TESTIMONY OF GERALD J. NIELSEN BEFORE THE SUBCOMMITTEE ON HOUSING AND COMMUNITY OPPORTUNITY CONCERNING THE NATIONAL FLOOD INSURANCE PROGRAM

Thank you for the opportunity to present information to the Committee concerning the opinions held by the undersigned as to how the National Flood Insurance Act could be improved, made less costly, and made even more of a success than it already is at present.

EXECUTIVE SUMMARY

The undersigned will address each of the four bullet points referenced in Congressman Bob Ney's letter extending the invitation to testify dated March 25, 2003. These four points are as follows:

- The effectiveness and value of the National Flood Insurance Program and FEMA's flood mitigation programs;
- The need to reauthorize the NFIP before the end of the year and what changes, if any, should be made to the program before it is reauthorized;
- The effect on your insurance industry clients as well as on flood insurance policyholders and the real estate market when there is a lapse in reauthorization of the NFIP;
- Your proposals for saving the National Flood Insurance Program money by decreasing its litigation costs.

As to the first point, the undersigned will offer his view of what are the two most important benefits of the NFIP, and also note what a few courts have said as to their understanding of what the Program is designed to achieve.

As to the second point, it is submitted that any reauthorization should include a second revision of the Program jurisdictional statute. This point is the primary focus of the undersigned's testimony. Just as occurred in 1983, several court cases have sparked an expensive and unintended battle over whether the

states have jurisdiction and regulatory control over the procedures and rules for how the United States Treasury is placed at risk by insurance agents and insurance companies involved in the issuance of NFIP policies. We currently have the states holding that the federal courts have sole jurisdiction over how the policies are sold, and federal courts holding that state courts have sole jurisdiction over this issue.

Third, the Program would most certainly operate more smoothly if it could be reauthorized for terms exceeding two years. The uncertainty of not knowing if the Program will actually be reauthorized, and whether the complicated systems that are needed to keep it operating must be turned off on short notice, is a problem that most likely could be avoided. The latest lapse, for instance, was a logistical and legal nightmare for the companies. The processing systems that handle policy administration simply could not be stopped in the timeframe allotted by the first notice that reauthorization was a problem.

The principal cost savings that Congress can provide in terms of Program litigation, is the revision of the jurisdictional statute. The benefits of that revision will be explained within this written testimony. Other significant savings could be achieved from the resolution of two other matters involving dealings between the carriers and FEMA. These other matters actually need to be dealt with within FEMA in the first instance, but also must be noted herein to at least alert the Congress to these issues. They are extremely serious from the perspective of the carriers, and are the cause of certain carriers considering leaving the NFIP.

BACKGROUND OF THE WITNESS

The undersigned has been practicing in the field of flood insurance litigation since 1988. Currently, virtually every major participant "Write-Your-Own Program" ("WYO")[1] insurance company in the NFIP utilizes Nielsen Law Firm, L.L.C. to handle its NFIP-related litigation on a national basis. If one were to run a Westlaw search of the undersigned's name and the word "flood," one would find that the majority of all Program caselaw being announced in the country over the last few years lists the undersigned as the attorney of record for the WYO carrier. Just recently, the undersigned won his *tenth* appellate decision in a row for the Program. In addition, the undersigned teaches the workings of the NFIP to adjusters, insurance agents, and insurance company personnel. He has also given seminars to the general adjusters of the NFIP Bureau and Statistical Agent, and taught the NFIP to newly hired agents of FEMA's Office of Inspector General.

Also, the undersigned is not exactly an "insurance defense" counsel. It is not that there is anything wrong with that designation; it is just that it does not fit. Essentially 100% of Nielsen Law Firm's workload has always involved governmental interest litigation. The firm's practice focuses upon the representation of municipal, state, and federal governmental systems and officials. The undersigned is General Counsel to the Louisiana Association of Chiefs of Police, and also practices extensively in the fields of civil rights and constitutional tort litigation. The firm's efforts to work with the WYO Program insurance carriers to build an effective body of caselaw to govern the operations of the NFIP on a nationwide basis is seen as a complementary adjunct to the firm's representation of various governmental interests of the State of Louisiana and its numerous municipalities and municipal officials.

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[1] 44 C.F.R. Pt. 62.23, *et seq*.

1. EFFECTIVENESS AND VALUE OF THE NFIP

The NFIP is believed by the undersigned to be one of the finest examples of a public-private partnership ever devised in this country. It functions exceptionally well. Its effectiveness and value are in two primary areas:

First, the premiums received through the Program allow the Government to defray a large portion of all costs attendant to flood disaster relief. It also allows the Government a mechanism through which it can change behaviors, specifically in the areas of construction and zoning, so as to mitigate future loss of life and property. By utilizing an insurance model to collect revenues specific to these issues, the particular citizens who are most likely to have need of flood disaster assistance, are the exact people who will purchase flood insurance so as to help build a pool of funds to help defer the costs of natural disasters.

