When disaster strikes home

Proving fraud or negligence by insurance agents as to policy limits and coverage requires careful investigation

By Lee S. Harris

When disaster strikes home, the heart and wallet receive a devastating blow. California homeowners are underinsured by an average of $240,000. Insurance companies compound the problem by writing an ever-increasing number of exclusions into their policies and adjusting claims restrictively. Homeowners who lose their homes are crushed by the loss emotionally and financially. In the aftermath of the loss, the lines between careful adjusting and contract breach, bad faith and fraud are often crossed.

Most homeowners rely on their insurance company and the local agent or broker to set their policy limits for the correct cost of repair or replacement of their home in a disaster.

Many insureds don't understand the legal relationship between the "agent" they work with to order insurance and the insurance company that actually issues the policy and decides whether or not to pay a loss.

Insurers frequently claim they are insulated from any potential responsibility for negligence or misrepresentation by the customer's representative. What the insured calls an "agent" may be an "independent broker" without binding authority and separated by another intermediary from the insurance company. If the customer's agent does have binding authority or is otherwise directly an agent of the insurer, the customer's agent may be held to be the actual or ostensible agent of the insurer with the result that an insurer is held to promises made by the agent.

Unfortunately broker/agents and insurance companies have strong incentives to underinsure homes. It is easier to sell

insurance if the price is lower. And if disaster strikes, an insurer saves substantial sums if it doesn't have to pay the full cost of replacement or repair.

Insurance companies have repeatedly tried to insulate themselves from the financial consequences of total home destruction. They eliminated true replacement cost coverage language in their policies. They have taken advantage of legislation to make misrepresentation claims more difficult to pursue.

Legislation requires a special form be sent to homeowners at policy issuance or renewal listing broad coverage categories including whether there is full, partial or no replacement cost coverage. Insurers and their representatives point to these mandated disclosures after a loss to dispute homeowner assertions about promised replacement cost coverage.

Policy holders often think they can rely on the expertise of their insurance company and agent or broker to set policy limits. This may be a mistake. Insurers and agents are usually not responsible for their failure to tell property owners the types and amounts of coverage they should buy. If an owner asks for something that isn't delivered, that is different. The question remains whether insurance companies, agents and brokers should be responsible for lousy advice or agent/broker malpractice that set limits too low. Supportive California case law on the issues of ostensible agency and agent negligence include *Desai v. Farmers Ins. Exchange* (1996) 47 Cal.App.4th 1110 and *Free v. Republic Ins. Co.* (1992) 8 Cal.App.4th 1726. On the other side of the issue, insurers cite *Everett v. State Farm* (2008) 162 Cal.App.4th 649 to place sole responsibility for inadequate limits on the policy holder.

If an insurance company succeeds in limiting its payout, a property owner may be left to search for the tender mercy of a negligent third party to pay for the uninsured loss. Responsible third parties, unlike first-party insurers, have no fiduciary or good faith duty to the victim and are not obligated to quickly or fairly settle a claim. The victim may well have to wait until his case reaches the courtroom or beyond to receive justice.

Fighting low policy limits

After a loss, if it becomes apparent that policy limits are too low, a preliminary question is whether homeowners asked for adequate limits or were somehow misinformed about what their coverage limits were. In *Everett v. State Farm*, a court of appeal decided that 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.

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 doctrine of ostensible agency. Even if the local representative is a customer's broker and not the insurance company's, if the broker has binding authority, ostensible agency and insurance company liability may be found. In situations where the customer's representative is not the insurer's agent and has no binding authority, an insurer can end up on the hook for agent 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 liable for negligence.

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* (1968) 264 Cal.App.2d 667, 675.)

Exclusions

Adequate policy limits don't guarantee a full and fair recovery. Policy exclusions are subject to misinterpretation and unfair conduct. Just because the insurance company says there is an applicable exclusion doesn't 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.* (1971) 5 Cal.3d 112, 115. See also, *Fire Ins. Exchange v. Superior Court* (2004) 116 Cal.App.4th 446.) 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.* (1985) 40 Cal.3d 870, 881.) The exclusionary clause 'must be *conspicuous, plain and clear.*' (*State Farm Mutual Automobile Insurance Co. v. Jacober* (1973) 10 Cal.3d 193, 201-202.) 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* (2003) 31 Cal.4th at p. 648.)

Proximate cause

A factual dispute may well exist about what caused the loss. 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.* (1989) 48 Cal.3d 395.) The policies may cover damage caused by rain depending 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 this type of dispute would be when a mudslide occurs the winter after a major fire has denuded the 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.* (1990) 218 Cal.App.3d 1446, 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 situation 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 pipe 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.

Delay and statute of limitations

Insurance carriers don't always reject a loss immediately or in its entirety. Frequently the process is delayed by repeated requests for additional information. Many times property owners will attempt to work with the carrier until they finally throw their hands up in frustration and merely give up and take whatever they are given. Delay by an owner making a decision on what to do after a claim is rejected, works to the advantage of the insurance company. Many property insurance policies contain a special "statute of limitation" deadline for filing suit that shortens 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 but a written agreement "tolling" the statute of limitations is another option to protect rights prior to the statute date.

Valuing the loss

It is also important to thoroughly assess the nature and extent of a loss. Insurance companies use computer programs to estimate losses. Insurance carrier

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 an insured's claim. For example, following mass disasters, such as brush fires, there may be a shortage of labor and materials and a strong demand for services. Also the "average" numbers used in the 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 insured 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. Is Pergo acceptable as a "similar" material to hardwood flooring for purposes of fulfilling the carrier's obligation under the contract? The term "equivalent construction" has been held to be substantially similar to the language of section 2071 that limits replacement to "material of like kind and quality."(*McCorkle v. State Farm Insurance Co.* (1990) 221 Cal.App.3d 610, 614.)

Even an insurance policy with properly set limits is likely to leave gaps. And, absent bad faith, compensation for the anguish and distress of a total home loss is not included in an insurance recovery. Claims against a negligent third party may be the only available path to recover for these uninsured losses.

Conclusion

Getting fair compensation for someone following destruction of a home can be a complicated and distressing process. Restoring their home and getting them back the life they thought they had lost is what makes it worthwhile.


Harris

Lee S. Harris is a partner at G3MH (Goldstein, Gellman, Melbostad, Harris & McSparran, LLP), *San Francisco with over 30 years experience fighting for consumers who have problems with insurance companies. He has also served as chair of the American Association for Justice, Insurance and Bad Faith Litigation groups and on the board of Consumer Attorneys of California. Visit: www.g3mh.com.*