PROVING A THEORY OF LOSS IN A LARGE OR COMPLEX CLAIM

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Wesley R. Brandt is a senior insurance executive with more than thirty years of experience as a broker for leading firms in the industry. In his capacity as senior client executive, he set strategies and directed the execution of client services as well project initiatives. His work has included team and resource development for large hotel clients.

Mr. Brandt is an expert in the field of hotel insurance and risk management. His practice focuses on: a) initiatives designed to reduce the total cost of risk; b) property policy design specific to the hotel industry; c) creative risk financing and broking; d) improved outcomes for difficult claims; e) risk management information systems (RMIS) and the use of data to reduce the total cost of risk. He specializes in multiple property owners and operators, large resorts, and condo hotels. Most of his clients have significant properties exposures, particularly in high catastrophe locations.

His hotel insurance and risk management experience includes ten years as the senior broker and client executive for Westin Hotel Company and Starwood Hotels & Resorts, Worldwide, Inc. Leading a team of more than 20 professionals worldwide at Aon, he was responsible for the combined global property and casualty program, consisting of more than 500 participating hotels around the world with more than $17 billion in property values and more than $60 million in annual total cost of risk. His current clients consist of insured assets in excess of $10 billion and total rooms in excess of 26,000.

Mr. Brandt differentiates his practice in the property area through policy design, coverage analysis often engaging outside coverage counsel, selection of independent designated adjusters, Business Interruption consultants, and remediation contractors. Most recently he has incorporated an important added resource including coverage for Construction Managers for Insureds in the repair and claims resolution process. His claims advocacy begins prior to the loss, and carries through until final settlement. Using these strategies, has led teams of resources in the successful resolution of more than $200 million in complex catastrophe property claims since 2004.

He is a frequent speaker at the Fall Lodging Conference, The Hospitality Law Conference, The Condo Hotel Conference and The Hotel Investors Conference. He was named 2006 Power Broker for the Hospitality Industry by Risk & Insurance Magazine and again in 2007. Wes is a graduate of the U.S. Naval Academy and is an allied member of the American Hotel & Lodging Association (AH&LA).

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William F. "Chip" Merlin, Jr. represents policyholders. His practice focuses on insurance claim presentation and benefit recovery, insurance coverage, bad faith and wrongful claims conduct litigation. He is a Board Certified Civil Trial Lawyer and currently holds Bar certifications in Florida, Mississippi, Texas, Tennessee, and the District of Columbia.

A graduate of the University of Florida, School of Law in 1982 where he served as Executive Editor of the Law Review and on the Moot Court, he became a member of the Florida Bar in 1983. He briefly represented insurance companies in coverage litigation and since 1985 has dedicated his career to seeking justice for insurance policyholders in claim presentation and disputes with their insurance companies.

Mr. Merlin is the founder and President of the Merlin Law Group. The nineteen-attorney firm also limits its practice to the representation of policyholders. It maintains offices in Houston, TX, Coral Gables and West Palm Beach, FL, and its home office is in Tampa, FL. The firm represents

commercial, governmental, residential and private policyholders throughout the Gulf Region and as co-counsel nationwide.

Mr. Merlin was named a finalist and then received an Honorable Mention in the LexisNexis Insurance Law Center Person of the Year 2008 -Policyholder Attorney of the Year. He is routinely invited to be a featured speaker on insurance law at some of the nation's most prestigious conferences and seminars. He has addressed his peers at the American Bar Association, the American Association for Justice, and the Florida Justice Association. He has also presented before members of such organizations as the National Association of Public Insurance Adjusters (NAPIA), the Florida Association of Public Insurance Adjusters (FAPIA), the Community Associations Institute, and the Windstorm Network.

Because of the breadth and depth of his knowledge and experience, Mr. Merlin is frequently sought to provide comment and insight into current legal issues on the stage of the national media. He has appeared on Fox News, ABC News, CNN, and MSNBC on topics as diverse as freedom of speech, employee's and property owners' rights to privacy and slander and emotional distress.

