HANDLING PROPERTY DAMAGE AND BUSINESS INTERRUPTION INSURANCE CLAIMS

Part II

by

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Part I of this series discussed the problem of intentional ambiguity in insurance contracts, the use of such ambiguity by insurers and the legal ramifications thereof. This part discusses some basic legal concepts that apply to all insurance disputes of which insureds and their attorneys should be aware.

THRESHOLD LEGAL ISSUES

A. Overview

The fundamental goal of contract interpretation is to give effect to the parties' mutual intentions. The insured's objectively reasonable expectations are the focal point in interpreting the contract. Given the public interest in insurance, "the public has a right to expect that they will receive something of comparable value in return for the premium paid."[1] However, no expectation is reasonable if it is contrary to clear and unambiguous policy language in which case the parties' intent should be inferred solely from the written terms of the policy, unless fraud[2] or sharp practices[3] can be shown. If that language is clear and explicit and no exceptional circumstances exist, it governs.[4]

B. Principles of Construction for Insurance Policies

"Insurance policies should be construed to effect, not deny, coverage.[5] Any ambiguity in exclusion should be narrowly construed in favor of coverage.[6] The insurer bares the burden of proving the applicability of an exclusion.[7] If the language in an exclusion is subject to two or more reasonable interpretations, the interpretation that favors coverage must be applied."[8] Even if the express contract language is arguably

[1] *Benevento v. Life USA Holding, Inc.*, 61 F. Supp.2d 407, 418 (E.D. Pa. 1999) (*citing Tonkovic v. State Farm*, 513 Pa 445, 456 52 A.2d 920, 926 (1987)).

[2] *Benevento*, p.418 ("the insurer may not unilaterally change the coverage or issue a policy differing from what the insured requested and paid for without affirmatively showing that the insured was notified of and understood the change, regardless of whether the insured read the policy").

[3] *E.g., Atwater Creamery Co. v. Western National Mutual Insurance Co.*, 366 N.W.2d 271, 276, 278 (1985) (finding burglary coverage despite "clear and precise" policy language defining "burglary" to exclude thefts that did not leave visible evidence of forced entry); id. at 279 (each of the four concurring justices described the definition as "ambiguous").

[4] *General Star Indemnity Co. v. Superior Court*, 47 Cal.App.4th 1586, 1592 (1996).

[5] *Yount v. Maisano*, 627 So.2d 148 (La.1993).

[6] *Id.*

[7] *Id.*

[8] *KLL Consultants, Inc. v. Aetna Cas. & Sur. Co. of Illinois*, 99-14 (La.App. 5 Cir. 6/1/99), 738 So.2d 691.

construed wholly in favor of defendant, the contract must be interpreted consistent with the reasonable expectations of the insured and public policy.[9]

C. Reasonable Expectations

The reasonable expectations doctrine was first described as follows: "The objectively reasonable expectations of applicants and intended beneficiaries regarding the terms of insurance contracts will be honored even though painstaking study of the policy provisions would have negated those expectations."[10] Actually, the doctrine is about public policy and not subjective expectations.[11]

In commenting on decisions in the area of insurance coverage that appeared to depart from standard rules of policy construction, Keeton identified two principles that could be used to rationalize or explain these decisions.[12] Those two principles consist of the following: (1) "an insurer will be denied any unconscionable advantage in an insurance transaction" and (2) "the reasonable expectations of applicants and intended beneficiaries will be honored even though a painstaking study of the policy provisions would have negated those expectations."[13]

Application of the reasonable expectations doctrine under Keeton's formulation did not depend upon the existence of an ambiguity in the policy, a hidden policy provision, or any other bizarre policy language. The doctrine was simply a rule of policy construction.[14] In other words, Keeton's version of reasonable expectations permitted the court to reach a result that was in direct conflict with the clear written terms of a contract. This concept understandably troubled insurers, who were charged with drafting those contracts.

D. Standardized Contracts

The reasonable expectations doctrine was also shaped by the RESTATEMENT OF CONTRACTS.[15] Section 211 of the RESTATEMENT (SECOND) OF CONTRACTS deals with the

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[9]*Ritter v. Mutual Life Ins. Co.*, 169 U.S. 139 (S. Ct. 1898) (Any insurance policy "the tendency of which is to endanger the public interests or injuriously affect the public good, and which is subversive of sound morality, ought never to receive the sanction of a court of justice or be made the foundation of its judgment.").

[10]Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L.REV. 961 (1970).

