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The 1st Party Report

A PROPERTY AND INSURANCE UPDATE

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KATRINA'S ROBIN HOOD IS ON THE PROWL

By Michael H. Schroder & Shannon V. Alexander

The media has taken to calling him Robin Hood, allowing him to ride the coattails of that populist rascal into the hearts of potential jurors everywhere. What could be more endearing than taking up the cause of the poor, defenseless, underinsured victims of Hurricane Katrina against that heartless beast – the insurance industry? If he succeeds, Robin Hood and his victims may wish he had failed, because a Nottingham with no Sheriff is not necessarily better off.

Jim Hood, Attorney General of Mississippi, made headlines nationwide when he filed suit on behalf of Mississippi Katrina victims against State Farm, Allstate, USAA, Nationwide and Mississippi Farm Bureau. The suit assaults policy language by seeking to have flood exclusions declared void and unenforceable as contrary to public policy, unconscionable and ambiguous. In the political eyes of Mr. Hood, insurers are not simply trying to enforce policies as they were written, nor are they just trying to limit coverage to that for which the consumer bargained and paid. Mr. Hood reassures the masses that he will do whatever it takes to get insurance companies to "pay what they owe." According to Mr. Hood, "All that the [Katrina victims] have left is hope and I'm not going to allow an insurance company to wrongfully take that hope away." In the face of such politically motivated rhetoric, the efforts by insurers to pay what coverage is owed will likely be demonized because it does not fulfill the false hopes of the insureds.

Mr. Hood is certainly not alone in his efforts. Trial attorney Dicky Scruggs and others have filed lawsuits in all of the hurricane-affected states, making the familiar argument that homeowner's insurers and their agents promised "full coverage" for hurricane damages; therefore, flood losses should be covered in spite of clear flood and water damage exclusions. No need to purchase flood insurance, Mr. Scruggs argues, because flood losses are already covered in homeowners policies. (Why, then, did Mr. Scruggs pay premiums for his own National Flood Insurance Program policy?) Even those who did purchase flood insurance through the government's NFIP have sued their insurers, arguing that the insurers breached a fiduciary duty by not informing them that excess flood coverage was available from private insurers. Other suits argue that flood damages were caused by the negligence of third parties, primarily by those responsible for designing, building and maintaining the levees around New Orleans.

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NEW DANGERS SURROUNDING DISCLAIMERS OF COVERAGE?

By Brian M. Leepson & Amanda B. Speed

In a recent case, *St. Paul Reinsurance Co., Ltd. v. Ross*, 276 Ga. App. 135 (Sept. 2005), the Georgia Court of Appeals arguably changed longstanding Georgia law regarding when an insurer may disclaim coverage with confidence. While *certiorari* has been applied for in this case, and while we can only hope that it will be reversed, insurers in Georgia need to be aware of this recent decision and the potential opportunities it offers to insureds and claimants to put insurers in very tough positions following disclaimers of coverage.

Before getting into the *Ross* decision, it will be helpful to first review prior Georgia law on when a disclaimer is proper. Long-standing Georgia precedent holds that an insurance company's duty to defend its insured under a liability policy is generally determined by the allegations of the complaint filed against its insured. As the Georgia Supreme Court noted in *Penn-America Ins. Co. v. Disabled American Veterans, Inc.*, 268 Ga. 564 (1997), when the complaint sets forth true factual allegations showing no coverage, an insurer can disclaim coverage. By contrast, if the allegations of the complaint set forth even one covered claim, an insurer must defend the entire case (even if the covered allegations are completely groundless). As further noted by the *Penn-America* court, this rule changes only in the "rare class of cases" in which the insurer is aware of true facts that could show coverage that are not alleged in the complaint. For example, in *Colonial Oil Industries v. Underwriters*, 268 Ga. 561 (1997), the Georgia Supreme Court explained that when the complaint on its face shows no coverage, but the insured notifies the insurer of factual contentions that would place the claim within the policy's coverages, the insurer has an obligation to conduct a reasonable investigation into those contentions. The *Colonial Oil* court held that this duty of investigation on insurers "in these limited circumstances" is not an unreasonable burden, especially since an insurer has the option of providing a defense under a reservations of rights and filing a declaratory judgment action to determine its obligations.

