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Wildfire victims' insurance fight

Underinsurance remains an ever-present problem in rebuilding after a wildfire destroys a home; a new law on replacement-cost estimates may help

By Lee S. Harris and Adrian Hern

The experiences of victims of the 2017 California wildfires has again revealed a simple truth: No one ever calls their homeowners insurance agent and asks to be underinsured. Surveys are showing that to the surprise of the victims, a significant majority are substantially underinsured. The post-fire revelation that they are seriously underinsured is a second devastation for these fire victims. According to the California Department of Insurance, insurers have received nearly 45,000 insurance claims totaling more than $11.79 billion in losses from the devastating wildfires that burned across California in October and December 2017 damaging and destroying more than 32,000 homes. The tally from the more recent 2018 wildfires is ongoing.

The California Supreme Court recently stated that wildfires are a fact of life in California. The court noted in the years prior to 2017, "Recommended coverage nonetheless understated what was actually needed to rebuild the insured's home over 80 percent of the time. Even when the homeowner had purchased extended replacement-cost coverage, 57 percent of these policies still underinsured their policyholders relative to the cost of rebuilding their homes."

(*Association of California Insurance Companies v. Jones* (2017) 2 Cal.5th 376.) The recent fires show the problem is continuing. The San Francisco Chronicle reported that consumer group United Policyholders surveyed 2017 North Bay fire victims and found 66 percent said their dwelling was underinsured.

The California Department of Insurance has attempted to address the ongoing underinsurance crisis by drafting regulations governing replacement- cost values given homeowners when they purchase or renew policies. The fight over requiring more accurate estimates was at the heart of the *Jones* decision. 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." (*Jones* at 382.) The Supreme Court went on to cite a Department of Insurance review that noted that the serious ongoing underinsurance problem existed even though the policy limits in question matched what was indicated by the insurer's own coverage calculator.

If provided, estimates must meet new standards

As a result of this ongoing problem, the Department of Insurance issued a regulation governing replacement-cost calculations. 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, however, 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 … 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, by itself, does not give homeowners a "private cause of action" for a failure of an insurer to estimate accurately. Enforcement of the Regulation rests with the Department of Insurance. And, as noted in press reports, underinsurance has continued to be a substantial roadblock to burned out fire victims' attempts to put their lives back in order. Following the October and December 2017 fires, the legislature attempted to address the underinsurance problem. The result was not encouraging for fire victims. The May 31, 2018 *Press Democrat* of Santa Rosa newspaper headline summed up the result, "Insurance relief measures for California fire victims yanked or gutted in Legislature."

Homeowners do, however, have some enforceable rights that they can personally apply to underinsurance problems. Insurance agents have an obligation to use reasonable care, diligence, and judgment in procuring the insurance requested by an insured. Agents who transmit mistaken information or fail to follow instructions can open themselves and the insurer up for liability. Issues that should be reviewed include whether the agent promised to obtain additional or different insurance prior to the disaster. Another issue is whether the agent provided the insured with a broader interpretation of the policy than the language contained in the policy form. Marketing material or cover letters that accompany the policy should be carefully reviewed as they may contain descriptions of coverage that differ from the policy's language.

An agent's failure to deliver the agreed-upon coverage may constitute actionable negligence. The failure can be the proximate cause of an injury claim applied against both the agent and the insurance company. One basis for holding the insurance company responsible for the promises of the agent is the doctrine of ostensible authority. Ostensible authority is authority that "[a] principal, intentionally or by want of ordinary care, causes or allows a third person to believe the agent to possess." (Civ. Code, § 2316 (Deerings 2015).) California insurance policies have for the most part eliminated full replacement-cost coverage and substituted actual cash value or replacement cost with caps. The ostensible authority doctrine, however, can sometimes be used to bind an insurance company to full replacement-cost coverage. One such example is where an agent makes promises that an insured later finds are not contained in the written language of the policy.