[11]James J. Fisher, *The Doctrine of Reasonable Expectations Is Indispensable, If We Only Knew What For*? 5 CONN. INS. L.J. 151, 152, (1998).

[12]Robert H. Jerry, III, *Insurance Contract, and the Doctrine of Reasonable Expectations*, 5 CONN. INS. L.J. 21 (1998); Roger C. Henderson, *The Formulation of the Doctrine of Reasonable Expectations and the Influence of Forces Outside Insurance Law*, 5 CONN.. INS. L.J. 69 (1998).

[13]Keeton, *supra; see, e.g., Thomas, supra*.

[14]Henderson, *supra* at 69, 72.

[15]*Id.* at 74.

enforceability of standard form contracts and addresses those situations where contract terms can be ignored.[16] This section of the RESTATEMENT was being drafted at roughly the same time as when Keeton published his article in the HARVARD LAW REVIEW.[17] Section 211 provides that standard form contracts will be enforced without regard to the parties' knowledge or understanding of the actual terms of the contract,[18] provided that the assenting party to the agreement has reason to believe that the contract is indeed a standard form.[19] Section 211(3) of the RESTATEMENT provides, however, that if one of the parties to the contract has reason to believe that the other party would not agree to the contract if it knew that it contained a particular term or condition, that term is not part the contract.[20]

Even though Section 211 of the RESTATEMENT was not necessarily directed at insurance contracts *per se*, it is easy to see how it is applicable. Indeed, many jurisdictions cite the RESTATEMENT as a basis for their adoption of the reasonable expectations doctrine.[21] It also sheds some light on how courts could have strayed from the undiluted version of Keeton's reasonable expectations doctrine to something less potent. In particular, Section 211 of the RESTATEMENT may explain why the majority of jurisdictions require an ambiguity or other hidden term limiting coverage before an analysis of the reasonable expectations doctrine is applicable. Section 211 offered courts an alternative and, in many ways, competing formulation for development of the reasonable expectations doctrine.[22]

E. The Plain Meaning Rule

"The rules governing policy interpretation require us to look first to the language of the contract in order to ascertain its plain meaning or the meaning a layperson would ordinarily attach to it,"[23] "unless used by the parties in a technical sense or unless a special meaning is given to them by usage, in which case the latter must be followed."[24]

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[16]RESTATEMENT (SECOND) OF CONTRACTS § 211 (1981).

[17]Jerry, *supra* at 21, 39 (1998).

[18]Since reliance is not an element of this breach of contract claim, individual issues of reliance would not preclude class action treatment of this claim. *See In Re The Prudential Ins. Co. of America*, 962 F. Supp. 450, 516 (D. N.J. 1997) (certifying class action against life insurance company for fraudulent sales practices in part because "Plaintiffs' claims for breach of contract, breach of implied obligation of good faith and fair dealing . . . and unjust enrichment do not involve reliance").

[19]Henderson, *supra* at 75.

[20]*Id.*

[21]§ 211 cmt. f; Henderson, *supra* at 74.

[22]Henderson, *supra*.

[23]*Waller v. Truck Ins. Exch. Ins.*, 11 Cal.4th 1, 18 44 CAL. RPTR.2D 370, 378 (1995).

[24]Civ. Code § 1644. This is an objective test, and not an inquiry into what a particular agent said.

Leaving aside reasonable expectations, policies must be interpreted as a whole, giving force and effect to every provision where possible.[25] The courts will not adopt a strained or absurd interpretation to create an ambiguity where none exists. The policy terms must be construed in the context of the whole policy and the circumstances of the case and cannot be deemed ambiguous in the abstract.[26] If an ambiguity cannot be eliminated by the language and context of the policy, then ambiguities are construed against the party who caused them—the insurer—in order to protect the insured's reasonable expectations of coverage.[27] When it comes to limitations on policyholder rights, courts have construed such limitations narrowly, recognizing that the form insurance contract is a contract of adhesion.[28] Absent evidence indicating the parties intended a special usage, the words used in an insurance policy should be interpreted in their "ordinary and popular sense."[29]

If, on the other hand, the court finds that the meaning of the contract is not "plain and clear," or is deemed ambiguous because of two internally and necessarily inconsistent provision,[30] then the court must interpret the ambiguous provisions in terms of the insured's "objectively reasonable expectations."[31] The objectively reasonable expectation is that the insurance company bears the risk of its actuarial and underwriting mistakes or misstatements. Since such mistakes or misstatements are alleged to be the reason for the rate increase, we need go no further.

