REPLACEMENT COST INSURANCE: A PRIMER

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I. REPLACEMENT COST INSURANCE

A. Introduction

1. History of Replacement Cost Insurance

The purpose of property insurance is indemnity: to provide the insured with the full value of its damaged or destroyed property, but no more. Traditionally, the "value" of damaged property has been the "market value" of the property immediately before the casualty. For purposes of insurance in Washington, the value of damaged property is its "fair market value": the difference in value immediately before the loss and immediately after. *See National Fire Insurance Company v. Solomon*, 96 Wn.2d 763, 638 P.2d 1259 (1982).

By statute, RCW 48.27.010, "over-insurance" is prohibited. Over-insurance exists if property or an insurable interest is insured by one or more policies against the same hazard in any amount "in excess of the fair value of the property or of such interest" determined as of the date the policy was issued. For purposes of determining "over-insurance," the statute defines "fair value" as replacement cost less depreciation.[1] RCW 48.27.010(2). The only exception to the over-insurance statute is RCW 48.27.020 which allows for the full cost of repair or replacement, without deduction of depreciation. The nature of replacement cost insurance is therefor to reimburse the insured for the depreciation inherent in the damaged property.[2]

If replacement cost insurance can be calculated as the cost of "new v. old," or replacement cost at the time of the casualty less depreciation, than the latter concept, the fair market value of the property is also known in the insurance industry as the "actual cash value" ("ACV"). As noted, in Washington, the actual cash value is the fair market value of the property at the time of loss. The concept of actual cash value is discussed in more detail below.

2. Typical Replacement Cost Valuation Provisions

Most replacement cost provisions can be found in that part of the property policy under "Valuation" or "Settlement of Loss. Typical Settlement of Loss or Valuation provisions are as follows:

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[1] The definition of fair value, replacement cost less depreciation, is also used as the definition for "Actual Cash Value" in many states. *Boise Assoc. of Credit Men v. U.S. Fire Ins. Co.*, 256 P. 523 (Idaho 1927).

[2] The reluctance to issue policies with replacement cost is traditionally because of the "moral hazard" involved. Moral hazard is the desire to replace old dilapidated or outdated properties with new up to date replacements suggesting insureds might have an incentive to damage intentionally or otherwise existing property. To combat the moral hazard, replacement cost insurance incorporates a number of limitations which will be discussed throughout this paper.

VALUATION:

In the event of physical loss or damage to covered property by perils insured against, the company will not pay more than the lesser of: the minimum liability applicable to loss or damaged property; the interest of the insured in the lost or damaged property; the cost to repair the lost or damaged property; the actual expenditure incurred in repairing or replacing the damaged property; or the value of property insured determined as follows:

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For purposes of this valuation section:

The term **replacement cost** used herein means the cost to repair or replace lost or damaged property with property of comparable material and quality on the same or another site, and used for the same purpose, without deduction for depreciation, deterioration, and obsolescence.

The term **actual cash value** as used here means the replacement cost with deduction for depreciation, deterioration, and obsolescence.

All the above to be *computed as of the time and at the place of loss* insured against by this policy.

(Property policy issued by Continental Casualty Company) (1-17).

Another typical ISO form (HO 00 03 10 00) provides:

If at the time of loss, the amount of insurance in this policy on the damaged building is 80% or more of the full replacement cost of the building immediately before the loss, we will pay the cost to repair or replace, after application of any deductible and without deduction for depreciation, *but not more than the least of the following amounts:*

(1) The limit of liability under this policy that applies to the building;

(2) The replacement cost of *that part* of the building damaged with material of like kind and quality and for like use; or

(3) The necessary amount *spent* to repair or replacement the damaged building.

If the building is rebuilt at a new premises the cost described in (2) above is limited to the cost which would have been incurred if the

building had been built at the original premises.

See, for example, Hess v. North Pacific Ins. Co., 122 Wn.2d 180, 859 P.2d 586 (1993).

A somewhat simpler valuation provision in an Affiliated FM policy provides:

VALUATION:

Adjustment of the physical loss amount under this policy will be as of the date of loss at the place of loss, and for no more than the interest of the insured.

1. Adjustment of physical loss to property will be determined based on the lesser of the following unless stated otherwise below or elsewhere in this policy:

(A) Cost to repair.

(B) Cost to rebuild or replace on the same site with new materials or like kind and quality.

(C) The cost to rebuild repair or replace on the same or another site, but not to exceed the size and operating capacity that existed on the dated loss.

(D) On real property machinery or machinery and equipment, other than stock, offered for sale on the date of the loss, the selling price.

