Handling cases for the underinsured homeowner

In the wake of California wildfires, there can be viable cases against insurance companies, agents and brokers.

BY RICARDO ECHEVERRIA

One of the major problems that faced homeowners who lost their homes in the 2003 and 2007 wildfires is under-insurance. Stated differently, their homes were not "insured to value" and there was a gap between the true cost to replace the home and the policy limit. Dealing with an under-insurance issue requires a careful analysis of the facts that led to the issuance of the policy. This article will set forth a guide to handling an under-insurance case.

The evolution of homeowners' property coverages

At first blush, the thought of under-insurance is counter-intuitive. After all, you would expect that an insurance company would want to sell more insurance so that it could recover more premiums. But the insurance business is about balancing the premiums collected with the corresponding risk exposure that the carrier undertakes. In most cases, a substantial increase in policy limits will not result in a corresponding dramatic increase in premiums. To help explain why so many homeowners find themselves under-insured these days, it is important to look back at the evolution of the types of property coverage available to homeowners.

The standard homeowner's policy usually provides four discrete property loss coverages. Coverage A is the "Dwelling" coverage which insures the residence. Coverage B insures "Other Structures" such as guest houses, detached garages, etc. Coverage C insures "Personal Property" items and Coverage D provides "Loss of Use" benefits for the additional living expenses incurred during the period of repair or replacement.

With respect to Coverages A and B for "Dwelling" and "Other Structures," the policy will contain loss settlement provisions. In the early 1990s, most policies were written on a "Guaranteed Replacement Cost" basis. Under a Guaranteed Replacement Cost policy, the insurer would guarantee the replacement of the dwelling in case of a total loss, regardless of the policy limit. In the mid-90s following the Northridge Earthquake, most insurers began switching from Guaranteed Replacement Cost coverage to "Extended Replacement Cost" policies. While an Extended Replacement Cost policy may sound like the insured is getting more coverage with an "extension," in reality this type of policy provides less coverage than under a Guaranteed Replacement Cost policy.

An Extended Replacement Cost policy will "extend" the stated policy limit by

an additional percentage. Most policies provided a policy-limit extension of an additional 10 percent to 25 percent. The trouble with the change from Guaranteed Replacement Cost to Extended Replacement Cost is that the "guarantee" is gone and there is now a finite limit of insurance available. Many insureds were under-insured after the switch to Extended Replacement Cost coverage, but did not realize it until they suffered a catastrophic loss. The reason is because with Guaranteed Replacement Cost policies, insureds were often told not to worry about whether their policy limit was adequate since there was a "guarantee" to replace in the event of a total loss, regardless of the limit. In contrast, under Extended Replacement cost, the policy limit did matter since the extension was based on a percentage of the policy limit.

Analysis of an under-insurance case

The starting point in dealing with an under-insurance case is to look back and determine who set the policy limit. In most cases, insureds rely upon their insurance agent or broker to set the policy limit, and had no involvement in the process. In analyzing liability for under-insurance, you must first determine if the insured was dealing with an insurance "agent" or "broker."

•An insurance agent v. insurance broker

An "Insurance Agent" is a "person authorized, by and *on behalf of an insurer*, to transact all classes of insurance other than life insurance" (Ins. Code, §31) (Emphasis added). In contrast, an "Insurance Broker" is a "person who, for compensation and on behalf of another person, transacts insurance other than life with, but *not on behalf of, an insurer*" (Ins. Code, §33) (Emphasis added). Thus, the major difference between an agent and broker is that the conduct of an agent is imputed to the insurance company while the conduct of a broker is not. In practice, most of the larger insurance companies that have the deepest market penetration only sell policies through captive insurance agents so they are responsible for the agent's conduct.

•The general rule regarding the setting of policy limits

The general rule is that an insured is responsible for the establishment of their policy limit and an insurance agent or broker does not have a duty to volunteer that an insured should procure additional or different insurance coverage (*Fitzpatrick v. Hayes*, (1997) 57 Cal.App.4th 916 [67 Cal.Rptr.2d 445].) However, exceptions to this general rule have evolved over time.

•The exceptions to the general rule

The first case to deal with an insurance agent's liability for inadequate policy limits was *Jones v. Grewe*, (1987) 189 Cal.App.3d 950, [234 Cal.Rptr. 717]. In *Jones*, the court determined that an insurance agent could *not* be held liable for failing to obtain sufficient limits on a *third-party* liability policy. The *Jones* court reasoned that an agent could not accurately forecast the upper limit of liability insurance that the insured would need and further noted that extending liability to agents for not obtaining sufficient liability limits would effectively transform the agent into an excess insurer.

The *Jones* decision was later followed by *Free v. Republic Ins. Co*. (1992) 8 Cal.App.4th 1726 [11 Cal.Rptr.2d 296]. In *Free*, the insured asked his broker whether the policy limits would be sufficient to cover his home in the event of a total fire loss, and the broker represented that he was fully insured to value. When the insured was determined to be under-insured after a loss, the broker was held liable. In so ruling, the *Free* court made a distinction between misrepresentations about limits on *first-party* property coverage as opposed to misrepresentations on *third-party* liability coverage as was involved in *Jones*. The *Free* court reasoned that in a *first-party* setting, an agent or broker *can* objectively determine the amount of coverage necessary to replace a dwelling after a total loss which was the basis it distinguished itself from *Jones*, which as stated above dealt with third-party liability limits.