Also, the Program's use of insurance companies and insurance agents in this regard results in significantly higher premium revenues to the Program. Prior to the decision made in 1983 to enlist the aid of the insurance companies in the Write-Your-Own Program, the policy count stood at less than 2 million policies. Currently, the policy count is in the neighborhood of 5 million policies. That is two and one-half times the premium revenue as a result of utilizing this country's insurance companies and insurance agents to make the Program a success.

The second critical benefit received by the Federal Government from the operation of the NFIP is this: After a flood disaster, the economy of a community devastated by a flood has literally been turned off. Every large business, as well as every "mom and pop" shop, ceases operation. The economic impact of the flood upon that community depends in large part on how quickly those businesses restart their operations. In other words, if it takes six months to infuse federal benefits back into a community that has

been affected by a flood, many small and large businesses will no longer be there, thus exacerbating the economic impact of the disaster.

The current operating system of the NFIP, which utilizes the expertise of insurance companies and various adjusting organizations, handles claims very rapidly. Huge amounts of federal dollars are infused into communities affected by flood disasters in a matter of 30 to 60 days, rather than a matter of 120 days or more as might occur in a normal grant process. Also, the money flows accurately and to the specific individuals who have been affected by the flooding.

A great example of the success of the Program is what happened in Houston after Tropical Storm Allison. Literally thousands of homes and businesses flooded in that storm. The event could have been an economic disaster for the City of Houston. However, given the rapidity within which the claims handling processes of the NFIP's insurance carriers responded, Allison is now but a blip on the economic radar of Houston's history. *But for* those quick and accurate claims handling systems of the NFIP's insurance carriers, the overall costs of revitalizing Houston after Tropical Storm Allison would no doubt have been far higher. It follows then that the overall costs to the Federal Government would have been far higher.

The NFIP has now been in existence for over 30 years. In that time, several judicial opinions have commented upon *why* the Congress implemented the Program, and *why* the Federal Government utilizes the services of private insurance companies to make it a success. As to the purpose of the Program, one court noted this:

> The principal purpose in enacting the Program was to reduce, by implementation of adequate land use controls and flood insurance, the massive burden on the federal fisc of the ever-increasing federal flood disaster assistance. *Till v. Unifirst Federal Savings & Loan Assoc*., 653 F.2d 152, 159 (5th Cir. 1981)

As to why FEMA utilizes private insurance companies, the U.S. Seventh Circuit Court of Appeals recently made this observation:

> [A]lthough private insurers issue the policies, FEMA underwrites the risk. The insurance companies handle administrative business for FEMA by selling policies and processing claims but do little else (unlike the Industry Program, where the private companies underwrite the risk). Arrangements like this make sense. FEMA likely is unsuited to tasks such as selling insurance and collecting fees, and even less adept at processing individual claims for flood damage. By purchasing the services of a more efficient claims processor, FEMA saves money. *Downey v. State Farm*, 266 F.3d 675, 679-80 (7th Cir. 2001)

2. THE NEED TO REAUTHORIZE THE NFIP, AND WHAT CHANGES SHOULD BE MADE

The justification for a reauthorization of the NFIP is best demonstrated by comparing the recovery of communities affected by flood disasters before the NFIP, to those that have suffered flood disasters after its adoption by the Congress. Communities for whom the NFIP was not there to jumpstart a recovery, took far longer to recover after a flood disaster. In addition, one may see the practical changes caused by the NFIP by visiting countless coastal communities to see how building practices have changed all along our country's seaboard. As a direct result of the NFIP, building practices have been altered so as to lessen the loss of both property and life due to flood disasters.

Before considering the proposed change to the Act to be submitted below, the Committee is asked to ponder that the current operating system of the NFIP is the Federal Government's third attempt to operate the Program. The first two efforts failed. From 1968 until 1978, the Program was operated by a pool of insurers. This first system failed, largely due to a lack of leadership. In 1978, the Government ended the insurers' involvement, and sought to operate the Program without industry assistance from 1978 until 1983. This second effort likewise failed, largely due to the fact that the Government lacked the

expertise possessed by the insurance industry.

In 1983, someone devised a simple yet brilliant plan - - marry the expertise of the insurance industry to the leadership that only meaningful Government control could provide. In other words, and using the best parts of the two prior systems, it was decided that the Government would act as the general, and the carriers would act as the army. For 20 years, that which FEMA implemented under the title "Write-Your-Own" Program,[2] and which FEMA has always called a "partnership," has succeeded beyond all expectations.

Over 93% of all policies are now written through the private insurers who have chosen to partner with FEMA to make the NFIP actually operate successfully. Note, that while there are far more than 100 property insurers in this country, and while approximately 100 of these have actually signed on to participate in the Program, the number of carriers that actually and meaningfully participate with large numbers of policies in force is down to about 15. Just 15 private companies shoulder almost all of the burden of actually making the Program work. Their expertise is of immense value to the Program.

