Evaluating Valued Policy Law After Katrina

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(TO BE PUBLISHED SHORTLY IN THE INSURANCE COVERAGE LAW BULLETIN)

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Since first enacted in 1874 in Wisconsin, Valued Policy Law ("VPL") has become an important regulatory fixture in the insurance law of many states. At least nineteen states have enacted some version of a traditional VPL. In its original formulation, VPL obliges an insurer that collected premiums for an insurable interest based on an assigned value to pay that predetermined value to the insured in the event of a total loss. That statutorily-imposed obligation prevents insurers from collecting premiums on artificially inflated property values on the front end while paying insureds less than that amount after a total loss, based on actual values. VPL thus encourages insurers to investigate the actual value of the insurable interest and to collect premiums on that amount, thereby avoiding the hazards of over-insurance. Furthermore, by encouraging insurers to minimize variance between assigned values and actual values, VPL theoretically reduces insurance fraud by policyholders.

In recent years, however, multi-peril disasters, such as hurricanes, have strained the rationale behind VPL. In 2004, a Florida District Court sent shockwaves rippling through the insurance industry when it decided *Mierzwa v. Florida Windstorm Underwriting Association,* 877 So. 2d 774 (Fla. App. 2004). In *Mierzwa,* the court ruled that a policyholder's insurer had to pay its homeowner's policy limits for the constructive total loss of a home damaged by Hurricane Ivan even though a significant portion of the damage was caused by an uninsured peril, flood, and had already been paid for by a flood carrier. At that time, Florida's VPL provided in relevant part:

> In the event of the total loss of any building…insured by an 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.

§ 627.702(1), Fla. Stat. (2003). The *Mierzwa* court reasoned that the VPL applied if only two facts were true: (1) a total loss occurred to certain property and (2) that property was insured as to *a* covered peril. On that basis, wind, the covered peril, need not have been *the* covered peril that caused the entire loss. Arguably, under the *Mierzwa* interpretation, an insurer who may have covered a peril that merely contributed—no matter how slightly—to a total loss could be held liable for its policy limits even though the total loss was actually caused by an uncovered peril. It could also be argued that an insured who underinsured his property for a flood peril with another carrier could recover the face-value of his homeowner's policy if wind or another covered peril caused *any* damage. While *Mierzwa* did not specifically address those scenarios, as discussed below, the danger in *Mierzwa* lies in its potential to statutorily rewrite specific policy exclusions and to convert policies covering specific perils into all-risk policies, even though insurers did not collect premiums for certain risks.

Since *Mierzwa,* the Florida legislature has amended its VPL so that it no longer applies to total losses resulting from both covered and uncovered perils. Nevertheless, the inherent danger of *Mierzwa* to the insurance industry underscores the importance of fully understanding the purpose, construction, interpretation, and operation of VPLs in jurisdictions particularly susceptible to multi-peril disasters.

To ascertain the limitations of a specific jurisdiction's VPL, several threshold questions must be asked. Which insurance policies and losses are affected by the statute? What constitutes a "total loss?" Does a total loss have to be caused solely by a covered peril? If the statute applies to total losses caused by a combination of covered and

uncovered perils, does the statute provide a mechanism for allocating indemnity based solely on a covered cause of loss? Finally, does the VPL permit an insurer to provide an alternative method of computation and, if so, what standards apply to that alternative computation? Subtle variations in the answers to these questions can have profound implications.

1. Which Insurance Policies and Losses are Affected by the Statute?

As an initial matter, the VPL in some states applies only to certain types of policies and/or losses, making it necessary to determine which policies are affected. The answer to that question may not always be obvious from a plain reading of the statute.

For instance, unlike Florida's amended VPL, which applies to any type of policy if a covered peril *causes* the total loss, a plain reading of Mississippi's VPL indicates that only fire policies are affected. Section 83-13-5 of the Mississippi Code prohibits any insurer from issuing a "fire policy" exceeding the fair market value of the insured interest. The Mississippi statute further estops an insurer from denying payment for anything less than the policy's face value on which premiums were collected when that insured property is "totally destroyed by fire." *Id.* While the statute specifically references a fire policy, Mississippi courts have applied the VPL to other policies providing coverage for fire perils. *See, e.g., Necaise v. U.S.A.A. Casualty Company,* 644 So. 2d 253 (Miss. 1992) (applying the VPL to fire loss under a homeowner's policy). Despite Mississippi's application of VPL to policies other than pure fire policies, Mississippi courts have limited application of VPL to those situations where the insured interest was in fact "totally destroyed by fire." *But see, Commercial Union Insurance*

Company v. Byrne, 248 So. 2d 777 (Miss. 1971) (suggesting in dicta that the VPL may apply to damage under a windstorm policy).

