Does *Everett v. State Farm* Shut the Door on Underinsured Homeowners?

By Lee Harris, with contributions by Amy Bach and Richard Huver

A recent California appellate decision in *Everett v. State Farm Insurance Company* (2008) 162 Cal.App.4th 649 appears to be an attempt by the Fourth District, Division Two, to create a new hurdle for homeowners who find themselves underinsured after a catastrophic loss. Victims of the 2007 Southern California wildfires now know the *Everett* case by name because as soon as it came out, adjusters began citing to it as the reason insurers won't pay full value on total loss claims.

Everett is a classic example of bad facts making bad law and its timing could not have been worse for these recent disaster victims. But its impact should not be overstated. Property owners that reasonably relied on express promises of full replacement coverage made by agents and insurers can still assert claims for negligence and/or fraudulent misrepresentation. These causes of action will still be viable where factually supported.

The *Everett* court veered in a direction different from prior California case law on the issues of ostensible agency and agent negligence. It attempts to bypass *but not overrule* the leading cases of *Desai v. Farmers Ins. Exchange* (1996) 47 Cal.App.4th 1110 and *Free v. Republic Ins. Co. (1992) 8 Cal.App.4th 1726*.

Everett and the prior cases deal with an insurance problem all too common to disaster victims: "underinsurance" (inadequate coverage). Underinsurance has been reported to be the most common and formidable impediment to financial recovery for disaster victims in California today, with homeowners underinsured by an average of $240,000.[1] The certification of *Everett* for publication was strenuously opposed by United Policyholders as well as the California Insurance Commissioner, policyholder attorneys and disaster relief non-profits because it gives an official seal of approval to two insurance company profit driven schemes:

1) Routinely undervaluing the cost of rebuilding, and;
2) Defrauding consumers by referring to strictly limited coverage as "replacement cost."

Despite the thoughtful comments submitted by the Insurance Commissioner, a law professor, a San Diego City Councilman and three non-profit organizations that are working directly with severely underinsured disaster victims, the California Supreme Court allowed the decision to remain published. That means it can be used as case precedent in future matters. Insurance companies are already trying to expand the use of *Everett* to further limit homeowners' rights after a disaster. But even with the new case and the efforts of insurance companies, the prior cases have not been overruled or made obsolete. And, with respect to its attempt to attack *Desai*, *Everett* contains a very conspicuous shortcoming.

Everett frames itself as a decision that addresses modifications to prior replacement cost coverage in a homeowner's insurance policy. The modifications were adopted pursuant to newer statutory law regarding replacement cost coverage and notice requirements. The Court of Appeal decided that notices that conform to state law allow elimination of true replacement cost coverage. The decision also attempts to ensure an insurance company isn't responsible for an agent giving a homeowner lousy advice on what it costs to repair or replace a home.

Lee S. Harris is a lawyer with over 30 years experience fighting for consumers against insurance companies. He has also served as chair of the American Association for Justice Insurance and Bad Faith Litigation groups. He is a partner at G3MH (Goldstein, Gellman, Melbostad, Gibson & Harris, LLP), San Francisco.
www.g3mh.com

Amy Bach is an attorney currently serving as the Executive Director of United Policyholders, a national organization that helps solve claim problems and advocates for fairness in insurance transactions. She is an official consumer representative to the National Association of Insurance Commissioners and is in constant contact with policyholders and policyholder advocates throughout the United States.
www.uphelp.org

Richard Huver is a San Diego attorney with the firm of Levine, Steinberg, Huver and Miller. He litigated many 2003 wildfire claims and is currently advising victims of the 2007 wildfires.
www.levinelaw.com

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In light of this new decision what arguments can a homeowner who has suffered a loss and finds themselves underinsured make?

Language in *Everett* appears to use the "integration clause" in the policy to insulate insurance companies and agents from failure on their part to obtain or advise about inadequate reconstruction cost valuation. The decision mixes the issue of whether a policyholder got proper notice of a reduction in coverage with the issue

of whether the policyholder reasonably relied on representations by an agent. Although no evidence appeared to have been submitted to establish reliance or misrepresentations, *Everett* attempts to distinguish itself from the leading *Desai* case that held insurance companies *are* liable for agent misrepresentations regarding replacement cost coverage. Despite *Everett*, *Desai* remains the law in California.

The *Everett* opinion conflicts with the vast majority of other California case law that specifically allows homeowners to make ostensible agency claims based on policyholder's reasonable belief received from their agent that specific promises of coverage by an agent are binding on the insurance company. California courts have long held that an agent has the authority the principal actually or ostensibly confers. As noted in *Frasch v. London & Lancashire Fire Insurance Company (1931) 213 Cal. 219, 223*, insurance agents possesses powers third persons have a right to assume that they possess under the circumstances of the case. As a general rule an agent's powers are determined by the nature of the business entrusted to the agent and are *prima facie* coextensive with its requirements. (*Silverberg v. Phoenix Ins. Co. (1885) 67 Cal. 36, 41; Skyways Aircraft Ferrying Service, Inc. v. Stanton* (1966) 242 Cal.App.2d 272.)