F. Burden of Proof

Courts employ a shifting burden of proof in cases construing the terms of insurance policies. Initially, the insured, seeking to recover under an insurance policy has the burden of pleading and proving that his claim falls within the terms and conditions of

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[25]*City of Oxford v. Twin City Fire Ins. Co.*, 37 Cal.App.4th 1072, 1079 (1995).

[26]*General Star, supra*, 47 Cal.App.4th at p. 1592-1952.

[27]*Id.* at p.1593.

[28]Exclusions are an example where the insurer bears the burden of proving the exclusion applies. *De May v. Interinsurance Exchange*, 32 Cal.App.4th 1133, 1136-1137 (1995).

[29]Civ. Code § 1644; *AIU Ins. Co. v. Sup.Ct. (FMC Corp.)* 51 Cal.3d 807, 821-822, 274 CAL. RPRT. 820, 831 (1950. The "plain meaning: of a policy provision cannot be determined in isolation or without regard to the insured's reasonable expectations:

> In order to conclude that an ambiguity exists, it is necessary first to determine whether the coverage . . . is consistent with the insured's objectively reasonable expectations. In order to do this, the disputed policy language must be examined in context with regards to its attendant function in the policy as a whole. This requires a consideration of the policy as a whole, the circumstances of the case in which the claim arises and 'common sense.'"

Nissel v. Subscribing Underwriters at Lloyds of London, 62 Cal.App.4th 1103, 1111-1112, 73 CAL. RPTR.2D 174, 179-180 (1998).

[30]*See, Delgado v. Heritage Life Ins. Co.*, 157 Cal.App.3d 262, 271, 203 CAL.RPTR. 672, 677 (1984); *Smith Kandal Real Estate v. Continental Cas. Co.*, 67 Cal.App.4th 406 79 CAL. RPTR.2D 52, 57 (1998).

[31]*AIU Ins. Co. v. Superior Court (FMC Corp.)*, 51 Cal.3d 807, 822 274 CAL. RPRT. 820, 83 (1950).

the policy.[32] In order to recover under a policy, the insured must: (1) establish the existence of the policy; (2) prove the policy terms; and (3) show that the loss is covered under the insuring agreement. Once the insured has satisfied these requirements, the burden of proof shifts to the insurer to demonstrate that the loss is excluded under the policy terms,[33] or that coverage is otherwise excluded or limited.[34]

G. Problem with Burden of Proof

The reality here on the Gulf is that people are desperate for money and one-on-one not looking for a fight with their insurers. Most people do not hire lawyers for these kinds of things (assuming you could find many functioning law offices).

So the insurer negotiates with the insured and tells them what they will pay. In most cases, the insureds take it. Some small number can afford to wait years for their checks and fight and win.

All the bullying pays off in the end. It is the same kind of cost benefit analysis you remember in the Ford, Pinto case. Unfortunately, in Louisiana, there are no punitive damages to tell a company not to play these kinds of odds.[35]

H. The Covenant Of Good Faith And Fair Dealing

In Louisiana, the insurers duty of good faith and fair dealing is prescribed by statute.

> **La. R.S. 22:1220.** Good faith duty; claims settlement practices; cause of action; penalties
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> A. An insurer, including but not limited to a foreign line and surplus line insurer, owes to his insured a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.

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[32] *Carriere v. Triangle Auto Service*, 340 So.2d 665 (La.App. 4th Cir.1976), *citing Myevre v. Continental Casualty Co.*, 245 So.2d 785 (La.App. 4th Cir.1976), *appl. den.*, 258 La. 764, 247 So.2d 863 (1971).

[33] *Georgetowne Square v. United States Fidelity & Guar. Co.*, 3. Neb. App. 49, 523 N.W.2d 380 (1994). The insurer has the burden of proving facts which establish the applicability of the exclusionary clause in the policy.

[34] *Executive Aviation, Inc. V. National Ins. Underwriters*, 16 Cal. App. 3d 799, 806, 94 Cal. Rptr. 347 (1971).

[35] Louisiana's insurance code provides some penalties against an insurer in certain specified circumstances. *See* LA R.S. 22:658 and LA R.S. 22: 1220.

