# ESSAY

# A "Flood of Uncertainty": Contractual Erosion in the Wake of Hurricane Katrina and the Eastern District of Louisiana's Ruling in *In re Katrina Canal Breaches Consolidated Litigation*

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*The United States District Court for the Eastern District of Louisiana's decision in* In re Katrina Canal Breaches Consolidated Litigation *(*Canal Breaches Litigation*) undermines freedom of contract because it erroneously concludes that the term "flood" is ambiguous and holds that insurance contracts with "flood" exclusions do not bar coverage for flood-related property damage.*



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The opinions expressed in this Essay are solely those of the authors and may not necessarily reflect those of Hunton & Williams LLP or its clients.

*What's in a name? That which we call a flood*
*By any other name would be just as destructive.*

Integral to the concept of contracting is the sanctity of the written word and the understanding that parties who clearly reduce their intent to a written medium can rely upon that writing.[1] However, on November 27, 2006, the United States District Court for the Eastern District of Louisiana issued a decision in *In re Katrina Canal Breaches Consolidated Litigation* (*Canal Breaches Litigation*) that directly undermined the notion of the written contract by declaring the term "flood," as that term is used in standard form contracts for property insurance, to be ambiguous.[2] Accordingly, the court held that the contracts' flood exclusions would not bar coverage for flood-related

1. *See generally* RESTATEMENT (SECOND) OF CONTRACTS § 209 introductory note (1979).

2. 466 F. Supp. 2d 729, 756 (E.D. La. 2006). The court's decision dealt with motions in four consolidated cases involving "all risk" homeowners and commercial property insurance contracts. *Id.* at 733.

property damage sustained after the New Orleans levee system failed following Hurricane Katrina.[3]

The implications of this decision could be devastating and far-reaching. For instance, the decision, if allowed to stand, could wreak havoc on our free-market commerce by substantially increasing transaction costs due to an increased cost of insurance and a lack of overall certainty in contracting.[4] The decision also could substantially impact policyholders and the insurance industry alike, with the purchasers of insurance realizing an exponential increase in premiums, while the insurance industry will be left to wrestle with how to continue to remain economically viable in the absence of contractual reliability.[5]

It is understandable that everyone (including judges) would be sympathetic to New Orleans' residents due to the manifest tragedy caused by Hurricane Katrina. That sympathy, however, cannot lead to the rewriting of contracts. Doing so can, for all the reasons discussed below, hurt others, both within and away from the areas affected by Hurricane Katrina, and cause other adverse consequences that may not have been anticipated.

This Essay focuses on how the *Canal Breaches Litigation* court's November 27, 2006, decision detours from the basic principle of Louisiana law that a written contract, when plain and unambiguous on its face, should not be construed to negate the intent of one or more of the parties to that contract.[6] It also discusses the likely impact of the decision on the fundamental tenets of contract interpretation in the State of Louisiana.[7] Finally, the Essay discusses how the decision could significantly decrease the value of contractual agreements, by allowing courts to ignore or rewrite unambiguous contractual provisions to reach an outcome unrelated to the parties' original intent.

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3. *Id.* at 765.

4. *See* discussion *infra* Part II.C.1.

5. *See* discussion *infra* Part II.C.2-3.

6. *See* LA. CIV. CODE ANN. art. 2046 (1987) ("When the words of a contract are clear and explicit and lead to no absurd consequences, no further interpretation may be made in search of the parties' intent."); *see also* Gertler v. City of New Orleans, 03-2131, p. 4 (La. App. 4 Cir. 9/1/04); 881 So. 2d 792, 795 ("The interpretation of a contract 'is the determination of the common intent of the parties.' When a contract is not ambiguous . . . it will be enforced as written . . . ." (citation omitted)).

7. This Essay is not alone in criticizing the court's ruling. For another discussion of the flaws in the court's reasoning, see, for example, John J. Pappas, Commentary, *When a Flood Is Not a Flood*, MEALEY'S LITIG. REP.: INS. BAD FAITH, Dec. 20, 2006, at 31, 32.

## I. BACKGROUND

### *A. Hurricane Katrina*

On August 29, 2005, Hurricane Katrina swept over New Orleans, causing an estimated $125 billion of damage in Louisiana and Mississippi.[8] The storm caused the waters near New Orleans to rise, either pushing against or overtopping the city's levee system, or both.[9] As a result, the levees failed in numerous places, resulting in more than eighty percent of New Orleans being flooded under as much as twenty feet of water.[10] The damage from the flooding and the storm resulted in approximately 1.7 million insurance claims that could result in an estimated $40 billion in covered insurance losses.[11] Substantial litigation has followed.[12]

### *B. The* Canal Breaches Consolidated Litigation

It was into this morass of litigation that the United States District Court for the Eastern District of Louisiana was forced to wade when presented with certain dispositive, or partially dispositive, motions in the *Canal Breaches Litigation*—a consolidated action consisting of all cases pending in the Eastern District "which concern damages caused by flooding as a result of breaches or overtopping" of various canals in

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8. *Katrina Damage Estimate Hits $125B*, USA TODAY.COM, Sept. 9, 2005, http://www.usatoday.com/money/economy/2005-09-09-katrina-damage_x.htm.

9. For a detailed examination of the possible causes of the levee failure, as well as the timeline of the storm and resulting flood, see FREE REPUBLIC, NEW ORLEANS LEVEE FAILURE ASSESSMENT—PART V (2005), http://www.freerepublic.com/focus/f-news/1517817/posts.

10. *In re* Katrina Canal Breaches Consol. Litig., 466 F. Supp. 2d 729, 735-36, 768 (E.D. La. 2006); *see New Orleans Files $77 Billion Claim Against Corps*, CNN.COM, Mar. 2, 2007, http://www.cnn.com/2007/03/01/Katrina.claim/index.html. The court's November 27, 2006, decision was issued on motions to dismiss and other dispositive motions. *Canal Breaches Litig.*, 466 F. Supp. 2d at 734. In deciding a motion to dismiss, a court is obligated to accept as true all alleged facts. *See* FED. R. CIV. P. 12. The plaintiffs in *Canal Breaches Litigation* alleged, among other things, that the levees failed because of man-made (or artificial) causes. 466 F. Supp. 2d at 735, 768. The actual cause of the levee failures has not yet been determined and, in fact, is very much in dispute. *See* FREE REPUBLIC, *supra* note 9.

11. Press Release, Ins. Info. Inst., Nearly 95 Percent of Homeowners Claims from Hurricane Katrina Settled and Tens of Billions of Dollars Paid to Affected Communities in Louisiana and Mississippi, Insurance Information Institute Reports (Aug. 22, 2006) (available at http://www.iii.org/media/updates/press.760032/).

12. *Property Owners Rush To Sue Insurers*, TIMES-PICAYUNE (New Orleans), Sept. 15, 2006, at A-14.

and around New Orleans.[13] The *Canal Breaches Litigation* court's decision concerned, in part, four of the consolidated cases, where the insurers moved for judgment on the pleadings or to dismiss on the ground that flood exclusions in their homeowners/commercial property contracts expressly barred coverage for damage that resulted when water overflowed the levee system and inundated the properties they insured.[14] Through its November 27, 2006, decision, the court denied, with limited exceptions, the insurers' motions and granted, in part, the plaintiffs' motion for partial summary judgment.[15]

Central to the court's decision is the scope and effect of the term "flood," as that term is used in the insurers' flood exclusions.[16] Though a number of different iterations of the exclusion were at issue, all similarly excluded coverage for water damage resulting from "flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these all whether driven by wind or not."[17]

Ignoring the basic rules of Louisiana contract interpretation, that an unambiguous provision in a contract must end a court's interpretation of the contract,[18] the *Canal Breaches Litigation* court instead attempted to interpret the exclusions at issue and concluded that the operative term "flood" was ambiguous.[19] The court based its decision on an initial narrow reading of the term, which led to what the court ascertained to be two "reasonable" interpretations of the term—

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13. *Canal Breaches Litig.*, 466 F. Supp. 2d at 733. The cases were consolidated pursuant to an en banc ruling from the Eastern District of Louisiana to ensure consistency in pretrial discovery and motions practice. *Id.*

14. *Id.* at 733-35, 743-44.

