

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Banking and Insurance Committee

BILL: CS/SB 286

INTRODUCER: Banking and Insurance Committee and Senator Fasano

SUBJECT: Sinkhole Insurance

DATE: April 11, 2006

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Knudson	Deffenbaugh	BI	Fav/CS
2.			RI	
3.			JU	
4.				
5.				
6.				

I. Summary:

The Committee Substitute for Senate Bill 286 revises the laws relating to sinkhole insurance claims. The CS permits deductibles of 1, 2, 5, and 10 percent to be applied to residential property insurance policies. The CS permits an insurer, if approved in writing by the policyholder and any lien holders, to make direct payment to the persons selected by the policyholder to perform land and building stabilization and foundation repairs caused by a sinkhole.

The report prepared after sinkhole testing is conducted is required to provide a finding on the actual cause of distress to the property, instead of simply verifying or eliminating a sinkhole as being the cause of damage. The sinkhole report is to be filed with the clerk of court, instead of the county property appraiser.

The CS provides an alternative dispute resolution process for sinkhole claims. The neutral evaluation process is to be optional and nonbinding, with either the policyholder or insurer declining to participate. However, if the policyholder declines to participate or declines to follow the recommendations of the neutral arbitrator, the insurer shall not be liable for attorney's fees or for extra contractual damages related to a claim for sinkhole loss. The neutral evaluator will be assigned by the Department of Financial Services (DFS) and must be a qualified engineer or professional geologist who has completed an alternative dispute resolution course designed or approved by the department.

For matters not resolved by the parties during the neutral evaluation, the neutral evaluator must prepare a report stating whether the sinkhole loss has been verified or eliminated. If the existence of sinkhole loss is verified, the report must include the evaluator's opinion regarding the need for estimated costs of stabilizing the land and any covered structures as well as appropriate

remediation or structural repairs. The evaluator's report must be sent to all parties in attendance at the neutral evaluation and to the DFS. If a policyholder declines to follow the recommendations of the neutral evaluator, the insurer is not liable for attorney's fees or for extra contractual damages related to a claim for sinkhole loss. If the neutral evaluator recommends repairs that exceed the insurer's offer to pay, the insurer is liable to the policyholder for up to \$2,500 in attorney's fees. Either party may seek judicial review of whether the recommendation of the neutral evaluator was unreasonable and must be vacated. However, unless the recommendation was procured by corruption, fraud, or other undue means; there is evident partiality or misconduct by the evaluator prejudicing the rights of a party; or the evaluator exceeded his or her authority or power, it will be found to be reasonable by the court. Evidence of an offer to settle a claim during neutral evaluation is inadmissible regarding liability or claim value.

The CS prohibits a general contractor, subcontractor, or other business providing sinkhole remediation services from soliciting legal business for an attorney. Doing so is a first degree misdemeanor.

This CS substantially amends the following sections of the Florida Statutes: 627.706, 627.707, 627.7072, 627.7073, and 877.02

This CS creates the following sections of the Florida Statutes: 627.7074

II. Present Situation:

Sinkhole Claims

Nationwide, property insurance policies typically exclude coverage for "earth movement." But, in Florida, every authorized insurer must make available coverage for insurable sinkhole losses on any structure and the personal property contained within it.¹ Even though the coverage must be "made available", insurers include sinkhole coverage within their policies, apparently because it would lead to adverse selection if offered as an option, i.e., only those in sinkhole prone areas would elect the coverage.

In some areas of the state, sinkhole costs have grown at an exponential rate in recent years. This has caused policy cancellations due to the payment of policy limits on sinkhole claims, and insurers refusing to issue new policies in sinkhole prone areas. Citizens Property Insurance Corporation has had a significant increase in policies from the Tampa Bay area (Hernando, Hillsborough, Pasco, and Pinellas counties), increasing from 1,012 policies at the end of 2001, to 140,171 policies, or an increase of 13,751 percent.² This is believed to primarily be due to private insurance companies refusing or limiting coverage in this area due to the sinkhole exposure. By way of comparison, the growth in Dade, Broward, and Palm Beach counties during the same period was 104 percent. Not only do more homeowners have to seek coverage from Citizens, but such policyholders are being hit with exploding premium costs. The average Citizens premium in Pasco County more than doubled from \$1,006 on March 1, 2003, to \$2,368

¹ Section 627.706, F.S.

