Floods, Flood Insurance, Litigation, Politics – and Catastrophe: The National Flood Insurance Program[1]

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The extraordinary flooding caused by Hurricanes Katrina and Rita in 2005 damaged or destroyed hundreds of thousands of homes and businesses in Florida, Alabama, Mississippi, Louisiana, and Texas. Policy holders submitted over 165,000 flood insurance claims to the National Flood Insurance Program (NFIP) – more than the combined number of claims submitted throughout the preceding 35 years of the NFIP's existence.[3] The vast majority of these claims were settled without controversy – and the NFIP has now paid over $16 billion in claims.[4]

But in addition, thousands of lawsuits were brought by property owners claiming they were paid less for flood losses than they should have received under their insurance policies. Indeed, Hurricanes Katrina and Rita exposed an extraordinary number of homeowners and businesses who found to their dismay (and perhaps in some cases, surprise) that not only had their homes been destroyed, but that much of the damage was not covered by insurance – either because they had never had a flood insurance policy, or because their flood insurance policy had expired, or because it did not cover much of the damage that they suffered. In their disappointment, thousands chose to litigate, hoping to obtain relief from (allegedly) negligent or miscreant insurance agents, private flood insurance companies, private 'all risk' insurance companies, mortgage lenders, flood zone determination companies, the Federal Emergency Management Agency (FEMA), or any other entity that might be shown to be legally responsible for their losses.

Understanding this litigation – and how it differs from "traditional" insurance litigation – requires an overview of the NFIP and its decades long efforts to generate premium income adequate to cover losses and expenses. These efforts never did allow the NFIP to achieve full solvency, and the National Flood Insurance Fund has never charged premiums high enough to build a reserve for catastrophic flooding. Indeed, Hurricane Katrina claims could be and were paid by the NFIP only with borrowed money, and in the aftermath of the flooding Congress was forced to increase the statutory cap on how much the NFIP

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[1] This paper was presented during the Sea Grant Law and Policy Journal's inaugural symposium on Coastal Resiliency held on March 25–26, 2008 at the University of Mississippi in Oxford, Mississippi. Coastal resiliency refers to the ability of coastal cities, towns, and communities to adapt and recover from natural hazards, including hurricanes, tsunamis, floods, and disease epidemics. Seven authors were selected to present papers on a wide range of topics related to coastal resiliency. Powerpoint presentations and additional information about the symposium are available at http://www.olemiss.edu/orgs/SGLC/National/SGLPJ/SGLPJ.htm .

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[3] Aggregate number of claims and total dollar amount for Hurricane Katrina are published on FEMA's website at http://www.fema.gov/business/nfip/statistics/sign1000.shtm (as of 5/30/2008).

[4] *Id.*

could borrow from $1.5 billion to $20.775 billion.[5] It is generally understood by Congress that the NFIP will never be able to repay this debt, which now stands at over $17,000,000,000.[6]

This article examines the efforts of the NFIP to become financially self-sustaining and shows how these efforts may have created misunderstanding – subsequently reflected in litigation – about the need for and scope of flood insurance. This litigation is rarely successful, in large part because the NFIP can avail itself of defenses available to the federal government (e.g., sovereign immunity, federal preemption, and a requirement of strict compliance with regulatory requirements) in order to protect federal taxpayers from paying costs beyond those covered by the terms of the NFIP's policy, and to assure that private sector contractors and agents of the federal government in the flood insurance program remain willing to serve in that capacity.

Flood insurance litigation nonetheless reveals the strains that appear when a government program with government rules and regulations steps in to offer a commercial service – flood insurance. These strains are particularly severe when the insured risk – flooding – is one that most property owners won't buy, and property lenders won't require, unless forced to by law. Hurricane Katrina litigation has also arisen from the frustration experienced by property owners when insurance adjusters allocate loss between that caused by wind (covered under standard private sector insurance) and by flood (insured under the strict NFIP policy if the property owner had any flood coverage at all). In these cases, courts have upheld the flood exclusion in private sector policies, but castigated any efforts by some insurers to deny responsibility for hurricane damage when damage occurred as a combined result of both wind and flood.

The NFIP is at a crossroads. It is currently set to expire on September 30, 2008. While the fiscal insolvency of the NFIP has led some to conclude it is a "colossal policy failure,"[7] both the Senate and House have passed (differing) bills to reauthorize the Program, recognizing that it provides critical financial protection to property owners and critical incentives to reduce future flood damage. These bills would attempt to allow the NFIP to reach financial solvency by permitting increased premiums, elimination of many subsidies on existing properties, and broadening mandatory insurance purchase requirements. These bills also respond to the frustration of policyholders whose settlement checks did not pay their flood losses in full – but not by opening the door for litigation against the NFIP. Rather, they mandate more training and communication and advocacy and administrative appeal programs. As long as it is the federal taxpayer who ultimately stands behind flood losses experienced by property owners, litigation will remain an unpleasant and largely unfruitful enterprise for policyholders.

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[5] Pub. L. No. 109-65, 119 Stat. 1998 (9/20/2005, from $1.5 to $3.5 billion); Pub. L. No. 109-106, 119 Stat. 2288 (11/21/2005, from $3.5 to $18.5 billion); Pub. L. No. 109-208, 120 Stat. 317 (3/23/2006, from $18.5 to $20.775 billion).

[6] As of May, 2008, the NFIP still owes more than $17 billion. *U.S. Senate Renews Flood Insurance Program,* Reuters, May 13, 2008, *available at* http://www.alertnet.org/thenews/newsdesk/N13406839.htm.

[7] JUSTIN R. PIDOT, GEORGETOWN ENVIRONMENTAL LAW & POLICY INSTITUTE, COASTAL DISASTER INSURANCE IN AN ERA OF GLOBAL WARMING: THE CASE FOR RELYING ON THE PRIVATE MARKET, 14 (2007) ("First, the program is a major burden on taxpayers because it has not been run in a financially responsible fashion.")

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1. Failure of Private Flood Insurance Market

Flooding is the one of the most, if not the most, common natural hazard to damage or destroy homes and other structures.[8] Yet flood damage historically has been (and still is) routinely excluded from private homeowners' insurance and commercial insurance policies. One difficulty with flood risk for insurers is that the risk of flooding to structures varies enormously due to the specific geography of individual properties – and homeowners would generally know more about their properties' geography and even its flood history than insurers.[9]

The mapping of flood prone areas was virtually non-existent prior to the creation of the NFIP. This tended to jeopardize the ability of insurers to spread risk: homeowners who were confident, based on their own geography and memories of past flooding, that they had minimal flood risk would not pay for flood

[8] Press Release, FEMA, Flooding: America's #1 Hazard (Aug. 16, 2004), *available at* http://www.fema.gov/news/newsrelease.fema?id=13427.
[9] For further elaboration of history and difficulties inherent in offering private flood insurance see Adam Scales, *A Nation of Policyholders: Governmental and Market Failure in Flood Insurance*, 26 Miss. C. L. Rev. 3, 7-11 (2005).

insurance, while homeowners who were aware of significant flood risk did so. And because the flood risk of those wanting to obtain flood insurance would be very high, the premiums that would be necessary to cover flood losses on those properties would also be very high. High insurance premiums would deter property owners from obtaining coverage whenever flood risk did not appear real and imminent – and this self-selection of flood insurance applicants (known as "adverse selection") for structures in high flood risk areas would lead to even further increases in premium as the overall experience worsened.

A corresponding and seemingly inconsistent challenge of flood risk is that many property owners are overconfident of their ability to evaluate flood risk. If the risk of flooding is not physically and historically obvious, many property owners assume that the water could not rise to levels that had not been seen over the last twenty or so years. Yet even if their reliance on only a twenty-thirty year time horizon were appropriate (and it is not),[10] the construction of new subdivisions and commercial areas has accelerated runoff of heavy rains and increased flood risk in many areas – making reliance on memory of historical flooding even more inaccurate. Finally, while mortgage lenders would rarely advance funds unless a standard "all risk" (excluding flood) homeowner's policy were in effect, lenders historically were indifferent as to whether a mortgaged structure was insured against damage caused by flood.[11] Finally, local governments tended not to incorporate flood risk or floodplain management into their zoning or land use planning ordinances and building codes.

The result of these forces was the withdrawal of the private insurance industry from the flood insurance market, increasing development in flood-prone areas, and rising uninsured damages from major flooding.

2. Creation of the National Flood Insurance Program

Congress enacted the National Flood Insurance Act of 1968 ("the Act") in response to the rising cost of disaster relief and the damage to communities and individuals from floods. Congress found that:

> (1) many factors have made it uneconomic for the private industry alone to make flood insurance available to those in need of such protection on reasonable terms and conditions; but (2) a program of flood insurance with large scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated.[12]

The Act created a coordinated National Flood Insurance Program, incorporating:

- **Risk identification/assessment**: mapping of flood prone areas in communities which joined the NFIP.
- **Risk mitigation**: adoption of a set of floodplain management regulations that communities must agree to adopt and enforce as a condition to their participation in the NFIP.
- **Insurance:** the federal government was authorized to arrange for the sale of federally supported flood insurance in communities which have joined the program.
- **Subsidization:** insurance premiums for properties in existence when a community joins the NFIP are subsidized (actuarial premiums for many of these older, high risk properties were

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[10] RICHARD TOBIN AND CORINNE CALFEE, THE NATIONAL FLOOD INSURANCE PROGRAM'S MANDATORY PURCHASE REQUIREMENT: POLICIES, PROCESSES, AND STAKEHOLDERS, 1, fn.1, and 37-38 (Mar. 2005). This report was prepared as part of the American Institutes for Research's Evaluation of the National Flood Insurance Program, funded by the Federal Emergency Management Agency (FEMA).

[11] *See* Scales, *supra* note 9, at 18-19 for his hypothesis that lenders were willing to ignore flood risk because bank officers making the loan simply assumed that flood events would normally not lead to borrower foreclosures, and that in any event the risk of flood would be sold off to investors when the loan was sold.

[12] National Flood Insurance Act of 1968, Pub. L. No. 90-448, § 1302, 82 Stat. 572 (Aug. 1, 1968) (codified as amended at 42 U.S.C. § 4001 *et seq.*).

considered unaffordable). Insurance for properties constructed after a community joins the program (and thus have presumably been constructed in accordance with flood plain management ordinances) is intended to be set at actuarial levels.[13]

- **Attrition of high risk properties:** while existing properties were grandfathered from compliance with new floodplain ordinances and could be insured at subsidized rates, a structure damaged more than 50% by flooding must be relocated or reconstructed in compliance with current floodplain management regulations.

It was the combination of *risk identification*, *risk mitigation*, and *attrition* – along with restrictions on the scope of insured losses insured under the flood insurance program – which was supposed to give this new Government insurance program, in contrast to past private flood insurance offerings, a chance to succeed.

