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## ESSAY

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### HURRICANES, FRAUD, AND INSURANCE: THE SUPREME COURT WEIGHS IN ON, BUT DOES NOT WADE INTO, THE CONCURRENT CAUSATION CONUNDRUM IN *STATE FARM FIRE AND CASUALTY COMPANY v. RIGSBY*

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#### INTRODUCTION

Imagine being a homeowner and leaving your coastal home in compliance with a hurricane evacuation order. Upon returning home, you find your home is gone. All that remains is the foundation slab.<sup>1</sup> You, however, are one of the lucky few homeowners who has both homeowners insurance and flood insurance.<sup>2</sup> Yet, when you tender a claim for the loss of your home to your insurers, both deny coverage. The homeowners insurer contends flooding—the storm surge—destroyed your home, while the flood insurer contends the home was blown away by the hurricane winds. The insurers' positions leave you homeless and without an insurer willing to pay for your lost home, even though you have insurance for both wind and flood losses.

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<sup>1</sup> See, e.g., *Broussard v. State Farm Fire & Cas. Co.*, 523 F.3d 618, 622 (5th Cir. 2008) (recounting the story of homeowners who returned home after evacuating for a hurricane only to find their homes “completely destroyed”).

<sup>2</sup> Many homeowners in flood prone areas do not have flood insurance. In fact, only about ten percent of Hurricane Katrina victims had flood insurance, while approximately fifty percent of the victims of Super Storm Sandy had flood insurance. Christopher C. French, *Insuring Floods: The Most Common and Devastating Natural Catastrophes in America*, 60 VILL. L. REV. 53, 53 (2015) [hereinafter French, *Insuring Floods*]. Approximately seven percent of homeowners nationwide have flood insurance. *Id.* at 54.

This relatively common situation can be described as the concurrent causation conundrum.<sup>3</sup> Standard form homeowners insurance policies exclude coverage for flood damage but provide coverage for wind damage.<sup>4</sup> Flood insurance, which is sold and administered by private insurers but financially backed by the federal government, on the other hand, covers flood damage but not wind damage.<sup>5</sup> When certain natural catastrophes occur, such as hurricanes, it is often unclear whether the resulting damage was inflicted by the concurrent causes of wind or water because the damage is so extensive and occurs in a short period of time with few or no eyewitnesses. Concurrent causation situations create a problem for the homeowner, who has the burden of proving that the claim is covered under the basic insuring agreement.<sup>6</sup> It also creates a conflict of interest for the homeowners insurer if the homeowners insurance policy is issued by the same insurer that is administering the flood insurance policy on behalf of the federal government, which commonly is the case.<sup>7</sup> To minimize its claims payments and thereby increase its profitability, the homeowners insurer has a financial incentive to claim that most, if not all, of a concurrently caused loss is due to water.<sup>8</sup> Doing so ensures that the federal government, instead of the homeowner insurer, will pay for the loss.<sup>9</sup>

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<sup>3</sup> Numerous articles have been written about the concurrent causation conundrum since Hurricane Katrina. *See, e.g.*, Erik S. Knutsen, *Confusion About Causation in Insurance: Solutions for Catastrophic Losses*, 61 ALA. L. REV. 957, 962-68 (2010) (discussing how concurrent causation complicates insurance coverage); Joseph Lavitt, *The Doctrine of Efficient Proximate Cause, the Katrina Disaster, Prosser's Folly, and the Third Restatement of Torts: Cracking the Conundrum*, 54 LOY. L. REV. 1, 15 (2008) (explaining how the way in which a concurrent causation problem is resolved can determine whether insurance covers a loss). The author of this Essay is, however, the first person to propose the following solutions to the problem discussed in this Essay.

<sup>4</sup> *See* French, *Insuring Floods*, *supra* note 2, at 76-77 (explaining that homeowners insurance typically covers wind damage but not flood damage); *see also* KENNETH ABRAHAM & DANIEL SCHWARCZ, *INSURANCE LAW AND REGULATION* 197-98 (6th ed. 2015) (reprinting the flood exclusion currently contained in many standard form homeowners insurance policies).

<sup>5</sup> French, *Insuring Floods*, *supra* note 2, at 66. Very few private insurers are willing to cover flood losses, so the federal government created the National Flood Insurance Program (NFIP) in 1968 to sell flood insurance. *See id.* (discussing the federal government's NFIP).

<sup>6</sup> *See, e.g.*, Lunday v. Lititz Mut. Ins. Co., 276 So. 2d 696, 699 (Miss. 1973) ("The trial judge correctly instructed the jury that the burden of proof was on the plaintiff to prove that the damages sustained were covered by the peril insured against, that is, by direct action of the wind.").

