CLAIMS JOURNAL

View this article online:
http://www.claimsjournal.com/news/national/2014/05/02/248354.htm

The Emerging Hail Risk: What The Hail Is Going On?

By Steven Badger, Zelle Hofmann Voelbel & Mason LLP | May 2, 2014

- Article
- 2 Comments

The number of reported claims involving hail damage to residential and commercial roofing products has increased dramatically over the past few years. Some reports place the increase at almost double historical claim totals.

What is the cause of this significant increase? There is no disputing that in recent years there have been significant hail events in large metropolitan areas. But does this alone account for the near-double increase in claim filings? Plus, in addition to the increase in the number of claims, an abnormally high percentage of these claims are ending up disputed and ultimately in appraisal or litigation. In Texas, hundreds, literally hundreds, of lawsuits are being filed each week in Dallas, Tarrant, Potter, Hidalgo, and other counties involving alleged underpayment of hail related roof

damage claims – far, far more than has ever previously been the case.

Has the property insurance industry suddenly stopped paying these claims? Or are more sinister forces involved, causing both the increase in number of claims being submitted and number of claims resulting in litigation.

There is no question it is the latter.

What The Hail Is Going On?

Over the past decade, a cottage industry has emerged of individuals who believe they can make a living by involving themselves in the insurance claims process. These individuals have previously focused primarily in hurricane claims, fighting over what constitutes wind damage and the never-ending debate over wind versus water damage.

Most significantly, in 2008, Hurricane Ike struck the Texas coast. The feeding frenzy was on. Almost overnight, an entirely new industry of roofing contractors, general contractors, claims consultants, and professional appraisers appeared ready to help building owners take-on the "greedy insurance companies." A new generation of public adjusters also appeared. In the past two years alone, membership in the Texas Association of Public Insurance Adjusters has more than doubled. Further, to assist these individuals in pursuing their claims, a new generation of "roofing experts" emerged, many with absolutely no previous experience with roofing systems but prepared to issue reports.

Finally, when the insurers refused to pay claims that lacked merit, attorneys were everywhere. With Texas tort reform making it difficult for plaintiffs' attorneys to earn a living handling their usual docket of fender bender and slip-and-fall cases, fighting evil insurance companies became the go-to practice area. All of a sudden, every personal injury plaintiffs' attorney was also a policyholder attorney. Armed with favorable Texas laws governing the underpayment of insurance claims

(automatic 18 percent statutory penalty, attorneys' fees, treble damages and potential bad faith damages), the race to the courthouse was on.

Today, almost six years later, most of the Hurricane Ike lawsuits are gone. But lawsuit coffers needed to be filled. Hail claims have become the obvious next target. Unlike major hurricanes, which only arrive every few years, hail falls many times a year all across Texas. Plus, like wind damage, determining what constitutes hail damage to a roofing product is often subject to debate. With favorable Texas law, hail claims present the perfect full employment opportunity until the next hurricane comes along.

For all of these reasons, it is obvious – the increase in hail damage claims and resulting lawsuits have nothing to do with abnormally large or frequent storms. It also has nothing to do with insurance companies refusing to pay meritorious claims. Instead, it has everything to do with strangers to the insurance policies in question injecting themselves into the claims process with the intent to bleed-off whatever money they can into their own pocketbooks. That is what the hail is going on.

Managing the Current Crisis

These claims are predictable. They all have the same warning signs:

• ***Late notice***. Most of these claims originate with a contractor knocking on the building owner's door promising "a free roof from your insurance company" in exchange for execution of a "roofer contingency contract" allowing the contractor to negotiate the claim and perform the roof replacement work. The contractor then orders a "hail report" to find a recent storm somewhere in the general area to use as the date of loss. The claim is then reported. Often this is months or even years after the reported hail event.

• ***Absence of the insured***. The building owner itself is noticeably absent from the claims process. Only the contractor or public adjuster is involved in the actual handling of the claim. The insured, with no out-of-pocket risk, figures "What the hail? If he's gonna get me a free roof, I might as well let him try."

