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Insurer Guilty of Bad Faith For Denying Coverage For Claim Under Homeowner's Insurance Bound By Agent In Connection With Escrow Transaction For A Home Mortgage Refinance

Summary by Rebecca B. Aherne, Esq.

On September 9, 2010, the Fourth Appellate District filed its opinion in Chicago Title Ins. Co. v. AMZ Insurance Services, Inc., holding that a document entitled "Evidence of Property Insurance" (EOI) issued by an agent in connection with an escrow transaction was an enforceable binder of homeowner's insurance extending coverage by the insurer for a fire loss. The court also held the EOI had not been lawfully cancelled, the agent had authority to issue the EOI as a binder, and the insurer acted in bad faith by failing to properly investigate the loss and pay the policy proceeds.

Factual and Procedural Background

In the fall of 2005, Thomas and Cheryl Mustain contacted Security Mortgage Lenders to refinance their home. The loan was obtained from New Century Mortgage. Kara Mrozek at Chicago Title opened an escrow account. New Century required a new homeowner's insurance policy. Thu Vu, Security's loan processor, contacted Jorge Torres at AMZ Insurance Services.

AMZ was owned by Adel Zibara which had written homeowner's insurance with Pacific Specialty Insurance Company (PSIC) since 1997. AMZ was not an appointed agent of PSIC. The personal lines producer's agreement specified that AMZ had no authority to bind PSIC other than as provided on the insurance application which specified that the application must be fully completed and signed and the premium be paid within 15 days. However, AMZ had authorization from PSIC to bind coverage of homeowner's insurance for escrow transactions by issuing EOI's before receipt of the premium payment and the signed application. Zibara testified that Jeff Jacob, PSIC's regional sales manager, had authorized him issue EOI's as binders for escrow transactions. PSIC had never objected to AMZ's issuance of EOI's as binders on behalf of PSIC, nor did it require AMZ to send it copies of the EOI's. AMZ would obtain the information from the escrow holder, issue and fax the EOI to the escrow, and send the application to the insured. Once AMZ received the signed application from the insured and the premium payment from escrow, AMZ would forward them to PSIC. If the application and payment were received within 15 days, PSIC would issue a policy. If the payment and application was not received within 15 days, AMZ was authorized to cancel the EOI. Jacob instructed AMZ to cancel the EOI by stamping the word "void" on the EOI.

Vu sent Torres a request for insurance. Torres prepared an EOI naming PSIC as the insurer and the Mustains as the insureds under a policy of homeowner's insurance. The EOI also identified the property to be insured, the nature and limits of coverage, the amount of the deductible, the premium amount, and the effective date of coverage. Torres sent the EOI and premium invoice to Vu. Torres testified he also sent an application to the Mustains, but Cheryl claimed she never received a copy of the application or a premium invoice. Vu sent a copy



of the EOI to Mrozek at Chicago Title. The EOI did not indicate a due date for payment of the premium and AMZ did not advise Mrozek payment was required within 15 days. At the time escrow closed on October 12, 2005, Chicago Title had not sent a check for the premium to AMZ. Because the premium was not paid within 15 days, AMZ stamped the word “void” on a copy of the EOI as instructed by PSIC. Although Zibara claimed he informed Security, New Century and the Mustains that the policy had been voided, Mrozek, Vu and the Mustains denied receiving any notice. The Mustain’s home was destroyed by a fire on November 11, 2005. Thomas Mustain perished in the fire.

Cheryl contacted Vu to report the loss. Vu referred her to Torres. Torres told Cheryl he would investigate, but he did not contact her and did not return her phone calls. AMZ also gave notice of the fire to PSIC which denied the claim. Cheryl sought coverage from Chicago Title which paid her and New Century \$270,200—the full amount of coverage provided by the EOI—and received an assignment of their rights against PSIC. Chicago Title sued PSIC for breach of contract and bad faith. The trial judge found the EOI was a legal binder which was not conditional upon payment of the premium or receipt of the signed application. The jury found 1) the EOI was not legally cancelled before the fire; 2) AMZ had authority to issue the EOI on behalf of PSIC; and 3) PSIC breached its obligation of good faith and fair dealing by failing to pay the claim and by failing to properly investigate the loss. Judgment was entered in favor of Chicago Title in the amount of \$480,321.85 (\$270,200 plus attorney fees). PSIC appealed. The Court of Appeal affirmed the judgment.

Judicial Holding and Analysis

The primary issue on appeal was whether the EOI constituted a binder providing insurance coverage by PSIC at the time of the Mustains’ loss. The court noted that a binder “temporarily obligates the insurer to provide . . . insurance coverage pending issuance of the insurance policy.” It is evidence of the existence of an insurance contract and is “necessarily of the most informal character.” It need not recite the terms of the policy because it is deemed to include all the usual terms of the policy as to which the binder was given. A binder remains in force for at least 30 days unless it is cancelled, rejected or surrendered earlier. If cancelled, coverage terminates 10 days after written notice to the insured is deposited in the mail. A binder must contain the name and address of the insured, a description of the property insured, a description of the nature and amount of coverage and any exclusions not contained in a standard policy, the identity of the insurer and agent, the effective date of coverage, and binder number.