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12. On property if not repaired replaced or rebuilt on the same or another site within two years from the date of loss, unless such time is extended by the Company, the **actual cash value**.

3. Summary of Common Valuation Clauses:

The foregoing valuation or loss settlement provisions all have certain attributes in common:

(1) the insured is only allowed to recover replacement cost up to but not exceeding the limits of liability of the policy;

(2) the estimate of replacement cost is predicated on the cost of materials of like kind and quality to be used in the repair or the rebuilding of the damaged property;

(3) at the time and place of loss;

(4) the property to be replaced must be used for the same general purpose as that of the damaged or destroyed property; and

(5) the insured is entitled to no more than the cost to actually repair or rebuild the property regardless of limits or the hypothetical "replacement cost" of the damaged or destroyed property.

4. Functional Replacement Cost

The limitations incorporated in the policy's valuation or loss settlement provisions inhibit the ability to replace lost or damaged property with other property, with different materials not of like kind and quality, or at a different site, but which might be the functional substitute for the destroyed property. A good example encountered by the author of this paper involved a fish processing company whose remote shore-based processing facility in Alaska was destroyed by fire. The processing company had no desire to rebuild the destroyed facility as it was too remote and inflexible for the company's needs.

The company was insured under a London policy which provided simply that the insured was entitled to "replacement cost." There were no limiting principles involved in the replacement cost provision such as we see in ISO provisions. Because of the breadth of the replacement cost provision, this author suggested that the insured's concept of replacing the shore-based facility with a processing vessel could very well comply with the replacement cost provision of the policy.

A processing vessel with the ability to move from the Bering Sea to southeast Alaska was the "functional" equivalent of a shore-based plant as the processing vessel and the processing plant performed the same "function." However, a vessel is not "like kind and quality" of a shore-based plant. It is clearly not constructed using materials of 'like kind and quality'. Nor is a vessel built on the 'same site'. The insurer, after some hesitancy, agreed in view of the breadth of its own provision, it would calculate the cost of replacement of the shore-based plant and allow the insured to use those funds to purchase an ocean-going vessel.

Insurers have available, functional replacement cost endorsements. These endorsements are useful for properties that are difficult to replace such as churches, historical buildings, heirlooms, or are constructed with materials that are no longer available. Under functional replacement cost coverage, what is being insured is the function or use of a building or item rather than its architectural or historical details. A typical "functional replacement cost" endorsement provides indemnity for:

> The amount which it would cost to repair or replace the damaged building with *less costly common construction materials and methods which are functionally equivalent to obsolete, antique or custom construction materials and methods* used in the original construction of the building (HO 32 50 05 03).[3]

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[3] Whether in the absence of an endorsement "functional replacement cost" or "functional similarity" will be allowed in Washington has not been clearly decided. As discussed below, the issue was raised but not decided in *Mount Zion Lutheran Church v. Church Mutual Ins. Co.*, 8 Wn.App.2d 461, 442 P.3d 22 (2019) where the court may have

5. Actual Cash Value ("ACV")

a. Calculation of ACV

We have briefly discussed the concept of "actual cash value." In Washington, the actual cash value is the fair market value of property. Most property policies issued in Washington define replacement cost as either "fair market value" or "replacement cost less depreciation."

In the world of property valuation outside of insurance, such as eminent domain or tort , the measure of loss is usually the difference between the value of property immediately before the casualty and that immediately after – "diminution in value." To determine the fair market value, appraisers will often use one of three methods depending upon the type of property: replacement cost less depreciation, the income approach, or the comparable sales approach. All three of the valuation methods can be used to determine fair market value and, in many jurisdictions, "actual cash value", as well.

Employing the variety of methodologies has resulted in many jurisdictions adopting a valuation method known as "the broad evidence rule." In fact, the broad evidence rule, which is designed to consider a variety of valuation elements, is nothing more than an aggregation of the methodologies employed by property appraisers, regardless whether the property is real or personal.[4]

b. Duty to Pay ACV Until Replacement Complete

The importance of determining actual cash value is that an insured is entitled to be paid the actual cash value of property until the insured actually replaces or repairs the property. In Washington, an insured must replace or repair the property before the insurer is required to pay the replacement value. *See Hess v. North Pacific Insurance Company, supra* and the cases examined.

In *Hess*, the insured's cabin was destroyed by fire. The ACV was $20,000; the replacement cost $43,000. The insureds decided not to replace the property but sought the replacement cost. The issue in *Hess* was whether under the terms of their policy, the Hesse's could collect full replacement cost without actually replacing the destroyed cabin. The parties stipulated the Hesse's were not going to rebuild their cabin.