<sup>7</sup> *See* French, *Insuring Floods*, *supra* note 2, at 66, 76 n.129 (explaining how private insurance companies administer the NFIP policies on behalf of the federal government).

<sup>8</sup> For a discussion of how the profit imperative has undermined the risk transferring function of insurance, *see generally* Christopher C. French, *The Role of the Profit Imperative in Risk Management*, 17 U. PA. J. BUS. L. 1081 (2015).

<sup>9</sup> A significant amount of flood insurance losses are actually paid by taxpayers because the NFIP has been insolvent for many years. *See* French, *Insuring Floods*, *supra* note 2, at 69 ("[T]he NFIP was insolvent with a deficit of \$24 billion as of December 2013."). Thus, some of the flood loss claims must be paid with taxpayer dollars.

On December 6, 2016, the United States Supreme Court decided a case in which the concurrent causation conundrum was center stage: *State Farm Fire and Casualty Company v. United States ex rel. Rigsby*.<sup>10</sup> There, Hurricane Katrina damaged a homeowner's house.<sup>11</sup> The homeowner had homeowners insurance with State Farm and a flood insurance policy administered by State Farm on behalf of the federal government.<sup>12</sup> The claims adjusters assigned by State Farm to handle the homeowner's claim were allegedly instructed by State Farm "to misclassify wind damage as flood damage in order to shift [State Farm's own] liability to the [federal] [g]overnment."<sup>13</sup>

The claims handlers filed a lawsuit against State Farm under the False Claims Act (FCA),<sup>14</sup> which imposes civil liability on any entity who "knowingly presents . . . a false or fraudulent claim for payment or approval" to the federal government.<sup>15</sup> A jury entered a verdict against State Farm in the amount of almost \$3.7 million, which included a treble damages award and attorneys' fees.<sup>16</sup> The issue before the Supreme Court was whether the case should have been dismissed because the claimants violated the FCA by revealing to the media the existence of the complaint against State Farm while the complaint was still under seal.<sup>17</sup> Ultimately, a unanimous Supreme Court concluded that the District Court did not abuse its discretion in declining to dismiss the action.<sup>18</sup> It reached this decision, in part, because the primary purpose of the requirement that FCA complaints be filed under seal is to protect the confidentiality of federal government investigations regarding a defendant's conduct, not the interests of the defendant itself.<sup>19</sup> The violation of the seal did not prejudice the federal government's

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<sup>10</sup> 137 S. Ct. 436 (2016). This is not the first time that State Farm's claims handling practices have been at issue before the Supreme Court. One of the Court's landmark decisions in the area of punitive damages, *State Farm Mutual Automobile Insurance Co. v. Campbell*, 538 U.S. 408, 414-15 (2003), involved allegations that State Farm acted in bad faith in its handling of an auto insurance claim in accordance with a corporate policy of underpaying claims to maximize State Farm's profits at the expense of its policyholders. See JAY M. FEINMAN, DELAY, DENY, DEFEND: WHY INSURANCE COMPANIES DON'T PAY CLAIMS AND WHAT YOU CAN DO ABOUT IT 64, 97, 106-09, 138-40, 145, 158, 163 (2010) (describing the claims payment practices of State Farm and concluding that it does not act "like a good neighbor" when it comes to paying claims).

<sup>11</sup> *Rigsby*, 137 S. Ct. at 441.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> 31 U.S.C. § 3729(a)(1)(A) (2012).

<sup>16</sup> *United States ex rel. Rigsby v. State Farm Fire & Cas. Co.*, 794 F.3d 457, 465 (5th Cir. 2015), *aff'd*, 137 S. Ct. 436 (2016).

<sup>17</sup> *Rigsby*, 137 S. Ct. at 439-40.

<sup>18</sup> *Id.* at 444.

<sup>19</sup> *See id.* at 443 ("[T]he seal requirement was intended in main to protect the Government's interests.").

investigation in the case because the government had decided not to join the lawsuit against State Farm, and it was not seeking any relief as a result of the leak.<sup>20</sup>

The case will likely be remembered for the Supreme Court's consideration of the purpose of the requirement for filing FCA complaints under seal, and the Court's further discussion of whether dismissal of a complaint is an appropriate sanction when a claimant leaks information about that complaint. But the case should also be remembered for turning the spotlight on the concurrent causation conundrum associated with certain insurance claims—particularly hurricane claims where both water and wind cause the losses. Although the Supreme Court did not resolve the concurrent causation conundrum in *Rigsby*, is there a solution to it?

