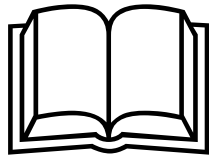


Interpreting Property Insurance Policies

A Layman's Guide



© 1998 Law Offices of K Mark Pistorius
8340 Meadow Road, Suite 150, Dallas, Texas 75231-3751
Phone 214.373.0800 Fax 214.361.5255
E-Mail lawcoach@onramp.net

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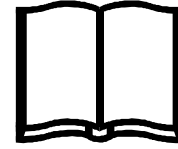
This guide is intended to help a non-lawyer become familiar with the insurance policy and claim procedures that normally follow when a loss occurs. It is not intended to be a substitute for expert counsel if a problem arises during the adjustment process. The reader is advised that while most claims are paid upon adequate proof through documentation and loss measurement, competent counsel should be obtained if the claim comes under dispute.

© 2000 K. Mark Pistorius
Hubble •Pistorius
5956 Sherry Lane, Suite 800, Dallas, Texas 75225
Phone 214.369.8501 Fax 214.378.8402
E-Mail mpistorius@hubblepistorius.com

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Interpreting Property Insurance Policies



THE INSURANCE POLICY

Reading the policy and understanding what it means.

An insurance policy is a written document setting forth the rights and obligations of the parties to the agreement. Generally, an insurance policy is viewed by the policyholder as a boring document with the insured relying on the agent to understand his needs and issue a policy accordingly. Only when a loss occurs does the fine print spring to life as both the insurance company and the policyholder try to determine the extent and amounts of coverage.

Interpreting an insurance policy involves a careful reading of the policy in light of legislative and judicial definitions of key words and phrases. This guide is intended to provide this interpretive help so that an insured can determine his rights and liabilities under property insurance policies. Its purpose is to be a practical guide to the layman client of a public insurance adjuster or loss consultant when a loss occurs. It is not intended, however, to be a substitute for examination by competent legal counsel should important language be confusing or a dispute as to policy construction arise under the policy.

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TYPES OF INSURANCE

Generally, there are three kinds of insurance:

1. **property insurance**, including fire and allied lines, inland marine insurance, multi-peril insurance and miscellaneous,
2. **casualty insurance** (principally liability insurance) and
3. **Life, health and accident insurance.**

Property insurance policies often contain casualty and occasionally medical coverage provisions. This guide only concerns the property coverage portions of property policies, relating to losses to improvements on real estate (structures) or to the contents of structures, or a loss of profits by a business (business interruption coverage) caused by direct loss to property. Typically, losses are caused by fire or storm.

FORMS OF INSURANCE

The standard forms of insurance policies have evolved over time. Insurance is regulated by insurance departments, boards or commissioners in each state. Most states requires fire and other property policies to be of a standard form prescribed by the state insurance regulatory body. As a general rule, the fire insurance policy adopted as a standard in New York State in 1943 has been adopted, with minor modification, as the standard form of the fire policy in all the states.

Other standardized property insurance policies are in use, notably the homeowners and multi-peril policies. In less frequent use are manuscript policies which are more or less tailor-made for a particular risk or group of risks. Although property policies tend to be similar, there is a great deal of variety in them, so there is no acceptable alternative to thoroughly reading the policy in question when a loss occurs.

The purpose of this guide is to provide orientation and reference that will assist in — not substitute for interpreting the actual policy in question. The basic provisions of the 1943 New York Standard Fire Policy will be discussed and referred to as “the standard policy.”

This guide is only intended to provide assistance in the adjustment of claims. Once again, if litigation should become necessary in the pursuit of a claim, competent legal counsel should be consulted.

PUBLIC INSURANCE ADJUSTERS AND LOSS CONSULTANTS

Who they are.

In industry parlance, there are three kinds of insurance adjusters:

- *company adjusters* are paid employees on staff of the insurance carrier,
- *independent adjusters* are retained by insurance carriers on an as needed basis, and
- *public adjusters* are hired by policyholders to document and measure the loss.

Just as insurance adjusters use the services of people trained and experienced in measuring losses and adjusting insurance claims, the public adjuster is likewise trained and experienced at representing the policyholder. Working together, the company or independent adjuster and the public adjuster strive to arrive at a fair and accurate determination of the loss.

