

INSURANCE LITIGATION

FIGHTING FOR A FAIRER APPRAISAL

MORE THAN JUST MARKET VALUE SHOULD FACTOR INTO LOSS CLAIMS

By CHRISTOPHER M. GALLAGHER and
JON D. BILLER

Most property owners in Connecticut are insured under property insurance policies which provide that in the event of loss, payment is to be based upon the cost to replace or repair the property as of the date of the loss. Many of these policies further provide that if the amount of loss is greater than a nominal amount, usually \$2,500, then the insured can only receive the actual cash value of the loss until it has proven that repair or replacement is actually taking place.

When that occurs, the insured is entitled to receive the difference between the replacement cost evaluation and the actual cash value determination, and the difference is known as withheld depreciation. Given the downturn in the real estate market, some insurance adjusters and appraisers argue that market value should be used to determine actual cash value. This approach leaves Connecticut insureds with inadequate compensation and ignores other facts that must be considered in determining the actual cash value of the loss.

In 1978, the Connecticut Supreme Court in *Sullivan v. Liberty Mutual Insurance Company* confirmed that when determining actual cash value, there are three tests available. The *Sullivan* court discussed the so-called "broad evidence rule," which means that any evidence logically tending to the formation of a correct estimate of the value of the destroyed or damaged property might be considered by the trier of the facts in determining actual cash value at the time of the loss. As a result of the language in the *Sullivan* decision, Connecticut is known as a broad evidence state and, literally, any evidence which might logically help establish value can be considered.

The *Sullivan* court also mentioned two other tests to determine actual cash value. One of

these tests is replacement or reproduction cost. The third is where market value can readily be determined, market value has been applied as a criterion of actual cash value. Unfortunately, many insurers have interpreted this decision as supporting the belief that market value alone should be a cap on the determination of actual cash value. This view is not supported by the *Sullivan* court or other decisions addressing actual cash value within the state of Connecticut.

Market Value

First, where an insured is issued a replacement cost policy some of those policies actually define actual cash value as replacement cost less depreciation. In such a situation, we believe there is no room for any other definition and even an attempt to apply a broad evidence calculation should be rejected because the policy language must control. Further, even where the policy is silent on the definition of actual cash value, if the policy is a replacement cost policy then actual cash value should be determined by first establishing replacement cost then establishing the amount of depreciation and finally deducting the depreciation to arrive at the actual cash value.

Second, in some policies the insurance is not provided on a replacement cost basis, but instead is limited to actual cash value. In these situations, replacement cost less depreciation can be seen as only one measure in determining actual cash value, and under the broad evidence rule, any other evidence can be offered to try to determine actual cash value. While market value can be one of the factors used in a broad evidence determination of actual cash value, it is, in fact, the least reliable measure of damage.

The fact that market value is one of the least reliable factors in determining actual cash value

has already been addressed by at least one court in Connecticut.

In the 1959 case *Castoldi v. Hartford County Mutual Fire Insurance Company*, then-Superior Court Judge John P. Cotter discussed broad evidence and also discussed utilizing market value as a factor to determine actual cash value. Judge Cotter analyzed cases throughout the country and noted "where market value would fail properly to indemnify the insured, the Court has refused to apply this test..." and went on to state that "market value is not a proper criterion of the actual cash value of buildings insured to that extent at the time of damage or loss, according to what would be the majority view."

One can readily see why market value should be rejected as a significant criterion for determining actual cash value and should never be used as a cap when determining actual cash value.

Construction Costs

While construction costs generally increase with inflation, it is rare that construction costs will decrease from year to year. Even during the great recession of the past couple of years, construction costs have increased from year to year, mainly due to the increased costs of materials. While construction costs are generally stable and increase over time, the market value of property can have dramatic swings. This has been made clear by the recent downturn in the real estate market which has moderately affected Connecticut but severely affected other parts of the country.

A home that might have sold for \$300,000 a few years ago might sell for \$200,000 now, yet the mortgage may very well be in excess of the current market value of the property. Utilizing



Christopher M. Gallagher



Jon D. Biller

market value as a measure of determining actual cash value when real estate prices are subject to dramatic swings up and down seems inherently unfair and is the reason why most jurisdictions reject that approach.

Perhaps most troubling is when insurance companies try to limit actual cash value payments to their appraiser's opinion of market value, and in the current economic downturn that value is often less than the debt on the property.

Paying an insured for damages based upon market value will leave them without the ability to repair or replace their property and will only lead to more homes remaining in a state of disrepair and potentially further decreasing the value of properties throughout the state.

On the other hand, using replacement cost less depreciation encourages the repair and rebuilding of damaged property and would help to increase the value of properties during these difficult economic times. ■

Christopher M. Gallagher is an attorney at Biller, Sachs, Raio & Zito in Hamden where his practice areas include insurance litigation. Jon D. Biller is the managing partner of the firm.