Yes, two potential solutions come to mind: (1) eliminate the flood exclusion in homeowners insurance policies; or (2) broadly apply the “ensuing loss” exception to exclusions such as the flood exclusion. This Essay summarizes both options.

## I. ELIMINATION OF THE FLOOD EXCLUSION IN HOMEOWNERS INSURANCE POLICIES

If “all risk” homeowners policies, which purport to cover all risks of loss except those risks specifically excluded,<sup>21</sup> did not contain flood exclusions, then concurrent causation would not be a problem in the situation where it most commonly arises—wind damage versus water damage in hurricane cases.

Since the 1960s, insurers almost uniformly have refused to insure flood losses despite selling “all risk” homeowners property policies.<sup>22</sup> Thus, insurers created the concurrent causation conundrum by inserting flood exclusions into standard form homeowners insurance policies.<sup>23</sup>

The primary theoretical justification for excluding flood losses from coverage—the correlated risk problem, which insurers have traditionally used to justify the exclusion—is not valid today. Correlated risks are risks that result in numerous significant losses in the same geographic area at

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<sup>20</sup> *Id.* at 441.

<sup>21</sup> See Christopher C. French, *The “Ensuing Loss” Clause in Insurance Policies: The Forgotten and Misunderstood Antidote to Anti-Concurrent Causation Exclusions*, 13 NEV. L.J. 215, 222 (2012) [hereinafter French, *Ensuing Loss*] (“‘All risk’ property and homeowners policies typically contain broad insuring language that is the same as or similar to the following: ‘This policy insures against all risks of direct physical loss or damage to property insured . . . except as excluded.’”).

<sup>22</sup> See Warren Kriesel & Craig Landry, *Participation in the National Flood Insurance Program: An Empirical Analysis for Coastal Properties*, 71 J. RISK & INS. 405, 405 (2004) (“The National Flood Insurance Program (NFIP) was initiated . . . in response to high annual disbursements of disaster relief payments and the failure of the private market to provide flood insurance.”).

<sup>23</sup> ABRAHAM & SCHWARCZ, *supra* note 4, at 197-98.

approximately the same time, as is the case with floods.<sup>24</sup> According to insurers, the frequency, severity, and location of correlated risks cannot be accurately predicted, potentially resulting in catastrophic insurer losses for which actuarially sound premiums cannot be calculated and charged in advance.<sup>25</sup> Thus, insurers exclude correlated risks from coverage if they are permitted to do so. But unlike sixty years ago, when insurance companies were local businesses that sold insurance in narrow geographic areas, many insurance companies today are global entities that sell insurance throughout the world.<sup>26</sup> Consequently, the fear of catastrophic insurer losses from a major event like a flood is not as great today. The losses associated with flooding in New Orleans, for example, are not correlated to the risk of flood losses in New York City.

In addition, the risk profiles of policyholders covered by homeowners insurance today are much more diverse and uncorrelated than they were sixty years ago. Ninety-six percent of the sixty-nine million homeowners in America buy homeowners insurance because one cannot get a federally guaranteed mortgage, which most are, without homeowners insurance.<sup>27</sup> Consequently, if flood losses were covered by homeowners insurance, then the risk of a flooding event causing an enormous drain on insurers' capital reserves would be minimal. Specifically, the capital reserves would be generated by the premiums of sixty-nine million homeowners with diverse risk profiles instead of the much more limited pool of premiums currently being generated by the 5.5 million homeowners who are insured under the NFIP and primarily live in known flood areas.<sup>28</sup> The risks of losses under the NFIP are much more correlated than they would be if floods were covered under homeowners insurance.

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<sup>24</sup> See Véronique Bruggeman, Michael Faure & Tobias Heldt, *Insurance Against Catastrophe: Government Stimulation of Insurance Markets for Catastrophic Events*, 23 DUKE ENVTL. L. & POL'Y. F. 185, 187 (2012) (describing how correlated risks like natural catastrophes "pose a number of challenges for insurers," including "very large losses"); Adam F. Scales, *A Nation of Policyholders: Governmental and Market Failure in Flood Insurance*, 26 MISS. C. L. REV. 3, 10-11 (2006) ("Losses due to flood, earthquake, or windstorm . . . tend to be highly correlated within geographic areas. That is, if A's house is lost to flood, it is extremely likely that B's house, located nearby, has been exposed to the same forces.").