Without a professional representative on the side of the policyholder, the insured must deal with the company or independent adjuster without the benefit of training and experience

and whose job it is to measure losses and claims every day. The policyholder, unless he is a property insurance adjuster himself, must rely on the company or independent adjuster to advise him and to adjust the loss properly. The public adjuster gives the policyholder access to advice and counsel that is clearly on his side and is looking out for his interests.

What they do.

Public adjusters and loss consultants measure and document the loss.

The public adjuster then works with the company or independent insurance adjuster to get the claim adjusted as promptly in the appropriate amount. The public adjuster’s knowledge of this particular industry and its claims personnel can be invaluable in making sure that the claim proceeds as it should.

At what stage to retain.

The most frequent and important mistake made by the policyholder in the adjustment of a property insurance claim is the failure to retain a competent, experienced public adjuster immediately. Frequently, the policyholder seeks to avoid the public adjuster’s fee and attempts to adjust the claim on his or her own. Only after considerable frustration does the policyholder turn to the public adjuster to remedy what has become a bad situation. The public adjuster can definitely help at this stage, but is unable to help as much as would have been possible had he been retained earlier.

POLICYHOLDER’S DUTIES

A section of the standard policy is entitled “Requirements in Case of Loss.” That provision imposes the following duties on the insured:

1. The insured shall give immediate written notice to this company of any loss,.
2. Protect the property from any further damage,
3. Forthwith separate the damaged and undamaged personal property,
4. Put it in the best possible order,
5. Furnish a complete inventory of the destroyed, damaged and undamaged property, showing in detail quantities, cost, actual cash value and amount of loss claimed;
6. And within sixty days after the loss, unless such time is extended in writing by this company, the insured shall render to this company a proof of loss, signed and sworn by the insured, stating the knowledge and belief of the insured as to the following:
 - The time and origin of the loss
 - The interest of the insured and of all others in the property

- The actual cash value of each item thereof and the amount of loss thereto,
- All encumbrances thereon,
- All other contracts of insurance, whether valid or not, covering any of said property,
- Any change in the title,
- Use,
- Occupation,
- Location,
- Possession or
- Exposures of said property since the issuing of this policy, by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of loss,
- And whether or not it then stood on leased ground, and
- Shall furnish a copy of all the descriptions and schedules in all policies, and
- If required, verified plans and specifications of any building, fixtures or machines destroyed or damaged.

7. The insured, as often as may be reasonably required, shall exhibit to any person designated by this company all that remains of any property herein described, and

8. Submit to examinations under oath by any person named by this company, and

9. Subscribe the same, and

10. As often as may be reasonably required, shall produce for examination all books of account, bills, invoices, and other vouchers, or certified copies thereof if originals be lost, at such reasonable time and place as may be designated by this company or its representatives, and

11. Shall permit extracts and copies thereof to be made.

Protect the Property from Further Damage

Sometimes the company adjuster will arrange for the protection of the property from further damage, but if he does not, the insured must deal with the problem. Typical would be the protection of the remaining property after damage to the roof (by wind or hail, for example), or protection of the property from looting by such measures as boarding up entries and/or hiring guards.

As soon as possible, fire protections systems should be repaired and electricity, refrigeration, air conditioning and heating should be restored, if necessary.

If the loss occurs to a business, operations should be resumed as quickly as possible to minimize any business interruption loss.

Avoid Changing Appearance of Loss

The company has a right to ascertain the nature and extent of the loss by inspection. This can place the policyholder in a quandary, especially if foul weather or looting appears imminent. If it is necessary to change the appearance of the loss, photographs and video tapes made in an orderly and professional fashion may help prove the extent and type of damage later on. However, protection of the property is the primary concern.

Separate the Damaged and Undamaged Personal Property

The policyholder is charged with the responsibility for this task “forthwith”. A public adjuster can be helpful in determining what was damaged. This is part of the function of the inventory, as required of the insured under the standard policy.

THE PROOF OF LOSS

It must be filed

The standard policy requires, unless the time is extended IN WRITING by the insurance company, the rendering to the company of a “proof of loss” signed and sworn to by the policyholder. Statutes and case law in some states vary the time limit and conditions under which the proof of loss is due and provide further relief from the possible harsh consequences that can result from failure to file the proof of loss in a timely and satisfactory manner. However, the best procedure by far is to immediately read the policy provision concerning the requirements for filing the proof of loss, and scrupulously follow that procedure. Statutes in some states require the insurance company to furnish the forms for the proof of loss, but most of those laws do not relieve the insured from the burden of complying with the provisions of the policy even if the insurance company fails to provide the forms.

