

[The List: 10 Reasons Why Insurance Companies May Have Underpaid Sandy Victims](#)

NJ Spotlight

Theories abound in the absence of clear information about just what went on behind the scenes in the aftermath of disastrous storm

In the aftermath of Superstorm Sandy, many insurance policyholders were denied coverage after engineering reports determined that their damage supposedly pre-existed the storm or was due to natural earth movement rather than raging floodwaters.

Other storm victims say their insurance companies failed to include coverage for sales tax and that their adjuster estimates vastly undercounted how much it would actually cost them to rebuild their homes. Now the unfolding scandal and the complaints of those Sandy victims have led to a growing number of lawsuits and congressional hearings, forced FEMA to conduct an internal investigation, and sparked calls for substantial reforms to the National Flood Insurance Program.

But this mystery remains: Exactly why would insurance adjusters and engineers intentionally go out of their way to shortchange and deny policyholders coverage?

The confusion revolves around the fact that most flood-insurance claims — unlike other types of insurance — are paid using federal taxpayer money, so private companies processing the claims would have little financial incentive to underpay their customers.

As federal inquiries continue, more information is likely to come out over the coming months detailing just what happened and why. In the meantime, experts interviewed for this article have floated a number of theories and partial explanations for what may have transpired behind the scenes.

1. Unbalanced penalty structure

Since private companies process flood insurance claims on behalf of FEMA — issuing payouts from federal coffers — they're on the hook for repaying any excess money if government auditors later find those payments were issued in error. But critics point out that they don't face equally severe penalties for underpaying policyholder claims.

"The only thing that motivates these guys is fear of pain," said David Charles, who's worked as an

adjuster for close to four decades, and now represents homeowners and business owners fighting their insurance companies.

Charles and others speculate that this unbalanced penalty structure has led to insurers, in the aftermath of Sandy, systematically rejecting legitimate claims and otherwise paying less than they should.

A federal task force is currently examining how to balance the sanctions in the future, so insurers would be penalized equally, whether they pay out too much or too little.

2. Business as usual

“Originally, the notion was that insurance companies paid what they owed. No more, no less,” said Jay Feinman, who teaches insurance law at Rutgers. But over the past few decades, companies have brought in management consultants who’ve dramatically changed the economics of the industry.

“We’ve seen a transformation where claims become a profit center. There’s an attempt to reduce costs by paying less and delaying payment of claims,” he said.

To be clear, these changes apply to claims for homeowners’ coverage — which companies pay out of their own pockets — but not to federal flood-insurance policies, where they have no similar profit motive. Still, notes David Charles, many of the same adjusters and engineers handle both types of claims. He thinks that if it’s their standard operating procedure to deny homeowner claims, they’ll likely reject many valid flood claims as well.

3. Giving insurance companies what they want

When homeowners filed 74,000 flood claims in New Jersey — including some 16,000 that required engineering inspections — insurance companies were overwhelmed, and the scale of the disaster strained their resources. So they brought in teams of outside engineers — hired guns who travel around the country from disaster to disaster to assist with damage inspections.

Following up on the previous theory, many of these engineers are used to dealing with homeowners’ insurance claims, where they’re under pressure from their firms to write reports that make the insurance carriers — their clients — happy, said Chip Merlin, an attorney representing hundreds of Sandy victims in the state.

“If the insurance companies get reports from these engineers that side with the policyholder and they have to pay more money, those honest engineers get de-listed because the engineering firm wants to keep business with the insurance carrier,” he said. “So you end up only with those that write what I would say are conservative reports that help the insurance company pay less on claims. That’s a big problem in the industry.”

4. Quantity over quality when it comes to inspections

Merlin thinks that many of the current problems stem from how adjusters and engineers are paid in the first place.

“We don’t pay them to get an accurate estimate. They get paid on a percentage basis of the amount of claims that they do. So they try to write not just one home a day. They’ll try to do about eight of them,” he explained.

“We’re incentivizing the adjusters to go out there and write massive amounts of estimates very quick, way too shoddy, not with the outlook of them fully getting all the money to the policyholder, but in a system of compensation to the adjusters that prohibits that.”

He recommends reforms to the National Flood Insurance Program that would allow adjusters and engineers to spend as long as they need to do a thorough job, so all homeowners get the consideration they deserve.

