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License to Bill: Insurance Companies are Overpaying Excessive Restoration Costs

Understanding the Issue

The emergency response and restoration industry in the United States is currently structured and managed to encourage excessive billing and costs to the insurance carrier and property owner following a CAT loss such as Hurricanes Harvey or Irma, or any environmental event, fire, spill, release, water, or wind storm-related loss. While there are many professional remediation, response, restoration, and mitigation companies operating both nationally and locally, the current industry standard contracting structure and project delivery method is fundamentally flawed, resulting in excessive cost incurred by these firms and subsequently invoiced to the policy owner. The unaware policy owner submits these costs to the insurance carrier often resulting in invoices being rejected or reduced. This leads to payment delays, disputes, and litigation.

This session will define the problem and present how all of this can be avoided by applying proven construction management principles and project delivery methods. Real world examples shall be presented.

The Basic Problem

Following a property loss, especially one that is large and unanticipated, the policy holder is unsure how to respond and uncertain of the process for filing a claim and, consequently, chaos ensues. This is exacerbated with losses associated with a fire, flood, environmental release, or large water loss when the property cannot be readily accessed. Typically, the insured informs the broker and insurance carrier after a response contractor has been retained and the work has begun. In the “chaos” period, the insured is at the mercy of the response contractor as he/she is led into a response contract that may not be favorable to the insured, or the carrier. The contracting methods and the actual contract forms utilized favor only the vendor/response

contractor and have the potential of being exploited and may lead to inappropriate billing practices and possibly consumer or insurance fraud.

When the policy owner submits the restoration costs to the insurance carrier, the invoices, upon review and scrutiny, are often rejected or reduced. This results in payment delays, disputes, litigation, and difficulty in subordination recovery.

The Solution

Chaos can be controlled with the proper planning and contracting mechanisms in place, followed by a response management approach that meets the needs of the insured and is consistent with the policy and coverage. This can be achieved with the implementation of three programs:

- A site-specific Disaster Recovery Plan;
- The pre-contracting of vendors and disaster response contractors; and
- The proper management of a loss response which employs proven construction management techniques.

Insurance Complications

Although property and environmental insurance policies are put in place to anticipate and address losses and claims, the language and conditions often do not adequately address the nuances of an unanticipated, large property loss and the necessary response. Often, there are various policies in place on a single site, such as property coverage, (with environmental exclusions) and a complementary environmental policy. These policies may not be with the same carrier or at the same terms and coverage limits. These separate policies may have different requirements for reporting the loss and other criteria for the loss response. Consequently, there is a need to reconcile coverage gaps and reporting requirement before the policies are bound, as it relates to a possible emergency.

Large, unanticipated losses and emergency responses can occur under all policy types, including Builder's Risk, construction Owner/Contractor Controlled Insurance Plan (OCIP/CCIP) programs (which often exclude all environmental coverage) as well as Comprehensive General Liability and Contractors Pollution Liability.

Types of Losses

There are many types of losses surrounding an emergency or rapid response where mismanagement and abuse may lead to excess costs, coverage disputes, and payment delays. The largest areas for chaos, confusion, mismanagement, improper contracting and overspending are in large CAT claims (hurricanes, tornadoes, floods), and environmental spills or releases of either airborne or liquid contaminants. However, the mismanagement and abuse is also very prevalent in water releases and mold claims. The "drying" and restoration contractors serving

both the large commercial property policy holders as well as homeowners are notorious for exploiting the insurance carrier.

The water loss and possible ensuing mold claim can occur through normal building operations, such as a pipe break or freezing, an inadvertent or damaged sprinkler head release, sewage back-up or heavy rain storm and flood. The causation may be free water entry, the lack of weather tightness of a building or construction site, or the failure or improper operation of mechanical or plumbing systems.

Environmental-related losses resulting in an emergency response are numerous. Some examples include a fire or explosion at a chemical handling facility, the penetration of an undiscovered underground storage tank, the unanticipated and inadvertent disturbance of asbestos in a simple building renovation, overfilling a home oil heating tank, and simply spilling diesel during the refueling of construction equipment. These and many similar events, require immediate attention so as not to exacerbate the situation or cause harm to human health and the environment.

Without proper response and control, a simple loss may escalate very quickly into an expensive loss, based on simply the method the response is contracted and managed.

