North Dakota Law Review

Volume 74 | Number 1 Article 2

1998

Flood Insurance Is Not All Created Equal

Craig M. Collins

FLOOD INSURANCE IS NOT ALL CREATED EQUAL

CRAIG M. COLLINS

Some residents of areas affected by floods will be fortunate enough to have flood insurance—either because they were forced to buy it to get financing, or because life had taught them that floods are a recurring phenomenon. If their claims are not paid in full, however, these insureds may learn that litigation arising from a flood insurance policy differs from lawsuits over ordinary insurance. Also, not all flood insurance policies are created equal.

I. FEDERAL INSURANCE POLICIES

Most flood insurance is issued under the National Flood Insurance Act, which was adopted in 1968 because private insurers had stopped covering floods except at exorbitant premiums. Now, flood insurance can be issued either by the Federal Emergency Management Agency (FEMA) or by a private insurer, but in either case, it is governed by federal law, whereas other types of homeowner's insurance are governed by state law. Private insurers that have authority to issue federal flood insurance are known as Write Your Own (WYO) insurers.[1] Policies issued by WYO insurers are fully reinsured by FEMA.

The premiums and language are substantively identical in both FEMA and WYO federal flood policies. In fact, the language of the standard policy is dictated by the Code of Federal Regulations.[2] No provision of the policy may be altered, varied, or waived other than by an endorsement approved by FEMA.[3] Still, homeowners who have the stamina to withstand the onslaught of procedural requirements can sometimes fare better with one of the standard policies issued by a WYO insurer than with a policy issued directly by FEMA.

II. FEDERAL FLOOD POLICIES

Damages from flood and mudflow usually are not covered by standard homeowner's insurance policies.[4] Therefore, people affected by these disasters will look to their flood insurance policies, which

1. 44 C.F.R. § 62(c) & App. B (1997).
2. 44 C.F.R. § 59.
3. 44 C.F.R. § 61.13(d).
4. This is subject to an important exception, however, when a mudflow (which is not covered) is predominantly caused by fire (which is covered). *See, e.g.*, Howell v. State Farm Fire & Cas. Co., 267 Cal. Rptr. 708, 717 (1990).

substantively cover flood and mudflow losses. Yet technical traps in the law of flood insurance can leave unwary homeowners with less coverage than they expected—or no coverage at all.

Lawsuits under federal flood policies—whether issued by FEMA or WYO insurers—are different from other insurance litigation because federal law governs[5] and because the lawsuits must be filed in federal court,[6] whereas litigation over other homeowner's insurance is typically filed in state courts. A number of problems confront the plaintiff-insured when federal law governs. Generally speaking, federal law is not as generous as state law in making allowances for the average policyholder's lack of sophistication and bargaining power in dealing with insurers, and his or her lack of savvy about insurance law issues. Federal law holds insureds to a standard of strict compliance with the policy terms. State law generally is not so strict.

This difference can be seen in the way courts have dealt with the standard requirement that a policyholder must file a proof of flood loss within sixty days after the loss in order to make a claim.[7] The two problems that generally arise with proofs of loss are that the policyholder either misses the deadline or understates the damages.[8]

While other types of homeowner's policies require a proof of loss, some courts have held that it would be unfair to strictly enforce this requirement: state courts have applied the "notice-prejudice rule," which holds that even a policyholder who gives late notice has sufficiently fulfilled its obligation, unless the insurer suffered some form of prejudice because the notice was late.[9] But federal courts generally have been stricter in enforcing the sixty-day limit.

An issue arises about whether these rules of "strict compliance" with policy terms apply to flood insurance that is issued by WYO insurers. A recent case from the Ninth Circuit, involving a different type of federal insurance program, suggests by analogy that the same pro-insurer rules would apply to owners of WYO flood policies as to other types of homeowner's insurance.[10]

---

5. Brazil v. Giuffrida, 763 F.2d 1072, 1075 (9th Cir. 1985) (citing West v. Harris, 573 F.2d 873, 881 (5th Cir. 1978)).

6. 42 U.S.C. § 4053 (1994).

7. *See, e.g.*, 44 C.F.R. § 61, App. A(1), art. 9 (1997).

8. *See, e.g.*, Phelps v. Federal Emergency Management Agency, 785 F.2d 13, 18-19 (1st Cir. 1986) (holding that failure to provide a written proof of loss, absent a waiver by FEMA, prevents recovery); West Augusta Development Corp. v. Guiffrida, 717 F.2d 139, 141 (4th Cir. 1983) (allowing FEMA to deny coverage under flood policy for insured's failure to file timely proof of loss); Bullard v. Connor, 716 F. Supp. 1081, 1086 (N.D. Ill. 1989) (stating that FEMA had not waived the flood policy requirement that the insured sign proof of loss form within 60 days after damage occurred).