No proof—no pay.

Another important reason to file the proof of loss as soon as possible is that the time limit for the insurance company’s paying the loss does not usually start to run until the proof of loss has been filed with the company. Some states also put the insurance carrier under statutory deadlines and penalties once the proof has been filed.

It is important to file a proof of loss within the time required in the policy or obtain written extension of the time limit from the company.. Document the date, location and actual filing of the proof of loss; the use of certified mail, return receipt requested, or some other witness proof should be secured.

It is equally important to understand that the proof of loss is a sworn document, and must clearly reflect the true oath of the insured. If the proof form is unclear or inaccurately states what the insured is prepared to swear is true, the insured should consult with counsel to modify the form to comply with the truth.

It is also important to keep meticulous records of written and oral communications with the insurance company, and a diary that logs the time and date of important events, conversations, commitments and the like.

When Loss is Payable

The standard policy provides that the claim is payable “Sixty days after proof of loss, as herein provided, is received by this company **AND ASCERTAINMENT OF THE LOSS IS MADE EITHER BY AGREEMENT BETWEEN THE INSURED AND THIS COMPANY EXPRESSED IN WRITING OR BY THE FILING WITH THIS COMPANY OF AN AWARD AS HEREIN PROVIDED** (emphasis supplied).”

Non Waiver Agreements and Reservation of Rights Letters

If the company has any doubt as to the validity of a claim for any reason, it will usually ask the policyholder to voluntarily sign a “non-waiver agreement,” or will serve the insured with a “reservation of rights letter.” These two events have the same legal effect. In either case, the company feels that it might have a defense to the claim and naturally desires to preserve its right to deny the claim on that basis, if it should decide that it wants to do so. If the company investigates the claim without having made it clear to the insured in advance that it does not intend to waive various technical defenses, the company could be held by a court to have waived its right to deny the claim on the bases of those defenses. The non-waiver agreement should simply state that the insured and the company agree that by investigating the claim and attempting to adjust it, the company does not waive any of the defenses it might have to the claim.

If either the non-waiver agreement or the reservation of rights letter is presented by the insurance company, the policyholder should ask in writing for the specific reason or reasons for the tactic.

Getting Draft Cleared Through Mortgagee

Property policies almost universally have a mortgage clause. This clause usually provides that no acts or omissions of the policyholder will affect the rights of the mortgagee under the policy. Thus, even if the insured intentionally causes a loss and therefore cannot recover, the mortgagee is protected. Some states have statutory provisions to this effect. Thus, in effect, with a mortgagee there are two insurance policies—one covering the insured and one covering the mortgagee.

If the insurer denies liability because of some act of the policyholder, which, under the mortgage clause, does not bar recovery of the mortgagee, upon notice of this problem, the mortgagee can file its own proof of loss and prosecute its own claim. If the insurer pays the mortgagee’s claim under these conditions, it may obtain an assignment of the mortgage from the mortgagee. In that event, the insurance company assumes the role of the mortgagee and, if the mortgage payments become overdue, has a right to foreclose and to offset the mortgage loan against the insured’s claim if it is litigated.

When a loss to property is made the subject of a mortgage, and the mortgagee is listed on the insurance policy or otherwise comes to the attention of the insurance company, the company will, almost without fail, place the name of the mortgagee, in addition to the name of the policyholder, on the draft or check in payment of the claim. If the insurance company pays the claim directly to the insured without protecting the interest of the mortgagee by putting the mortgagee's name on the settlement check or draft, and the insured fails to replace or repair the mortgaged and insured property, the insurance company is then in danger of having to pay the claim twice.

Therefore, it is entirely correct and appropriate for the insurance company to place the name of the mortgagee on the claim settlement check or draft.

The mortgagee has a right to ensure that the mortgaged property is repaired or replaced with the insurance claim money, and will want to satisfy itself, usually by inspection, that the mortgaged property is restored to its pre-loss condition before releasing the claim funds. The extent of the control held by the mortgagee in this circumstance is further described in the deed of trust or other instrument and any applicable statutes describing the interest of the mortgagee.

