SB 894 AND RELATED WILDFIRE LEGISLATION

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I. Procedural History

In response to the considerable losses caused by the 2017 wildfires, the California Legislature enacted and amended several statutes to allow insureds the resources to rebuild their homes, especially given the reality of construction delays and price gouging of individuals in disaster locations. The following addresses the impact of these statutory revisions.

Effective September 21, 2018, California Insurance Code section 2051.5(b)(2) was amended to read:

> In the event of a covered loss relating to a state of emergency, as defined in Section 8558 of the Government Code, coverage for additional living expenses shall be for a period of no less than 24 months from the inception of the loss, but shall be subject to other policy provisions. An insurer shall grant an extension of up to 12 additional months, for a total of 36 months, if an insured acting in good faith and with reasonable diligence encounters a delay or delays in the reconstruction process that are the result of circumstances beyond the control of the insured. Circumstances beyond the control of the insured include, but are not limited to, unavoidable construction permit delays, lack of necessary construction materials, and lack of available contractors to perform the necessary work. Additional extensions of six months shall be provided to policyholders for good cause. (Emphasis added.)

During the discussions related to Senate Bill 894, which enacted this amendment, the state Senate declared the following as the purpose of this amendment to the statute:

> ***Purpose.*** The bill has several provisions intended to address the unique problems faced by policyholders who suffer total losses as a result of wildfires. It is frequently the case that the standard time frames associated with rebuilding after a major disaster are simply not long enough when so many losses have occurred. The bill is intended to grant these policyholders more flexibility with respect to temporary living expenses and policy renewals. But most important, the bill is intended to grant flexibility in how policyholders are allowed to use different types of coverage. Specifically, the bill allows use of contents and "other structures" coverage for purposes of rebuilding the primary dwelling.

(https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180SB894 ("894 Legislature Website"), 08/24/18 Assembly Floor Analysis.)

With respect to replacement cost coverage, Insurance Code section 2051.5(c) was also amended to read as follows:

> In the event of a total loss of the insured structure, a policy issued or delivered in this state shall not contain a provision that limits or denies, on the basis that the insured has decided to rebuild at a new location or to purchase an already built home at a new location, payment of the building code upgrade cost or the replacement cost, including any extended replacement cost coverage, to the extent those costs are otherwise covered by the terms of the policy or any policy endorsement. However, the measure of indemnity shall not exceed the replacement cost, including the building code upgrade cost and any extended replacement cost coverage, if applicable, to repair, rebuild, or replace the insured structure at its original location. (Emphasis added.)

The purpose of this amendment was to change an alleged practice among insurers not to pay replacement cost coverage otherwise owed if the insured opted to purchase a home in another area as opposed to rebuilding in the same location. In discussing Assembly Bill 1800 to enact this amendment, the purpose of the amendment was stated as follows:

> It has long been the law that policyholders are not required to rebuild on the insured site in order to obtain the coverage provided by a replacement cost policy. However, according to the Department of Insurance (DOI), some insurers have maintained that "extended replacement cost" and "building code upgrade" coverages do not transfer to a new location. The bill is intended to make it clear that, if the policyholder bought these coverages, they transfer if the policyholder decides to rebuild or replace at a new location.

(https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180AB1800 ("1800 Legislature Website"), 08/31/18 – Assembly Floor Analysis.)

In requiring insurers to provide estimates of the cost necessary to rebuild a residence, section 10103.4 was added to the Insurance Code. The statute reads as follows:

> (a) An insurer that provides replacement cost coverage in accordance with Section 10102, except an insurer that satisfies the requirements of subdivision (b), shall, on an every other year basis, at the time an offer to renew a policy of residential property insurance is made to the policyholder, provide an estimate of the cost necessary to rebuild or replace the insured structure that complies with Sections 2695.180 to 2695.183, inclusive, of Article 1.3 of Subchapter 7.5 of Chapter 5 of Title 10 of the California Code of Regulations, as those sections provided on January 1, 2018.

(b) An insurer that satisfies either of the following is not subject to subdivision (a):

(1) The policyholder has requested, within the two years prior to the offer to renew the policy, and the insurer has provided, coverage limits greater than the previous limits that the policyholder had selected.