Mr. Merlin has shared his wealth of knowledge of insurance law via articles he either authored or co-authored. Some of the titles include: Hurricane Coverage and Litigation Issues; Florida's New Valued Policy Law and the Question of Concurrent Causation; Rules of the Road – A Different Methodology For Proving Duty and Breach; Ten Things a Florida Public Adjuster Can Do to Raise Professionalism and Be More Successful; Disaster Preparedness: A Call to Action, Establishing the Right Trial Theme for Your Bad Faith Case. He contributes daily to discussion of property insurance law on his blog, propertyinsurancecoveragelaw.com.

Mr. Merlin's reputation for judiciously seeking fair and just treatment of those who put their faith in their insurance providers recently earned him a governor-appointed seat on Florida's Citizen's Property Insurance Corporation Mission Review Task Force.

Some of Mr. Merlin's other honors and peer recognition include:

- AV Rated by Martindale-Hubbell
- Best Lawyers in America
- Corporate Counsel's Best Lawyers in Insurance Law
- Florida Trend Magazine: Florida's Legal Elite
- Florida's SuperLawyers
- 2007 National Association of Public Insurance Adjusters Co-Person of the Year
- Outstanding Amicus Brief of the Year, United Policyholders,
- Eagle Talon Award, The Florida Justice Association (for upholding the highest ideals of Florida Trial Lawyers)

PROVING A THEORY OF LOSS IN A LARGE OR COMPLEX CLAIM

Introduction

When a catastrophic loss occurs, a business owner's or management's first impulse is to do whatever necessary to mitigate the loss and resume operations as quickly as possible. Accepting an insurance company adjuster's opinions or an insurance company's offer of settlement in haste and without independently investigating the damages and reviewing the insurance policies for available coverage can easily lead to a settlement that is far less than the business bargained for and may not allow the business to fully recover from the loss.

If a claimant will accept less than the full benefits owed to expedite a recovery, an insurer has little incentive to pay benefits quickly and in full. Remember, an insurance company makes a profit both on premiums that are not paid out in claims and also by using float -- the premium money that an insurance company gets to hold and invest for its own profit between the time customers pay premiums and the time claims are paid or reserved. In his 2009 letter to Berkshire Hathaway shareholders, Warren Buffet explained the concept:

> Insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. ***This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit.*** Though individual policies and claims come and go, the amount of float we hold remains remarkably stable in relation to premium volume. Consequently, as our business grows, so does our float.
>
> ***If premiums exceed the total of expenses and eventual losses, we register an underwriting profit that adds to the investment income produced from the float. This combination allows us to enjoy the use of free money – and, better yet, get paid for holding it.*** Alas, the hope of this happy result attracts intense competition, so vigorous in most years as to cause the P/C[1] industry as a whole to operate at a significant underwriting loss. This loss, in effect, is what the industry pays to hold its float.[2]

The longer an insurance company holds on to float, the more money it will make. When an insurer delays adjustment and payment of a claim, it is not just delaying an inevitable

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[1] Property and Casualty Insurance

[2] Warren Buffet's 2009, letter to Berkshire Hathaway shareholders (dated February 26, 2010), at page 4 (*emphasis added*).

loss; every additional day that an insurer earns investment income on the float is pure profit.

While some insurers believe that honest dealing and good customer service is the best way to run a profitable business, it has been proven time and again that other insurers give their adjusters and claims handlers incentives to reduce claims payments and use delay as leverage. With every claim, it is important to remember that insurance is a business and when an insurance adjuster is handling your loss, he acts in the insurance company's best interests, not yours.

None of this means that it is impossible to get a fair adjustment and quick recovery, but the realities of the insurance industry often make claims handling more of a struggle than a straight forward bargained for exchange. Adding to this it the fact that when a catastrophic loss occurs, a business owner or management is often in uncharted territory. It can be difficult for a layperson to find qualified professionals to investigate the damage and raise coverage issues with the insurer early in the process so that any disputes can be resolved before substantial expenses are incurred and the likelihood of the business' full recovery is diminished.

A Team of Qualified Professionals Can Maximize Benefits and Hasten the Recovery

Commercial policyholders usually have an easier and fuller recovery when a team of experienced professionals assist in the claims process. Business losses are complex because they involve damage to the business' real, structural and personal property, as well as damage to the business itself. The insured is faced with the tasks of investigating and documenting all of the losses, tangible and not, and must become familiar with the insurance policies at issue, including the coverages available, limitations on those coverages, deductibles, conditions precedent, and specific requirements necessary to make a claim. Insurance brokers, public adjusters, and policyholder attorneys can help businesses through recovery from a catastrophic loss. These professionals know the intricacies of the insurance industry and claims process and are able to present the claims to the insurer, using the terms and materials specific to the industry, to maximize the policyholder's benefits in a manner that will keep the business viable while the restoration and repairs occur.

