkus Engineering, an engineering firm based in Houston, Texas that supplied engineering services for State Farm in the assessment of Hurricane Katrina claims was confronted with allegations from several of its engineers. Those engineers disavowed the signatures on the engineering reports purporting to be their own and further denied that they in any way authorized secretaries or other administrative staff within Rimkus to sign on their behalf.

Rimkus responded to these allegations by posting a rebuttal on its web site, claiming falsely that it had been assured by the Mississippi Attorney General's Office that it was not a target in any criminal investigations. My office had given Rimkus no such assurance. For its part, State Farm continued to rely on Rimkus' engineering services and continued to award them jobs despite the allegations. Many homeowners were, not surprisingly, concerned that State Farm had decided their claim based on a Rimkus report that may or may not have been signed by the engineer. However, State Farm would not share with homeowners whether or not their home damage had been inspected by an engineer at all, and if so, by whom and with what result.

2. Keeping engineers on a short leash. Rimkus was not the only provider of engineering services to State Farm following the storm; at least nine other engineering firms were used. Some were verbally promised work loads of up to 1,000 cases, although the number of jobs eventually received was much lower because State Farm ultimately stopped ordering engineering reports in all but a very few cases. Considerable investment was required of engineering firms that wanted to participate in this work, e.g. hiring additional staff, arranging for adequate housing, establishing a work space and securing a communications set-up to do the

work, etc. No good businessperson would undertake this level of investment in order to perform fifty inspections at an average of $2500 per job.

One might expect the standards of performance of the engineers under these circumstances to have been explicitly set forth in writing, but we found no evidence of this practice. Rather, the ability of an engineering firm to continue receiving Katrina cases from State Farm seems to have been most closely correlated with the extent to which their conclusions could be used to deny or at least minimize coverage. The unspoken guarantee was that as long as Lecky King, a State Farm CAT Coordinator who reviewed all engineering reports, was pleased with the report, the firm would continue to receive job assignments.

C. The McIntosh case. A particularly egregious and outrageous scenario resulted from State Farm's response to the claim of Thomas and Pamela McIntosh, residents of Biloxi, Mississippi. The couple had purchased a Homeowners policy with a hurricane deductible, and this coverage was in effect at the time Hurricane Katrina devastated their home. Their dwelling was insured for $619,6000, and their personal property was insured for $464,700. The McIntosh family filed suit against State Farm, and their trial is scheduled to take place in December of 2007.

It is unclear what degree of "investigation," if any, was done of the damage to the McIntosh home prior to the issuance of a denial letter dated September 28, 2005. The unsigned denial letter informed Mr. and Mrs. McIntosh that "damage to your property may have been caused by wind and water. We are continuing to investigate that portion of your loss caused by wind." [See Exhibit D.] However, a check for wind damage for approximately $36,000 was enclosed with the denial letter. The letter also claimed that "[b]ased on the site visit and other facts, our investigation showed that some of your property was damaged as a result of storm surge, wave wash and flood. Unfortunately, that damage to your property is not covered under the policy identified above."

This practice by State Farm of 1) making coverage decisions and/or 2) assigning a dollar amount to a particular cause of damage 3) without making an assessment of the total amount of damage regardless of cause and 4) without a determination of the proportion of damage attributable to the various causes involved was used extensively in the handling of Hurricane Katrina claims. As discussed in more detail in the following section, this expensive practice has proven to be burdensome for the NFIP and nightmarish for homeowners.

Although the conclusive language used in the McIntosh's denial letter suggests that any further investigation would be little more than a pretext, an engineer from Forensic Analysis & Engineering Corporation (hereinafter "FAEC") was nonetheless dispatched to inspect the damage in October 2005. FAEC's first report was dated October 12, 2005, and concluded that wind and wind-driven debris damaged the roof, door, carport and window of the McIntosh home and that interior structural damage was also caused primarily by wind. Clearly, this professional opinion showed that far more than $36,000 of the total damage was due to wind. This report, according to sources, was found in a State Farm CAT office with what appears to be a self-adhesive note

reading "put in wind file–do not pay bill–do not discuss." [See Exhibit G.]