A. The Problem

Currently, the carriers are becoming increasingly nervous over where the Program is heading. One of the main reasons for this is that the federal courts are having a very difficult time with NFIP jurisdictional issues. This confusion, which the Congress was able to ameliorate once before, is costing the Program a small fortune in terms of litigation bills, and in unnecessary settlements. The problem is growing, for now it is published fact, as a result of recent judicial decisions. The problem is this:

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[2] 44 C.F.R. Pt. 62.23, *et seq*.

Everyone seems to still agree that jurisdiction over claims for benefits upon a flood insurance policy must be filed in the federal courts. (There is very little agreement as to why this is true, just that it is.) However, if a plaintiff's counsel chooses to try to evade the Congress's command of "exclusive" federal court jurisdiction found at 42 U.S.C. §4072, by making claims that the reason the claim was not paid relates to how the policy was originally sold or issued, (a.k.a. through "artful pleadings") the courts are unsure of who has jurisdiction. Plainly, when the issue of jurisdiction is unclear, no one has any idea what rules and standards of care are applicable. Do FEMA's rules govern, or do the different rules of 50 different states govern? This leads to very expensive legal battles, and unnecessary settlements, all at Program expense.[3]

The courts of the states of California and Florida have both squarely held that regardless of what type of claim is made, that jurisdiction is restricted to the federal courts. *McCormick v. Travelers Ins. Co.*, 103 Cal. Rptr.2d 258 (Cal. App. 4th Cir. 2001); *Seibels Bruce Ins. Co. v. Deville Condominium Assoc.* 786 So.2d 616 (Fla. Dist. App. 1st Cir. 2001). Reaching exactly the opposite conclusion, are U.S. district court judges in Louisiana and in Pennsylvania. See *Powers v. Autin-Gettys-Cohen Ins. Agency, Inc.*, 2000 WL 1593401 (E.D. La. Oct. 24, 2000); and *Roxbury Condominium Assoc., Inc., v. Cupo* , 01-2294 DMC (D.N.J. 9/21/01). One federal judge sitting in South Carolina ruled one way upon this question in *Houck v. State Farm*, 194 F.Supp.2d 452 (D.S.C. 2002), and then the opposite way just 30 days later in *Southpointe Villas Homeowners Association v. Scottish Insurance Agency Inc.*, 213 F.Supp.2d 586 (D.S.C. 2002).

[3] All WYO carrier defense costs are borne by the Program. *Van Holt, infra*.

The NFIP, like all insurance operations, has two sides. One side concerns all rules and procedures for how the risk is accepted and what policies are issued. In the context of the NFIP, this regards all of the procedures pursuant to which the insurance agents and insurance companies place the U.S. Treasury at risk upon flood insurance policies. The other side concerns the claims after a flood. The procedures and rules here concern how the companies pay out money from the U.S. Treasury upon the risks previously accepted.

No one would argue that the Congress ever intended that the 50 different sets of state courts would have exclusive jurisdiction over how the U.S. Treasury was placed at risk in NFIP operations, while the courts of the Federal Government would have "exclusive" jurisdiction only over how that risk that the U.S. Government accepted as per the rulings of the 50 different state courts, would be paid upon. However, that is precisely where the Program is heading. In Louisiana and in Pennsylvania, the Program is there right now. See *Moore v. USAA*, ___ F.Supp.2d ___ (E.D. La. 2002) (2002 WL 31886719); and *Roxbury, supra*.

Only Congress can solve this problem. The Constitution provides that Congress sets the jurisdiction of the federal courts. As such, neither FEMA nor the carriers have any ability to solve this issue. Accordingly, and just as the Congress fixed an almost identical problem for the Program in 1983, it is asked to do so again now.

The current text of 42 U.S.C. §4072 is as follows:

> In the event the program is carried out as provided in section 4071 of this title, the Director shall be authorized to adjust and make payment of any claims for proved and approved losses covered by flood insurance, and upon the disallowance by the Director of any such claim, or upon the refusal of the claimant to accept the amount allowed upon any such claim, the claimant, within one year after the date of mailing of notice of

> disallowance or partial disallowance by the Director, may institute an action against the Director on such claim in the United States district court for the district in which the insured property or the major part thereof shall have been situated, and original exclusive jurisdiction is hereby conferred upon such court to hear and determine such action without regard to the amount in controversy.