To expedite a full recovery, experienced policyholder advocates can demand an insurance adjuster who has experience with hospitality industry claims and understands the nuances of the business. The policyholder advocates will present transparent theories of recovery and engage in an open dialogue with the insurer. Both parties must understand up front the claims made and benefits available. Hiring such professionals at the outset to work with the insurance adjuster can expedite the process; not only do these professionals understand the role of each party and tools used in the industry, a team of professionals can make it clear to the insurance company at the outset of a loss that the insured business expects the benefits it paid for promptly and without gamesmanship.

At the same time, the policyholder is faced with the task of hiring and coordinating architects, engineers and contractors, educating the labor force and overseeing their work. Construction managers can assist the policyholder in finding qualified architects and contractors who specialize in designs and construction for the hospitality industry. These professionals can explain to the insurance adjuster the necessity of expenses unique to construction in the hospitality industry, such as educating the construction teams on the strict codes of behavior required of hotel and resort employees and protocols that will comply with the high customer service standards expected in the industry. The construction manager will also oversee the entire project, coordinate the work, and ensure compliance with building laws and ordinances.

In complex claims where millions of dollars are at stake, insurance companies are not going give up their profits unless they are reasonably convinced that it is necessary and in the companies' best interests to do so. To maximize benefits, the successful claimant must work with the insurer, if possible, document the damage, and provide policy and evidentiary support for each benefit requested. A relatively small amount of extra effort and expense at the outset of a claim will usually prevent the substantial expenses and frustration caused by delayed and denied claims. If an insured can present a convincing claim to the insurer, it is much less likely to present the same claim to a court years later in a suit for breach of contract and bad faith.

In many cases, insurance benefits will cover these services. Endorsements can provide coverage for claim preparation expenses, although public adjuster fees are usually specifically excluded. The services of other professionals, including construction managers, contractors, architects, engineers, accountants, and attorneys, who often work with a public adjuster in preparation of a claim are covered under such endorsements if their services are required to present the loss to the insurer.[3]

For example, in *Fountain Powerboat Ind., Inc. v. Reliance Ins. Co*., 119 F. Supp. 2d 552, 559 (E.D. N.C. 2000), the policy provision at issue stated:

> Expenses incurred by the insured or by the Insureds Representatives including auditors, accountants, appraisers, lawyers, consultants, architects, engineer, or other such professionals in order to arrive at the loss payable under this policy in the event of a claim. This provision does not cover expenses incurred for the services of any public adjuster.

Fountain Powerboat claimed attorney fees for the cost of preparing the claim and the lawsuit, as well as fees for a risk manager, who happened to be an unlicensed public adjuster. The insurer argued that because the risk manager was a public adjuster, his

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[3] If relying on these endorsements to cover fees for such professional services, it is best to confirm with the insurer that these services are covered at the outset of a claim, as fees in a complex claim can be thousands of dollars, and the policyholder and insurer may have different interpretations of the coverage.

services were explicitly excluded, and that only the attorney fees incurred in preparing the claim, not litigating it, were covered.

The United States District Court for the Eastern District of North Carolina rejected the insurer's argument, explaining that it "would hamstring the insured's ability to determine the loss payable and force the insured to accept all policy interpretations given by Reliance." Noting that the policy expressly covered expenses incurred in preparing the claim to arrive at the "loss payable," the Court explained that the parties had not yet determined the "loss payable." Accordingly, the Court held that the insurer was obligated to pay the insured's attorney fees incurred in determining the loss payable, including expenses after the filing of the lawsuit, expenses incurred in preparing for and attending the claim preparation conferences, and expenses for presenting the legal question to the Court.