At this point, it is worthwhile to point out that if the instrument with which the insurance company pays the claim indicates that it is "payable through" a particular bank, it is a "draft," instead of a check. The difference is significant. A check is called a "demand item" and is payable by the issuing bank upon presentation. A draft is a "collection item" and is not payable until the insurance company authorizes the bank to pay the draft. When a draft is deposited by the policyholder, the bank sends the draft to the insurance company's bank. At that point, the insurance company's bank will not release any funds. Rather, the insurance company's bank will send the draft to the insurance company.

Then the insurance company will inspect the draft and do whatever it desires to ensure that it wants the draft to be paid. Upon deciding to do so, it will then instruct its bank to release the funds to the insured's depositing bank. This process typically takes ten business days. The important thing for the policyholder to remember is to wait until the draft has cleared the insured's bank before writing checks against the insured's bank account. The insured should check with the bank cashier to determine when the draft has cleared and his funds are good.

Appraisal

If the only dispute between the insurance company and the policyholder is the amount of the loss, the policy provides for a speedy, inexpensive and informal means of resolving that dispute—the appraisal provision. The appraisal clause provides that if the parties disagree as to the actual cash value of the insured property or the amount of loss, then, upon the written demand of either, the insurer and the policyholder appoint a competent and interested appraiser to appraise the loss. The appraisers select and umpire, and any two of the three then can resolve the dispute. The exact wording of the appraisal clause varies slightly from the standard policy in a few of the states.

There have been a number of court challenges to the appraisal clause on the grounds that

the clause deprives the parties of their constitutional right to have a jury determine the dispute. However, almost all states' courts regularly enforce the appraisal provision. Appraisal is different from arbitration; in appraisal, the only matters in dispute are the value or cost of the property in question and the amount of loss. In arbitration, both the question of liability and the extent of liability, if any, are decided.

Although the procedure for appraisal is simple, there are pitfalls. If used, the appraisal clause should be followed closely. Preferably, the instructions to the appraiser and umpire detailing the scope of their examination will be reduced to writing through agreement between the insured and the insurance company.

Once the appraisal award has been completed, the amount of the loss and the actual cash value of the property are determined. The amount of the actual cash value is very important because of the co insurance clause discussed later.

THE LAND MINES

Subrogation.

The loss may have been caused by the acts or omissions of some third party or as a result of a defective product. If so, the third party or seller of the product might be legally liable for the loss. If the property insurance company pays (indemnifies) the policyholder for all or part of a loss, it thereby obtains the right to pursue repayment from any party liable for the loss to the extent of the insurance company's payment. The right to seek compensation for damages to property caused by someone else's liability-producing acts, is subrogated or transferred to the insurance company to the extent of its payment. If the company pays for only part of a loss, the insured may have a cause of action against the third party who caused the loss, for any uninsured or underinsured loss. If the insurance company chooses, it may require the policyholder to assign its cause of action to the extent of its payment as a condition to payment.

Impairment of the insurance company's right to subrogation gives the insurance company a defense against a claim. That is, if the insured does anything to destroy the company's right to seek repayment of its payment from any legally liable third party, the company can refuse to pay the claim. Thus, it is very important to preserve any possible evidence of the cause of the loss. Obtain written permission from the insurance company to destroy any possible evidence or to accept any payment from a potentially liable third party that might compromise the company's subrogation right.

Policy provisions concerning "Telling the Truth"

The first six lines of the standard policy provide "This entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto." In most state, either by statute or case law, the policy will not be voided unless the false claims in question were made with the intent to defraud or deceive the insurance carrier and the misrepre-

sentations are material and substantial, or in some cases, contributed to the cause of the loss.

Polygraph

Insurance companies sometimes ask the policyholder to submit to a polygraph examination.

The only intelligent way to take any polygraph examination (if at all) is with the assistance of legal counsel.

Stress Analysis

A number of products are available for allegedly analyzing a person's voice, either live or recorded, for identification of stress. The stress analysis has been claimed to identify stress for the purpose of identifying deception or lack of deception. Some of these devices are no larger than a package of cigarettes. Either the device or a recorder can be used without the subject's realization that he or she is being recorded.

Scholarly studies of stress analysis machines have reported that, for the purpose of determining deception, the stress analyzers are less accurate than flipping a coin. After study, the United States federal government ordered discontinuation of the use of these devices by federal agencies.

