



By Scott Glovsky

Liability of insurance agents and brokers for under-insuring residential properties

After the 1994 Northridge earthquake, most insurance companies writing homeowner's coverage stopped issuing "guaranteed replacement cost" policies. Hence, most homeowners whose homes were destroyed in the recent fires in Southern California will have, at best, an "extended" policy limit; that is, a promise by the insurer to pay some fixed percentage above the policy limit should repair costs exceed the policy limit. The demise of guaranteed replacement cost coverage highlights the importance to policyholders of having adequate coverage. This article addresses the liability of insurance agents and brokers when a residential property is underinsured.

Is the property underinsured?

The first question to address is whether a property is underinsured. Homeowners' policies specify their coverage limits on their Declarations page. The Declarations page provides separate limits for the dwelling (often listed as Coverage A), separate structures (Coverage B), and personal property (Coverage C). The dwelling limit applies to the cost to repair the dwelling or structure. The separate structure limit applies to the cost to fix dwellings or structures that are not attached to the main dwelling or structure. The personal property limit applies to repairing or replacing personal property.

In many policies, the dwelling limit provided on the Declarations page is not the actual dwelling limit. Many policies include provisions such as Guaranteed Replacement Cost Coverage ("GRC") or Extended Replacement Cost Coverage ("ERC") that raise the dwelling limits beyond the amount specified on the Declarations page. Although most carriers no longer offer GRC, it generally expands the dwelling limits to the full cost to repair the dwelling regardless of the limits listed on the Declarations page. ERC often extends the dwelling limits to 150% of the amount stated on the Declarations page. California Insurance

Code section 10101 requires residential property insurers to provide policyholders with a separate disclosure form that specifies whether the policy includes GRC or ERC.

Is the potential defendant an agent or broker?

To evaluate the potential liability of the agent or broker that procured the insurance, it is crucial to determine whether the individual is an *agent* or *broker*.

An insurance *agent*, on the one hand, is an individual "authorized, by and on behalf of an insurer, to transact all classes of insurance other than life insurance." Cal. Ins. Code § 31. Agents are required to be licensed by the California Department of Insurance and must file with the Department of Insurance a notice of appointment from each insurer that they represent. Cal. Ins. Code §§ 1631 and 1704(a). Agents' main responsibility is to represent insurance companies and their conduct can be imputed to insurance companies.

An insurance broker, on the other hand, is an individual "who, for compensation and on behalf of another person, transacts insurance . . . with, but not on behalf of, an insurer." Cal. Ins. Code § 33. Thus, because brokers do not work on behalf of insurers, they are not agents of insurers and their conduct cannot be imputed to insurers.

Determining whether an individual is an agent or broker depends upon their role in the insurance transaction at issue – regardless of whether they refer to themselves as an agent or broker. *Maloney v. Rhode Island Ins. Co.*, 115 Cal.App.2d 238, 244, 251 P.2d 1027, 1031 (1953).

Liability of insurance agents

Insurance agents generally have no duty to advise policyholders that they should purchase additional or different coverage. In *Fitzpatrick v. Hayes*, 57 Cal.App.4th 916, 927, 67 Cal.Rptr.2d 445 (1997), plaintiff was standing on a street

corner when she was hit by an automobile and suffered brain damage. Plaintiff received the driver's \$15,000 policy limit, and then recovered an additional \$85,000 under her own State Farm underinsured motorist coverage. Plaintiff then sued her State Farm agent for failing to recommend that she purchase a State Farm umbrella policy that would have provided her with additional coverage at a nominal cost. Although plaintiff had bought insurance through the State Farm agent for 20 years, she had not asked her agent or State Farm about obtaining higher underinsured-motorist limits before the accident. The Court of Appeal determined "as 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." *Id.* at 927.

Notwithstanding the general rule, agents assume "special duties" when they (1) misrepresent the nature, extent or scope of coverage being provided, (2) fail to procure coverage specifically requested by an insured, or (3) hold themselves out as having particular expertise in the type of insurance that the insured is purchasing. Agents assume special duties when they misrepresent the nature, extent or scope of the coverage that is being provided. *Id.* at 927.

In *Desai v. Farmers Ins. Exchange*, 47 Cal.App.4th 1110, 55 Cal.Rptr.2d 276 (1996), the plaintiff purchased insurance to cover property in Santa Monica. He advised his Farmers agent when he bought the policy that he wanted "100 percent coverage" for the cost of repairing or replacing the property. The agent assured him that the policy provided 100% coverage for the cost to repair or replace the property. The policy provided limits of \$150,000 for dwelling damage. The Northridge Earthquake damaged the property. The repair cost totaled \$546,757.

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Farmers argued that its agent could not be liable based on case law suggesting that insurance agents have no duty to advise policyholders that they should purchase additional or different coverage. But the Court of Appeal rejected Farmers' argument and reasoned that the agent could be 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.