As for the risk manager, the insured argued that he was not a public adjuster because he was not licensed as a public adjuster in North Carolina and that he did not perform the services of a public adjuster. The insurer argued that he performed all the services of a public adjuster. In deciding the issue, the Court examined North Carolina statutes that define and regulate public adjusters and the risk manager's actions in helping the insured present its claim. Noting the risk manager had a 10 year relationship with the insured, during which he consulted with the insured on insurance issues, and that he took information given to him to present the claim and attempt to negotiate a settlement but did not investigate, the Court held that the risk manager's work was that of a consultant, not an adjuster, and was covered under the policy.[4]

Even if an insured does not purchase an endorsement that covers claim preparation expenses, a general commercial policy may cover some of the costs of a professional construction manager. After all, when an insured suffers a covered loss, replacement cost benefits include the supervisory costs to restore the property to pre-loss conditions. Construction management fees directly related to the construction should be covered as part of the total repair cost and possibly also under extra expense coverage if the services minimize the period of restoration.

Additionally, insurers may cover the fees of a construction manager or other insurance professional if their work also benefits the insurer. For example, a situation could arise where part of a resort hotel is damaged by a covered loss and the resort has the option of closing for three months to repair the damage or remaining open at a smaller capacity while repairs are made as discretely as possible. If business interruption benefits are likely to be substantial if the resort closes, the insurer might prefer the option of discrete repair. If a construction manager is able to hire quality contractors experienced in the resort industry, run the bidding process, educate the labor force, and ensure that the

[4] Though the Court reached a decision beneficial to the insured in this case, there is little published law on the subject, and another court could have easily reached a different conclusion. *See e.g. CSX Corp. v. North River Ins. Co. et al.*, No. 3: 08–CV–00531, (M.D. Fla. Sept. 25, 2009)(holding claims adjustment expenses are those incurred by an adjuster, not a business consulting service.) Whether claim preparation expenses are covered depends on the facts and policy provisions specific to each case.

repairs are done quickly and in a manner which minimizes disruption to the resort's continuing business, it would be well worth the insurer's money to pay the construction manager's fee.

The Best Time to Employ a Team Approach is Before a Loss Occurs

The first opportunity for a business to use a team of professionals actually occurs *before* insurance is purchased. The best way to protect a business from disaster is to purchase the necessary coverages in amounts that accurately reflect the cost of restoring business property to pre-loss conditions. To do this, a business owner or management must carefully scrutinize the policies offered and catalog every item used in the business to determine what is and is not covered under each individual policy and what endorsements or other coverages must be added. This task is easier with the help of a professional risk manager or insurance broker.

Professionals should also assist in the accurate valuation of property and obtaining coverage that accurately reflects the cost to repair or restore business property. The standard forms are often not sufficient to protect a business and can put the business at a disadvantage. For example, the ISO Commercial Policy form provides for actual cash value coverage (ACV), but, in most situations, it is advisable to purchase replacement cost value coverage (RCV). Actual Cash Value is generally defined as the cost of replacing damaged or destroyed property with identical or comparable property, less accumulated depreciation and obsolescence. If a restaurant's cooking equipment is damaged, the RCV benefit would be the amount needed to purchase new equipment of similar quality. If the same business purchased ACV coverage, the benefit would be the amount similar equipment of the same year would cost at a re-sale outlet. This could mean the difference for a complete recovery after a catastrophe, as the actual cash value usually will not provide sufficient benefits to replace or restore damaged property.

Furthermore, business property is often unintentionally under-valued because of misunderstanding regarding replacement value and repair value. Replacement value is limited by the total policy value. In many cases, the cost to repair a structure far exceeds the stated replacement value. For example, an insured may have determined the cost of their building based on the purchase price or current market value. However, after a loss, the structure is to be *repaired* rather than simply replaced, and the cost of repairing the structure can far exceed the estimated replacement costs. Debris removal, specialized work to dry out walls, and new building ordinances and codes can push the repair costs well over the replacement value limit. Additional factors such as transportation of machinery and temporarily high prices in the wake of a catastrophe can also significantly increase repair costs.

A business' failure to insure to value can result in significant coinsurance penalties which reduce the amount a policyholder can recover within policy limits. Under a coinsurance provision, if the property is not insured to a certain percent of its replacement cost value, usually anywhere between 80% to 100%, benefits can be prorated to the percentage of the amount purchased. For example, if only $100,000

worth of insurance was purchased but the replacement value of a property was $200,000 and there was a $50,000 loss, the insurer may pay only $25,000, less the deductible, because only 50% of the replacement value amount was purchased.