Coverage language and exclusions – dominos

Coverage problems also occur because of conflicts between coverage language and exclusions. Insurance policies on homes destroyed by mudslides following the 2017 wildfires illustrate this conflict. Homeowner policies cover destruction caused by fire. The same policies exclude coverage for damage due to earth movement or mudslides. Some commentators expressed concern that there would be no coverage for homeowners who lost their homes in the slides that followed the wildfires because of the earth movement exclusion. California law however does not support such a summary denial of coverage.

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.) In simplified terms, if the chain of causation is a line of dominos that has fallen, California looks to see which coverage domino set the rest of the dominos in motion.

Some states, like Florida (but not California) use the simpler and more consumer-friendly concurrent causation test to determine coverage where there are conflicts between coverage and exclusions. In those states, if there are two causes to a first party's claim of loss and one is covered and the other is not, coverage is awarded without going through the "efficient proximate cause analysis."

Using the domino analogy, if any one of the falling dominos is a covered cause, coverage is found even if it isn't the one that set the others in motion. That is, the courts find coverage for the loss just by virtue of there being a covered cause involved even if it isn't the "most important" cause. (*Sebo v. American Home Assurance Co., Inc*., 208 So.3d 694 (Fla. 2016).)

In California, homeowners and insurers must evaluate the "efficient proximate cause" of the loss. When a mudslide occurs the winter after a major fire has denuded the hillside, the question is whether the loss is due to the mudslide (excluded under the earth movement exclusion), or is it 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.

Using the *Howell* and *Garvey* analysis, California Insurance Commissioner Dave Jones issued a notice to insurers outlining his office's position that they should be responsible for paying for the Southern California (Montecito) earth movement damage. "Preliminary indications that we have at the Department of Insurance are that the fires burned vegetation that was holding soils in place and absorbing water," said Jones. "And with the vegetation burned, when the rain came down the hills came down as well."

Prepare a careful reconstruction estimate

It is also important for the homeowner to prepare a thorough reconstruction cost estimate for the repair of the loss. Initial insurance company-generated estimates are frequently too low. One reason for the low estimates may be their source. The companies that own the estimating program used by most insurers have long-standing ties to and were originally owned by the major insurers.

Information from Xactware website

The Xactmate construction estimator is used by the majority of insurance adjustors. The parent of Xactmate is Xactware. The parent of Xactware is Verisk Analytics, Inc. Verisk is also the parent of Insurance Services Office, Inc. (ISO) which publishes standardized policy forms used by many insurance companies. Verisk raised $1.9 billion in a 2009 IPO for several of the large casualty and property insurance companies including AIG, Travelers and Hartford. According to Verisk, more than 80 percent of insurance repair contractors and service providers with computerized estimating systems use Xactware pricing data.

Programs don't consider problems specific to a claim

Often the standardized valuation models fail to consider specific problems or issues in a homeowner's claim. For example, following mass disasters, such as wild fires, there may be a shortage of labor and materials and a strong demand (and associated higher labor rate) for services. Xactware's August 2018 price list updates for more than 460 regions in the United States and Canada available on its website notes, "Since actual market prices can vary and change rapidly, and since many factors can affect the cost of a project (including – but not limited to – labor, equipment, and material costs as well as the rates and application of sales tax), we strongly recommend customers monitor their local markets for any such changes and adjust their estimate pricing as deemed appropriate." An interesting question is whether the material and labor costs used in pre- and post-fire computer estimating models carefully followed the advice to monitor the local market and whether the models used conformed to the standards required by the California Insurance Department for replacement-cost estimating.

"Like kind and quality"

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. When creating a post-disaster replacement-cost estimate, it is important to carefully select the same construction materials and finishes that existed in the home prior to the disaster. Reconstruction estimates

have hundreds or thousands of individual components.

Price differences on each component may vary from pennies to hundreds or even thousands of dollars. Differences can also arise over what is equivalent to the destroyed property. The courts have lent some guidance on this issue. 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*. (1990) 221 Cal.App.3d 610, 614.)