(2) The insurer has, in connection with its annual offer to renew the policy, done both of the following:

(A) Offers, on an every other year basis, the policyholder the right to have a new estimate of the replacement cost for the insured dwelling, that is compliant with Sections 2695.180 to 2695.183, inclusive, of Article 1.3 of Subchapter 7.5 of Chapter 5 of Title 10 of the California Code of Regulations, as those sections provided on January 1, 2018, provided the policyholder provides the necessary, requested information.

(B) Offered the renewal of the policy and the dwelling coverage limit in the renewal offer is based on an inflation factor that reflects the cost of construction in the policyholder's geographic area. This paragraph applies whether or not the policyholder has elected to accept that coverage limit.

(c) This section shall not be deemed to limit or preclude an insurer and insured from agreeing to provide coverage for a policy limit that is greater or lesser than the estimate of replacement value provided in accordance with subdivision (a).

(d) This section is not intended to change existing law with respect to the duty of the policyholder or applicant to select the coverage limits for a policy of residential property insurance.

(e) This section shall become operative on July 1, 2019.

The purpose of this addition was to combat the common issue of underinsurance by homeowners after a natural disaster. In stating the purpose of the statute, the Assembly stated:

> Underinsurance often occurs as a result of inaccurate or outdated replacement cost estimates that were used to establish the coverage limit on the insured dwelling. The bill is aimed at improving the information available to policyholders so that they can make sound, informed decisions with respect to how much coverage to buy. Current regulations establish an approach that is intended to result in a sound estimate of the cost to replace a home, but that regulation does not mandate insurers to produce or update a replacement cost calculation.

(https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=201720180AB1797 ("1797 Legislature Website"), 08/03/18 – Assembly Floor Analysis.)

We have evaluated the impact of these revisions to the Insurance Code to address any underwriting concerns for carriers with respect to additional living expenses (ALE), extended replacement cost coverage, and the requirement to provide estimates as to the replacement costs of the residence at the time of an offer of renewal.

II. Analysis

Issue No. 1: Does the ALE payment extension for up to an additional 12 months apply if the policy has an ALE limit?

We researched the impact of the change on policies with ALE limits and specifically whether the limits could be paid in full regardless of the time remaining for the reconstruction of the residence. Based on the legislative history of the change in statute, it appears that the increased time limit for ALE payments by the statute is specifically subject to policy conditions, including limits. Thus, once the limits are exhausted, the carrier's obligation is complete. There is no requirement that the carrier pay ALE amounts beyond the policy limits regardless of the length of ALE coverage needed by the insured.

Given the revisions to the statutes are new, there is no case law that has evaluated the impact on the carrier's responsibilities. Therefore, we looked to the legislative intent in passing the law to evaluate how courts would likely view the issue.

There are notes in the legislative history that are relevant to this inquiry. In the Senate, it was noted that the bill "requires an insurer, in the case of a covered loss due to a state of emergency, to grant an additional 12-month extension for a total of 36 months for ALE if an insured acting in good faith and with reasonable due diligence encounters a delay in the reconstruction process, subject to policy limits, as specified." (894 Legislature Website, 08/30/18 – Senate Floor Analyses (emphasis added).) The carve-out that the bill is subject to the policy limits would suggest that the Legislature did not intend for the revision to expand the limits. More on point, the state Assembly noted that the bill "provides that, in cases of a declared emergency, coverage for ALE shall be for no less than 24 months, subject to other policy provisions (such as fixed dollar limits), and shall be extended an additional 12 months for good cause, as defined. This additional 12 months applies regardless of whether the policy uses fixed dollar limits or duration limits on the additional living expense coverage." (894 Legislature Website, 08/08/18 – Assembly Floor Analysis (emphasis added).)

