

were instructed that if they found the property to be in one of these three conditions, they were to request that an engineering inspection be ordered to provide additional guidance in assessing the damage. This subsumes that the adjusters were not considered qualified or sufficient to make a final determination as to the cause of damage. However, many of these adjusters at this stage, without the benefit of an engineering report and often without the benefit of proper flood training and certification themselves, would go ahead and recommend maximum payment of flood coverage and contents coverage through the NFIP.

B. An illustration. So, to illustrate, a home is insured by State Farm under a homeowner's policy for \$500,000 for structural damage and \$250,000 for contents; in addition the homeowner purchases \$250,000 of protection against structural damage due to flood and \$100,000 for contents due to flood pursuant to NFIP policies. An adjuster visits the damage, determines that maximum coverage is available under the NFIP and advises the homeowner that further investigation will be needed to assess the extent of wind damage.

In doing so, the adjusters are making a decision about the ratio of damage attributable to wind and that attributable to water, but the ratio is not based on the actual damage. It is based on the availability of coverage. In the McIntosh case, the policyholders received a denial letter at this stage. Even though that denial letter referenced the need for further investigation, the decision to deny coverage had already been made according to the plain meaning of the letter. Clearly State Farm is willing to spend the NFIP's own money with only nominal investigation, but is much more deliberate and hesitant to spend its own.

To continue the illustration, an engineer may then visit the property and submit a report of damage to State Farm. Even though the report was requested in order to assist the adjuster's evaluation, the reports were not given to adjusters. The reports were not given to the claim representatives or even openly circulated within the CAT offices. Records of whether and when engineering reports had been ordered and received were only accessible to a limited number of CAT employees, and the reports themselves were reviewed by only a handful of people.

C. Discretion in the interpretation and use of engineering reports. With notable exceptions, as in the McIntosh case, the conclusions in these engineering reports were not always sufficiently clear-cut to be easily classified as "wind" or "water" reports. The conclusions typically included descriptions of damage and ascribed some to wind, some to water, but numerical proportions were not assigned to each cause. If the engineer was not able to do that, the ability of a CAT employee to do so is dubious; yet that is exactly the sort of determination that needed to be made in order to properly assess the availability of coverage. To the extent that such a determination was not possible, particularly in slab cases, Mississippi law construes ambiguity against the insurer. Citing an engineering report as support for denial of coverage then refusing to let the homeowner see the report does not inspire much confidence in the integrity of this process. This has been a common complaint received by the MSAG's office.

Equally disturbing are the instances in which an engineering report was not used to deny the

claim. For example, reports were received and ignored; reports were received then subjected to “peer review” (which typically amounted to soliciting an opinion from a second engineering firm without mentioning the previous inspection and report); reports were requested then canceled; reports were ordered then canceled after the property inspection but before the report was done; or reports were requested then canceled then reordered.

One excuse given for this seeming lack of organization has been that the sheer volume of claims and the overwhelming devastation from Katrina was more than anyone anticipated. No one would argue against the horrific scale of this disaster. But the State Farm CAT team featured its most highly trained and experienced employees and vendors, people who worked disasters as a way of life. Given the expenses of this “confusion,” State Farm might have been expected to use its existing information network to keep all CAT employees, agents and vendors informed about the status of engineering reports that were delaying decisions on claims. State Farm did not earn its position as the country’s largest insurer by making costly mistakes. **The “mistakes” and irregularities in the Katrina claims process share a common denominator; they all facilitated State Farm’s practice of denying wind coverage expressly included in its homeowners’ policies.**

D. Haag Engineering. Haag Engineering has worked several disasters for State Farm and depends on them for approximately 75-80% of their work. Haag Engineers were hired by State Farm to evaluate Katrina damage and were on the scene, doing inspections and writing reports prior to the issuance of Haag’s “Hurricane Katrina Storm Damage Survey” issued in October 2005. Certain other engineering firms were relieved of their duties after the issuance of Haag’s Survey with the explanation that, with that weather data in hand, coverage decisions could be made without the assistance of engineers. The issuance of the report did not alleviate the need for all engineering services however.

