April 2005 Insurance Law Column

The Short Life of the Use It and Lose It Homeowners Insurance Regulation

by Richard A. Huver, Column Editor

Richard A. Huver is a partner with the law firm of Levine, Steinberg, Miller & Huver, where he represents plaintiffs in the areas of insurance bad faith, products liability and personal injury litigation. He received his Bachelor of Arts degree from the University of San Diego in 1982 and his Juris Doctor from Southwestern University School of Law in 1987. Mr. Huver is an Officer for the Consumer Attorneys of San Diego and has been the Insurance Law Column Editor for ***Trial Bar News*** *since 1998. He may be reached by e-mail at:* ***rhuver@levinelaw.com****.*

As the saying goes, there are only two certainties in life: death and taxes. Add to that insurance. It is everywhere. Home, auto, life, health, disability, residential and commercial, individual and group insurance are available to cover virtually anything and everything. We often buy insurance because we have to, sometimes because we want to, but regardless, we buy insurance to protect ourselves, our homes, our assets, and our families. That being said, is it fair for you to be penalized for using your insurance -- known as the "use it and lose it" phenomenon?

A growing problem in the homeowners insurance arena is the use of an underwriting database known as CLUE and the implications it has on policies being canceled, non-renewed or not issued at all. The Comprehensive Loss Underwriting Exchange is a national database available to all insurance companies. File an insurance claim and you now have a black mark on your personal CLUE record. Inquire about coverage and the inquiry may appear as a claim on CLUE. As a result, either your insurance rates increase substantially or your insurance policy is canceled or non-renewed. Worse yet, if your homeowners insurance is canceled, you may not be able to purchase insurance from any other company because of the information about you in the CLUE database.

CLUE has drawn significant attention in the press in the past few years. In addition, consumer complaints about the database have grown nationwide and include (1) the information in CLUE is unknown to the consumer; (2) the CLUE information is incorrect but cannot be corrected; (3) a simple inquiry about coverage is treated as if it were a claim and logged in as such in CLUE; (4) policies are being canceled because a homeowner made a claim; and (5) carriers are not selling homeowners insurance to some people because of the CLUE information.

The use of CLUE and the resulting cancellation or non-renewal of homeowners insurance policies was well documented and reported to the California Department of Insurance ("CDI"). The CDI reported a recent increase in consumer complaints regarding cancellation, non-renewal and unavailability of homeowners insurance. A quick search on Google revealed as many as

434,000 hits about CLUE. Included are the Texas, California, Washington and Illinois departments of insurance web sites, all of which discuss the problem.

Incident to the 2003 California wildfires, several fire survivors joined forces with California legislators and the CDI to introduce new legislation, including a bill which would have prohibited homeowners insurers from canceling or non-renewing a policy simply because a claim had been submitted. The bill sought to create a point system similar to that for a driving record so that consumers were permitted a certain number of claims during a certain time period without penalty. In addition, the bill would have prohibited counting any claims submitted as a result of natural disasters against a homeowner. That legislation was soundly crushed by the insurance industry and never made it out of committee.

About the same time, the CDI issued an advisory warning notice to insurance companies regarding the problems associated with the use of CLUE. The notice read:

> **The purpose of this advisory notice is to direct your [the insurance industry's] attention to those laws concerning the appropriate use of loss history information in the rating and underwriting of residential property insurance in California. The CDI has received numerous complaints from homeowners and tenants who have been treated unfairly by insurance companies, particularly in the gathering and use of loss information in the underwriting process.**

In response to the notice, three insurance industry trade associations filed a petition for a peremptory writ of mandate seeking to invalidate the notice as an illegal "underground regulation." The trial court agreed and stayed enforcement of the notice. Thereafter, the CDI formulated and adopted a new regulation, California Code of Regulations, Title 10, §2361, addressing the appropriate use of the CLUE database as an underwriting tool in homeowners insurance. The pertinent provisions of §2361 read:

> **An adverse underwriting decision based on losses or loss exposure ... shall be based upon conditions of the individual risk which bear a substantial relationship to the loss exposure and which present an increased risk of loss ... An insurer shall not base, in whole or in part, an adverse underwriting decision on losses or loss exposures that have been fully remedied or otherwise resolved ...**
> **An insurer shall not base an adverse underwriting decision, in whole or in part, on an inquiry regarding coverage, unless a hazard or condition is identified which both bears a substantial relationship to loss exposure and presents an increased risk of loss.**

The new regulation also defined the terms: "adverse underwriting decision", "increased risk of loss", and "substantial relationship to loss exposure". In addition, the regulation required insurers to conduct independent inquiries if a decision was based solely on CLUE information, and to maintain documentation supporting and explaining their decisions.

Again, the insurance industry was not pleased and filed another writ to invalidate the new regulation. The trial court agreed with the insurance industry and this time, the CDI appealed. In *American Insurance Association v. Garamendi* (2005) 127 Cal.App.4th 228, 24 Cal.Rptr.3d 905, the Third Appellate District affirmed the trial court's decision, holding that the CDI had no authority to regulate underwriting of homeowners insurance. *Id.* at 24 Cal.Rptr. 905, 908.

The appellate court listed several reasons for its decision. First, the court held that new regulation §2361 conflicted with existing Insurance Code §791.12, which already prohibited certain defined "adverse underwriting decisions" (but did not include those within regulation §2361). *Id.* at 912-913. Secondly, the appellate court reviewed and rejected each of the statutory bases upon which the CDI relied as conferring it with authority to regulate underwriting of homeowners insurance. *Id.* at 913-917. And finally, the court gave great weight to the fact that the Legislature had rejected a proposed bill aimed at addressing similar problems as were addressed by regulation §2361. *Id.* at 917-918.

The only bright light from this decision may be its effect on future primary jurisdiction motions by insurance companies in the homeowners insurance arena. Why? Because the insurance industry strenuously argued that the CDI has no business regulating how they underwrite or chose not to underwrite homeowners insurance policies. And the Third Appellate District agreed, stating: "We have found the Insurance Code does not give the Commissioner authority to regulate underwriting for homeowners insurance." *Id.* at 918. Thus, if you have a bad faith claim or unfair business practices case dealing at all with underwriting issues, you might be able to use this case to defeat an effort to remove the case to the Department of Insurance.