LIMITATIONS OF SUIT.

Compliance with the policy

The standard policy provides "No suit or action on this policy for the recovery of any claim shall be sustained in any court of law or equity unless all the requirements of this policy shall have been complied with"

Statutes in several states and case law in most states soften this provision.

Time Limits

The standard policy provides that no lawsuit or action on the policy for the recovery of any claims shall be sustainable in any court "unless commenced within twelve months after inception of the loss."

Many states have statutes or case law prohibiting this contractual limitation period from being shorter than some statutory period, varying from one year to six years, depending on the state.

Also, many such statutes and cases provide that the time for limitations begins with certain events, such as the date of loss, the date the fire is extinguished, or the date the claim is payable by the insurance company (or the date the claim is denied).

There is a great deal of case law concerning the insured's efforts to avoid the limitation period, or the "tolling" of this period. Be sure to consult legal counsel if the claim time periods are in question.

Co-Insurance Penalties

Many property insurance policies contain co-insurance clauses. Those clauses provide that when co-insurance is indicated (on the face sheet of the policy) for an insured item, the insured must maintain insurance for that item not less than a specified percentage of the actual cash value of the item. If the policyholder has insured less than the indicated percentage of the actual cash value of the item, the policyholder will be a co-insurer, along with the insurance company, to the extent of the under insurance on that item, on a proportionate basis.

For example, if the actual cash value of the property is one million dollars, and the co-insurance percentage indicated on the front page of the policy is 80%, in order to avoid what is called the co-insurance penalty, the insured must maintain 80% of the one million dollar actual cash value in insurance, which is \$800,000. If the property is only insured for \$600,000, the insurance company would only owe the portion of the loss determined by applying the percentage that the insurance coverage bears to the amount of coverage required by the co-insurance clause. Thus, in this example, the insurance carried is six/eighths of the \$800,000 required, or 75%. So if the loss to the property is measured at \$120,000, the company would only be required to pay 75% of that sum, or \$90,000. The logic is that the insured by underinsuring the property by 25% , is self-insured to that extent.

If the policy is a replacement cost policy, in most instances, the co-insurance percentage is applicable to the replacement cost of the property, as well as its actual cash value. In addition, if the value of the property increases and the amount of insurance remains the same, the co-insurance penalty also increases.

Other Insurance.

Some insurance policies simply provide that the policy is void if there is other insurance covering the same property. Most policies provide for pro rata payment by each policy if there is more than one. Some states have statutes with provisions relating to losses when more than one policy is in force.

Normally, the "other insurance" clauses are held by the courts to be inapplicable when policies insured different parties or interests.

Vacancy or Unoccupancy

The standard policy provides that "While a described building, whether intended for occupancy by owner or tenant is vacant or unoccupied beyond a period of sixty consecutive days," coverage is terminated. Some policies terminate coverage only upon the occasion of vacancy, and some terminate coverage only for unoccupancy.

Vacancy contemplates the absence of people and contents. Unoccupancy seems to address only the absence of people. There is a large body of case law in the various states concerning what factual showing establishes each of those conditions.

The standard policy also provides that “...while the hazard is increased by any means within the control and knowledge of the insured” coverage is suspended. Likewise, if the insurance company attempts to deny coverage on this ground, counsel must look closely at the large body of case law construing this provision.

Agent or Broker—Whose agent (The policyholder or the Company)?

When a problem adversely affecting coverage is caused by the acts or omissions of the insurance agent or broker, the insurance company may deny responsibility for those acts or omissions, denying that those acts were done by the company’s agent or that the agent acted with proper authority.

Brokered policies are those written through two agents who split the commission. In this situation, the policyholder is purchasing insurance through one agent who obtains the coverage, in turn, through another agent who represents the insurance company. In that situation, normally, only the agent with whom the policyholder deals is considered to be the insured’s agent. The agent representing the insurance company, who acquired the policy for the insured’s agent, is the company’s agent.

Several states have statutes providing that any person soliciting insurance is the agent of the insurer rather than the policyholder.

ARSON

General

Both fire departments and insurance companies are interested in learning where and how fires start. This determination is usually made by the inspection and analysis of the remains of a fire by people who claim expertise in the determination of the origin and cause of fires. Fire departments have employees who are trained and experienced in this line of work. Independent consultants are also available. If the insurance company decides that, in its opinion, a fire was intentionally set, the claim is likely to be denied unless it appears clear the insured is innocent of any involvement. The policyholder may have a criminal problem as well.