The fact that this led to a disparity among carriers offering fixed limits versus ALE time periods was specifically debated before enactment of the amendment. The perceived impact of the statute remained the same. The intention was for fixed limits policies to merely provide the insureds longer to use the limits – not to increase the limits. The Assembly noted:

> Limits on the amount of ALE expense that is covered by the policy typically take one of two forms: there is either a fixed dollar amount available to be used by the policyholder, often capped by a one or two-year time frame; or there is no dollar limit on the expenditure level, but a specified time frame, usually 24 months, during which the policyholder is entitled to compensation for living quarters comparable to the destroyed home, regardless of how much those comparable quarters

> cost. Demand surge can have a substantial impact on these costs. Insurers that do not use fixed dollar limits complain that the bill treats them differently than insurers that use those dollar limits. Under the bill's language, the extent of coverage in fixed dollar limit policies is not increased, [*sic*] it merely provides the policyholder longer to use those limits. These insurers point out that the good cause extension of 12 months is actually a 50% increase in mandated coverage. Because in many circumstances the specified time frame approach provides "better" coverage to the policyholder, the insurers that offer this option argue they are being penalized by having a more favorable option for their insureds. (894 Legislature Website, 08/24/18 Assembly Floor Analysis (emphasis added).)

Without direction from the courts, the legislative history is the best evidence of how the statute will be interpreted. As a discussion as to limits was specifically addressed, the courts will likely follow the Legislature's lead and hold that the revisions to the statute do not operate to increase the limits on fixed limits policies. The Assembly specifically stated that the revisions were meant to give the insureds a longer period of time to use the limits but that it would not increase the limits on fixed ALE limit policies.

Based on the language used by the Senate and Assembly, it appears this extension of time to use ALE coverage only extends to a residential owner's cost to rent another home while the primary home is being rebuilt as opposed to a loss of rent from the destruction of a rental unit. The Assembly noted that ALE "provides coverage for the expenses associated with obtaining alternative lodging while the destroyed home is being rebuilt." (894 Legislature Website, 08/08/18 – Assembly Floor Analysis.) The Senate similarly noted that "ALE benefits generally . . . are intended to allow the insured to maintain a comparable standard of living during the rebuilding process." (894 Legislature Website, 08/30/18 – Senate Floor Analyses.) There is no discussion of rental coverages in the legislative history. As the only ALE addressed in the legislative history is relocation costs, the amendment was not intended to impact loss of use coverage beyond ALE specifically.

Issue No. 2: What policies will this change impact (future policies, policies in effect at the date of statute, or retroactively)?

It is our opinion that the change in statute respecting ALE will only apply to policies issued or renewed after July 1, 2019. Any policies in effect prior to that time will not be subject to the change in statute. The chances of a court finding that the statute amendment would be applied retroactively is highly unlikely. In fact, the point of retroactivity was debated, and a retroactivity provision was removed at the request of pro-insurance interests.

"It is an established canon of interpretation that statutes are not to be given a retrospective operation unless it is clearly made to appear that such was the legislative intent." *Aetna Cas. & Sur. Co. v. Indus. Acc. Comm'n*, 30 Cal. 2d 388, 393 (1947). "Generally, statutes operate prospectively only." *McClung v. Employment Dev. Dept.*, 34 Cal. 4th 467, 475 (2004), quoting *Myers v. Philip Morris Cos., Inc.*, 28 Cal. 4th 828, 840 (2002). "The presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly.… For that reason, the 'principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal.'" *Aetna Cas. & Sur. Co.*, 30 Cal. 2d at 393, quoting *Landgraf v. USI Film Prod.*, 511 U.S. 244, 265 (1994). "The renewal of a policy incorporates changes in the law prospectively and applies to conduct that occurred after

the Statutes were enacted." *Bentley v. United of Omaha Life Ins. Co.*, 2016 WL 7443189, 5 (C.D. Cal. June 22, 2016) (emphasis in original).

A "statute may be applied retroactively only if it contains express language of retroactivity or if other sources provide a clear and unavoidable implication that the Legislature intended retroactive application." *McClung*, 34 Cal. 4th at 475, quoting *Myers*, 28 Cal. 4th at 844 (emphasis in original); *see also*, *Bentley*, 2016 WL 7443189 at 5. Here, there is no statement of retroactivity in the amended statute. In fact, Insurance Code section 2051.5(e)(2) specifically provides, "[o]n and after July 1, 2019, all policy forms issued or renewed by an insurer shall comply with this section in its entirety, including the changes made to this section by the act that added this paragraph."[1] (Emphasis added.) Moreover, there is no discussion of the statute applying retroactively in the legislative history.