To ensure that the replacement value of a property is accurate, it is advisable to consult an expert, such as a construction manager or contractor, who is knowledgeable about the current costs of construction, including current costs of materials and compliance with local laws, ordinances and codes. For large properties, the relatively small costs of the estimate and premiums based on accurate value could significantly affect a business' ability to recover.

Recent and Recurring Issues in Which a Team Approach Can Greatly Benefit the Policyholder

The following discusses recent and recurring issues in property insurance claims. While some of the cases discussed did not involve a hospitality industry business, the legal decisions and demonstrative facts are common to all property claims. Each presents a situation in which a team of professionals can substantially benefit the policyholder.

Issue 1: The Insured Intends to Use the Insurance Proceeds to Make Improvements, Modernizations, and Design Changes.

Catastrophic loss is a tragedy, but if a business is adequately insured, it also presents opportunity. A luxurious and state of the art hotel that was refurbished or built ten years ago is not state of the art today and is probably showing signs of wear and tear. Should a covered loss occur, RCV benefits can provide an opportunity to modernize a structure and furnishings, make it more efficient, or even change locations.

Merriam Webster defines "replace" as:

1: to restore to a former place or position <replace cards in a file>
2: to take the place of especially as a substitute or successor
3: to put something new in the place of <replace a worn carpet>[5]

The term clearly encompasses rebuilding a structure to its exact pre-loss condition, and it also encompasses improvements and modernization. Moreover, ACV is generally defined as RCV minus depreciation, and an item depreciates in value due to wear and tear and obsolescence. Insurers accordingly assume the risk of obsolescence, so that RCV should include the cost of modernizations or technological upgrades. "Replacement cost insurance was devised to provide money for reconstruction. *In effect, the insurer, under this plan, agrees to pay not only actual value but also the difference between actual cash value and full replacement cost*."[6]

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[5] http://www.merriam-webster.com/dictionary/replace (December 16, 2010).
[6] *Columbia College v. Pa. Ins. Co*., 157 S.E. 2d 416, 423 (S.C. 1967).

For example, if a hotel that was state of the art ten years ago suffered a catastrophic loss, the insured is entitled to replace it with a hotel that is state of the art today, subject to policy limits. In rebuilding, the hotel can equip the rooms with wired and wireless internet connections and connectivity for working and charging computers and phones. Similarly, the hotel can upgrade to high definition flat screen televisions. Replacements that take into account this type of depreciation are contemplated by the RCV policy, as this depreciation is considered to the insurer's benefit in the ACV policy.

There is, however, a limit to the improvements that can be paid for with insurance benefits. Most standard RCV policies provide that insurer will pay the least of three amounts: 1) the policy limit applying to the damaged property; 2) the amount the insured actually spends in repairing or replacing the damaged structure; or 3) what it would cost to restore the property on the same site using equivalent construction and for equivalent use. In essence, this provision provides a measure of damages.[7] For example, a hotel was destroyed by fire. The policy limit for the structure was $10,000,000, but the insured chooses to rebuild with improvements which costs $12,000,000. It would have cost $9,000,000 to rebuild the hotel using construction equivalent to its pre-loss conditions. The insured would be entitled to $9,000,000 in benefits; just because the insured chooses to make improvements, the insurer is not required to pay for it.[8]

Further, an insured's financial ability to add improvements may also be limited by the business interruption benefits available. As discussed in more detail *infra*, business interruption insurance is designed "to do for the insured what the business itself would have done had no interruption occurred and the interest protected is the right to income generated by an operating business enterprise."[9] If the insurer in the example above determined the period of restoration to repair the building using equivalent construction to be six months, the insured would be entitled to only six months of benefits, even if the improvements added additional time to the actual period of restoration.

Issue 2: Business Interruption and Extra Expense Coverage

Business interruption coverage is a complex topic, worthy of a separate series of presentations.[10] For purposes of this presentation, however, it is important to note that business interruption coverage is essential to a business' survival in the event of a catastrophe and that the business interruption benefits can impact or influence an insurer's position on a property claim. Simply put, business interruption coverage is intended to provide the funds needed to sustain a business while its operations are suspended as a result of damage caused by a covered peril. The standard Business Income (And Extra Expense) Coverage Form CP 00 30 04 02 states, "We will pay for the

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[7] *Conway v. Farmers Home Mutual Insurance Company*, 26 Cal. App.4th 1185 (4th Dist. 1994).

