California Quakes Should Shake UP Policyholder Complacency

This article was originally published in *Law360* on April 7, 2014.

by Robert L. Wallan, Kimberly L. Buffington and Alyson R. Parker

Robert L. Wallan
Intellectual Property
+1.213.488.7163
robert.wallan@pillsburylaw.com

Kimberly L. Buffington
Intellectual Property
+1.213.488.7169
kbuffington@pillsburylaw.com

Alyson R. Parker
Intellectual Property
+1.213.488.7172
alyson.parker@pillsburylaw.com

Los Angeles residents didn't need to go to McDonald's for their "Shamrock Shake" on St. Patrick's Day when a 4.4 magnitude earthquake shook L.A. County out of bed. Two weeks later, a 5.1 earthquake centered in Orange County, Calif., was followed by over a hundred aftershocks. The late March quakes flipped cars, crumbled walls and caused rockslides, gas leaks, power outages and broken water mains near the epicenter. Authorities evacuated some hotels and residences, and other businesses were interrupted due to loss of power, structural damage or broken inventory.

The March earthquakes serve as a resounding reminder to consider your residential and commercial earthquake insurance coverage needs.

Many Californians may not be financially prepared to rebuild after "the Big One."

While many Golden State residents witnessed the televised trail of destruction following the March 11, 2011, earthquake in Fukushima, Japan, it seems that for many Californians, a similar local disaster is unfathomable. The Los Angeles Times reports that five-out-of-six homeowners currently have no coverage for losses resulting from a quake. These homeowners may not even be aware that most California homeowners' policies expressly exclude earthquake coverage. In areas of California, where earthquakes are inevitable, commercial earthquake insurance is an integral part of a long-term business plan. Still, many business owners choose not to add earthquake coverage.

The "big ones" in California can be devastating.

On an early morning in April 1906, a 7.8 earthquake struck San Francisco. Over the next few days, fires erupted from burst gas mains, stoves and severed electrical wiring. The upheaval disconnected sources of water, leaving firemen helpless as they watched 80 percent of the city razed by fire. The quake and fire left an estimated 55-75 percent of San Francisco's population homeless.

Insurance companies were completely unprepared for the costly disaster and denied claims under the theory that the damage was caused by the uninsured earthquake, not the subsequent devastating fires. For the most part, policyholders' lawyers successfully argued that the more significant losses were covered fire losses, not excluded earthquake losses. In response, insurers toughened policy language to minimize their exposure, a process that continues to this day.

Other major quakes have struck California in the last few decades. In 1971, a 6.6 earthquake hit north of Los Angeles in Sylmar, causing around $5 billion in property damage measured in 2013 dollars. During the 1989 World Series, a 7.1 quake hit south of San Francisco, causing an estimated $14 billion in property damage. In January, 1994, a 6.7 earthquake struck Northridge, Calif., causing upwards of $20 billion in property damage — in just 15 seconds. Beyond property damages, all of these quakes produced other significant economic losses.

When Will the Next "Big One" Occur?

Studies abound on earthquake prediction. Global Weather Oscillations Inc. recently published a report warning of a 75 percent chance of a 7 to 8 magnitude earthquake near Los Angeles within the next four months. The UC Berkeley Seismological Laboratory predicts that there will be a near-term significant earthquake from the Hayward Fault east of the San Francisco Bay, which runs under the campus.

Scientists and the media call the inevitable high-magnitude earthquake that will hit the southern part of the San Andreas Fault the "Big One". After the March 2014 Los Angeles earthquakes, however, seismologists are paying closer attention to the Puente Hills Fault. Because the Puente Hills Fault runs directly underneath downtown Los Angeles, and ends underneath Hollywood, experts estimate that a quake in this fault could kill 3,000 to 18,000 people and cause up to $250 billion in damage. Aside from predictions as to timing or location, the fact is that California will suffer more major earthquakes in the future.

Relying on Government Assistance in the Wake of a Natural Disaster is Risky

California homeowners without earthquake insurance will likely hope to rely on the federal government for money to rebuild after a "big one." But, when the federal government helps out after a disaster, that help comes in the form of Federal Emergency Management Agency loans, which must be repaid. After Hurricane Katrina, many question the availability of government assistance and have very real concerns about delays in federal relief efforts.

Be informed about your earthquake policy, especially some of the typical pitfalls for insureds.

As illustrated by the disaster of 1906 and Fukushima, earthquakes can trigger other perils like fire, land movement, tsunami and water damage. Like Japan, much of coastal California is a tsunami zone. Policyholders should be careful and cautious in reviewing their earthquake coverage contract and make sure they understand in advance the extent of their coverage.

History also shows that the insurance industry will argue strenuously for the narrowest interpretation of coverage. After the Northridge earthquake in 1994, most insurance companies developed a scheme to exclude coverage for concurrent perils when one or more peril is excluded: so-called anti-concurrent causation language. ACC clause language purports to exclude coverage for damage caused by an excluded peril, such as an earthquake, even if the loss is jointly caused by a covered peril, such as a fire. Most states enforce these clauses, which can greatly devalue an earthquake policy's worth. However, some states, like California, will not fully enforce ACC clauses.

California Compels Insurers to Provide Earthquake Insurance to Homeowners

All California homeowners' insurers have an obligation to offer their policyholders earthquake insurance at least every other year. The California Earthquake Authority, a publicly managed organization of most private homeowners' insurers, provides a standard residential earthquake insurance policy.

While coverage will ultimately depend on the specific characteristics of the property, and the exact form purchased, the CEA policy usually covers: (1) damage to the property up to the limit on the homeowner's residential policy with a 10 or 15 percent deductible for the structure; (2) loss of most personal property up to $100,000, with a 10 or 15 percent deductible that may be waived depending on the amount of the total loss; (3) living expenses or loss-of-use costs, like replacement housing, restaurant meals and laundry expenses or the expense of moving to another permanent home (up to $25,000 without deductible); and (4) some coverage for building code upgrades and emergency repairs.

Policies may have overlap between earthquake coverage and homeowners' coverage. For example, some homeowners' policies cover direct loss from explosions or breaking glass caused by an earthquake. Also, homeowners' policies cover loss due to fire, which commonly follows quakes.

Earthquake coverage is usually available to and advisable for business owners.

Like residential policies, most general commercial property insurance policies in California do not cover loss resulting from an earthquake. Accordingly, business owners should consider supplementing their property insurance with a named-peril earthquake endorsement, or purchasing a separate earthquake coverage policy. A commercial earthquake insurance policy typically covers damage to buildings and business property, loss of business income, sprinkler leakage and betterment or repairs required by local ordinance or law caused by an earthquake.

Earthquake insurance can be costly — but earthquake damage to property can be catastrophic.

Consideration of earthquake coverage and related property coverage should include both a cost analysis as well as a coverage analysis. Our prediction: Businesses and homeowners who prepare for the next "big one" stand to be in far better financial condition than those who simply hoped for the best.

Robert Wallan is a partner in Pillsbury Winthrop Shaw Pittman's Los Angeles office, where he is co-chairman of the firm's insurance recovery and advisory practice group.

Kimberly Buffington is a partner and Alyson Parker is an associate in Pillsbury Winthrop Shaw Pittman's Los Angeles office.

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | +1.877.323.4171

Pillsbury Winthrop Shaw Pittman LLP