With these decisions in mind, we have typically advised clients that (1) when the complaint against the insured does not allege a claim within the subject policy's coverage, and (2) if the insurer is not put on notice – from any source – of other facts or allegations

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KATRINA'S ROBIN HOOD...*continued*

Robin Hood and his cohorts have not limited their assault on policy terms to filing lawsuits. Mr. Hood is urging the Mississippi Legislature to require homeowner's insurers to offer a storm surge waiver. Another proposed bill imposes 12% interest as a penalty for claims not paid in a "timely" manner. Moreover, the Mississippi Commissioner of Insurance has issued directives shifting the evidentiary burden to insurers so that they are required to "clearly demonstrate the cause of the loss" on any claim denied or limited based on a water exclusion, and requiring insurers to consider eyewitness testimony and damage to neighboring structures before making any determination as to coverage.

What are the consequences if Hood and Scruggs win these suits to retroactively rewrite homeowner's contract language that is well-established and that has long been approved by the state insurance regulators? In the short term, there would be an obvious insolvency risk to insurers with inadequate reserves. Katrina caused more than $44 billion in flood and storm surge damage alone, most of it uninsured. Insurer insolvencies would quickly exhaust the state guarantee funds, requiring huge assessments against Mississippi taxpayers. Property insurers would be reluctant to write future coverage in a state where policy language is willfully ignored, causing an availability crisis for those who are now rebuilding their homes. In a state that already beat out West Virginia in the 2005 U.S. Chamber of Commerce rankings for the worst legal liability system in the country, businesses previously reluctant to invest in Mississippi's economy due to liability concerns will find the state even less attractive. By spreading the notion among potential jurors that clever lawyering can legally create coverage where none exists, Hood makes Mississippi's legal system a disincentive to future investment.

If homeowner's insurers are forced to cover flood and storm surge losses, the increase in premiums would be unprecedented. The Insurance Information Institute estimates that premiums would at least double from the current levels. Yet Mississippi citizens are already among the poorest in the country and are least able to pay for the increase. According to the National Center on Child Poverty, more than half of all Mississippi children live in poor families. When their landlords pass along the cost of increased insurance premiums through higher rents, the poverty rate in Mississippi will only deepen. Hood and Scruggs not only spread false hopes among desperate people, their victory would actually create further hardship for Mississippi's poorest citizens.

The law on these flood and water damage exclusions has been challenged in prior hurricanes and has stood the test of time. To the extent insurers can keep these cases in federal courts, before appointed judges who do not need to curry political favor with the voters, the policy language should hold. Ultimately, we can hope that property owners understand the importance of reading their policies and obtaining separate flood insurance, and that insurers will do a better job of communicating the substance of exclusions and the need for supplemental coverage.

NEW DANGERS... *continued*

(not alleged in the complaint) that would show potential coverage, then an insurer can reasonably disclaim coverage outright and not provide a defense to an insured under a reservation of rights.

In *Ross*, however, the Georgia Court of Appeals went beyond this established Georgia precedent and found coverage even when the complaint against the insured showed no coverage and when no one put the insurer on notice of facts that could otherwise show coverage.

The complaint in *Ross* alleged liability against an insured defendant arising out of an assault and battery, but the policy in question contained an assault and battery exclusion. With this exclusion in mind, the insurer disclaimed coverage to the defendant. Later, a judgment was obtained against the insured. A second lawsuit was then filed against the insurer for the amount of the judgment.

Ruling on the coverage issues in this second lawsuit, the trial court found that coverage existed despite the assault and battery exclusion, and in *Ross*, the Georgia Court of Appeals affirmed. The Court of Appeals first noted that the trial court reached its conclusion on the assault and battery exclusion following an evidentiary hearing on the insurer's motion for summary judgment. The Court of Appeals held that since a transcript of this hearing was not in the record, the Court could not review the insurer's claim of error. Relying on the principles outlined above, St. Paul responded by arguing that the transcript was not necessary, because the allegations of the complaint brought against the insured provided the basis for determining whether coverage exists under an insurance policy. Therefore, any information that the transcript could provide was irrelevant.

The Court disagreed, reasoning that the complaint was not the sole basis for determining the insurer's duty to defend. Rather, according to the Court, an insurer can only use the allegations of the complaint to meet its initial burden of showing that a policy exclusion applies. However, the burden then shifts to the party seeking coverage to come forward with other evidence creating a genuine issue of fact over whether the exclusion applies. This was despite the fact that on their face, the complaint's allegations were all outside the policy's coverages. As such, the Court held that the party seeking coverage was not bound in a subsequent garnishment action to the specific allegations contained in his underlying personal injury complaint.

Importantly, the Court found that it would have been perfectly permissible for the party seeking coverage to assert – regardless of what was alleged in the complaint – that the claim was not truly one that arose out of an excluded assault and battery. In other words, the plaintiff could (1) file a lawsuit seeking damages for assault and battery for which no coverage is plainly owed, (2) obtain a judgment against the insured based on that lawsuit, and then (3) later assert in a coverage action against the insurer that, despite the allegations of the initial lawsuit, the insured's liability was not "really" based on an excluded assault and battery. The plaintiff was allowed to essentially contradict his assertions in his lawsuit against the insured.