Given the strong public policy against retroactivity, it is our belief that the statutory changes will not apply retroactively as there is no evidence to suggest it was intended to be applied in that manner. Rather, all policies issued or renewed after July 1, 2019, will be required to include policy forms that reflect these changes.

Issue No. 3: Is the amendment to the statute related to extended replacement coverage applied retroactively?

The amendment to the replacement cost coverages was created through Assembly Bill 1800. The Legislative Counsel's Digest for this bill provides:

> This bill would … prohibit, in the event of a total loss of an insured structure, a fire insurance policy issued or delivered in this state from containing a provision that limits or denies, on the basis that the insured has decided to rebuild at a new location or to purchase an already built home at a new location, payment of the building code upgrade cost or the replacement cost, including any extended replacement cost coverage, to the extent those costs are otherwise covered by the terms of the policy or any policy endorsement. The bill would prohibit the measure of indemnity from exceeding, rather than requiring it to be based upon, the replacement cost, as specified. The bill would require all policy forms issued or renewed on and after July 1, 2019, to contain these provisions.
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> This bill would declare that it is to take effect immediately as an urgency statute.

(https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB1800)

In other words, extended replacement cost limits may be transferred to a substitute purchase if the insured elects not to rebuild the damaged premises.

As discussed in the digest, the bill specifically included an urgency clause for the statutory amendment to take effect immediately. The legislative history states that the bill "includes an urgency clause so that victims of the remainder of the 2018 fire season may choose to rebuild in a different location with the full benefits of their policy as provided by this bill." (1800 Legislature Website, 08/27/18 – Senate Floor Analyses.)

1 It should be noted that "the act that added this paragraph" was Assembly Bill 1800, discussed infra. Assembly Bill 1800 did not involve any amendments to the ALE coverages.

The legislative intent to make Assembly Bill 1800 retroactive while not requiring Senate Bill 894 (for ALE) to be applied retroactively is consistent with the purposes of the bills. Assembly Bill 1800 was intended to make "clear" the existing law related to extended replacement coverages as opposed to just replacement cost coverages. (1800 Legislature Website, 08/31/18 – Assembly Floor Analysis.) Specifically, the purpose of the bill was stated as follows:

> It has long been the law that policyholders are not required to rebuild on the insured site in order to obtain the coverage provided by a replacement cost policy. However, according to the Department of Insurance (DOI), some insurers have maintained that "extended replacement cost" and "building code upgrade" coverages do not transfer to a new location. The bill is intended to make it clear that, if the policyholder bought these coverages, they transfer if the policyholder decides to rebuild or replace at a new location. (1800 Legislature Website, 08/31/18 – Assembly Floor Analysis.)

On the other hand, Senate Bill 894 was intended to "grant" additional avenues through which policyholders could rebuild after a disaster. (894 Legislature Website, 08/24/18 Assembly Floor Analysis.) Thus, it logically follows that the new coverages would not be applied retroactively (absent express legislative intent to the contrary), whereas coverages that were already owed would be applied retroactively.

As to the position of the state of the existing law, the legislative history of Assembly Bill 1800 references Assembly Bill 2199 as the prior authority that precluded insurers from limiting replacement coverages if the insured opted to rebuild or purchase in another location:

> Prior to 2004, some insurers applied this principle [of replacement cost coverages] to argue that in a total loss of the home situation, the policyholder could take an actual cash value (depreciated) settlement and use it anywhere, but to obtain the *replacement* value of the home, it had to be *replaced on site*.
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> After wildfires in the San Diego area in the early 2000's brought this issue to the attention of the Legislature, AB 2199 (Kehoe), Chapter 311, in 2004 made it clear that policyholders have the right to choose to rebuild or replace at a different location. (1800 Legislature Website, 08/31/18 – Assembly Floor Analysis (emphasis in original).)