9. *See, e.g.*, CALIFORNIA INSURANCE LAW & PRACTICE, § 12.06 at 12-20 (Matthew Bender 1993).

10. *See* Seattle Fur Exchange v. Foreign Credit Ins. Ass'n, 7 F.3d 158 (9th Cir. 1983).

In *Seattle Fur Exchange v. Foreign Credit Insurance Association*,[11] a fur exporter purchased insurance against defaults by foreign buyers from a consortium of private insurers known as the Foreign Credit Insurance Association (FCIA).[12] The policy was fully reinsured by a federal agency known as Eximbank.[13]

The fur exporter made a claim and FCIA denied it, saying that because of some procedural defects in the claim, the exporter had not strictly complied with the terms of the policy and thus had failed to invoke coverage.[14] The fur exporter argued that FCIA, a consortium of private entities, did not enjoy the right reserved to the government to insist on "strict compliance" with the terms of the policy.[15] Rather, the traditional rules of equitable estoppel (which would have required FCIA to show some prejudice from the procedural defects) applied.[16] The issue was whether the court would apply the pro-insured rules of interpretation typically used in private insurance cases or those of "strict compliance" normally used in cases against the government.[17]

Distinguishing a number of federal decisions endorsing the fur exporter's position, the court found one fact crucial: that even though the policy was issued by private insurers, Eximbank was the reinsurer.[18] This created a "direct contractual link" between the insured and the government, and thus the rules of strict compliance prevailed.[19] Summary judgment was affirmed in favor of FCIA.[20]

The standard flood insurance policy also states that it is fully reinsured by FEMA. Thus, even a WYO insurer might have the right to insist on "strict compliance" with the terms of the policy. A homeowner who fails to file any proof of loss within sixty days probably will be out of luck.

III. PROOF OF LOSS

The law is less clear, however, when the homeowner gives timely notice but understates the amount of damages. As a way of defeating

11. 7 F.3d 158, 159 (9th Cir. 1993).
12. Seattle Fur Exch. v. Foreign Credit Ins. Ass'n, 7 F.3d 158, 159 (9th Cir. 1993).
13. *Id.*
14. *Id.* at 159-60.
15. *Id.* at 161.
16. *Id.* at 162.
17. *Id.* at 161-62.
18. *Id.* at 161-63.
19. *Id.* at 163.
20. *Id.*

claims for more than the amount stated in the initial proof of loss, FEMA has concocted an argument which, like that in *Seattle Fur Exchange*, would not arise with other types of private insurance. This argument depends on an ambiguity in the statute that created the flood insurance program.

FEMA argues that the federal district court, by statute, only has jurisdiction to hear a lawsuit after a claim has been disallowed.[21] Thus, if the homeowner did not claim the full amount of his or her damages in the proof of loss, regardless of the frequent difficulty of determining this in the allotted sixty days, then the portion of the policy benefits not timely claimed could not have been "disallowed."[22] Since FEMA cannot disallow a claim that has not been made, the federal district court in this situation does not have jurisdiction to hear the homeowner's case.[23]

At least one court has rejected this argument, holding that a defective flood insurance proof of loss does not necessarily deprive the court of jurisdiction to hear a case.[24] Another federal court has shown some leniency in dealing with the issue, holding that a policyholder who submits a timely proof of loss will be allowed to later seek a larger dollar amount of benefits than was claimed in the proof of loss—unless the flood insurer can show that the policyholder should be estopped from doing so.[25]

In *Criger v. Becton*,[26] a flood insurance policyholder signed a claim seeking $3,721.06.[27] FEMA argued that Criger could not recover any more than this amount at trial.[28] The court ruled that this was essentially an equitable estoppel claim by FEMA.[29] FEMA had the burden to prove the elements of estoppel.[30]

---

21. 42 U.S.C. § 4072 (1994).
22. *Id.*
23. *Id.*
24. Reeves v. Giuffrida, 756 F.2d 1141, 1142 (5th Cir. 1985).
25. *See* Criger v. Becton, 702 F. Supp. 761 (E.D. Mo. 1988).
26. 702 F. Supp. 761 (E.D. Mo. 1988).
27. Criger v. Becton, 702 F. Supp. 761, 765 (E.D. Mo. 1988), *reversed on unrelated grounds*, 902 F.2d 1348 (8th Cir. 1990).
28. *Id.*
29. *Id.* at 765-66.
30. The court stated:

> In essence, defendant argues that plaintiff is equitably estopped from asserting that his claim exceeds $3,721.06. To establish estoppel, defendant must demonstrate the following:
> (1) The party to be estopped knew the facts;
> (2) The party to be estopped intended that his conduct be relied upon, or acted in a manner to justify such reliance;
> (3) The party asserting estoppel was ignorant of the facts; and
> (4) The party asserting estoppel reasonably relied on the other's conduct and was substantially injured as a result. Bell v. O'Leary, 577 F. Supp. 1361, 1365 (E.D.Mo. 1983), aff'd, 744 F.2d 1370 (8th Cir. 1984). The evidence fails to demonstrate that

The homeowner in *Criger* was fortunate that the court framed the issue as one involving the application of estoppel to the homeowner, rather than as one requiring the homeowner to prove FEMA was estopped to assert the understated proof of loss. Estoppel is difficult to prove against the government.

The law of estoppel against the federal government is complex. While some cases have protected the insured's right to assert estoppel, holding that estoppel can be asserted even against the United States where justice and fair play require it,[31] (a court has held, for example, that partial payments by FEMA support an insured's claim that FEMA should not later be allowed to raise defects in the proof of loss),[32] many cases make it very difficult for plaintiffs to assert estoppel against the federal government. In *Wagner v. Federal Emergency Management Agency*,[33] the Ninth Circuit held that a party seeking to raise estoppel against the government must establish affirmative misconduct going beyond mere negligence.[34] Even then, estoppel will only apply where the government's wrongful conduct will cause a serious injustice and the public's interest will not suffer.[35] In *Office of Personnel Management v. Richmond*, the Supreme Court said that litigants may not use the doctrine of estoppel offensively to support "a claim for payment of money from the Public Treasury contrary to a statutory appropriation."[36]

Estoppel, of course, will always depend on the facts of any particular case, but counsel should be aware of the type of problems that can arise when the federal government is behind the insurance.

IV. PRIVILEGED LITIGANT

The common theme to the problems for insureds under flood insurance policies issued (or reinsured) by the federal government relates to the federal government's status as a privileged litigant in its own courts. The doctrines of estoppel, waiver, and immunity can cause problems for a plaintiff suing the federal government that do not exist in cases against private insurers in state courts.

> the government relied upon the claim form to its detriment. Defendant never paid plaintiff the $3,721.06, and thus, suffered no injury. Prejudice in some tangible form is an essential element of an equitable estopped claim. Old Republic Ins. Co. v. United States, 645 F. Supp. 943, 947 (Ct. Int'l. Trade 1986).

Id.

31. Bolton v. Giuffrida, 569 F. Supp. 30, 33 (N.D. Cal. 1983) (imposing estoppel against FEMA to raise defects in a flood insurance proof of loss).

32. Meister Bros. Inc. v. Macy, 674 F.2d 1174, 1177 (7th Cir. 1982).

33. 847 F.2d 515 (9th Cir. 1988).

34. Wagner v. Federal Emergency Management Agency, 847 F.2d 515, 519 (9th Cir. 1988).

35. *Id.*

36. Office of Personnel Management v. Richmon, 496 U.S. 414, 424 (1990).

Another problem is the paucity of federal insurance decisions. Most insurance disputes are fought in state courts. Consequently, a richer body of citable authority exists in the state courts. Perhaps realizing this, federal courts have developed a rule that if no statutory or decisional federal law exists, the courts may draw upon "standard insurance law principles."[37]

The Court in *Brazil v. Giuffrida* said:

> In creating the [Flood Insurance] Program, Congress did not intend to abrogate standard insurance law principles. Thus, we hold that federal law controls the interpretation of the policy in issue, recognizing that neither the statutory nor decisional law of any particular state is controlling, but that we shall apply the traditional common-law technique of decision by drawing upon standard insurance law principles.[38]

Another way for a lawyer to invoke state law is to assert that the suit pertains to the handling of the claim. One court has held that even though federal law governs the interpretation of the flood insurance policy, state law provides the rule of decision in cases involving claims handling.[39] With respect to claims handling, state law requires only that insureds give a proof of loss based on the best evidence available to them at the time. Only willful misstatements in the proof of loss will permit the insurer to avoid liability under the policy.[40] Recognizing that insureds can hardly be expected to know as much about the law of insurance coverage as insurance companies, state law imposes on insurance companies a duty to properly investigate insurance claims to determine if the insurance company might owe more than the insured realizes.[41]

