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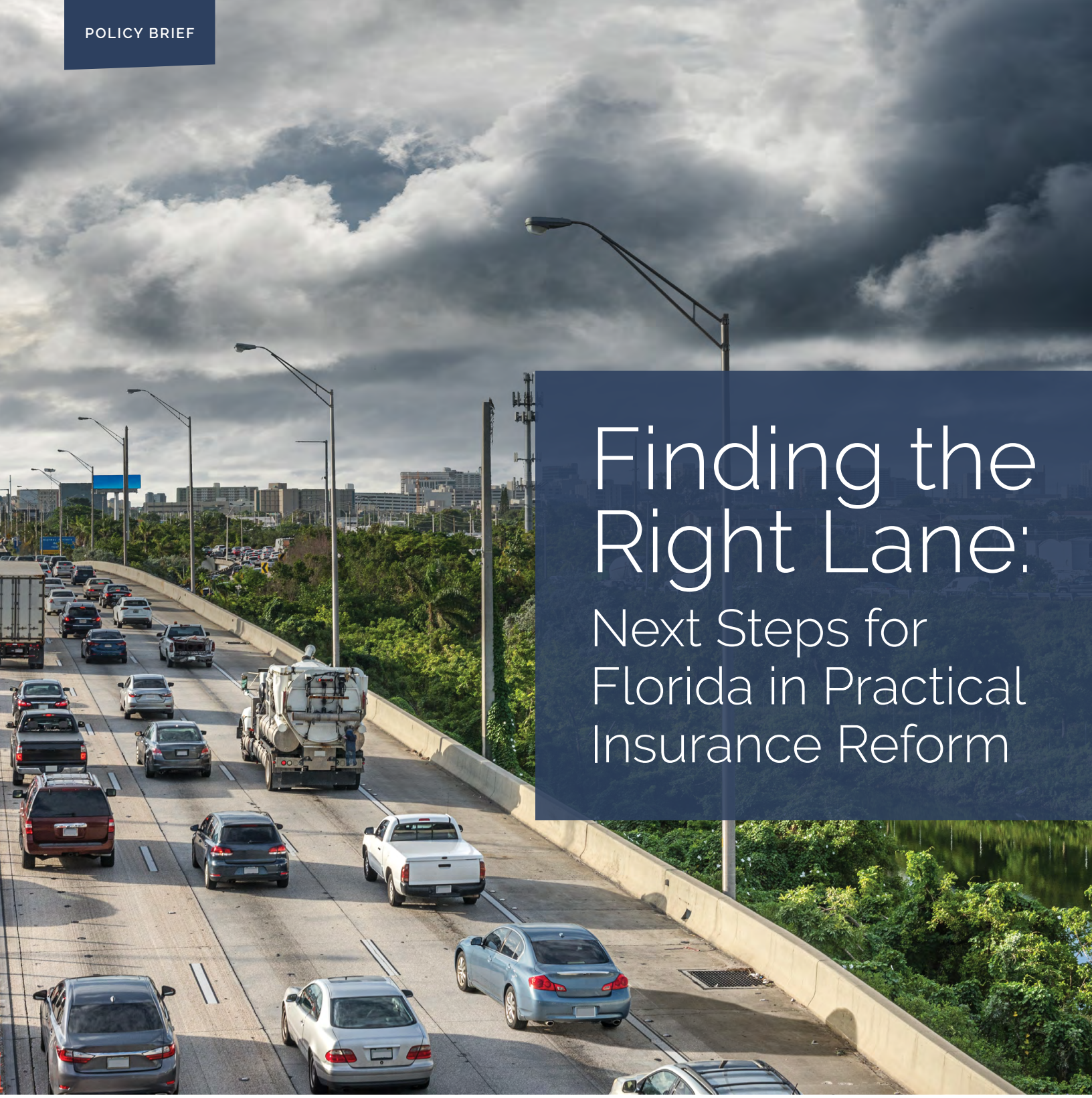

Finding the Right Lane:

Next Steps for Florida in Practical Insurance Reform

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Introduction

Florida's pro-growth, business-friendly environment, as well as its climate, sunshine, and proximity to Latin-America have encouraged the flow of people and capital into the state and created enviable levels of economic and population growth. Indeed, in 2014 Florida surpassed New York to become the third-most-populous state in the nation,[1] and as of last year boasts a GDP surpassing $1 trillion per year, making the state the 17th largest economy in the world.[2]

This growth has resulted in a concentration of wealth and population primarily in the state's more desired coastal areas, which are more naturally prone to storms and flooding. There are also more cars, trucks and, by extension, traffic accidents on the state's increasingly congested roadways. Florida's geographic position coupled with the aforementioned growth in population and economic activity have caused property and auto insurance rates to be costlier than in many other states.

Indeed, these cost drivers would justify some modest rate escalation, all things being equal. However, the rate spikes many Florida insurance consumers are experiencing disproportionately outpace the gradually increasing risks inherently connected to the state's natural factors and aforementioned growth.

Increasing insurance rates are appropriate when they reflect actual risks. Lawmakers, the insurance industry, and even the free market itself may take actions that ameliorate those risk factors (i.e., technological advances, stronger building codes, safer cars, penalties for distracted driving, and discounts or other incentives that reward responsible consumer behavior). But until such risks are actually reduced—whether organically or intentionally—and the reductions are reflected by a decrease in the frequency and severity of claims, insurance premiums will likely continue to rise. Subsidizing insurance rates in one form or another, as politically alluring as such proposals may be, would only serve to prolong or exacerbate the risks or risky behavior driving the underlying costs.

Nevertheless, given how insurance premiums are disproportionately outpacing the risks associated with Florida's steady growth, it is apparent that the rate increases plaguing insurance consumers are being propelled by other cost drivers disconnected from the state's inherent risk factors.

The following pages describe how property and auto insurance rate increases have stemmed from behavior by stakeholders exploiting vulnerabilities in the law, what the Florida Legislature did in 2019 to curb property insurance fraud and abuse, and how it can build upon those reforms to bring similar clarity to the state's auto insurance system.

Property Insurance Crisis Averted

After the catastrophic 2004 and 2005 hurricane seasons, no one could have predicted that the state would be granted an unprecedented, decade-long reprieve by Mother Nature, while simultaneously enjoying some of the lowest global reinsurance rates in recent memory. This remarkable streak of combined luck allowed the state's insurance market to rebound.

Nevertheless, well into that hurricane-free decade, property-insurance premiums kept rising. In 2016, 72.3 percent of approved rate filings were for rate increases despite a multi-year lull in hurricane strikes. A year later in 2017, that figure had jumped to 90 percent.[3] Consumers had legitimate concerns when they asked why this was the case, especially during such a long and unprecedented dry spell and with reinsurance rates and other risk transfer products at near-record low prices.

The evidence pointed to the proliferation of non-catastrophe claims—mainly water damage from broken pipes—as the main culprit.

According to data furnished by the Office of Insurance Regulation (OIR), the frequency of water claims between 2015 and halfway through 2017 increased 44.1 percent, which is nearly triple the 14.2 percent average annual increase contained in its previous reports. According to the OIR's 2018 report, these increases were happening across the entire state, but were mostly concentrated along Southeast Florida and the Tampa Bay region.[4]

This spike in water claims did not come as a result of some unexplained natural phenomenon afflicting only the state of Florida. Instead, it was largely instigated by the exploitation of laws and court decisions governing an insurance practice known as "assignment of benefits."

An assignment of benefits (AOB) allows a third party – such as a contractor, a water-extraction company or other vendor – to stand in the place of the insured and assume the policyholder's benefits by collecting payments directly from the insurance company for a covered loss. The policyholder also transfers to the third party the right to negotiate and adjust the claim in question. Hence, no payments are made directly to the policyholder.

Most health insurance and personal injury protection (PIP) auto policies function under this arrangement, which

allows health care providers to collect insurance payments directly for covered medical services.