Depreciation deduction

An additional pitfall for homeowners is the deduction for physical depreciation that insurers take when calculating their initial actual cash value payment. Most insurance policies provide that the homeowner receives the actual cash value of a loss initially, and only receives more than that if and when they actually repair or replace the damaged or destroyed property. The initial actual cash value payment can be critical in either paying off or otherwise dealing with a mortgage holder. It can make a significant difference in assisting a homeowner with repair or replacement of their home.

When paying the actual cash value on a component, such as a roof, the insurer may look at the remaining useful life of the component and make a deduction to adjust for the amount of wear that has already occurred.

In some cases, insurance adjusters attempt to depreciate all or most of an older structure. This is frequently improper. The insurance code provides that depreciation shall apply "only to components of a structure that are normally subject to repair and replacement during the useful life of that structure." (Ins. Code, § 2051, subd. (b)(2), added by Stats.2004, ch. 605, § 2.) Citing Insurance Code section 2051, the Insurance Commissioner adopted a regulation that states, "Except for the intrinsic labor costs that are included in the cost of manufactured materials or goods, the expense of labor necessary to repair, rebuild or replace covered property is not a component of physical depreciation and shall not be subject to depreciation or betterment." (Cal. Code Regs., title 10, § 2695.9, subd. (f)(1), Register 2006, No. 22 (operative Aug. 30, 2006).)

Homeowners have the right to insist that insurers play fair on depreciation deductions. When making a depreciation deduction an insurer must itemize, justify and fully explain all adjustments to the amount claimed, including for depreciation, and that depreciation must be attributable to the condition and age of the property: "When the amount claimed is adjusted because of ... depreciation ..., all justification for the adjustment shall be contained in the claim file. Any adjustments shall be discernable, measurable, itemized, and specified as to dollar amount, and shall accurately reflect the value of the ... depreciation.... Any adjustments for ... depreciation shall reflect a measurable difference in market value attributable to the condition and age of the property and apply only to property normally subject to repair and replacement during the useful life of the property. The basis for any adjustment shall be fully explained to the claimant in writing." (Cal. Code Regs., title 10, § 2695.9, subd. (f), and *Kirkwood v. California State Auto. Assn. Inter-Insurance Bureau* 193 Cal.App.4th 49, 54 (2011).)

Furthermore, depreciation cannot be based solely on age. Insurance Code Section 2051 requires consideration of condition. An insurer may not depreciate structural components that are not normally repaired and replaced during the useful life of a structure. (c.f. *Alexander v. Farmers Insurance Company, Inc*. (2013) 219 Cal.App.4th 1183, 1197.

Additional money from third parties

Insurance shortfalls can sometimes be supplemented by recoveries from third parties. Tort law damage rules apply to the claims against the negligent parties. In addition to negligence, responsible third parties may be responsible under trespass, nuisance and/or inverse condemnation law. Trespass and nuisance liability may allow a homeowner to recover damages for annoyance and discomfort, including emotional distress or mental anguish, proximately caused by the trespass or nuisance. The trespassed plaintiff need not be physically present when the invasion occurs to recover for resulting emotional distress. (*Hensley v. San Diego Gas & Electric Company* (4th District, Division 1, 2017) 7 Cal.App.5th 1337.) If the loss is caused by the operation of utility company equipment or property inverse condemnation there may be an avenue for compensation. (*Barham v. S. Cal. Edison Co*. (1999) 74 Cal.App.4th 744.)

Given the above problems with underinsurance, California does have in place the "made-whole rule." Where, a homeowner was underinsured or, for other reasons, was not fully "made whole" through their insurance policy, that insured can sue for recovery from the third-party tortfeasor. An insurance company may not enforce a right to subrogation until the insured has been fully compensated, in other words, made whole. (*Progressive West Ins. Co. v. Yolo County Superior Court* (2005) 135 Cal.App.4th 263, 274. Being aware of and pointing out this protection can oftentimes prevent an insurance company from engaging in overly aggressive subrogation tactics at the insured's expense.

Conclusion

Getting fair compensation for a homeowner following destruction of their home is complicated by the crushing emotional and financial loss they have suffered. It is critical that the issues mentioned above are carefully reviewed to

provide the best path for recovery.


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