A plain reading of Louisiana's VPL for immovable property also reveals that the statute applies only to fire insurance policies. Louisiana's VPL for immovable property provides in relevant part:

> Under any fire insurance policy…if the insurer places a valuation upon the covered property and uses such valuation for purposes of determining the premium charge to be made under the policy, in the case of total loss the insurer shall compute and indemnify or compensate any covered loss of, or damage to, such property which occurs during the term of the policy at such valuation without deduction or offset, unless a different method is to be used in the computation of loss, in which latter case, the policy, and any application therefor, shall set forth in type of equal size, the actual method of such loss computation by the insurer.

LSA R.S. 22:695 (West 2006). Unlike Mississippi's VPL, Louisiana's statute does not expressly require that the insured property be "totally destroyed by fire." Application of Louisiana's rules of statutory construction, however, suggests that the legislature intended Section 695 to apply to fire losses only.

By way of example, the Louisiana Insurance Code distinguishes between "Fire and Extended Coverage" and "Homeowners' Insurance" as two different kinds of insurance. LSA R.S. 22:6. Moreover, because Louisiana's VPL appears in the chapter of the Louisiana Insurance Code pertaining specifically to Standard Fire Policies, it must be interpreted in light of other statutes appearing within that same chapter. Importantly, the statutes governing Standard Fire Policies prohibit any insurer from deviating from the requirements set forth for fire perils, but not for other perils in multi-peril policies. LSA

R.S. 22:691(E). This distinction confirms the legislative intent to treat fire perils differently from other perils.

Additionally, had the legislature intended Louisiana's VPL for immovables to apply to total losses caused by perils other than fire, it could have easily said so just as it did in the VPL applying to personal property. In La. R.S. 22:667, Louisiana's VPL for movables, the legislature made clear that the VPL applies to damaged personal property "*from whatever cause."* The contrast between Louisiana's VPL for personal property, which appears outside of the Standard Fire Policy provisions, and Louisiana's VPL for immovable property further supports the conclusion that the legislature intended for Section 695 to apply to total losses caused by fire perils only.

In a couple of instances, Louisiana state courts have applied the VPL for immovables to total losses caused by perils other than fire, but have done so without any analysis about whether the statute should apply to other perils at all. *See, e.g., Holloway v. Liberty Mutual Fire Ins. Co.*, 290 So. 2d 791 (La. App. 1 Cir. 1974) (applying the VPL to a water leak under a homeowner's policy). Moreover, the Louisiana Supreme Court has yet to weigh in on the scope of Louisiana's VPL for immovables. Nevertheless, one Louisiana federal court has analyzed Section 695 and determined that the VPL for immovables does not apply to non-fire losses under an all-risks commercial property policy. *In re Consolidated Companies, Inc.,* 185 B.R. 223 (E.D. La. Aug. 2, 1995), *aff'd*, 106 F.3d 396 (5th Cir. 1996) (Table Opinion).

2. What Constitutes a "Total Loss?"

Once it is determined which policies and perils are affected by a jurisdiction's VPL, it must be determined whether a "total loss" has occurred, so as to trigger application of that VPL.

Not all jurisdictions define "total loss" in their VPLs. While it is possible that some courts have defined the term "total loss," other courts may have adopted a single test or a series of tests to determine whether a total loss has occurred. In Florida, the *Mierzwa* court deemed the insured's building that had been "effectually condemned" to be a total loss where a local authority had determined that the cost of repairs exceeded half of the value of the building. Other jurisdictions, like Louisiana, have considered a variety of tests to ascertain whether there has been a constructive total loss. For instance, in *Occhipinti v. Boston Ins. Co*., 72 So. 2d 326 (La. App. Orl. 1954), the court held that a total loss occurs when "the building has been so damaged that in effect it has lost its identity as a building, and that even though certain parts which remain may be made use of, if the work which is required must be looked upon as construction rather than repair, the loss must be considered as total." *Id.* at 329. The *Occhipinti* court went on to hold that a constructive total loss exists if the policyholder cannot be made whole because there is a reasonably remote possibility that he later may have to repair hidden defects resulting from the same occurrence insured against. *Id.* at 332.

Other courts have evaluated the existence of a constructive total loss based on whether the damaged property (1) is economically repairable, (2) can be incorporated in a new building of like character, (3) is practically worthless, (4) has been condemned by the local government, (5) cannot be repaired because permits necessary to repair the property cannot be obtained, or (6) has been deemed a public menace or nuisance.