At the urging of State Farm, FAEC issued a second report on the McIntosh property, this one dated October 20, 2005. This second report failed to mention the conclusions from the first report or even to acknowledge its existence. While the first report recognized the significant damage cause by wind, the second report concluded that this same damage was attributable to water. It also claimed erroneously that Mr. McIntosh had been present for the second site inspection. A second denial of coverage letter was sent to Mr. and Mrs. McIntosh from State Farm.

Shortly thereafter, Mr. McIntosh requested a copy of his engineering report from State Farm. He was told the engineering report was never finished. Then State Farm claimed to have found the report and sent him a copy of the second report, with nothing to indicate to him or his wife that a prior engineering inspection concluded they were entitled to payment on their claims.

The fraudulent conduct in the McIntosh case cannot be placed solely on the shoulders of the State Farm CAT team. State Farm's in-house counsel clearly should have known about the concealment of the first engineering report from the policyholders. On August 15, 2006, Brian Ross of ABC News brought the existence of a prior report to the attention of one of State Farm's local counsel Wayne Drinkwater of the firm Bradley, Arant, Rose & White as part of an investigation for the *20/20* broadcast program. Mr. Drinkwater claimed to have no knowledge of that report's existence. Two days later, Tamara Rennick, an in-house attorney for State Farm, contacted Mr. McIntosh about his claim. Mr. McIntosh mentioned the two engineering reports done to assess his damage. Without responding to that point, Ms. Rennick arranged for Mr. McIntosh to meet with another local counsel for State Farm, Peter Barrett of the firm Butler, Snow, O'Mara, Stevens & Cannada.

On August 21, 2006, Mr. McIntosh met with Mr. Barrett and also J. Kennedy Turner, III of the same firm to discuss his claim. Mr. Barrett explained that due to State Farm's efforts to achieve a paperless office two engineering reports did in fact exist, but that this was merely a misunderstanding in that one copy was paper and the second copy was the scanned image of the paper file copy. He did not mention that two substantively different versions of the reports existed and that the first version would have entitled the policyholders to payment. Mr. Barrett prepared a statement for Mr. McIntosh's signature; the statement attested to the policyholder's satisfaction with the way his claim was handled by State Farm. Mr. McIntosh was concerned at the impact refusal would have on his ability to obtain coverage in the future and, based on the partial information presented to him by State Farm, signed the document. [See Exhibit F.]

D. Mechanisms in place to protect Mississippi policyholders and the obstacles to relief.
The invitation of the Oversight and Investigations Subcommittee inquired as to whether Mississippi has adequate measures in place to ensure that policyholders receive proper payment of claims. The available avenues for relief have not proven to be effective in practice; in fact, the obstacles Mississippians encountered are not unique to this state and would likely be

problematic for other states affected by natural or terrorist disasters.

The following mechanisms were in place at the time Hurricane Katrina struck:

1. The Mississippi Department of Insurance. The Mississippi Department of Insurance accepts complaints from consumers. If the Commissioner is not responsive to their complaints, the only remedy citizens have is to vote against him or her in the next election cycle. The mediation process encouraged by the current Mississippi Insurance Commissioner George Dale is of questionable success. This is best evidenced by the complaints our office has received from homeowners offered approximately ten cents on the dollar for the value of their unpaid claims, as well as the fact that, even in mediation, State Farm continued to conceal the existence of multiple engineering reports for some claims.

On February 16, 2007, the MSAG's Office proposed legislation to require State Farm to continue writing new homeowners and commercial property policies in the State of Mississippi. We attempted to work with Governor Haley Barbour and Commissioner Dale to model a response after the legislation passed in Florida last month that requires insurance companies selling automobile coverage in the state to also sell homeowners and commercial policies statewide if they sell those policies in other states. As of this writing, neither Governor Barbour nor Commissioner Dale has taken any action on this proposal.