Proof

The three elements of factual proof needed for both the criminal and insurance company’s side of a civil dispute are: 1) incendiary origin of the fire, 2) motive on behalf of the insured, and 3) opportunity of the insured to start the fire or have someone else start the fire.

Innocent Spouse Doctrine

Sometimes one spouse or business partner sets a fire without the knowledge or participation of the other spouse or business partner. Then, the question arises whether the innocent spouse or partner is covered for his or her portion of the loss. In some states, the innocent person is denied coverage, and in others the innocent person is granted coverage. The trend seems to be toward coverage in these cases where there is adequate proof of the innocence of the wronged partner or spouse.

Fraud

If any other kind of fraud is suspected on behalf of the insured, such as claiming that a theft occurred which did not, similar problems can be anticipated.

THE REST OF THE POLICY

The Declaration Page

This is normally the very front page of the policy in which the “declarations” appear of what person, entity and property is insured, the period of time insured for, the amount of the premium and the perils insured against.

The Insuring Agreement

This is the part of the policy which states whether the policy insures against all risks of physical loss to the described property or whether the insurance is for only named perils, such as fire, lightning, etc.

Exclusions

The exclusions of insurance coverage are of two kinds: exclusions of specific kinds of losses and exclusions of specifically described property or kinds of property not covered.

Conditions

Here, the policy describes under what conditions the insurance is suspended, the conditions under which particular kinds of losses are covered, the conditions under which the policy is voided entirely, and those conditions under which both the insurance company and the insured may cancel the policy.

Endorsements

Endorsements are changes, amendments or modifications of the coverage provided in the basic policy. The endorsements are usually separate pages, attached to the basic policy, and they provide the function of further limiting, expanding or clarifying the coverage. These endorsements are necessary to provide desired flexibility.

When insurance is initially acquire, almost any desired coverage can be effected by selecting standardized endorsement forms or by using even further tailored endorsements. When assessing coverage under an existing policy, all of the endorsements must be reviewed.

Extensions of Coverage

Some policies have extensions of coverage to cover items not described on the declaration page, such as trees, shrubs, plants, lawns, and outbuildings, which are usually insured in this way in homeowners' policies.

Measurement of Loss and Coverage

The principal problem presented by a property claim is how much the payment will be. On the front page of the policy usually appears a description of the upper limit of liability and the measurement of claims contemplated in the policy. The exact wording of this measurement varies, but the basic idea behind the measurement is fairly uniform. The fundamental idea of property insurance is indemnification for loss. That is, the policy is designed to monetarily place the policyholder in the same position after the loss as before the loss.

Replacement Cost

Property insurance policies are very often written on a replacement cost basis. With this coverage, the policyholder is able to replace or repair the property without having to finance the difference between replacement cost and the actual cash value (ACV) of the property if the property has depreciated from a new condition.

Most replacement cost coverage for structures requires that the property actually be replaced before the full replacement cost is collected on the claim. In this situation, the insurance company usually pays the actual cash value of the loss as soon as it is determined and withholds the difference between replacement cost and actual cash value (this should be the same as the amount the estimated depreciation of the property), until replacement has been completed and invoices and canceled checks have been reviewed by the insurance company to verify the total replacement cost.

For the payment of replacement cost claims, the standard policy once required that the property be replaced at the same location. Now that requirement is rare and may not be enforceable even if it still appears in the policy.

Some policies provide that the property be insured to a specific minimum extent of its replacement cost before the policyholder is eligible for replacement cost coverage.

Even with replacement cost coverage, a dispute sometimes develops concerning what replacement expenditures are appropriate and covered, and those that were unnecessary or a betterment of the property. Consultation with an adjuster and/or attorney will then be required.

Actual Cash Value

Property policies almost universally describe the measurement of recovery for loss in terms of actual cash value, actual value or amount of direct loss — terms that describe the same thing. There has been a great deal of litigation and judicial writing specifically concerning the proper formula and evidence needed to measure a loss and arrive at the actual cash value, and there is a large amount of literature addressing this topic.

