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Fire Insurance Claims and Homeowner Rights

by Lee S. Harris and Adrian Hern

California's wildfires have delivered a devastating blow to thousands of homeowners. Adjustment of a claim by an insurer often comes into conflict with the homeowner's belief of what is fair. Insurers have their own formulas and favored processes for handling claims adjustment that use industry selected forms and data that may conflict with information given to homeowners working with local architects, estimators and contractors. The opportunities for disagreement on adjustment processes and costs are numerous.

Homeowners in California wildfires may find that they are dramatically underinsured. Throughout the country roughly 60 percent of American homes are underinsured by an average of about 20 percent, according to CoreLogic, a company based in Irvine California that provides data to home insurers. The problem is compounded by an ever-increasing number of exclusions in policies and restrictive claims adjusting. In the aftermath of the loss, the lines between careful adjusting and contract breach, bad faith and fraud may be crossed. Full compensation also requires careful investigation focusing on who caused the loss in the first place to see if there are potentially responsible negligent parties. A homeowner who has suffered such a loss should pay careful attention to the following issues set forth below.

HOW HOMEOWNERS END UP UNDER-INSURED

Broker/agents and insurance companies may benefit from underinsuring homes. It is easier to sell insurance if the price is lower. The interests of consumers frequently are secondary to the primary profit goal of insurance agents or brokers and insurance companies who are running businesses to make money.

Given the above, insurance companies have instituted industry wide behaviors to induce homeowners to be under-insured. One way they have done this is that insurance companies have dropped "true replacement cost" coverage language from many policies. A second way insurance companies induce under-insurance is through taking advantage of the unsophisticated homeowner when entering into the policy and setting the limits. Most homeowners rely on their insurance company and the local insurance agent or broker to set their policy limits for the correct cost of repair or replacement of their home in a disaster. And, if disaster strikes, an insurer saves substantial sums if it doesn't have to pay the full cost of replacement or repair. Another way they have done this is through legislation (often backed by insurance companies) that has made misrepresentation claims more difficult to pursue. For example, California law requires a special form be sent to homeowners at policy issuance or renewal time that lists broad coverage categories that loosely / generically state instances of full, partial or no replacement cost coverage. Insurers and their representatives point to these self-serving mandated disclosures after a loss to indicate a homeowner was made aware of their full insurance coverage options and failed to exercise the best option for themselves. In other words, it makes it easier for the insurance company to dispute that the homeowner asked for and was not property given any promised replacement cost coverage. A fourth way insurance companies induce under-insurance is to again to rely on inertia and homeowner naiveté. Costs of building materials and construction labor goes up every year. Most policies do not track with the cost of inflation or the rise / fall of these construction costs. As such, unless the homeowner regularly reviews their policy and demands an increase that covers the current replacement cost value of their home, their dwelling limits can be based on several years old values. In short, they will be trying to rebuild a home in the present day, based on yester-year's prices. Again, a homeowner should educate themselves on the issue and not rely on the insurance company to establish these increased coverage limits.

A recent California Supreme Court decision, *Association of California Insurance Companies v. Jones*, 2 Cal.5th 376 (2017), highlighted the problem confronted by homeowners and upheld the validity of an Insurance Department regulation governing insurance company generated replacement cost estimates in connection with homeowners insurance applications and renewals. The Supreme Court, citing legislative analysis, found, that, "In case after case, California residents whose homes had been damaged or destroyed explained why they had believed their homeowners insurance would enable them to rebuild their dwellings. Once they presented their claim to their insurance company, though, these homeowners discovered that their coverage fell well short of what they needed—sometimes by hundreds of thousands of dollars—to rebuild their homes." Id at 382 The Supreme Court went on to cite a Department of Insurance review that noted that the serious ongoing under insurance problem existed even though the policy limits in question matched what was indicated by the insurer's own coverage calculator.