15. *Id.* at 765, 767, 777-78, 780. The exceptions dealt with contracts that excluded damage from water "regardless of the cause" or that defined flood to include "the release of water held by a levee." *See id.* at 742-43. As we will discuss, the fact that these other contracts contained differing terms cannot render the term "flood" ambiguous. *See* discussion *infra* note 17.

16. *Id.* at 747-53.

17. *Id.* at 742. That the specific flood exclusions at issue were not identical is immaterial where, as in the *Canal Breaches Litigation*, each of the exclusions plainly barred coverage for flood. *See* Am. Cas. Co. v. Tenet Healthsystem Hosps., Inc., Civil Action No. 04-3270, 2006 WL 2631936, at *2-3 (E.D. La. Sept. 13, 2006) (discussing the fact that even though terms in two separate insurance policies differed, the dissimilar terminology did not render either contract ambiguous); *see also* NME Hosps., Inc. v. Am. Cas. Co., Civ. A. No. 96-0998, 1996 WL 599468 (E.D. La. Oct. 17, 1996), *aff'd*, 132 F.3d 1454 (5th Cir. 1997) (recognizing that contracts for insurance may differ yet still be unambiguous, as long as the wording of each of the policies is plain and unambiguous).

18. *See, e.g.*, Etienne v. Nat'l Auto. Ins. Co., 99-2610, p. 4 (La. 4/25/00); 759 So. 2d 51, 54.

19. 466 F. Supp. 2d at 747 ("Definitions and Usage of the Word 'Flood' Demonstrate Two Reasonable Interpretations of the Term[.]").

floods that are caused by man and floods that are the result of nature.[20] Despite the fact that the term unambiguously encompassed both causal events, the court determined that its two ascertained meanings of the term "flood" supported a finding of ambiguity.[21] Because of this, the court concluded, the exclusion would not apply to bar coverage for damage caused by the flooding.[22]

## II. ANALYSIS

### *A. Unambiguous Contracts, Including Insurance Contracts, Are To Be Interpreted and Enforced as Written*

Parties enter into written contracts because they provide certainty.[23] Without such certainty, commercial transaction costs could be astronomical because no party would ever accurately know the scope of the deal to which they are agreeing.[24] Parties would be required to adjust their contracting price in order to compensate for the potential negative outcome that might result despite their clearly expressed written manifestation of intent.

Courts in Louisiana have recognized this fundamental principle for more than a century and have stated that the "purpose of the written contract and of the specifications is to fix with certainty the obligations of the parties, and thereby obtain definite results."[25]

The significant weight placed on written contracts is evidenced by long-standing doctrines, such as the parol evidence rule,[26] the statute

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20. *Id.* at 747-48.

21. *Id.* at 756.

22. *Id.* at 765.

23. *See, e.g.*, Florrie Young Roberts, *Let the Seller Beware: Disclosures, Disclaimers, and "As Is" Clauses*, REAL EST. L.J. 303, 327 (2003) ("One of the principal reasons parties enter into written contracts is to provide certainty to their transactions.").

24. *See, e.g.*, Michael S. Bogner, *The Problem with Handshakes: An Evaluation of Oral Agreements in the United States Film Industry*, 28 COLUM. J.L. & ARTS 359, 361 (2005).

> The higher degree of certainty provided by written contracts can reduce transactions costs by offering clear parameters to parties about what constitutes breach of contract. Such certainty has proven so beneficial over time that state and federal legislators have enacted a variety of laws that attempt to limit the effectiveness of oral contracts in order to incentivize parties to enter into written agreements. Such statutory measures against oral contracts include the enactment of shorter statutes of limitations and the application of the general Statute of Frauds for oral contracts lasting longer than one year.

*Id.* (footnote omitted).

25. *See, e.g.*, Pleasants v. City of Shreveport, 35 So. 283, 291 (La. 1903).

26. Prudhomme v. Prudhomme, 06-516, p. 5 (La. App. 3 Cir. 9/27/06); 941 So. 2d 102, 106 ("'The parties' intent in executing a compromise is normally discerned from the

of frauds,[27] and other bars to the introduction of extrinsic evidence to alter the plain meaning of a contract. These rules and others serve to facilitate commerce,[28] decrease the cost of doing business,[29] provide a stable platform for free-market trade,[30] and decrease the likelihood of litigation.[31]

It is in this context that the rules of contract interpretation exist. The plain and unambiguous language of a contract is supposed to govern the contracting parties' obligations.[32] It is the widely accepted rule, therefore, that a court should never strive to create ambiguities in a contract where the contract sufficiently expresses the parties' intent.[33]

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four corners of the document; extrinsic evidence is normally inadmissible to explain, expand or contradict the terms of the instrument.'" (quoting Randall v. Martin, 03-1311, p. 5 (La. App. 5 Cir. 2/23/04), 868 So. 2d 913, 916)).

27. *See, e.g.*, LA. CIV. CODE ANN. art. 1821 (1987) ("An obligor and a third person may agree to an assumption by the latter of an obligation of the former. To be enforceable by the obligee against the third person, the agreement must be made in writing."); *see also* Head & Amory v. Providence Ins. Co., 6 U.S. (2 Cranch) 127, 149 (1804) ("One of the principal reasons which must always give a contract written and signed with deliberate solemnity a more powerful sanction than a verbal agreement is its superior certainty. . . . The whole system of law founded upon the statute of frauds is built upon the principle that a contract in writing, and signed by the party contracting the engagement, is more forcible and binding in its nature, than an engagement verbally made, or agreed to without being reduced to that form.").

28. *See, e.g.*, Stephen J. Choi & G. Mitu Gulati, *Contract as Statute*, 104 MICH. L. REV. 1129, 1139 (2006) ("Standardized contracts also facilitate trades in public markets . . . .").

29. *Cf.* Bogner, *supra* note 24, at 361 (noting that written contracts tend to reduce transaction costs).

30. *Cf.* Alan J. Meese, *Property Rights and Intrabrand Restraints*, 89 CORNELL L. REV. 553, 601 (2004) (discussing how contracts may establish the free market).

31. *See, e.g.*, Bogner, *supra* note 24, at 361 (discussing the benefits of statutory measures against oral contracts); *cf.* Roberts, *supra* note 23, at 328 (noting that clear rules to enforce "as is" clauses will discourage lawsuits).

32. *See* LA. CIV. CODE ANN. art. 2046; Gertler v. City of New Orleans, 03-2131, p. 4 (La. App. 4 Cir. 9/1/04); 881 So. 2d 792, 795.

33. *See, e.g.*, Cadwallader v. Allstate Ins. Co., 02-1637, pp. 3-4 (La. 6/27/03); 848 So. 2d 577, 580 ("The rules of construction do not authorize a perversion of the words or the exercise of inventive powers to create an ambiguity where none exists or the making of a new contract when the terms express with sufficient clearness the parties' intent."); Menendez v. O'Niell, 06-0451, pp. 6-7 (La. App. 1 Cir. 12/28/06) (same); Green v. Nat'l Bellas Hess Life Ins. Co., 124 So. 2d 397, 398 (La. App. 3 Cir. 1960) ("In the absence of a statute to the contrary, insurance companies have the same right as individuals to limit their liability, and to impose whatever conditions they please upon their obligations, not inconsistent with public policy, and courts have no right to add anything to their contracts or to take anything from them." (citing Kennedy v. Audubon Ins. Co., 82 So. 2d 91 (La. App. 1 Cir. 1955); Muse v. Metro. Life Ins. Co., 192 So. 72, 75 (La. 1939))).