Complicating resolution of the *Hess* case was an older Washington case, *National Fire Ins. Co. v. Solomon, supra. Solomon* is known for two principals, only one of which survived *Hess*: 1) actual cash value equals fair market value; and 2) an insured can collect replacement

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rejected the notion of "functional replacement cost" or "functional similarity" although deciding the issue is not necessary for purposes of the case.

[4] The broad evidence rule appears to be applied in most jurisdictions. Under this rule, a court or jury is allowed to consider a variety of different factors in determining the value of damaged or destroyed property. The factors that may be considered include opinions in market value given by expert witnesses or appraisers, the original cost of construction and projected cost for rebuilding, highest and best use of the property, physical economic and functional depreciation, and any other factors an appraiser might use in assessing the value of the property. For a list of cases, see *Knoll, Replacement Cost Insurance*, Cozen, Insuring Real Property, §25.02, n.3.

cost without actually replacing the property.

In *Hess*, the Washington Supreme Court reviewed *Solomon* and a case from Pennsylvania, *Reese v. Northern Insurance Co. of New York*, both of which held that under the replacement cost provisions in their respective policies, the insured did not need to replace the property in order to collect replacement cost value. After a somewhat tortured analysis, the *Hess* court rejected *Solomon,* and limited it to its facts, essentially depositing *Solomon* in the dust bin of jurisprudential history. The holding that ACV equals fair market value, however, survives to this day.[5]

In Washington, it is clear (as it is in every other jurisdiction in the United States) an insured is not entitled to receive replacement cost unless the property is actually replaced. Thus, in practice, insurers (assuming compliance with both policy terms and the Unfair Claim Settlement Practice Act, WAC 284-30-330) will calculate both the replacement cost and actual cash value of property. Insurers generally determine the replacement cost and the amount of "depreciation" deducting the latter from the replacement cost to arrive at actual cash value. The ACV is, or should be, then paid to the policyholder until the property is replaced.

c. 180-Day Limit to Claim Replacement Cost

Many valuation and loss settlement provisions require the policyholder to replace or repair the damaged property within 180 days of the casualty. In today's regulatory and construction environment, the 180-day limit is almost impossible to achieve. Indeed, in one homeowner matter presently being handled by the author, the policyholder could not even get a septic permit within 180 days. In fact, because of regulatory delays and the limited availability of construction professionals, the policyholder only recently began rebuilding his home almost three years after it was destroyed by fire.

Nonetheless, there are insurers who will deny replacement cost coverage if the property is not rebuilt or repaired within 180 days. A classic case is one from Maine, *Blanchette v. York Mutual Insurance Co.*, 455 A.2d 426 (Me. 1983). In *Blanchette*, the insured's home was destroyed in a fire. The Blanchette's elected to take the ACV and informed York Mutual they also intended to claim replacement costs by rebuilding the home. Being the property was in Maine, and where most everything shuts down around Thanksgiving because of the weather, the Blanchette's informed York Mutual of their need for an extension. York granted them an additional 90 days and advised that unless the property was completely rebuilt within 270 days, they would not qualify for replacement cost coverage.

Of course, not even 270 days was enough, as the Blanchette's soon learned the house could not be rebuilt on the same lot because of a "sewage disposal ordinances." The Blanchette's were therefor required to find another lot upon which to build a replacement home. In its

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[5] Most current policies define "actual cash value" as replacement cost minus depreciation. With this definition, the issue in Solomon is obviated. However, the explicit definition has done little to bring peace between insureds and insurers as conflicts continue to arise over what constitutes replacement cost and its amount, as well as calculation of depreciation. Rather than simplify the adjustment, insurers, by defining actual cash value as replacement cost less depreciation, have increased the disputes between the parties.

inevitable wisdom, York denied coverage for replacement cost resulting in the instant lawsuit. The Supreme Judicial Court of Maine held there was no support in the policy for York's insistence that the obligation to make claim for replacement cost imposed a requirement that the property be "substantially complete" within the time-period allowed in the policy.

The "make claim within 180 days" language has been interpreted in other cases to require the insured apprise the insurance company of the policyholder's intention to repair or rebuild. In the absence of a time within which replacement must be complete, courts would imply a requirement that repair or replacement be within a reasonable time.

It appears the current state of the law is that "an intent to rebuild" will satisfy the repair/replacement requirement. *See Parker, Replacement Cost Coverage: A Legal Primer, 34 Wake Forest Law Review*, 295 (1999).