What is meant by actual cash value is not often described or defined in the policy. Conceptually, it should be the measure of diminution in value of property caused by the covered peril. Actual cash value is intended to be that sum necessary to indemnify the policyholder so that he or she is in the same place, economically, after the loss as before.

Traditional methods of determining actual cash value are:

- . Estimated replacement cost less depreciation;
- . Fair market value
- . Extrapolations of an income stream (if the property is income producing).

By far the most common method used by adjusters in the field is estimated replacement cost less depreciation. This method is easy to use and easy to adjust between fair minded adjusters striving for a fair determination of the value of the loss.

Special problems arise in situations that include very old buildings or buildings that have a unique function or design, especially in determining the appropriate depreciation calculation.

A widely followed approach used by the courts to determine actual cash value in situations where the policy is silent regarding its definition is called the “broad evidence rule.” In a number of cases, one or more of the approaches used to measure actual cash value could lead to unreasonable results due to particular facts of the building in question. Under this rule, the jury is permitted to hear evidence from both sides concerning almost any reasonable method to determine actual cash value, and then balance and evaluate the evidence to determine the method that makes the most sense.

Depreciation

The accounting definition of depreciation is “the systematic allocation of cost of a period of time,” but depreciation in the property insurance context describes the gradual reduction in value of property that occurs over time, either as a result of physical aging, war and tear or deterioration caused by weather, reduction in value caused by obsolescence or other changed conditions such as economic or demographic changes.

Sometimes insurance adjusters determine depreciation based on a straight percentage basis. Or they reference books or data bases showing appropriate depreciation percentages for specific items depending on condition or age.

Frequently, there is little or no depreciation, especially to the more sturdy aspects of some buildings, such as brick, stone, wood, glass and the like. Of course, some buildings or portions of buildings appreciate rather than depreciate.

Although some property insurance policies determine actual cash value using an allowance for depreciation, the majority of property policies no longer mention depreciation in the determination of actual cash value. A number of courts do not allow depreciation to be taken on partial losses in claims on policies silent on depreciation. Others do not permit depreciation on partial losses even if the policy mentions depreciation on a theory of indemnity.

The essence of insurance is indemnification for loss without betterment. Without replacement cost coverage, an amount should be deducted from a claim for depreciation to avoid betterment of the property. Frequently, the repairs required in partial losses do not result in betterment, so no deduction for depreciation is appropriate. For example, replacing part of a roof causes no betterment because the undamaged portion of the roof will wear out as soon as would have been the case without the repairs.

Although it becomes important in many areas, this is a particular area in which it is important to note that if policy language is ambiguous, the courts uniformly construe policy ambiguity in favor of the insured. This is especially true in instances where the bargaining position of the policyholder compared to the position of the insurance carrier is unequal. If interpretation of the policy description of actual cash value can lead to two or more reasonable meanings, then the value method most favorable to the insured should be applied.

Contents

There are many kinds of contents, including personal property and many other types of property, all requiring different approaches to determine their value. Measurement of both contents and building loss is complicated, and these are areas for reliance on a public adjuster. It is especially important to know if the payment received by the policyholder is for the actual cash value of what is lost, or if replacement cost coverage is extended to personal property. In the latter event, detailed records should be kept to support a supplemental claim for the actual amounts expended to replace the personal property damaged or lost.

Valued Policy Laws

Many states have statutes which provide that, in the event of a total building loss, the insurance company owes the full face value of the insurance policy, without regard to the actual cash value of the property. Insurance policies themselves can define certain terms as “valued”, fixing a sum upon loss determined by a simple formula. What constitutes a total loss is often disputed, especially if the amount paid is materially larger if a total loss occurred.

Some of these statutes apply only to specified kinds of losses. A few of the statutes apply to partial losses as well.

ATTORNEY FEES, INTEREST AND PENALTIES

Attorney Fees

In most states, the insured's attorney fees are recoverable in a successful litigation of a property insurance claim. However, if suit is filed and the lawsuit is settled before trial, the insurance company is rarely willing to set aside an amount for the insured's attorney fees by way of voluntary compromise settlement. Even with this limitation, many times it makes sense for the policyholder to accept a compromise settlement and pay attorney fees from the settlement, simply because the actions of judges and juries are unpredictable, and a "bird in the hand" is the wisest course of action.