3. Does the Statute Permit Allocation Between Covered And Uncovered Perils That May Have Contributed to a Total Loss?

One might argue that, as evidenced by *Mierzwa,* a court interpreting another jurisdiction's VPL could require an insurer to pay the face value of a policy for damage caused during a multi-peril disaster no matter how slight the damage caused by a covered peril may have actually been if a covered peril merely *contributes* to a total loss. Under *Mierzwa,* an insurer could neither dispute the cause of the loss nor allocate its percentage of resulting liability among covered and uncovered perils. It is worth noting that even the *Mierzwa* court suggested that this rule should not be taken literally, pointing out that the covered loss in that case was responsible for more than half of the total damage. Accordingly, the court had "no occasion to consider the 'parade of horribles'…when [the] covered peril might be responsible for…only 1% of the total damage." 877 So. 2d at 778 n.5.

Nevertheless, in other jurisdictions and post-*Mierzwa* Florida, the VPL may apply only if the total loss is caused solely by a covered peril or a combination of covered perils. For that reason, determining which peril caused the total loss may pretermit any discussion of VPL altogether. As amended, Florida's VPL expressly does not apply unless covered perils alone would have caused the total loss. Moreover, where a covered peril would not have caused the total loss, then the insurer is only liable for that damage attributable to the covered peril. Thus, application of a jurisdiction's law regarding efficient proximate causation, concurrent causation, and/or successive losses and their effects on total loss may determine whether the VPL applies.

Even in jurisdictions that do not distinguish between covered and uncovered perils, however, issues of causation should not be ignored because ascertaining the cause of a loss may determine *how* liability is calculated. Specifically, some jurisdictions may permit allocation between covered and uncovered losses based on how much of the total loss is attributable to a particular peril. For instance, Louisiana's VPL for both immovables and personal property provides that the insurer shall "compute and indemnify or compensate any covered loss of, or damage to, such property…at such valuation without deduction or offset…." LSA R.S. 22:695, LSA R.S. 22:667. Because Louisiana's VPL contemplates some computation by the insurer based on the covered loss rather than requiring the insurer to pay the full policy limits in the event of any liability, the statute may be interpreted as requiring an insurer to pay only that percentage of valuation that equals the portion of damage caused by fire, in the case of immovables, or other covered perils, in the case of personal property. Louisiana courts have yet to address this issue.

4. Are Alternative Methods of Compensation Allowed?

Even if a jurisdiction's VPL does not permit an insurer to compute its liability based on a covered peril, the statute may permit an insurer to contract out of the VPL.

If a jurisdiction's VPL permits alternative methods of compensation it is important to know how those alternative methods of compensation must be presented in an insurance policy in order to be effective. Louisiana permits insurers to contract out of the VPL. Specifically, Louisiana's VPL governs valuation "unless a different method is to be used in the computation of loss, in which latter case, the policy, and any application therefore, shall set forth in type of equal size, the actual method of such loss computation

by the insurer." LSA R.S. 22:695; LSA R.S. 22:667. One Louisiana state court has determined, in the context of personal property, that the language contained in a Loss Settlement provision may constitute an alternative method of compensation. *Bonnette v. Foremost Ins. Co.,* 493 So. 2d 874 (La. App. 3 Cir. 1986). That court, however, declined to apply that alternative method because the language was not set forth in "prominent print" within the policy. *See Jackson v. Security Indus. Ins. Co.,* 484 So. 2d 966 (La. App. 3 Cir. 1986). One federal court applying Louisiana's VPL has determined, however, that an alternative method of calculation existed where the insurance policy presented a valuation method based on the actual cash value of the property at the time of loss as determined by an appraisal as defined in the policy. *Scottsdale Ins. Co. v. Wasserman,* 1997 WL 7222940 (E.D. La. 11/17/1997).

In conclusion, where a policyholder's insured property is damaged by a multi-peril disaster in a VPL jurisdiction, several threshold questions must be answered before the insurer can be found liable for the face value of the policy. If it is determined that the VPL applies to the particular policy issued and to the type of damage suffered, then it must be determined whether there has been a total loss. Even then, prevailing rules of causation can pretermit application of the VPL to losses caused by combined covered and uncovered perils or enable an insurer to limit its liability solely to that portion of the loss attributable to covered perils. Finally, some jurisdictions permit insurers to contract out of VPL so that if the policy at issue provides an alternative method of calculation and satisfies any jurisdictional requirements, then the insurer may not be liable for the face value of the policy.

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