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R STREET POLICY STUDY NO. 31  
January 2015

## COME HAIL OR HIGH WATER: TEXAS' LITIGATION EXPLOSION

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### INTRODUCTION

Texas is known for its extreme weather. From hurricanes along the coast to wildfires in Bastrop, the state has absorbed more than its share of weather-related property damage. Yet when it comes to property damage, the most costly culprit is one we typically don't think about: hail.

Between 1999 and 2011, homeowners' insurers paid \$10.4 billion for hail-related losses, more than any other peril.<sup>1</sup> From 2010 to 2012, Texas generated more than 320,000 hail insurance claims, more than double any other state.<sup>2</sup> Hail insurance claims have increased 84 percent since 2010.<sup>3</sup>

1. Eleanor Kitzman, "War on Hail," Texas Department of Insurance, Nov. 27, 2012. <http://www.tdi.texas.gov/commish/documents/wohopening.pdf>

2. National Insurance Crime Bureau, 2010-2012 United States Hail Loss Claims and Questionable Claims, June 25, 2013.

3. "Number of Hail Damage Insurance Claims Up 84% Since 2010," *Insurance Journal*, July 18, 2013. <http://www.insurancejournal.com/news/national/2013/07/18/298895.htm>

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That trend appears likely to continue. An April 2014 storm in Denton is expected to result in \$500 million in losses,<sup>4</sup> while June storm in Abilene may result in another \$400 million.<sup>5</sup>

Texans have the highest insurance premiums in the country, 50 percent higher than the national average.<sup>6</sup> Hail claims are the most significant single contributor to those costs. Insurance losses from hail claims in Texas exceed those from hurricanes and tornados combined.<sup>7</sup>

4. "Insured Loss Estimate from North Texas Storm Rises to \$500M," *Insurance Journal*, May 2, 2014. <http://www.insurancejournal.com/news/southcentral/2014/05/02/328140.htm>

5. "Damage Estimate in Texas Hailstorm Pegged at \$400M," *Insurance Journal*, July 11, 2014. <http://www.insurancejournal.com/news/southcentral/2014/07/11/334410.htm>

6. Terrence Stutz, "Texas Homeowners Still Paying Nation's Highest Insurance Premiums," *Dallas Morning News*, Dec. 18, 2012. <http://www.dallasnews.com/news/state/headlines/20121218-texas-homeowners-still-paying-nations-highest-insurance-premiums.ece>

7. "Hailstorms are the Costliest Natural Peril in Texas," *Insurance Journal*, Nov. 14, 2012. <http://www.insurancejournal.com/news/southcentral/2012/11/14/270566.htm>

## WHY CLAIMS ARE GROWING

A growing frequency of hailstorm events is, without question, part of the explanation for Texas' explosion in hail claims. According to the National Insurance Crime Bureau, Texas had more hailstorm events than any other state in 2010, 2011 and 2012.<sup>8</sup>

But increased storm activity does not account for all of the increases in losses. While Texas accounted for 16 percent of all hail claims nationally from 2010 to 2012, 28 percent of questionable claims tracked by the NICB during that period were filed in Texas.<sup>9</sup> Storm intensity also cannot explain why litigation over hail claims has become so much more common. Historically, only about 2 percent of property insurance claims result in a lawsuit.<sup>10</sup> Yet according to attorneys G. Brian Odom and Tyler McGuire, in Hildalgo County, 35 percent of recent hail damage claims have resulted in a lawsuit.<sup>11</sup> The Dallas area also has seen a sharp uptick in the number of hail-related lawsuits.

Odom and McGuire blame the increase in hail-related lawsuits on "case-running," an organized process of public adjusters and others soliciting and referring individuals with potential claims to attorneys, who then bring large numbers of coordinated suits against insurance companies. Many of these cases may involve re-opened claims that previously have been settled, or claims of otherwise dubious merit.

As with many forms of nuisance suits, the large number of cases and the cost of litigation can create an incentive for insurance companies to settle. With insurance cases, state law looks to provide a disincentive for insurers to deny claims in bad faith, slapping them with 18 percent interest for nonpayment or underpayment of claims later deemed valid. This law provides additional incentive to settle claims quickly. Ultimately, the costs associated with litigation are passed along in form of increased policyholder premiums.

In an article reaching similar conclusions, Steven Badger of Zelle Hofmann Voelbel & Mason LLP traces the origins of the current hail lawsuit boom to the aftermath of litigation over Hurricane Ike in 2008. As a result of Hurricane Ike, Badger writes, "an entirely new industry of roofing contractors, general contractors, claims consultants, and professional appraisers appeared."<sup>12</sup> The number of public adjusters also grew, with membership in the Texas Association of Public Insurance Adjusters doubling. The resulting conflicts

between policyholders and carriers drew in attorneys to handle the legal challenges. Once Ike-related claims began to dry up, these individuals sought other areas to apply their newfound skills. Notes Badger:

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.<sup>13</sup>

Proposals to address these problems can be divided roughly into two categories. First, there are proposals to reform the litigation process to remove incentives for bringing questionable hail claims. A second set of proposals concerns increased professional regulation of public adjusters, roofers and other related individuals.