Congress could close all avenues of attempting to evade its command that NFIP disputes be filed in the federal courts by revising the statute to read as follows:

42 U.S.C. §4072 (as proposed)

> Jurisdiction over any dispute arising out of participation, or attempted participation, in the National Flood Insurance Program shall be within the original exclusive jurisdiction of the United States district courts. Venue on all such actions shall be in the United States district court for the district in which the insured property or major part thereof shall have been situated. Any such action shall be filed within one year of the date of mailing of notice of disallowance or partial disallowance of a claim under a Standard Flood Insurance Policy, or if the dispute does not arise from a specific claim denial, one year from the date on which sufficient facts are known about the alleged harm such that reasonable inquiry would reveal the cause of action.[4]

Significant point: Revising this statute would not alter any available remedies for participants in the NFIP. In those few areas where state law remedies are indeed available, federal judges certainly have the power to adjudicate state claims along with federal claims. 28 U.S.C. §1367. Providing for uniformity of jurisdiction for all claims across the United States, such that one court system would provide a uniform rule of decision for the entire country for all Program issues, would do nothing other than make certain that whatever remedies are available in one state, mirror the remedies available in another state. Everyone

[4] The current 42 U.S.C. §4072 fails to set a time limit for all types of claims that could be made. The proposed language provides a rule of one year from discovery for any claim other than a direct claim for benefits under a policy. A longer period could be added if such would be deemed appropriate. The writer's only concern is that a discernable date be established, not with what that date ought to be.

would be assured the same "deal."[5]

B. Discussion

In 1978, the original U.S. Fifth Circuit Court of Appeals wrote the seminal NFIP decision of *West v. Harris*, 573 F.2d 873 (5th Cir.1978), *cert. denied*, 99 S.Ct. 1424 (1979). Despite its age, *West* remains the most-frequently cited judicial decision in the Program's history. In *West*, the court made two points that subsequent judges have reiterated time and time again. The first, is that the flood program is a "child of Congress." *Id*. at 881. The second, is that "uniformity of decision" all across the United States is very important if the Congress's objectives are to be achieved. *Id*. at 881. This is a point that the U.S. appellate courts continue to stress today. In *Flick v. Liberty Mut. Fire Ins. Co.*, 205 F.3d 386 (9th Cir. 2000), *cert. denied*, 121 S.Ct. 305 (2000), the court predicated its ruling upon a philosophy that, "There is a compelling interest in assuring uniformity of decision in cases involving the NFIP." *Id*. at 390.

While these points are not truly subject to debate, they are currently in need of additional consideration by both the Congress and by FIMA. It is the Congress of all of the states that created (and now underwrites) the Program. Under no circumstance should the citizens of one state be able to get a better "deal" under the Program, or be allowed to circumvent the National Government's rules through the laws or courts of their own state. If the laws and decisions of 50 different sets of state courts govern any aspect of Program operations, that aspect will not operate on a uniform national basis. Our ship will have

[5] Also, this would not materially impact the workload of the federal courts. Litigation involving the NFIP is a very small practice area.

a hole in it.

In 1983, at the same time the Government brought the insurance companies back into the NFIP, the Congress reexamined the Program's jurisdictional statutes, and, how the courts were interpreting those statutes at the time.[6] The legislative history of what the Congress did as to this issue in 1983, and why, was set forth in detail as follows in *Hairston v. Travelers Cas. & Surety Co.*, 232 F.3d 1348 (11th Cir 2000). In *Hairston*, the claimant wanted his flood insurance claim to be litigated in a Georgia state court, rather than in federal court. (The carriers constantly face claimants attempting the same thing.) In reviewing the issue, the U.S. Eleventh Circuit explained the following as constituting critical evidence in its review of what the Congress had actually intended:

> 2. An Unmistakable Implication From Legislative History
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> Although we need not address the legislative history in light of the explicit statutory directive and our holding that the "exclusive" language of the statute rebuts the presumption of concurrent jurisdiction, our review of the legislative history reinforces our holding. As originally enacted, §4072 did not contain the words "original exclusive" before jurisdiction. [FN4] This language was added by Congress in 1983. See Supplemental Appropriations Act, 1984; Domestic Housing and International Recovery and Financial Stability Act, Pub.L. 98-181, §451(d)(5), 97 Stat. 1229 (1983). In the accompanying legislative history, Congress made clear that the adoption of the language was purposeful:
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> In the case where the claimant refuses to accept the amount allowed oN the claim, the claimant may institute an action on the claim **against the company or other insurer** within one year after the mailing of the notice of disallowment or partial disallowment in the U.S. district court for the district in which the insured property is situated. Jurisdiction is conferred on the U.S. district court to hear and determine the action regardless of the amount in controversy. This section is amended to specify that the U.S. district court has original exclusive jurisdiction over this action.

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[6] It is unlikely that it is a mere coincidence that Congress agreed to fix the jurisdictional statute in 1983, that being the same year that the insurers agreed to return to the NFIP.