Moreover, there is no suggestion in *Ross* that – either before or after the disclaimer was issued – the insurer was put on notice of any facts that could arguably show coverage. Thus, despite the fact that the complaint on its face showed no coverage, and despite the fact that no one ever put the insurer on notice of any other information that would show coverage, coverage was still potentially owed. The insurer pointed out the unfairness of this result, but the Court brushed the insurer's concerns aside by noting that the insurer could have resolved the coverage issue by seeking a stay of the personal injury suit and filing a declaratory judgment action.

The problem with this decision is that, if taken to its logical conclusion, it means that an insurer always bears a significant risk following a disclaimer of coverage – even when the complaint on its face shows absolutely no potential for coverage and when no other facts that could show coverage are brought to the insurer's attention. Even in those situations, the *Ross* decision allows the claimant or the insured to later say – even after judgment against the insured is granted – that the judgment was based on some other theory or allegation that was not alleged in the complaint. Further, by dismissing the insurer's concerns about this result by noting that an insurer always has the option of defending under a reservation of rights and then filing a declaratory judgment on the coverage issues, the Court of Appeals seems to be trying to force insurers to file declaratory judgment actions even when there is nothing to suggest that coverage is owed.

To our minds, this holding goes beyond what prior Georgia case law – and indeed case law throughout the country – has held. The insurer in *Ross* has asked the Georgia Supreme Court to review the Court of Appeals decision, and it is our hope that this case will ultimately be reversed on a further appeal. We at Swift Currie will continue to monitor this case closely. In the meantime, insurers and their lawyers need to be wary of the implications of the *Ross* case and act accordingly.

Subrogation of Unknown Origin

By David C. King

So your insured's building was damaged when a neighboring property caught fire and spread to your insured's structure. An easy, classic subrogation scenario, right? Wrong. The problem is that your cause and origin investigator cannot actually pinpoint the cause of the fire or where in the neighboring property the fire began. So how can you prosecute a subrogation with a fire of unknown origin? In this article, we will look at two possible options for solving these issues: (1) *res ipsa loquitur*, and (2) negligent control or maintenance.

Res ipsa loquitur is a Latin phrase meaning "the things speaks for itself." In layman's terms, *"res ipsa loquitur"* is a legal theory by which a plaintiff can infer that a defendant is responsible for a fire simply by the very nature of the fire itself, all without directly proving that the defendant did anything wrong. No direct evidence of the defendant's actual negligence is required. To make a *res ipsa loquitur* case, a plaintiff must prove three different elements: (1) that the fire was one that would not ordinarily have happened in the absence of negligence by someone; (2) that the fire was not due to any voluntary action or contribution on the part of the plaintiff; and (3) that the instrumentality where the fire started was in the defendants' exclusive control. If all three elements are met, a plaintiff can simply imply to a jury that the defendant was negligent. It need not prove it.

The first two of these elements are often easily shown. Fires ordinarily do not occur without someone's negligence, and your insured is often completely free of any voluntary action or contributory negligence. The third and most difficult of these elements is that of "exclusive control." If only the potential defendant is in exclusive control of the property, then only that defendant could arguably be responsible for the fire.

For example, in *Levy-Zentner Company v. Southern Pacific*, 74 Cal. App. 3d. 762, 142 Cal. Rptr. 1 (Cal Court App. 1977), Defendant Southern Pacific owned a large wooden warehouse near a San Francisco rail yard. The Plaintiffs in that case owned other adjacent warehouses. A fire broke out at the Southern Pacific warehouse. The fire not only consumed Southern Pacific's building, but it also spread and consumed the Plaintiffs' two adjacent buildings.

The experts in that case could not determine the cause of the fire or its place of origin. There was testimony, however, from several eyewitnesses that the smoke began emanating from under the Southern Pacific warehouse. As Southern Pacific was in exclusive control of its warehouse, as none of the Plaintiffs did anything to contribute to the fire, and as a fire of this sort normally does not occur without negligence, the Court found that the three elements required in order to justify *res ipsa loquitur* had been met. Therefore, it allowed the neighboring Plaintiffs to argue to a jury, even without specific evidence of wrongdoing by Southern Pacific, that Southern Pacific should be responsible for this loss. The Plaintiffs did, in fact, argue this to a jury and received a very substantial verdict against Southern Pacific.

