Strange Changes – Coverage Reductions in Renewal Policies are Not Enforceable Without Conspicuous, Clear and Specific Notice

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Companies and individuals often spend considerable time and effort selecting an insurer and an insurance policy that meets their needs. Once the initial policy period expires, it is common for policyholders to renew their insurance policies with the same insurer, while expecting that the renewal policy will provide the same coverage as the original policy. In many cases, insurance policies are renewed for several years before an incident takes place or a claim arises, and often it is the policy in effect at that time that applies to the specific matter. However, this is not always the case.

For example, as demonstrated by the cases discussed below, when an insurer renews a policy and makes changes that narrow the coverage or reduce the limits, the insurer must inform the customer of the specific changes made and must do so in a manner and with language that is conspicuous, plain, and clear.[1] Providing the insured with a copy of the revised policy language, advising the insured to read the new policy, or telling the insured that the policy has changed is not enough. When insurers have failed to provide the requisite notice, courts have held that the revised policy language is invalid and that the original policy language applies.[2]

Industrial Indemnity Co.

In *Industrial Indemnity Co. v. Industrial Accident Commission of California,*[3] the insurer issued a policy of "workmen's" compensation insurance to a partnership and to its two partners covering all of their employees for the period from January 22, 1946, to January 22, 1947. On the subject of whether relatives were excluded, the policy provided that if a partnership was the insured it would not include partners, but nothing was said as to relatives of the partners. The policy further provided that if it was issued to an "individual" then such individual's relatives were not covered. Thus, the court explained, it could be reasoned that, as long as the insured was a partnership, the employees of the partnership would not be excluded even though related to one of the partners, but when an individual was the insured, his relatives were excluded.[4]

While that policy was in effect, one of the partners, Mr. Schultz, sold his interest in the partnership business to the other partner, Mr. Cornish, in July 1946, and the partnership was dissolved on August 1, 1946. The insurer cancelled the policy that had been issued to the partnership and issued a new policy to Cornish, as an individual and not as a partnership, covering the period August 1, 1946 to August 1, 1947. According to the court, the evidence clearly indicated that Cornish only had sought to change the name of the insured from a partnership to him as the succeeding individual owner without any reduction in coverage. However, the clauses in the new policy with respect to non-coverage for relatives of individuals were the same as in the previous policy that had been issued to the partnership.

An accident took place on December 10, 1946, in which Cornish's son-in-law was killed while working for him. According to its terms, the insurance policy did not apply to the loss because the deceased employee was a relative of the insured. In the course of discussing whether the policy issued to Cornish as an individual should be reformed to provide the same coverage for employees as had been provided by the original policy issued to the partnership, the court discussed California Insurance Code section 304. That section provided, "[i]n the case of partners, joint owners, or owners in common, who are jointly insured, a transfer of interest by one to another thereof does not avoid insurance, even though it has been agreed that the insurance shall cease upon an alienation of the subject insured."[5] The court explained that section 304 indicated that the "interest in the insurance" passes when one partner buys out the others, and that the interest should embrace the character of the employees covered.[6]

The court also stated, "[t]here is some analogy to the renewal cases in the policy expressed by section 304 of the Insurance Code. Where an insured requests an existing but expiring policy to be renewed, no change may be made in the terms of the renewal policy without notice to the insured."[7] As examples of the "renewal cases," the court cited two out-of-state cases.[8] The court concluded that,

under the circumstances of this case, section 304 of the Insurance Code preserved the coverage in effect under the original policy although one of the partners bought the other's interest.[9]

Sorensen

In *Sorensen v. Farmers Insurance Exchange*,[10] the plaintiff was struck by an uninsured motorist while riding his motorcycle in 1973. His insurer denied coverage based on an exclusion in his policy that was in effect at the time of the incident.

Several years earlier, plaintiff had obtained a family automobile policy from Farmers on a 1959 Ford station wagon. Plaintiff did not own a motorcycle then, but he sometimes rented them. The agent for Farmers told plaintiff that he also had coverage under this policy while riding a motorcycle, and the policy provided uninsured motorist benefits for plaintiff while occupying a motor vehicle "or otherwise."

In 1968, California Insurance Code section 11580.2 was amended to permit insurers to exclude coverage for bodily injury of the insured while occupying a motor vehicle owned by an insured that is not an insured motor vehicle.

Plaintiff purchased a new automobile in 1970 and informed Farmers of the change of vehicles. He received a new edition of his automobile policy that excluded coverage to the insured if caused by an uninsured motorist unless the vehicle occupied by the insured was itself insured. A letter accompanying the new policy stated that the "most significant" change to the policy as compared to the previous policy "involves stereo tapes and tape players." The insurer's letter did not mention the change in the policy removing the uninsured motorist coverage that had been in the previous policy.