In recent years, however, AOBs have become more common in property insurance claims where a policyholder has the right to assign his or her policy benefits for a specific loss,[5] including the benefit in Florida law that allows policyholders to sue an insurance company and then have their attorney fees covered by the insurer, also known as the "one-way attorney fees" provision.[6]

Although most vendors conduct themselves professionally, there is significant anecdotal evidence that some abused these assignments, since policyholders were no longer involved in price negotiations or any subsequent discussions with their vendor or insurance company on a given claim. With the homeowner out of the picture and no longer in a position to negotiate repair costs, crooked contractors oftentimes inflated their bills, and/or charged for repairs that were unnecessary or unrelated to the specific loss. In more and more cases, contractors partnered with trial lawyers as a matter of practice, availing themselves of the aforementioned "one-way attorney fees" benefit in state law, as well as bad-faith rules that were designed to protect ordinary consumers. One particularly egregious case cited by Florida's former state-appointed insurance consumer advocate included billings that totaled more than the house was worth.[7]

The constant threat of litigation and massive judgments far beyond policy coverage limits borne out of lawyers exploiting the one-way attorney fee and bad faith laws served as a perverse incentive for insurers to settle for amounts greater than they otherwise would have. These abuses amplified the severity of claims and thus resulted in even higher rates for consumers.

But despite efforts by most insurers to avoid litigation, AOB-related lawsuits increased—exponentially. Such lawsuits were rare in Florida a little over a decade ago. Between 2004 and 2005, there were just slightly more than 9,400 assignment-of-benefits related suits filed statewide. In subsequent years, these lawsuits multiplied by nearly 1,000 percent, with 92,000 such suits filed between 2013 and 2014.[8] In 2018 alone, there were roughly 135,000 AOB lawsuits – an increase of 70 percent in just 15 years.[9]

After six years of debating various AOB-related reform bills, the Florida Legislature finally passed and Governor DeSantis signed a meaningful reform package into law earlier this year, which is expected to tackle the incentives and abuse that drove the property insurance rate increases in recent years. HB 7065 established requirements for the

execution of AOBs and other consumer protections. Most importantly, it contained a legal reform component intended to reduce litigation by amending Florida's "one-way attorneys fee" law with a formula to determine which party, if any, receives an award of attorney fees should an AOB lawsuit result in a judgment. The law took effect in July.[10]

Given the rash of hurricane strikes the past couple of years, AOB reform might have come at just the right time. There were fears that the AOB cottage industry could easily pivot from exploiting non-catastrophe losses to hurricane claims. Indeed, even reinsurers took note of a potential post-hurricane AOB crisis and expressed concerns as early as 2016 that the issue was starting to trickle into reinsurance pricing[11] due to fears that their industry would be on the hook for artificially inflated claims stemming from AOB abuse and excess litigation after a hurricane.

Indeed, days after Hurricane Michael struck the Florida Panhandle in October 2018, there were already reports of vendors pushing AOBs in storm-ravaged areas.[12] However, they will now have to operate within Florida law's new consumer protections and legal provisions after the passage of AOB reform.

What's Driving Auto Insurance Rates?

Perverse incentives, abuse, and consequent rate increases have not been confined to the property insurance sector. System-gaming and litigation have instigated auto insurance rate spikes that have disproportionately outpaced the gradual rise in auto accidents caused by additional drivers on the road, changes in driving behavior, the proliferation

of mobile devices, and other inescapable risk factors.

Florida is one of only a few states that has a no-fault system of auto insurance commonly known as "personal injury protection" (PIP). Under this system created almost 50 years ago, Florida drivers are required to carry $10,000 of PIP coverage and at least $10,000 in property damage coverage.[13] The intent behind this requirement was to avail drivers and their passengers of up to $10,000 in medical coverage regardless of fault to quickly resolve claims and avoid long and costly court fights.

Despite its noble intentions, Florida's PIP system has become plagued with growing fraud, litigation, and consequent auto insurance rate increases. In order to tackle these abuses and put a tourniquet on these rate increases, Florida lawmakers enacted HB 119 in 2012[14] with the expressed goal of passing expected savings on to consumers.