If State Farm, based on its experience with catastrophes knew weather data was forthcoming and that it would be conclusive on the causation of damage, their decision to incur the costs of using adjusters and engineers in advance of receiving such weather data does not make sense. In other words, if weather data could close a claim, why use expensive contractors whose opinions are not actually needed? Further, weather data was freely available from various governmental agencies; a legitimate reason to commission Haag to collect weather data is not self evident.

Haag’s weather collection efforts should also not be described as “independent.” Collecting weather data that could then be used to support conclusions in engineering reports that would result in additional job assignments from State Farm just adds another level of bias to the process, i.e., Haag had a vested interest in both the weather conclusions and the conclusions in their engineering reports.

E. No real investigation was done by State Farm.

The flaws in each step of this supposed “investigation” of a claim cannot be remedied by

arguing that no one part of the investigation was the sole basis for denying coverage. If each part is inherently deficient, the cumulative effect of them can be no better. As our investigation has shown, the efforts to ignore the role of wind in Katrina's devastation did not stop with adjusters, engineers and weather data. Legal gymnastics in the form of a wind/water protocol and the anti-concurrent causation clauses were also employed to deny coverage.

F. Legal gymnastics

1. Anti-concurrent causation clauses. Policy exclusions should be understandable to the agents selling the policies, the customers buying them, and the personnel interpreting them when a claim is made. The so-called "anti-concurrent causation clauses" and the water exclusions featured in Homeowners policies that became disputed after Katrina are excessively convoluted and confusing. Members of the Subcommittee are urged to review Exhibits A, B and C for the comprehensibility of these provisions.

In August of 2006, the Honorable Judge L.T. Senter Jr. of the U.S. District Court for the Southern District of Mississippi, Southern Division found Nationwide's anti-concurrent causation clause to be unacceptably vague in the Leonard case, pointing out that "[t]his reading of the policy would mean that an insured whose dwelling lost its roof in high winds and at the same time suffered an incursion of even an inch of water could recover nothing under his Nationwide policy... I do not believe this is a reasonable interpretation of the policy." An honest and realistic assessment of whether this language is likely to be applied consistently and fairly by employees and vendors with varying degrees of training and experience working under challenging circumstances, yields little certainty.

State Farm may have recognized this problem. A wind/water protocol issued September 13, 2005, instructed CAT workers, in under three pages, how to make coverage decisions. The protocol was prefaced with this explanation:

Because of the combination of wind and water damages many homes sustained from Hurricane Katrina, the following materials have been developed and are intended for use as a guide for handling various wind and/or water claims in Louisiana, Mississippi and Alabama.

[See Exhibit E.]

Surely homeowners policies issued by State Farm already contemplated that in a hurricane, a combination of wind and water damages could and would occur. The wind/water protocol was not available for policyholders' review, but it was, by its language, designed to evaluate their right to coverage. In other words, the protocol constitutes a unilateral change in the insurance contract.

However, the anti-concurrent causation clause was maintained by the protocol. The second page of the protocol features the following language:

Damage to Property Caused by Flood Waters with available Flood Policy

Where wind acts concurrently with flooding to cause damage to the insured property, coverage for the loss exists only under flood coverage, if available...

Stated differently, the protocol dictates that if damage is caused by both wind and water, the policyholder only gets paid if they have a flood policy. If they have a wind policy, they get nothing. Thus, the anti-concurrent causation clause is applied to deny claims of policyholders who have no flood insurance, and is used to shift the burden to the federal government through the NFIP.

The insurance industry is quick to cite the need for predictability as a reason to exit the Mississippi market, but policyholders deserve predictability too. At the very least, their rights should be interpreted under the policies they sign, not protocols developed after the storm.