5. Inspectors were overtaxed and exhausted

Many storm victims have complained that engineers deemed their homes not substantially damaged or concluded that their damage was caused by long-term settlement of the earth – even though those inspectors never even looked in their crawlspaces.

While the financial incentive to rush through and move onto the next house was probably a significant factor, there was also the human element, suggests Amy Bach with United Policyholders, a national insurance consumer advocacy group.

“With Sandy, the damage was so widespread and so awful,” she said. “Going into houses that are wet and smelly and soggy and dark, most people want to get in and get out. It’s not like you want to spend time looking at every nook and cranny. So some of the underestimating of Sandy damage was unintentional.”

6. Possibly unqualified or poorly trained inspectors

When contractor Larry Steimel observed an insurance adjuster inspecting the home of one of his clients who had experienced flooding during Sandy, he was taken aback by what he saw.

“To me, it seemed like she was very inexperienced,” he said. “If I remember right, there were some things that she didn’t even know what they were, some building components that she really wasn’t aware of.”

As if that’s not concerning enough, lack of construction expertise is just the tip of the iceberg, said Amy Bach.

“The National Flood Insurance Program policy is very specific. It’s got a lot of nit-picky rules. And some of these adjusters are just not that experienced with it,” she said. “Then there were some that weren’t

adjusted properly because the adjusters were using Xactimate or a similar software program for estimating the repair costs, and the accuracy of the estimates these software programs produce is only as good as the training that the individual adjuster had in using the software.”

7. Valid policy exclusions and denials

It’s worth noting that one reason policyholders may have received less than they were expecting isn’t necessarily because they were shortchanged – some were legitimately denied.

Insurance industry representatives say some people were confused about whether certain damage was caused by wind or water, and thus whether they should be reimbursed by their homeowners’ insurance or their flood policy. Others may have been underinsured to begin with, or they never bothered to read the fine print when they purchased their policy to fully understand the various exclusions that wouldn’t be covered. Some exterior structures such as decks, sheds and landscaping probably wouldn’t have been covered, for instance, but many policyholders weren’t necessarily aware of that — nor did they realize that the contents of their homes would only be covered at a depreciated rate.

8. Insurance reimbursement rates are too low

Private insurance adjusters processing flood claims on behalf of the federal government use standardized price lists to determine how much to reimburse homeowners for their losses. But some observers, like attorney Chip Merlin, fear that the figures used are unrealistically low in some cases.

“We think it will come out in some of the congressional investigations that the database far underestimates the cost of estimates, especially in the barrier island coastal areas,” he said. “Right after the storm for the first year, it was very difficult for the community to get logistic supplies and enough repairmen out there, and the prices charged by contractors were quite a bit higher as a result of it. It’s just a very expensive place to do rebuilding. You have a very short construction cycle because in the wintertime, it’s nearly impossible to put roofs back together and things like that. In the summertime, you have an inundation of people, so it costs more to build on the shore. And a lot of the pricing isn’t geographically accurate enough to reflect that.”

9. Attorneys profit from increased litigation

It’s not a widely held theory, but some have suggested that there was a sort of conspiracy among the lawyers representing insurance companies to advise them to do whatever they could to avoid overpaying Sandy claims, even if it meant paying far less than they should. After all, lawyers are the one class of individuals — so the thinking goes — who benefit from the resulting lawsuits. And since these are federal flood-insurance policies, it’s not the private insurance companies that get stuck with the legal bills, but rather the government — and by extension, taxpayers.

10. Honest mistakes

Jay Feinman — the Rutgers law professor — has thoroughly researched the multitude of problems policyholders have faced following previous disasters such as Hurricane Katrina. A few years ago, he even wrote a book called “Delay Deny Defend: Why Insurance Companies Don’t Pay Claims and What You Can Do About It.”

He calls the current issues storm victims are facing puzzling and mysterious, but he thinks much of the explanation may ultimately be less intriguing than some others have speculated.

“My observation about this industry is it tends to be less often about people meeting behind closed doors coming up with vast conspiracies,” he said. “Mistakes are made, particularly when companies have to handle tens of thousands of claims all at once. And there are going to be mistakes that often will run in one direction. So I think when FEMA starts reviewing these claims, we’re going to see all kinds of issues. And fraud may not be the largest part of it.”