The Mold Exaggeration

Although the scientific community has agreed that mold, a naturally occurring, ubiquitous organism, is not a threat to the human population and is merely an allergen, it remains one of the most prolific causes of insurance claims. It is also an area where response firms and mold “experts” can exploit the system and significantly, and unnecessarily, increase costs. There have been cases in California, Florida, and Texas where firms have been prosecuted for exploiting homeowners on water and mold clean up requirements, passing these costs on to the insurance industry.

State legislators and regulators also work- to rein in the profiteers. Again, Texas took the lead, successfully prosecuting several “remediators” for insurance fraud in the aftermath of a 2001 tropical storm. The Texas legislature enacted licensing, training, and professional requirements for mold contractors. New York, Florida, California, and other states continue to consider such requirements to protect consumers.

Licensing and Training is Inferior

This author believes that the continued growth of the mold response industry, and increasing insurance claims, are the result of an increase in “certified” mold professionals and contractors. However, are they really “certified,” and are they indeed experienced?

The presence of mold in a building is the result of excess moisture and humidity in the HVAC system, moisture or free water penetration of the building envelope and/or the result of a water or flood event. The diagnosis and correction of the water source should be performed by a forensic architect, mechanical engineer or experienced industrial hygienist.

The licensing for a certified mold assessor in many states requires very little experience or training. For example, New York prerequisites for mold assessor are a minimal age requirement of 18 years old and successful completion of a state-mandated, 5-day New York licensing course. There is no requirement for formal professional training in public/environmental health, microbiology, moisture dynamics, building structure and systems, or HVAC operations. We suggest that one does not confuse well established licenses/certifications that have educational and experience requirements, (such as Professional Engineer, Certified Industrial Hygienist, or Certified Safety Professional), with a “licensed” mold assessor.

Mold Data Claim Misinterpretation and Exploitation

However, mold is still attractive as an income source, especially in the commercial liability arena, where it continues to play a significant part in insurance claims and litigation against building owners, managers, and construction companies. And the licensing of mold professionals (e.g. “assessors”) has not minimized claim frequency or size, and actually exacerbates the opportunity for exploitation.

The common response to the suspicion or notice of mold is to perform a test. Testing companies and laboratories commonly advertise this as a method to insure the health and safety of the home. It must be understood that there are no government or regulatory agency-fixed standards for the procedure to test for mold and no standard to which to compare the results. This is the ultimate in “how clean is clean?” as there is no lower limit. “Mold Test” data from an “accredited laboratory” is not the same as standardized materials testing data (e.g., concrete strength) nor can it be compared to a regulatory exposure standard (e.g., OSHA 8 hr. Time Weighted Average or a Permissible Exposure Limit).

With the lack of states’ strict licensing requirements and no fixed standards, the data from “mold tests” can be misused (intentionally or out of ignorance) or “interpreted” to fit a particular agenda. What we are seeing is that the mold assessor deems a property “contaminated” based on flawed test data and then directs a costly remediation, all with no scientific basis.

Contracting Methods

Over the past century, the construction industry has perfected contract delivery mechanisms that are fair to the client and the contractor. The various methods are applied to the correct set of circumstances; however, they all contain the same basic principles:

- *Scope*: A definition of the work to be performed, or the specifications;
- *Schedule*: The relationship between work tasks and the duration of tasks and the complete project completion date;
- *Budget/Cost*: The cost to complete the Scope within the Schedule; and
- *Quality*: The safety, quality, and project controls to govern the work.

The general construction and renovation industries utilize four basic project deliveries or contracting methods to execute their work in compliance with the above referenced principles:

1. Fixed Price / Lump sum;
2. Guaranteed Maximum Price;
3. Cost Plus; and
4. Time & Materials—Not to Exceed.

All of these contracting methods have one thing in common; they fix the cost of the work before the work begins. When there are changes in scope or schedule, there is a legitimate mechanism for adjusting the cost or price, with the concurrence of the client, in advance of incurring the additional costs

The emergency response and restoration industry works almost exclusively on a Time and Materials basis where the client, and eventually the insurance carrier, is charged for all labor, supervision, materials, equipment, and supplies they believe are required for the project.