III. Concerns for the continued economic viability of coastal regions and the insurance industry

A. Doing business with State Farm, the "good neighbor." With over 130 million Americans living in coastal counties in 2003^{iv} and the inevitability of future natural disasters, the continued viability of the NFIP is jeopardized if private insurers use federal flood policies as a form of corporate welfare to avoid or reduce liability. How can anyone properly assess whether or not an insurance company can reasonably be expected to continue to do business in coastal areas without getting to the truth of how much a private insurer actually owed, how much of that they paid, and how much was improperly passed on to the NFIP? How can anyone determine whether or not rate increases are appropriate without that information?

If private insurers are not financially able to cover the losses under the policies they write and remain solvent, then issues of market saturation and adequate reserve levels must be re-examined. The time to determine that a market is saturated is not after a disaster hits. If the premiums charged in Mississippi were not enough to cover the policies, then perhaps the inquiry should be into whether or not State Farm's actuaries anticipated implementing this scheme to maximize coverage under the NFIP when they recommended the rates in effect when Katrina hit.

According to recent press releases by State Farm, they have "handled" about 84,000 claims and paid out "over one billion dollars" in Katrina claims in Mississippi, excluding all payments made through the NFIP. [See Exhibit H.] That roughly averages out to less than \$12,000 per claim and covers claims from an undisclosed number of Mississippi's eighty-two counties. The "duty to remain solvent," frequently trotted out as an explanation by State Farm employees, is not a moral obligation or the obligation of a "good neighbor," but is legally required. However, claimants in this disaster should not be denied coverage in the interests of keeping State Farm

flush with cash for the claimants in the next disaster.

Since the storm, State Farm has threatened to stop “doing business” in the state, and on February 14, 2007, announced its intention to make good on that threat. However, accepting premiums is not the same thing as “doing business” in a state. If a State Farm insurance policy is nothing more than a meaningless security blanket, then Mississippians do not benefit from having them stay in the state to collect premiums.

The last time a hurricane of this magnitude directly hit the Mississippi Gulf Coast was Hurricane Camille in 1969. Since then, policyholders have faithfully paid their premiums every year, and until 2005, the insurance companies got the benefit of the bargain. In 2005, thirty-six years later, Mississippians needed the benefit of the bargain they made with State Farm. State Farm has responded to the disaster by taking their premium dollars and leaving the state. They do not have to concern themselves with customer satisfaction because they do not intend to retain customers who actually try to invoke the protection they have paid for. State Farm will just find new customers, who will again pay their premiums with the expectation of protection.

Fundamentally, the insurance industry is about the assessment and allocation of risk. The gambling industry is also about risk. Part of what separates the two is the duty of good faith and fair dealing that, by Mississippi law, is required of the insurance industry in an effort to equalize the inherent imbalance of power between a large business and an individual who has experienced an illness, death in the family, fire, tornado, hurricane or other costs and losses for which they seek coverage.

Another distinction between the insurance industry and the gambling industry is the protection of a contract. A policyholders' rights, under an insurance contract, should not be determined without regard to the degree and type of damage or by reference to a wind/water protocol to which policyholders never agreed. A “reasonable investigation” of damage should be an actual analysis of damage done by objective professionals, not a foregone conclusion dictated by the availability of coverage.

If these duties are not observed in the insurance industry, then it is not much different from the gambling industry. A policyholder who pays premiums in good faith should have a more predictable and favorable result than a person who just drops a quarter into a slot machine at the casino. Without some changes in the insurance industry, insurance is just such a gamble.

B. Predictability. State Farm has cited the lack of predictability in the Mississippi insurance market as a reason to drop policyholders. However, some of the consequences State Farm has encountered in our state are not entirely unforeseeable. For instance, no one should be surprised that denying coverage with the explanation that hurricane winds caused no damage generates controversy. The type of misleading conduct alleged in the McIntosh case is practically guaranteed to produce outrage and litigation costs. Offering homeowners who voluntarily participate in mediation ten cents on the dollar for their claims and refusing to let them see the

engineering reports done on their property is another fairly certain way to provoke public outcry and backlash. Interpreting policies according to external, undisclosed documents and inconsistently applying contractual provisions is an invitation to trouble. We can also predict that if the insurance industry cannot concede any wrongdoing in the handling of Katrina, that the next group of policyholders affected by a disaster can expect the same treatment, as can the NFIP and FEMA.

