CLM 2019 Annual Conference
March 14, 2019
Orlando, Florida

Actual Cash Value – The Trojan Horse of Inflated Claims

I. Various types of claims and unique issues with each

Fire and Explosion

Fire losses result in more than $12 billion in annual damage. Fire and explosion claim present unique situations in that not all property may be identifiable following the incident – especially on personal property loss claims. As a result, a thorough investigation into the affected property is required to determine what items were damaged or destroyed. Also, while certain property may not encounter fire damage in the incident, it may still be damaged by smoke, soot, water or other matters. Even property that may visually appear undamaged may be left with smoke or fire odor which require the property to be cleaned by a specialist. It is also important to respond to a fire or explosion scene quickly to limit property damage. Since the structure is often exposed to the elements following a fire or explosion, a timely response can often prevent claims for further property damage.

Water Damage

Water damage can come in many shapes, forms and sizes. Water losses in the U.S. result in more than $9 billion in property damage annually. They may be as a small as a leak in a water line to as large as an open line that allows water to flow into a structure for an extended period of time. Water damage requires immediate remediation efforts to prevent the growth and spread of mold and mildew. As a result, the initial step to limit property damage is to retain a water remediation specialist to dry out the property. Once that is complete, the property can then be assessed to determine the extent of damage and an identification of what property can be repaired.

Catastrophic

Catastrophic property damage typically includes damage caused by severe weather events or other natural disasters. When a catastrophic event occurs, insurers will regularly send out a rapid response team to assess damage to their insureds' properties. Often it will be a team effort as numerous parties are impacted by catastrophic events in a short period of time. In these instances, each insureds policy needs to be examined to determine what damage is covered. Depending on the nature of the catastrophic event, the insurer may only provide coverage for part of the damages or its policy may not cover the event at all.

Construction/Structural

Construction cases are unique in that they can involve numerous parties. These parties can include owners, developers, design/engineers, contractors, and material providers or manufacturers. Given the number of parties involved, that aspect typically increases the costs associated with prosecuting or defending construction cases. Also, insurance coverage issues, especially with the contractor parties, are typically an issue. Generally, CGL policies do not provide coverage for defective workmanship, but the CGL policy may provide coverage for damage to other property caused by the defective workmanship. This often creates a situation where some property damage is covered, but others may not be. There are also a number of other CGL exclusions that often come into play.

Other

While the above represent the most common categories of property damage claims, there are certainly others that can arise. Some examples include chemical spills, hazardous materials exposure, and animal damage. All of these "other" categories present their own set of circumstances that must be assessed. Certainly, every insurer has its list of odd and unusual property damage claims they have handled.

II. Property Damage Calculations

Actual Cash Value

Actual cash value ("ACV") equates to the property's market value at the time of the loss. In essence, this calculation represents the value the property would have received on the open market immediately before it was damaged or destroyed. ACV claims, however, are not as straight forward as they sound. To do a proper ACV analysis the property's original cost, age and condition must be taken into account. When these items are assessed, a deprecation percentage is then assigned, and that percentage is applied against the property's cost. Different property appraisers, however, can have different views of what depreciation percentage to apply, which can result in large differences in their respective ACV calculations.

While some insurers may issue policies that provide replacement cost coverage, if the property damage results in a viable subrogation claim, that same insurer may only be able to claim damages under an ACV calculation. This often creates a situation where the insurer is not able to recover all of the damages it paid out on the first party property claim. As a result, insurers will often perform both ACV and RCV calculations for damaged property.

Replacement Cost Value

Replacement cost value ("RCV") is used to determine the replacement cost of a property item. This equates to the cost that would have been incurred to purchase the property item new as of the loss date. An RCV calculation does not take into account the property's original cost, age or condition and, therefore, depreciation does not come into play. The RCV calculation is typically greater than the ACV calculation, but even RCV calculations can differ – especially when real property damage is involved.

Also, many first party property policies only allow the insured to recover RCV damages if the property damaged is physically replaced. This requires the insurer to keep the first party claim open until the insured has completed its replacement purchases, which can often take an extended period of time.

Other calculations and considerations

Other property damage calculations include those for rare or unique property and property with great sentimental value. Rare or unique property may not have an adequate market to conduct ACV or RCV calculations. In those instances, specialized appraisers will be necessary to determine or assign a property value. For example, an original Monet painting may not have an adequate market to assess its value. While it can be compared to other rare paintings, the value cannot be as easily assessed as doing a simple internet search to determine its current market value. Also, the original purchase price for a rare or unique item of property may not even be a good starting point to determine its value as the owner may have under paid or over paid for the property at the time it was purchased.

Sentimental value is often not recoverable. Sentimental value is value in excess of the property's market value. Examples of such property include wedding memorabilia, photographs, heirlooms, etc. Some jurisdictions allow for the recovery of sentimental value but place the burden of proof on the property owner to establish that sentimental value. Other jurisdictions, however, do not allow for sentimental value considerations.

III. Property Damage Strategy

Use of Experts

On the first party side, generally the insurer will have a property appraiser, adjuster or expert involved in assessing the loss from the outset. On the third party side, often damage experts are not retained until well after the loss. With certain losses, however, it is important for the liability defendants to consider retaining a damage expert at the outset as well. This is especially true with a larger loss.

The first party property insurer will almost always have a damage professional physically inspect the property and assess the damages immediately after the loss. This first party damage expert may then be used as the damage expert in a subsequent subrogation action if the first party property insurer decides to pursue its subrogation rights. This gives the first party property expert an advantage over the defense experts if the defendants did not retain an expert to inspect the property at the outset. While the general thought is that property insurers do not over pay for property damage on a first party claim, that is not always true. The property insurer may not do a good job in their damage assessment, could be facing pressure from an insured or public adjuster to increase the damage calculations, or the property insurer may have an incentive to inflate certain property damage calculations - such as their ACV calculation if the policy provides first party coverage on an RCV calculation. Given these circumstances, all parties involved or with a potential interest in a loss should consider retaining a damage expert early in the process.

Additionally, when considering damage experts, the nature of the property damage should be the driving force. For example, if rare or unique property is involved, the parties should hire damage experts with experience in the market associated with the damaged property.

Property damage standards for various jurisdictions

First party property damages are generally governed by the insurance policy language. In contrast, third party claims are governed by jurisdiction's tort law standards. Consequently, each jurisdiction must be assessed differently. While some jurisdictions may allow a plaintiff to claim RCV damages, other jurisdictions may limit the plaintiff to ACV damages. The same goes for sentimental property damage claims. Given the differences, it is imperative for parties involved in property damage claims to research and understand the property damage standard used in the jurisdiction where the property was damaged.

Actual case examples

A large condo fire occurred at the base of a ski resort in Vermont. The building was a total loss and the property insurer has now pursued its subrogation claim. Vermont allows the parties to offer multiple property damage calculations and instructs the jury decide which calculation may be the most appropriate. This case will be discussed in the context of each party's strategy and approach to convince the jury that their calculation is the most appropriate.