Imagine the insured who recently experienced an unexpected loss. He is in a state of chaos as his property and assets are severely damaged. As the “expert,” the arriving restoration contractor is there to stabilize the situation and restore the asset. The response contractor then proceeds to deploy all of the labor, supervision, materials, equipment, and supplies that he can; he is being paid for every item and no one is there to determine applicability, reasonableness or necessity.

The contracts for the response contractors include unit prices for all materials from large portable generators at thousands of dollars a day, down to rags and trash bags at a few dollars each. All will be charged to the project. The unit price lists can contain over 100 individual items.

The contract language in the response contractors' agreement includes such clauses as:

- Operations Personnel Labor—Rates apply to personnel engaged to fulfill the terms of the contract:
 - *Fulltime employees* of Restoration Contractor;
 - *Temporary hires* employed directly by Restoration Contractor; and
 - Personnel secured through *subcontracted labor*.

Even though the multiple categories of labor rates are set in the contract, the language states:

- Restoration Contractor may, at its sole discretion, make adjustments to the hourly rates and other labor provisions stated above or invoice all wages at the billed rate plus a markup of thirty percent (30%) on all of the classifications listed above.

Equipment is charged as a daily rental rate. The contract lists dozens of pieces of equipment, each with a daily unit rate. However, the contract states:

- The daily rental rate shall be charged for each calendar day, or portions thereof, during which the equipment is utilized to perform work, *regardless of the number of shifts on which the equipment is used* during the day.
- In the event any item of equipment is damaged beyond reasonable repair by conditions at the work site, the Owner shall be charged the replacement cost plus ten percent (10%).
- A small tools usage charge will be calculated at three percent (3%) of total labor and applied to all projects.

In addition to the listed equipment, the contract language states:

- **Non-Scheduled Equipment**—Restoration Contractor shall charge for any equipment utilized in performance of the work that is not listed in the schedule above and is not added to schedule as follows:

For such unscheduled equipment that is rented by Restoration Contractor for performance of the Work, the price shall be the cost to Restoration Contractor (*before any discounts*) plus twenty percent (20%).

As stated above, all of the materials that could possibly be used are itemized in the unit price schedule attached to the contract, however the contract language states:

- During the course of performance of the Work, Restoration Contractor may add additional materials to the schedule above, ***at rates determined*** by Restoration Contractor.

And lastly, if the response contractor has not included everything above, the contract language also states:

- If a specific need for a particular trade or service exists, which is not otherwise listed on the Material and Rate Schedule, or which Restoration Contractor does not provide or is unable to provide for the project, the amount will be billed at cost (before any discounts) plus twenty percent (20%) for overhead and profit.
- *Subcontractor* is defined as any entity specializing in a specific trade or service related to the performance of a project.
- *Vendor* is defined as any entity providing general goods or services related to the performance of a project (e.g., *materials, fuel, supplies*, etc.).

And:

- Restoration Contractor will charge for the costs incurred for *the transportation of equipment and materials to and from the work site*. This will include the cost of transportation for removing the equipment and remaining supplies and materials upon completion of the Work. All common carrier freight charges will be invoiced at Restoration Contractor cost plus twenty percent (20%).

How Can This Be Prevented

While there are many professional remediation, response, restoration, mitigation and environmental emergency response companies operating both nationally and locally, the current industry standard contracting structure and project delivery method is fundamentally flawed, resulting in excessive cost incurred by these firms and subsequently invoiced to the policy owner and conveyed to the carrier at a significant markup. In addition, many of the items billed for by the contractor are taken from the site and utilized elsewhere to another unsuspecting client.

Property carriers need to ensure their policy holders have in place the proper plans to deal with an emergency response. And while policies recognize the policy holder has an obligation to immediately mitigate the loss and, in some cases, take the steps to protect human health and the environment with his own forces and vendors, he must inform the carrier in a timely fashion. Based on the anticipated size of the loss, the carrier should deploy its own experts and capabilities to observe and participate in the response decisions, consistent with the policy language and good construction practices.

The construction industry utilizes a process of; *Plan, Design, Schedule, Estimate, Procure, and Execute*. An emergency response action is no different, except for the rapid response and condensed time frame. The sooner the loss response can get out of the chaos and time and materials mode, and be managed like a construction project, efficiencies will increase, costs will be controlled, and disputes will be reduced.