This concept applies equally in the context of insurance.[34] Thus, when the language of an insurance contract is clear, the intent of the parties is ascertained and no further inquiry is required.[35]

Courts presume that the terms of an insurance contract express the intent of the parties.[36] An insurance contract, therefore, "should not be interpreted in an unreasonable or strained manner under the guise of contractual interpretation to enlarge or to restrict its provisions beyond what is reasonably contemplated by unambiguous terms or achieve an absurd conclusion."[37] Furthermore, "broad language" in an insurance contract does not create an ambiguity,[38] nor does "the mere fact that an insurance policy is a complex instrument, requiring analysis to understand it, . . . make it ambiguous."[39] Thus, whether broad or

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34. Head & Amory v. Providence Ins. Co., 6 U.S. (2 Cranch) 127, 149 (1804) ("There is no instrument reduced to a greater degree of certainty than a policy of insurance."); Rolston v. United Servs. Auto. Ass'n, Nos. 06-0978, 06-0414, p. 4 (La. App. 4 Cir. 12/13/06); 948 So. 2d 1113, 1116 ("An insurance policy is a conventional obligation . . . . As such, courts . . . should interpret insurance policies the same way they do other contracts by using the general rules of contract interpretation as set forth in our Civil Code." (citing Ledbetter v. Concord Gen. Corp., 95-0809, pp. 6-7 (La. 1/6/96); 665 So. 2d 1166, 1169; Crabtree v. State Farm Ins. Co., 93-0509 (La. 2/28/94); 632 So. 2d 736)).

35. Fontenot v. Duplechine, 04-424, p. 5 (La. App. 3 Cir. 12/8/04); 891 So. 2d 41, 46 ("The parties' intent determines the extent of the coverage; and, if the wording at issue is clear and expresses the intent of the parties, the agreement must be enforced as written.").

36. *See, e.g.*, Blackburn v. Nat'l Union Fire Ins. Co., 00-2668, p. 6 (La. 4/3/01); 784 So. 2d 637, 641 ("Obviously, the initial determination of the parties' intent is found in the insurance policy itself.").

37. *Cadwallader*, 02-1637 at p. 3; 848 So. 2d at 580.

38. *See, e.g.*, Naquin v. La. Power & Light Co., 05-2104 p. 1 (La. App. 1 Cir. 11/17/06) (Kuhn, J., concurring) ("The broad language utilized in the contract is unambiguous . . . . That the contract did not include limiting language does not create an ambiguity . . . ."); *see also* Harper v. Intracoastal Truck Lines, 451 So. 2d 1289, 1291 (La. App. 1 Cir. 1984) ("Although broad, the cited [insurance] contract language is not ambiguous.").

A plethora of other Louisiana decisions also illustrate this point. *See, e.g.*, Monteleone v. Am. Employers' Ins. Co., 120 So. 2d 70, 73 (La. 1960) (stating that the exclusory term "convey," which did not describe speed of or directness of delivery, was not ambiguous in an insurance contract); Hemel v. State Farm Mut. Auto. Ins. Co., 29 So. 2d 483, 485-86 (La. 1947) (finding that an exclusion for "mechanical breakdown" excluded damage from fire in the engine compartment); *see also* Williams v. Union Cent. Life Ins. Co., 291 U.S. 170, 180 (1934) ("While it is highly important that ambiguous clauses should not be permitted to serve as traps for policyholders, it is equally important . . . that the provisions of insurance policies which are clearly and definitely set forth in appropriate language, and upon which the calculations of the company are based, should be maintained unimpaired by loose and ill-considered interpretations.").

39. Bernard v. Chrysler Ins. Co., 98-1846, p. 4 (La. App. 3 Cir. 3/24/99); 734 So. 2d 48, 51 (citing La. Ins. Guar. Ass'n v. Interstate Fire & Cas. Co., 93-0911 (La. 1/14/94); 630 So. 2d 759).

narrow, where the terms are clear, a court may neither insert language into an insurance contract,[40] nor otherwise alter or change its terms.[41]

### *B. The* Canal Breaches Litigation *Court's Decision Ignored Louisiana Law and Effectively Rewrote the Parties' Contracts To Broaden Coverage Beyond that Contemplated by the Parties*

#### 1. First and Foremost, the Unmodified Term "Flood" Must Be Afforded Its Plain and Ordinary Meaning—Flood Is a Flood Is a Flood Is a Flood

The court's decision in the *Canal Breaches Litigation* ignores the parties' chosen words; instead, it misapplies Louisiana's fundamental rules of contract construction to afford the plain and unambiguous term "flood" an artificially narrow meaning by resorting to rules of strict construction that ordinarily are employed *only* after a finding of ambiguity. Doing so, however, completely disregards the term's plain and ordinary meaning. Yet it is this meaning that a Louisiana court must look to first when construing a contract for insurance.[42]

The court correctly recognized the governing rules, however, quoting at length the Louisiana Supreme Court's recent reiteration that terms of contract be afforded their plain and ordinary meaning and emphasizing those rules as "the most important guiding principles."[43]

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40. *See id.* at p. 8; 734 So. 2d at 53 (rejecting the argument that the words "*to customers*" be added to an endorsement when it would "distort the plain meaning of the policy"); *see also* Calcasieu-Marine Nat'l Bank v. Am. Employers' Ins. Co., 533 F.2d 290, 295-300 (5th Cir. 1976) (applying Louisiana law to conclude that the plain and ordinary meaning of the term "loan" in an exclusion unambiguously included both "de facto" and "formal" loans and therefore should be given its plain meaning and bar coverage).

41. Michelet v. Scheuring Sec. Servs. Inc., 95-2196, p. 17 (La. App. 4 Cir. 9/4/96); 680 So. 2d 140, 147 ("When the wording is clear, the courts lack the authority to alter or change the terms of the policy under the guise of interpretation." (citing *La. Ins. Guar. Ass'n*, 93-0911; 630 So. 2d 759)); *see* Commercial Union Ins. Co. v. Piker, 557 So. 2d 717, 722 (La. App. 2 Cir. 1990) ("While all ambiguities in an insurance contract must be construed in favor of the insured and against the insurer, courts have no authority to change or alter the terms of the insurance contract under the guise of interpretation when such terms are couched in clear and unambiguous language." (citing Dear v. Blue Cross of La., 511 So. 2d 73 (La. App. 3 Cir. 1987); Coates v. Northlake Oil Co., 499 So. 2d 252, 255 (La. App. 1 Cir. 1986); Pomares v. Kan. City S. Ry., 474 So. 2d 976, 980 (La. App. 5 Cir. 1985); Harvey v. Mr. Lynn's, Inc., 416 So. 2d 960, 962 (La. App. 2 Cir. 1982))).

42. Fontenot v. Duplechine, 04-424, p. 5 (La. App. 3 Cir. 12/8/04); 891 So. 2d 41, 46 ("The parties' intent determines the extent of the coverage; and, if the wording at issue is clear and expresses the intent of the parties, the agreement must be enforced as written.").

43. *In re* Katrina Canal Breaches Consol. Litig., 466 F. Supp. 2d 729, 737 (E.D. La. 2006) (citing Cadwallader v. Allstate Ins. Co., 02-1637 (La. 6/27/03); 848 So. 2d 577).

