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PUTTING A STOP TO THE PARADE OF HORRIBLES

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This past September, 2007, after three long years of claims handling and litigation chaos, the Florida Supreme Court put an end to the havoc wreaked by the 2004 appellate court decision in *Mierzwa v. Florida Windstorm Underwriting Ass'n*, 877 So.2d 774 (Fla. 4th DCA 2004), that shifted the burden of paying for non-covered flood damage to homeowner insurance companies. In *Florida Farm Bureau Casualty Insurance Co. v. Cox*, --- So. 2d ----, 2007 WL 2727072, at *5 (Fla. 2007), the Florida Supreme Court disapproved the decision in *Mierzwa*, and held that home insurers are not required to pay policy limits if the damage from a covered peril did not cause a total or constructive total loss,¹ even if the covered peril combined with a non-covered peril to cause such a loss.

Mierzwa had held that because of the state's Valued Policy 2 "VPL", insurance companies were required to pay claimants' policy limits when wind damage (a covered peril) combined with flood damage (a non-covered peril) to cause a total loss, even when the damage was minor.

The impact of *Mierzwa* on the insurance industry was immediate and huge. *Mierzwa* was decided in the summer of 2004, just as Florida started to experience an abnormally active and destructive hurricane season. As a result of *Mierzwa*, policyholders whose property had been rendered a total loss, mainly as a result of flooding by the four named hurricanes and one tropical storm that hit Florida in 2004, made claims for the full policy limits against their property carriers.

The wind damage to the home in the *Mierzwa* case was significantly greater than the flood damage, but it still wasn't enough to make the home a total loss by itself. In making its decision to require the property insurer wind carrier to pay policy limits, the 4th District refused to consider the effect of its ruling in cases where the wind damage was only a small fraction of the total damage and suggested that the insurance industry was exaggerating the situation by referring to such hypothetical claims as a "parade of horrors".

Unfortunately, however, with the devastating 2004 Florida hurricane season, the "parade of horrors" became a reality. On August 13, 2004, Hurricane Charley hit the state, causing an estimated \$6.75 billion in insured damage. A few weeks later, on September 5, 2004, Hurricane Frances damaged 15,000 homes and 2,400 businesses in Palm Beach County alone, with insured damage across the state totaling \$4.11 billion. Eleven days after that, on September 16, 2007, Hurricane Ivan brought strong waves and a 10 to 15 foot storm surge that severely damaged the Interstate 10 Bridge in Pensacola. The insured damage from Ivan totaled over \$4 billion. Then, on September 26, 2004, Hurricane Jeanne hit the southern portion of the state, very near where Frances had struck just three weeks earlier. The insured damage throughout the state as a result of Francis was

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estimated at \$3.44 billion.

Much of the damage caused by these four storms was a combination of wind and flood damage, with many coastal homes suffering primarily flood surge damage. Yet, very few coastal homeowners had more than \$250,000 in flood coverage, the maximum policy limits available under the National Federal Flood Insurance Program, ("NFIP"). As a result of *Mierzwa*, the insurance industry in Florida was forced to shoulder the liability damages, including damages attributable to flooding.

Windstorm insurers had not included the risk of flooding in calculating their insurance premiums. Nevertheless, *Mierzwa* exposed them to significant risk. A 2004 study by Applied Insurance Research Worldwide calculated the value of residential and commercial coastal property in Florida at \$1.94 trillion, which represented 79% of the state's total insured property values. As a result of *Mierzwa's* holding, the insurance industry did two things: first, they were able to have the Valued Policy Law amended in 2005 by the Florida Legislature to ensure that they would be responsible only for the *pro rata* share of the damage caused by the covered peril.³ Second, they aggressively fought the *Mierzwa* decision in court. Vindication came three years later in the *Cox* decision.