> B. Any one of the following acts, if knowingly committed or performed by an insurer, constitutes a breach of the insurer's duties imposed in Subsection A:
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> (1) Misrepresenting pertinent facts or insurance policy provisions relating to any coverages at issue.
>
> (2) Failing to pay a settlement within thirty days after an agreement is reduced to writing.
>
> (3) Denying coverage or attempting to settle a claim on the basis of an application which the insurer knows was altered without notice to, or knowledge or consent of, the insured.
>
> (4) Misleading a claimant as to the applicable prescriptive period.
>
> (5) Failing to pay the amount of any claim due any person insured by the contract within sixty days after receipt of satisfactory proof of loss from the claimant when such failure is arbitrary, capricious, or without probable cause.
>
> C. In addition to any general or special damages to which a claimant is entitled for breach of the imposed duty, the claimant may be awarded penalties assessed against the insurer in an amount not to exceed two times the damages sustained or five thousand dollars, whichever is greater. Such penalties, if awarded, shall not be used by the insurer in computing either past or prospective loss experience for the purpose of setting rates or making rate filings.
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> D. The provisions of this Section shall not be applicable to claims made under health and accident insurance policies.[36]

The Louisiana Supreme Court has said, "we have described an insurer's action as arbitrary and capricious' when its willful refusal of a claim is not based on a good faith defense, *Louisiana Maintenance Servs., Inc. v. Certain Underwriters at Lloyd's of London*, 616 So.2d 1250, 1253 (La. 1993), or is unreasonable or without probable cause, *Darby v. Safeco Ins. Co.*, 545 So.2d 1022, 1029 (La. 1989)."[37] One circumstance is failure to adjust and pay claims fairly and promptly. Another circumstance is when claim is denied without a proper inspection of property subject to claim.[38]

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[36]*McGee v. Omni Insurance Company*: "'the wording and structure of [Acts 1990, No. 308, § 1, whereby La.R.S. 22:1220 was added] strongly suggest that the legislature intended Subsection B to constitute an exclusive list of the types of conduct for which damages and penalties can be sought by insureds and third-party claimants pursuant to the statute...[T]he only acts which give rise to a cause of action for violation of La. R.S. 22:1220 are the specific acts enumerated in Subsection B(1)-(5).'" 840 So. 2d 1248, 1254 (La.App. 3 Cir. 2003). *Quoting, Theriot v. Midland Risk Ins. Co.,* 694 So.2d 184 (La. 1997)

[37]*Calogero v. Safeway Ins. Co. of Louisiana*, 753 So.2d 170, 173 (La. 2000).

[38]*Gibson v. Allstate Insurance Co.*, 832 So.2d 1209 (La.App. 3 Cir. 2002).

Act No. 12, passed by the First Extraordinary Session of 2006 of the Louisiana Legislature revised La. R.S. 22:1220, above, adding a sixth action constituting a breach of an insurer's duty that will trigger the statute's penalty provisions. Section B(6) of the statute now provides that "Failing to pay claims pursuant to R.S. 22:658.2, when such failure is arbitrary, capricious or without probably cause" constitutes breach of the duty of good faith and fair dealing.

R.S. 22:658.2 is a new statute also enacted during the 2006 First Extraordinary Session, which statutorily establishes the burden of proof for insurance claims, as well as restricts some activities by insurers in adjusting or evaluating claims. This statute provides the following:

> §658.2. Claims involving immovable property
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> A.(1) No insurer shall use the floodwater mark on a covered structure without considering other evidence, when determining whether a loss is covered or not covered under a homeowner's insurance policy.
>
> (2) No insurer shall use the fact that a home is removed or displaced from its foundation without considering other evidence, when determining whether a loss is covered or not covered under a homeowner's policy.
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> B. If damage to immovable property is covered, in whole or in part, under the terms of the policy of insurance, the burden is on the insurer to establish an exclusion under the terms of the policy.
>
> C. Any clause, condition, term, or other provision contained in any policy of insurance which alters or attempts to alter the burden on an insurer as provided in Subsection B of this Section shall be null and void and of no effect.
>
> D. Any insurer determined to be in violation of the provisions of this Section shall be liable pursuant to R.S. 22:1220.

The convent of good faith and fair dealing is intended to protect the reasonable expectations of parties involved in a contractual relationship, absent express contractual provisions to the contrary. In the early case of *Krike Lashell Co. v. Paul Armstrong Co.*,[39] the New York Court of Appeals succinctly espoused the theory, stating that every contract contains an implied covenant that neither party shall do anything that will have the effect of destroying or injuring the rights of the other to receive the fruits of the contract.

[39]188 N.E. 1634, 1678 (1933).