It should be noted, however, that *res ipsa loquitur* merely allows the case to proceed to a jury without direct proof of negligence against the defendant. The defendant is still free to argue that it was not negligent. What the doctrine of *res ipsa loquitur* does, however, is allow negligence cases to proceed to a jury that might otherwise be disposed of in a defendant's favor on summary judgment.

What happens if the doctrine of *res ipsa loquitur* is unavailable? Another option for a subrogating insurer is to allege a claim for "negligent control" or "negligent maintenance" of the property. Where an owner of real property leaves it vacant, the property is susceptible to vagrants or others who may intentionally or accidentally set fires. If you can show that a neighboring property owner did not exercise sufficient control of the property, and either knew or should have known of the problem, a claim for negligent control or negligent maintenance of the property may be a real possibility.

As another example, in *Whitco Corporation v. Indianapolis*, 762 F. Supp. 834 (S.D. Ind. 1991), the City of Indianapolis took ownership of a building, but then left the building vacant. The City took no measures to keep out vagrants, even though it knew

of vagrancy problems. A fire of inconclusive origin broke out in the building and spread to an adjacent property owned by the Plaintiff. Both the City and the Plaintiff believed (without confirmation) that vagrants started the fire. The Plaintiff alleged that the City, as the owner of the property, negligently failed to maintain its neighboring property, allowing it to stay open and vacant for vagrants and unauthorized persons to use. In deciding on the merits of such a claim, the federal court found that the City's failure to exercise enough control over the building – allowing the building to stay vacant, unattended, and attractive to vagrants – could constitute negligence, and allowed that claim to go before a jury. Therefore, even without direct evidence of the cause of the fire, and certainly no evidence that the City set the fire, the Plaintiff had a valid claim against the Indianapolis government.

Obviously, we would all rather prosecute subrogation cases with strong expert proof that a particular defendant caused the fire. Often, though, we do not have that luxury, and we are instead faced with a fire of unknown origin. While not every fire of unknown origin and cause is a candidate for *res ipsa loquitur* or a negligent control claim, these doctrines can provide a second chance at recovery when there is no direct proof that the defendant actually caused the fire.

Case Update: Additional Insured Coverage

By Brian Burkhalter

***Ryder Integrated Logistics, Inc. v. BellSouth Telecomm., Inc.*, 2006 Ga. App. Lexis 74 (January 23, 2006)**

Ryder Integrated Logistics, Inc. ("Ryder") entered into a comprehensive contract to provide transportation and logistical services to BellSouth Telecommunications, Inc. ("BellSouth"). While unloading cargo at a BellSouth facility, a Ryder employee was injured after the metal grate on which he was standing gave way and he fell 16 feet onto a concrete slab. The employee filed suit against BellSouth, which in turn demanded that Ryder and its insurer, Old Republic Insurance Company, defend and indemnify BellSouth. BellSouth's indemnification claim was based on various contractual provisions requiring Ryder to procure and maintain a CGL insurance policy naming BellSouth as an additional insured with respect to work performed under the contract. Ryder's CGL policy added as an insured any organization for which Ryder was obligated by written agreement to provide liability insurance, but only with respect to liability "arising out of [Ryder's] operations."

In this case of first impression, the Court interpreted "arising out of your operations" to mean arising out of a "business transaction or work performed by Ryder." The Court reasoned that at the time he was injured, Ryder's employee was performing work at a BellSouth facility pursuant to Ryder's "business transactions," or pursuant to its contract with BellSouth. The *Ryder* case, therefore, stands for the proposition that where an insurer provides additional insured coverage for liability "arising out of" the named insured's work, the additional insured is covered without regard to whether the injury is attributable to the named insured's or to the additional insured's negligence. In reaching this conclusion, the *Ryder* Court followed the majority rule throughout the country, which holds that an additional insured may be covered under a CGL policy regardless of whether the injury or damage at issue is caused by the additional insured's own negligence. This rule is also in line with prior Georgia decisions holding generally that the phrase "arising out of" requires only a slight causal connection and does not equate to proximate cause. *See Jefferson Ins. Co. of N.Y. v. Dunn*, 269 Ga. 213, 496 S.E.2d 696 (1998).

Save the Date!

You and your co-workers are invited to attend our Annual Swift, Currie, McGhee & Hiers Property Seminar on Friday, November 3, 2006, from 9:00 AM to 2:30 PM. This year's seminar will be held at Villa Christina, 4000 Summit Boulevard in Atlanta, GA. The seminar is free of charge and includes a complimentary lunch.

You can register for this seminar online at our web site, ***http://www.swiftcurrie.com/news/seminars.asp***

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