CONCLUSION

The insurance industry cannot operate as a charity and remain solvent, but it is not unreasonable to require them to be accountable members of the business community. The need for timely, meaningful accountability of this industry is urgent. State Farm's publicity experts have done an outstanding job of spinning this situation as the protestations of Katrina victims who did not buy flood coverage and now want someone-State Farm, the federal government, anyone-to pay for their flood damage. The MS AG's Office is hopeful that our investigation will show that, in fact, State Farm pretended that Hurricane Katrina caused no wind damage, and that policyholders fully insured against wind were wronged by the various tactics employed to deny their claims. Our citizens do not want sympathy or handouts. They just want to be paid for the wind damage under wind policies. The MS AG's Office urges Congress to fully investigate this matter and pledge our full assistance and cooperation in any such efforts.

Thank you for holding this hearing and for inviting me to testify. I would be pleased to answer any questions.

Endnotes

- i. The suit, styled *Jim Hood v. Miss. Farm Bureau Ins. Co. et al*, named Mississippi Farm Bureau Insurance Company, State Farm Fire & Casualty Company, Allstate Property & Casualty Company, United Services Automobile Association, Nationwide Mutual Insurance Company, and “A” through “Z” entities to be named pursuant to Mississippi Rule of Civil Procedure 9(h)
- ii. The MSAG is grateful for the assistance of the following prosecutors in this investigation: The Honorable Melvin C. Wilson, Davis County Attorney, Utah; the Honorable Michael Harson, Lafayette Parish District Attorney, Louisiana; the Honorable Liz Sruz, Maricopa County Attorney’s Office, Arizona; the Honorable George S. Webb, III, Commonwealth Attorney for Madison County, Virginia; the Honorable Christopher E. Connolly, District for the 11th Judicial District, Alabama, the Honorable William L. Gibbons, District Attorney General, Memphis and Shelby County District Attorney’s Office, Tennessee; the Honorable Amy Klobuchar, Hennepin County Attorney, Minnesota; the Honorable Dianna Wheeler, Commonwealth Attorney for Orange County, Virginia; the Honorable Bill Cox, Hamilton County District Attorney General.
- iii. Allstate’s purchase of a similar program is discussed in *From Good Hands to Boxing Gloves* by David Berardinelli. Allstate has been in defiance since 2004 of an order from a New Mexico state court ordering them to disclose copies of PowerPoint slides prepared for them by the McKinsey Group. Since this business model was sold as a product to more than one customer, claims of attorney-client privilege are not properly raised.
- iv. The National Oceanic and Atmospheric Administration (NOAA) stated in a March 1, 2005 report that an estimated 153 million people (53% of the population of the United States) lived in coastal counties in 2003; a figure that is only expected to rise in the coming years.

JIM HOOD

Attorney General of Mississippi

Attorney General Jim Hood is a progressive leader who believes prevention is the best way to tackle crime. He is a strong proponent of victims' rights. One of his first acts as Attorney General was the establishment of a Crime Prevention and Victims' Services Division.

Under General Hood's direction, his office has launched initiatives to prevent workplace and school violence. Since the start of Youth Patrols, a groundbreaking partnership with MS CrimeStoppers and the MS Department of Education Safe & Orderly School program, approximately 70 patrols have been launched in high schools and middle schools across the State to improve school safety.

One of his most recent accomplishments is the establishment of a Domestic Violence Unit as a resource for law enforcement, prosecutors, judges and all other individuals or entities having legal duties related to domestic violence victims. The unit also provides services to domestic violence victims within the state.

Other notable services created by Attorney General Hood and focused on helping victims are the Child Support Unit which tackles the most serious offenses of deadbeat parents across the state. The Medicaid Fraud Unit boasts the establishment of the "Friendly Nursing Home Visitors Program" to make sure senior citizens are being properly cared for in the state's nursing homes.