Plaintiff purchased a motorcycle in 1972. He obtained insurance coverage from the seller of the motorcycle through another insurance company for comprehensive and liability coverage only. Plaintiff testified that he specifically waived uninsured motorist coverage on the policy because he believed he was covered by the Farmers policy.

After Plaintiff was struck while riding his motorcycle in 1973, Farmers denied coverage based on the policy exclusion in the new policy it had issued in 1970. Plaintiff sued the insurer and claimed that the new policy's exclusion should not apply. He argued that the insurer had a duty to inform him of the material change in the terms of his uninsured motorist coverage, and that its failure to do so required it to cover him under the terms of his original policy.

Farmers did not dispute that it had not provided plaintiff with any specific notice of the change to his uninsured motorist coverage. Instead, Farmers argued that plaintiff had received notice of the change in coverage because he had received the new policy and the new policy contained the new exclusion.

The court of appeal noted that the original policy contained a provision requiring the insurer to provide a notice describing any reduction in coverage at least 10 days before going into effect.[11] The court stated that "merely" setting forth the new exclusionary clause in a subsequent policy does not comply with the original policy's notice requirement.[12] The court also noted that the letter accompanying the new policy ignored the new exclusion for uninsured motorist coverage while referring to another coverage change, and it would not be unreasonable under the circumstances for the insured to read only the changed provision identified in the letter.[13]

The court of appeal went on to explain that the insurer's attempt at a "buried notice" violated several fundamental principles found in this field of law:[14] (1) "[a]n insurer cannot escape its basic duty to insure by means of an exclusionary clause that is unclear"[15] and "any exception to the performance of the basic underlying obligation must be so stated as clearly to apprise the insured of its effect;"[16] (2) "[i]nterpretation of an insurance policy must be pursued in light of the insured's reasonable expectations;"[17] and (3) "[a]ny ambiguity or uncertainty in an insurance policy is to be resolved against the insurer."[18]

In addition, the court of appeal noted that the faces of the original and new policies showed boxes marked for uninsured motorist coverage, and there was "no indication in this facial gloss that the insured's coverage has been qualified or modified in any manner."[19] The court concluded that Farmers did not notify plaintiff by a conspicuous, plain, and clear notice that the coverage he originally had was "greatly reduced" by the new policy and held that plaintiff was entitled to the coverage contained in the original policy.[20]

Fields

Fields v. Blue Shield of California[21] arose out of an insurer's refusal to pay for the insured's psychotherapy under a group medical policy. The insured was a medical doctor who wished to become a psychoanalyst. To attain such a career goal, he enrolled in a psychoanalytic training institute and was required to complete 300 hours of personal psychoanalysis. The insured began receiving psychoanalysis in October 1974, and was subsequently diagnosed with a mental illness. The insured also received credit for the training analysis requirement from the time his analysis began in 1974.

When the insured enrolled in a group health insurance plan in June 1975, the policy had a supplemental benefits section providing coverage for psychotherapy for treatment of nervous and mental illness, with an exclusion for "marital, family or other counseling or training services." The insurer changed the policy that would go into effect in January 1976 to add an exclusion in the supplemental benefits section for "[p]sychoanalysis or psychotherapy . . . that is credited towards earning a degree or furtherance of the education or training of a Subscriber, regardless of diagnosis or symptoms that may be present."

In late 1975, the insured obtained a copy of the brochure for the plan that would go into effect in 1976. The new exclusion was contained at page 20 of the 32-page benefit plan in the "supplemental payments" section. On page 31 of the benefit plan, Blue Shield notified its insureds in bold type: "How Plan Changes In January 1976." The insurer warned that the brochure had been reorganized and should be read in its entirety. The booklet then stated: "[i]n addition to many clarifications, the following benefit changes are effective January 1, 1976." The insurer then listed several specific coverage changes, including new coverage for hypnosis and hypno-therapy, which had not been covered under the 1975 plan, and two reductions in benefits, but did not refer to the new exclusion for psychotherapy, also used in furtherance of training, set forth at page 20.

The insurer paid for the insured's psychoanalysis treatment until 1978, when it disallowed benefits based on the 1975 policy language "as clarified in the 1976 plan." The insured filed suit and the insurer prevailed at trial.

