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Colorado Wildfire Suits Point To Underinsurance Issues

By **Eli Flesch**

Law360 (June 14, 2023, 11:42 AM EDT) -- Lawsuits filed by Colorado homeowners and businesses against their insurance companies for coverage of wildfire losses are a symptom of a broader underinsurance problem in a state where climate change now poses serious risks, insurance experts say.

While policyholders continue to accuse insurers of shortchanging them for damages connected to the 2021 Marshall Fire, Colorado lawmakers have approved a series of bills meant to help homeowners who find their insurance inadequate. Those measures have come against a backdrop of high inflation and construction costs that have complicated recovery from the fire, industry professionals say.

Coverage suits over Colorado fires have continued to hit state and federal dockets. They are often brought by homeowners alleging their carriers improperly delayed the claims process, performed inspections that didn't capture the scope or real cost of the fire damage, or failed to pay benefits upon the discovery of additional smoke damage.

Other property owners have accused their insurers of undervaluing or excessively depreciating the contents of their homes.

Katherine Goodrich, a founding member of the Denver-based MoGo LLC law firm, described Colorado as a "canary in the coal mine" for what other states might face as a result of climate change. Other states like California and New Mexico are already contending with issues of total losses following wildfires, Goodrich told Law360.

"I feel like in Colorado, we really just don't know what the scope of the underinsurance problem is. We don't know what percentage of people are most likely underinsured, and I think if [state regulators] collected more data, they could probably figure that out," said Goodrich, who is representing policyholders in multiple suits over wildfire coverage.

The Marshall Fire, which ripped through suburbs near the Front Range mountains west of Denver and Boulder in December 2021, destroyed an estimated $1 billion worth of property, according to market analysts. A year earlier, the East Troublesome Fire became Colorado's second-largest ever as it burned over 190,000 acres of land.

Climate scientists have cited drier conditions throughout the West as responsible for helping to create the conditions for massive wildfires. Last month, State Farm said it would no longer sell new property and casualty policies in California, citing high construction costs, growing catastrophe exposure and a challenging market for reinsurance, which insurance companies purchase to cover their own losses.

Experts said the move could lead other insurance companies to pull out of high-risk markets, creating a dearth of competition. Last week, the San Francisco Chronicle reported Allstate quietly stopped homeowner policy sales in California in 2022. Those two companies accounted for around 13.5% of the property and casualty insurance market share in 2021, according to the California Department of Insurance's latest data.

While the Colorado Division of Insurance estimated last year that up to two-thirds of homeowners who experienced total losses in the Marshall Fire were underinsured, the agency also said the true number could be lower depending on rebuilding costs.

And those figures only accounted for total losses. In much of the recent litigation over the Marshall Fire, disputes concern partial losses to property, according to Goodrich.

The reasons for widespread underinsurance are myriad, experts say. Insurance professionals have variously pointed to high construction costs, the tools insurers use to calculate policy limits, and types and costs of policies carriers sell.

After the CDI's report last year, insurance commissioner Michael Conway suggested that getting a more accurate read on rebuilding costs would be critical to properly measuring the underinsurance crisis. In a 2018 paper, California Western School of Law professor Kenneth S. Klein argued that underinsurance was pervasive in the U.S. because insurers routinely recommend inadequate limits.

"For insurers, the prevalence of inadequate and eroding coverage limits resulting from cost estimators is a feature, not a glitch," Klein wrote in the Connecticut Insurance Law Journal. "Cost-estimating software creates the opportunity to capture and retain more market share by selling nominally 'full' but actually inadequate insurance coverage."

Susan Minamizono, a Levin Sitcoff Waneka PC lawyer who's representing homeowners in Marshall Fire suits, said many policyholders with replacement cost coverage found themselves severely underinsured after the fire. Such coverage, common in standard homeowners policies, affords insurance benefits up to a set limit in the policy.

Extended replacement cost coverage, for an extra premium, ups the amount a homeowner can recover by a percentage of the overall dwelling coverage limit, usually 10% to 50%.

"Even those who got the extended replacement coverage right — just added on, got the most robust version of a policy that was available at the time prior to the loss — I mean, they're still encountering underinsurance issues," Minamizono told Law360.

She said that ongoing litigation over the fire reflected those underinsurance problems. While many of the early cases involved total losses, more of the cases that have come up in recent months involve partial losses and losses from smoke damage, Minamizono said. Some of the suits also concern homeowners who have identified toxic particulates on their property but haven't been able to secure policy benefits, Minamizono added.

Legislators in Colorado have taken steps to alleviate the underinsurance issue by approving bills this month that would create an insurer of last resort, similar to insurance pools in other states, and increase coverage limits for certain types of policies. Still, those measures were watered down in the legislative process, insurance experts said.

The coverage limit bill, for example, initially contained a provision that would have required insurance companies to offer guaranteed replacement cost coverage, a type of policy that covers full reconstruction costs, even if the loss exceeds policy limits.

The new bill, approved by Gov. Jared Polis, sets higher limits for extended replacement coverage, which is added onto homeowners policies, and law and ordinance coverage, which helps pay for costs associated with rebuilding a damaged structure to code.

The bill approving the insurer of last resort would allow homeowners and businesses that have been unable to secure coverage on the traditional market to do so through an unincorporated private entity, called a "fair access to insurance requirements plan association."

Limits for the FAIR plan, scheduled to be implemented over the next several years, will be set at $750,000 for residential properties and $5 million for commercial properties. Similar to how last-resort insurers operate in other states, all Colorado-licensed carriers must participate in the FAIR Plan. The plan will be led by governor-appointed individuals representing insurers and industry and consumer trade groups, according to the bill.

Eric C. Scheiner, a Kennedys Law LLP attorney who partly represents insurers in natural disaster matters, said dry conditions would only increase the potential exposure to high-loss events like fires.

He said carriers are more carefully evaluating how well potential insureds are proactively trying to mitigate wildfire exposure, including through their business dealings with other companies that could play a potential role in a fire.

Such other companies could become the target of subrogation suits in which homeowners, business, plaintiffs and other insurers seek to recoup payments, he told Law360.

"Some people might decide that they want a better or higher amount of coverage, and others will decide, 'Maybe if I have a fire, it won't completely burn my business, so I only need a smaller amount of insurance with respect to fire risk or loss,'" Scheiner said.

--Editing by Philip Shea.