Under statutory and case law a principal is bound by acts of its ostensible agent to those persons "who have in good faith, and without want of ordinary care, incurred a liability or parted with value, upon the faith thereof." Liability of the principal for the acts of an ostensible agent rests on the doctrine of "estoppel," whose essential elements are representations made by the principal, justifiable reliance by a third party, and a change of position from such reliance resulting in injury. *(Kelley v. R.F. Jones Co. (1969) 272 Cal.App.2d 113*; *Preis v. American Indemnity Co.* (1990) 220 Cal.App.3d 752.)

The *Desai* appellate court took this well seasoned body of law and noted that, "[T]his is not a situation wherein an insured belatedly realized – after an accident occurred and a claim was made and denied – that he or she should have had more or different coverage. Rather, Desai demanded a particular level of coverage at the outset, before he agreed to purchase a policy. It was then represented to him that he was receiving the demanded level of coverage from Farmers, and only afterwards did he discover the coverage he purchased was neither what he had demanded nor what the insurer and its agent warranted it was. This is not a "failure to recommend more coverage" case; it is a "failure to deliver the agreed-upon coverage" case.... A broker's failure to obtain the type of insurance requested by an insured may constitute actionable negligence and the proximate cause of injury. (*Nowlon v. Koram Ins. Center, Inc.* (1991) 1 Cal.App.4th 1437, 1447, 2 Cal.Rptr.2d 683.) Moreover, if the agent fails to exercise reasonable care in procuring the type of insurance that the insured demanded and bargained for, the cases hold that the insurer may be liable under theories of ratification and

ostensible authority." (*Desai v. Farmers Ins. Exchange* (1996) 47 Cal.App.4th 1110, 1119-1120.)

Despite *Everett*'s argument about the policy's integration clause, *Everett does not* say that *Desai* was wrongly decided and it leaves available the typical *Desai* claim of homeowners who actually asked for specific coverage and didn't receive what they asked for. The *Everett* court limits its decision by noting that "there is nothing in the record that shows Everett requested her policy limits to be increased since they were set in 1991. Accordingly, Everett's assertion that State Farm failed to maintain limits equal to replacement cost fails, and as such, does not support a claim for breach of contract." (*Id.*, 821-822)

Everett appears to conflict with other existing California case law which holds that an agent and an insurance company can be liable for giving lousy advice to a homeowner even if the homeowner has not explicitly requested higher limits or specified full replacement cost coverage. Those cases hold that an insurance agent may also assume a greater duty toward the insured by misrepresenting the policy's terms or extent of coverage. Despite this conflict, the fact that *Everett* is an appellate decision means it does not overrule the prior decisions and their arguments and reasoning should continue to be used.

The prior cases include *Westrick v. State Farm Ins. (1982) 137 Cal.App.3d 685*, where the appellate court held an insurance agent may be liable for his negligent failure to accurately apprise an insured of the policy terms upon request. The *Westrick* court held that, based on the insured's inquiries and the agent's superior knowledge of the scope of an automatic coverage clause under the policy, the agent had "the duty reasonably to inform an insured of the insured's rights and obligations under the insurance policy." (Id., at p. 692.)

Free v. Republic Ins. Co. (1992) 8 Cal.App.4th 1726, dealt with a situation where the plaintiff asked the agent whether the policy limits were adequate to rebuild his home if necessary. On each occasion the agent assured plaintiff the policy limits were adequate. After a fire destroyed his home, plaintiff learned for the first time the coverage provided by the policy was not adequate to replace his home. The court held that once an insurer or its agent elects to respond to an insured's questions about coverage, a special duty arises which requires them to use reasonable care to provide accurate information.

And in *Paper Savers, Inc. v. Nacsa* (1996) 51 Cal.App.4th 1090, the agent suggested the "replacement cost coverage endorsement" and negligently explained the endorsement's meaning and effect to mean the "replacement cost coverage" endorsement was sufficient to replace all lost or damaged personal property regardless of policy limits.

It's important to note that the renewal certificate that Ms. Everett had received from State Farm included the following wording: "The State Farm replacement cost is an estimated replacement cost based on general information about your home. It is developed from models that use cost of construction materials and labor rates for like homes in the area. The actual cost to replace your home may be significantly different. State Farm does not guarantee that this figure will represent the actual cost to replace your home. You are responsible for selecting the appropriate amount of coverage and you may obtain an appraisal or contractor estimate which State Farm will consider and accept, if reasonable. Higher coverage amounts may be selected and will result in higher premiums." This type of language is increasingly common, but in the right case with the right facts – it will not shield agents or insurers that defraud customers into believing that their coverage *was* appropriate.

What's the bottom line for underinsured property owners post-Everett?

Homeowners pursuing an underinsured loss should not abandon any of the claims they might have made before *Everett*. *Everett* has not overruled the prior cases. At most, because of conflicting language, it has set up a possible further review of this issue by the California Supreme Court. ■

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[1] See www.uphelp.org, "Recent News," and "Wildfires heat up debate on rising building costs" in the June 6, 2008 edition of the Los Angeles Times http://articles.latimes.com/2008/jun/06/business/fi-fires6.