6. Requirements of Replacement Cost Insurance

The policy language employed by property insurers varies depending upon the type of property being insured: commercial, industrial, or residential. While the valuation or loss settlement provisions provide in general terms the method of how an insurer will respond to property damage, there are always questions that arise with the specific application of general principals. In this section, we will explore some of the issues and questions that replacement cost provisions leave unanswered but have been considered by courts across the country, including Washington.

a. Time and Place of Loss

Most replacement cost policies in the current marketplace, require that property be valued "at the time and place of loss" or "as of the time of loss or damage."

During inflationary times and inevitable regulatory delays restricting the replacement cost valuation to the "time and place of loss" is a decided detriment to policyholders. We have seen over the last two or three years, a significant increase in the cost of materials which of course must be considered in connection with "like kind and quality of materials." Similarly, regulatory delays are becoming increasingly difficult and expensive to navigate. Couple regulatory delays with inflation, and you have a recipe for a policyholder being unable to replace destroyed property within the monetary limits of the policy issued by the insurer.

There are many examples of an insured finding itself woefully underinsured because of the passage of time, lack of foresight or failure to update policy limits and property valuation.

In the case of *Snoqualmie Summit Inn, Inc. v. Travelers Property and Casualty Co. of America*, 2007 WL 709297 (W.D. Washington 2007), a building at Snoqualmie Pass collapsed under an excessive snow load sometime during the winter of 1998-1999 and was a total loss. As the cost or reconstruction had significantly increased between the date of loss and date of rebuilding, the policyholder sought replacement cost coverage as of the date of replacement rather than the date of loss.

The Snoqualmie policy required valuation to be determined "as of the time of loss or

damage." The court held the policy language controlled, and the policyholder was not entitled to a valuation other than that immediately prior to the casualty giving rise to the loss. Thus, replacement of the property in 2007 would be valued as of 1998-1999.

Another case often cited considered similar policy language with the same result. *SR International Business Insurance Co. Ltd. v. World Trade Center Properties, LLC*, 2006 WL 3073220 (S.D. N.Y. 2006) (language "at the time and place of loss" does not allow for increased costs attributable to inflation, construction pressures, or code upgrades).

b. Repair, Rebuild, or Replace with Due Diligence and Dispatch

Older policies often included a requirement that an insured had to replace property with "due diligence and dispatch." Most courts have interpreted this provision to mean within a reasonable period. In today's policy world, employment of the phrase "due diligence and dispatch" is usually incorporated in the business interruption provisions of a policy which serves as a limiting principal on the obligation of an insurer to pay business interruption by requiring the policyholder to rebuild, replace, or repair damaged property with "due diligence and dispatch." Thus, the requirement of an expeditious repair or replacement serves as a limit to the obligation of an insurer to pay business interruption on the one hand while providing a sense of urgency to the insured on the other.

c. Like Kind and Quality

Most insurance policies sold in the current environment include within the valuation/settlement of loss provisions a requirement the replacement property be of "like kind and quality" or of "materials of like kind." The purpose of these requirements is to ensure that what is being replaced is what was in existence prior to the casualty, that the policyholder is put back in a similar position to what existed prior to the casualty and that the policyholder does not receive a windfall.

Often when considering "like kind and quality," insurers will argue the policyholder's repair or replacement includes "betterment." *See, for example, Siegle v. Progressive Consumers Ins. Co.*, 819 So.2d 732 (Fla. 2002) (relating to repair of an automobile in which the court held the insurer was obligated not only to completely provide "first rate repair to return the vehicle to its pre-accident level of performance, appearance, and function."); *Ray v. Farmers Ins. Exchange*, 200 Cal.App.3d 1411, 246 Cal.Rptr. 593 (1988) "like kind and quality means substantially the same condition as before the accident."). The concept of Betterment is the last refuge of property insurers. Betterment is involved in most all property adjustments.

"Like kind and quality" has also been interpreted to be substantially similar to "equivalent construction." *Fire Ins. Exchange v. Superior Court*, 116 Cal.App.4th 466, 10 Cal.Rptr.3d 617 (Cal.App.2d 2004).[6] Other courts have interpreted "like kind and quality" to

[6] In Washington, "like kind and quality" has been defined to be similar to "like construction" or "equivalent construction." *See Dombrowsky v. Farmers Ins. Co. of Washington*, 84 Wn. App. 245 928 P.2d 1127 (1998) (*Dombrowsky* and earlier cases were more concerned whether "like kind and quality," "like construction," or

mean substantial equivalent rather than "literal identity." *Tenley Enterprises v. Harbor Ins. Co.*, 1986 U.S. Dist. LEXIS 19275 (E.D.Pa. 1986). And finally, when materials out of which a building was originally constructed are not available at the time of reconstruction, the policyholder may be entitled to reconstruction with new, similar materials that would be reasonably appropriate for the rebuild. *See, for example, SR International Business Ins. Co. Ltd. v. World Trade Center Properties, LLC, supra.*