• ***Microscopic damage***. Roofs seldom actually leak from hail damage. When they do, building owners call their insurance companies right after the hail event and the claims get paid. The claims at issue today almost always involve roofs that are not leaking and the alleged damage is not visible to the naked eye. Instead, the alleged roof damage "requires microscopic technology to see," "might leak in the future," "will cause the roof to prematurely fail," or "will void the warranty."

• ***Modified bitumen, built-up, or metal roofs***. Again, when damage is obvious, insurance companies pay claims. With a single-ply membrane, the holes or fractures in the membrane are usually quite apparent. With composition shingles, holes and soft spots are readily apparent. But creativity abounds when identifying alleged damage to other types of roofing systems – "the modified membrane lost granules, which are needed to protect the interplys from long term deterioration," "the hail struck and displaced the gravel, which exposed the asphalt flood coat of the built-up membrane which will now deteriorate," and of course, "the minor dings in the metal roof will collect water and particulates, which will cause rusting and leaks over time."

With these similarities in issues, these claims all follow a predictable pattern. Once a dispute arises as to the existence or scope of damage, the contractor or public adjuster has all he needs to demand appraisal. With courts now holding that such disputes are subject to appraisal, all that is needed for a guaranteed payday is an aggressive, manipulative appraiser and a favorable umpire appointment.

Finally, for those claims that are not dumped into appraisal, litigation is also an attractive option. What constitutes physical loss or damage to a roofing product will often be a factual issue driven by expert testimony. With new "roofing experts" having broad views as to what constitutes hail damage, policyholder attorneys have no problem getting cases to trial. Faced with this reality, the significant cost of litigation, and draconian penalties if they happen to be wrong in their position, insurers typically have no choice but to settle claims. They are in damage control mode. Every day, claims are settled that have absolutely no merit whatsoever.

Of course the contractors, public adjusters, and policyholder attorneys all know this. With absolutely no downside, there exists no impediment to submitting meritless claims or filing meritless lawsuits. Search Craigslist, read the roofing contractor forums, and follow the policyholder attorney blogs. It is a feeding frenzy for claim referrals.

In response, insurers can do no more to protect themselves than carefully proceed through the claims process and hope to mitigate the predictable outcome. Below are a few recommended strategies that can help:

- Engage qualified engineers with real experience in identifying hail damage;
- Refuse to negotiate claims with contractors and other individuals acting as unlicensed public adjusters;
- Hold the insured to its policy burdens (establishing physical loss or damage and establishing a date of loss within the insurer's policy period);

- Refuse to accept inflated Xactimate estimates but instead require real bids from real contractors;
- Refuse to pay "10+10" overhead and profit when general contractors are not reasonably necessary and their costs not incurred (there is no "TDI Bulletin" or "three trade rule" dictating otherwise);
- Closely monitor appraisals to avoid the inevitable manipulation of the process and race to the courthouse for a favorable umpire appointment; and steer clear of the predictable traps.

Finally, insurers can also decide to step up and start fighting the worst abusers, not only in the claims process itself, but also in the shady underworld of referral fees, inflated invoices, kickbacks and outright fraud.

The Underwriting Solution

Given the current crisis, insurers have no choice but to eventually restrict coverage. Several policy wording changes are on the horizon:

Increased deductibles. Percentage and per building deductibles are becoming the norm. Unfortunately, the effect of this change is easily overcome by a contractor's promise to waive the building owner's deductible. The contractor or public adjuster knows that by inflating the estimate he can recover enough on the claim to hire a subcontractor to actually perform the work, absorb the deductible, and still make a healthy profit.

ACV only coverage. Most of the disputed claims involve old roofs which have suffered from years of deterioration, lack of maintenance, and quite often non-damaging impact from numerous hail events. By providing actual cash value coverage for roofs older than 10 or 15 years, the building owner is forced to shoulder a significant portion of the roof replacement cost. If the roof is not leaking, the building owner will typically defer that capital cost. Only when a "free roof" has been promised will it be motivated to pursue the insurance claim.