Thus, flood maps would determine the flood risk in particular areas, allowing the development of actuarial premiums for flood insurance – and also providing communities and property owners the information they needed to implement the risk mitigation requirements of the flood program. Insurance was only to be made available in communities which adopted and enforced floodplain management regulations that prohibited development in floodways, and required that any new construction in floodplains be flood-proofed or elevated to above base flood elevation. These new structures would be insured under the NFIP at actuarial rates – but because of the reduction in flood risk caused by compliance with floodplain management regulations, these premium rates could be relatively low and affordable. And while structures in existence when a community joined the NFIP were "grandfathered" and eligible for subsidized[14] premiums, flood damage forcing major repairs (costing over 50% of the market value of the structure before the flood)[15] would trigger compliance with floodplain management regulations; the hope was that over time at least the most flood-prone of these structures would come into compliance.[16]

By some measures, the program has been an extraordinary success. While policy growth was slow in the early years (as discussed below), the NFIP now insures over 5.5 million properties[17] with a total coverage in excess of $1 *trillion* dollars.[18] Over 20,000 communities in the United States have joined the program – and have therefore adopted floodplain management regulations that will – to the extent that flood maps are accurate – limit flood risk for new construction. Yet as demonstrated by the program's vast $17 billion debt and the anguish of residents who have experienced uncovered flood losses, characteristics of flood risk which caused the private insurance market to flee from the flood market continue to plague the NFIP.

B. Development of the Standard Flood Insurance Policy: Balancing Cost, Coverage, and Deficit Spending

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[13] The unsubsidized insurance rates for newer properties, constructed after promulgation of a "Flood Insurance Rate Map" showing the "Special Flood Hazard Areas" in a community, are significantly lower than the subsidized rates for older structures.

[14] The "subsidy" – consisting of reduced rate premiums (i.e., lower than actuarial cost) – is available only to properties located in the 100-year floodplain, as mapped by FEMA, and built before the Flood Insurance Rate Map became effective in the community.

[15] 44 C.F.R. § 59.1 defines "substantial improvement"; 44 C.F.R. § 60.3 specifies the flood plain management regulations that communities participating in the NFIP must adopt and enforce; in most cases these regulations apply to "new construction and substantial improvements."

[16] Rawle O. King, *Federal Flood Insurance: The Repetitive Loss Problem*, CRS Report to Congress RL32972, CRS-15 (June 30, 2005).

[17] FEMA, Total Policies in Force by Calendar Year, http://www.fema.gov/business/nfip/statistics/cy2006pif.shtm .

[18] FEMA, Total Coverage by Calendar Year, http://www.fema.gov/business/nfip/statistics/cy2006cov.shtm .

1. Balancing Coverage and Affordability

The Act required the Federal Insurance Administrator, when establishing the initial terms and conditions and the premiums to be charged for insurance, to balance the extensiveness of coverage under the policy against the affordability and marketability of flood insurance. Thus, the Administrator was required to develop the "types, classes, and locations" of properties eligible for insurance,[19] the "nature and limits of loss or damage"[20] to be covered and the risks to be rejected by insurance,[21] and other key policy terms. At the same time, the Administrator was to calculate and, for new construction,[22] to charge actuarial premiums for this insurance. And recognizing that actuarial rates for many existing structures would be too high, the Administrator was required to determine, for existing structures, lower (and hence cross-subsidized) premiums that would "be reasonable, would encourage prospective insureds to purchase flood insurance, and would be consistent with the purposes of" the Act.[23]

In order to keep flood insurance affordable, several significant restrictions on coverage were incorporated into the Standard Flood Insurance Policy:

- Statutory limits (originally $30,000,[24] now $250,000 for structure/$100,000 for contents) on a homeowners' policy on the amount that could be paid on any claim.[25]
- Payments based on actual value less depreciation rather than replacement cost unless the amount of insurance is 80% of value or the NFIP statutory maximum, whichever is lower.[26]
- No coverage for loss of access, loss of use, alternate accommodation during repairs (e.g., rental of temporary quarters), business interruption, and other economic damage caused by flood other than direct damage to property.[27]

But just as private insurers had found flood insurance to be unprofitable, the NFIP had trouble generating premium income that would cover the program costs. In the NFIP's early years, a relatively high proportion of policies (75% in 1978, 62% in 1982) were issued on existing structures at subsidized rates. Not surprisingly, as a result, the NFIP ran deficits in years of substantial flooding. Indeed, despite the relatively small scale of the program (with only 5,500 policies in 1970, growing to 1,897,271 policies in 1980) the NFIP had to borrow $854 million from the U.S. Treasury by 1980.[28] In reaction to these deficits and the budget impact of using appropriations to bail out the NFIP, the Reagan Administration sought to make the program self-sustaining.

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[19] 42 U.S.C. § 4013(a)(1).
[20] *Id.* § 4013(a)(2).
[21] *Id.* § 4013(a)(3): (the "classification, limitation and rejection of any risks which may be advisable").
[22] *Id.* §§ 4014(a)(1), 4015(c)(1); *see also,* Pub. L. No. 93 – 234.
[23] *Id.* § 4014(a)(2).
[24] Section 1306(b)(1)(c) of the National Flood Insurance Act, Pub. L. No. 90-448, 82 Stat. 572 at 575 (1968).
[25] In addition, provisions in other statutes had an effect on coverage of some structures. For example, the Coastal Barrier Resources Act (16 USC § 3505(d)(2)) prohibits flood insurance on structures located in the Coastal Barrier Resources Zone, and any policies mistakenly issued on such properties are void *ab initio*. 42 U.S.C. § 4028.
[26] The 80% coverage requirement for replacement cost coverage is relatively standard in other lines of property insurance. *See* http://www.investopedia.com/ask/answers/06/80percentrule.asp (Last visited May 13, 2008).
[27] 44 CFR § 61, App. A(1)V.A.5. While not covered by the Standard Flood Insurance Policy (SFIP), alternate accommodation – temporary housing – is one of the "losses" that is eligible for the Disaster assistance that the NFIP was in part hoping to supplant. Temporary housing can be provided under §408 of the Stafford Act. 42 U.S.C. § 5174(c)(1)(A)(i)-(ii). However, this provision will generally be available only to those with very limited financial resources; individuals are generally ineligible for grants unless they cannot qualify for a Small Business Administration disaster loan.
[28] U.S. GENERAL ACCOUNTING OFFICE, NATIONAL FLOOD INSURANCE PROGRAM: MAJOR CHANGES NEEDED IF IT IS TO OPERATE WITHOUT A SUBSIDY, GAO-RCED-83-53, at 40 (Jan 1, 1983).

The first approach was to increase NFIP premiums: by 45 percent in 1981, and a total of 120 percent over the next seven years.[29] However, these premium increases quickly attracted political attention – and Congress responded by substantially limiting the NFIP's ability to use the technique of premium increases:

- in 1983, Congress prohibited any premium increases for a period of one year and directed that the NFIP study and then report to Congress on premium rates.[30]
- When Congress removed this freeze on premium, it imposed a limitation – still in effect as of this writing – prohibiting increases in premium of greater than 10% per year for any risk classification.[31]

Second, with market and political forces preventing premium increases from reaching actuarial alignment and financial sustainability, the program turned to reductions in the scope of insurance coverage. In the 1980s, the NFIP added several significant exclusions to the flood coverage offered by the NFIP:

- Limited coverage for damage in basements – does not include payment to repair or replace finished walls, floors, furniture, and other personal property.
- If the homeowner chooses to cover personal property:
  - Personal property limit of $2,500 for all jewelry, artwork, securities, and business equipment combined, and no coverage for these items if located in a basement
- A detached garage is covered by a dwelling policy only if it is used solely for vehicles and storage. If it is improved it is not covered unless separate coverage for that improved building is purchased.

The hope was that with these coverage limitations, premiums – even without the increases prohibited by Congress – could pay for a higher percentage of flood losses and reduce the program's reliance on cash infusions from the taxpayers. These reductions were maintained despite litigation claiming that they were illegal, and despite a congressional demand that GAO investigate their propriety.[32]

2. Recovery from Third Parties: Failed Subrogation Efforts

FEMA also sought to reduce the cost to the program of flood insurance claim payments by seeking recovery of the cost of paying for flood damage to new structures constructed in violation with floodplain management regulations. As noted above, a key element of the NFIP was that flood insurance would be offered only in communities that agreed to "adopt and enforce" floodplain management ordinances consistent with FEMA floodplain management regulations. These regulations required communities to allow construction of buildings in floodplains only if the lowest floor was at or above the base flood elevation. In some communities, however, new developments had somehow been granted building permits in areas that were mapped as SFHAs and – as a consequence – flooded with some frequency.

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[29] AMERICAN INSTITUTES FOR RESEARCH, A CHRONOLOGY OF MAJOR EVENTS AFFECTING THE NATIONAL FLOOD INSURANCE PROGRAM (December 2005) *available at* http://www.fema.gov/library/viewRecord.do?id=2601.

[30] Pub. L. No. 98-181, 97 Stat. 1153 at 1229 (Nov. 30, 1983).

[31] 42 U.S.C. § 4015(e), enacted in § 2302(e)(5) of Pub. L. No. 101-508. In 2004, Congress did exempt from its restriction on premium increases "any property leased from the Federal Government (including residential and nonresidential properties) that the Director determines is located on the river-facing side of any dike, levee, or other riverine flood control structure, or seaward of any seawall or other coastal flood control structure." *Id.* § 4015(c)(2).

[32] U.S. GOVERNMENT ACCOUNTING OFFICE, FEDERAL EMERGENCY MANAGEMENT AGENCY'S BASEMENT COVERAGE LIMITATIONS, GAO-RCED-86-10FS, at 25-26 (Jan. 1986); *Nelson v. Becton*, 929 F.2d 1287 (8th Cir. 1991).

In *United States v. St. Bernard Parish,*[33] the court considered an appeal of decisions in two actions brought by the United States on behalf of FEMA and the Federal Insurance Administration against the Parishes of St. Bernard and Jefferson, the State of Louisiana, and various home builders, engineers, and surveyors. Extensive litigation revealed building permits issued for and construction of entire neighborhoods built in particularly flood prone areas.[34] The United States claimed a right of recovery for massive flood damages incurred as a result of construction that did not comply with the NFIP's regulations; it claimed, *inter alia,* a breach of the communities' contract with the NFIP: the NFIP had made flood insurance available on condition that the community enforce floodplain ordinances and they had failed to do so. The Fifth Circuit held, however, that the Act did not authorize actions in contract for recovery of damages. The only federal enforcement option available under the Act was suspension of the community from the program.[35] The United States chose not to seek Supreme Court review of this decision – which had been politically charged from the outset.

Further, political reaction to premium increases not infrequently intervened to reduce the NFIP's ability to become financially self-sustaining. For example, when a portion of the Sacramento Valley was about to be placed in a SFHA due to decertification of levees, the California congressional delegation reacted to ensure that the many properties in this flood zone would not be subject to any increase in flood insurance premiums to reflect its flood risk: Congress enacted special legislation requiring that the NFIP charge premiums in that area (called the "AR Zone") as if a property were not in a flood hazard area – even though, in fact, it was.[36] Similarly, whenever a new Flood Insurance Rate Map (FIRM) is published revising the boundaries of the SFHA, the program bestows "grandfather" status to properties that were previously mapped as *outside* a SFHA:[37]

> To recognize policyholders **who have remained loyal customers of the NFIP** by maintaining continuous coverage and/or **who have built in compliance with the FIRM**, the Federal Insurance and Mitigation Administration has "Grandfather rules" to allow such policyholders to benefit in the rating for that building.[38]

Essentially, the structures are treated as if they are not in the flood plain when in fact they are; this status continues (even through transfer of ownership). Private insurance companies face similar political and market reaction when they raise rates to reflect changes in their understanding of the actuarial risk of loss; their (unpopular) solution has been to raise rates and/or withdraw from that insurance market. But the NFIP has generally not had that option.[39] In short, the political impact of raising insurance rates to actuarial levels has meant that the premium structure of the NFIP includes not only the original subsidy for structures built before communities entered the program decades ago, but also newer subsidies for structures whose flood risk emerges as a result of development or other factors.