> See Joint Explanatory Statement of the Committee of Conference, reprinted in 1983 U.S.S.C.A.N. 1768, 1814 (emphasis added). The inclusion of the clear language restricting jurisdiction to the district court, without any qualifying statements, demonstrates Congress's intent to restrict jurisdiction.
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> The addition of the language in 1983 is especially convincing in light of the split that had developed in the federal courts about whether jurisdiction over actions brought pursuant to NFIP policies was confined to federal courts. Compare *Bains v. Hartford Fire Insurance Co.*, 440 F.Supp. 15 (N.D.Ga.1977) (holding that concurrent jurisdiction existed); *Burrell v. Turner Corp. of Oklahoma*, 431 F.Supp. 1018 (N.D.Okla.1977)(same) with *Schultz v. Director, Federal Emergency Management Agency*, 477 F.Supp. 118 (C.D.Ill.1979) (holding the same language in the jurisdictional statute for Part A of the NFIP restricted jurisdiction to the federal courts); *Siekmann v. Kirk Mortgage Co.*, 548 F.Supp. 50 (E.D.Pa.1982)(same). Thus it would appear that Congress was responding to the growing split and amended the statute in order to alleviate any further confusion. Because we conclude that both the language of the statute and the legislative history dictate the conclusion that the federal courts have exclusive jurisdiction, we decline to consider the third potential rebuttal factor, the compatibility of state-court jurisdiction and federal interest. (emphasis added) *Hairston*, 232 F.3d at 1351-52.

Since 1983, when the Congress last addressed this issue, two further problems have recently surfaced in the courts. These problems have developed as a result of incessant efforts by claimants to attempt to maneuver NFIP cases into the state courts. One problem is that there is no explicit reference to the insurance companies in the statute. As noted above in the *Hairston* decision, there is a reference to the companies in the legislative history. However, the reference is not actually to be found within the enacted statute. Another problem is that the word "claim" has gone unaltered within the statute since the year 1968.

In the U.S. Third, Fifth, Sixth, and Ninth Circuits Courts of Appeals, holdings exist clearly finding that 42 U.S.C. §4072 provides a rule of exclusive jurisdiction for "claims" raised against FEMA's private insurance company "Write-Your-Own Program" carriers, despite the fact that the carriers are not explicitly

named within the statute. These courts essentially read 42 U.S.C. §§4071(a)(1)[7] and 4072 in *para materia*. *Van Holt v. Liberty Mutual Fire Ins. Co.*, 163 F.3d 161 (3rd Cir. 1998); *Spence v. Omaha Indemnity Ins. Co.*, 996 F.2d 793 (5th Cir. 1993); *Gibson v. American Bankers*, 289 F.3d 943 (6th Cir. 2002); and *Flick, supra*.

The U.S. Seventh Circuit Court of Appeals, however, refused to hold that §4072 applies to the carriers, specifically because they are not expressly named in the statute. *Downey v. State Farm Fire & Cas. Ins. Co.*, 266 F. 3d 675, (7th Cir. 2001). In the U.S. Fourth Circuit, the situation is even less clear. In *Battle v. Seibels Bruce Insurance Company*, 288 F.3d 596 (4th Cir.2002), the U.S. Fourth Circuit looked at what had been done by the Third, Fifth, Sixth, and Ninth Circuits, and then looked at *Downey*. Finding only confusion, the U.S. Fourth Circuit decided to completely sidestep §4072, and to determine its jurisdictional foundation based upon general federal question jurisdiction. 28 U.S.C. §1331. Respectfully, when a U.S. court of appeals expressly avoids grappling with a congressionally-mandated jurisdictional statute directly on point, and specifically a statute that four other appellate courts had ruled was indeed directly on point, we have clear evidence of a problem. (The U.S. Fourth Circuit is not known for avoidance of issues involving debates over congressional intent.)

The second of the two problems that has surfaced since the 1983 congressional amendments to §4072 concerns how the courts are now interpreting the word "claim." The issue has only become important recently, because FEMA preempted all bad faith claims on the claims side of its operations

[7] This statute makes clear that the companies act as the "fiscal agent" of the United States. *Gowland, supra.*

approximately three years ago.[8] Currently, and specifically because plaintiffs' attorneys understand that normal bad faith claims raised in the context of NFIP claims handling issues are now barred and preempted, they are now looking for a new avenue of attack. That new avenue is to claim that the insurance agent said something untoward in the context of discussions during the sale of the policy. The vast majority of these claims are frivolous, and nothing beyond a tactical maneuver. (Three years ago, very few such claims were being filed.) As a direct response to FEMA's decision to preempt bad faith claims, insurance agents are now seeing a dramatic increase in frivolous and unwarranted claims being raised against them.[9]

Federal courts are trying to determine whether they have jurisdiction to consider these new tactics. The problem for them comes down to this:

Does the word "claim" as found in the current §4072 apply to just the claim for coverage under the flood policy? Alternatively, does it apply to that claim and also to the claims for how the claim against the policy was handled by the insurer? (the so-called "bad faith" claims) In the further alternative, does it apply to "claims" arising out of FEMA's procedures and rules for how policies are sold and issued before a loss has occurred? As to these various possibilities, there is no way to describe the current state of the caselaw as anything other than as a mess.

The states are of a view that all three types of claims are restricted to the federal courts. The view

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[8] For a discussion of this issue, please see *Scherz v. South Carolina Ins. Co.*, 112 F. Supp.2d 1000 (C.D.Cal. 2000); and *Neill v. State Farm Fire and Cas. Co.*, 159 F.Supp2d 770 (E.D. Pa. 2000).