Endorsements limiting coverage. Given that most disputes involve the issue of what constitutes physical loss or damage, one solution is to provide an actual definition for damage to roofing systems, roof top accessories, and roof top equipment. One possible definition would be: "For purposes of covered property that is the subject of this endorsement, we define "physical loss or damage" as a reduction in the roof's water shedding capacity or life expectancy." More specifically, language can be provided for a particular roof type, such as metal: "For purposes of this endorsement and the definition of physical loss or damage set forth

above, dents, dings, and dimples to metal roofing systems and metal roof top accessories do not constitute physical loss or damage." Or, quite simply: "We do not provide coverage for dents, dings, and dimples to metal roofing systems and metal roof top accessories." Similar specific provisions can be used for other types of roofing systems and HVAC equipment.

Choice of law/venue endorsement. Some states have laws more favorable to insurers than others. For example, Texas law provides that disputes as to the existence or scope of damage are subject to appraisal. New York law does not. Texas law does not recognize suit limitation provisions less than two years and a day. New York law allows such provisions if they are reasonable under the circumstances. Some insurers are including mandatory New York choice of law and choice of venue provisions to avoid the inequities of current Texas law.

Appraisal provision changes. Appraisal has become a non-judicial dispute resolution process entirely devoid of procedural rules or ethical guidelines. Manipulation and outright fraud is rampant in the process. Appraisal provisions are being rewritten to limit appraisal to situations where both parties agree to the process. Other changes include requiring the parties to jointly seek the appointment of an umpire (to avoid the race to the courthouse) and to allow the parties to execute an Appraisal Protocol identifying the issues to be appraised and procedures to be followed (to ensure an equitable appraisal process and clear award).

Hail damage exclusions. Like high winds in hurricane prone areas, unless this problem is solved, the inevitable result will be the complete exclusion of all physical loss or damage resulting from hail events.

In addition to these policy wording changes, another underwriting solution is to document the condition of a roof on or near the date of policy inception. This can be done with pictures and video. No report or opinions are necessary. A simple "snapshot" showing the condition of the roof as it existed on the date the insurer commenced coverage on the risk. This would allow the insurer to compare the reported damage to what was present on the date of inception. This would solve the common problem of claims being submitted for alleged "hail impact damage" that has been present for years but was of no concern to the building owner until a roofing contractor knocked on its door and advised that a free roof was in its future.

Other Solutions

To avoid the inevitable significant restrictions on available coverage absent other solutions, the crisis can be managed with legislative change. For example, roofing

contractor licensing could be required accompanied by guidelines as to impermissible conduct. This could include a ban on all "roofer contingency contractors", a clear prohibition against contractor involvement in the claims handling process, and a ban against waiving deductibles. Additionally, legislative change could remedy problems created by the courts in expanding the scope of the appraisal process and return the process to what it was originally intended to address – situations where the parties agree on the existence and scope of damage but disagree only as to the cost to repair such damage. Another potential legislative change would be to require an inspection and written report from a licensed professional engineer to be filed with any lawsuit involving a dispute as to the existence of physical loss or damage. Finally, for those states with automatic statutory penalties for delays in claim payment, such as Texas, fairness and equity could be restored by requiring a finding of bad faith prior to the imposition of such penalties, limiting statutory penalties to residential claims where consumer protection is more important, and requiring the building owner to pay the insurer's attorneys' fees if a lawsuit is found to have been filed without a reasonable basis.

Conclusions

It is very clear what the hail is going on. The property insurance industry is under attack. The present battle has nothing to do with repairing roofs actually damaged by hail, but instead putting money in the pockets of individuals who can find a way to inject themselves into the insurance claims process. Like mold and similar previous attacks on the industry, in the end the insurance companies will respond by limiting or even excluding coverage. That effort is already underway. While that will provide the necessary and inevitable end to the battle, the unfortunate loser in all of this is the building owner who truly had holes knocked in his roof by large hail. Because of all the money being paid today to contractors, public adjusters, policyholder attorneys, and other assorted crooks and frauds, the guy with water pouring through large holes in his roof caused by large hail will no longer have coverage.

And that is truly unfortunate but inevitable absent legislative change.

An abbreviated version of this article first appeared in the spring issue of Claims Journal magazine.

Steven Badger represents the commercial property insurance industry, both as a plaintiff in large loss catastrophe subrogation matters and as a defendant in coverage matters involving roofing and other construction issues.

More from Claims Journal

Today's Insurance Headlines | Most Popular | National News