[8] *See Ga.-Pac. Corp. v. Allianz Ins. Co*., 977 F.2d 459, 461-62 (8th Cir. 1992) ("The policy makes clear that the insurer will pay the lesser of repairing or replacing the property. If the insured decided to replace the property with property of better kind or quality or of a larger capacity, the insurer will not pay for the extra cost.")

[9] 4 Appleman Ins.L. and P. § 2329.

[10] For more information on business interruption and business income benefits, please see Michelle Claverol, *Business Interruption Claims an Ongoing Series*, available at http://www.merlinlawgroup.com/

actual loss of Business Income you sustain due to the necessary 'suspension' of your 'operations' during the 'period of restoration.'" Business Income is generally established by calculating a business' pre tax net profit that would have been earned and the normal operating expenses that continued during the period of restoration. For example, if a business would have earned $300,000 in net profit each month before the loss and it incurred $100,000 in continuing normal operating expenses each month after the loss, the monthly business income benefit would be $400,000.

The period of restoration is usually defined as the period of time that:

> Begins with the date of direct physical loss or physical damage caused by or resulting from
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> a. Covered Cause of Loss at the "scheduled" premises, and
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> b. Ends on the date when: (1) The property at the "scheduled premises" should be repaired, rebuilt or replaced with reasonable speed and similar quality; or
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> (2) The date when your business is resumed at a new, permanent location. Whichever is earlier.[11]

If the property could be rebuilt with reasonable speed and similar quality in six months, the insured is entitled to $400,000 each month, or a total of $2,400,000. Additionally, the insured may be entitled to extra expense benefits,[12] which are those incurred during the period of restoration to minimize the suspension of business, and extended business interruption income.[13]

When coverage of both property damage and business interruption is established at the beginning of a loss, the insurer loses the incentive to delay benefits. An insurer's delay in paying benefits owed and necessary to begin repairs can extend the period of restoration.[14] Further, business interruption benefits can easily amount to a considerable sum and could negate any benefit of delay.

Issue 3: Inadequate Investigation of Damage and Repair of Damaged Property.

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[11] Coverage Form CP 00 30 04 02

[12] Extra expenses may cover construction manager fees and money spent to maintain customer goodwill.

[13] Extended business interruption income usually provides indemnification beyond the period of restoration for the difference in income for up to 30 consecutive days or when the business generates the same amount of pre-loss income, whichever occurs first.

[14] *See Hampton Foods, Inc. v Aetna Casualty & Surety Co*., 843 F. 2d 1140 (8th Cir. 1988)("Aetna should be liable for business interruption coverage for the duration of the reasonable period of time needed for Hampton to reenter business plus any delay attributable to Aetna's failure to perform its duties under the policy."); *Omaha Paper Stock Co. v. Harbor Ins. Co*., 445 F. Supp. 179 (D.Neb. 1978), *aff'd*, 596 F. 2d 283 (8th Cir. 1979).

As mentioned above, the insurance adjuster who will document and identify damage works for the insurance company, not the insured business. As such, many insurance adjusters have little incentive to look for hidden damage or the potential risks of attempting an inexpensive repair when replacement is necessary. As demonstrated below, undiscovered damage and inadequate repair often lead to more property damage, future claims problems, and litigation.

In *First Home Insurance Company v. Fleurimond*, 36 So. 3d 172 (Fla. 3rd DCA June 2, 2010), the insured's home sustained damage during Hurricane Wilma in 2005. The insured submitted a claim, and First Home inspected the home and paid less than $12,000. Mr. Fleurimond retained a public adjuster, who submitted an additional claim after Mr. Fleurimond's roof collapsed and the interior of his home flooded. First Home requested both Mr. Fleurimond and his wife appear for an Examination Under Oath (EUO). They appeared without counsel at the specified time and place. According to Mr. Fleurimond, the examiner badgered him and yelled at him during the EUO. After the Fleurimonds answered the examiner's questions in English, the examiner retained an interpreter and needlessly repeated the same questions in Creole. After answering the second series of questions, the Fleurimonds left during a break and did not reappear.