On appeal, the insured argued that the insurer could not enforce the reduction of benefits in 1976 because as a modification, and as an exclusion, it was not conspicuous, plain, and clear as required by California law. The court of appeal explained, "[i]t is a long-standing general principle applicable to insurance policies that an insurance company is bound by a greater coverage in an earlier policy when a renewal policy is issued but the insured is not notified of the specific reduction in coverage."[22]

The court of appeal also referred to previous California appellate decisions demonstrating that, in the case of standardized insurance contracts, made between parties of unequal bargaining strength, "exceptions and limitations on coverage the insured could reasonably expect must be called to the subscriber's attention clearly and plainly before the exclusion will be interpreted to relieve the insurer of the liability." [23] The court noted that the new coverage exclusion in the 1976 policy was not placed in the limitation or exclusion section, but at the end of benefit granting provisions, and that the insurer did not notify the insured by a clear, conspicuous notice in an expected place that the coverage he originally had was totally withdrawn.[24]

Regarding the insurer's notice to the policy to read the entire policy, the court stated that "such direction is not a substitute for notice to the subscriber of a loss of benefit."[25] The court also explained, "[t]he rule is and should be: Deletions or exclusions from a renewal group policy should be communicated and explained to the subscriber by a plain, clear and conspicuous writing. The prominent and express listing of certain specific changes whether grants or exclusions coupled with the omission of very specific exclusion of coverage, can only mislead the subscriber. Reduction of benefits, to be effective, cannot be placed in an unconspicuous place under the heading 'Supplemental Benefits.'"[26]

Fibus

In *Allstate Insurance Co. v. Fibus,*[27] the Ninth Circuit applied California law and ruled that an insurer's notice of policy changes was inadequate. The insurer issued an automobile insurance policy to the insured that contained a limit of liability of $100,000 per person and $300,000 per occurrence. The policy stated that the $100,000 limit for each person would apply to all damages because of bodily injury sustained by one person in any single accident. When the policy was renewed, the insurer added language to this provision stating that the $100,000 limit would include not only the damages to the person that suffered the bodily injury, but also to all resulting damages sustained by any other person. While the renewal policy was in effect, the insured was involved in an accident and another person was severely injured. The insurer paid $100,000 to the injured person, but would not pay the loss of consortium claim of the injured person's spouse.

In a lawsuit filed in federal court against the insurer, the insured asserted that the insurer did not properly notify the insured of the reduction in coverage and this failure rendered the policy amendment inoperative. The trial court ruled in favor of the insurer and the insured appealed. The Ninth Circuit quoted from and cited *Fields* for the propositions that "an insurance company is bound by a greater coverage in an earlier policy when a renewal policy is issued but the insured is not notified of the specific reduction in coverage" and "[t]o be adequate, notice must be conspicuous, plain, and clear."[28]

The insurer argued that it had properly notified the insured of the policy change because before it issued the

renewal policy it allegedly sent an eight-page "Amendatory Endorsement" to the insured that set forth the changes in the renewal policy. The first page of this document stated that the section of the original policy containing the $100,000 limit of liability had "been replaced by the following" and then set forth the language of the new section. The Ninth Circuit noted that the insurer had not highlighted any of the language of the new section, and thus the insurer had not identified what was new or different within the new section as compared to the original version. The court thus ruled that the insurer's Amendatory Endorsement did not conspicuously notify the insured of a reduction in coverage.[29]

Davis

In *Davis v. United Services Automobile Ass'n*,[30] the insurer issued an "all-risk" insurance policy to a homeowner and then renewed the policy for several years. When first issued in 1978, the policy used the "HO-3" policy form, which excluded coverage for loss resulting from earth movement. This same form was used when the policy was renewed during each of the next five years.

The insurer issued a renewal policy in 1984 with a new "HO-82" form that had the earth movement exclusion and also contained a new exclusion for loss caused by contractor negligence. The insurer also issued a chart to the homeowner comparing coverages of the old and new policies. The insurer further provided a notice stating that the new policy contained some changes and that the insurer hoped that the homeowner would read the entire new policy and, in particular, the section containing the coverage exclusions. However, the chart and the notice from the insurer did not specifically mention the new exclusion for loss caused by contractor negligence.

In 1986, the insurer renewed the policy with a new policy form, "HO-84", that continued the exclusions for earth movement and contractor negligence and added additional exclusions relating to contractor negligence. The insurer also issued a notice summarizing coverage changes in the new policy, including a section discussing policy exclusions. This section had three subparts for broadening of coverage, reduction of coverage, and clarification of coverage. The reduction of coverage section did not refer to the exclusion for contractor negligence. The "clarification" section stated that the insurer was attempting to clarify that the original policy intent was not to provide coverage for losses caused by or contributed by an excluded peril and added three new exclusions for weather conditions, acts or decisions, and faulty, inadequate, or defective planning, development, design, specifications, materials, or maintenance.