The reforms essentially added restrictions, prohibitions and deadlines to qualify for reimbursement under PIP to rein-in rampant fraud, and created a two-tiered system of benefits contingent upon the gravity of the injury. For example, the full $10,000 benefit is reserved only for acute medical emergencies suffered as a result of the accident; if not, the medical benefit is reduced to $2,500 for less serious injuries. In order for accident injuries to be covered by PIP, motorists must receive initial care within 14 days of an auto accident, and the medical services need to be ordered, provided, or supervised by licensed physicians or rendered in hospitals, facilities owned by a hospital, or licensed emergency transportation and treatment providers.[15] Massage and acupuncture were made ineligible for PIP reimbursement.

By 2018, Floridians were paying more than $1,250 yearly for auto policies on average, and the state is now the second costliest in the nation for auto insurance. Like the increases in property insurance discussed previously, there is no inherent risk factor that can justify the dramatic spike in auto insurance rates.

The 2012 reforms also instituted medical fee limits for PIP reimbursement that are largely tied to Medicare and workers' compensation fee schedules.[16] The law also prohibited the application of attorney fee multipliers in no-fault cases and required attorney fees to comply with reasonable standards to avoid the artificial inflation of legal charges.

The 2012 PIP reforms seemed to have worked initially. According to a 2014 press release by the Office of Insurance Regulation, PIP rates decreased by roughly 13.5 percent after the law took effect. However, because the PIP portion accounts for only about 25 percent of the total cost of a standard auto insurance policy, consumers experienced roughly a 3 to 4 percent average reduction in their overall auto insurance premiums.[17]

Although the rate rollbacks appeared low, PIP rates had increased by 46.3 percent immediately prior to the reforms, which translated into an overall average increase of almost 13 percent for a full auto insurance policy. According to the OIR, "the bill significantly impacted the personal auto market and changed the trajectory of the trends that were being seen prior to the bill."[18]

However, the benefits were short-lived. The rate reductions in the first two years after the reforms were quickly erased by subsequent premium increases. In 2015, PIP premiums rose by nearly 15 percent.[19] And the increases have since only accelerated. Between 2015 and 2017, the rate reductions achieved by the 2012 law were erased, resulting in average premiums being higher than they were before the reforms passed.[20] Between 2017 and early 2018 alone, PIP rates shot up a staggering 54 percent with costs increasing 35 percent faster than the soaring premiums since January 2017. By 2018, Floridians were paying more than $1,250 yearly for auto policies on average,[21] and the state is now the second costliest in the nation for auto insurance.[22]

Like the increases in property insurance discussed previously, there is no inherent risk factor that can justify the dramatic spike in auto insurance rates. These rate increases have far outpaced any surge in injury crashes that can be attributed to population increases, the rise in automobiles per capita, increased workforce participation, and the emergence of distracted drivers due to the proliferation of mobile devices. For example, there was only a 1.9 percent increase in insured automobiles in Florida[23] and only a 4 percent increase in injury crashes[24] between 2015 and 2017—hardly a justification for the 54 percent spike in PIP rates in the same period.

But despite the marginal increase in cars and accidents, there were over 60,000 PIP-related lawsuits filed in 2017, representing an increase of almost 50 percent in one year.[25]

And therein lies the cause of PIP rate increases.

As was the case with property insurance, the main culprits behind the explosion in auto insurance-related litigation are Florida's lopsided bad faith law and the one-way attorney fee statute.

Indeed, the 2012 PIP reforms largely tackled the fraud

and abuse happening on the ground—the staged crashes, over-billing by medical providers, and the proliferation of shady PIP clinics, to name a few. However, other than prohibiting attorney fee multipliers and establishing modest requirements for the recovery of plaintiff attorney fees, the law did little to curb other rampant tort abuse.

Because of the low policy limits in PIP claims, many unscrupulous attorneys and third party claimants have resorted to setting up insurers into a condition of bad faith to convert a $10,000 maximum claim under a policy into massive six- or even seven-figure recoveries, as judgments for bad faith awarded by juries are not capped by policy limits.