The office of the Mississippi Insurance Commissioner has inherent limitations; it is not designed to filter out and punish abuses in the application of federal programs, such as the National Flood Insurance Program (NFIP). Whether insurance commissioners in other states have the statutory authority and, if so, the practical ability to adapt their offices to undertake this sort of task following a catastrophe is questionable, as is the merit of having fifty different applications of federal programs. One of the benefits of a federal program such as the NFIP ought to be consistency of results for citizens, regardless of the state in which they reside.

2. The statewide prosecuting authority of the MSAG's Office. Reports of suspected insurance fraud are referred to the MSAG's Office by the Mississippi Insurance Commissioner, other law enforcement agencies, investigators working for private insurance providers and citizens. However, while criminal investigation and prosecution are appropriate responses to crimes against the public, the criminal justice system is not designed to enforce the proper payment of claims.

a. Our ability to reach beyond state lines is limited. In this case, the court system in Jackson County, Mississippi, already devastated by the storm and operating its clerk's office from fairgrounds until December of 2006, was responsible for the costs of bringing in out-of-state witnesses pursuant to the criminal investigation into State Farm's conduct. The District Attorney for Jackson County, Tony Lawrence, had to adjust his already heavy case load to accommodate the additional demands the Attorney General's criminal investigation placed on his office. Since State Farm used employees and vendors from all over the country to process

Hurricane Katrina claims, the MSAG's Office had to seek cooperation from the prosecuting authorities in the jurisdictions in which witnesses for the investigation could be found. In one instance, a jurisdiction refused to cooperate with these efforts, thereby allowing a State Farm employee who worked with the State Farm CAT team on Katrina claims to be able to avoid having to appear in Mississippi to be accountable to the citizens of Mississippi[ii].

As our criminal investigation progressed, we realized that some of the documented conduct may not constitute a violation of Mississippi state law, but that federal criminal charges may be appropriate. Business practices observable in the handling of Hurricane Katrina claims that have caused problems for State Farm reaching as far back as the Northridge earthquakes in California in 1994 and the rash of tornadoes in Oklahoma in 1999 raised our concerns that State Farm's response to disasters was part of a disturbing business model that could be applied in other states in future disasters.

Attorney Jeff Marr of Oklahoma City, Oklahoma, who has represented hundreds of homeowners in their claims against State Farm arising out of the 1999 Oklahoma tornadoes, has engaged in six years of vigorous discovery and litigation with State Farm and has learned that State Farm purchased a business model from the McKinsey Consulting Group and named it the Advancing Claims Excellence Program (ACE)[iii]. Ostensibly, the model was designed to promote cost efficiency and quality assurance. Substantively, the model represented a decisive shift in State Farm's views concerning the claims assessment process.

State Farm's once consumer-friendly approach to handling claims by fairly assessing the nature and degree of damages and the resulting obligations or exclusions from the policy language was redirected into a strategy to reduce "indemnity shortfall," or the overpayment of claims. A 1995 State Farm newsletter announced that ACE "has the potential of taking a billion dollars of cost out of our system every year!" Those costs seem to be taken out of the pockets of policyholders and the NFIP.

Although the program has been defended as a legitimate effort to promote quality customer service, State Farm issued a memo in 1997 directing its employees to send all ACE documents to company headquarters because "we anticipate Advancing Claims Excellence may be an issue in future lawsuits." Ordinarily, an employer would be expected to encourage its employees to familiarize themselves with the company's goals and objectives. Legitimate training and policy materials have no need to be kept from the employees who are expected to follow them.