Because the EOI contained all the required elements, it constituted a binder as a matter of law. The court noted that during the trial, Chicago Title’s expert testified that the EOI is routinely used as a binder. The court rejected PSIC’s argument that the EOI was not a binding contract because the Mustains never returned a signed application. The Mustains never returned the application because, as Cheryl Mustain testified, she never received one. In addition, the requirements set forth in the AMZ/PSIC binding procedures and producer’s agreements were not binding on the Mustains who were not parties to those agreements. Further, the evidence established that in escrow transactions, PSIC authorized AMZ to bind coverage by issuing an EOI before receiving a signed application. Nothing contained in the EOI indicated that payment of the premium or a signed application was necessary for the binder to be effective.

The court also rejected PSIC’s argument that AMZ was not its agent. Although AMZ did not have a notice of appointment from PSIC on file with the DOI, the evidence established AMZ had authority to bind PSIC by issuing EOI’s for escrow transactions. Testimony at trial established that Jacob instructed Zibara and Torres to bind PSIC in escrow transactions by issuing EOI’s before receipt of the premium payment and a signed



application. Zibara and Torres understood they could issue binders on behalf of PSIC by following these procedures, and had done so on many occasions without complaint from PSIC. Neither the Mustains, nor Chicago Title, was informed that AMZ’s authority to issue EOI’s as binders of homeowner’s insurance was limited in any way.

The court refused to consider PSIC’s objection to the jury’s determination that the EOI was not legally cancelled, because of PSIC’s delay in raising the issue. Thus, the court held PSIC was bound by the jury’s finding that the EOI was not legally cancelled.

The jury’s finding of bad faith was also upheld. The ultimate test of bad faith liability is whether the refusal to pay policy benefits was unreasonable. An insurer cannot reasonably and in good faith deny insurance without fully investigating the grounds for its denial. Shortly after the Mustain’s loss, Zibara provided notice to PSIC and provided Jacob with copies of all the documents from AMZ’s file. Jacob indicated he would handle the matter. He discussed the matter with PSIC VP Weaver, but did not provide him with copies of the relevant documents which he had in fact discarded. Jacob determined the EOI was legally “inconsequential” and not worth forwarding to the claim department.

Without question, the loss fell within the coverage identified by the EOI. AMZ issued the EOI in accordance with PSIC’s instructions for binding insurance for escrow transactions. PSIC did not investigate whether its policy of authorizing AMZ to cancel a binder by stamping “void” on the EOI was lawful. The appellate court believed the evidence also supported the inference that PSIC’s policies and practices for issuing EOI’s were created in bad faith. Although PSIC authorized AMZ to issue EOI’s as binders before receiving payment and a signed application, its stricter written guidelines and policies for issuing binders were used by PSIC as a basis to claim that AMZ was not its agent, EOI’s were not binders, and its procedures were not followed.

PSIC also argued that Chicago Title had no right to sue because of its failure to pay the premium. The trial court held that, despite the failure to pay the premium, the equities weighed heavily in favor of Chicago Title. PSIC allowed AMZ to issue binders in violation of the producer agreement and failed to recognize coverage when obligated to do so. The appellate court agreed, stating that “at worst” Chicago Title acted negligently by failing to pay the premium. Its negligence was not the direct cause of the loss, because the EOI was not lawfully cancelled after AMZ failed to receive the premium payment. In contrast, PSIC acted in bad faith. It authorized AMZ to issue EOI’s as binders before receipt of the premium and signed application, instructed AMZ to cancel binders in an improper manner and declined to submit the claim to its claim department.

The court rejected PSIC’s additional argument that Chicago Title could not recover from PSIC because it acted as a volunteer by paying Cheryl Mustain. Chicago Title did not act as a volunteer. It faced potential liability at the time it paid Mustain, because it had failed to pay the premium before the loss. Its potential liability was a protectible interest sufficient to create subrogation rights.

Lastly, the court upheld the trial court’s finding PSIC was not entitled to indemnity against AMZ. PSIC argued that the producer agreement provided that AMZ would indemnify PSIC in the event of an unauthorized binder or other unauthorized statement of coverage. The court held PSIC was not entitled to indemnity because AMZ did not issue an unauthorized binder or statement of insurance. PSIC authorized AMZ to issue EOI’s as binders in escrow transactions before receipt of premium payments and a signed application, and authorized AMZ to attempt to cancel binders in an unlawful manner. In addition, the indemnity provision does not permit PSIC to



recover for its intentional and bad faith conduct. The evidence established PSIC engaged in intentional conduct and the jury found it engaged in bad faith.

Comments and Implications

The court noted that PSIC represented 10 to 20 % of AMZ's business, and that Torres selected PSIC because its binding procedures were easier than those of other insurance companies. The court further noted that in escrow transactions for home refinance, using an EOI is the industry standard for providing proof of insurance. The court cited Insurance Code section 382.5 which provides that a binder "shall be deemed an insurance policy for purposes of proving that the insured has the insurance coverage specified in the binder." According to the statute, a binder is a writing which includes the name and address of the insured and any additional named insureds, mortgagees or lienholders, a description of the property insured, a description of the nature and amount of coverage and any special exclusions not contained in a standard policy, the identity of the insurer and the agent executing the binder, the effective date of coverage, and binder or policy number.