In *Cadwallader v. Allstate Insurance Co.*, the Supreme Court of the State of Louisiana set forth succinctly the most important guiding principles:

> Words and phrases used in an insurance policy are to be construed using their plain, ordinary and generally prevailing meaning, unless the words have acquired a technical meaning. An insurance contract, however, should not be interpreted in an unreasonable or strained manner under the guise of contractual interpretation to enlarge or to restrict its provisions beyond what is reasonably contemplated by unambiguous terms or achieve an absurd conclusion. The rules of construction do not authorize a perversion of the words or the exercise of inventive powers to create an ambiguity where none exists or the making of a new contract when the terms express with sufficient clearness the parties' intent.
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> . . . .
>
> If the policy wording at issue is clear and unambiguously expresses the parties' intent, the insurance contract must be enforced as written. Courts lack the authority to alter the terms of insurance contracts under the guise of contractual interpretation when the policy's provisions are couched in unambiguous terms. The determination of whether a contract is clear or ambiguous is a question of law.[44]

Yet, the *Canal Breaches Litigation* court failed to follow these "most important guiding principles" and, consequently, concluded that "flood," as that term is used in a flood exclusion, means something less than the same term might mean in everyday language.[45] There can be little reasonable doubt, however, that water pouring through levees due to storm surge, which is exactly what caused much of the Katrina-related damage,[46] qualifies as a "flood" within the meaning of the flood exclusion. Under any set of normal circumstances, when water inundates property that is otherwise dry, whether pushed by wind or not, it is a "flood."[47] The *Canal Breaches Litigation* court concluded

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44. *Cadwallader*, 02-1637 at pp. 3-4; 848 So. 2d at 580 (citations omitted).

45. *Canal Breaches Litig.*, 466 F. Supp. 2d at 737, 747-49, 759.

46. *See* Joseph B. Treaster, *Storm and Crisis: The Coverage*, N.Y. TIMES, Sept. 24, 2005, at C1; *see also* FREE REPUBLIC, *supra* note 9.

47. *Compare* Russell G. Donaldson, Annotation, *What Is "Flood" Within Exclusionary Clause of Property Damage Policy*, 78 ALR 4th 817, 820 (1990) (noting that situations "involv[ing] the actual covering of the property in question by water, either through inundation . . . or through movable personalty being projected, tossed, or pitched from above the surface into and beneath existing waters and hence lost" constituted a flood), *with Canal Breaches Litig.*, 466 F. Supp. 2d at 736-37, 759. Additionally, see 44 C.F.R. pt. 61, app. A(1) (2006), which defines "flood" in the context of the National Flood Insurance Program (NFIP) as:

otherwise, however, and ruled that the unmodified term "flood," as used in the flood exclusions, does not mean all floods but rather only floods caused by natural causes.[48]

The court failed to follow, therefore, what it explicitly recognized as the "most important" steps of analysis mandated by the Louisiana Supreme Court—ascertaining the parties' true purpose and intent through the plain and ordinary meaning of the chosen words.[49] Instead, the court made a leap of logic to apply rules of construction that are reserved *only* for instances where the plain and ordinary meaning of a contractual term or provision results in an ambiguity.[50] As the court explained, "[w]ith respect to the proper approach concerning the interpretation of an exclusion, they are generally strictly construed."[51] Such a strict construction, however, is wholly contrary to the principles articulated by the Louisiana Supreme Court in *Cadwallader*, which the *Canal Breaches Litigation* court explicitly recognized.[52] More to the point, the *Canal Breaches Litigation* court's use of a strict construction of the term "flood" imparted an artificial limitation into that term of the contracts where they otherwise contained no such limitation.[53] The

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> 1. A general and temporary condition of partial or complete inundation of two or more acres of normally dry land area or of two or more properties (one of which is your property) from:
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> a. Overflow of inland or tidal waters,
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> b. Unusual and rapid accumulation or run-off of surface waters from any source,
>
> c. Mudflow.
>
> 2. Collapse or subsidence of land along the shore of a lake or similar body of water as a result of erosion or undermining caused by waves or currents of water exceeding anticipated cyclical levels that result in a flood as defined . . . above.

48. *Canal Breaches Litig.*, 466 F. Supp. 2d at 756-57.

49. *Compare id.* at 736-39 *with* Blackburn v. Nat'l Union Fire Ins. Co., 00-2668, p. 6 (La. 4/3/01); 784 So. 2d 637, 641 (explaining that the intent of the parties is first found in the insurance contract itself), *and* Etienne v. Nat'l Auto Ins. Co., 99-2610, p. 4 (La. 4/25/00); 759 So. 2d 51, 54 ("Basic contract law mandates that if the words of an insurance policy are clear and explicit and lead to no absurd consequences, no further interpretation may be made in search of the parties' intent and the agreement must be enforced as written.").

50. *See, e.g.*, Calcasieu-Marine Nat'l Bank v. Am. Employers' Ins. Co., 533 F.2d 290, 295-96 (5th Cir. 1976) (stating that Louisiana law prohibits reliance on rules of construction when a contract is unambiguous).

51. *Canal Breaches Litig.*, 466 F. Supp. 2d at 738.

52. *Id.* (citing Cadwallader v. Allstate Ins. Co., 02-1637, p. 4 (La. 6/27/03); 848 So. 2d 577, 580).

53. *See id.* at 741. Four of the insurers, Standard Fire Insurance Company, Hartford Insurance Company of the Midwest, Hanover Insurance Company, and Unitrin Preferred Insurance Company, issued standard form policies containing identical language. *Id.* Each

effect was a rewriting of the contract in contravention to the Louisiana Supreme Court's mandate that a court can neither expand nor restrict a party's contractual obligations absent a finding of ambiguity in the contract.[54]

The *Canal Breaches Litigation* court's unprovoked and immediate resort to the rules of contract construction was contrary to Louisiana law, which requires that the "strict construction principle applies only if the ambiguous policy provision is susceptible to two or more *reasonable* interpretations."[55] Indeed, there was no initial finding of ambiguity.[56] Other courts in Louisiana have held that there must be ambiguity before strict construction,[57] as have courts in other jurisdictions.[58]

Misapplying the strict construction principle, the *Canal Breaches Litigation* court construed the term "flood" restrictively and rejected the insurers' argument that the term encompasses floods regardless of cause.[59] Instead, the court determined that the term "flood" refers only to floods resulting from natural causes.[60] The court likewise rejected the authority cited by the insurers, which concluded that the term

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policy provides: "COVERAGE A-DWELLING and COVERAGE BOTHER [sic] STRUCTURES: We insure against risk of direct loss to property described in Coverages A and B only if that loss is a physical loss to property." *Id.* The policies also each contain the following pertinent exclusion:

> (1) We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in any sequence to the loss.
>
> . . . .
>
> (c) Water Damage, meaning:
>
> Flood, surface water, waves, tidal water, overflow of a body of water, or spray from any of these, whether or not driven by wind . . . .

*Id.* (emphasis and footnote omitted).

54. *See Etienne*, 99-2610 at p. 4; 759 So. 2d at 54.

55. *Cadwallader*, 02-1637 at p. 4; 848 So. 2d at 580.

56. *See Canal Breaches Litig.*, 466 F. Supp. 2d at 744-47 (holding exclusion should be strictly construed before finding any ambiguity).

57. *See, e.g.*, Haas v. Romero, 06-401, p. 3 (La. App. 3 Cir. 9/27/06); 940 So. 2d 757, 759-60; Cloud v. Nat'l Auto. Ins. Co., 03-1438, pp. 2-5 (La. App. 3 Cir. 5/26/04); 875 So. 2d 866, 869-71; McEachern v. Mills, 36,156, p. 8 (La. App. 2 Cir. 8/16/02); 826 So. 2d 1176, 1180-81.