In Washington, "functional similarity" may not be covered if the property claimed to be functionally similar is in fact, a betterment or was not in existence at the time of the casualty. *Mount Zion Lutheran Church v. Church Mutual Ins. Co.*, 8 Wn.App.2d 461, 442 P.3d 22 (2019). *Mount Zion* is an interesting case involving several issues arising out of replacement cost insurance.

In *Mount Zion*, a church was damaged in a fire. The church ultimately elected to repair rather than replace certain glu-lam beams. Bids were received from contractors for replacement of the glu-lam beams which also would have required removal of the roof. A national company, J.S. Held, calculated both replacement cost and an ACV, and Church Mutual paid the ACV. As matters proceeded, the church elected to simply repair the glu-lam beams rather than replace them, but claimed it was entitled to the "substitute cost" of actually replacing the beams even though they were only repaired.

The court held that Mount Zion was limited by the replacement cost valuation provisions in which the limit of liability would be "actual cost." The court further held that the replacement cost can be analyzed on an item-by-item basis rather than on the property as a whole. And finally, as noted, it rejected the notion of "functional similarity" or "functional replacement."

Interestingly, with respect to "functional similarity," the court distinguished those cases cited by Mount Zion allowing functional similarity including the World Trade Center cases. The court held that functional similarity was not an issue. Rather, it held Mount Zion was not entitled to recover on something it did not replace – the glu-lam beams and other items.

The concept of "like kind and quality" can be somewhat elastic depending on the jurisdiction and the facts. This is a classic example of the concept of "replacement cost" generating a multitude of issues around what constitutes "replacement cost" and what constitutes "like kind and quality." While one can generally not replace an apartment complex with a manufacturing facility or a strip mall with a condominium, if the property to be replaced serves the same function and is of a similar "generic" type as that which was destroyed, arguments can be made that the replacement is of "like kind and quality."

d. Must the Property be Replaced on the "Same Site?"

It is now well established that destroyed property need not be replaced on the same site.[7]

"equivalent construction" included the cost to comply with building codes enforced at the time of loss. This issue is discussed in more detail below).

[7] *See generally "Construction and Effect of Property Insurance Provision Permitting Recovery of Replacement Cost to Property,"* 1 ALR 5th 817 ¶ 11 (1992 and Suppl.).

Cases cited earlier in this paper such as *Blanchette* from Maine, have established the principal that the loss settlement provisions of a replacement cost policy do not require an insured to rebuild or replace the property on the same site as the destroyed property. Even cases involving language calling for replacement with "like kind and quality on the same site" will not require an insured to rebuild on that site. Rather, current case law allows an insured to either replace on the same site or select a different site. The measure of loss, however, will be that amount that would have been incurred had the property been replaced on the "same site." The limitation is simply that the amount of money that will be available for the rebuild will be that amount calculated as a cost of replacement on the same site upon which was located the destroyed property.

7. Acquisition of Another Property Constitutes Replacement

In earlier sections, we have alluded to the fact that an insured need not necessarily replace property that has been destroyed if it wishes to take the proceeds from the hypothetical rebuild and transfer those proceeds to another site or another building.[8]

Current policies allow an insured to replace a damaged or destroyed property by purchasing another property. There is nothing in the current ISO replacement cost valuation or settlement provisions that preclude substituting an already existing property for one that has been damaged or destroyed. The issue is not one of "whether the property could be acquired," but "how much" would the insurer be obligated to reimburse the policyholder if it acquires an already existing building. As we have noted earlier, almost all courts allow the acquisition of an existing property. The calculation is simple. What would the cost to replace the damaged or destroyed property be regardless of whether it is actually repaired or replaced. The amount of loss can then be transferred by the policyholder to acquire another similar property.

a. Restrictions When Buying Another Property

There are some restrictions when a policyholder elects to take the money from the hypothetical cost of replacement and purchase of another property. These restrictions relate to whether the property to be acquired is similar in use to the property destroyed. Most courts would not allow an apartment owner to buy a manufacturing plant or a strip mall. These are dissimilar. However, acquiring a fish processing vessel is substantially equivalent to a shore-based plant, since both are engaged in the business of processing fish. Thus, under some circumstances, the functional similarity may qualify as a replacement acquisition. Again, we note the *Mount Zion* court did not rule out "functional similarity'; it decided the concept was not at issue given the facts of the case.