Replacement Cost Regulation

As a result of this situation the Department of Insurance issued a Regulation governing policy limit calculation. The replacement cost regulation was codified at California Code of Regulations, title 10, section 2695.183. The Regulation does not require an insurer to set or recommend a policy limit or to provide an estimate of the cost to rebuild or replace a home. (Cal. Code Regs., § 2695.183, subd. (m)). If the insurer does choose to opine on replacement costs, the Regulation specifies how that estimate is to be calculated and communicated. The Regulation is quite detailed and bars insurers from communicating a replacement cost estimate in connection with an application for or renewal of a homeowners' insurance policy "unless the requirements and standards set forth in subdivisions (a) through (e) below are met." (Cal. Code Regs., § 2695.183.)

Pursuant to the Regulation, estimates must include local labor and material costs as well as the particular features of the insured structure," such as the type of foundation and framing, the roofing and siding materials, the square footage and number of stories, and the structure's geographic location. (Id., subd. (a)(5)(A)-(K).) Unfortunately the Insurance Department Regulation does not give homeowners a "private cause of action" for its breach. Enforcement of the Regulation rests with the

Department of Insurance. The homeowner should be aware that the insurance policy sale business can be a stacked deck. Before a tragedy strikes, a *homeowner* needs to *carefully review* the policy language they have to make sure they have the coverage that is most appropriate for their needs.

FIGHTING THE STACKED DECK TO WIN MORE COVERAGE

Fighting underinsurance after a disaster requires an understanding of the relationships and obligations of brokers, agents and insurance companies. The homeowner may have worked directly with an "agent" to purchase insurance and then the insurance company issues the policy and decides whether to pay a loss. What the homeowner calls an insurance agent may actually be an *independent* broker who is separated by another intermediary and has no binding authority on the insurance company that issues the actual policy of insurance. In that instance, when a catastrophic property loss happens, the insurance company may claim it is insulated from any potential responsibility for negligence, misrepresentation or failure to procure the insurance asked for or expected by the homeowner. In other words, they argue, the underinsurance was not the insurance company's fault, but the agent's and the homeowner's.

However, if the homeowner worked with an agent or broker who has "binding authority" or is otherwise directly an agent of the insurer, that agent may be held to be the actual or ostensible agent of the insurance company with the result that an insurance company is held liable to the homeowner for the promises made by the agent.

To remedy their underinsured position, homeowners may argue that their insurance companies, agents and brokers should be responsible for lousy advice or agent/broker malpractice that set limits too low. Insurance agents or brokers as well as their insurance companies, in turn, often claim they have no obligation to the homeowner to pick the "right" coverage value for the homeowner's property. They claim the homeowner is responsible for picking their own insurance coverage amounts to satisfy any potential losses they might experience. Under the caselaw, in many instances, they are right. However, the hard and fast position of insurers and their agents and brokers can be defeated in some cases under specific circumstances. This usually occurs, where the homeowner *specifically asks for a type or amount of insurance* and the agents, broker and/or the insurance company *provides the homeowner with less coverage than what was asked for*. California case law supporting this homeowners' coverage position includes *Desai v. Farmers Ins. Exchange,* 47 Cal.App.4th 1110 (1996) (A "failure to deliver the agreed-upon coverage" case is actionable, unlike the "failure to recommend"; the negligence of the agent was attributable to the insurer). On the other side of the issue, insurers cite *Everett v. State Farm*, 162 Cal.App.4th 649 (2008) to place sole responsibility for inadequate limits on the policyholder (notices that conform to state law protect an insurance company from liability for eliminating replacement cost insurance and stranding an insured with inadequate insurance limits).

After a loss, if it becomes apparent that policy limits are too low, a preliminary question is whether the homeowner specifically asked for adequate limits that were not provided or were they somehow misinformed about what their coverage limits were by the agent or insurance company. If an *agent* of the insurer makes a specific representation about coverage, the insurance company may be held liable for the promises of its agent under the agency doctrine of ostensible authority. Even if the local representative is a customer's *broker* and not the insurance company's, if the broker has binding authority, insurance company liability may be found under the agency doctrine of ostensible authority. In situations where the customer's representative is not the insurer's agent and has no binding authority, an insurer can still end up on the hook for the customer's representative's mistakes if it independently takes action that a customer relies on. For example, if the insurer inspects a property and then improperly adjusts the policy limits based on its own work, it could become directly liable for negligence.