The concept of good faith and fair dealing is embraced by the RESTATEMENT (2D) CONTRACTS, which provides that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and in its enforcement." The duty is one of faithfulness to an agreed common purpose consistent with the justified expectations of the other. The Uniform Commercial Code also incorporates the duty of good faith, by providing that every contract or duty within the act imposes an obligation of good faith in it performance or enforcement.[40] Good faith is defined within the Code as "honesty, in fact in the conduct or transaction concerned."

The application of the duty of good faith and fair dealing to insurers is appropriate in light of the competing policy concerns on this issue.[41] It may be argued that insurers have a certain dominance over their insureds, and that this dominance exists when an insured has suffered a loss and seeks coverage for the loss. Often an insured seeking coverage has extensive bills and dire need for policy benefits. It is within the power of insurers to deny claims and force insureds to choose between expensive litigation or settlement for less than the policy coverage. There is a clear policy to prevent abuse of such a dominant position.[42] The duty of good faith and fair dealing imposes obligations which are fiduciary in nature, but it does not rise to the level of fiduciary obligation. An insurer bound by the duty of good faith and fair dealing is required to "take into account the interest of the insured and give it at least as much consideration as it does to its own interest."[43]

J. The Problem of Suitability

An important type of fraud relates to suitability, which may be defined as the duty on the part of the seller to recommend, sell, or renew to a buyer only those insurance products which are suitable for that customer. In some cases, the product may be generally unsuitable for any customer or any customer within a class. The facts relating to this would usually be known by the seller. In other cases, the product may be

[40]U.C. § 1-203.

[41] The obligation is a two-way street. According to the Roman law principle, the duty of good faith was required in all cases of contracts, and the concealment of any material facts of which the other party was ignorant was prohibited. Under this principle, any breach of this duty entitled the aggrieved party to a rescission of the contract.

Some similarities are found between the current doctrine of *uberrima fides* in English insurance contracts and the Roman concept of utmost good faith in contracts. First, there is no requirement for the proof of fraudulent intent in claiming a breach of this duty. Second, there is no need to prove that non-disclosure of a material fact had actually induced a particular party (insurer) to enter into the contract. Lastly, the remedy for a breach of this principle is very similar.

In the United States, the concept to a common law duty of disclosure was recognized in *Stipcich v. Metropolitan Life Insurance Company*, 277 U.S. 311, 317 (1928) where the court said that *uberrima fides* was applied to all insurance contracts. In this case, Mr. Justice Stone said that "the most elementary spirit of fair dealing would seem to require him (the insured) to make a full disclosure. *Id.* p.317.

In *Hare and Case v. National Surety Co*., 60 F.2d 909 (2nd Cir. 1932), Swan J., confirmed the fact that the English principle of the insured's duty of disclosure developed in *Carter v. Boehm*, (1776) 3 Burr. 1905, was also adopted in the U.S.A. See, E. Patterson, "*The Delivery of a Life Insurance Policy*", 33 Harv. L.R. 198 (1919); F. Kessler, "*Contracts of Adhesion - Some Thoughts About Freedom of Contracts*", 43 COLUMBIA L.R. 629 (1943).

[42]Barker, *Is an Insurer a Fiduciary to Its Insureds*, 25 TORT & INS. L.J. 1 (1989).

[43]*Comunale*, 50 Cal.2d at 659, 328 P.2d at 201 (1958).

unsuitable only because of the objectives' means and needs or the particular customer. This later inquiry would focus on facts about the customer and the defendants' (or their agents') knowledge of the same.

General suitability cases that turn on bad products are generally easier (and focused on what the selling company knew or should have known about its product) than other suitability cases. In those other cases, fault may be derived from what was withheld about the product or what was known or should have been known about the customer.[44]

K. Restoration or Repair?

Louisiana cases do not draw a distinction between repair and restoration. A common provision in insurance contracts obligates the insurer to insure the property to the "extent of the actual cash value of the property at the time of loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time." The goal of "actual cash value" policies is to get the insured back to the position he was in prior to the damage.

Louisiana's Valued Policy Statute, La. R.S. 22:695(B), provides that under any fire insurance policy on any inanimate, immovable property in Louisiana, "the insurer shall pay to the insured, in case of partial damage without criminal fault on the part of the insured or the insured's assigns, such amount, not exceeding the amount for which the property is insured, at the time of such partial damage, in the policy of such insured, as will permit the insured to restore the damaged property to its original condition." Although the statute specifically mentions fire policies, Louisiana courts have applied the "actual cash value" of the Valued Policy Statutes to claims other than fire losses. Some of these cases are discussed below:

- *Holloway v. Liberty Mutual Fire Ins. Co.*[45] Leaking drain pipe caused water damage to carpeting in plaintiff's master bedroom and in the adjacent hallway. Plaintiff's carpet was 6 years old and had been discontinued at the time of the damage. Plaintiffs made a proof of loss and requested the cost of replacing the carpeting in the entire bedroom wing of the house. Defendant's insurance company tendered payment for the loss of the specific carpet damaged, less depreciation.