8. Special Issues with Replacement Cost Coverage

a. Code Compliance: What is Covered

Regulatory changes have a significant impact on the amount replacement cost insurance

[8] Even though most current policies allow acquisition of another property as the equivalent of replacement, case law also supports the proposition that the policyholder is allowed to acquire a similar property to the one destroyed. *See Huggins v. Hanover Ins. Co.*, 423 So.2d 147 (Ala. 1982); *Conway v. Farmers Home Mutual Ins. Co.*, 26 Cal.App.4th 1185, 31 Cal.Rptr.2d883 (1994).

that will be available to an insured. In most instances, a property will have been built under one code and, if damaged or destroyed years later, will be subject to a myriad of other codes, ordinances, etc. With few exceptions, the law has evolved such that "code compliance" is not covered by replacement cost insurance.[9] And this is certainly true in the State of Washington.[10] There are numerous cases holding that compliance with code is not part of the loss settlement or valuation provisions and hence of replacement cost. An insured needs to have "code upgrade coverage" or "code coverage" to secure the funds necessary to rebuild property impacted by regulatory changes.[11]

b. Repair Part or Replace the Whole

What happens if only part of property has been damaged with the remaining part undamaged? This is a problem that often arises with roofs, shutters, siding – external features that can be damaged individually but not in their entirety. Very often the policyholder will argue that aesthetic values require an entire roof be replaced rather than replacing individual tiles or shingles, leaving the roof a patchwork of colors and shapes.

The general rule, which is apparently now followed in Washington is that a replacement cost policy does not require a complete replacement of a roof if only a portion of the shingles or roof material has been damaged. *Godwin v. State Farm Fire and Casualty Co.*, 22 Wn.2d 374, 518 P.3d 1045 (2022). In *Godwin*, a windstorm damaged a portion of a policyholder's roof. State Farm agreed to cover repairs to the damaged portion, but not to the rest of the roof which was undamaged. Godwin argued that the valuation part of the policy requiring the insurer to replace the "damaged *part* of the property" extended to the entire roof as the policy required State Farm to make repairs with "similar construction." According to Godwin, this required State Farm to match new shingles with the old, and if no shingles existed to provide a uniform appearance, the insurer had to replace the entire roof.

The court's decision in *Godwin* allowing State Farm to only replace the damaged shingles was predicated upon the State Farm policy requiring indemnity for "all or part" of the damaged property. With the use of the term "part," the court was able to distinguish numerous other cases, including a federal decision in Washington, in which insureds were allowed to

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[9] In Washington, an exception is *DePhlelps v Safeco Ins. Co. of America*, 116 Wn. App. 441, 65 P3d 1234 (2003) in which the valuation language allowed reimbursement on the basis of "any ordinance or law that regulates the construction…".

[10] In an earlier case of *Starczewski v. Unigard Ins. Group*, 61 Wn. App. 267, 810 P.2d 58 (1991); *review denied*, 117 Wn.2d 1017, 818 P.2d 1099 (1991), the court held that the additional cost of complying with a new building code was covered under the policy there at issue. The policy language was very general covering lost settlement as "do not necessary to repair or replace the damaged property." Later cases have distinguished *Starczewski* and essentially limited it to its holding and have rejected the holding that replacement cost insurance includes code compliance. Later cases have held that "like kind and quality," "like construction," or "equivalent construction" do not include code upgrade coverage. *Roberts v. Allied Group Ins. Co.*, 79 Wn. App. 323, 901 P.2d 317 (1995); *Dombrosky v. Farmers Ins. Co. of Washington*, 84 Wn. App. 245, 928 P.2d 1127 (1996).

[11] The requirement for separate code coverage was made clear in *Lesure v. Farmers Ins. Co. of Washington*, 197 Wn. App. 239, 392 P.3d 1076 (2016). (Code coverage in the policy or by endorsement "is the sole source of the obligation to pay for bringing the remodeled home up to code.")

replace their entire roof even though only a portion of the roof was damaged.[12]

Considering *Godwin*, there may be another avenue to approach replacement of an entire roof even though only a portion of it is damaged. In *Higginbotham v. New Hampshire Indemnity Co.*, 498 So.2d 1149 (La.App. 1986) an insured's roof was partially damaged by wind and hail. The damage was restricted to a portion of the composite roof shingles. The policyholder requested a complete replacement, and the insurer argued for a selective repair, as in *Godwin*.

