UNDERINSURANCE AFTER THE WILDFIRES
What to do about it

BY PAUL HILDING

The Smiths were bursting with excitement when they learned that a seller had accepted their offer to purchase a beautiful new house in San Diego. Mr. Smith promptly called his insurance agent, Mr. Jones, to inquire about homeowner's coverage.

Jones asked a number of detailed questions about the location, size and construction quality of the house. Then, sagely, he pronounced: "I recommend that your homeowner's policy have coverage limits of at least $400,000. At today's construction prices, this would permit you to rebuild the house completely in the event of a total loss."

Smith, a professional gambler, thought carefully. "No," he said. "I only want $200,000 of coverage so I can save a few dollars a month in premiums. If my house burns down, I plan to raise the other $200,000 by winning the lottery."

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Like Smith, most homeowners ask their insurance agents for advice on how much insurance they need to carry on their house. Unlike Smith, most follow their agent's advice. Few actually read the insurance policy when it arrives in the mail, several months after they buy it, and of those who do, almost none can make heads or tails of it.

Prior to the recent wildfires, almost all homeowners in San Diego bought insurance for their homes with the expectation that they would be fully covered (after paying the deductible) in the event of a loss. Luckily for them, California law provides protection for such "reasonable expectations," particularly where the expectations are bolstered by representations from insurance professionals upon whom the homeowners rely for advice.

In the good old days, "guaranteed replacement" coverage was widely available to homeowners. In the event of a total loss, the insurer would rebuild the home to its original standards regardless of the cost.

After the 1991 Oakland Hills fires destroyed nearly 3,000 homes, the insurance industry started phasing out this coverage in favor of policies that capped their exposure at specific dollar amounts. Both the magnitude and the cost of the disaster had stunned the industry. A recent article in *The San Diego Union-Tribune* explained the industry's rationale for eliminating the guaranteed replacement coverage, quoting an agent in the Oakland Hills area: "We did away with that clause because it was pretty stupid."

Unfortunately, no one seems to have relayed that industry perspective to homeowners. Instead, insurance agents, competing with each other for business, began telling their customers about new insurance products with such reassuring names as "extended replacement cost" and "enhanced replacement cost."

The agents had the same conversations with their customers about how much coverage they thought the homeowners would need to rebuild their home, and then the agents closed the deal by saying, "Even if the cost of construction goes up, we've built a 25 percent margin of error into the policy to cover inflation."

Many insurance agents in San Diego substantially underestimated the cost of reconstruction when recommending appropriate coverage. As a result, most San Diegans who lost their homes in the recent wildfires are underinsured.

Generally, the agents who recommended too little insurance are agents of the insurance companies, not of the homeowners, so representations they made regarding the adequacy of coverage are imputed to the insurer. In such cases, courts will rewrite the insurance policy to conform to the reasonable expectations of the insured based on representations made by the agents.

In the less common circumstance where the homeowner buys coverage through an independent agent, the representations of the independent agent are not imputed to the insurer. The homeowner's only remedy would be to file a claim for professional negligence against the independent agent.

In either case, if a homeowner is underinsured, he or she will usually have a remedy against his or her agent or insurer. Unlike Smith, few homeowners knowingly gamble on their most valuable asset—their home. ■