A recent example-turned-landmark court decision could have serious implications for Florida's insurance industry. In September 2018, the Florida Supreme Court found that a jury was justified in its finding of bad faith against an auto insurer and upheld a multi-million dollar judgment against it after an appellate court reversed the jury's award.

The case stemmed from a fatal 2006 accident in which the plaintiff's vehicle was covered by a $100,000 liability policy through GEICO. Despite the insurer's attempts to settle the claim by sending the deceased man's estate a check for the full $100,000 within nine days of the accident, the estate returned the check and instead filed a wrongful death lawsuit against the plaintiff arguing that GEICO had not provided a statement from the plaintiff that would have disclosed his assets. The plaintiff then sued for bad faith, despite GEICO fulfilling every obligation owed to its policyholder. The jury sided with the plaintiff and awarded him $9.2 million, which was reversed by the 4th District Court of Appeals. A sharply-divided Florida Supreme Court backed the jury's determination and overruled the appellate court.[26]

Florida's bad faith statute outlines an insurer's responsibilities to act in good faith to settle a claim,[27] but is silent about the claimant's responsibilities to likewise act in good faith when dealing with an insurer to settle a claim. This one-sided application can reasonably create a situation where a claimant—be it a policyholder or a third party—can refuse to cooperate with the established claims settlement process or even sabotage it altogether thereby "setting up" an insurer into a condition of bad faith despite a clear willingness to settle the claim in a timely, good faith manner. The recent Supreme Court case involving GEICO is one such example where the claimant's attorney refused to accept and actually returned the check for full policy limits from GEICO.[28] Other examples include intentionally making unreasonable or vague demands of insurance companies that are impossible to comply with, sending demand letters to an obscure company address (i.e., a different department or a satellite office in another state) in order to purposely create delays, and demanding payment of full policy limits when the case does not justify it.[29]

Indeed, even the courts have taken notice of how attorneys are gaming the system. In 2006, Florida's Second District Court of Appeal noted that:

> The number of bad faith cases filed in the courts appears to be exponentially increasing, but the increase does not appear to be directly linked to the actions of the insurers. Instead, plaintiff's attorneys are filing bad faith actions over issues that it seems could be simply resolved, like the wording of the release in this case.[30]

This rash of lawsuit abuse is largely unique to Florida, which came in 46th in the 2019 ranking of state liability systems.[31] A partial explanation for this flood of litigation appears to be that Florida is only one of five states that even allow third-party bad faith claims.[32] The action is called a

"third-party" lawsuit because the plaintiff alleging bad faith is not a direct party to the insurance contract (i.e., is not the policyholder). In most cases, these lawsuits arise after a person files an insurance claim alleging injury caused by someone else who has liability coverage for such a situation, and then claims that the policyholder's insurance company has refused to settle the liability claim in good faith.

In most of the other 45 states where third-party bad faith lawsuits are not allowed, claims settlement procedures are enforced through the state's own administrative mechanisms by imposing stiff fines and other penalties against insurers who act in bad faith. Thus, it is the state or its regulators that hold insurers accountable, not trial lawyers who stand to personally profit from bad faith judgments and are therefore incentivized to ensnare insurers into a condition of bad faith.

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Indeed, a recent report estimated that abuse of Florida's liberally-applied third-party bad faith laws increased injury claim costs per insured vehicle in Florida by 103 percent from 1995 to 2017; this has added an average $106 to every insurance policy in 2017, resulting in a total of $7.6 billion in additional claim costs over 12 years.[33]

Indeed, a recent report estimated that abuse of Florida's liberally-applied third-party bad faith laws increased injury claim costs per insured vehicle in Florida by 103 percent from 1995 to 2017; this has added an average $106 to every insurance policy in 2017, resulting in a total of $7.6 billion in additional claim costs over 12 years.

Other large states with auto insurance systems similar to Florida's show very different figures. In New York, average claim costs per insured vehicle rose by only 1.3 percent during the same period; in New Jersey and Pennsylvania, they actually decreased. Additionally, auto liability claim frequency fell by 43 percent in these states while they rose 36 percent in Florida.[34]

The most notable difference between these states and Florida? They do not allow third-party bad faith lawsuits.