A homeowner can also attempt to undo a stacked deck by levying allegations of fraud. However, finding fraud against an insurer or broker in setting policy limits is difficult. In order to proceed with fraud for inadequate insurance limits, the victim *must be able to plead specific facts of the alleged fraud*. The facts constituting fraud must be determined from the circumstances of each case, and fraud may be proved from direct evidence or inferred from all the circumstances in the case. *See Ach v. Finkelstein*, 264 Cal. App. 2d 667, 675 (1968).

UNDERSTANDING AND OVERCOMING HOMEOWNER POLICY EXCLUSIONS

Adequate policy limits do not guarantee a full and fair recovery. Policy exclusions are also subject to misinterpretation and unfair conduct. Just because an insurance company says there is an applicable exclusion does not make it so. "Any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer. If semantically permissible, the contract will be given such construction as will fairly achieve its manifest object of securing indemnity to the insured for the losses to which the insurance relates. Any reasonable doubt as to uncertain language will be resolved against the insurer." *Crane v. State Farm Fire & Casualty Co.*, 5 Cal.3d 112, 115 (1971). *See also, Fire Ins. Exchange v. Superior Court,* 116 Cal.App.4th 446 (2004). Insurance coverage is "…interpreted broadly so as to afford the greatest possible protection to the insured, [whereas] ... exclusionary clauses are interpreted narrowly against the insurer." *White v. Western Title Insurance Co.*, 40 Cal.3d 870, 881 (1985). The exclusionary clause "must be *conspicuous, plain and clear.*" *State Farm Mutual Automobile Insurance Co. v. Jacober*, 10 Cal.3d 193, 201-202 (1973). This rule applies with particular force when the coverage portion of the insurance policy would lead an insured to reasonably expect coverage for the claim purportedly excluded. *MacKinnon v. Truck Insurance Exchange*, 31 Cal.4th at p. 648 (2003).

A factual dispute may well exist about whether or not a loss was caused by a cause listed as excluded in the policy. When there are two causes to a loss and one is covered and the other is not, courts will look to the most important cause, the so called "efficient proximate cause" of the loss to determine whether or not there is coverage. *Garvey v. State Farm Fire & Casualty Co.*, 48 Cal.3d 395 (1989). A homeowners' policy may or may not cover damage caused by rain. Coverage may depend on how the water entered the house. In many cases there are disputes whether the damage was caused by "surface water", wind driven "rain" or some other cause. Another example of a dispute that may occur over included or excluded causes of a loss is when a mudslide occurs the winter after a major fire has denuded a hillside. Was the loss due to the mudslide (excluded under the earth movement exclusion)? Or, was the loss due to the fire that caused the vegetation to be removed and the soil to become vulnerable? The court of appeals addressed this issue in *Howell v. State Farm Fire & Casualty Co.*, 218 Cal.App.3d 1446 (1990), and concluded in a "Garvey" type analysis that the insurer may not exclude coverage when a covered peril is the efficient proximate cause of loss even though an excluded peril has contributed to or is necessary for the loss. An additional dispute over homeowner policy exclusions is where the foundation sinks and causes cracks and other damage to the building. Is this settlement and earth movement (excluded losses), or is it due to burst drainage or other burst pipes with resultant collapse (with coverage applying)? Not all claims of dual causes to a loss will create coverage. The courts exercise great discretion in deciding what a legitimate factual dispute is. An insurance policy is a contract, and when the facts are undisputed, whether or not claimed coverage exclusion applies is simply a matter of law. Ultimately, it is important to make sure that there is a thorough investigation to uncover the true cause or causes to the loss.