58. *See, e.g.*, Lank v. Moyed, 909 A.2d 106, 110 (Del. 2006) (stating that the principle of *contra proferentem* may not be applied before a finding of ambiguity); Enviro Express, Inc. v. AIU Ins. Co., 901 A.2d 666, 669 (Conn. 2006) (same); Country Mut. Ins. Co. v. Livorsi Marine, Inc., 856 N.E.2d 338, 342-43 (Ill. 2006) (same); Cole v. Auto Owners Ins. Co., 723 N.W.2d 922, 924-26 (Mich. Ct. App. 2006) (same).

59. *Canal Breaches Litig.*, 466 F. Supp. 2d at 755-57.

60. *Id.*

"flood" does not contain a distinction between natural and artificial.[61] For instance, the insurers relied heavily upon *Kane v. Royal Insurance Co. of America*, in which the Colorado Supreme Court held that the term "flood," as used in a flood exclusion, was unambiguous and encompassed flooding caused by a break in a dam.[62] The *Kane* court based its decision on the generally accepted meaning of the unmodified term "flood," which it ascertained from a review of basic dictionary definitions:

> For example, *Webster's New World Dictionary* defines "flood" as: "[A]n overflowing of water on an area normally dry; inundation; deluge. . . ." *Webster's Ninth New Collegiate Dictionary* defines the term as: "[A] rising and overflowing of a body of water esp[ecially] onto normally dry land. . . ." *Black's Law Dictionary* contains a similar definition: "An inundation of water over land not usually covered by it. Water which inundates area of surface of earth where it ordinarily would not be expected to be."[63]

Although the *Canal Breaches Litigation* court discussed *Kane* and its incorporated definitions at length, it reached a contrary determination after reviewing its own select dictionary definitions.[64] Remarkably, however, even the definitions selected by the court define "flood" broadly and without a distinction between natural and artificial causes.[65] Yet, the court found that "the majority of the definitions of the noun 'flood' . . . require[d] an 'overflowing' or an 'overtopping.'"[66] Accordingly, based on these select definitions, the court concluded that a "natural" event was implicit in the "overtopping" definitions.[67] The

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61. *Id.* at 743-47.
62. 768 P.2d 678, 681 (Colo. 1989).
63. *Id.* (citations omitted).
64. *Canal Breaches Litig.*, 466 F. Supp. 2d at 747-48.
65. *Id.*
66. *Id.* at 748.
67. *Id.* The court's conclusion that flooding in New Orleans may be the result of an artificial cause, negligence, and not the result of a natural cause rests mainly on two grounds. *Id.* at 735-36, 745. First, given the nature of the motions before the court, the court was obligated to accept as true the allegations contained in the plaintiffs' complaints. *See id.* at 736; *see also* FED. R. CIV. P. 12. According to the court, the plaintiffs alleged that the losses at issue were the result of negligence. *Canal Breaches Litig.*, 466 F. Supp. 2d at 733-36. Those facts have not yet been proven and are very much in dispute. *See generally* FREE REPUBLIC, *supra* note 9. The second ground is the doctrine of "efficient proximate cause," which, according to the court, says that when there are concurrent causes, "the efficient cause—the one that sets others in motion—is the cause to which the loss is to be attributed." *Canal Breaches Litig.*, 466 F. Supp. 2d at 745. This Essay does not discuss the issues raised by this aspect of the court's decision. It is noted, however, that at a minimum, any attempt to determine which cause in a series of concurrent causes is the most "efficient" cause, is highly

court thereafter concluded that the term "flood" could be interpreted to refer only to natural events, even though neither the dictionary definitions considered by the court nor the policy language at issue explicitly supported the court's imposition of a delineation between natural and artificial.[68] Yet, the fact of the matter remains that there is no actual delineation in the language of the insurance policies.[69] To read such delineation into the policies, therefore, would amount to rewriting the terms of the contracts.

The court's finding that the term "flood" means only floods from natural causes and not floods from artificial causes is significant in the context of the *Canal Breaches Litigation*, where it is alleged that the damage sustained by the insured was caused by negligence in the design and construction of the New Orleans levees.[70] This negligence, the court explained, is artificial or man-made and, therefore, distinguishable from floods resulting from natural causes.[71] The actual cause of the flooding has not yet been determined, however, and, in fact, is hotly contested.[72] It remains altogether possible, therefore, that the actual cause of the flooding may be a "natural" cause.

The *Canal Breaches Litigation* court's finding that the term "flood" pertains only to naturally caused floods sets the stage for the next step in the court's analysis—the creation of an ambiguity. Indeed, having concluded that the term "flood" was limited to some instances of flooding but not others, it required little additional effort for the court to conclude that the term also could refer to instances of flooding not contemplated under the policies, such as artificial or man-made floods, thereby rendering the term ambiguous under Louisiana law.[73]

### 2. How To Construct an Ambiguity

Having concluded that a flood is not always a flood, at least in the context of insurance, the *Canal Breaches Litigation* court then proceeded to determine the effect the limited definition had in the

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subjective and fact based and, as such, not appropriate for determination by a court without a properly developed factual record. *Cf.* Rob Risley, *Landslide Peril and Homeowners' Insurance in California*, 40 UCLA L. REV. 1145, 1162-63 (1993) (discussing the difficulty of applying the efficient proximate cause standard).

68. *See Canal Breaches Litig.*, 466 F. Supp. 2d at 748.
69. *See id.* at 741-42, 756.
70. *Id.* at 735-36.
71. *Id.* at 746-48.
72. *See generally* FREE REPUBLIC, *supra* note 9.
73. *See Canal Breaches Litig.*, 466 F. Supp. 2d at 746-49.

context of the insurance contracts' flood exclusions.[74] But, because the court had concluded that multiple "reasonable" meanings could exist, the court found the term ambiguous and the flood exclusion unenforceable.[75] The court explained:

> As demonstrated earlier, the word "flood" has numerous meanings. It is defined in virtually all dictionaries first as a noun then as a verb. In the policies being examined by the Court it is used as a noun. As noted, most of the definitions of the noun imply encroachment of water caused by an act of nature. Furthermore, this exclusion has been the subject of differing interpretations in the jurisprudence which further demonstrates that it is susceptible of two reasonable interpretations. As such, under Louisiana civilian principles and the *jurisprudence constant*, this Court finds the ISO Water Damage Exclusion ambiguous.[76]

The court's finding of ambiguity based on a perceived difference between floods of natural causes and floods of man-made causes effectively eviscerates the flood exclusion by creating a delineation under which virtually any flood could be viewed one way or the other. Indeed, it is difficult to imagine any flood scenario that a creative plaintiff's lawyer could not argue was the result of either a natural cause or a man-made cause; such as, for example, a failure to design or build a sufficient sea wall, plumbing or drainage system, or a failure to implement an appropriate building code. In other words, virtually every flood could be characterized as resulting from an act or failure to act—and thus be man-made.

Nevertheless, as noted by the *Canal Breaches Litigation* court, other jurisdictions have reached opposite conclusions, some under the same general facts at issue in the *Canal Breaches Litigation*. For example, in *Buente v. Allstate Property & Casualty Insurance Co.*, a federal court in Mississippi held that the inundation that occurred during Hurricane Katrina was a flood according to that term's plain meaning, and, accordingly, the term "flood" was unambiguous.[77] The exclusion found in the pertinent insurance policy for damage attributable to flood, therefore, was held valid and enforceable.[78] Other

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74. *Id.* at 756.
75. *Id.* at 746-49, 756.
76. *Id.* at 756.
77. No. 1:05 CV 712 LTS JMR, 2006 WL 980784, at *1-2 (S.D. Miss. Apr. 12, 2006).
78. *Id.*

courts have reached similar conclusions.[79] Indeed, the Eastern District of Louisiana, the same district in which the *Canal Breaches Litigation* court sits, squarely addressed the meaning of the flood exclusion some ten years ago under contract language virtually identical to that at issue in the *Canal Breaches Litigation*. In *Travelers Indemnity Co. v. Powell Insurance Co.*, an unreported decision cited to the *Canal Breaches Litigation* court by the insurers but not referenced by the *Canal Breaches Litigation* court in its decision, Judge Vance held that a property policy's flood exclusion (which incorporated the term "flood") was unambiguous and barred coverage for damage sustained following heavy rains.[80] Significantly, the *Travelers* court did not address the cause of the flood, thereby suggesting that such an inquiry is neither pertinent nor necessary to a determination of whether the term "flood" is ambiguous under Louisiana law.[81]

Just as imparting an artificial limitation to the term "flood" effectively rewrote the contract, so, too, did the *Canal Breaches Litigation* court's creation of an ambiguity. And the outcome is the same in each instance—risks that the insurers never intended to cover and for which the insurers neither charged nor collected a premium became covered—a vastly different outcome than originally contemplated by the contracting parties.