What distinguishes *Higginbotham* from *Godwin* is that repair of the damaged shingles in the *Higginbotham* case would not have secured the property from leaks caused by the damaged shingles and perhaps other areas of the roof. It is not unusual in windstorms for there to be "uplift." Some shingles or roof material can be visibly damaged and would need to be replaced. However, there may be underlying damage because of the uplift which while not visible, cannot be secured against leakage. In these types of cases, the entire roof may well have to be replaced.

In Florida, the court in *Farm Bureau Casualty Ins. Co. v. Sheaffer*, 687 So.2d 1331 (Fla. App. 1997), agreed with *Higginbotham* that a guarantee against leakage required complete roof replacement rather than selective repair.

To get around *Godwin*, a policyholder would need to argue that the roof assembly itself has been damaged and not just the shingles or exterior roof material.

c. Sale of Property After Loss: Does the Insured Forfeit Replacement Cost?

A variant on the question whether an insured forfeits replacement cost coverage if it sells the property is "who must repair or replace the damaged property?" While this situation is not uncommon, the case law addressing the issue is not particularly well developed.

The underlying function of property insurance is to allow the insured to receive full indemnity for the loss suffered, but not to the extent of putting the insured in a position better than before the loss. Many replacement cost valuation provisions do not contain a requirement that proceeds will be paid only in the event the *insured* performs the repair or replacement. An insured may be able to secure replacement cost proceeds even though it sells the property and does not repair or replace the damaged property. The seminal case in this area is *Ruter v. Northwestern Fire & Marine Ins. Co.*, 178 A.2d 640 (N.J. 1962). In *Ruter*, the insured's property was destroyed by fire. The insured sold the damaged property to a third party on an "as is, where is" basis. The purchaser subsequently repaired and rebuilt the property ten months after

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[12] *Godwin* may not be the end of the story on matching as the court relied significantly on the word "part." In other jurisdictions, matching and therefore replacement of undamaged but unmatched material has been ordered. *See, e.g., Cedar Bluff Townhome Condominium Assoc. v. American Family Mutual Ins. Co.*, 857 N.W.2d 290 (Minn. 2014); *160 Lee Street Condominium Homeowner's Association v. Mid-century Ins. Co.*, 2018 WL 1994059 (W.D. Wash. 2018). In *160 Lee*, the district court decided a policy containing language giving the insurer the option to pay the value of the "lost or damaged property" or to "repair, rebuild, or replace the property with other property of like kind and quality" required the insurer to match the entire building to the condition before the fire so that there was "no visual mismatch between the east and west towers." *160 Lee Street* was distinguished by *Godwin*, however, on the basis that Godwin's policy contained the word "part."

the sale.

The *Ruter* court permitted the insured to recover replacement cost because the policy language did not require the property be replaced "by the insured." Thus, unless the policy explicitly requires replacement to be performed by the insured, a property may be sold to a third party, and if the third party repairs or replaces that property, the insured may be entitled to the replacement cost proceeds.

There are a couple of cases that have distinguished *Ruter* and applied a different analysis. *Athena Restaurant, Inc. v. Sheffield Ins. Co.*, 681 F. Supp 561 (N.D. Ill. 1988) and *Paluszek v. Safeco*, 517 N.E.2d 565 (Ill. App. 1987). Both *Athena* and *Paluszek* suggest that if the policyholder has taken a "discount" on the sale price, it would be entitled to replacement cost since there would be no "windfall" to the property owner. Thus, if the insured sells the property at a discount to reflect its damaged condition, the insured should be able to secure replacement cost proceeds as if it repaired the property. The author of this paper has employed the *Ruter* and *Athena* analysis on three or four occasions to hotel properties damaged in hurricanes but later sold without the insured making the repairs. In one or two cases the properties were sold at a discount reflective of their damaged conditions, and another in compliance with *Ruter*. In each instance, the author's clients were able to secure replacement cost.

9. Replacement Cost Involving Schedule of Values and Blanket Coverage – a Problem that Won't go Away

It is very common for one all-risk property insurance policy to extend coverage to multiple properties owned by the same insured or insureds. The properties are aggregated with generally a single limit of liability. Insureds purchasing property insurance to cover multiple risks have the option to purchase either a blanket limit or scheduled limits. What limit applies when the policy contains both blanket coverage language and includes as an attachment a statement of values listing the agreed values of each individual property covered under the policy? Although the issue arises with some frequency, there are few appellate decisions discussing blanket v. scheduled property coverage.