[9] Plainly, the Congress is not being asked to weigh in on the merits of this debate. All that is sought is one court system for the review of all of these debates so as to have a level playing field, and a uniform body of law whichever way the issue pans out.

of both Florida and California (two states with a great interest in the success of the NFIP) is that it would be absurd to hold that Congress actually intended that fully one-half of all NFIP operations would be under state court jurisdiction, while the other half would be under federal court jurisdiction. As the California appellate court explained within its *McCormick* ruling:

> We see no basis for turning the jurisdictional question on a distinction between errors allegedly committed while explaining the scope of coverage to a new policyholder and errors allegedly committed in interpreting the amount of insurance proceeds to which the policyholder is entitled following a loss. The breadth of activities WYO insurers pursue in furtherance of the NFIP encompasses procuring policies, servicing the accounts, and processing claims. At all of these stages of the insured/insurer relationship, the workings of the NFIP are intimately involved. Moreover, treating some claims as exclusively within the jurisdiction of the federal courts and some within the concurrent subject matter jurisdiction of state courts invites the very balkanization of lawsuits FEMA forecasts with justifiable dread in its amicus brief.
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> Our own case illustrates the potential vice in treating misrepresentation claims jurisdictionally unique under the NFIA. In describing the interplay between the claims of misrepresentation and bad faith alleged in the first amended complaint, the McCormicks state in their opening brief: "These causes of action for misrepresentation are essentially alternative causes of action to the 'Bad Faith' cause. If coverage is ultimately held to be as interpreted by Travelers (e.g., that the Flood Policy does not cover damage from flood water *below* the standing water line inside the house), then the policy was misrepresented to the McCormicks at the time of purchase." (emphasis in original)
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> Therefore, were we to follow *Moore,* we would necessarily put our imprimatur on the McCormicks' strategy of allowing them to litigate in a federal forum their coverage dispute (which a state court unquestionably does not have jurisdiction to decide), while allowing their misrepresentation and related state claims to repose in state court awaiting the outcome of the federal action. Surely, this orphaning of the "child of Congress" to 50 state court jurisdictions was not the intention of Congress in establishing "a pervasive and comprehensive scheme of federal regulations setting forth the rights and responsibilities of insureds and insurers under the NFIP." (*West, supra,* 573 F.2d at p. 881; *Davis, supra,* 96 F.Supp.2d at p. 1002.)

> For all of these reasons we find the decision in *Moore* unpersuasive.[10] Instead, like the federal courts, which have squarely decided the issue, we conclude that the federal courts have exclusive jurisdiction over all of the claims asserted in the McCormicks' first amended complaint. This exclusive jurisdiction encompasses all claims regardless of whether they plead contract, tort, or state statutory remedies and damages, and regardless of whether the named defendant is the FEMA or a WYO insurer. *McCormick, supra*, at 419-420.

Also, every state insurance commissioner to have examined the issue agrees with the position of California and Florida. Attached are sworn affidavits of the insurance commissioners of Texas, Mississippi, South Carolina, and North Carolina. (Ex. A) Each affidavit attests that the insurance commissioner of that state is of a view that his state has no jurisdiction over any NFIP operations. No commissioners are known to be in disagreement.

Federal courts, being courts of limited jurisdiction (unlike state courts), and being wary of undertaking jurisdiction where the Congress has not provided for it, have signaled a very real problem here. Unlike the state courts of California and Florida, federal courts to have examined the issue apparently believe that it would be inappropriate for them to construe the word "claim" in §4072 as encompassing claims arising out of policy procurement matters.[11] As such, they are refusing to do so. Several examples of the resulting problems are as follows:

In South Carolina, and in two cases arising out of whether higher than necessary premiums had been charged for a NFIP policy, a single federal court judge ruled in one of the cases that federal jurisdiction was absent, but then ruled just 30 days later in the second case that jurisdiction was present.

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[10] Alaska, in a decision entitled *Moore v. Allstate*, 995 P.2d 231 (Alaska 2000), had disagreed. The *McCormick* decision from California explains where the earlier Alaska decision had fallen into error.

[11] Note, that the cases usually come to the federal courts pursuant to removal jurisdiction. In that setting, federal courts are all but required to construe the assertion of their jurisdiction narrowly.

Houck, supra, and *Southpointe, supra*, respectively.

The problem is likewise evidenced in the holdings of the U.S. Third Circuit Court of Appeals. There, it is settled law that §4072 applies to "claims" under policies, as well as to "claims" as to how the claim under the policy was handled. *Van Holt v. Liberty Mutual, supra*; and *Linder & Assoc. v. Aetna*, 166 F.3d 547, FN 3 (3rd Cir. 1999). However, to avoid these two holdings, a claimant need only avoid making these *types* of claims. This occurred in the matter now to be discussed.