Interest

If the insured is successful in litigation of a property insurance claim, interest is usually payable also. The rate of interest varies with each state. Again, rarely will an insurance company be willing to voluntarily pay interest without trial.

Penalties

In most cases, either by statute or common law, extra contractual damages are available in successful claim litigation if, and only if, the policyholder is successful in proving in court, in addition to the claim, some form of vexatious or inappropriate behavior by the insurance company or its agent that could be fairly described as dealing with the insured in bad faith. The laws in this area vary a great deal from state to state. In most cases, the insured is better off to accept a reasonable figure voluntarily than to endure the delays, expense, uncertainty and aggravation of litigation for a chance at extra contractual damages.

Reformation

If the insured and the insurance company's agent agreed that the policy in question would have certain coverage, and for whatever reason, the policy actually issued by the insurance company fails to have that coverage, should a loss requiring that coverage occur, the court will "reform" the policy to conform with the agreement between the policyholder and the insurance company's agent.

Cancellation

Frequently, the insurance company claims that a loss is not covered because the policy was canceled before the loss. Almost universally, the courts require that the insurance company strictly follow the provision in the policy for cancellation.

The most frequent dispute concerns mailing of written notice of cancellation to the policyholder in cases in which the insured denies receiving the cancellation notice. Some policies provide that the insurance company must “provide” or “give” the cancellation notice to the insured. In those cases, in almost all states, the “paper must arrive.” Thus, even though the insurance company mailed the correctly addressed cancellation notice with ample time to reach its destination, and there is no return of the mailed notice, the cancellation is not effected unless it actually arrives.

There are a few ways in which insurance policies can be canceled as a practical matter without following the written procedures contained in the policy. The most frequently observed of these is “cancellation by substitution.” Assume that an insured has the property in question insured with one insurance company and then, without canceling that policy, insures the same property with another company, apparently to replace the coverage. If there is a loss at that point, the courts consider the first policy to have been canceled by virtue of the act of substituting the second policy for it.

MISCELLANEOUS

Insurance Commissions and Boards

A policyholder will often write letters to the insurance commissioner or board of insurance in his or her particular state demanding assistance in getting an insurance claim paid. The state insurance regulatory body’s power to intervene in the handling of insurance claim varies dramatically from state to state. In some states, the regulatory bodies are empowered by statute to give an insured considerable assistance in getting the appropriate attention of the insurance company to adjust claims. In other states, however, the legislatures have not given the insurance regulatory boards any power to give the insure assistance.

Therefore, if an insured writes a letter to the insurance regulatory body in a state in which the body has no real power, the only effect is to make the insurance company less cooperative than before.

Waiver and Estoppel

Waiver

Normally, waiver is defined as the intentional relinquishment of a known right. Courts hold that one has waived a right when one does or forbears doing something inconsistent with the existence of the right in question or the intention to rely on that right.

Almost all courts find that if an insurance company begins to adjust a claim, it has implicitly waived most technical defenses it could have otherwise used to deny the claim in question, such as the late filing of the proof of loss, failing to file suit within the limitation period and the like. This the reason insurance companies use non-waiver agreements or reservation of rights letters as soon as they have any indication that they might have a technical defense to the

policy claim.

Estoppel

Estoppel occurs when one party causes another party to be induced to change his position for the worse.

Generally, in this context, if an insurance company misleads the policyholder, with the expectation that the insured will act on that misrepresentation, and the insured does act on that misrepresentation to the insured's detriment, the courts will not allow the insurance company to take advantage of that misstep by the insured. This process is called "estoppel," whereby the insurance company in the foregoing example will be held by the courts to be "estopped" (more or less prevented by its own behavior) from asserting a defense that it otherwise would have had, because the policyholder took or failed to take action because he or she was misled by the conduct of the company.

An example would be if an insurance company continues conversation and correspondence with the insured through the deadline for filing a proof of loss, and the policyholder is thereby lulled into complacently failing to file the proof on time, the courts should hold that the insurance company is estopped from defending the claim on the grounds of the insured's failure to file the proof of loss on time.

CONCLUSION

The purpose of this guide is to assist the insured in the interpretation of his or her property insurance policy. Further, more in depth questions or questions involving contract interpretation and dispute should be discussed with appropriate legal counsel. Normally, however, property insurance claims are adjusted quickly and without problems, especially when assisted by a public insurance adjuster or loss consultant.