INSURANCE COMPANY DELAY TACTICS AND STATUTE OF LIMITATIONS "GOTCHA" ISSUES

Insurance carriers don't always reject a loss immediately or in its entirety. Frequently the process is delayed by repeated requests for additional information. Delay in resolving a claim can work against a homeowner if policy deadlines are allowed to expire. Property insurance policies often contain a number of special deadline dates. Included in these are deadlines for finishing purchases or reconstruction to obtaining "replacement cost" payments for the difference between depreciated value and the actual cost of repair and replacement. Another policy deadline may be a special "statute of limitation" deadline for filing suit shortening the normal four year period that applies to cases involving breach of written contract to as little as one year. The special shortened period might in some cases be extended based on an estoppel argument if the carrier is still considering the claim. A written agreement "tolling" this insurance policy created deadline is another option to protect the homeowner's rights prior to this contractual deadline date.

VALUING THE LOSS

It is also important for the homeowner to prepare a thorough reconstruction cost estimate for the repair of the loss. Insurance companies use computer programs to estimate losses. Insurance company preprogrammed labor and materials rates may be far too low to perform the actual reconstruction. Often the standardized valuation models fail to take into account specific problems or issues in a homeowner's claim. For example, following mass disasters, such as brush fires, there may be a shortage of labor and materials and a strong demand (and associated higher labor rate) for services. Also the "average" numbers used in the insurance company programs may come from different areas of the country with lower material or wage rates.

A competent and trusted contractor or architect estimating on behalf of the homeowner can help assure that each component is thoroughly considered and that every necessary component and specification is included in the reconstruction plan. Reconstruction estimates have hundreds or thousands of individual components. There may be 25 or more different types of light switches, door handles, etc., that could be chosen in a repair bid. Price differences on each component may vary from pennies to hundreds or even thousands of dollars. If there are 40 doors in a house and an insurance adjuster chooses a "cheaper" door style that "complies with code" but isn't the same as the type of door that previously existed, a $100 product difference becomes a $4,000 lower bid. If an insurance company tries to substitute a laminated "Pergo" floor for a destroyed hardwood floor does this fulfill the insurer's obligation under the insurance contract? The term "equivalent construction" has been held to be substantially similar to the language of California Civil Code Section 2071 that limits replacement to "material of like, kind and quality." *McCorkle v. State Farm Insurance Co.,* 221 Cal.App.3d 610, 614 (1990).

Even the best prepared repair cost estimate may not persuade an insurance company to pay the full amount. There is a procedure available to deal with a claims adjusting stalemate. If the homeowner and insurer are not able to agree on the cost of repair, the claim can be put into appraisal. Appraisal is an arbitration like process that ends with a final valuation being delivered. Appraisal can be a frustrating process, but it may well be a better alternative than simply giving in to a low ball offer or long delayed resolution.

No matter how carefully the homeowner has handled their insurance, after the close out of their loss claim there are likely to be unmet financial needs. Claims against a negligent 3rd party may be the only available path to recover for these uninsured losses.

FINDING ADDITIONAL MONEY TO REBUILD FROM WRONGDOERS

If an insurance company succeeds in limiting its payout (aka paying out less than what the homeowner fully suffered), the homeowner may be left to try and make themselves whole via the tender mercies of the person or persons who caused the property loss in the first place (aka the one who started the fire or caused the disaster). Potential responsibility of negligent parties is another reason to carefully investigate the cause of the loss. Tort law damage rules apply to the claims against the negligent parties. However, the negligent parties, unlike insurance companies, have no fiduciary or good faith duty to the homeowner victim and are not obligated to quickly or fairly settle a claim. The homeowner victim may well have to wait until his or her case reaches the courtroom or beyond to receive justice. (As a side note, in most claims against the wrongdoer, the homeowner gets to be made whole *before* the insurance company is reimbursed in a joint damages/subrogation claim.)

CONCLUSION

Getting fair compensation for a homeowner following destruction of a home requires the navigation of a mine field of potential problems and pitfalls. The process is complicated by crushing emotional and financial loss suffered by the homeowner. An effective attorney must pay attention to the legal and factual issues mentioned above to have the best chance of success.

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