Similarly, in *Paper Savers, Inc. v. Nasca*, 51 Cal.App.4th 1090, 59 Cal.Rptr.2d 547 (1996), the plaintiff purchased property insurance to cover his business from a Farmers insurance agent. The plaintiff was not sophisticated in insurance matters and relied on the agent's expertise. The agent represented that despite the fact that the policy had business personal property limits of \$500,000, the policy would "provide full coverage to replace all business personal property . . . regardless of the policy limit." *Id.* at 1093. The agent stated that the plaintiff could "rest easy" because he was fully insured against loss. *Id.* After the property was destroyed by fire, Farmers refused to pay more than the limit of \$500,000. The Court of Appeal determined that triable issues of fact existed about whether the agent had misrepresented the meaning and effect of the replacement cost coverage endorsement. The court ruled that this factual question "must be resolved to determine whether in making the representations he assumed a special duty toward Paper Savers to ensure it had adequate insurance coverage to in fact replace all the . . . personal property in the event of a total loss." *Id.* at 1104.

Agents also assume "special duties" where they fail to obtain coverage specifically requested by an insured. In *Westrick v. State Farm Insurance*, 137 Cal.App.3d 685, 187 Cal.Rptr. 214 (1982), the plaintiff purchased automobile insurance from a State Farm agent. Later, the plaintiff considered purchasing a pickup truck and asked the State Farm agent if the

pickup truck would be covered after he purchased it. The agent advised him that the pickup truck would automatically be covered for 30 days after it was purchased.

The plaintiff did not purchase the pickup truck, but two months later, purchased two different trucks. He then advised the State Farm agent that he had purchased the trucks and offered to provide the trucks' serial numbers and license plate numbers to the agent. The agent advised him that he did not need the additional information and that the agent's office would contact the plaintiff the next day.

The next day, one of the new trucks was involved in an accident. State Farm denied coverage for the accident on the ground that truck was not covered under the policy. The Court determined that plaintiff's complaint adequately stated a cause of action against the agent for negligently failing to inform the plaintiff that the truck was not covered under the policy. *Id.* at 687. See also, *Macey v. Allstate Property and Cas. Ins. Co.*, 220 F.Supp.2d 1116 (2002).

Agents also can assume a special duty when they hold themselves out as having particular expertise in the type of insurance that the insured is purchasing. *Fitzpatrick*, 57 Cal.App.4th at 927.

Liability of insurance brokers

Like insurance agents, insurance brokers generally do not have a duty to advise policyholders to purchase additional or different coverage, but they can assume "special duties" when they misrepresent coverage, fail to procure coverage specifically requested, or hold themselves out as experts. In *Jones v. Grewe*, 189 Cal.App.3d 950, 234 Cal.Rptr. 717 (1987), the owners of an apartment building were sued after a child was injured in the apartment building's swimming pool. The owners sued their insurance broker for failing to ensure that their liability limits were sufficient. The owners had purchased insurance through the broker for ten years and the broker claimed to be an insurance expert. Regardless, the appellate court determined that the broker had no duty to advise the owners to obtain additional coverage.

But brokers can assume a special duty where they misrepresent coverage or fail to obtain the requested coverage. In *Free v. Republic Ins. Co.*, 8 Cal.App.4th 1726, 11 Cal.Rptr.2d 296 (1992), the plaintiff homeowner repeatedly asked his broker if the coverage limits of his policy were sufficient to rebuild his home if it were destroyed by fire. His broker repeatedly advised him that the limits were sufficient to rebuild his home in the event of a fire. By responding to the plaintiff's inquiry, the broker assumed a special duty of care.

In addition, brokers can assume a special duty when they hold themselves out as experts in a particular type of insurance. For example, in *Kurtz, Richards, Wilson & Co. v. Insurance Communications Marketing Corp.*, 12 Cal.App.4th 1249, 16 Cal.Rptr.2d 259 (1993), an insurance broker claimed to be an expert in group health insurance. The broker wrongly advised the insured that the insured's group plan was not subject to the Medicare provisions of the Tax Equity and Fiscal Responsibility Act (which made the company's private medical insurance primary to Medicare).

The insured relied on the broker's advice and included this information on the insurance application. Later, after the insured submitted a claim under the policy, the insurer denied the claim based on the misrepresentation in the application. The Second District Court of Appeal ruled that because the broker held itself out as an expert in the area of health insurance, and the insured relied on the broker's representation, the complaint stated a cause of action against the broker for negligent misrepresentation.

Liability of insurance companies

Because an insurance agent is an agent of the insurance company, the agent's conduct can be imputed to the insurance company and the insurance company can be liable for the agent's misrepresentations or failure to obtain requested coverage. For example, in *Desai v. Farmers Ins. Exchange, supra*, Farmers argued that it could not be liable for misrepresentations of its agent. The Court rejected its argument and held that

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Farmers could be liable for its agent's failure to deliver the "agreed-upon" coverage under theories of ratification and ostensible authority. *Desai*, 47 Cal.App.4th at 1120. *See also, Paper Savers*, 51 Cal.App.4th at 1099.

Finally, in litigating cases involving underinsured residential properties,

search the policy for any guarantees that the insurance company will periodically adjust the dwelling limits to ensure that the limits will be sufficient to replace the damaged property in the event of a loss. If this type of provision is in the policy, the insured can argue that the insurer assumed a special duty to ensure that the

dwelling limits were adequate to replace the dwelling and therefore is estopped from limiting coverage to the stated dwelling limits.

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