<sup>25</sup> See Bruggeman, Faure & Heldt, *supra* note 24, at 187 ("Pricing catastrophe insurance products is complicated by a number of factors, including the difficulty of predicting the frequency and probability of catastrophic accidents and their related losses (although some catastrophe-modeling firms have made such calculations the core of their business). Spreading the risk of catastrophe losses over a sufficiently large base of buyers is also difficult and makes it harder for insurers to offer affordable products." (footnote omitted)); French, *Insuring Floods*, *supra* note 2, at 63 ("Insurers do not want to insure correlated risks of loss because they do not believe they can accurately predict [them] . . .").

<sup>26</sup> French, *Insuring Floods*, *supra* note 2, at 64.

<sup>27</sup> *Id.* at 75.

<sup>28</sup> *Id.*

Finally, through global reinsurance<sup>29</sup> and catastrophe bonds,<sup>30</sup> the financial impact of flood events on individual insurers is further reduced. Under both of these risk-transferring mechanisms, an individual insurer's losses are spread to other insurers and investors. Thus, the financial burden of individual loss events, such as floods, is spread farther across the capital markets today and each event has a lower impact on each individual insurer.

In sum, the historical and theoretical justifications for excluding coverage for flood losses under "all risk" homeowners insurance policies are no longer sound. It is possible to require homeowners insurance to cover flood losses, and doing so would be one way to eliminate the concurrent causation conundrum in the situation where it arises most commonly.

## II. BROAD APPLICATION OF "ENSUING LOSS" CLAUSES

"All risk" property policies cover all risks of loss unless a particular risk or peril is excluded.<sup>31</sup> To avoid covering all risks of loss, insurers have added numerous exclusions to such policies, including exclusions that are known as "anti-concurrent causation" exclusions.<sup>32</sup> Anti-concurrent causation exclusions purport to eliminate coverage when both an excluded peril and a covered peril cause a loss. Many policies with anti-concurrent causation exclusions also contain, however, a little known exception to such exclusions called an "ensuing loss" clause.<sup>33</sup>

Ensuing loss clauses are poorly understood exceptions to exclusions contained in property policies, such as homeowners insurance policies. One example of an ensuing loss clause provides, "We insure for all risks of physical loss to the property described in Coverage A except for loss caused by [any of the six following excluded perils] . . . Any ensuing loss from items 1 through 6 not excluded is covered."<sup>34</sup> The term "ensuing loss" is not defined in the policies. It commonly is understood, however, to mean "[t]o take place after or as a result."<sup>35</sup> Thus, in essence, an ensuing loss clause reinstates

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<sup>29</sup> Bruggeman, Faure & Heldt, *supra* note 24, at 187-88 (noting that "the traditional insurance sector will increasingly have to rely upon the reinsurance (i.e. insurance for insurance companies) market to recompense catastrophic damages to the victims").

<sup>30</sup> See French, *Insuring Floods*, *supra* note 2, at 75 (suggesting that the availability of catastrophe bonds cuts against concerns of insurer insolvency).

<sup>31</sup> See *supra* note 21 & accompanying text.

<sup>32</sup> See French, *Ensuing Loss*, *supra* note 21, at 217 (noting that property policies often contain an anti-concurrent causation exclusion).

<sup>33</sup> See *id.* ("Today, the ensuing loss clause is found in various types of property policies such as 'all risk' and homeowners policies that also contain anti-concurrent causation exclusions.").

<sup>34</sup> *Roberts v. State Farm Fire & Cas. Co.*, 705 P.2d 1335, 1336 (Ariz. 1985) (emphasis omitted).

<sup>35</sup> THE AMERICAN HERITAGE DICTIONARY 594 (5th ed. 2011).

coverage for an otherwise excluded loss where the loss results after a covered peril occurs—even if an excluded peril is also part of the causation chain.

Ensuing loss clauses can play an important role in resolving concurrent causation claims, such as hurricane losses where both wind and water cause damage to property. Because ensuing loss clauses can be read to conflict with anti-concurrent causation exclusions, the rules of policy interpretation—*contra proferentum*<sup>36</sup> and the reasonable expectations doctrine<sup>37</sup>—dictate that they be construed broadly in favor of reinstating coverage.