Repair, Repeal, and Replace

Given the challenges outlined above and the artificial cost drivers being foisted on the state's insurance consumers, lawmakers need to pass meaningful reforms by repairing and bringing clarity to Florida's bad faith rules, repealing the state's outdated PIP system, and replacing it with a commonsense, functional auto insurance structure similar to most other states.

REPAIR BAD FAITH

Insurers have many duties to their policyholders, most important of which is to act in good faith. When they actively and knowingly fail to defend a lawsuit, refuse to make a reasonable settlement offer within appropriate timeframes, or improperly delay or altogether refuse to process legitimate claims, a policyholder's ability to seek remedy against them should be preserved. Indeed, penalties levied against multimillion dollar companies that intentionally and legitimately act in bad faith should sting and deter others from engaging in similar behavior.

However, claimants and their legal representatives should also have a duty to act in good faith. The current one-sided menace of a six or seven-figure bad faith claim looming over just one party has created a perverse incentive for the other party with a lot to gain and nothing to lose. As previously discussed, there is ample evidence—including last year's Supreme Court case and observations by other courts—to conclude that many claimants' attorneys are setting up insurers into conditions of bad faith with very expensive consequences for non-culpable insurers and the insurance market as a whole.

Requiring both sides to act in good faith will deter unreasonable offers, demands and deadlines, and foster more productive negotiations. When a claimant makes a settlement demand, the insurer should have a reasonable time—or "safe harbor" period—to accept, investigate, negotiate, or reject the offer. Acting in bad faith by engaging in dilatory and other devious tactics to deliberately plunge a good faith actor into a state of delinquency against his own will should be penalized, not rewarded with a cash windfall.

Lawmakers should also look at other states who effectively dealt with similar lawsuit abuse. For example, in 2005 West Virginia eliminated the right of third-party claimants to file lawsuits against a policyholder's insurer for bad faith. Instead, such lawsuits were replaced with an administrative procedure whereby aggrieved third parties file com-

plaints with the insurance commissioner who investigates the cases and imposes fines and other punitive measures against insurers who violate claims settlement procedures and otherwise act in bad faith. Five years after eliminating third-party bad faith lawsuits, consumers experienced an estimated $200 million reduction in automobile liability insurance rates in West Virginia[35]—a state with a population less than 10 percent of Florida's.[36]

Allowing third-party bad faith lawsuits makes Florida an outlier. Eliminating them would be a bold move that would harmonize Florida with the 45 states that do not allow such lawsuits and would largely address many of the problems outlined herein.

Finally, lawmakers should take note of the long-standing precedent that the Florida Supreme Court narrowly overturned in the aforementioned 2018 landmark GEICO case, and consider codifying the previous standard. In his dissent, Justice Charles Canady observed that "negligent claims handling does not equate to bad faith," per legal precedent now erased by this decision.[37] Indeed, the insurer in this case may have "dropped the ball" on a procedural matter, but that action alone had no bearing on the insurer's obvious willingness to settle the claim days after the accident in question for the full policy limits. The Legislature would do well in clarifying Florida law so that a mistake during the claims settlement process does not constitute an act of bad faith, especially if such a mistake has no dilatory or other demonstrable effect on the insurer's clear willingness to settle the claim in good faith.

REPEAL AND REPLACE PIP

The reforms made to Florida's no-fault auto insurance system in 2012 seemed to have reined-in some of the PIP fraud happening on the ground with consequent short-lived rate relief, but did little to discourage abuse elsewhere. In recent years, legislation has been filed to repeal PIP altogether and replace it with a tort system where the party at fault of an accident would be liable for damages, including medical expenses. The proposals in recent years would have established a mandatory bodily injury liability (BI) system with minimum coverage amounts.