In *Roxbury Condominium v. Selective,* the WYO carrier was sued upon allegations that the legal duties applicable to the sale of flood policies had been breached. While the claim was pleaded as being one of negligence under state law, it is noteworthy that all applicable duties and standards of care were those set by FIMA as a uniform rule for the whole country. Selective removed the case from state court to federal court. In response, a U.S. district court judge sitting in New Jersey remanded the case back to state court and also imposed attorneys fees upon Selective for having asserted that such a dispute could possibly come within the jurisdiction of the federal courts. In other words, FIMA's WYO carrier was sanctioned for having argued that the courts of the United States had jurisdiction over the procedures for how the United States Treasury was placed at risk in the context of the United States Congress's NFIP. This was indeed a surprising ruling. However, given that remand orders may not be appealed, Selective was limited to appealing only the award of attorneys fees. The U.S. Third Circuit reversed that award, noting upon its review of the underlying remand order that the insurer's jurisdictional argument was "colorable." *Roxbury Condo v. Selective, supra*.

Consider - - the current operating system for the NFIP has been up and running for 20 years, and

it is at this juncture still only arguable that a federal judge might have jurisdiction over fully one-half of Program operations.

To be sure, FEMA has adopted a plethora of rules and procedures and guidelines on both sides of NFIP operations, that being both the sale of the policies, as well as the procedures for payment of the claims. Any rule FEMA adopts on either side of the operations must be enforced by the carriers. If 50 different sets of state courts each get to decide when they think it was reasonable for the flood carrier to have refused to do what the plaintiff's attorney claims would have been "fair," and instead enforced FEMA's rules, the system will not be operating for long. The few carriers that continue to work with FEMA to make the Program work will likely bolt.

In closing as to this issue, if Congress provides for exclusive jurisdiction over all NFIP operations in the federal courts of the United States, then the Congress will reap the benefit of significant cost savings. If all disputes are to be resolved on a uniform basis in one court system, and if all debates over jurisdiction are put at an end, the Congress receives a lower bill for litigation costs, and, bolsters the development of a uniform body of caselaw to govern all NFIP operations. As more issues become the subject of settled caselaw, Program costs drop even further. We achieve greater efficiency, and we achieve lower costs. Also, we achieve for all NFIP participants, a clearer understanding of everyone's rights and responsibilities.

Only the Congress can fix this problem. It did so in 1983. It is asked to do so again.

3. EFFECT OF LAPSE IN REAUTHORIZATION

As the Committee is well aware, the insurance and banking industries learned with less than 60-days notice that the Program was to lapse without reauthorization effective December 31, 2002. Prior to that notice, everyone had assumed that reauthorization would occur as a matter of course. The lack of

reauthorization caused a logistical and legal nightmare for the insurance and banking industries.

For the insurers, the Committee is asked to consider the enormous machinery that actually operates the Program. On a daily basis, literally thousands of paper notices must be generated on such subjects as new policy issuances, renewals, cancellations, etc. When calls were made to the individuals who actually operate these machines that they needed to be reprogrammed on less than 60-days notice, these people were literally apoplectic. There simply was no way to actually shut down all of these systems and machines on such short notice, and definitely no way to do it and then restart the operation in a similarly short timeframe. The companies had absolutely no choice but to trust that the Congress would indeed reauthorize the Program, and to continue to issue the policies despite the lack of any statutory authority. (As should be noted, that trust was well placed.)

Clearly, this was a legal problem for the companies. All flood policies state in no uncertain terms that they are issued pursuant to the U.S. Government's National Flood Insurance Program. The unanticipated lack of reauthorization caused the companies to be forced to issue polices that were not actually authorized by the Program. The liabilities that this could have opened up for the carriers had the Program not been reauthorized in such short order, is still a sore subject with the carriers.[12]

The undersigned is not truly in a position to speak in regards to lending institutions. However, he is aware that at some point during the discussions about the lapse of reauthorization, that various banks were strongly considering a complete halt to all loan closings. It was widely stated that if reauthorization did not occur in early January, that a halt to loan closings was exactly what was going to happen. Had that

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[12] Several carriers sent out separate notices and took other steps at great expense. Thus far, FEMA has not been willing to reimburse the companies for these expenses.

occurred, the housing industry would have come to an abrupt halt.

The National Flood Insurance Program is now intertwined with the housing industry to such an extent that impacting the NFIP necessarily impacts the housing industry. For this reason, and for the purpose of the stability of both the Program and the housing industry, it would be far more preferable if the Program could be reauthorized on terms exceeding two years. The carriers are very sensitive to the prospect of what will or will not occur this coming December 31, 2003. They are very wary of having to go through all of the exact same process once again. Hopefully, such can be avoided.

4. PROPOSALS FOR REDUCING LITIGATION COSTS

The principal cost savings being proposed by the undersigned is the rewrite of the jurisdictional statute. This would save the Program a small fortune in unwarranted legal bills, as well as settlements that are made solely because of a lack of confidence in a non-federal forum. Notably, the savings would not be just on those cases where jurisdiction is directly put at issue. When the carriers are able to litigate in a forum where the rules are understood and where enforcement by the court is predictable, then legal bills can be kept to a minimum because the litigation will be efficient, and the only settlements will be those where either it turns out that the benefits are genuinely owed, or a mere cost-of-defense-type settlement entered into for no other purpose than to avoid unnecessary costs of defense.

