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State Farm Pays $100 Million to Settle Quake Suit Insurance:
Secret agreement involved 117 policyholders alleging that coverage was unfairly lowered before Northridge temblor.
Firm denies wrongdoing.

By KENNETH REICH, SOLOMON MOORE, JEFF LEEDS, Times Staff Writers

State Farm Insurance Co. secretly has paid $100 million to 117 policyholders to settle a lawsuit alleging that the company unfairly cut their earthquake coverage before the devastating 1994 Northridge temblor. The settlement, hammered out before a retired state Supreme Court justice working as a private mediator and filed under a seal of "deepest confidentiality," marks the largest known single payout by an insurer involved in post-earthquake claims. Lawyers for the homeowners said the case could also expose State Farm, the nation's richest insurance company, to claims by thousands of other policyholders whose insurance was covertly pared years before the Northridge quake. In a September 1984 internal memo obtained by The Times, State Farm executives considered sending their policyholders a written clarification of their earthquake coverage. But the executives, Rob Kelley, John Rosenstock and J.P. De Cicco, decided against the idea, saying that it would "appear inconsistent with our marketing philosophy since we don't want to sell the coverage." The company did restructure the policies available to customers, however. It replaced two insurance plans with a less costly "combined limit policy" and eliminated the notion of "guaranteed replacement," the idea that it would pay to replace homes destroyed by an earthquake even if the cost exceeded a homeowner's coverage limit. "There were a lot more people that were victims of State Farm's marketing ploy," said George Kehrer, founder of the nonprofit homeowners group that advised most of the plaintiffs.

Nonetheless, Kehrer said he felt "a great sense of relief and satisfaction that a wrong had been made right." Northridge resident Irene Allegro and 116 other homeowners alleged that State Farm secretly restructured their policies in 1985 to limit the amount of money they could recover if their homes were damaged in an earthquake. The homeowners said State Farm concealed the true nature of the changes by sending notices that described the coverage as "new" or "different," without disclosing that it also amounted to less. State Farm had been under pressure to settle the case since May 1997, when a Superior Court judge found that the company had "failed to give specific notice in 'clear and understandable language,' " as required under state law. The company appealed that ruling, but settled before the appellate court could decide the case. Lawyers for Allegro and the other homeowners said that about 25,000 other policyholders were similarly misled and could sue the company based on the Superior Court's ruling. State Farm officials declined to discuss the potential for future litigation, but noted that the company admitted no wrongdoing in the settlement. "Ultimately, settlement, although a bitter pill, is the best way to go," said company spokesman Bill Sirola. "There are business considerations that must be weighed."

Lawyers for the plaintiffs and other advocates, however, said the case could pave the way for numerous lawsuits by other property owners, who purchased insurance before 1985. "The fact that State Farm paid a $100-million settlement to more than 100 people indicates that there was massive fraud and wrongdoing and that there are many other policyholders entitled to money as well," said Harvey Rosenfield, founder of the Santa

Monica-based Proposition 103 Enforcement Project. But even if other homeowners file new lawsuits, experts said, they would have to navigate particularly murky territory in insurance law, and prove that they had not missed a one-year statute of limitations that insurance companies believe has been established by California court decisions. While insurance companies like State Farm make it their business to assess risk, the unpredictability of earthquakes has been a source of anxiety in the industry for more than a decade.

Companies Sought to Limit Liability

Before 1984, insurance companies tried to limit their potential liability in disaster-prone states like California by capping sales of certain policies. Under a state law that became effective that year, however, insurance companies were required to offer earthquake coverage to people who had homeowners' insurance. "They didn't perceive that earthquake insurance would be a profitable enough line of business," said Keith Crocker, who holds a teaching chair at the University of Michigan. "Once they were required to offer earthquake insurance, they may well indeed have tried to figure out how to reduce their exposure to a risk that they never wanted to take in the first place." Policyholder Jerry Yandell, 58, didn't know about the change in his coverage until it was too late. He had insured eight rental properties and his Chatsworth townhouse before 1985, and hoped to retire on the rental income before the Northridge quake shook his dream to the ground. State Farm eventually offered a settlement equal to his coverage limit, $641,000, although the damage to all his properties was estimated at more than $1 million. "We went to our agent and I said: 'I know the damage is more than [our policy limit], but I have guaranteed replacement,' " Yandell said. "The agent looked at me and told me: 'No, you don't.' I could have just fallen off my chair." Yandell said he filed his claim just before the one-year time limit expired, and was unsure whether others who tried to file now would be successful even if they are armed with a Superior Court decision. State Farm officials said they believe that had the Allegro case continued to the appellate level, they would have prevailed. Michael J. Bidart, the plaintiffs' lawyer, disagreed. "We thought our odds were good," he said. "That's what makes cases settle."
* SECRECY ISSUES: Columnist Kenneth Reich questions secret settlement. B5

BUSINESS NEWS

Homeowners said State Farm sent them notices that described different coverage, without disclosing that it amounted to less coverage.

The Associated Press L O S A N G E L E S, June 11 State Farm Insurance Co. said today it settled claims of more than 100 policyholders who accused the company of trimming coverage about a decade before the 1994 Northridge earthquake. The Bloomington, Ill.-based insurer would not confirm a newspaper report that the policyholders received $100 million to drop their lawsuit, or divulge other details of the agreement reached last November. "The settlement amount is confidential, as agreed to by all parties, but represents a small part of the more than $3 billion paid by State Farm to more than 117,000 policyholders whose property was damaged," a company statement said. The settlement is the largest known single payout by an insurer involved in post-earthquake claims, the Los Angeles Times reported. According to an internal company memo in

September 1984, executives considered informing policyholders about restructuring plans but decided against it because it would "appear inconsistent with our marketing philosophy."

Company Used Muddled Terms The lawsuit said two insurance plans were ultimately replaced by a less expensive policy, and the company eliminated the notion of "guaranteed replacement," which would require the insurer to replace homes destroyed by a quake even if the cost surpassed a policyholder's coverage limit. Instead, State Farm sent policyholders notices that described the coverage as "new" or different" without disclosing that it amounted to less coverage, according to the lawsuit filed by 117 homeowners. In May 1997, a Superior Court judge ruled that the company failed to give notice in "clear and understandable language,"' as required under state law. State Farm's appeal of the ruling was pending when the settlement was reached. "Ultimately, settlement, although a bitter pill, is the best way to go," said Bill Sirola, a company spokesman. The magnitude 6.7 earthquake in Northridge, in Los Angeles' San Fernando Valley, killed 72, injured thousands and caused more than $40 billion in damage and economic losses.