V. PUNITIVE DAMAGES

Most of the problems discussed apply to flood insurance policies whether issued by FEMA or WYO insurers. Some additional problems arise in litigation under flood policies issued by FEMA that do not apply

37. Dixie Warehouse v. Federal Emergency Management Agency, 547 F. Supp. 81, 83 (M.D.N.C. 1982).

38. Brazil v. Giuffrida, 763 F.2d 1072, 1075 (9th Cir. 1985) (citing West v. Harris, 573 F.2d 873 (5th Cir. 1978) (citations and quotations omitted)).

39. Zumbrun v. United Servs. Auto. Ass'n, 719 F. Supp. 890, 894 (E.D. Cal. 1989); *Giuffrida*, 763 F.2d at 1075.

40. *See, e.g.*, CALIFORNIA INSURANCE LAW & PRACTICE, § 12.06 at 12-20 (Matthew Bender 1993).

41. *See, e.g.*, McLaughlin v. Connecticut Gen. Life Ins. Co., 565 F. Supp. 434, 451 (N.D. Cal. 1983).

to policies issued by WYO insurers. For example, a significant disadvantage to suing FEMA, as opposed to a WYO insurer, is that punitive damages probably are not available.

The United States Code provides: "*The United States . . . shall not be liable . . . for punitive damages*."[42] No reported cases apply this rule to FEMA, but other cases have applied it to federal agencies such as the Small Business Administration[43] and the United States Postal Service.[44]

Private insurers, of course, are liable for punitive damages. This leads to the result that a homeowner can seek punitive damages for misconduct against a WYO but probably not against FEMA—even when both entities have issued identical flood insurance policies and may have committed the same egregious acts. FEMA is liable for breaching the implied covenant of good faith and fair dealing, but this requires the homeowner-plaintiff to comply with the Federal Tort Claims Act.[45]

In *Latz v. Gallagher*,[46] the claimants filed an insurance claim to be reimbursed for the cost of moving their home due to an erosion problem; FEMA denied it.[47] The claimants then sued FEMA for breach of contract and for tort damages of intentional infliction of emotional distress and intentional or negligent misrepresentation.[48] The court held that filing an insurance claim did not permit the claimants to sue for the tort damages, too.[49] The claimants had not complied with the requirements of filing an administrative claim first.[50] The court held that the insurance claim did not give adequate notice of the tort claims.[51] The claimants had not given the agency written notice of the claim sufficient to enable the agency to investigate and had not placed a value on the claim.[52] The court held that "there are certain jurisdictional prerequisites with which the plaintiffs must without exception comply."[53]

---

42. 28 U.S.C. § 2674 (1993).

43. Small Bus. Admin. v. Rinehart, 887 F.2d 165 (8th Cir. 1989). The Small Business Administration violated a provision of the Bankruptcy Code. *Id.* at 166. A trial court awarded punitive damages to the plaintiffs. *Id.* The Eighth Circuit overturned the award for punitive damages, ruling "[w]e reverse the court's award of punitive damages as barred by the government's sovereign immunity." *Id.* at 170.

44. Hassan v. United States Postal Serv., 842 F.2d 260 (11th Cir. 1988). A postal truck struck the plaintiff's vehicle. *Id.* at 261. The court held that the trial court should "assess damages under the Federal Torts Claims Act pursuant to the law of the state of injury—except to the extent that the state permits punitive damages." *Id.* at 262 n.3.

45. *See* 28 U.S.C. §§ 2671-2680.

46. 562 F. Supp. 690 (W.D. Mich. 1983).

47. Latz v. Gallagher, 562 F. Supp. 690, 691 (W.D. Mich. 1983).

48. *Id.*

49. *Id.* at 693.

50. *See id.* at 692-93.

51. *Id.* at 693.

52. *Id.* at 692.