In addition to the jurisdictional issue, the undersigned believes that he would be less than candid if he did not at least raise, in a general sense, two other issues. These issues are in need of serious scrutiny by FIMA in the first instance. However, it is important that the Committee know that they are out there. The two points to be addressed below are points of immense concern to the companies. Specifically, there are companies that are considering withdrawing from the Program because of the two problems to be

described below:

A. A Lack of Communication

At the current time, there is a serious lack of communication between company representatives and FIMA. It should be quickly pointed out that it is well understood that all of the personnel connected to FIMA and FEMA have had a very full plate as a result of 9/11, as well as from the reorganization of FEMA into the Homeland Security Department. Neither the undersigned nor the carriers are unmindful of the realities of these developments. That having been said, however, we now have approximately 18 months worth of backlog in unfinished business, and in disputed important matters where decisions are absolutely necessary.

In considering this point, please consider that the NFIP is an extremely complicated operating system. It manages approximately one-half *trillion* dollars in risks against the U.S. Treasury. It demands constant attention and the focus of sophisticated management both from the companies, and from FIMA. Just as any large corporation could not survive 18 months without managerial oversight, the NFIP is in need of attention.

It is the understanding of the carriers that it is the intention of FIMA's Administrator to commence meetings with the principal flood coordinators of the various companies within the next few months. Assuming this occurs, it is likely that the company representatives and the FIMA representatives can examine the backlog of issues, debate them thoroughly, reach consensus, and move on.

B. Agent Error

A major philosophical and legal debate has arisen between the companies and FIMA over the role and legal status of the insurance agents who sell flood insurance policies. As of 1999, FIMA and the

companies were on the exact same page. FIMA had published to the courts a formal statement of the position of the Agency upon the role and legal status of agents, and the companies are in full agreement with that 1999 declaration. However, since that time, there seems to be a developing 180E change in how the Program views the agents. This is alarming to the companies.

Congress has a prior history on this issue as well. In 1981, Congress enacted a hold harmless agreement providing protection to insurance agents who agreed to participate in the NFIP. That hold harmless agreement is now found at 42 U.S.C. §4081(c) of the Act. In the legislative history to that statute, the following comments by Senator Richard Lugar are available and explain Congress's intention for that statute:

> As I stated in the Congressional record on June 3, 1981, a statutory hold harmless agreement became necessary after an opinion issued by the Comptroller General of the United States voided an earlier agency hold harmless agreement that had been in effect since 1978.
>
> It is my firm belief that nullification of the agreement that shielded insurance agents from sometimes substantial losses caused by the mistakes of others seriously jeopardized the overall success of the flood insurance program. Even apart from the potentially adverse impact of the Comptroller General's opinion, I believe as a matter of simple equity that insurance agent participants in the flood insurance program should not be caused to suffer for the mistakes of others.
>
> The language I offer, and agreed to by the conference committee members, restores a hold harmless agreement to the flood insurance program. As importantly, it restores to the Program the confidence of the many thousands of insurance agents who bring flood insurance to the public. *Congressional Record – Senate*, July 13, 1981, p. 19133

It is presumed that the Administrator will shortly be engaging the carriers in a serious and robust debate of any change in philosophy that places the Program at odds with congressional intent for that hold

harmless agreement, or with prior commitments to the carriers. However, it is believed that the Congress should be aware of this controversy, and that there are several carriers who are contemplating ending their participation in the flood program if FIMA decides to take a position that is at odds with this statute, or with FEMA's current regulations and declarations. Hopefully, as with numerous other issues that have been resolved through frank and open debate between the principal representatives of the Government and the carriers, such can be avoided.

RECOMMENDATIONS

The following recommendations are offered for the Committee's consideration:

1. Revise 42 U.S.C. §4072 to make clear that all disputes arising out of participation, or attempted participation, in the NFIP must be filed in the federal courts. Doing so will allow for the development of a uniform body of case law across all of the states for all Program issues, allowing all persons who seek the benefit of the Program to know precisely where they stand on all issues. The result will be greater efficiency, greater predictability in the law, and lower overall costs. It would also validate the positions taken by key states that have a great interest in the continued success of the Program.

2. Consider reauthorizing the Program for terms exceeding two years, for the purpose of attaining the stability that this achieves for everyone concerned.

3. Be aware that the difficulties experienced by FIMA over the past 18 months have not been without impact to the normal operation of the NFIP. It is important that FIMA officials be allowed to get back into a structure where they can focus on the Program's serious operational issues.

4. Ask that FIMA provide information to the Congress if indeed it does intend to alter its

previously-published views on the role of insurance agents in the Program, particularly if any such decisions implicate 42 U.S.C. §4081(c).

Respectfully submitted,

Gerald J. Nielsen