The MSAG's Office is not empowered to bring criminal charges on behalf of the federal government. Full Congressional investigation or at a minimum an investigation by the Department of Justice is needed to completely expose the national implications of State Farm's conduct in this disaster. The MSAG's Office pledges its full support and cooperation in any such efforts.

b. E.A. Renfroe. Another example of the problem State Farm's use of out-of-

state employees and vendors poses for a state criminal investigation is illustrated by an active lawsuit in Alabama between E.A. Renfroe, an adjusting services firm based in Birmingham and two of its former employees, Cori Rigsby Moran and Kerri Rigsby, two sisters who worked with the State Farm CAT team in Katrina. (See generally E.A. Renfroe & Company, Inc. v. Cori Rigsby Moran and Kerri Rigsby, CV-06-WMA-17520S, U.S. District Court, N.D. Alabama, Southern Div.) Renfroe is an adjusting services firm based in Birmingham, Alabama that receives approximately 75% of its revenue from State Farm.

Cori and Kerri Rigsby, two sisters employed by E.A. Renfroe, were working with the State Farm CAT team during Hurricane Katrina and became concerned by the apparently fraudulent nature of some of the conduct they observed. They decided to make copies of documents they believed would be of assistance to law enforcement inquiries into the matter. Copies of these documents were provided to both the Mississippi Attorney General's Office and the U.S. Attorney's Office in Jackson.

Renfroe, without disproving the substance of the alleged wrongdoings, has since sued these cooperating witnesses for violating an employee confidentiality agreement and the Alabama Trade Secrets Act and is currently attempting to have them found in criminal contempt for refusing to return the documents. Renfroe argues that, under the terms of the confidentiality agreement, any concerns of illegal or unethical conduct must be brought to the attention of Mr. Renfroe, one of the two shareholders in the corporation. (The other shareholder is his wife.) Renfroe insists that it has no gripe with the fact that the documents were turned over to law enforcement agencies, but has tried repeatedly to get custody of the documents despite the concerns of the MSAG's Office that this would allow Renfroe to see documents intended for the grand jury during an ongoing criminal investigation.

The documents at issue consisted of electronic documents reduced to paper copies, so neither State Farm nor E.A. Renfroe were deprived in any way of documents they needed to process homeowner claims. E.A. Renfroe's proprietary interests in the documents are not entirely clear, since State Farm maintains custody of the information used and generated by the adjusters they hire from E.A. Renfroe. As part of this litigation, E.A. Renfroe had to issue a subpoena to State Farm in order to provide the Court with a sample of an E.A. Renfroe Katrina file. State Farm policyholders whose claims were adjusted by E.A. Renfroe understandably have legitimate questions concerning the ability of these purported independent professionals to exercise independent and objective judgment when those same adjusters do not seem to maintain independent files.

The MSAG's Office briefly intervened in the case to urge the presiding judge, the Honorable Judge William M. Acker Jr., to deny E.A. Renfroe's demand for the return of the documents until the criminal probe into State Farm's conduct could be completed. The MSAG's Office as a matter of policy makes concerted efforts to shield cooperating witnesses in any case from retaliation at the hands of persons or entities under investigation. As the top law enforcement agency for the state, the MSAG's Office would be remiss to ignore strong and reliable evidence

suggesting that criminal acts have been committed against the citizens of our state. We have never allowed subjects of criminal investigations to pick and choose the sources we use against them. Judge Acker was urged to consider the destructive impact such a decision would have on the ability of this or any other office to effectively investigate white collar crime.

To illustrate, in a street crime investigation, the Government's evidence may be a crack rock, shotgun, taped confession or medical report. White collar investigations, on the other hand, are by their very nature rooted in and driven almost exclusively by documents. Enron, HealthSouth and WorldCom were undone by criminal prosecutions based in part on their own documents; in fact, it is difficult to envision a set of facts in which the documents that serve as evidence in a white collar crime prosecution would not be in some way the property of the defendant at some time. The probative value of documents is premised on identifying the owner of those documents.

To date Judge Acker has denied any sort of relief either to the Rigsby sisters or the Mississippi Attorney General's Office. Thus as a practical matter, an employee confidentiality agreement between private citizens in a neighboring state may be interpreted in a way that guts the investigative powers of a grand jury in a sister state.