The Legislative Counsel's Digest for Assembly Bill 2199 states, "this bill would prohibit any policy issued or delivered in this state from containing a provision that limits or denies payment of the replacement cost of the insured structure in the event the insured decides to rebuild or replace the property at a location other than the insured premises, as specified." (http://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=200320040AB2199)

The legislative history indicates that arguments in favor of the bill include that "it is unfair to deny full recovery just because someone wants to move from a fire-prone area." (http://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=200320040AB2199, 06/22/04 – Senate Floor Analysis.)

In 2004, Assembly Bill 2199 added Insurance Code section 2051.5, which, at the time, read in relevant part as follows:

> (c) In the event of a total loss of the insured structure, no policy issued or delivered in this state may contain a provision that limits or denies payment of the replacement cost in the event the insured decides to rebuild or replace the property at a location other than the insured premises. However, the measure of indemnity shall be based upon the replacement cost of the insured property and shall not be based upon the cost to repair, rebuild, or replace at a location other than the insured premises.[2]

Based on subsequent changes to the statute, including those revisions set forth herein, section 2051.5 currently reads as follows:

> (c) In the event of a total loss of the insured structure, a policy issued or delivered in this state shall not contain a provision that limits or denies, on the basis that the insured has decided to rebuild at a new location or to purchase an already built home at a new location, payment of the building code upgrade cost or the replacement cost, including any extended replacement cost coverage, to the extent those costs are otherwise covered by the terms of the policy or any policy endorsement. However, the measure of indemnity shall not exceed the replacement cost, including the building code upgrade cost and any extended replacement cost coverage, if applicable, to repair, rebuild, or replace the insured structure at its original location. (Emphasis added to highlight change in relevant text.)

The addition of section 2051.5 through Assembly Bill 2199 did not address extended replacement cost coverages, rather only discussing replacement costs. Therefore, it appears the Legislature was conflating "replacement cost" coverage and "extended replacement cost" coverages in its analysis that the law was being misapplied by insurance companies.

With respect to the recent revisions to section 2051.5 through Assembly Bill 1800, there does appear to be some ambiguity in how the statute is now phrased. Section 2051.5(e) currently provides as follows:

> (e)(1) On and after July 1, 2005, and only until July 1, 2019, all policy forms used by an insurer shall be in compliance with this section, except for the changes made to this section by the act that added paragraph (2).
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> (2) On and after July 1, 2019, all policy forms issued or renewed by an insurer shall comply with this section in its entirety, including the changes made to this section by the act that added this paragraph.

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2 At that time, section 2051.5(e) was added to state, "[t]he changes made to this section by the act that added this subdivision shall be implemented by an insurer on and after the effective date of that act, except that an insurer shall not be required to modify policy forms to be consistent with those changes until July 1, 2005. On and after July 1, 2005, all policy forms used by an insurer shall reflect those changes." Therefore, the addition of section 2051.5(c), which allowed for replacement cost coverages to be used to rebuild or purchase in a new location, only went into effect as of the date the law went into effect on August 25, 2004.

Assembly Bill 1800 changed the language of the statute to add subparagraph (2). Therefore, it could be read that all amendments to the statute, except for those added through Assembly Bill 1800, go into effect immediately. This would suggest that the ALE amendment applies retroactively, but the replacement cost coverages amendment does not. This reading does not conform to the discussions of the amendments in the Legislature.

Despite this lack of clarity in the statute itself, the intent of the Legislature is clear. Given the weight of authority suggests the replacement cost coverage was intended to apply retroactively, unlike the ALE coverages amendment which has no discussion of retroactivity, it is our recommendation that carriers immediately put into effect the replacement cost coverages changes. It seems likely the courts will interpret the statute as intended to only afford retroactivity for replacement cost coverages.

Issue No. 4: What is the impact of the addition of Insurance Code section 10103.4 as added through AB 1797?

The Legislature also worked to reduce the problems caused by residential homeowners being underinsured by providing an avenue that required insurers to give estimates to the insureds of the likely cost of replacement of the dwelling in the case of a total loss. Assembly Bill 1797 created a requirement for insurers that write residential property insurance to conduct a replacement cost estimate every other year and provide the estimate to the insureds. Through Assembly Bill 1797, section 10103.4 was added to the Insurance Code.