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[33] 756 F.2d 1116 (5th Cir. 1985).

[34] The full saga is carefully documented by Oliver Houck in *Rising Water, the National Flood Insurance Program and Louisiana*, 60 TUL. L. REV. 61, 135-156 (1985).

[35] *St. Bernard Parish*, 756 F.2d at 1123 (5th Cir. 1985). The Court did conclude that the NFIP could exercise its rights of subrogation for any claims.

[36] 42 U.S.C. § 1307(f), enacted by § 928 of Pub. L. 102-550, 102 Stat. 3652 at 3886 (1992). The basis of this special legislation was that funds to restore the levees had been appropriated, and that the flood risk in this area was only temporary.

[37] FEMA guidance explaining the NFIP Map Grandfather Rule is available (as of May 29, 2008) at www.fema.gov/library/file?type=publishedFile&file=grndfthr_sht.pdf&fileid=ff525740-4449-11dc-bda9-000bdba87d5b .

[38] *Id.* (emphasis in original).

[39] The principal exceptions are for properties built in violation of applicable floodplain management regulations (if discovered) and more recently to certain repetitive loss properties affected by legislation described in Part II, D., *infra*.

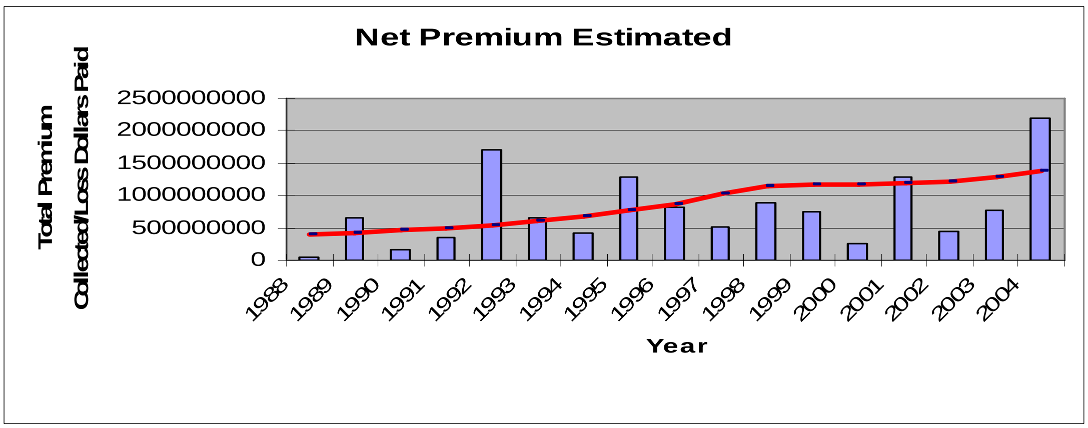
3. Result: Financially Self-Supporting But Only To Limited Extent

As a result of the increased premiums and the restrictions on coverage, and despite the political and market resistance to these measures, the NFIP achieved a measure of financial sustainability:

> For the first time, the NFIP [became] financially self-supporting for the historical average loss year . . . During FY 1986, no taxpayer funds are required to meet the NFIP's flood insurance expenses. In addition, at the beginning of the fiscal year, the NFIP is required for the first time to pay all program and administrative expenses with funds derived from insurance premiums.[40]

And while being "financially self-supporting for the historical average loss year" does not meet "the traditional insurance definition of solvency"[41] (since the historical average did not include any catastrophic loss years), the program was funded solely by premiums from the mid-1980s until 2005. Yet despite all of the premium increases from the start of the program, and the substantial restrictions in the scope of coverage offered, the National Flood Insurance Fund was never able to generate a reserve for a catastrophic flood year.[42]

Thus, as shown below, in a low to medium flood year (such as 1986-88, 1994, and 1997) the fund might show a surplus; in a relatively heavy flood year (such as 1993 [Missouri River], 1995 [Louisiana Flooding and Hurricane Opal], 2001 [Tropical Storm Allison], 2004 [Four Florida Hurricanes]) the Fund would run a substantial deficit and be forced to borrow from the Treasury to pay claims.[43]



Source: FEMA, http://www.fema.gov/business/nfip/statistics/cy2006losspd.shtm.[44]

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[40] NFIP Chronology, *supra* note 29, at 40.

[41] *Id.*

[42] Recognizing that the NFIP was operating without reserves for a catastrophic event, the Federal Insurance Administrator explored establishing a special financial reinsurance vehicle in 2000 that would require an increase in premium (to cover the cost of the reinsurance) but would pay out in catastrophic loss years to reduce the need for borrowing. This proposal was not adopted in large part because of concern that any reinsurance vehicle would cost more than the cost of debt to the United States Treasury.

[43] Prior to Hurricane Katrina, the maximum amount borrowed was just over $1 billion.

[44] The net premium estimated has been calculated based on an average of Total Underwriting Expenses deducted from the Total Revenue Earned (values provided by the National Flood Insurance Program *Operating Results by Fiscal Year*) per annum from 1985 through 2005, averaging approximately at a 33.37 percent increase per year.

When Katrina hit in 2005, the Fund had only just managed to pay off the debt incurred in the 2004 Hurricane Season. It had no real reserves – despite the vast increase in policies outstanding spurred in large part by the Mandatory Purchase Requirement. Yet the NFIP's efforts to achieve financial solvency (in the historical average loss year) did have an impact: flood insurance policies became much narrower in scope that many policyholders expected. To their surprise and disappointment, many policyholders who had diligently paid premiums discovered, when they experienced a flood loss and made their claim on the policy, that many of the losses they experienced in the flood were not covered.[45] This disappointment, in turn, was one of the drivers behind the litigation discussed below.

C. The Mandatory Insurance Requirement: Encouraging Policy Growth in Special Flood Hazard Areas and Mis-communicating Flood Risk

1. Background of the Mandatory Purchase Requirement

After enactment of the National Flood Insurance Act in 1968, the federal government worked feverishly to implement the program. It created a new Federal Insurance Administration, drafted floodplain management rules, developed the Standard Flood Insurance Policy, and entered into agreements with private industry under which a "private industry pool" would issue flood insurance policies and adjust claims. The first insurance policies were sold in June 1969.[46] But policy growth – then wholly voluntary – was slow. After four years, less than 10 percent of eligible communities had joined the program, and only 95,000 policies across the country were in force.[47]

Despite the slow growth of properties insured for flood, flood damage and federal flood disaster assistance continued to rise. In 1973, Congressional frustration with the low market penetration of flood insurance led to enactment of a flood insurance purchase requirement: federally regulated or supported mortgage lenders became *legally required* to ensure that a property in the SFHA had flood insurance, up to the amount of the loan balance, before they could advance a mortgage loan secured by a property in a defined flood hazard area.[48] Concern with lack of compliance with this requirement – which became obvious to all after widespread flooding along the Missouri River in 1993 – led Congress to clarify and strengthen the mandatory purchase requirement in the National Flood Insurance Reform Act of 1994.[49]

At the same time that it was making the purchase of flood insurance mandatory in SFHAs, Congress encouraged communities to join the NFIP (so that flood insurance could be available in the community) by prohibiting federal financial assistance, including disaster assistance, "for acquisition and construction purposes" in flood prone areas unless the community had joined the NFIP.[50] The disaster assistance law already provided that insurance be obtained (if available) as a condition precedent to receipt of disaster assistance funding repair or replacement of structures. It was amended first to prohibit FEMA from waiving this requirement for the risk of flooding,[51] and then to prohibit payment of flood disaster assistance if flood insurance required as a condition of assistance has not been maintained.[52]

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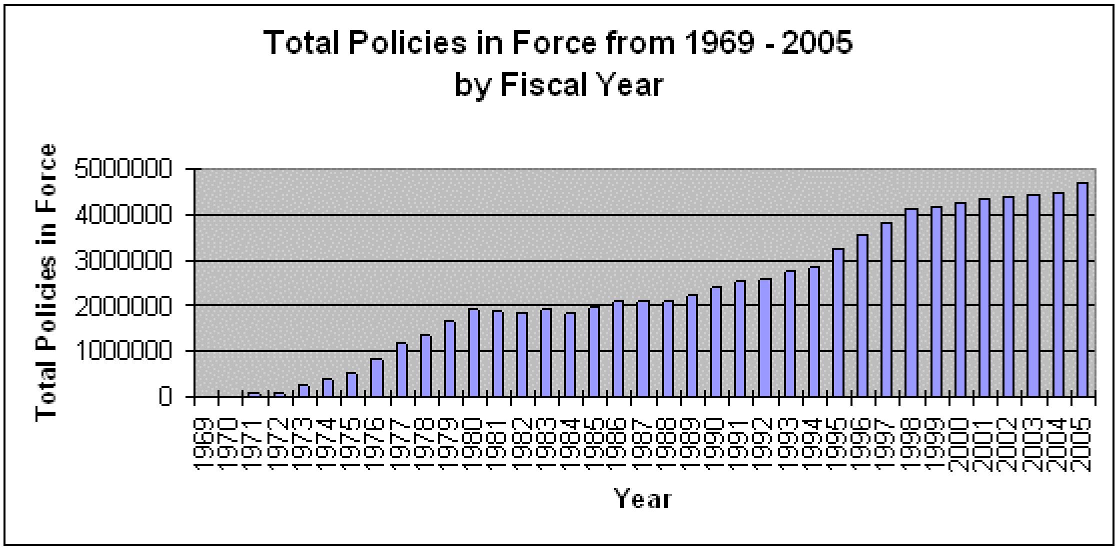
[45] *See, e.g.* William O. Jenkins, Director, Homeland Security and Justice Issues, Testimony Before the Subcommittee on Housing and Community Opportunity, Committee on Financial Services, House of Representatives, GAO-05-532T, at 5-6 (April 14, 2005).
[46] NFIP Chronology, *supra* note 29, at 13.
[47] Tobin and Calfee, *supra* note 10, at 8 fn.5.
[48] Section 102 of the Flood Disaster Prevention Act of 1973, Pub. L. No. 93-284, 87 Stat. 975 at 978.
[49] The National Flood Insurance Reform Act of 1994 ("1994 Act"), Title V of the Riegle Community Development and Regulatory Reform Act of 1994, Pub. L. No. 103-325, 108 Stat. 2160, at 2255-2287.
[50] Section 202 of the Flood Disaster Prevention Act of 1973; 42 U.S.C. § 4106.
[51] Section 521 of the 1994 Act, 42 U.S.C. § 4012a.
[52] Section 582 of the 1994 Act, 42 U.S.C. § 5154a.