  Plaintiff brought in an interior design expert who testified that it was impossible to replace the damaged carpeting without replacing all of the carpeting in the entire wing. He testified that even if the same color and texture of carpeting could be obtained, to replace only the damaged carpeting would result in unsightly seams and the contrast between the old and new carpeting would be readily apparent and would have an adverse effect on the overall market value of the

[44] Given the sellers knowledge that a product is not suitable for everyone, it follows that the seller is expected to make reasonable inquiry concerning the customers objectives, means, and needs.

[45] 290 So.2d 791 (La. App. 1st Cir. 1974).

house. He further testified that it was the general practice in Baton Rouge in houses of plaintiff's type to use one kind of carpeting and one color in all bedrooms. Plaintiff also produced a realtor expert who testified that if carpeting of the same texture and color is not used in the entire bedroom wing of houses such as plaintiff's, it diminishes the value of the house by $1,000 - $2,000.

The court determined defendant's insurance obligation was governed by the provision of the policy that provides that the insurer insures the insured to the extent of the actual cash value of the property at the time of loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time. Defendant argued that the "actual cash value of the property at the time of the loss" is limited to the carpet actually damaged and should reflect depreciation of the carpet replaced.

The court cited the Valued Policy Statute, La. R.S. 22:695(B), and found that the carpet at issue was applied directly to the concrete slab and became immovable property and found plaintiff was due recovery equivalent to the actual cash value at the time of loss, not to exceed the repair or replacement cost using material of like kind and quality. The court found no mention of allowance of depreciation in the statute and found that replacement of carpeting in the entire bedroom wing of the house was necessary to restore the damaged property to its original condition.

- *Bingham v. St. Paul Ins. Co.*[46] This case discussed the meaning of the term "actual cash value" as follows: This court had occasion to establish the definition of the term "actual cash value" as limited by the term "not exceeding the amount which it would cost to repair or replace the property with material of a like kind and quality." In *Mercer v. St. Paul Fire and Marine Insurance Company,* 318 So.2d 111 (La.App. 2d Cir.1975), we approved the assessment in *Reliance Insurance Company v. Board of Supervisors, Louisiana State University and Agricultural and Mechanical College,* 255 F.Supp. 915 (E.D.1966), that in determining actual cash value, the court should consider original cost, possible appreciation and *depreciation,* the nature of the property lost and the current replacement cost. This court further stated that "[t]he touchstone for the court in determining actual cash value is the basic principle that an adequately insured person should incur neither economic gain nor loss when his property is destroyed by fire."

- *Real Asset Management v. Lloyd's of London.*[47] This is a total loss case, rather than partial loss. Plaintiff purchased a building and shortly after purchase, sought to insure the property based on the actual purchase price of the building ($75,000); however, the insurer refused and required plaintiff to obtain coverage in the amount of $160,000 based on an appraisal. One month after the purchase,

[46] 503 So.2d 1043, 1045 (La. App. 2nd Cir. 1987).

[47] 61 F.3d 1223 (5th Cir. 1995).

> Hurricane Andrew cause significant damage to plaintiff's building, and plaintiff filed a claim with defendant's insurer. Plaintiff rejected defendant's tender offer for settlement, and plaintiff filed suit. The district court held that the actual cash value of the building prior to the storm was $160,000 and based on the replacement cost, less depreciation, the court found that the damage sustained was more than $160,000 and declared the building a total loss. Defendant appealed.
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> The Fifth Circuit Court of Appeal agreed with the district court that the actual cash value of the building prior to the storm was commensurate with the insurance company's own valuation. The policy at issue was an "actual cash value" policy, and the premium of such a policy is based on the value assigned by the insurer. "Under Louisiana Valued Policy Law, if the insurer bases the premium on its valuation of the property, then in the event of a total loss, the insurer shall pay the actual cash value, or in other words, the policy amount." *Id*. at 1228. Moreover, the court noted that it was the insurance company's own formulation that ultimately set the policy amount.
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> Addressing defendant's argument that the district court did not factor in reasonable depreciation when it considered the cost of repair, the Fifth Circuit disagreed. "Under an 'actual cash value policy', the insured is entitled to recovery the actual cash value (reproduction cost less depreciation) of the property in the event of a total loss. The district court recognized the building was old and slightly deteriorated before the hurricane, but had been receiving basic maintenance." The district court factored depreciation into the determination of the building's value.[48]