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79. *See Canal Breaches Litig.*, 466 F. Supp. 2d at 745-46, 750-52 (discussing TNT Speed & Sport Ctr., Inc. v. Am. States Ins. Co., 114 F.3d 731, 733-34 (8th Cir. 1997) (holding that there was no coverage where vandals removed sandbags and dirt from levee causing levee to break); Pakmark Corp. v. Liberty Mut. Ins. Co., 943 S.W.2d 256, 262 (Mo. Ct. App. 1997) (holding that there was no coverage where levee broke); Bartlett v. Cont'l Divide Ins. Co., 697 P.2d 412, 413 (Colo. Ct. App. 1984) (finding no distinction between natural and artificial causes where dam failure caused damage), *aff'd*, 730 P.2d 308 (Colo. 1986); E.B. Metal & Rubber Indus., Inc. v. Fed. Ins. Co., 444 N.Y.S.2d 321, 322 (N.Y. App. Div. 1981) (upholding the lower court's decision to deny coverage for water damage caused by improperly constructed and maintained dike that failed)).

80. Travelers Indem. Co. v. Powell Ins. Co., Civil Action No. 95-4188, 1996 WL 578030, at *3-4 (E.D. La. Oct. 4, 1996). This case was cited in Defendants' Memorandum in Support of Motion To Dismiss or Alternatively Motion To Sever at 9, *Canal Breaches Litig.*, 466 F. Supp. 2d 729 (No. 05-4182).

81. *Travelers Indem. Co.*, 1996 WL 578030, at *1-3. More recently, at least one Louisiana state trial court had occasion to address issues concerning a policy's flood exclusion in the context of a hurricane-related claim. *See* Landry v. La. Citizens Prop. Ins. Corp., No. 85571 (La. 15 Jud. Dist. Ct. Jan. 4, 2007). That ruling, however, is premised on Louisiana's Valued Policy Law, rather than application of the flood exclusion and, therefore, is beyond the scope of this Essay.

3. The Court's Decision Is Even Contrary to the Parties' Reasonable Expectations

In addition to ignoring Louisiana's fundamental rules of contract construction concerning plain meaning and findings of ambiguity, the *Canal Breaches Litigation* court's decision even runs afoul of doctrines long embraced by the policyholder bar, such as the reasonable expectations doctrine. Indeed, even a cursory survey of the reasonable expectations of a New Orleans resident *before* the flooding occurred would likely have yielded the conclusion that standard-form property insurance *does not* cover flood, regardless of its cause.[82] And, it is difficult to imagine that any resident of New Orleans would have viewed water up to the roof of their home due to a break in the levees as anything other than a flood.[83] Likewise, no evidence has shown that insurers ever expected or intended to cover such claims.[84] The federal government likewise apparently had no such expectation and even advised potential claimants via its Web site that "[f]lood damage is not covered by your homeowners insurance policy."[85] Nevertheless, the *Canal Breaches Litigation* court found otherwise.[86]

The court's view that insureds in the City of New Orleans (and the insurers who issued their insurance contracts) reasonably expected that an inundation of water up to their rooftops could be anything other than a flood within the meaning of their homeowners insurance defies logic. It also ignores the existence of a federal flood insurance program. Congress enacted the National Flood Insurance Program (NFIP) to afford coverage for flood because ordinary property insurers "could not profitably provide such coverage at an affordable price" and

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82. *See, e.g.*, Donaldson, *supra* note 47, at 821 (stating that most courts agree that flooding caused by bursting dams or similar situations would not be covered by property insurance).

83. As one would expect, there is not even anecdotal evidence from NFIP sales agents of any attempt by homeowners to only buy coverage for natural flooding because flood damage resulting from human negligence would be covered in their standard homeowner contract. *See* Nat'l Flood Ins. Program, Floodsmart.gov, Considering Coverage, http://www.floodsmart.gov/floodsmart/pages/faq_consider.jsp (last visited Mar. 24, 2007) ("Flood damage is not covered by your homeowners insurance policy.").

84. *See, e.g.*, Walter Olson, Opinion, *Katrina Ravages Mississippi—Contracts Badly Hit*, WALL ST. J., Sept. 24-25, 2005, at A11 (noting that the insurance industry had no intention of covering flood losses).

85. *See* Nat'l Flood Ins. Program, *supra* note 83.

86. *In re* Katrina Canal Breaches Consol. Litig., 466 F. Supp. 2d 729, 760 (E.D. La. 2006).

to assist flood victims outside of disaster assistance.[87] The NFIP provides up to $250,000 of real property coverage and another $100,000 in contents coverage to those who live in flood risk zones and is available to residents of New Orleans for as little as $10 per month.[88] A substantial number of New Orleans' residents subscribed to this program.[89] It is difficult to fathom that these residents paid money to participate in the NFIP despite an expectation of the same coverage under their property insurance, and it is equally difficult to fathom why such a program would even exist if private insurance contracts included such coverage.[90]

### *C. Effects of the* Canal Breaches Litigation *Court's Ruling*

The *Canal Breaches Litigation* court's decision stands to impede contracting in the free market by increasing transaction costs in contracting. It also stands to injure policyholders, both in Louisiana and elsewhere, by limiting the availability of affordable and predictable insurance coverage. Finally, it places an immense burden on the insurance industry, which must not only absorb the unanticipated cost associated with an unexpected expansion of coverage, but must also operate in the wake of uncertainty created by the decision.

#### 1. Effect on the Free Market

The *Canal Breaches Litigation* court's decision stands to interfere with contracting in the free market by demonstrating an increased involvement by courts in reshaping the written agreements of contracting parties and thereby changing the manner in which private parties conduct commerce and trade. Absent confidence that contracts will be enforced as written, parties will be reluctant to enter into contracts, or they will demand a risk premium, anticipating that the

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87. *See* Nat'l Flood Ins. Program, *supra* note 83; FED. INS. & MITIGATION ADMIN., FED. EMERGENCY MGMT. AGENCY, NATIONAL FLOOD INSURANCE PROGRAM: PROGRAM DESCRIPTION 1-2 (2002).

88. Nat'l Flood Ins. Program, Floodsmart.gov, Types of Flood Insurance, http://www.floodsmart.gov/floodsmart/pages/faq_types.jsp (last visited Mar. 24, 2007).

89. David C. John, *Providing Flood Insurance Coverage After the Disaster Is a Mistake*, HERITAGE FOUND., Oct. 19, 2005, WebMemo 888, http://www.heritage.org/Research/Regulation/wm888.cfm.