Spurred on by the growing strength of the mandatory purchase requirement, policies outstanding grew substantially – reaching over 5 million policies in force at the end of 2006:



Source: NFIP Operating Results (FEMA)

Clearly the mandatory purchase requirement stimulated a significant expansion of coverage over a "voluntary" system; significant growth occurred in the period following adoption and strengthening of the requirement in 1973 and 1994, respectively. The significance of the "mandatory" requirement is also shown by the following statistics: In 2006, about 75% of the homes in SFHAs were covered by the mandatory purchase requirement – and compliance with this requirement was about 75%. By comparison, of the 25% of homes in SFHAs that were not subject to the mandatory purchase requirement,[53] only 20% had insurance. Yet concerns about lender compliance and market penetration remain. In SFHAs, the NFIP Evaluation Final Report Working Group concluded in 2006 that only about 50% of homes in SFHAs had flood insurance[54]

2. Misunderstanding Generated by Requirement

While it was (somewhat) effective, litigated cases show that the mandatory insurance purchase requirement nonetheless seems to have generated confusion about flood risk both among those who were and were not subject to its requirements – and this uncertainty has also led to some of the current litigation.

3. "Should Purchase" vs. "Required to Purchase"

Note first that the NFIP's mandatory insurance requirements only apply to structures located in an area shown, on the Flood Insurance Rate Map (FIRM) promulgated by FEMA after technical studies and consultation with a community, as having at least a 1% chance per year of flooding in any given year. A property which is not located in an SFHA is not subject to the mandatory purchase requirement. Reflecting the perceived absence of flood risk in areas not mapped in SFHAs, only 1% of insurable homes in non-SFHAs have flood insurance.[55]

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[53] There is no requirement, for example, for homes whose mortgages have been paid off.
[54] AMERICAN INSTITUTES OF RESEARCH, THE EVALUATION OF THE NATIONAL FLOOD INSURANCE PROGRAM FINAL REPORT, at 26 (October 2006).
[55] L. DIXON, ET AL., RAND CORPORATION, THE NATIONAL FLOOD INSURANCE PROGRAM'S MARKET PENETRATION RATE: ESTIMATES AND POLICY IMPLICATIONS, at 29 (Feb. 2006). This Report is part of the Evaluation of the Flood

While the majority of properties outside of SFHAs may well have no real risk of flooding, experience has shown that many properties do. The maps may have been wrong, technically, from the outset. Areas that had a 1% chance per year of flooding may now have a 1 in 30 year chance of flooding after development has replaced land that absorbs rainfall with impervious roads and rooftops. Levees may have been improperly built or maintained. Areas that have only a 1 in 100 chance in any year of flooding may well flood during a storm with a 1 in every 200 year severity. In fact, in the history of the NFIP, over one third of all flood claims have been paid on properties located outside the SFHA – and in one state (Idaho) 82% of flood claims were incurred in areas mapped as having a less than 1% per year chance of flooding.[56]

The problem – at least as it is disclosed in the complaints filed by uninsured plaintiffs[57] – is that some property owners seem to believe that if they are not in a Special Flood Hazard Area, they do not have a flood risk and so should not purchase flood insurance. In many cases they may ask their agent, before buying a home, whether they *"have to have"* flood insurance on their new home. Many agents construed these request as asking whether the property owner was legally required (by the mandatory purchase requirement) to have flood insurance – and said "no."[58] Indeed the documentation of flood risk required by statute, with a lender obtaining and keeping in its files a "Standard Hazard Determination Form"[59] showing whether a property is in a SFHA and thus required to have flood insurance, may have led both insurance agents and property owners to think that if the Form said the property was not a flood area, flooding and flood insurance need not be of concern.

But almost inevitably, some of these uninsured properties then flood, and property owners have then brought suit alleging that the insurance agent had negligently failed to advise them, when asked, that they *"needed"* flood insurance. Thus, the mandatory purchase requirement, in addition to communicating flood risk to property owners in a SFHA and stimulating the purchase of flood insurance, appears also to have *incorrectly* communicated an *absence* of flood risk for those not in mapped SFHAs.

4. Minimum Required Coverage and Replacement Cost

A second effect of the mandatory purchase requirement has been to create the impression that, if the property owner purchases the *required amount* of flood insurance, the property owner is protected from losses due to flood. But the purchase requirement does not do so and was not even designed to provide full protection. The NFIP's flood insurance requirement only requires that flood insurance be obtained in an amount covering the outstanding loan balance. When homeowners purchase only the amount of flood insurance "required," they not only purchase no coverage whatsoever for any equity they may have had in their home – the amounts in excess of the mortgage loan – but they also automatically – and perhaps unwittingly – do not even purchase coverage that would pay for repair of flood damage within the policy limits.

Insurance Program funded by FEMA and is available (as of May 21, 2008) at http://www.fema.gov/library/viewRecord.do?id=2599.

[56] Tobin and Calfee, *supra* note 10, at 1 fn.1 and 37.

[57] *Nast v. State Farm Fire and Cas. Co.*, 82 S.W.3d 114 (Tex. App. 2002); *Jones v. State Farm General Ins. Co.*, 2007 WL 1428705 (E.D.La. May 11, 2007).

[58] Demonstrating significant lack of understanding of the flood insurance program, some insurance agents have even advised property owners, incorrectly, that flood insurance is not available in areas that are not mapped as SFHAs. *See, e.g., Jones*, 2007 WL 1428705. Plaintiffs asked insurance agent 90 days prior to Katrina if she could procure flood insurance. Agent's representative told her that because her property was in a no flood zone, flood insurance was not necessary. Plaintiffs' house was destroyed by water that flowed through levee breaches. Agent later admitted that his office was incorrect, and that insurance can be purchased in a no flood zone. (Case decided on jurisdictional grounds). Flood insurance in these areas is not only available, but relatively cheap; homeowners can qualify for a "preferred risk" policy.

[59] 42 U.S.C. §1365.

How can this be? The deficiency in coverage occurs because a flood policy will only provide "replacement cost coverage" if the policy limit is 80% of the replacement cost of the insured structure (or the maximum amount available under the NFIP).[60] If a property owner has paid for only $100,000 in coverage, and the replacement cost of the structure is $150,000, then in the event of flood damage the policy will pay only the Actual Cash Value (ACV) of the damaged property at the time of loss *less its accumulated depreciation."*[61] For older buildings, where there is substantial depreciation, the actual cash value of damaged property is considerably less than the cost of repairing or replacing the damaged property.

The significant difference between ACV and Replacement Cost Coverage interacted with the flood insurance purchase requirement in a way that may have surprised many policyholders. The NFIP mandatory insurance requirement directed mortgage holders to assure that mortgaged property located in a special flood hazard area had flood insurance "in an amount at least equal to the outstanding principal balance of the loan or the maximum limit of coverage made available under the Act . . ., whichever is less."[62] This protected lenders but is incomplete protection for the property owner for medium to large flood losses.

Faced with a number of recalcitrant buyers and some litigation,[63] many lenders were reluctant to require flood insurance greater than the amount they were under an obligation to require. And whenever only "the required amount" of insurance was purchased, replacement coverage of structure and contents was in effect only for those loans with less than 20% equity. For older homes – the ones with the greatest adjustments for depreciation – this meant no replacement cost coverage. So if the amount of a mortgage loan were less than 80% of the replacement cost of a structure, and a homeowner only insured (as required) to the amount of the mortgage loan, the homeowner *by definition* would receive less in a claim settlement than the amount required to repair or replace the damaged property.[64]

The significant restrictions and exclusions in the Standard Flood Insurance Policy – crafted in an effort to stem the hemorrhage of red ink in the program – meant that many insured policyholders would experience substantial uncovered losses after significant flood events. We have also seen that the mandatory flood insurance requirement – while encouraging many policy holders to have coverage – may have caused misunderstanding of the actual flood risk on properties not within SFHAs. The mandatory purchase requirement may also have caused property owners to think that they were appropriately insured in purchasing only the amount of insurance required – and led them to be underinsured.[65]

Thus, after Hurricanes Katrina and Rita devastated the Gulf Coast, many thousands of property owners found that their homes had been destroyed by flooding, and all too many of them had no flood policies at all, or wholly inadequate flood coverage given the scale of the damage. Many of these property owners

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[60] Standard Flood Insurance Policy (44 CFR Part 61, App. A(1), Article V, ¶ 1a.

[61] *Id.*, Article V, ¶ 2.

[62] Section 102(b)(1) of the Flood Disaster Protection Act of 1973, as amended, 42 U.SC. § 4012a(b)(1).

[63] *Norris v. Union Planter's Bank,* 98-1581 (La.App. 1 Cir. 6/25/99); 739 So.2d. 869 (holding bank purchased more insurance than permitted by National Flood Insurance Act); but see *Hayes v. Wells Fargo Home Mortg.*, 2006 WL 3193743 (E.D.La. Oct. 31, 2006) (Holding bank was clearly within its rights under the federal flood program to require Hayes to obtain flood insurance beyond the outstanding value of the mortgage).

[64] U.S. GOVERNMENT ACCOUNTING OFFICE, IMPROVEMENTS NEEDED TO ENHANCE OVERSIGHT AND MANAGEMENT OF THE NATIONAL FLOOD INSURANCE PROGRAM, GAO-06-119, at 20-21 (Oct. 2005).

[65] It is also plausible that these underinsured property owners would have refused all coverage in the absence of the mandatory purchase requirement – so that they would have uninsured rather than underinsured in a flood. Whatever their motivation, these policy holders – after their property was flooded – discovered that their policy left them with substantial uncovered losses.

then sued insurance carriers and insurance agents under a wide variety of theories that are now being evaluated by the courts. In the vast majority of the cases involving the NFIP, the federal government is not even a party to the litigation. The federal government may have created the insurance policy, promulgated rules governing its interpretation and applicability, accepted all insurance risk, and agreed to pay most of the costs of litigating cases – but is not in the courtroom when its liability is at stake. To understand flood insurance litigation, it is necessary first to describe the relationship between the federal government and the private insurance industry.

II. Flood Insurance Litigation

A. The Role of the Private Insurance Industry in the NFIP

From the outset of the NFIP, Congress anticipated and encouraged a very active role for the private insurance industry. The purpose of the Act was to "authorize a flood insurance program by means of which flood insurance, over a period of time, can be made available on a nationwide basis through the cooperative efforts of the Federal Government and the private insurance industry. . ." [66] The insurance program could commence only after consultation with representatives of the insurance industry.[67] The Congress expressed a clear preference that the new program provide flood insurance through an industry flood insurance pool supported by the federal government.[68] Indeed, the federal government could assume operational responsibility of the program only after consultation with the insurance industry and a report to Congress and to the industry.[69] And the Secretary of Housing and Urban Development (HUD) had to include in this report a determination either that the industry pool arrangement "cannot be carried out," or that the NFIP "would be assisted materially by the federal government's assumption of operational responsibility for the program."[70] But even if the federal government assumed operational control, Congress gave the Secretary wide latitude to utilize "insurance companies and other insurers, insurance agents and brokers, and insurance adjustment organizations, as fiscal agents of the United States."[71]

The NFIP commenced operations in 1969 under Part A of the Act through the National Flood Insurers' Association (NFIA), a private industry pool created for this purpose. NFIA issued these policies with federal government subsidies of the pool's losses under a financial assistance agreement.