3. Civil action brought on behalf of the people of Mississippi by the MSAG's Office. The civil lawsuit filed by our office that the Defendants removed to federal court and was rightfully and completely remanded to state court in December 2006, but during the time the case remained idle pending remand, neither the Defendants, nor the policyholders, were able to benefit from the clarification of the application of the anti-concurrent causation clauses and water exclusions at issue in the litigation.

4. Mississippi law. Mississippi law on contracts should also have offered basic protections to policyholders, but catastrophe survivors are often unable or unwilling to undertake slow, expensive litigation against an insurance company with vastly greater resources. At the time of this writing, approximately 30,000 Mississippians are living in trailers provided by the taxpayers through FEMA. Most if not all would have preferred to receive, within a timely fashion, the contractual benefits upon which they relied to begin rebuilding their homes and lives. Litigation is, for most, a last resort.

State Farm's use of outside adjusters and engineers allowed the insurer to ignore the duty of good faith and fair dealing it would ordinarily owe policyholders under long-standing Mississippi law. Policyholders were not in a contractual relationship with these adjusters and engineers and so could not sue for breach of contract if they had any objections to the way in which these services were performed. Also, the lack of a contractual relationship was used as a justification to keep the adjusters' conclusions and engineering reports out of policyholders' reach.

Following the Mississippi Supreme Court's 2004 decision in *Mangialardi*, state joinder law has been interpreted much more restrictively, making the ability to join even two properly related

claims together substantially more difficult. Now policyholders forced to litigate also face the prospect of absorbing the costs of hiring experts to testify in each and every case. Since the affected citizens have just survived what hopefully will be the most traumatic experience of their lives and lost most if not all of their possessions and assets, they are frequently unable to pay legal retainers for representation. As a result, contingency fee arrangements are often the only way for these citizens to achieve access to the courts. The insurance industry, because of its inherently stronger bargaining position and favorable cash flow advantage, will always be better suited to participate in litigation under these circumstances than is an individual policyholder. Entangling policyholders in tedious litigation does not achieve recovery for the Mississippi Gulf Coast.

II. Tactics used by State Farm to pretend Katrina was a windless hurricane

A. The false dichotomy of "wind versus water." The most generic definition of a hurricane is a "tropical cyclone." Thus the event of a hurricane is defined by the combination of wind and water. Part of the challenge of keeping the NFIP and private insurers viable is untangling our understanding of the two forces that occur naturally together in a hurricane and either imposing a somewhat artificial division in order to allocate risk and assess damages or developing a unified approach that accurately reflects the reality of the destruction a hurricane can cause.

Much of the controversy following Katrina has been reduced to a question of "wind versus water." This simplification itself is a reflection of the insurance industry's approach to claims and has little or nothing to do with the actual experience of a hurricane. It is easy enough to neatly sort out which policyholders have purchased wind coverage, flood coverage or both. Looking at a concrete slab that used to be a family home and determining with any reasonable degree of certainty that 50% of the damage was caused by wind and 50% was caused by water is a tall order, not to be undertaken lightly by under-qualified adjusters and/or rookie, or even seasoned, engineers. Individual lawsuits filed since Katrina have inevitably featured a battle of weather experts, but the actual decisions regarding causation of damage were not made on site by professional weather experts. Soliciting the advice of adjusters and engineers to determine whether a home was destroyed by "wind or water" makes any ensuing "investigation" more closely correlated with the availability of coverage rather than the factual findings of damage.

Damage should be assessed first, then the availability of coverage. Reversing this order turns the entire premise of insurance on its head. In our investigation we found evidence that E.A. Renfroe adjusters working for State Farm were dispatched to damage sites and instructed to determine whether the damage could be categorized as a slab, "popsicle stick," or "cabana." "Popsicle stick" is industry slang for a foundation with support pilings intact; a "cabana" is industry slang for a structure that maintains some degree of post and lintel support but is otherwise a skeleton due to water washing through. Not much effort beyond riding past the property in a car and looking out the window would seem to be required to make this determination, but the fees for this adjusting "service" were passed along to the NFIP. Adjusters