The *Free* decision was later followed by *Desai v. Farmers Ins. Exchange*, (1996) 47 Cal.App.4th 1110 [55 Cal.Rptr.2d 276], where the insured advised his agent that he wanted "100 percent coverage" for his dwelling in the event of a total loss. However, the policy that was delivered to the insured only provided for coverage up to $150,000, and there was no Guaranteed Replacement Cost benefit. After the Northridge Earthquake, the cost to repair the insured dwelling was $546,757. The Court held that the agent could be held liable because the agent "negligently represented that the policy in fact provided the 100 percent replacement cost coverage that [plaintiff] demanded ... This is not a 'failure to recommend more coverage' case; it is a 'failure to deliver the agreed-upon coverage' case" (*Id*. at 1119 (Emphasis added).)

Finally, in *Fitzpatrick v. Hayes*, (1997) 57 Cal.App.4th 916 [67 Cal.Rptr.2d 445], the court analyzed the history of authorities dealing with liability of agents and brokers for under-insurance as reflected, among other cases, in *Jones*, *Free*, and *Desai*. The *Fitzpatrick* case then summarized and set forth the three recognized exceptions under California law to the general rule of no liability of agents and brokers for under-insurance as follows:

> …[A]s a general proposition, an insurance agent does not have a duty to volunteer to an insured that the latter should procure additional or different insurance coverage….The rule changes, however, when - but only when - one of the following three things happens:
>
> (a) the agent misrepresents the nature, extent or scope of the coverage being offered or provided;
>
> (b) there is a request or inquiry by the insured for a particular type or extent of coverage; or
>
> (c) the agent assumes an additional duty by either express agreement or by "holding himself out" as having expertise in a given field of insurance being sought by the insured.

(*Id*., 57 Cal.App.4th at 927.)

Necessarily, an under-insurance case will depend on whether the particular facts fit within one of the three *Fitzpatrick* exceptions set forth above. Your focus should be on whether the agent represented to the insured that the limits were sufficient; whether the insured specifically asked about the sufficiency of the limits; and/or whether the insured requested that he/she be fully covered and protected, etc. In many cases, insurance agents have computer programs and tools that the carrier requires them to use to come up with a policy limit to propose to the insured. In many cases, when presented with such a proposal from the agent, insureds will ask if the limit is enough or "will it provide full protection." As long as the insured asks for full coverage and/or the agent affirms there is adequate coverage, you should be able to fall within one of the first two *Fitzpatrick* exceptions.

At trial on a case like this, you can expect the agent or carrier's main defense to be that they never "guaranteed" that the limit would be sufficient and that any proposal they made about the policy limit was "just an estimate." To address this defense, paint the picture of two different scenarios.

• ***First scenario:*** The agent proposes a policy limit and tells the insured: "…this is the company's estimate of the policy limit but it's not a guarantee and, in fact, it could be way off base and may be completely insufficient to fully cover you, so you may want to consider investing your own money to hire a contractor to give you your own replacement cost estimate, and then come back and we may or may not cover you for that amount."

• ***Second scenario:*** The agent proposes a policy limit and tells the insured: "…this is the company's estimate of the policy limit and, while it's not a guarantee, the company has invested millions into the development of the computerized 'insurance-to-value' tool that generated this estimate, and it's expected to be accurate to plus or minus five percent so that you, the customer, can be satisfied that you and your family are fully protected."

While the agent did not "guarantee" that the limit was sufficient in either scenario, the impact on the insured is quite different. Moreover, it is important to point out that agents are trying to sell a product and in doing so must gain the confidence of the customer. Of the two scenarios, can there be any doubt about which approach might better gain the customer's confidence and sell more policies? So the issue is not whether the agent "guaranteed" that the estimate was sufficient, but rather, whether through interaction with the insured the agent misrepresented the adequacy of the limits or failed to deliver upon the full protection requested.

There are also cases where the insured never spoke with the agent or broker about the policy limits. In some cases, insureds blindly rely upon the agent to set sufficient limits without ever questioning or discussing it. Even if the insured and the agent or broker did not interact about the sufficiency of the limits, check to see if there was any advertising or promotional material given to the insured that could show the agent or broker was "holding himself out" as having expertise. Also, most agents have used computerized tools to estimate policy limits on homes hundreds, if not thousands, of times per year depending on how big their book of business is, while the insured renews one policy a year. Demonstrating the agent's expertise could be a way to fit within the third *Fitzpatrick* exception.

• ***Insurance policy considerations***

Finally, analysis of an under-insurance case (and for that matter any type case dealing with insurance) requires a thorough review of the policy. Regardless of the interaction between the insured and the agent or broker, look for any provision where the insurer has contractually taken on the responsibility for making sure the property is insured to value.

For example, at least one carrier has endorsed the following provision to some of its policies:

> The limit of liability shown on the Policy Declarations for 'Coverage A – Dwelling Protection' *will be revised* at each policy anniversary to reflect the rate of change in the *replacement cost of your dwelling* as identified in the Policy Declarations.

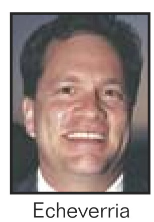
Emphasis added).

Look for provisions similar to this where the carrier has contractually obligated itself to increase the policy limit to keep pace with the rate of change in the replacement cost of the dwelling. This could be yet another basis for liability in an under-insurance case.

Conclusion

The above cases and factual scenarios demonstrate the many ways that plaintiffs maintain claims for liability against insurance companies, agents and brokers. (Oh, and by the way, you may want to check your own policy limits as well!)

Ricardo Echeverria is an associate attorney at Shernoff, Bidart & Darras, LLP in Claremont specializing in insurance bad faith matters on behalf of individual and business consumers. His practice focuses primarily on liability, property, and HMO insurance cases. He has litigated a variety of cases, including construction defect, earthquake, bad faith, wrongful death, personal injury, and professional negligence against an insurance agent. He received his B.S., Magna Cum Laude, from California Polytechnic State University, San Luis Obispo, in 1990 and his J.D. from Santa Clara University in 1993. He is a member of the Million Dollar Advocates.



Echeverria