The private industry pool program of NFIA operated for less than ten years. Tensions between the HUD and the NFIA on cost and performance issues grew throughout the Nixon and Ford Administrations and in 1977, the Carter Administration's new Secretary of HUD determined that operation of the program "would be assisted materially by the Federal Government's assumption . . . of the operational responsibility for flood insurance."[72] Despite a flurry of legal maneuvering by the NFIA,[73] HUD commenced direct Federal operation of the flood program, utilizing a servicing contract with EDS Federal Corporation, on January 1, 1978. Virtually simultaneously, the Secretary of HUD's responsibilities over the flood insurance program, and the entire Federal Insurance Administration, transferred to the newly created Federal Emergency Management Agency (FEMA).[74]

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[66] 42 U.S.C. § 4001(d)(1).
[67] *Id.* § 4041.
[68] *Id.* §§ 4051-4056.
[69] *Id.* § 4071.
[70] *Id.* § 4071(a).
[71] *Id.* § 4071(a)(1).
[72] Secretary's Report to Congress Upon Making Determination to Operate Under Part B Framework, 42 Fed. Reg. 58569 (Nov. 10, 1977).
[73] *See National Flood Insurer's Association v. Harris*, 444 F. Supp. 969 (D.D.C. 1977).
[74] Reorganization Plan No. 3., 43 Fed. Reg. 41943, Exec. Order No. 12,127 (1978).

The assumption of operational responsibility under Part B of the Act meant, as a legal matter, that all policies were issued directly by the federal government. The name of the Insurer on every flood insurance policy – printed by the U.S. Government Printing Office – was the Federal Insurance Administration. Indeed, all policies issued by the NFIA became direct obligations of the United States. The insured's premium checks were deposited in the Flood Insurance Fund in the U.S. Treasury. Claims made were made against the United States. The servicing contractor acted as agent of the United States in selling policies, training insurance agents, and servicing claims. The Department of Justice defended litigation arising from disputes over flood insurance policies. A policyholder could have no doubt that he or she was dealing with the federal government.

Shortly after the start of the Reagan Administration, the new Federal Insurance Administrator began formulating a new arrangement to bring the private insurance industry back into the flood insurance arena. FIA promulgated the resulting Write-Your-Own ("WYO") Arrangement (so named because participating insurance companies could write flood insurance policies on their own "paper" or policy forms) in 1983.[75] While this new arrangement did not eliminate the agency's "direct" insurance program, within a very few years, more than 90% of all flood insurance policies were issued under the WYO Arrangement. This Arrangement created a unique public-private partnership with a fascinating and still unfolding mixture of public and private responsibilities.

The statutory foundation of the WYO Arrangement is the same as that of the direct program: it is a "Government Program with Industry Assistance" under Part B of the Act.[76] The WYO Arrangement not only remains a federal program, it looks like a federal program as it relates to the relationship between FEMA and the participating insurance companies. The "Arrangement," or contract,[77] between FEMA and the insurance company participants (WYO carriers) is itself promulgated by rule in the Code of Federal Regulations. FEMA also continues to specify in the Code of Federal Regulations every provision of the Standard Flood Insurance Policy. This policy cannot be altered by anyone – not even the private insurance company "writing" or issuing the policy – without the express written consent of the Federal Insurance Administrator.[78] FEMA continues to set the premium applicable for each type of policy in each of the risk zones specified on the Flood Insurance Rate Map (FIRM) issued by FEMA for participating communities. In the absence of underwriting mistakes – that is, assuming all companies properly determine a property's flood zone on a FIRM and correctly enter elevation, age, and other relevant data for the property – every insurance company must charge the same premium for the same coverage on a property as FEMA would if selling the policy directly. FEMA continues to be financially responsible for every loss incurred on any policy sold under the WYO arrangement to the same extent as if it had sold the policy itself. From a legal standpoint, WYO companies are acting as "fiscal agents" of the United States,[79] not as general agents.[80]

[75] 48 Fed. Reg. 46789-01 (Oct. 14, 1983)

[76] 42 U.S.C. § 4071-4072. Specifically, under Part B the Director shall "undertake any necessary arrangements to carry out the program of flood insurance . . . through the facilities of the federal government, utilizing, for purposes of providing flood insurance coverage, either (1) insurance companies and other insurers, insurance agents and brokers, and insurance adjustment organizations, as fiscal agents of the United States, (2) such other officers and employees of any executive agency . . . as the Director and the head of any such agency may from time to time, agree upon, on a reimbursement or other basis, or (3) both the alternatives specified in paragraphs (1) and (2)." *Id.* § 4071(a).

[77] The arrangement is treated as a "subsidy agreement" and not as a federal contract by FEMA. As a result, government procurement regulations are not applicable to it and participating insurance companies are not considered to be federal contractors.

[78] 42 C.F.R. Part 61, App. A(1)VII(D); App. A(2)VII(D); App. (A)(3)VII(D); *Gowland v. Aetna,* 143 F.3d 951 (5th Cir. 1998).

[79] 42 U.S.C. § 4071(a)(1); *Van Holt v. Liberty Mut. Fire Ins. Co.,* 162 F.3d 161, 166 (3rd Cir. 1998).

[80] *See Parsons Footwear, Inc. v. Omaha Property & Casualty Co.* 19 F. Supp 2d 588 (N.D.W.V. 1998).

Nonetheless, the WYO Arrangement has given flood insurance the appearance of a private sector program to its policyholders. Participating insurance companies sell flood insurance to the general public in their own name: it is the Company's name, and not FEMA's, that appears at the top of the policy declaration page. While there are ample hints in the policy that the federal government has something to do with the policy, these hints will likely appear to most policyholders in a mass of boilerplate.[81] Policies are sold by and through the same agents who handle homeowners' other lines of insurance, such as automobile and homeowners' insurance.

An insured's premium check is made out to the WYO carrier. All contacts in connection with the policy are made through the agent or directly to the WYO carrier. The WYO carrier determines and collects the appropriate premium, processes renewals and coverage changes, receives notice of claims, hires adjusters for those claims, and settles the claims, providing a company check written on the company's bank.[82] In short, customers interact with their agent and WYO carrier in the same manner that they interact with their agent and insurance carrier for homeowners insurance – in many cases with the same agent and carrier (or family of carriers) used for homeowners and automobile insurance. Indeed, a principal justification for the WYO program was to give the flood program access to the private insurance industry's vast network of agents and adjusters rather than rely on a single purpose network comprised of federal contractors that perhaps would not even be adequate to respond to catastrophic flooding.[83]

B. Impact of the NFIP Public-Private Partnership on Flood Insurance Litigation

We have now seen that the WYO program of the NFIP, under which well over 90% of policies are sold, was designed to "look like" a standard private insurance policy sold and serviced by private insurers. The "real" insurer (the entity holding all risk of loss) is the federal government – but the federal government designed the WYO program to virtually eliminate any interaction of the federal government with policyholders. However, there is a big difference between the law applicable to private insurers and the law applicable to the federal government.[84]

As a result, NFIP litigation over the last several decades has been characterized by a largely unsuccessful struggle by policyholders to have their "sold by the private sector" flood insurance policies treated by standard principles of insurance law in state courts rather than treated as a federal government program defended in federal court.

1. Federal Versus State Court Jurisdiction

The Act provides for "original exclusive jurisdiction" in federal district court of challenges brought by policy holders from a total or partial disallowance by "the (FEMA) Director"[85] of a claim on a flood

[81] These are (1) Policy subject to NFIA and Regulations, (2) No alteration of policy without consent of FIA, (3) Definition of NFIP, (4) Reference to FEMA building standards, (5) What Law Governs etc.
[82] Indeed, FEMA is not a proper party to the action. *Tollini v. State Farm Fire and Cas. Co.*, No. C99-3383 MJJ (D. N.J. Feb. 9, 2000).
[83] 48 Fed. Reg. 46789-01 (Oct. 14, 1983).
[84] Under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015, Congress made "the business of insurance, and every person engaged therein, . . . subject to the laws of the several States which relate to the regulation or taxation of such business." Further, "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance." Since the National Flood Insurance Act indeed relates to the business of insurance, it does preempt state law.
[85] The head of FEMA is now the Administrator.

insurance policy, and further specifies a one-year statute of limitations for these actions.[86] Relatively early in the history of the WYO Program, the Courts concluded that this jurisdiction and limitation provision applied not just to suits directly against FEMA, but also to suits filed against a WYO carrier. [87] Later cases have made it clear that when a WYO Company denies a claim, it does so as "fiscal agent of the United States," and therefore that any suit brought against the WYO Company challenging its total or partial disallowance of a claim on a flood insurance policy may be brought only in federal court.[88]

Policy holders sought to evade this provision by claiming they brought suit not under their Standard Flood Insurance Policy (SFIP), but for extra-contractual damages under state laws requiring prompt handling of insurance claims, or for fraud in the manner of handling claims, and the like. These efforts generally proved unsuccessful, particularly after FEMA amended the language of the SFIP (in 2000) to state that

> If you do sue, you must start the suit within one year after the date of the written denial of all or part of the claim, and you must file the suit in the United States District Court of the district in which the covered property was located at the time of loss. *This requirement applies to any claim that you may have under this policy and to any dispute that you may have arising out of the handling of any claim under the policy*. [2000 Amendment italicized.][89]

Further, in what was a clear effort by FEMA to preempt state remedies arising from the handling of flood insurance claims, the policy provides that:

> This policy and all disputes arising from the handling of any claim under this policy are governed exclusively by the flood insurance regulations issued by FEMA, the National Flood Insurance Act of 1968, as amended, and Federal common law.[90]

On the other hand, courts found that exclusive jurisdiction in federal courts did not apply to disputes arising from failures of an insurance agent or WYO Company to obtain an SFIP in the amount and with the coverage requested by a property owner.[91] Thus in most cases, if fault of the agent prevented a policy from coming into existence, then no dispute can arise "under the policy" and the matter may remain one properly handled in state courts.

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[86] "The Director shall be authorized to adjust and make payment on any claims for proved and approved losses covered by flood insurance, and upon the disallowance by the Director of any such claim, or upon the refusal of the claimant to accept the amount allowed upon any such claim, the claimant, within one year after the date of mailing of notice of disallowance or partial disallowance by the Director, may institute an action against the Director on such claim in the United States District Court for the district in which the insured property or the major part thereof shall have been situated, and *original exclusive jurisdiction* is hereby conferred upon such court to hear and determine such action without regard to the amount in controversy." 42 U.S.C. § 4072 (emphasis added).

[87] *Spence v. Omaha Indemnity Casualty Co.*, 996 F.2d 793 (5th Cir. 1993); *Van Holt v. Liberty Mut. Fire Ins. Co.*, 163 F.3d 161 (3rd Cir. 1998).

[88] *Newton v. Capital Assur. Co., Inc.*, 245 F.3d 1306 (11th Cir. 2001); *Van Holt* 163 F.3d 161.

[89] 44 C.F.R. App. A(1) at ¶ VII R, promulgated at 65 Fed. Reg. 60758, 60776 (October 12, 2000).

[90] *Id.* at ¶ IX.