Attorney General Hood is proud to have established through the Cyber Crime Center, a Cyber Crime Task Force whose members include the U.S. Attorney's Office of the Southern District of Mississippi, the F.B.I., U.S. Customs and U.S. Postal Inspectors. The Mississippi Cyber Crime Center is featured as a model cyber crime center for the nation through the University of Mississippi's National Center for Justice and the Rule of Law (NCJRL) program.

General Hood pioneered the establishment of an Identity Theft Unit. The office has published an identity theft prevention pamphlet and an identity theft victim's manual and passport. The office saw the successful push for tougher penalties for identity theft and the tighter penalties for home repair fraud.

Hurricane Katrina created a huge workload for the Consumer Division of the Attorney General's Office and investigators continue to work hundreds of cases of price gouging and home repair fraud. Part of the prevention efforts of the office include education and training to senior citizens and community groups on scams and identity theft.

On the personal side, Jim received his J.D. from the University of Mississippi in December 1988. He was educated in the public schools of Chickasaw County. He is a fifth generation Mississippian and an avid outdoorsman and hunter. Jim and his wife, Debbie, have three children – Rebecca, 12, Matthew, 9, and Annabelle Leigh, 3.

Exhibit List

- Exhibit A:** Anti-Concurrent Causation Language taken from Allstate Property and Casualty Insurance Company Deluxe Homeowners Policy
- Exhibit B:** Anti-Concurrent Causation Language taken from Nationwide Mutual Insurance Company Homeowner Policy
- Exhibit C:** Anti-Concurrent Causation Language taken from State Farm Fire and Casualty Company Homeowner Policy
- Exhibit D:** State Farm Notice of Denial Issued to the McIntosh Family September 28, 2005
- Exhibit E:** State Farm Wind/Water Claim Handling Protocol (Followed by a Transcript of the Exhibit)
- Exhibit F:** Handwritten Statement in Response to ABC 20/20 Report, Prepared by State Farm Counsel and Signed by Thomas C. McIntosh (Followed by a Transcript of the Exhibit)
- Exhibit G:** McIntosh Engineering Report Dated October 12, 2005
- Exhibit H:** State Farm Announcement Regarding Suspension of New Policies in Mississippi

Taken from Allstate Property and Casualty Insurance Company Deluxe Homeowners Policy, *Elmer and Alexa Buente v. Allstate Insurance Company et al*, Civil Action 1:05CV712 LTS-JMR, U.S. District Court, S.D. Miss., Judge Senter's Memorandum Opinion, March 24, 2006.

With respect to the insured dwelling (Section I, Coverage A) and other structures (Section I, Coverage B):

Losses We Do Not Cover...

We do not cover loss to the [insured] property consisting of or caused by:

1. Flood, including but not limited to surface water, waves, tidal water, or overflow of any body of water, or spray from any of these, whether or not driven by wind.

4. Water or any other substance on or below the surface of the ground, regardless of its source. This includes water or any other substance which exerts pressure on, or flows, seeps or leaks through any part of the residence premises.

21. Weather conditions that contribute in any way with a cause of loss excluded in this section to produce a loss.

23. We do not cover loss to property...when:

- a) there are two or more causes of loss to the covered property; and
- b) the predominant cause(s) of loss is (are) excluded under Losses We Do Not Cover, items 1 through 22 above.

With respect to personal property (Section I, Coverage C, Personal Property Protection):

Losses We do Not Cover...

We do not cover loss to [insured personal] property caused by or consisting of:

1. Flood, including, but not limited to surface water, waves, tidal water or overflow of any body of water, or spray from any of these, whether or not driven by wind.

4. Water or any other substance on or below the surface of the ground, regardless of its source. This includes water or any other substance which exerts pressure on, or flows, seeps or leaks through any part of the residence premises.

13. Weather conditions that contribute in any way with a cause of loss excluded in this section to produce a loss.

15. We do not cover loss to [insured personal] property when:

- a) there are two or more causes of loss to the covered property; and
- b) the predominant cause(s) of loss is (are) excluded under Losses We Do Not Cover items 1 through 14 above.

**MISSISSIPPI
ATTORNEY
GENERAL**

EXHIBIT A