LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
WEDNESDAY, OCTOBER 25, 2023

PERSPECTIVE

Wildfires spark challenges within the insurance market

By Chinye Uwechue


Shutterstock

"During 1984-2000, 1.69 million acres burned over 11 states. It doubled in size to ~3.35 million acres during 2001-2018. In 2020, the total annual burned area jumped to 8.8 million acres, more than five times of that in 1984-2000. Such rapid increase of wildfires has become a major threat to lives, property, public health, water resource quality, and local and regional economies over the western U.S. and beyond." "Study Shows That Climate Change is the Main Driver of Increasing Fire Weather in the Western U.S.," Rong Fu, UCLA, Nov. 9, 2021.

"In that study, researchers with the University of California, Los Angeles found that the leading cause of the rapid increase of wildfires over the western U.S. is the rapid increase of surface air vapor pressure deficit, or VPD, a measure of how thirsty the atmosphere is. The warming of surface temperature contributed 80% of the VPD increase across the western U.S between 1979-2020. Only 32% of the increase in VPD was caused by changes in weather patterns, which is mostly due to natural climate variability. The remaining 68% of the increase in VPD is explained by human-caused climate change." "Study Finds Climate Change to Blame For Record-breaking California Wildfires," National Integrated Drought Information System, Aug. 8, 2023.

Climate change has had a major impact on the insurance industry in California. "Two insurance industry giants have pulled back from California's home insurance marketplace, saying that increasing wildfire risk and soaring construction costs have prompted them to stop writing new policies in the nation's most populous state. State Farm announced in May that it would stop accepting applications for all business and personal lines of property and casualty insurance, citing inflation, a challenging reinsurance market and "rapidly growing catastrophe exposure." The decision did not impact personal auto insurance. Allstate, another insurance powerhouse, announced that starting in November it would pause new homeowners, condo and commercial insurance policies in California to protect current customers. "California insurance market rattled by withdrawal of major companies," Associated Press, June 5, 2023.

Practical and political reality

The situation in California is mirrored across the US. More homeowners are going without insurance coverage. In the background is the increased pressure on the California Fair Access to Insurance Requirements Plan. With worsening climate change related weather and increasing costs for home repairs, what are the options

Chinye Uwechue *is senior attorney at RPNA (Roxborough, Pomerance, Nye & Adreani).*

for states like California? Aside from the obvious "risk reduction" option, which raises a myriad of possibilities (e.g., "California Climate Insurance Report: Year 1 Implementation Update," (March 2023) - the following three that have been discussed:

a) Allow insurance companies to use "forward-looking" models (as are used for earthquake insurance).

"Excluding the effects of reinsurance or other recoveries, Milliman estimates that the 2017 wildfire season alone wiped out just over 10 years of underwriting profits for California homeowners insurers, and that the combined 2017 and 2018 wildfire seasons wiped out about twice the combined underwriting profits for the past 26 years, leaving the insurance industry with an aggregate underwriting loss of over $10 billion for the California homeowners line of business since 1991." "Wildfire catastrophe models could spark the changes California needs," Milliman White Paper, 2019.

Allowing insurers to factor in the realities of climate change (current and future) would be more realistic. Such models are typically proprietary creating an uphill battle with consumer watch dogs who have resisted this option on the ground (rightly or wrongly) that its opaqueness could be used to camouflage unnecessary premium hikes.

b) Force insurance companies to stay in California

The legality of this option may be questionable and in any event, the deadline to pass a Bill to address the issue this year has passed for the 2023 California Legislative session. The 2023 California Legislative session adjournment was scheduled for Sept. 14, 2023. This raises the question of whether there will be a special legislative session or an executive order from the State

Governor. The effectiveness of this option will depend on whether acceptable terms can be negotiated with the insurance companies, all of whom need to have a profit margin to survive.

c) Allow insurance companies to pass on the cost of reinsurance

It is difficult to force insurance companies to stay in a market with rising costs and simultaneously refuse to allow them to pass on some of these costs to their consumers.

Claims handling challenges

Extreme wildfires have created complications that impact claims handling. For example, *Fadeeff v. State Farm Gen. Ins. Co.*, 50 Cal. App.5th 94 (May 22, 2020), is a case where environmental factors (rapidly spreading wildfire originally caused by an outdoor electrical wiring malfunction) property damage (smoke damage and soot) and health issues (asthma) converge. We are likely to see such convergence more and more in future. This confluence can create genuine complications when investigating claims, thereby leading to delays and denials that could potentially become questionable in hindsight.

In 2015, during the fire season, the Fadeeffs' home sustained smoke and soot damage as a result of the Valley Fire in Lake County, California. The fire burned about 76,067 acres, causing four deaths and the injury of 4 firefighters. Structures destroyed number over 1,950, in addition to a significant number of damaged property.

State Farm denied the Fadeeffs' supplemental claim for repairs to the exterior paint and for the interior "wallpaper and ... carpet" based on Carpenter's conclusion that the damage was due to wear, tear, and deterioration. State Farm denied coverage for the rear deck because it concluded that this portion of the exterior "did not sustain accidental direct physical loss and therefore, there is no apparent smoke or fire (ember) damage." *Fadeeff v. State Farm Gen. Ins. Co.*, 50 Cal. App. 5th 94, 99 (2020). The Fadeeffs filed a bad faith action against the insurance company. Applying the doctrine of "genuine dispute" State Farm moved for summary judgment, which was granted and the Fadeeffs appealed resulting in a reversal at the California Court of Appeal.

The Court of Appeal noted: "[W] here an insurer, for example, is relying on the advice and opinions of independent experts, then a basis may exist for invoking the doctrine and summarily adjudicating a bad faith claim in the insurer's favor. ...We concur, however, with the caveat advanced by the Guebara court. It cautioned that an expert's testimony will not automatically insulate an insurer from a bad faith claim based on a biased investigation." *Fadeeff v. State Farm Gen. Ins. Co.*, 50 Cal. App. 5th 94, 102 (2020).

Conclusion

There is no easy solution and there are competing interests creating a constant political "tug of war." Only time will tell how California (and other states facing the challenges of climate change), and the courts, will resolve these challenges. One thing is certain - whatever decision Is taken will result in some form of sacrifice (voluntary or otherwise) by certain sectors of the community. What is also certain is that as a state, California cannot standby and do nothing.