

TOPICAL REVIVAL OF AN OLD CONCEPT - ACTUAL CASH VALUE - AND CHALLENGES TO ITS USE

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With the rapid decline in recent years of real property values, both residential and commercial, resurgence of the concept of "actual cash value" has arisen as a way of limiting payment in total property loss situations due to such perils as fire. Full cost of replacement is often inflated due to rising building materials and other construction costs. On the other hand, market value, which can be considerably less than full replacement cost in the case of a building, offers advantages in loss adjustment. Yet, there are legal and regulatory challenges to implementation of "actual cash value" (in insurance parlance, known as "ACV").

Illustrating the resulting clash of adjusting advantages and law-based challenges is the recent Iowa case of *Farmers Cas. Co. v. Birkby*,¹ in which fire destroyed the insured building. Insurer paid the owner of the building \$26,140 based upon the market value of the building at the time of the loss. However, the building had been insured for \$80,000 and the owner claimed he was entitled to that amount. By statute in some states, known as the "valued policy" rule, the value insured is the payout under the policy.² However, this approach did not govern in *Birkby*.³ While the Court indicated the cost to replace the building should be considered in determining "actual cash value," expert testimony on market value is usually taken as such, when market value can be ascertained.⁴ Only in the event that actual cash value cannot be ascertained does replacement cost, or stated value, govern.⁵ *Birkby* followed the long-standing pattern in which a variety of factors are utilized for determining actual cash value (referred to as the "broad evidence rule").⁶ The seminal case was *McAnarney v. Newark Fire Ins. Co.*⁷ There, the New York Court of Appeals noted that recovery based on a definition of actual case value as replacement cost minus depreciation could provide a windfall to an insured and that "in order to effectuate complete indemnity, every fact and circumstance which logically tends to the formation of a correct estimate of the loss" should have been utilized.⁸ In *Birkby*, this was interpreted to mean that the market value of only \$26,140, not the stated or insured value of \$80,000, was required to be paid by the insurance company to the insured.

The lesson to be garnered from this case is that it is futile for insurers to craft a definition of "actual cash value" in their policy. Of necessity, agents will be required to explain, at the time of purchase of the policy, that replacement cost may not govern. Indeed, as a consumer safeguard against possible unfair surprise, the Iowa Commissioner of Insurance requires all insurers to provide notice in advance of valuation methods in claims settlement on "actual cash value" policies.⁹

Meanwhile, case law remains far from clear. Issues include whether to allow a depreciation offset.

For example in *Reliance Ins. Co. v. Substation Products Corp.*,¹⁰ if recovery is based on insurance policies, it was held that the correct measure of damages is the actual cash value of the property at the time of loss, but not exceeding the cost of repair or replacement of the building with goods of like kind within a reasonable time after loss; in other words "actual cash value" means what the property is worth in money, allowing for depreciation. And in, *American Reliance Ins. Co. v. Perez*,¹¹ actual cash value of damaged property covered by homeowners' insurance policy was deemed to require consideration of depreciation. Put another way, according to *Manduca Datsun, Inc. v. Universal Underwriters Ins.*,¹² in determining whether "actual cash value" of a building destroyed by fire should include a deduction for depreciation, the fire policy must be read and considered as a whole.

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However, under some policies, the term "actual cash value," when applied to a partial loss under homeowner's policy means cost to repair without any reduction for depreciation.¹³ Likewise, in *General Cas. Co. v. Tracer Industries, Inc.*,¹⁴ considering obsolescence of a commercial building destroyed by fire was held to be unnecessary in determining its actual cash value.

Again, a statute can override the facts of each case. In *Farmers Merchants Bank & Trust Co. v. Katherine Ins. Co.*,¹⁵ a valued policy law was interpreted to require fire insurance to pay, in a total loss, the face value of the policy, with the provision that the insured is not criminally at fault. The public policy behind the valued policy law is very strong in those states where it is the rule and the statute is interpreted liberally in favor of the insured.¹⁶

In the eyes of courts in states with this orientation, the insurance policy is viewed as a contract of indemnity.¹⁷ And, of course, the parties may agree upon entirely different methods of adjustment of the loss.¹⁸ The cardinal rule is that the insured is to be placed in as good a financial condition as before the fire.¹⁹ Of course, the age and condition of the property must be considered.²⁰

Some perspective is in order. Despite the failing nature of real property values, the meaning of "actual cash value" is not a significant issue. It is a term used primarily in commercial, rather than personal property policies. Accordingly, further regulatory intervention, in the form of a mandate that the term must be defined in policies, is unnecessary and would simply discourage the availability in the marketplace of property insurance.

Endnotes

1. 2008 WL 238599 (Iowa Ct. App. 2008), *aff'd* 746 N.W.2d 280 (Iowa 2008).
2. See e.g. Ark. Code Ann. §23-88-101; La. Code Ann. 22:695. A "valued policy" is one where the value of the insured property is agreed to by the parties in the contract in advance, and, as a consequence, the insured does not have to prove the actual value of the destroyed property. *St. Paul Fire & Marine Ins. Co. v. Griffin Construction Co.*, 993 S.W.2d 485 (Ark. 1999).
3. An Iowa statute, Iowa Code §515.135, provides that insured value constitutes "prima facie" evidence of "actual value." However, the Court made clear that under another state, Iowa Code §515.137, "actual value" meant market value, or "actual cash value," in most cases. In other words, Iowa is not a "valued policy" state.
4. *Court View Centre, L.L.C. v. Witt*, 755 N.E.2d 75 (Ind. Ct. App. 2003).
5. *Britven v. Occidental Ins.*, 13 N.W.2d 791 (Iowa 1944), cited in *Birkby*.
6. *Strauss Bros. Packing Co. v. American Ins. Co.*, 298 N.W.2d 108 (Wis. App. 1980).
7. *McAnarney v. Newark Fire Ins. Co.*, 159 N.E. 702 (N.Y. 1928).
8. *Id.* at 904-05.
9. Bull. 09-03 (Iowa Insurance Division).
10. *Reliance Ins. Co. v. Substation Products Corp.*, 404 So.2d 598 (Ala.1981).

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11. *American Reliance Ins. Co. v. Perez*, 689 So.2d 290 (Fla. App. Dist.Ct. 1997).
12. *Manduca Datsun, Inc. v. Universal Underwriters Ins.*, 676 P.2d 1274 (Idaho Ct. App. 1984).
13. *Thomas v. American Family Mut. Ins. Co.*, 666 P.2d 676 (Kan. 1983).
14. *General Cas. Co. v. Tracer Industries, Inc.*, 674 N.E.2d 473 (Ill. App. Ct. 1996). *See also, McMillin v. American Family Ins. Co.*, 950 S.W.2d 242 (Mo. App. 1997).
15. *Farmers Merchant Bank & Trust Co. v. Katherine Ins. Co.*, 693 So.2d 876 (La. Ct. App. 1997).
16. *Id.*
17. *Kingsley v. Spoffoud*, 11 N.E2d 487 (Mass. 1937)
18. *DeSantis v. Michigan Basic Property Ins. Ass'n*, 265 N.W.2d 634 (Mich. Ct. App. 1978).
19. *Marshall Produce Co. v. St. Paul Fire & Marine Ins. Co.*, 98 N.W.3d 280 (Minn. 1959).
20. *Lee v. Providence Wash. Ins. Co.*, 266 P.2d 640 (Mont. 1928).