² Task Force on Long-Term Solutions for Florida's Hurricane Insurance Market-Final Report, pg. 41 (March 6, 2006).

on April 1, 2006. If a pending Citizens actuarial rate filing for such homes is approved, the average premium will rise to \$3,605 as of August 1, 2006.

2004-2005 Study on Paid Sinkhole Claims in Florida

In 2004, the Legislature commissioned a study by Florida State University, under the direction of OIR, of the feasibility and cost-benefit of a Florida Sinkhole Insurance Facility and other matters related to affordability and availability of sinkhole insurance. The report was submitted on April 1, 2005, as required. The study found that the number of paid sinkhole claims increased from 348 in 1999 to 1,108 in 2003 while total claims payments for sinkholes increased from \$22.4 million in 1999 to \$65 million in 2003. For this five-year period (which had no hurricane claims), there were a total of 2,509 paid sinkhole claims, representing 1 percent of all claims paid by insurers, but the \$219.2 million paid for sinkhole claims accounted for 16.2 percent of total claims payments.

The FSU sinkhole study listed options for the Legislature to consider, including keeping coverage for sinkholes in homeowners' policies and to required insurers to develop a separate rate for sinkholes; creating a state facility to act as direct insurer, including the handling of claims; and creating a state facility to act as a reinsurer to cover sinkhole losses of private insurer policies. The cost to the state of operating a direct insurer was estimated to be about 19.9 million, compared to about \$1.8 million to operate a reinsurance facility. Given that the risk is unlike the multi-billion catastrophic nature of potential hurricane losses, the study generally concluded that the sinkhole facility would probably not have a shortfall in funds if rates are conservatively set.

2005 Revisions to the Law on Sinkhole Claims

The Legislature in 2005 substantially amended the laws on sinkhole claims in response to a continuing crisis regarding the availability and affordability of sinkhole coverage. Definitions were created and amended by the legislation, primarily in an attempt to ensure that only legitimate sinkholes and sinkhole activity results in a sinkhole claim. A "sinkhole" was defined as "a landform created by subsidence³ of soil, sediment, or rock as underlying strata⁴ are dissolved by ground water. A sinkhole may form by collapse into subterranean voids created by dissolution of limestone or dolostone or by subsidence as these strata are dissolved." The definition creates boundaries for what can be considered a sinkhole. The definition of loss was amended to be "sinkhole loss" and requires structural damage to the foundation of a building in addition to damage to the building itself. The damage must also be caused by sinkhole activity. "Sinkhole activity" was amended to make clear that such activity must result from the movement or raveling⁵ of soils, sediments, or rock materials into subterranean voids caused by the effect of water on limestone or a similar rock formation.

The 2005 legislation created a sinkhole information database for the purpose of tracking sinkhole claims. The Department of Financial Services is primarily responsible for the development of the database, with input from the Department of Environmental Protection. The database is envisioned as a tool for tracking all current and past sinkhole activity in the state, with the information to be used to more effectively prevent and remediate sinkholes across the state.

³ A synonym of subsidence is sinking

⁴ Strata can generally be defined as layers of sedimentary rock having approximately the same composition throughout.

⁵ Raveling indicates a separation, or an undoing of texture.

A greatly expanded series of standards for the investigation of sinkhole claims by insurers was enacted. Upon a claim for sinkhole loss, the insurer must inspect the premises in question and make a determination whether there has been physical damage to a structure that may be the result of sinkhole activity. Following the insurer's initial testing it must provide written notice to the policyholder that details the insurer's initial determination, when the insurer is required to engage an engineer or geologist to perform testing, and a statement of the policyholder's right to demand certain testing to be conducted by a geologist or engineer. If the insurer is unable to determine the cause of the damage, or discovers damage consistent with sinkhole loss, then the insurer must retain a qualified engineer or geologist to perform testing on the property. The insurer may deny the sinkhole claim, but the policyholder has the right to demand testing conducted by an engineer or geologist.