53. *Id.*

The Federal Tort Claims Act imposes additional procedural requirements on the homeowner-plaintiff and short deadlines which, if missed, can defeat legitimate claims.[54] Also, in litigation against FEMA, the homeowner-plaintiff may not have a right to insist upon a jury trial.[55] The plaintiff probably can recover attorneys' fees under the Equal Access to Justice Act.[56] Another quirk arises from a decision that held the homeowner-plaintiff may not be able to sue FEMA in federal district court for breach of the insurance contract. One federal district court said that breach of contract suits must be brought in (what is now known as) the United States Court of Federal Claims.[57] The court struck the cause of action for breach of contract.[58]

This ruling might seem to contradict the statutory requirement that lawsuits pertaining to flood insurance policies must be brought in federal district court. To avoid this contradiction, counsel can style the cause of action as one for "Claim for Breach of Insurance Policy Under Section 4053 (or Section 4072)."[59] Section 4053 permits suits against Write-Your-Own insurers (for example, private insurers who issue flood insurance).[60] Section 4072 permits suits against FEMA.[61] Technically, the plaintiff is not suing for breach of contract but rather making a claim specifically authorized by the National Flood Insurance Act.[62]

VI. WORTH PURSUING

Despite these procedural difficulties, insurance coverage for flood and landslide losses is worth pursuing because it can be significant, especially in light of the "constructive total loss" doctrine of insurance law. If a flood condition is repeating and continuing such that a house likely will be destroyed eventually, the house is a constructive total loss. When a constructive total loss of the property has occurred, some states allow a homeowner to recover the full cost of eliminating the flood hazard or replacing the lost dwelling (up to the limits of the insurance policy).

---

54. *See* 28 U.S.C. § 2401(b) (1990); *see also* Johnson v. United States, 85 F.3d 217, 219 (5th Cir. 1996) (setting out a two year statute of limitations for Federal Tort Claims Act claims).
55. 28 U.S.C. § 2402 (1995 & Supp. 1997).
56. 28 U.S.C. § 2412(b).
57. Latz v. Gallegher, 562 F. Supp. 690, 692 (W.D. Mich. 1983).
58. *Id.*
59. 42 U.S.C. § 4053.
60. *Id.*
61. *Id.* § 4072
62. *Id.* § 4001.

With respect to flood insurance, the authority is *Gibson v. HUD*.[63] The Gibson's owned a home covered by a flood insurance policy on the bank of a creek.[64] The creek flooded, creating for one week an island on which their home rested.[65] The "gut" between their home and the new bank of the creek remained after the water subsided.[66] This gut filled with water three to five times a year, subjecting their home to an increased risk of flood damage.[67] According to an agreed statement of facts, the cost to repair the home after the flooding was $10,390.[68] However, the cost to replace the house (including relocating the second story) at another, safer location was $29,932.03.[69]

The flood insurer took the position that it was only required to pay to repair the home in the danger zone.[70] The homeowners contended that they were entitled to the cost of relocating to safer ground.[71] The court agreed, rejecting the flood insurer's argument that it need only pay for repairs to the existing home.[72] The Gibson's recovered the full cost of securing replacement premises elsewhere.[73]

Standard state law insurance principles applicable to homeowner's insurance are in accord with the rule in *Gibson*.[74] Counsel representing homeowners with flood insurance claims must be aware of the need to conduct a sufficient hydrological or geo-technical investigation into the flooding or mudflow incident to know the full extent of the client's claim. Counsel must look not only to the cause of the flooding or mudflow (to determine if homeowner's insurance might cover part of the loss) but also the scope of the future flooding or mudflow (to determine if the client's losses are greater than simply the cost to repair the damage).

---

63. Gibson v. HUD, 479 F. Supp. 3 (M.D. Pa. 1978). The defendant in Gibson was the Secretary of the Department of Housing and Urban Development (HUD), who at that time administered the federal flood insurance program. *Id.* The duties of the Secretary have since been transferred to the Director of the Federal Emergency Management Agency. *See* Meister Bros. Inc. v. Macy, 674 F.2d 1174, 1175 n.1 (1982). From June 6, 1969 to Dec. 31, 1977, the program was administered by the National Flood Insurers Association, an unincorporated association of insurance carriers under a contract with the Department of Housing and Urban Development. *Id.* Effective Jan. 1, 1978, HUD took over administration of the program. *Id.* By executive order on April 1, 1979, FEMA assumed responsibility for administering the program. *Id.*

64. *Gibson*, 479 F. Supp. at 4.

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *See id.*

72. *Id.* at 6.

73. *Id.*

74. *See* Snapp v. State Farm Fire & Cas. Co., 24 Cal. Rptr. 44, 48 (Cal. Ct. App. 1962); Strickland v. Federal Ins. Co., 246 Cal. Rptr. 345 (Cal. Ct. App. 1988).

Flood insurance can offer much relief to devastated homeowners. Flood insurance policyholders who fail to complete the obstacle course of procedural requirements, however, should expect no pity from FEMA—nor from the federal courts.