Despite decades of increasing healthcare costs, the current PIP benefit of $10,000 has not been increased since 1978.[38] This outdated benefit amount, coupled with the aforementioned abuse plaguing the PIP system, has resulted in greater calls to repeal PIP altogether and replace it with a more commonly used liability system with higher benefit thresholds.

Currently, 48 states operate under some form of BI liability structure where the insurer of the at-fault driver takes responsibility for injury or damage following a crash.[39] Switching to such a tort-based system would bring Florida in line with the vast majority of states and save drivers an estimated $81 per year, according to a 2016 actuarial study that analyzed a proposal by the Florida House. Additionally, switching to a tort-based system may address some lingering automobile insurance fraud, as dubious claims would be litigated and thus be given greater scrutiny.

One bill has already been introduced ahead of the 2020 regular legislative session that replaces PIP with a mandatory BI system. SB 378 by Senator Tom Lee (R-Brandon) provides for coverage levels of: $25,000 for the bodily injury or death of one person in a crash; $50,000 for the bodily injury or death of more than one person (subject to the $25,000 per person cap); and the current $10,000 coverage for property damage. Additionally, the bill creates an optional medical payments (med-pay) benefit of at least $5,000 to cover the medical expenses (or death) of the insured, his/her passengers and resident relatives, any authorized driver of the insured's vehicle, and persons struck by the insured's vehicle while not occupants of another vehicle.[40]

> Given the challenges outlined above and the artificial cost drivers being foisted on the state's insurance consumers, lawmakers need to pass meaningful reforms by repairing and bringing clarity to Florida's bad faith rules, repealing the state's outdated PIP system, and replacing it with a commonsense, functional auto insurance structure similar to most other states.

Some proposals in recent years likewise contained a med-pay coverage option,[41] while others mandated it,[42] which would have essentially resulted in a "PIP-light" functioning almost identically to the current no-fault system. At least one recent proposal contained no med-pay provision.[43]

Med-pay can and should be an optional coverage that motorists may elect to purchase if, for example, they do not carry health insurance or to cover their annual health insurance deductible in case of an injury crash. But requiring consumers to purchase a personal injury insurance benefit under a different name would only transfer the problems

and cottage industry that have sprouted around PIP over to the new med-pay system. Proponents of a mandatory med-pay fairly argue about an inherent cost-shifting from auto insurers to health insurers, but given the managed care arrangements that health insurance companies operate under, there would be a significant reduction in overall costs.

If consumers want to add med-pay as an additional benefit to their auto insurance policies, they should be afforded the option. However, it should neither be required nor added to a policy by default in such a way that a policyholder must actively opt-out of it. The commission-based structure under which most insurance agents operate already incentivizes them to sell their customers additional insurance products, riders, and enhanced coverage options such as med-pay.

Finally, to further reduce cost drivers, insurers should be authorized to limit reimbursements for benefits payable from BI coverage through a fee schedule similar to the one established in the 2012 no-fault auto insurance reforms. And for claims that are litigated, juries should be presented with the amounts medical providers will actually accept (i.e., commercial insurance allowables or fee schedules) instead of billed amounts, which are always substantially greater than what insurers are contractually obligated to reimburse medical providers.

Conclusion

High insurance rates are appropriate when they reflect actual risks. Costs inherent to a particular industry or regional market may be impossible to remedy through laws or the insurance system. However, it is apparent that the steep auto insurance rate increases Floridians are being slammed with stem from behavior by stakeholders exploiting vulnerabilities in the law and an antiquated system with obsolete coverage levels.

After six years of failing to address a festering AOB crisis, the seventh year was the charm for the Florida Legislature, which finally enacted sensible reforms aimed at protecting consumers and tackling the fraud, abuse, and unnecessary litigation that were driving up property insurance rates for over a decade. Lawmakers should build upon last year's meaningful AOB reforms by tackling the unnecessary auto insurance rate increases plaguing Florida drivers.

Repairing Florida's broken bad faith rules, repealing PIP, and replacing it with a commonsense, auto liability insurance system that 48 other states use will help to restrain cost drivers artificially inflating rates and restore sanity to one of America's most needlessly expensive and complicated auto insurance markets.

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