Testing standards for sinkholes were established in s. 627.7072, F.S. The professional geologist or engineer must perform whatever tests are sufficient to determine the presence or absence of sinkhole loss within reasonable professional probability and for the engineer to make recommendations regarding any necessary building stabilization and foundation repair. The testing must be in conformity with the Florida Geological Survey Special Publication No. 57 (2005). The publication contains protocols for the investigation of suspected sinkhole activity. The protocols provide limits on the number and types of tests that are appropriate for investigation, but allow leeway for the geologist or engineer to determine which of the specified tests are appropriate for the site.

A statement of the standard for verifying that sinkhole loss has occurred and standards for sinkhole reports detailing the findings of sinkhole testing were placed in s. 627.7073, F.S. After the completion of testing, a written sinkhole report must be submitted to the insurer and the insured.⁶ The report must detail whether or not, within a reasonable degree of professional probability, the cause of the actual physical and structural damage is sinkhole activity. The report must also state that testing was sufficient, describe the tests that were performed, and contain a recommendation by the engineer regarding stabilizing the land and building and making repairs to the foundation. The findings of the report are presumed correct.

The 2005 legislation maintained the requirement (with minor changes) that if the written report states that the cause was not sinkhole activity, the policyholder must reimburse the insurer for 50 percent of the cost of the testing and written report, up to \$2,500, but only if the policyholder submitted the sinkhole claim "without good faith grounds." It is reportedly very rare for a policyholder to be found to have made a sinkhole claim in bad faith and be required to pay for any part of the cost of the inspection.

Under s. 627.707(5), F.S., if a sinkhole loss is verified an insurer must pay to stabilize the land and building, and repair the foundation of the structure in accordance with the engineer's recommendations in the final report and in consultation with the policyholder. The insurer must also pay for other repairs to the structure and contents. All payments are subject to the coverage

⁶ An insurer that has paid a claim for sinkhole loss must file a copy of the report with the county property appraiser. Additionally, the seller of real property upon which a sinkhole claim has been made must disclose to the buyer of such property that a sinkhole claim has been paid and whether the full amount of the proceeds were used to repair the sinkhole damage. See s. 627.7073(2), F.S.

and terms of the insurance policy. The insurer may limit its payment to the policyholder to the actual cash value of the sinkhole loss, not including repair techniques performed below the foundation of the building, until the policyholder contracts for building stabilization or foundation repairs. Once the policyholder does enter into such a contract, then the insurer must pay the amounts necessary to begin and continue such repairs as work is performed and expenses are incurred. If work has begun on repairs, and the engineer determines the repair cannot be completed within policy limits, the insurer must either complete the engineer's recommended repair or tender the full policy limits to the insured without a reduction for incurred repair expenses.

Section 627.707(8), F.S., places limits on an insurer's ability to non-renew a policy on the basis of a claim for sinkhole damage. An insurer is prohibited from nonrenewing a policy on the basis of claims for sinkhole damage or clay shrinkage unless the total claims payments exceed the policy limits or the insured does not repair the structure in accordance with the engineering recommendations upon which the payment under the policy was based.

Mediation of Disputed Property Insurance Claims

Section 627.7015, F.S., provides a process for the mediation of disputed residential property insurance claims, including sinkhole claims. The process is administered by the Department of Financial Services, which promulgates rules for the conduct of the conference, the qualifications of a mediator, the selection of a mediator, and other matters. The mediation conference is designed to be an informal forum for helping homeowners and insurers to resolve claims disputes before entering the expensive and time consuming process of adversarial litigation. Mediation pursuant to this section is non-binding on either party. However, if a settlement is reached and not rescinded⁷, it is binding and releases all specific claims presented on the mediation conference.