The problem with ensuing loss clauses, however, is that courts have struggled to understand them and many courts have attempted to apply tort causation principles, such as “proximate cause” and “intervening and superseding” causation, to the clauses.<sup>38</sup> This is a mistake because ensuing loss clauses are contractual provisions that should be interpreted according to the rules of insurance policy interpretation, which dictate that any ambiguities in such clauses be interpreted in favor of coverage—not pursuant to tort principles in which a factfinder is asked to determine which cause of a loss was the “first” cause or the “dominant” cause in the causation chain or whether a covered peril is an “intervening and superseding” cause.<sup>39</sup>

In many situations, it is a legal fiction to pretend there is a single cause of a loss or that multiple causes of a loss can be unbundled in a reasoned manner. Indeed, even Michael Bragg, assistant counsel for State Farm, agrees with this point:

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<sup>36</sup> See *High Country Assocs. v. N.H. Ins. Co.*, 648 A.2d 474, 476 (N.H. 1994) (“If the language of the policy reasonably may be interpreted more than one way and one interpretation favors coverage, an ambiguity exists in the policy that will be construed in favor of the insured and against the insurer.”); *Salem Grp. v. Oliver*, 607 A.2d 138, 139 (N.J. 1992) (“When a policy fairly supports an interpretation favorable to both the insured and the insurer, the policy should be interpreted in favor of the insured.”); *Bonner v. United Servs. Auto. Ass’n*, 841 S.W.2d 504, 506 (Tex. Ct. App. 1992) (“The court must adopt the construction of an exclusionary clause urged by the insured as long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties’ intent.”); see also French, *Ensuing Loss*, *supra* note 21, at 222-25 (explaining that under the rule of *contra proferentem*, insurance policy ambiguities should be construed against the insurance company drafters).

<sup>37</sup> See, e.g., *AIU Ins. Co. v. Superior Court*, 799 P.2d 1253, 1264 (Cal. 1990) (holding that ambiguous coverage clauses in insurance policies are to be interpreted broadly to protect the objectively reasonable expectations of the insured); *Roland v. Ga. Farm Bureau Mut. Ins. Co.*, 462 S.E.2d 623, 625 (Ga. 1995) (“A contract of insurance should be strictly construed against the insurer and read in favor of coverage in accordance with the reasonable expectations of the insured.”); see also French, *Ensuing Loss*, *supra* note 21, at 225 (noting that it is a “staple of insurance policy interpretation law . . . that a policy should be interpreted to fulfill the ‘reasonable expectations’ of the policyholder”).

<sup>38</sup> See French, *Ensuing Loss*, *supra* note 21, at 228-34 (explaining how courts have applied these tort causation principles when they interpret insurance policies).

<sup>39</sup> For a more detailed critique, see *id.* at 239-54.

[E]very event has an infinite number of causes; and second, each cause can be described in an infinite variety of ways. Although these statements are beyond serious philosophic challenge, they seem far removed from the practical considerations faced daily by policy drafters, underwriters, and claims persons. The demanding careers of such professionals leave little time to ponder Aristotle's or Bacon's notion of causation . . . .

Property insurance, unlike liability insurance, is unconcerned with establishing negligence or otherwise assessing tort liability. Thus, we discover that "proximate cause has a different meaning in insurance cases than it has in tort cases. In tort cases the rules of proximate cause are applied for the single purpose of fixing culpability, and for that reason the rules reach back of both the injury and the physical cause to fix the blame on those who created the situation in which the physical laws of nature operated; in insurance cases the concern is not with the question of culpability or why the injury occurred, but only with the nature of the injury and how it happened." . . .

Thus, the "cause" of loss in the context of a property insurance contract is totally different from that in a liability policy. This distinction is critical to the resolution of losses involving multiple causes.<sup>40</sup>

In short, ensuing loss clauses, which are contractual provisions drafted by insurers and contained in standard form property policies such as homeowners insurance,<sup>41</sup> cut a path through the brambles of tort causation when read according to the rules of insurance policy interpretation. If they are broadly interpreted and applied, ensuing loss clauses could resolve the concurrent causation conundrum in many situations.

### III. CONCLUSION

*State Farm v. Rigsby* likely will be remembered as an FCA case in which the Supreme Court simply held that the disclosure of information contained in complaints required to be filed under seal does not mandate dismissal. However, the case also shines a spotlight on the concurrent causation conundrum. The case did not provide the Supreme Court with a meaningful opportunity to provide any guidance regarding how to resolve the problem, but there are at least two ways the problem could be solved. First, removing the flood exclusion from property policies would eliminate one of the largest

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<sup>40</sup> Michael E. Bragg, *Concurrent Causation and the Art of Policy Drafting: New Perils for Property Insurers*, 20 FORUM 385, 385-87 (1985) (alterations omitted) (quoting 43 AM. JUR. 2D *Insurance* § 463 (2d ed. 1982)).

<sup>41</sup> See Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113, 1153 (1990) ("[P]roperty owner's [sic] liability insurance contracts are standardized across insurers in a form few insureds have the power or experience to bargain around.").



and most common situations—hurricane claims—where the concurrent causation problem currently exists. Second, broadly applying the ensuing loss clause in other contexts where concurrent causation problems arise would resolve the problem in many cases.

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