[91] *Moore v. Allstate Ins. Co.*, 995 P.2d 231 (Alaska 2000); *Houck v. State Farm Fire & Cas. Co.*, 194 F.Supp.2d 452 (D.S.C. 2002*); Landry v. State Farm Fire & Cas. Co.*, 428 F.Supp.2d 531, 532-36 (E.D.La. 2006); *See, Houck v. State Farm Fire and Cas. Co.*, 620 S.E.2d 326 (S.C. 2005) (No duty under South Carolina law owed by agent and WYO Company to advise insured of availability of cheaper Preferred Risk Policy).

2. Construction of the Insurance Policy

State laws generally characterize insurance policies as contracts of adhesion drafted by the insurance company, and construe any ambiguity against the insurance carrier.[92] By contrast, the SFIP is developed by FEMA as a regulation, after opportunity for public notice and comment, and is codified in the Code of Federal Regulations. Its provisions have the force and effect of law. Ambiguity in a federal flood insurance policy is not construed in favor of the insured and against the drafter – the Flood Insurance Administrator (FIA). Rather, the FIA is granted deference as the Agency responsible for promulgating and interpreting the SFIP. Indeed, the federal law generally operates with a presumption that residents are bound by technical programmatic regulations whether or not the customer is aware of them.

3. Technical Defenses: the Proof of Loss Requirement

The SFIP includes a strict requirement that a claimant file and notarize a Proof of Loss within 60 days of the loss, and also a strict requirement that "you may not sue us to recover money unless you have complied with all the requirements of the policy."[93] The SFIP also provides that it cannot be

> changed, nor can any of its provisions be waived without the express written consent of the Federal Insurance Administrator. No action we may take under the terms of this policy constitutes a waiver of any of our rights.[94]

This Proof of Loss requirement has tripped up an astonishing number of claimants, given the clear language in the policy. A WYO Company's adjuster may provide a proposed settlement of a claim with which a policy holder disagrees. The policy holder refuses to sign the proposed Proof of Loss – and does not submit an alternative one, perhaps because the policy holder is not confident that he or she has adequate information to certify formally a specific dollar amount as the quantum of loss from the flood. The policy holder may even be advised (clearly by a lawyer with no flood insurance experience) not to sign a formal proof of loss because in most states the formal proof of loss is not required in insurance cases.

However, if negotiations between the WYO Carrier and the claimant break down and this claimant files suit, the claimant will be met by a motion for summary judgment for failure to comply with the policy's Proof of Loss requirement. This filing is almost always successful.[95]

4. Punitive and Extra-Contractual Damages

For private insurance companies, punitive damage exposure is the key consideration in evaluation of an insurance company's litigation position. Even in states where punitive damages are not available for contract actions, many states have established, either by statute or common law, an affirmative duty sounding in tort of good faith and fair dealing, and a breach of that duty gives rise to a tort action of bad faith.[96] In order to protect policy holders from delayed and "low ball" settlements on insurance claims, some state laws specifically allow the award of punitive damages for failure to pay claims in the amount ultimately approved by a jury, or within a specific period of time after the event triggering an insurance

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[92] Scales, *supra* note 9, at 24-25.
[93] 44 C.F.R. Part 61, App. A(1) at ¶¶ VII J and VII R.
[94] *Id.* at ¶ VII D.
[95] *Shuford v. Fidelity Nat'l Prop. & Cas. Ins. Co.*, 508 F.3d 1337 (11th Cir. 2007); *Richardson v. American Bankers Ins. Co.*, slip copy, 2008 WL 510518 (5th Cir. 2008); *Neuser v. Hocker*, 246 F.3d 508, 510 (6th Cir. 2001) ("Our sister circuits have consistently held that FEMA's proof of loss requirement is to be strictly enforced."); *Gowland v. Aetna*, 143 F.3d 951 (5th Cir. 1998).
[96] *Pickett v. Lloyd's*, 621 A.2d 445 (N.J. 1993).

claim.[97] A key rationale for awarding punitive damages is to eliminate any incentive insurance companies might have to fail to pay claims in full promptly.

WYO Companies do not have a profit incentive to fail to pay claims in full. All flood claim payments come not from the company's capital and surplus, but from the federal treasury. Indeed, because the WYO is paid, for claims handling expenses, a percentage (3.3%) of every claim dollar paid out on a flood policy, plus certain "allocated loss expenses,"[98] a WYO Company has a financial incentive to pay every proper claim presented to it. For a WYO Company, the principal cost of improperly over or underpaying claims is that improper claims handling could violate its contractual undertakings as "fiscal agent" of the United States. This could cause FEMA to suspend the WYO from the program.[99]

In any event, state extra-contractual and punitive damage claims do not apply in suits against the federal government. Indeed, suits against the federal government are allowed only to the extent that the government consents to be sued. While the federal government has generally authorized actions in tort, no tort action can be filed against the FIA in connection with errors or abuses arising out of issuance or servicing of a flood insurance policy because the Congress has not waived immunity for such suits. Similarly, the federal government has not authorized suits for punitive damages, although Plaintiffs have recently been having some success in obtaining costs and attorneys fees under the Equal Access to Justice Act when successful in flood insurance litigation.[100]

C. Courts and Congress: Litigation and Major Flood Events

1. Hurricane Isabel Litigation

The result of all of these provisions is that policyholders dissatisfied with their claim settlement under a flood insurance policy will generally not be successful in obtaining a higher settlement in the courts. An interesting example is *Moffett v. Computer Sciences Corp*.[101] In this case, 182 different SFIP policy holders received settlements on flood losses, incurred after Hurricane Isabel passed through Maryland in 2003, that were far lower than the cost to repair the damage. They sued FEMA and a number of FEMA's employees, as well as FEMA's flood insurance contractor, the Computer Sciences Corp. (CSC), several WYO Companies, and insurance adjusters working for the WYO companies. The principal objective of the lawsuit was to find some way of recovering damages in excess of those covered by their SFIP.

Count I sought damages from FEMA's employees under *Bivens v. Six Unknown Named Agents.*[102] "A *Bivens* action is a judicially created damages remedy designed to vindicate violations of constitutional rights."[103] The Court found that a *Bivens* action was unavailable because Congress had expressly provided for exclusive jurisdiction in federal district court for review of flood insurance claim determinations; this Count was dismissed.

Count II claimed fraud in selling the SFIP to plaintiffs; the fraud was that defendants falsely represented the "nature and extent of benefits that would be paid . . . in the event of a flood loss."[104] This Count was

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[97] *See*, FLORIDA STAT. ANN. § 624.155(1)(b).
[98] 44 C.F.R. Part 62 App. A, Article III, C.
[99] *Id.* at Article V, D. A WYO's pattern of overpaying claimants, and receiving reimbursement from federal funds, can be prosecuted under the False Claims Act. *See*, *U.S. v. Bankers Ins. Co*., 245 F.3d 315 (4th Cir. 2001).
[100] *See*, *Berger v. USAA General Indem. Co.*, slip copy, 2008 WL 1730533, (E.D.La., 2008);*Qader v. FEMA*, 2008 WL 576223 (E.D. LA. Feb. 29, 2008); *Grisaffi v. Audobon Ins. Co.*, 2008 WL 695375 (E.D. La. Mar. 13, 2008).
[101] 457 F.Supp.2d 571 (D.Md. 2006).
[102] 403 U.S. 388 (1971).
[103] *Moffett*, 457 F.Supp.2d. at 578.
[104] *Id.* at 586.

held preempted by federal law because it would in all likelihood be the federal treasury which would pay for any judgments.

Count III claimed fraud in the adjustment of the claim - by "misrepresenting the nature and extent of Plaintiffs' SFIP coverage in order to induce them to accept 'low ball' offers." Count IV claimed tortious interference with contract, based in some fashion on the handling of the claim. These counts were dismissed because a federal regulation – the language described earlier in the SFIP itself – expressly preempted state law, and also because even prior to the promulgation of this provision in the policy, three federal circuits had concluded that federal law preempted state remedies for disputes involving handling of claims under the SFIP.[105]

Finally, Count V sought damages for breach of the SFIP itself – but it claimed not just damages for "direct physical loss due to flood" as covered by the policy, but also "delay damages, prejudgment interest, disgorgement of profits, and a refund of premiums." The Court dismissed the portion of the Count seeking these *additional* damages – because they were not called for by the SFIP. In short – plaintiffs were left with no claim for any damages other than direct physical loss due to flood – after application of all of the exclusions set forth in the SFIP, and after computing the "actual cash value," less than replacement cost, for all properties that did not have replacement cost coverage.[106]

Meanwhile, plaintiffs had sought relief in the Congress, expressing outrage at congressional hearings over the minimal settlements offered under the NFIP. At first blush Congress appeared sympathetic, and in late 2004, Congress enacted the "Flood Insurance Reform Act of 2004.[107] The Committee's Report on the bill expressed sympathy for the difficulties experienced by policyholders after Hurricane Isabel and directed FEMA to respond:

> The Committee is aware of many problems in the flood insurance program as a result of recent flooding from Hurricane Isabel, which took place in September, 2003. As a result of this flood, 24,000 claims were made to NFIP. Unfortunately, many flood victims did not receive adequate settlements under NFIP to allow them to repair their homes. While the changes contained in this bill will ensure that future flood victims do not face these same problems, we expect FEMA to conduct a thorough review of all claims resulting from Hurricane Isabel, and to re-adjust those claims where flood victims did not receive fair and adequate payments. The Committee expects the review of claims to be an independent process, where adjusters are not reviewing claims for which they were initially responsible after Hurricane Isabel. FEMA must make all efforts to ensure that the claims in question are settled fairly.[108]

In response to Congressional concern, FEMA did establish a process to review Hurricane Isabel claims, with the following result: almost half of the 2,294 policyholders (of the 24,000 Hurricane Isabel claimants) who sought a review received additional payments averaging $3,300 more than the original settlement.[109]

Further, in the wake of Hurricane Isabel Congress imposed on FEMA a number of new requirements in the claims-handling process – all to be implemented in six months:

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[105] *Id.* at 581-83.
[106] *See also, Howell v. State Farm Ins. Companies*, 540 F.Supp.2d 621 (D.Md. 2008) (Proposed class action against WYO Companies; all extra-contractual claims dismissed).
[107] Pub. L. No. 108-264, 118 Stat. 712 (June 30, 2004).
[108] S. Rep. No. 108-262 (May 13, 2004) at 5.
[109] GAO, *supra* note 64, at 5-6.

- §202: FEMA must prepare supplemental forms explaining "in simple terms" the coverages of the SFIP, including exclusions, with "an explanation, including illustrations, of how lost items and damages will be valued under the policy in time of loss."
- §203: FEMA must prepare an "acknowledgement form" that SFIP purchasers must sign indicating the purchaser of the policy has received the policy and explanation of coverage "in simple terms" developed under §202.
- §205: FEMA must develop a new "appeals process" allowing any policyholder to file an administrative appeal *with FEMA* of any denial of coverage by a WYO company;
- §204: FEMA must develop a "claims handbook" describing how to file a claim under the NFIP and how to use the new appeals process.
- §207: FEMA must establish and publish minimum training and education requirements for all insurance agents.[110]

In addition, the Comptroller General was directed to conduct a study (within one year) on the adequacy of flood coverage, the adequacy of payments to flood victims under flood policies, and the practices of FEMA and insurance adjusters in estimating losses during a flood.