The mediation process begins once an applicable first-party claim is filed, at which time the insurer must notify all first-party claimants of their right to participate in mediation. If the insurer fails to provide notification, and the mediation does not resolve the claim, the policyholder need not participate in a contractual loss appraisal process of property loss damage as a precondition to legal action for breach of contract against the insurer for failure to provide benefits. Generally, the insurer must pay for all costs of mediation.

III. Effect of Proposed Changes:

Section 1. Amends s. 627.706, F.S., amends s. 627.706, F.S., to allow (but not require) insurers to include a deductible for sinkhole losses for residential property insurance equal to 1 percent, 2 percent, 5 percent, or 10 percent of the policy dwelling limits, with appropriate premium discounts offered with each deductible amount.

The bill also defines the term "professional engineer" rather than "engineer" but does not otherwise change the definition. This term is used throughout the following sections, to be

⁷ An insured may rescind the settlement within 3 business days if a check or draft received pursuant to the settlement has not been cashed or deposited.

consistent with the terminology used for “professional geologist,” but does not substantively change the law.

Section 2. Amends subsection (5) of s. 627.707, F.S., relating to standards for investigation of sinkhole claims. The bill allows the insurer to make payment directly to the persons selected by the policyholder to make the repairs, if approved by the policyholder and lienholder.

The current law requires that if the repair of the sinkhole loss has begun and the engineer selected or approved by the insurer determines that the repair cannot be completed within the policy limits, that the insurer must either complete the engineer’s recommended repair or tender the policy limits. The bill limits the application of this requirement to personal lines residential property insurance policies. Therefore, it would not apply to commercial lines (residential or non-residential) policies, such as a condominium association or commercial business.

Section 3. Amends s. 627.7072, F.S., to make technical conforming changes to the term “professional engineer.”

Section 4. Amends s. 627.7073, F.S., to specify that the sinkhole investigation report that is done by a professional engineer or professional geologist must include findings as to the “cause of distress to the property” rather than the “verification or elimination of a sinkhole loss.” This terminology is believed to be more consistent with the findings that are typically made in such reports.

The bill also requires that insurers that pay sinkhole claims must file sinkhole reports with the county clerk of court, rather than the county property appraiser.

Section 5. Creates s. 627.7074, F.S., to provide an alternative dispute resolution process for sinkhole claims. The process supersedes the current mediation procedures regarding property insurance claims contained in s. 627.7015, F.S. The process begins once an insurer receives the sinkhole report under s. 627.7073, F.S., or denies a sinkhole claim, at which point the insurer must notify the policyholder of the right to participate in the neutral evaluation process. The DFS is required to produce a consumer information pamphlet that details the neutral evaluation process and provides the directions and forms necessary for the policyholder to request a neutral evaluation. The insurer will be required to distribute the pamphlet to its policyholders.

The neutral evaluation process is to be optional and nonbinding, with either the policyholder or insurer declining to participate. However, if the policyholder declines to participate, the insurer shall not be liable for attorney’s fees under the insurance code or s. 627.428, F.S., or for extra contractual damages related to a claim for sinkhole loss. If a party desires neutral evaluation, the request must be filed with the DFS on a form approved by the department. The request must state the reason why neutral evaluation is being sought, and include an explanation of all issues in dispute. The filing of a request for neutral evaluation acts to toll the time period for filing suit for 60 days following the conclusion of neutral evaluation or the time prescribed in s. 95.11, F.S., whichever is later.

Once the DFS receives a request for neutral evaluation, it must refer the request to a certified neutral evaluator. The neutral evaluator must be a qualified engineer or professional geologist

who has completed an alternative dispute resolution course designed or approved by the department. The evaluator must be fair and impartial and attempt to resolve the dispute at issue.

The neutral evaluation is an informal process to which the formal rules of evidence and procedure need not apply. Though the process is informal, the DFS shall adopt rules of procedure for the neutral evaluation process. All parties must participate in good faith. The neutral evaluation conference must be held within 45 days of the department's receipt of a request. The neutral evaluator must notify the policyholder and insurer when and where the neutral evaluation conference will be conducted. The conference may be held by telephone. A party does not need to attend if a representative attends and has the authority to make a binding decision on behalf of the party. If a policyholder is not represented by an attorney, a consumer affairs specialist of the DFS or an employee of the DFS designated as the primary contact for consumers on issues related to sinkholes under s. 20.121, F.S., must be available to consult with the policyholder to the extent he or she may lawfully do so.