This statute was enacted to address the pervasive problem with homeowners being underinsured in times of a natural disaster, during which time replacement costs are often higher than usual given the demand and limited resources. (1797 Legislature Website, 06/20/18 Senate Floor Analyses.) In discussing the bill, the Senate noted that "very few homeowners routinely assess their coverage at the time of renewal, likely assuming the insurer would suggest higher limits if it was necessary, or assuming that increases for inflation are sufficient.… Although many policies include an automatic inflation adjuster, experience has shown that inflation is generally not a good barometer for replacement costs the longer it is since the homeowner first purchased the policy." (1797 Legislature Website, 06/20/18 Senate Floor Analyses.)

Previously, to address similar issues, the Department of Insurance implemented regulations about the methodology to be used if the insurer provides an estimate of the replacement costs to the insured. (1797 Legislature Website, 08/03/18 – Assembly Floor Analysis.) This did not require such estimates to be provided or updated. (1797 Legislature Website, 06/20/18 – Senate Floor Analyses.) The purpose of Insurance Code section 10103.4 was to implement a mandatory requirement for the benefit of the insureds.

The statute mandates that, for insurers that provide replacement cost coverages, at the time of offering a renewal policy, on an every other year basis, the insurer must provide an estimate of the cost necessary to rebuild or replace the insured structure in accordance with the previous estimate regulations. Cal. Ins. Code § 10103.4(a). The statute does not preclude the insurer and the insured from agreeing to limits different than called for by the estimate. Cal. Ins. Code § 10103.4(c). The statute also does not change the requirement that the insured select the desired coverage limits. Cal. Ins. Code § 10103.4(d). As the Senate noted, "[t]he insurer has the tools to inform the homeowner of the replacement cost. It then remains up to the homeowner to choose that level of coverage." (1797 Legislature Website, 08/03/18 – Assembly Floor Analysis.) The statute was an attempt to provide the insured more information to make an educated decision about the replacement cost of the home.

An insurer can avoid the estimate requirement if (1) within two years of the offer to renew, the insured requested and the insurer provided limits greater than the previous limits the insured selected or (2) with the renewal offer, on an every other year basis, the insurer offers the insured the right to have the estimate completed and the insurer offers the renewal limits to factor inflation "that reflects the cost of construction in the policyholder's geographic area." Cal. Ins. Code § 10103.4(b). Basically, this exception to the estimate mandate requires that the insurer provide higher limits than previously provided. This is the only means through which the insurer can avoid providing the replacement cost estimate.

This statute does not apply retroactively. The statute itself expressly provides that it "shall become operative on July 1, 2019." Cal. Ins. Code § 10103.4(e). The statute also only applies to renewal offers. Cal. Ins. Code § 10103.4(a). Thus, as of July 1, 2019, all renewal offers must abide by the estimate requirement. Therefore, unless the insurer has complied with the exception requirements, it is our recommendation that the insurers implement these procedures for all renewals immediately as of July 1, 2019, with the estimates to be repeated every two years from there.

III. Recommendations

Based on the information obtained with respect to the legislative history, it is our recommendation that carriers continue to pay the ALE coverage on the policies in accordance with the fixed limits irrespective of the length of time required to rebuild or repair the residence. Once the limits are exhausted, there is no further obligation owed. The change in the statute is not intended to expand the limits in such policies but rather to extend the time the insureds may use to reach the limit.

In addition, the changes to the time element of ALE coverages only impact policies issued or renewed after July 1, 2019. This is not the case with the amendment to the replacement cost coverages. In that case, the Legislature was clear the clarification of coverage that states an insured may use extended replacement cost coverage to rebuild in another location or to purchase another home was intended to apply retroactively. Therefore, we recommend immediately putting into place a practice to pay benefits in accordance with the amended Insurance Code section 2051.5(c).

With respect to the addition of section 10103.4 to the Insurance Code, these changes take place as of July 1, 2019. At that time, it is our recommendation that the insurer provide estimates to the homeowners in compliance with the statute requirements at the time any offer of renewal is made. The insurer does not need to comply with the estimate requirement if it has complied with the exception requirements of section 10103.4(b). After the initial estimate provided with the first offer of renewal after July 1, 2019, the estimate need only be provided every other year with the offer of renewal.