## POSSIBLE TORT REFORM SOLUTIONS

Over the past decade, the Texas Legislature repeatedly has passed reforms to the civil litigation system to ensure the smooth functioning of justice and to prevent lawsuits from being used as a rent-seeking opportunity against businesses.

In 2011, Texas passed H.B. 3, a major overhaul of litigation directed at the Texas Windstorm Insurance Association (TWIA), a state-run agency that provides windstorm insurance in certain designated coastal counties. The legislation established a process (including appraisals and time limits) that had to be followed before a suit could be filed over a disputed claim. Where a single causal event is at issue, such as a storm, time limits for filing claims can help provide certainty to insurers and claimants alike.

Texas law should also work to isolate the specific amounts at issue in a dispute. If an insurer believes a claim is worth \$8,000 while a policyholder believes it should be \$10,000, the amount in dispute is \$2,000, not \$10,000. Allowing legal fees to be set based on a \$10,000 recovery (assuming the policyholder wins the case) creates perverse incentives for nuisance suits.

Relatedly, Texas should consider updating current statutory provisions that apply an 18 percent interest rate for late payments in insurance claims. While some form of penalty rate may be appropriate, the 18 percent rate was set at a time of higher interest rates generally and can serve as an incentive for legal gamesmanship.

The state also should look for ways to resolve more insurance disputes outside of the court system. In many hail claims,

8. NICB Hail Loss Report, *supra* note 2.

9. *Ibid.*

10. *Supra*, note 1.

11. *Ibid.*

12. Steven Badger, "The Emerging Hail Risk: What the Hail is Going on?" *Claims Journal*, May 2, 2014. <http://www.claimsjournal.com/news/national/2014/05/02/248354.htm>

13. *Ibid.*

litigation has become a first step, rather than a last resort. A requirement that a claimant must communicate with the insurer about the dispute before filing suit could help to resolve some claims. Texas should also encourage greater use of arbitration and small claims court for small disputes.

## INCREASED PROFESSIONAL REGULATION

In addition to these legal reforms, there have been a number of proposals that attempt to deal with hail claim abuses by raising the bar for professional regulation, for instance with more stringent occupational licensing for public adjusters and roofers. During the 83<sup>rd</sup> Session, a bill to license roofers drew considerable controversy, and was ultimately defeated.

Several states also restrict the ability of public adjusters and others to coordinate with attorneys in bringing insurance lawsuits. Louisiana law, for example, provides that:

A public adjuster shall not solicit employment for or otherwise solicit engagement, directly or indirectly, for or on behalf of any attorney at law, contractor, or subcontractor, in connection with any loss or damage with respect to which such adjuster is concerned or employed.<sup>14</sup>

Increased professional regulation is not an appropriate remedy here. Licensing and other forms of professional regulation are themselves open to abuse. Such rules often serve not to protect the public, but as a means to protect incumbent members of a given occupation. Licensing raises prices for consumers and limits economic opportunities for a growing percentage of the workforce. Between the 1950s and 2006, the percentage of U.S. workers in fields requiring a license increased from 5 percent to 29 percent.<sup>15</sup> In Texas, the number of licensed occupations have grown tenfold since the 1950s, and Texas ranks 17th among states in terms of the sheer number of occupations that require licensing.<sup>16</sup>

According to guidelines developed by the Texas Sunset Commission, “[l]icensing of practice is the most stringent regulatory approach,” and “[o]nly the least stringent level of regulation needed to protect the public should be implemented.”<sup>17</sup> Given the existence of alternative legal reforms that could achieve the same goals, increased professional regulation of roofers or public adjusters cannot meet this high standard.

Nor should Texas adopt rules prohibiting roofers or public

adjusters from referring policyholders to attorneys. While the current incentive structure does encourage bringing questionable claims and litigation, the Legislature should address this by attacking the problem directly, not by attempting to limit commercial speech.

## CONCLUSION

The growth of hail claim litigation is certain to continue until it is addressed by the state. Right now, elevated activity is largely confined to a few areas. However, should these questionable practices spread throughout the state, the resulting costs to insurers -- and ultimately, to policyholders -- could be enormous.

Luckily, Texas has a menu of options it could use to make sure legitimate claims are processed and paid in a timely manner, while clamping down on questionable claims and abuse. In crafting a legislative solution, Texas should avoid increased professional regulation, and concentrate on reforming the legal process to remove perverse incentives and make the system run more smoothly.

## ABOUT THE AUTHORS

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14. LA. REV. STAT. §22:1706(F).

15. Morris M. Kleiner and Alan B. Krueger, “The Prevalence and Effects of Occupational Licensing,” NBER Working Paper No. 14308 (September 2008) 10.

16. Wesley Hottot, “Bureaucratic Barbed Wire: How Occupational Licensing Fences Out Texas Entrepreneurs,” Institute for Justice (October 2009) 2.

17. Texas Sunset Commission, “Sunset Occupational Licensing Model,” Nov. 20, 2007.