90. In addition to the issues discussed herein, the *Canal Breaches Litigation* court's decision raises other issues under the pertinent insurance contracts and Louisiana law that may support additional reasons why damage from Hurricane Katrina-related flooding is not covered under contracts for property insurance.

contract will not be enforced as they planned.[91] Consequently, this reluctance to contract and the increased transaction costs associated with uncertain enforcement of contracts entered into will undoubtedly have a negative impact on free-market capitalism.[92] Indeed, as at least one scholar has recognized: "'[A] market economy can reach its full potential only if all of the participants in that economy, whether individuals or corporations, native or foreign, have the right to the impartial enforcement of the contracts they make.'"[93] Furthermore, following the *Canal Breaches Litigation* court's decision to its logical conclusion could result in varied and conflicting results, even when interpreting the same contract under slightly different facts.[94]

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91. *See* O. Lee Reed, *Law, the Rule of Law, and Property: A Foundation for the Private Market and Business Study*, 38 AM. BUS. L.J. 441, 461 (2001) ("[C]ontract law substantially lowers the costs of transacting business; thus it is no coincidence that around the world when developing nations are seeking foreign investment and trade, their leaders reassure the international business community of the commitment to the rule of law and the sanctity of contracts."); *see also* Jorge Adame, *The UNIDROIT Principles and NAFTA*, 4 ANN. SURV. INT'L & COMP. L. 56, 57 (1997) ("It is also in the interest of a free trade area that private contracts be governed and enforceable by law.").

92. *See* Reed, *supra* note 91, at 460-61.

93. *Id.* at 460 n.47 (quoting MANCUR OLSON, POWER AND PROSPERITY 195-96 (2000)).

94. Take, for example, a homebuyer who contracts with a national developer to build a home. The contract, drafted by the buyer's real estate agent, states, among other things, that the "risk of loss or damage to the premises by fire until delivery of the deeds is assumed by the respective seller." Lightning strikes the house the day before settlement, burning it to the ground. The seller shows up to the closing table with deed in hand, demanding final performance under the contract. Under the *Canal Breaches Litigation* court's reasoning, the buyer would be obligated to perform, because the term "fire," which was not defined, could encompass either natural or man-made causes and is therefore rendered ambiguous and construed against the drafter to cover only man-made fires. Following the *Canal Breaches Litigation* court's reasoning, a failure to define a contractual term that potentially could result from multiple causes or which could yield multiple outcomes will always create a potential for ambiguity because one could always argue that the term includes or excludes a particular result or outcome.

Another potential effect of the *Canal Breaches Litigation* court's ruling is that it may jeopardize many of the very lawsuits that comprise the consolidated *Canal Breaches Litigation*. Specifically, to the extent that Louisiana in fact recognizes a causal distinction between events that occur naturally and events that result from negligence, the acts of the Louisiana legislature extending the prescriptive period for insurance claims involving losses from Hurricanes Katrina and Rita may likewise apply only to those losses resulting from natural causes. *Property Owners Rush To Sue Insurers*, *supra* note 12 (stating that the Louisiana Supreme Court upheld the recent law extending the deadline for property owners to sue their insurers over Katrina-related damage issues). This is because, like the flood exclusions analyzed in the *Canal Breaches Litigation*, the prescriptive extension applies only to claims caused by Hurricanes Katrina and Rita—both natural events. *See id.* Claims arising from negligence, such as those allegedly at issue in the court's decision, may be time-barred.

Through specially selected language, insurer and industry alike look to reduce transaction costs by achieving uniformity of judicial interpretation and minimizing uncertainty.[95] "[U]ncertainty in turn increases the costs for parties engaging in these transactions and may discourage certain of these transactions altogether."[96]

The net result of increased unpredictability is that contracting parties must anticipate that a court may construe any undefined term in a contract (whether insurance or otherwise) against the drafter. Likewise, the parties must anticipate that they will suffer the costs of additional litigation because previously clear and unambiguous contract terms may suddenly be rendered ambiguous.[97] Because of this, a buyer will likely offer less for a product because she must account for the possibility that she may bear ultimate responsibility for some risk that she never before had to consider. Sellers, too, will likely charge more for the same reason. In either case, the transaction cost attributable to the contract itself—the difference between the value of the goods with and without a contract—is significantly increased, while the intrinsic value of the written contract is inversely lessened.

In other words, the cost of doing business will increase because businesses no longer will be certain that their contracts mean what they say. While some amount of uncertainty has always existed in contracting, prior to the *Canal Breaches Litigation* decision, parties at least could be reasonably assured that if they expressed something in clear and unequivocal terms, a court would enforce that expression. Through that expression, they could mitigate their risk and thereby lower their transaction costs. But, given the uncertainty created by the *Canal Breaches Litigation* court's decision about what is clear and

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95. Steven G. Bradbury, *Original Intent, Revisionism, and the Meaning of CGL Policies*, 1 ENVTL. CLAIMS J. 279, 280 (1989) (analyzing the relevance of the standard-form Comprehensive General Liability policies' drafting history).

96. Steven L. Schwarcz, *Intermediary Risk in a Global Economy*, 50 DUKE L.J. 1541, 1545 (2001) (discussing the role of intermediaries between investors and companies in reducing risk); *see* John A. Sebert, Jr., *Rejection, Revocation, and Cure Under Article 2 of the Uniform Commercial Code: Some Modest Proposals*, 84 NW. U. L. REV. 375, 418 (1990) ("Certainty is one of the significant considerations here, for uncertainty tends to increase these transaction costs. . . . [A] remedial scheme that enhances predictability and certainty ought generally be preferred.").

97. The Eastern District of Louisiana is itself a prime example of this inconsistency, where ten years ago it found a virtually identical flood exclusion to be unambiguous. *See* Travelers Indem. Co. v. Powell Ins. Co., Civil Action No. 95-4188, 1996 WL 578030, at *2-3 (E.D. La. Oct. 4, 1996) (holding that a property policy's flood exclusion (and incorporated term "flood") was unambiguous and barring coverage for damage sustained following heavy rains and without regard for the cause of the flood).

unequivocal, contracting parties are no longer free to rely on that contracting mechanism as a means of mitigating risk. Instead, the mechanism could now be seen to increase risk. Such a result will, over time, affect every business that utilizes any form of contract and potentially greatly increase the cost of goods and services in Louisiana and elsewhere as contracting parties increase their prices to guard against the increased likelihood that their contract will be rewritten by a court.

2. Effect on the Insured

Some insureds may reap a windfall through the sudden receipt of unanticipated insurance proceeds. On the other hand, others will realize that they have been wasting money on flood insurance, because—under the court's ruling—the NFIP is merely duplicative of coverage afforded under ordinary property insurance. Assuming that other insurance principles apply, and that those who subscribed to the NFIP cannot recover twice for the same loss, the only persons who will actually benefit from the court's decision will be those who deliberately or inadvertently failed to buy flood insurance. Conversely, those who acted prudently and actually purchased flood insurance coverage through the NFIP will receive no windfall, nor will they receive a premium refund for premiums paid unnecessarily for coverage they already had. What they will receive, however, may be the largest fee increase in the history of the insurance industry.[98]

Indeed, the trickle-down effect of the ruling is already in progress, as evidenced by the fact that the Louisiana Citizens Property Insurance Corporation (CPIC), which has the statutory authority to reassess premiums across all of its policyholders, could be considering such a statewide reassessment to recoup all or part of the additional payments it would be obligated to make if the *Canal Breaches Litigation* ruling were to stand.[99] All insureds, therefore, regardless of their location and likelihood of exposure, could bear the cost of replacing property of those who choose to build in high-risk areas, even when the insurance contracts contain flood exclusions. This will effectively mean that insureds in low-risk areas will bear the burden of

98. *See* Pappas, *supra* note 7, at 33.

99. *See* LA. DEP'T OF INS., DIRECTIVE 191: NOTICE TO ALL LOUISIANA CITIZENS PROPERTY INSURANCE CORPORATION ASSESSABLE INSURERS 1 (2005), *available at* http://www.lacitizens.com/pdf/Directive%20191.pdf (discussing emergency assessments levied in late 2005 as a result of Hurricane Katrina).

paying for damage sustained by those in high-risk areas and those who chose to retain the risk of flood loss by deciding not to participate in the NFIP.

