LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
WEDNESDAY, FEBRUARY 5, 2025
Published In The Top Leading Commercial Litigators 2025 Supplement

Insurers facing heat under Unfair Competition Law over coverage cuts

Shawn S. Ledingham

While fire crews continue to battle the fires ravaging Southern California, the focus has begun to shift towards rebuilding communities lost to the flames. Property insurance has taken the spotlight, and frustration is mounting with insurers that decided last year not to renew policies in communities needing them the most. Homeowners affected by the reduction in coverage may find themselves looking for restitution under California's Unfair Competition Law.

Like the recent fires, the 1994 Northridge earthquake devastated the community, leaving thousands displaced and turning to their homeowners' policies. Insurance companies paid a reported $15.3 billion in the aftermath of the quake. However, many homeowners were surprised to learn that their earthquake endorsements had been terminated. Still others were unable to obtain home coverage of any kind after the quake.

A pair of lawsuits brought in the 1990s under the UCL, challenging these reductions in insurance coverage, are instructive as to the types of scope of liability insurers may -- and may not -- face for their decisions to reduce coverage.

INSURERS MAY FACE LIABILITY FOR POOR COMMUNICATION ON COVERAGE CUTS

About a decade before the 1994 Northridge earthquake, State Farm eliminated its earthquake endorsement in certain homeowners' policies, instead making the coverage available only through a separate earthquake policy. Rather than notifying policyholders of this fact, the insurer allegedly lulled customers into remaining underinsured for earthquake risk. State Farm executives at that time wrote in an internal memorandum that informing policyholders of the change in coverage would be "inconsistent with our marketing philosophy since we don't want to sell the coverage."

A group of over 100 homeowners affected by the Northridge quake, led by Irene Allegro, sued under the Unfair Competition Law. They alleged their earthquake coverage was reduced without their consent or adequate notice -- a scheme they claimed State Farm devised to reduce its exposure to earthquake liability. The Court of Appeal affirmed the plaintiffs' ability to proceed on their UCL claim. The UCL permits claims based on business practices that are either unlawful, unfair or fraudulent. The court acknowledged that certain violations of the Insurance Code cannot support a UCL claim under the unlawful prong. But, the court went on to hold, the alleged scheme to defraud Californians out of earthquake insurance was actionable under the unfair and fraudulent prongs of the UCL.

Shawn S. Ledingham *is a partner at Proskauer Rose LLP.*

COURTS REFUSE TO REGULATE INSURERS' DECISIONS TO EXIT MARKET

After the 1994 earthquake, State Farm and other insurance companies also decided to cabin their future exposure by reducing the number of homeowner policies they would offer going forward. Again, an affected homeowner sued, but this time to a much different result.

That plaintiff, Sterling Wolf, alleged that the insurers' refusal to sell new policies violated the UCL. In affirming a demurrer to that claim, the Court of Appeal observed, "Judicial intervention in complex areas of economic policy is inappropriate." The court went on to explain the various actions considered and taken by the legislature in response to the insurance crisis following the Northridge quake. In affirming dismissal, the court deferred to the legislature: "The availability of homeowners and earthquake insurance, its ramifications for the residential real estate market, and the need to guarantee that the insurers who write those policies can back them up when disaster strikes again, are peculiarly matters within the legislative domain."

The 2nd District issued its decision in the Wolfe case less than a month after it affirmed the right of the homeowners to pursue UCL claims in the *Allegro* case. In both cases, State Farm invoked the doctrine of primary jurisdiction to argue for judicial abstention. But unlike in the Wolfe case, where the only wrongdoing alleged was the decision not to sell insurance, the plaintiffs in Allegro alleged fraud in the failure to provide adequate notice of the changed insurance coverage. Fraud, the Court of Appeal held, is a matter "with which the courts have had considerable experience," and thus judicial abstention was inappropriate.

This distinction is consistent with how California courts have applied the UCL in other types of lawsuits brought by fire victims against insurance companies. For example, the courts have permitted UCL claims arising out of insurers' alleged false promises to pay the true value of covered property and improper calculation of replacement value for personal property.

The success of any UCL claim challenging insurance coverage changes will likely depend on the nature of the alleged wrongdoing. Mere challenges to an insurer's decision not to renew policies appear unlikely to succeed. But claims that policyholders were misled about the scope of their coverage or were denied the full value of their policies may be viable.