For matters not resolved by the parties during the neutral evaluation, the neutral evaluator must prepare a report stating whether the sinkhole loss has been verified or eliminated. If the existence of sinkhole loss is verified, the report must include the evaluator's opinion regarding the need for and estimated costs of stabilizing the land and any covered structures as well as appropriate remediation or structural repairs. The evaluator's report must be sent to all parties in attendance at the neutral evaluation and to the DFS.

The bill provides that evidence of an offer to settle a claim during the neutral evaluation process, or other relevant conduct or statements made concerning an offer to settle are inadmissible to prove or disprove liability or a claim's value. However, the recommendation of the neutral evaluator is admissible in any subsequent action or proceeding only for a determination regarding the award of attorney's fees. If a policyholder declines to follow the recommendations of the neutral evaluator, the insurer is not liable for attorney's fees under the insurance code or s. 627.428, F.S., or for extra contractual damages related to a claim for sinkhole loss. The CS provides that if the neutral evaluator verifies a sinkhole and recommends costs that exceed the amount the insurer has offered to pay the policyholder, the insurer is liable for up to \$2,500 in attorney's fees for the claimant attorney's participation in the neutral evaluation process. A party may seek judicial review to vacate the recommendation of the neutral evaluator if it was not "reasonable." However, the grounds are very limited in this regard, because a recommendation is reasonable unless: it was procured by corruption, fraud, or other undue means; there was evident partiality by the neutral evaluator or misconduct prejudicing the rights of any party; or the neutral evaluator exceeded the authority and power granted by this section.

This section of the bill takes effect October 1, 2006.

Section 6. Amends s. 877.02, F.S., regarding the illegal solicitation of legal services or retainers. The CS prohibits a general contractor, subcontractor, or other business providing sinkhole remediation services from soliciting legal business for an attorney. Doing so is a first degree misdemeanor.

Section 7. The act takes effect July 1, 2006, except as otherwise provided in the bill.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:**A. Tax/Fee Issues:**

None.

B. Private Sector Impact:

To the extent that the legislation reduces the cost of sinkhole claims, more private market insurers may be willing to write additional policies in areas of the state subject to heavy losses resulting from sinkhole claims. It may also reduce the premium that policyholders are forced to pay both within the private market and in Citizens. If the private market begins writing more policies, the amount of insureds forced to purchase coverage from Citizens may also drop.

If the neutral evaluation process is conducted fairly, it may provide a lower cost alternative for resolving disputes between policyholders and insurance companies. It will provide cost savings over litigation in instances where the two sides are able to resolve their differences. However, the process will curtail the ability of the insured to recover attorney's fees if the policyholder decides to litigate the disputes at issue. Failure of an insured to take part in the neutral evaluation process contained in the bill, or to follow the recommendations of the neutral evaluator will prevent the insured from being able to recover attorney's fees under s. 627.428, F.S., or under other provisions of the insurance code. The insurer will also not be liable for extra-contractual claims.

C. Government Sector Impact:

The Department of Financial Services will have additional duties regarding the neutral evaluation process of sinkhole claims. The DFS must certify and maintain a list of neutral evaluators. It must also receive requests for neutral evaluation and refer a neutral evaluator to mediate the dispute and make findings. The department will also receive the written report of the neutral evaluator.

The DFS has estimated the following costs related to these provisions:

- \$58,243 in salary and benefits, expenses, and start-up costs for a Management Analyst I who will implement and manage the neutral evaluation process.
- \$65,565 in salary and benefits, expenses, and start up costs for a Consumer Affairs Specialist who would serve as a liason for consumers participating in the neutral evaluation process without an attorney.
- Approximately \$2,000 to create 5,250 brochures regarding the sinkhole mediation process.

The total first year costs are estimated to be \$125,808.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

This Senate staff analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.

VIII. Summary of Amendments:

None.

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