Courts generally agree that "blanket" and "scheduled" are terms of art within the insurance industry and are therefore interpreted in accordance with their usage in the insurance industry. *Reliance Ins. Co. v. Orleans Parish School Board*, 332 F.2d 803 (5th Cir. 1963); *Anderson Mattress Co., Inc. v. First State Ins. Co.*, 617 N.E.2d 932 (Ind.App. 1993).

A policy with "blanket" coverage is one that insures different types of property at one or more locations and does not specify the valuation of the items protected under the blanket, but allocates an overall limit to the policy, upon which premiums are based. *Monumental Paving and Excavating, Inc. v. Pa. Manufactures Nfrs. Assoc. Ins. Co.*, 176 F.3d 794, 798 (4th Cir. 1999). A blanket policy applies a single, overall limit to multiple risks.

By contrast, a "valued" or "scheduled policy separately schedules different items of property…each separately treated item of property is in effect covered by a separate contract of insurance and the amount recoverable with respect to a loss affecting such property is determined

independently of the other items of property." *ARM Properties Management Group v. RSUI Indemnity Co.*, 2008 WL 5973220 at *8 (W.D. Tex. 2008). A scheduled property therefore applies separate limits to individual risks in a policy that covers multiple risks. The limits are in accordance with the "schedule of values" the policyholder has provided the insurer or its broker.

a. The Policy Language Matters

The policy language construed to indicate blanket coverage includes the following:

i. The amount of insurance listed on the declarations page is a single amount "listed without qualification or reference to any separately valued items." *Abraxas Group, Inc. v. Guaranty National Ins. Co.*, 648 F. Supp 304 (W.D. Pa. 1986); and

ii. The inclusion of endorsements "used only for blanket coverage." For example, that would be rendered meaningless or useless if the policy were not one providing a blanket limit.

b. A Scheduled Policy is Indicated by the Following Key Elements

i. The policy describes the insured premises by reference to a "statement of values"; and

ii. The policy does not reference any overall or combined limit of insurance, but instead each building or risk has its own limit of insurance. *See, e.g., Bahama Bay II Condo. Association Inc. v. United National Ins. Co.*, 374 F. Supp. 3d 1274 (M.D. Fla. 2019).

Although the inclusion of a Statement of Values is a key element of a scheduled policy, courts seem to agree that the mere inclusion of a Statement of Values in or with a policy or referenced as "schedule of values on file with the company" does not necessarily mean the policy is a scheduled policy. A Statement of Values has uses other than evidencing policy limits, namely providing agreed values for each of the properties to be insured for the purpose of arriving at an average premium rate for a blanket limit. *Reliance Ins. Co.*, 322 F.2d at 806 and *Monumental Paving and Excavating, Inc.*, 176 F.3d at 798. In this instance a "statement" or "schedule" of values is in theory distinguished from a "schedule" of limits. The inclusion of a scheduled limit of liability endorsement as opposed to a mere statement of value is therefore an indication the policy intends to provide scheduled limits. *See, for example, S. Ins. Co. v. Affiliated FM Ins. Co.*, 830 F.3d 337 (5th Cir. 2016).

The language used in the policy is very often determinative of whether coverage is blanket or scheduled and in turn, can have tremendous impact on the value to be assigned as a limit of insurance coverage. It is becoming increasingly common for disputes to arise between policyholder and insurer where the policy also has attached or referenced a "statement of values." The insurer interprets the statement of values scheduled limits. The insured argues the statement of values is for determination of premium, not for setting sub-limits.

For example, in a case presently ongoing in which the author is involved, a particular property was identified in a schedule of values at about 5.5 million Dollars in a policy with blanket limits. After a fire, it was determined the replacement cost was 25 million Dollars. The insurer naturally took the position that the limit of liability was that amount indicated in the schedule of values, 5 million Dollars, while the insured took the position that regardless of the schedule of values if it was within the blanket limits, the insurer was liable. In this case, the insured prevailed, and the policy was interpreted as containing blanket limits.

The lessons for attorneys and brokers, however, are clear. *First*, when a statement or schedule of values is created, the valuations must be accurate. Of course, the higher the valuation, the more premium is going to be paid. And yet, if there is a loss, as in the above example, the extra premium will be swallowed by the difference in valuation and the significant loss to the policyholder.

Second, the broker and insured must understand the use of the statement of values: Is it for setting limits as in scheduled property or for setting a premium?

The issue relating to blanket limits vs. scheduled limits is a trap for the unwary and is a common problem with insureds having multiple risks with varying valuations. The insured and its broker ignore the difference between blanket and scheduled coverages their risk.