Although not discussing repair versus restoration, *Bennett v. State Farm Ins. Co.*[49] allowed for costs to repair otherwise excluded items under a policy as incidental to repair of covered damage. Here, the insured filed suit against homeowner's insurance carrier alleging carrier failed to adhere to its responsibilities under its policy by not paying him for damage to his home in wake of storm damage. The court found that the insured was entitled under his homeowner's policy to one-half the cost of leveling his home as a result of wind storm damage to the siding of his home, despite exclusionary provision in policy indicating that repairs to home's foundation were not covered, given that, in order to correctly replace the home's damaged aluminum siding with vinyl siding, the home had to be leveled, making the leveling incidental to the repair.

> Although the provision at issue arguably excludes coverage for leveling the house, the leveling of the home was incidental to the repair of Mr. Bennett's damaged siding. In order to repair the siding correctly the home had to be leveled. If the home were not level the siding would not fit

[48] *Id.* at 1230.

[49] 869 So.2d 321, 2003-1195 (La. App. 3rd Cir. 3/24/04).

> correctly and it would be unable to perform its intended purpose of protecting the home.[50]

The court noted that the duty to replace the siding conflicts with the exclusionary clause, and the specific and affirmative duty to repair is controlling. [51] Additionally, the court found that the insured was entitled to the cost to replace windows in the home due to storm damage to the home's siding, since the window replacement was an incidental but necessary repair effectuated in order to ensure the replacement of siding's functionality.

L. Like Kind and Quality

- *Brouillette v. Fireman's Fund Insurance Company*.[52] The issue in this case was whether the insurance company has the right to elect to exercise a contractual option to rebuild plaintiff's home, which was totally destroyed by fire, at a cost of $28,500 rather than pay the $52,000 face value of the policy. The trial court found, and the appellate court agreed, that the offer to rebuild based on the $28,500 estimate was "not an offer to build a house of like kind and quality."[53] The "estimate of cost to rebuild did not include replacement of the fireplace, the hardwood floors, appliances, or the sewage system and did not provide for use of like quality materials for replacement."[54]

- *Johnson v. Illinois National Insurance Co.* [55] "We agree with those cases wherein it has been found that the 'like kind and quality' language is unambiguous and does not provide coverage for diminished value claims....[A] repair with like kind and quality requires a vehicle to be restored to good condition with parts and workmanship of the same essential nature that existed on the vehicle prior to the accident. This restoration of the damaged vehicle may or may not return it to its pre-accident market value, but a return to market value is not what the words 'repair' with 'like kind and quality' commonly mean."[56]

M. Reformation

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[50] *Id.* at 327.

[51] *Id.* The court cited Louisiana Civil Code Articles 2052 ("When the parties intend a contract of general scope but, to eliminate doubt, include a provision that describes a specific situation, interpretation must not restrict the scope of the contract to that situation alone.") and 2054 ("When the parties made no provision for a particular situation, it must be assumed that they intended to bind themselves not only to the express provisions of the contract, but also to whatever the law, equity, or usage regards as implied in a contract of that kind or necessary for the contract to achieve its purpose.") for the affirmative duty authority.

[52] 563 So.2d 1343 (La.App. 3 Cir. 1990).

[53] *Id.* at 1345.

[54] *Id.*

[55] 818 So.2d 100 (La.App. 1 Cir. 2001).

[56] *Id.* at 104.

Reformation of a contract is considered an extraordinary equitable remedy. It is typically only done where there is a mutual mistake between the parties that caused the contract to inaccurately reflect the parties' intent. A mutual mistake will provide a basis for equitable relief if the proof is clear and convincing.[57] A contract, which by reason of a mutual mistake in its execution does not conform to the real agreement of the parties, may be reformed when the mistake is established by clear and convincing proof.[58]