In short, despite very substantial concern about the flood victims who "did not receive adequate settlements" after Hurricane Isabel, and enactment of legislation specifically in response to this concern, about 5% of the Hurricane Isabel claimants received an average of $3,300 – largely due to price inflation between the time the initial settlement offer was made and the date of the review. *But the most significant political impact of this experience was creation of a number of mandates requiring FEMA, WYO Companies, and insurance agents to provide a better explanation of the substantial limitations on flood insurance coverage.*

2. Hurricane Katrina Litigation

Hurricane Katrina was a truly catastrophic flooding disaster; flood losses from this one event exceeded the losses experienced in the 35 years since the first flood insurance policy was sold.[111] It also generated more flood insurance litigation than any previous flood event. While relatively few cases have been decided on the merits,[112] the progress of litigation has been strikingly similar to the course of cases litigated after previous floods. Of roughly 1100 cases that remain pending, 740 allege inadequate claim settlements or improper claims handling, 60 challenged the administration of the policy by the WYO Company, and 100 were brought due to (alleged) failure of an agent/WYO Company to procure a flood policy as requested by the homeowner. And of these 1100 cases, all but 100 are being litigated in federal court.[113] In other words, in Hurricane Katrina cases just as in all other NFIP cases, the federal court has exclusive jurisdiction of any cases that involve claims handling and policy administration – because the statute itself provides for "original exclusive jurisdiction in federal district court" and because they involve the interpretation of a federal regulation (the Standard Flood Insurance Policy), and the implementation of federal policy and guidance on how WYO Companies must write policies and adjust claims that are effectively paid from federal funds.[114]

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[110] Pub. L. No. 108-264, 118 Stat. 712 (June 30, 2004).
[111] FEMA, Loss Dollars Paid by Calendar Year, http://www.fema.gov/business/nfip/statistics/cy2007lsdoll.shtm .
[112] At the 2008 National Flood Insurance Conference, Jordan Fried, Associate Chief Counsel for Litigation for FEMA, and Gerald Neilson, an attorney representing a number of WYO companies in NFIP litigation, reported on the status of Hurricane Katrina related flood litigation. Mr. Neilson noted that only five cases had gone to trial – although approximately 1000 cases had been settled.
[113] *Id.*
[114] 42 U.S.C. § 4072; e.g., *Cantelli v. Farmers Insurance Group*, 2008 WL 251803 (E.D.La. Jan. 28, 2008); *Catchot v. Felsher*, 2006 WL 3313779 (S.D. Miss Nov. 14, 2006).

Just as in prior flood cases, where policy holders bring suit challenging the claim settlements offered by FEMA or its WYO Companies, the federal courts deciding Katrina cases have upheld the technical requirements of the SFIP and protected the National Flood Insurance Fund against claims for extra-contractual damages. Many Katrina related flood cases were summarily dismissed due to the failure of the plaintiff to comply with the proof of loss requirement.[115] In order to expedite processing of claims after Hurricane Katrina, the Federal Insurance Administrator waived the Proof of Loss requirement for a twelve-month period – but policyholders challenging the proffered settlement were still obligated to provide a Proof of Loss within the twelve-month period or lose their right to litigate.[116]

Similarly, federal courts have protected the NFIP and WYO Companies from extra-contractual or punitive damages; extra-contractual claims based on state law are preempted by federal law,[117] and the National Flood Insurance Act does not authorize recovery of extra-contractual or punitive damages under federal law[118] – although, as noted earlier, it appears that attorney fees can be awarded under the Equal Access to Justice Act.[119]

As in prior flood litigation – but with far more cases – much of the continuing litigation has dealt not with adjustment of actual claims on policies, but claims that a policy that was not in place would have been in place absent negligent (or worse) conduct, advice or communications by agents and WYO companies.[120] Actions for extra-contractual damages of this type have had some (but not uniform) success – at least in surviving a motion to dismiss.

Some plaintiffs were incorrectly advised that their property was not located in a flood zone when it was, and brought suit against their mortgage lender,[121] or against the flood zone determination company retained by their lender to advise whether the lender was required to obtain flood insurance.[122] And even these efforts have generally not fared well despite a few notable exceptions.[123]

Perhaps the most controversial flood insurance litigation arising from Hurricane Katrina arose from the adjustment of claims where damage to a structure was caused concurrently by wind and flood. Many

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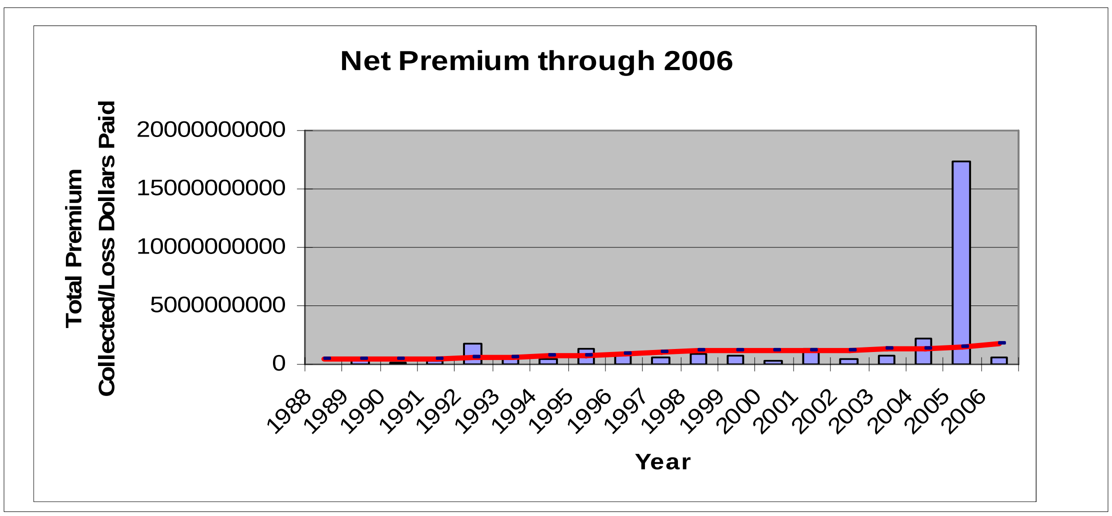
[115] *Shuford v. Fidelity Nat. Property & Cas. Ins. Co*. 508 F.3d 1337 (11th Cir. 2007); *Richardson v. American Bankers Ins. Co. of Florida*, 2008 WL 510518 (5th Cir. Feb. 27, 2008).
[116] Under this waiver, no proof of loss was required for a WYO Company to settle a claim within one year of the date of loss. However, if no proof of loss was filed within that year, then failure to file a proof of loss became fatal to the claim. *Shuford v. Fidelity Nat. Property & Cas. Ins. Co*., 508 F.3d 1337 (11th Cir. 2007). The text of the waiver is found at 1340.
[117] *Gallup v. Omaha Property and Cas. Ins. Co.*,434 F.3d 341 (5th Cir. 2005).
[118] *Wright v. Allstate Ins. Co.*, 500 F.3d 390 (5th Cir. 2007).
[119] *See, supra* note 100.
[120] *See*, *New Inv. Properties, LLC v. ABC Ins. Co*., 2007-0943 (La. App. 4 Cir. 11/21/07); 972 So.2d 392; *Robichaux v. Nationwide Mutual Ins. Co.*, 2007 WL 1536703 (S.D. Miss. May 24, 2007*); Landry v. State Farm Fire & Cas Co.*, 428 F.Supp.2d 531 (E.D.La. 2006).
[121] *Ellis v. Countrywide Home Loans*, 541 F.Supp.2d 833 (S.D. Miss. 2008); *Whitfield v. Countrywide Home Loans, Inc.*, 252 Fed. Appx. 654 (5th Cir. 2007); *Duong v. Allstate Ins. Co.*, 499 F.Supp. 2d 700 (E.D.La. 2007); *see Mid-America Nat. Bank of Chicago v. First Savings & Loan Ass'n of South Holland*, 737 F.2d 638 (7th Cir. 1984).
[122] *Lusins v. First American Real Estate Solutions*, 2007 WL 1745625 (S.D. Miss. June 14, 2007); *Ford v. Fisrt American Flood Data Services, Inc.*, 2006 WL 2921432 (M.D.N.C. Oct. 11, 2006); *Metoyer v. Auto Club Family Ins. Co*., 536 F. Supp. 2d 664 (E.D.La, 2008); *Audler v. CBC Innovis Inc.* 519 F3d. 239 (5th Cir. 2008).
[123] *See Saadat v. Landsafe Flood Determination, Inc*., 253 Fed. Appx. 343 (2007) (Directing district court to remand property owner's fraud and negligence action against determination company to state court); *Duhon v. Trustmark Bank,* 2007 WL 627889 (S.D. Feb. 25, Miss 2007).

property owners had only homeowners' insurance with its flood exclusion.[124] Others had both homeowners' and flood insurance – but had damage far exceeding either the limits on their flood policy or the amount that was offered by FEMA and WYO Companies for flood damage. The inadequate insurance proceeds available to these property owners generated considerable suspicion that insurance adjusters had been instructed by companies (where possible) to attribute losses to flood (covered, if at all, by flood insurance funded by the National Flood Insurance Fund) rather than to wind.[125] While GAO investigations did not uncover any such conspiracy to defraud the flood program, it did find that FEMA did not have access to company information about wind settlements to assure that there was no bias in apportionment of damage to wind, flood, or both.[126]

The lesson from flood insurance litigation – both before and after Hurricane Katrina – is that, despite the restrictions on coverage provided by the SFIP, and the uncovered losses sustained by many insured flood victims as a result, the courts have generally protected this federal program from expansion of coverage or from payment of extra-contractual damages.

3. Financial Insolvency Exposed by Katrina

This judicial protection has not been enough, however, to prevent the current financial crisis facing the NFIP. Even with all of the premium increases and reductions in coverage over the program's four decades of existence, the program has not been able to generate premium sufficient to cover the actual cost of the insurance provided including catastrophic loss years. As noted previously, while the "fixes" over the last thirty years did bring the program to sustainability on an "average year" basis, absent Congressional action, the program could never generate any significant reserves for a catastrophic year. And the impact of that one catastrophic year – 2005 – has effectively made the program insolvent.



Source: FEMA http://www.fema.gov/business/nfip/statistics/cy2006losspd.shtm.[127]

[124] The interpretation of the flood exclusion in *homeowners'* policies is beyond the scope of this paper for further information on this issue see Virginia Trainer, *Hurricane Insurance Litigation: More Than Wind Versus Water*, 68 LA. L. REV. 389 (2008)

[125] U.S. GOVERNMENT ACCOUNTING OFFICE, NATIONAL FLOOD INSURANCE PROGRAM: GREATER TRANSPARENCY AND OVERSIGHT OF WIND AND FLOOD DAMAGE DETERMINATIONS ARE NEEDED, GAO Report 08-28 (Jan. 30, 2008).

[126] *Id*. at 22, 26-27.