The homeowner sustained a loss to the home in 1986 due to soil subsidence. The insurer's investigation revealed that there were two causes of the loss: earth movement and the negligence of a contractor in failing to reinforce the foundation slab and properly prepare the subgrade soils. The insurer denied coverage based on the exclusions in the HO-84 policy form. The homeowner sued the insurer and asserted that the original HO-3 policy form, which did not exclude coverage for loss resulting from contractor negligence, should apply because the insurer had failed to notify the homeowner that the later HO-82 and HO-84 forms had the contractor negligence exclusion. The trial court and the court of appeal agreed with the homeowner.

The court of appeal quoted the *Fields* rule that an insurer must notify the insured of the specific reduction in coverage when a renewal policy is issued.[31] The court rejected the insurer's argument that *any* notice that the policy contains changes is sufficient to satisfy the insurer's duty.[32] "The law, however, requires notice of the *specific* reduction in coverage; a general admonition to read the policy for changes is insufficient."[33]

The court also stated that the insurer's chart comparing the policy changes was misleading because it made no mention of the new contractor negligence exclusion when discussing changes in the policies.[34] In addition, the court of appeal agreed with the trial court's finding that the notice accompanying the HO-84 form was ambiguous and did not provide clear and conspicuous notice of an exclusion for contractor negligence.[35] As a result, the court held that, since the insurer failed to provide adequate notice of the exclusion for contractor negligence in the HO-84 and HO-86 policy forms, the original HO-3 policy applied to cover the loss.[36]

Classic Distributing

Most recently, *Classic Distributing and Beverage Group, Inc. v. Travelers Casualty and Surety Co. of America*,[37] involved a dispute over an insurance claim arising under an employment practices liability ("EPL") policy issued to a company. The company initially had purchased an EPL policy from the insurer in October 2006. The company renewed the policy with the insurer in October 2007 and the insurer added a new Wage and

Hour Claim Exclusion endorsement that narrowed the policy's coverage as compared to the original policy. The policy was renewed in October 2008 and again contained the Wage and Hour Claim Exclusion endorsement that was not in the original policy.

The company was sued by its employees in April 2009 for violations of the California Labor Code. The insurer agreed to provide a defense under the policy that went into effect in October 2008, but it refused to provide independent defense counsel, and it reserved its rights to deny coverage for all claims based on the terms of the Wage and Hour Claim Exclusion. The company reached a settlement of the employees' lawsuit and sued the insurer in federal district court in California to recover independent counsel fees and indemnification for amounts payable under the settlement agreement.

The company asserted that the new Wage and Hour Claim Exclusion contained in the 2008 policy was invalid because the insurer had not provided adequate notice of the new exclusion. In its memorandum and order regarding the parties' motions for summary judgment, the district court noted that "[i]t is a long-standing general principle applicable to insurance policies that an insurance company is bound by a greater coverage in an earlier policy when a renewal policy is issued but the insured is not notified of the specific reduction in coverage" and cited several California cases.[38] The district court also stated that the Ninth Circuit had adopted and applied the "renewal rule" on more than one occasion.[39]

Applying the renewal rule, the court found that the insurer's notice of the new Wage and Hour Claim Exclusion was inadequate and held that the new exclusion was unenforceable.[40] The court noted that the EPL policy was nearly one hundred pages long and the exclusion was contained in an endorsement attached to the end of the policy, rather than in the body of the policy, along with other endorsements.[41] Like several other endorsements, it was labeled "This Endorsement Changes The Policy. Please Read It Carefully" and also had the label "Wage and Hour Claim Exclusion."

In addition, the court noted that the company's insurance broker stated in a declaration that the insurer had provided the company with no specific notice separate from the policy itself to direct the company's attention to the new exclusionary endorsement.[42] Further, when the insurer sent the broker a quote for renewal of the policy for the 2007–2008 policy period, the insurer did not include the endorsement. Regarding the insurer's contention that the company's insurance broker must have had notice of the endorsement because he admitted that it was included in the renewal policy issued in 2007, the court described this statement as "something of a non-sequitur" which "completely sidesteps the case law cited above concerning what constitutes adequate notice of material reductions in coverage."[43]