Louisiana courts have recognized that written contracts of insurance can be reformed to conform to the original intention of the parties if there exists either mutual error or for fraudulent, negligent, or mistaken conduct on the part of the agent issuing the policy.[59] In *Hebert*, the court held that the insurer was bound by the knowledge of its agent as to the true intention of the parties to the policy. This meant that the policy was reformed to allow coverage for the driver of the car involved in the accident, son of the named insured, because it was the intention of the insured to have the policy amended, he instructed the agent to do so, and it was just not done. In *Trahan*, the court found that "the policy cannot be reformed to include unlimited coverage under the guise of making it conform to the true intent of the contracting parties because there never was any such understanding between them."[60]

N. Valued Policy Law

In most total property loss cases, the insured has separate wind insurance and flood insurance policies. When there is a total loss to the property and/or the city has declared the property condemned or uninhabitable, insurance carriers generally blame one another in an attempt to reduce their share of liability and pay only a pro rata share as opposed to the face amount of the policy.[61] Valued Policy Law (VPL) states, in effect, "In the event of the total loss of any building . . . located in this state and insured by any insurer as to a covered peril . . . the insurer's liability, if any, under the policy for such total loss shall be in the amount of money for which such property was so insured as specified in the policy." In other words, the insurer pays the policy limits irrespective of concurrent causation.

One legal issue is the interpretation of Louisiana's VPL, and whether Louisiana would take an approach similar to that of the Florida courts in *Mierzwa v. Florida*

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[57] *Pierce v. Flynn*, 656 S.W.2d 42 (Tenn.Ct.App. 1983).

[58] *Commercial Standard Ins. Co. v. Paul*, 35 Tenn.App. 394 (Tenn.Ct.App. 1951)." *Eatherly Construction Co. v. HTI Memorial Hospital*, 2005 WL 2217078 (Tenn.Ct.App. 9/12/05).

[59] *Herbert v. Breaux*, 285 So.2d 829, 830 (La.App. 1st Cir. 1973); *Trahan v. Bailey's Equipment Rentals*, 383 So.2d 1072 (La.App. 3rd Cir. 1980).

[60] 383 So.2d at 1077.

[61] The wind insurer or flood insurer usually argue that those elements did not cause all fo the damage to their insured's property and that the insurers should not be held responsible for paying the total loss or face value of same. Therefore, under the anti-concurrent cause clause of their respective policies, they take the position that they are excluded and do not have to pay the claim.

Windstorm Underwriting Association.[62] A valued policy statute protects insureds faced with the total loss of their property from having to prove its value.

O. Concurrent Causation

For individuals and entities without flood insurance or with inadequate flood insurance,[63] it is vitally important that certain losses not be deemed to be solely "flood" losses.

The principle of concurrent causation has been widely recognized for many decades and works in favor of policyholders. To understand it, you have to keep in your head the difference between cause and effect. An insurance policy specifies what causes it covers (usually called "hazards" or "perils"). It also specifies what effects it covers (usually called "loss" or "damage") and which perils and losses are excluded from coverage. Those details are found in various sections of the policy language, such as "Perils Insured Against" and "Exclusions".

Concurrent causation principles say that if two causes combine to produce loss or damage, and one of the two causes is excluded (e.g. flood) and the other cause is covered (e.g. windstorm), the loss will be covered. Insurance companies have been drafting their policies in light of this basic principle for over a century, tweaking policies from time to time as fine points were re-interpreted, often in response to disasters that revealed unanticipated exposures. Many of those disasters, and the law interpreting the policies, comes out of the state of California and its earthquakes, mudslides, floods and brushfires.

Many policies currently have anti-concurrent causation language which operates to deny coverage if two causes combine to produce the loss or damage when one of the two causes is an excluded cause. Typical anti-concurrent causation language states, "We will not pay for loss or damage caused directly or indirectly by any of the following, regardless of any other cause or event that contributes concurrently or in any sequence to the loss."

The new statute, R.S. 22:658.2 discussed above, addresses in part the anti-concurrent causation language. The statute makes clear that if damage to immovable property is caused by two or more causes, one that is excluded and the other that is covered, thus, providing coverage in part, the burden is on the insurer to establish the exclusion. Prior versions of the bill that became R.S. 22:658.2 contained much stronger language against the anti-concurrent causation clauses, but unfortunately, these provisions did not make the final act. Therefore, it is important that the insured demonstrate some coverage, *e.g.*, wind damage, under the policy.

[62]No. 4D02-4996 (Fla. 4th District Court of Appeal, June 23, 2004).

[63]On the National Flood Insurance Program (NFIP), a division of FEMA, see, Annot., *Rain, Flood or Water Damage Insurance*, 43 Am. Jur. 2d Insurance § 486.