Also, until changes in contracts can be affected, individual insureds will be further burdened by higher premiums necessary to offset increased flood damage payouts.[100] Whether the policyholder wants the coverage or not (or has already paid to receive it from the NFIP), and whether the insurer wants or intends to provide it, the policyholder will have no choice but to pay for it. These and other premium increases could be felt by policyholders outside of Louisiana if multistate insurers raise premiums in low-risk states to offset the additional risk created by the *Canal Breaches Litigation* court.

3. Effect on the Insurance Industry

The *Canal Breaches Litigation* court's decision negating the plain meaning of the flood exclusion could also have a devastating impact on the insurance industry. For instance, estimates show that inclusion of flood-damage coverage in contracts that were clearly intended to exclude such coverage could result in billions of dollars in additional unanticipated exposure and for which premiums were never collected.[101] This fiscal impact will not only be felt by the Louisiana insurers involved, but by the financial markets to the extent that the companies are publicly traded. Add to this the anticipated cost of litigating the associated "other insurance"[102] and reinsurance implications, as well as significant additional short-term costs, and the result is a significantly increased cost of providing insurance, which may ultimately be passed on to policyholders.[103]

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100. *See id.*; Larisa Epatko, *Hurricane Katrina Poses Unique Challenge to Insurance Industry*, ONLINE NEWSHOUR, Sept. 9, 2005, http://www.pbs.org/newshour/bb/weather/july-dec05/Katrina/insurance_background.html.

101. *See* Malcolm Maclachlan, *Katrina Decision Could Affect Earthquake Insurance in California*, CAPITOL WEEKLY, Dec. 7, 2006, *available at* http://www.capitolweekly.net/news/article.html?article_id=1159; Joseph B. Treaster, *Judge Upholds Policyholders' Katrina Flood Claims*, N.Y. TIMES, Nov. 29, 2006, at C2.

102. "Other insurance" clauses are intended to allocate risk upon multiple lines of applicable insurance. *See* J. Price Collins & Ashley E. Frizzell, *Insurance Law*, 59 SMU L. REV. 1379, 1386 (2006) (discussing the effects of comprehensive general liability insurance policies). The question of how and to what extent the other insurance provisions within the affected contracts may apply to coverage afforded by the NFIP is a novel one that may require significant and expensive litigation to resolve.

103. Alternatively, insurers may choose to simply remove themselves from the Louisiana market. *See* Rebecca Mowbray, *Blanco Traveling To Woo Insurers to La.*, TIMES-PICAYUNE (New Orleans), Jan. 29, 2007, at A1. This would not only drive up the cost of

The *Canal Breaches Litigation* court's decision is likely to have long-term impacts for insureds and insurers alike.[104] The court's decision means that there is now significant additional risk inherent in all present and future insurance contracts because the ruling opens to interpretation any broad or undefined term in an insurance contract. Because of the risk that any term in a contract could be subject to a finding of ambiguity, no matter how time-tested or clear the language may be, insurers will be forced to increase substantially the cost of their product to compensate for the possibility that the next interpretation of their contract may be contrary to the contract's plain meaning and the parties' expressed written intent.

Furthermore, the *Canal Breaches Litigation* court's decision invites policyholders to forego additional or specialty lines of coverage, save the premium dollars, and simply argue in the event that a loss occurs that whatever loss they sustain is within the scope of their basic coverage. This too will lead to an increase in litigation costs which, in turn, will lead to further increases in premiums, and so on.[105]

Costs may also increase for underwriting. Investigating the likelihood of flood and other types of loss before issuing coverage will require time and money. Furthermore, manuscript forms may be needed due to subtle characteristics that previously would have gone undetected, but which now render some properties substantially greater risks than others. Even then, however, underwriters still will have to find ways to account for the additional risks that they can no longer uniformly exclude. Claims handling is also likely to increase in time and expense with the need to parse the proximate cause of a given loss to see if it may affect coverage that had previously been written with the intent to encompass all causes.

The composite effect of the *Canal Breaches Litigation* court's decision on insurers currently is unknown. What is known, though, is that even state insurers of last resort, such as CPIC, are facing dire

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insurance due to lack of market capacity, but it would also result in a shortage of insurance for those risks that insurers are actually willing to cover. *See* Pappas, *supra* note 7, at 33.

104. For instance, while the *Canal Breaches Litigation* court's decision cut against the insurers in that litigation as the drafters of the policy language at issue, what would be the outcome in a case involving policies manuscripted by representatives of the insured?

105. *See* Ted Griggs, *Judge: Insurers Liable for Water*, LA. AGENT (Indep. Ins. Agents & Brokers of La., Baton Rouge, La.), Nov. 2006, at 9, *available at* http://la.iiaa.org/Newsletter/2006/November_2006.pdf (referencing statements by Robert Hartwig, Executive Vice President and Chief Economist of the Insurance Information Institute, explaining how judicial rewriting of insurance policies will have a chilling effect on private insurers and increase the cost for all Louisiana residents).

consequences.[106] Indeed, in late 2005, the CPIC levied a special assessment against participants in its Coastal and FAIR Plans as a result of losses from Hurricane Katrina.[107] That levy, however, did not include the costs of paying for unanticipated flood damage and, as a result, an additional levy is likely in response to the *Canal Breaches Litigation* court's ruling.[108] Furthermore, the Louisiana Insurance Rating Commission recently refused to approve rate increases for the CPIC.[109] Meanwhile, Louisiana legislators agreed to take $56 million from a state emergency fund to reimburse policyholders who had previously been assessed to pay for CPIC losses.[110] As a consequence, policyholders could see a twenty percent homeowners' premium surcharge this year, a combination of insurers' passed-on assessments for the debt and the cost of issuing bonds to pay for additional Hurricane Katrina claims and to boost its reserves.[111] "Surcharges for the bond issue, which would be on top of any regular premium increases, would continue for as long as it takes to pay off the $850 million in bonds."[112]

The alternative to raising premiums and levying assessments—contracting around potential ambiguities—is simply untenable. Overspecification in the contract is likely to lead to even narrower readings and could create its own host of ambiguities. Likewise, no contracting party, insurers included, can predict every eventuality that a court might foresee as a possible interpretation of a term in a contract. Use of broad language in the contract, whether to grant or deny coverage, allows the insurer to mitigate these eventualities, particularly in situations where an insurer *intends* to exclude all causes related to a broad term.

## III. CONCLUSION

As discussed above, there is nothing that is supposed to be stronger and more definite than the written word, and it has long been recognized that the pen is mightier than the sword. Based on these concepts, it has been axiomatic that a clear expression of words is the

106. LA. DEP'T OF INS., *supra* note 99, at 1.
107. *Id.*
108. *See id.*
109. INS. INFO. INST., RESIDUAL MARKETS (Mar. 2007), http://www.iii.org/media/hottopics/insurance/residual/.
110. *Id.*
111. *Id.*
112. *Id.*

most efficient and consistent means of memorializing an agreement between two parties. The *Canal Breaches Litigation* court's decision belies this fundamental principle of contracting.

Above all, the written contract has allowed contracting parties to know, well after the date of their agreement, precisely what they agreed to do. It has ensured that any later debate would be premised not on the parties' faded recollections, but on the contemporaneous memorialization of the deal they originally struck. The *Canal Breaches Litigation* court's decision shifts this fundamental and sets the stage for a business environment in which the value of the written word is diminished significantly and where parties will routinely second guess the meaning of their written agreements out of fear that courts may construe their words in ways they had not envisioned at the time of contracting. While the *Canal Breaches Litigation* decision will not alter what many consider the general landscape of life, if left to stand it will alter commerce as we know it today, making life more expensive, less efficient, and considerably less predictable.