While the Supreme Court's decision in *Cox* is clearly a relief for the insurance industry, it will not solve all multi-causation scenarios and, unfortunately, will not prevent future litigation. The Florida Supreme Court decision in *Cox* specifically limits its holding to "only those cases in which a covered peril did not cause a total loss or constructive total loss." *Cox*, 2007 WL 2727072, at *5 n.6. This holding supports and concurs with the 2005 amendments to the Florida VPL. What constitutes a "constructive total loss", however, will continue to be hotly contested in the claims handling process and in the Florida court system. For example, whether a structure suffers "substantial damage", and must comply with local flood management regulations may depend on the amount of the damage as compared to the property's tax-assessed value. ⁴

As the tax-assessed value on a residence is generally much less than its market value, it is conceivable that a moderate amount of wind damage (damage that is less than fifty percent of the market value of the home) could require the rebuilding or relocation of the home, creating a "constructive total loss" scenario. In such cases, the wind carrier may be burdened with the lion's share of the cost of reconstruction due to the \$250,000 limits imposed by the federal flood coverage. In addition, the determination of whether a structure is a total loss or a constructive total loss will be determined by the trier of fact, which in most cases will be a jury.

In the end, "wind vs. water" will continue to be difficult decisions for adjusters and insurers to evaluate and will continue to keep adjusters, engineers and lawyers very busy for years to come. As a result, clear guidance in claims handling should be provided to adjusters with special care to obtain necessary valuations, assessments and expert reports (i.e., structural engineers, etc) in any multi-peril loss.

Endnotes

1. The "constructive total loss" doctrine as developed in Florida holds that a loss will be considered a total loss when the requirements of an ordinance or law prevent the insured from rebuilding or repairing the damaged structure or require that the structure be demolished. *Citizens Insurance Co. v. Barnes*, 124 So. 722 (Fla. 1929).
2. LawThe Valued Policy Law, Section 627.702, Florida Statutes (2004), provided, in pertinent part: "In the event of the total loss of any building, structure, mobile home as defined in s. 320.01(2), or manufactured building as defined in s. 553.36(12), located in this state and insured by any insurer as to a covered peril, in the absence of any change increasing the risk without the insurer's consent and in the absence

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of fraudulent or criminal fault on the part of the insured or one acting in her or his behalf, the insurer's liability, if any, under the policy for such total loss shall be in the amount of money for which such property was so insured as specified in the policy and for which a premium has been charged and paid." The Mierzwa court held the words "if any" applied only to "liability." Thus, the court concluded that any liability for damages meant liability for policy limits. In Cox, the Florida Supreme Court clarified that "if any", referred to whether the carrier had liability under the policy for a total loss. Cox, 2007 WL 2727072, at *4 (emphasis supplied). If a carrier had liability for a total loss, its liability was for the face amount of the policy. If a carrier did not have liability for a total loss, the valued policy law simply would not apply. In addition, the Florida Supreme Court correctly noted that the valued policy law was silent as to causation and provided that an insurer's liability for a total loss is "in the amount of money for which such property was so insured as specified in the policy and for which a premium has been charged and paid." Id. at *3 (emphasis supplied)

3. Florida's Valued Policy Law has been on the books for over one hundred years. Originally, when it was first passed in 1889, it only dealt with losses arising from fire and lightning. In 1982, it was amended to cover all perils. The main purpose of the law was to make sure that once an insurance company and an insured agreed as to the value of a home and set the amount of the policy limits, that there would be no opportunity for the insurance company to argue with the insured as to how much the home was worth in the event of a total loss.

4. As noted by the First District Court of Appeal in the case of *Citizens Property Insurance Co. v. Ueberschaer*, 956 So. 2d 483, 484 (Fla. 1st DCA 2007): "Under the [National Flood Insurance Program ('NFIP')] requirements 44 Code of Federal Regulations 59.1, structures located within the 100-year floodplain that receive damage of any origin, whereby the cost of restoring the structure would equal or exceed 50% of the structure value, must be brought into compliance with the NFIP requirements. For residential structures with more than 50% damage, the structures must be either removed from the floodplain or have the lowest floor (including basement) elevated to or above the 100-year flood elevation. Failure to comply with this requirement will result in fines and/or legal action by the County against the owner of the structure."