Conclusion

The cases discussed above demonstrate that California law requires insurers to provide specific notice of any reductions or limitations in coverage to their insureds in a manner that is clear, plain, and conspicuous. An insurer's failure to do so renders the new reductions or limitations invalid. This has been the law in California for many decades, yet insurers still sometimes fail to meet these requirements. Thus, whenever an insurer declines to provide full coverage for a claim, it may be beneficial to investigate whether the insurer is relying on policy terms that are different than those in an earlier version of the policy and if the insurer has met all the requirements of providing notice of the policy changes. ■

Endnotes

1 *See, e.g., Sorensen v. Farmers Ins. Exch.*, 56 Cal. App. 3d 328 (1976); *Fields v. Blue Shield of Cal.,* 163 Cal. App. 3d 570 (1985); *Davis v. United Services Auto. Ass.n,* 223 Cal. App. 3d 1322 (1990); *Allstate Ins. Co. v. Fibus,* 855 F.2d 660 (9th Cir. 1988).

2 *Id; See also Indus. Indem. Co. v. Indus. Accident Comm'n of Cal.,* 34 Cal. 2d 500 (1949).

3 34 Cal. 2d 500.

4 *Id.*

5 *Id.* at 505.

6 *Id.*

7 *Id.* at 506.

8 *Id.* (citing *Conn. Fire Ins. Co. v. Oakley Improved Bldg. & Loan Co.*, 80 F.2d 717 (6th Cir. 1936); *Ouachita Parish Police Jury v. N. Ins. Co. of N. Y.*, 176 So. 639 (La. Ct. App. 1937)).

9 *Id.* at 507.

10 56 Cal. App. 3d 328 (1976).

11 *Id.* at 332.

12 *Id.* at 333.

13 *Id.*

14 *Id.*

15 *Id.* (quoting *State Farm Mut. Auto. Ins. Co. v. Jacober,* 10 Cal. 3d 193, 201 (1973)).

16 *Id.* at 333.

17 *Id*. (quoting *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 270-74 (1966)).

18 *Id.* at 333 (quoting *McKinney v. Farmers Ins. Exch.*, 32 Cal. App. 3d 947, 950 (1973)).

19 *Id.* at 334.

20 *Id.*

21 163 Cal. App. 3d 570 (1985).

22 *Id.* at 579 (citing *Indus. Indem. Co. v. Indus. Accident Comm'n of Cal.,* 34 Cal. 2d 500, 506 (1949); *Sorensen v. Farmers Ins. Exch.*, 56 Cal. App. 3d 328, 333 (1976)).

23 *Id.* at 579 (citing *Steven v. Fidelity & Cas. Co. of N. Y.,* 58 Cal. 2d 862, 879 (1962); *Logan v. John Hancock Mut. Life Ins. Co.,* 41 Cal. App. 3d 988, 996 (1974); *Sorensen*, 56 Cal. App. 3d at 333; *Miller v. Elite Ins. Co.,* 100 Cal. App. 3d 739, 752 (1980); *Ponder v. Blue Cross of S. Calif.,* 145 Cal. App. 3d 709, 718 (1983)).

24 *Id.* at 579.

25 *Id*. at 583.

26 *Id*.

27 855 F.2d 660 (9th Cir. 1988).

28 *Id.* at 663 (quoting and citing *Fields v. Blue Shield of Cal.,* 163 Cal. App. 3d 570 (1985)).

29 *Id*. The court remanded the case to the district court for further litigation concerning whether the insurer used means other than the Amendatory Endorsement to notify the insured. *Id*. at 663-64.

30 223 Cal. App. 3d 1322 (1990).

31 *Id*. at 1332.

32 *Id*.

33 *Id*.

34 *Id*.

35 *Id*. at 1333.

36 *Id*.

37 No. CV 11–07075 GAF (RZX), 2012 WL 3860597 (C.D. Cal. Aug. 29, 2012). Following the issuance of the court's memorandum and order on August 29, 2012, the parties filed a notice of settlement and a joint application to vacate the August 29, 2012 memorandum and order, which the court granted on November 6, 2012.

38 *Id*. at *6.

39 *Id.* (citing *Lexington Ins. Co. v. Devaney,* 50 F.3d 15, No. 93-16284, 1995 WL 105985, at *1 (9th Cir. Mar. 9, 1995) (unpublished); *Allstate Ins. Co. v. Fibus*, 855 F.2d 660, 663 (9th Cir. 1988)).

40 *Id*. at *6-7.

41 *Id*. at *6.

42 *Id*.

43 *Id.* As noted, *supra* at note 38, the parties subsequently reached a settlement and the court vacated its memorandum and order pursuant to the parties' joint request.