[127] The net premium estimated has been calculated based on an average of Total Underwriting Expenses deducted from the Total Revenue Earned (values provided by the National Flood Insurance Program Operating Results by Fiscal Year) per annum from 1985 through 2005, averaging approximately at a 33.37 percent increase per year.

The principal hope to rescue the program must come from reducing the number of "high risk" properties that are insured under the program and by moving toward more actuarially based premiums which brings political issues to the surface.

D. Eliminating Repetitive Loss Properties (at Last?)

As noted at the outset of this article, encouraging the attrition of high risk properties was always one of the key objectives of the NFIP. Communities joining the NFIP were required to "adopt and enforce" floodplain management regulations that would substantially restrict new construction or substantial improvement of properties in floodplains. Over time, properties at severe risk of flooding were to disappear. But compliance with the restriction on rebuilding in floodplains was spotty,[128] and the financial cost of multiple flood insurance payouts to the same properties continues to drain the financial strength of the program.[129]

The problem is not new. In 1994, Congress found that there were "a number of properties in the program that do not comply with current flood protection standards."[130] To address the financial cost of these properties to the program, the National Flood Insurance Reform Act of 1994 sought to encourage compliance

1. by adding a new "cost of compliance" coverage to the SFIP, so that policyholders rebuilding after a flood would have the financial resources to elevate their property after it was severely damaged by flooding;[131]
2. by codifying the "Community Rating System" under which the NFIP encouraged community compliance by providing premium reductions in communities that had developed stronger systems to mitigate flood risk;[132] and
3. by creating the National Flood Mitigation Fund (generally funded at $30 million per year) to fund mitigation of existing properties that did not comply with current floodplain management requirements.[133]

Ten years later, in the National Flood Insurance Reform Act of 2004 (2004 Act), Congress again addressed the problem of repetitive loss properties that were receiving subsidized premiums. Political will was summoned to remove subsidies immediately on one small class of structures – those "leased from the Federal Government (including residential and nonresidential properties) . . . located on the river facing side of any dike, levee, or other riverine flood control structure or seaward of any seawall or other coastal flood control structure."[134] In addition, actuarial rates were to be gradually phased in (at the

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[128] AMERICAN INSTITUTES OF RESEARCH, AN EVALUATION OF COMPLIANCE WITH THE NATIONAL FLOOD INSURANCE PROGRAM PART A: ACHIEVING COMMUNITY COMPLIANCE, at 32. (Oct. 2006) (Concluding that 20-25% of participating communities are not in compliance).
[129] King, *supra* note 16, at 19-20 and Appendices A and B.
[130] H.R. Conf. Rep. 103-652, 1994 U.S.C.C.A.N. 1977, discussing Title V, Flood Insurance.
[131] National Flood Insurance Act of 1994, Pub. L. No. 103-325, § 555, 108 Stat. 2160 at 2274.
[132] *Id.* at § 541, 108 Stat. 2160 at 2268, codified at 42 USC 4022(b).
[133] *Id.* at § 553, 108 Stat. 2160 at 2270, codified at 42 USC 4104(d). Much greater resources – in the hundreds of millions of dollars – for mitigating flood risk on properties were made available under § 404 of the Stafford Act and by special legislation enacted after specific flood events such as Hurricane Floyd. *See,* Pub.L. 106-113 (HR 3194) Consolidated Appropriations Act 2000, 113 Stat 1501, 1501A-292 (1999) (appropriating $215,000,000 for the buyout of principal residences rendered uninhabitable by flooding caused by Hurricane Floyd, with land to be restricted for open space uses)
[134] Pub. L. No. 108-264, § 106, 118 Stat.712 (2004), codified at 42 U.S.C. § 4015(c)(2).

Congressionally limited 10% per year maximum rate of increase per year) for properties that had been constructed when floodplain management ordinances were in effect but had not been followed.[135]

Finally, the 2004 Act adopted a "pilot program" for addressing the repetitive loss problem. Because the program now could identify the specific properties that had received multiple large settlements on flood insurance claims, the 2004 Act specifically directed the NFIP to target mitigation efforts on "severe repetitive loss properties" – offering to buy these properties from the owner or to elevate them. But should an owner refuse this voluntary offer of mitigation assistance, the NFIP was directed to charge the actual actuarial cost of insuring the property. The actuarial cost of flood insurance for a severe repetitive loss property would range in the thousands of dollars per year: it would take net premium of $10,000 per year to pay flood claims on a property that incurs $50,000 in flood damage every 5 years.

Hurricane Katrina arrived before the "pilot program" created by the 2004 Act could make any impact on the repetitive loss problem. And many of the losses caused by Hurricane Katrina were not caused by repetitive loss properties. Rather, Hurricane Katrina exposed the significant residual risk for properties (primarily in Louisiana) protected by levees, and the further risk of coastal properties (primarily in Mississippi) affected by a storm far more severe than the 1 in 100 year events on which flood risk mapping had been based. The result was a $17 billion programmatic debt.

III. The Future Direction of the NFIP

The NFIP is at a crossroads. The overall authorization for the NFIP expires on September 30, 2008. At this writing, both the U.S. House of Representatives[136] and the U.S. Senate[137] have passed separate bills that would reauthorize and reform the NFIP; the differences between these bills must be reconciled in Conference before any change is enacted. While it is virtually certain that the program will be reauthorized even if reform cannot be enacted this year, the common characteristics of these bills demonstrate Congressional awareness that the program cannot achieve financial solvency without major reforms in virtually all aspects of the NFIP discussed in this paper: premium levels, coverage, market penetration/mandatory purchase, and repetitive loss.

Thus, both the House and the Senate bills would allow the NFIP to increase premiums by 15% per year (up from the current 10%), and the Senate bill would require minimum deductibles on policies. And while subsidized rates would continue to be available under both bills for homeowners' principal residences, the bills would withdraw the subsidy over time (the schedules vary) for different classes of non-residential properties, second homes, and severe repetitive loss properties.

The bills seek to increase market penetration (in slightly different ways) by expanding the properties subject to the mandatory flood insurance purchase requirements,[138] by increasing penalties for non-compliance, and by enhancing communications to homeowners and training for insurance agents about flood risk.

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[135] *Id.*, codified at 42 U.S.C. § 4015(c)(1).
[136] H.R. 3121, as passed by the U.S. House of Representatives on September 27, 2007, available as of May 28, 2008 at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3121eh.txt.pdf .
[137] H.R. 3121, as passed by the U.S. Senate on May 13, 2008, available as of May 28, 2008 at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3121eas.txt.pdf .
[138] The Senate Bill would extend the mandatory purchase requirement to include "residual risk areas" protected from flooding by man-made structures such as levees or dams; the House Bill calls only for enhanced disclosure of residual risk areas in flood maps.

The "pilot program" adopted in 2004 to eliminate repetitive loss properties would be expanded and accelerated. Both bills require recognition in flood maps of areas in the 500-year flood plain, as well as the areas that would be in the 100-year flood plain *but for* protection provided by levees and seawalls.

Both Bills respond to the frustration of homeowners that is reflected in the litigation arising under the program – but by increasing government requirements for customer service and not by opening the door to the courtroom. Under this proposed legislation, FEMA would be required – once more – to improve communications to the public about the risk of flooding and the limitations in the SFIP. Appeals from denials of coverage are to be handled more quickly, and better training required. A National Flood Insurance Advocate would be appointed with no connection to FEMA and with a background in customer service and in insurance.

No change is proposed in the legal doctrines that prove decisive in flood insurance litigation – federal jurisdiction, proof of loss requirement, and the status of the standard flood insurance policy as a federal regulation whose provisions have the force of law and cannot be waived except by the Federal Insurance Administrator. Indeed, the increase in the number of specific statutory customer service requirements that are proposed in both bills may have the effect of *reducing* the ability of policy holders to challenge WYO Company and insurance agent actions in state court. (The more federal statutory and regulatory requirements and federal dispute resolution procedures there are governing agent and WYO Company responsibilities in the marketing and sale of flood insurance, the more federal regulation "occupies the field" of marketing of flood insurance – and pre-empts state laws and remedies.[139])

Passage of NFIP reauthorization in 2008 remains uncertain – both because of the foreshortened legislative calendar in an election year and because of two major differences between the House and Senate bills. The first is somewhat technical: the Senate Bill would forgive the full debt owed by the program to the Treasury, while the House Bill would allow the debt to increase some more pending a study on whether and how the debt would ever be repaid. The Senate position reflects the reality that this debt will never be repaid; the House position arises from its own rule that no increase in spending (and debt forgiveness is treated as spending) can be enacted without identifying corresponding reductions of spending that will offset the impact on the national deficit.

Perhaps the most intriguing difference in the Senate and House Bills is the provision in the House Bill that would give purchasers of flood insurance the option to obtain wind coverage from the federal government at actuarial rates. Proponents of adding wind coverage to the NFIP argue that combined wind/water coverage is necessary to eliminate coverage disputes when wind and water both contribute to a loss; these coverage disputes at a minimum slowed claim settlements and generated acrimony with policy holders as well as substantial litigation. Proponents of adding wind coverage also point to the increasing difficulty property owners experience in obtaining wind coverage in coastal areas as private insurance carriers, saddled with losses from Katrina and other recent storms, seek to reduce exposure to losses due to hurricane force winds. They do so by increasing premiums, reducing coverage, increasing deductibles or withdrawing from the market altogether. The Senate bill did not add wind coverage to the program, but responds to the concerns of the House in two principal ways: (1) by appointing a "Commission on National Catastrophe Risk Management and Insurance" to study the issue; and (2) more substantively, by increasing the ability of FEMA to obtain information from WYO Companies about the settlements the Companies and their affiliates made for wind damage.[140]

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[139] C. Antieu and W. Rich, Modern Constitutional Law § 43.19-43.20.

[140] H.R. 3121, as passed by Senate, Title II (§§ 201-208). The provision allowing FEMA to obtain data about wind settlements from WYO Company affiliates was a recommendation of the U.S. Government Accountability Office's report on the Hurricane Katrina wind-water damage controversy. *See*, GAO Report 08-38, *supra* note 124.

The House proposal to add a new federal wind damage program due to the increasing cost and reduced availability of private wind insurance in high risk areas calls to mind the findings made by Congress almost exactly forty years ago in the National Flood Insurance Act:

> (1) many factors have made it uneconomic for the private industry alone to make flood insurance available to those in need of such protection on reasonable terms and conditions; but (2) a program of flood insurance with large scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry is feasible and can be initiated.

After forty years, the jury is still out on whether the program of flood insurance created in 1968 is financially feasible – although it certainly has accomplished a great deal in identifying and mitigating flood risk, and in providing insurance benefits to those who purchase policies. Have "many factors" also made it uneconomic for the private industry alone to insure for wind damage? And if so, would it take forty years to determine if a federal program of wind insurance at actuarial rates was good public policy?

The challenge is that more and more development is taking place in flood prone and hurricane prone areas. People like to live near the seashore. But unless the actual cost of living by the water is reflected in the cost of ownership – including the cost of building properly to resist wind damage, elevating out of floodplains, and insuring at actuarial rates for the cost of rebuilding after inevitable floods and hurricanes – then the result will only be more development in more risk prone areas and the potential for another $17,000,000,000 insurance debt that cannot be repaid.