Thereafter, Mr. Fleurimond retained counsel, who contacted the insurer and offered to resume the EUO. First Home refused. Mr. Fleurimond filed suit and demanded appraisal. First Home opposed the appraisal, arguing that the Fleurimonds breached their policy obligations to by failing to submit to a complete EUO. After an evidentiary hearing, the trial court ordered appraisal and First Home appealed.

Noting the specific facts that: the Fleurimonds appeared for the EUO at the appropriate time and place; Mr. Fleurimond testified that he was badgered and yelled at; Mr. Fleurimond was required to answer the identical series of questions twice, once in English and once in Creole; after he obtained counsel, Mr. Fleurimond offered to resume the EUO but the insurer refused; and that all of this occurred before Mr. Fleurimond filed suit, the Court affirmed the trial court's finding that the lawsuit was not premature, and appraisal was properly ordered.

Though this example involves a home and not a business, it is a recent small-scale example of how underestimated damage and insufficient repairs can lead to further property damage and a protracted litigation. Had this been a restaurant, it would have undoubtedly closed first for the inadequate repair and then again when the roof collapsed and interior flooded. Unless the business had the funds to independently make repairs, it would have remained closed throughout five years of unsuccessful adjustment and vexatious litigation. Notably, this case was decided nearly five years after the damage occurred, and the case simply approved the trial court's decision to send the case to appraisal. More than five years have passed since the damage occurred, and it is unlikely that the repairs have been made.

A seemingly small and simple claim can easily turn into a lengthy battle. Not only did the insurance company inadequately investigate and adjust the loss, it abused its

customers and then used the inevitable result of that abuse as a basis to deny the claim. There were only thousands at stake in this claim; what would the insurer have done if it were millions? Had the insureds in this case retained professional help at the outset of the claim, it is more likely that the extent of the damage would have been realized, the property would have been properly repaired, and the insured would not have been subject to the insurance company's abusive behavior. More importantly, the insured would have likely received the benefits owed much sooner than five years after the damage occurred.

Issue 4: In Most Commercial RCV Policies, the Insured Receives only ACV Benefits Until the Property is Repaired or Replaced. What Happens if the Insurer Delays or Refuses to Pay the ACV Benefits. Buckley Towers Condominium, Inc. v. QBE Insurance Corporation, 2010 WL 3551609 (11th Cir. September 14, 2010)

Buckley Towers Condominiums incurred millions of dollars in damage from Hurricane Wilma in 2005. Buckley Towers filed a claim with QBE, and QBE refused to pay the claim. Without the insurance benefits, the condominium did not have the money to make necessary repairs and was forced to file suit. Under the insurance policy at issue, Buckley Towers was required to actually make repairs before it was entitled to replacement cost value benefits. At the trial court, Buckley Towers successfully argued the doctrine of prevention of performance: by not paying at least ACV benefits on the claim, QBE prevented Buckley Towers from making repairs which would entitle it to replacement cost benefits. The jury awarded Buckley Towers $11,395,665 in ACV damages, $18,708,608 for RCV damages, ordinance and law damages and prejudgment interest. The final award was $24,986,750.87.

Unfortunately, the Eleventh Circuit Court of Appeals did not agree that the doctrine of prevention of performance should be applied to RCV provisions in insurance contracts, even when an insurer fails to pay ACV benefits that it owed. While the Court recognized that it would have been costly, inconvenient, and a hardship for Buckley Towers to pay millions of dollars in repairs without the assistance of ACV benefits, it held this hardship did not excuse the contractual requirement to actually repair the property before RCV damages were owed. The Eleventh Circuit reversed the trial court's award for RCV damages, but affirmed the trial court's award for ACV damages.

Fortunately, other courts have not rigidly adhered to contract interpretation in cases where equitable provisions should prevail. In *Rockford Mut. Ins. Co. v. Pirtle*, 911 N.E. 2d 60 (Ind. App. 2009), the insured bought a building that he rented while restoring it. In early 1999, the building was valued at $165,000.00. It was damaged in an accidental fire on November 11, 2000, and the damage made it impossible to rent. The insurer offered $80,000 to settle the claim. This was less than both the mortgage and the cost to repair the building, which the insured's contractor estimated at $232,915.39, so the insured rejected the offer.

Six months after the loss, after foreclosure proceedings started and the city condemned the property, the insurer offered $69,874.62 as ACV. The insured rejected the offer and filed suit. The insurer then paid $86,000 in ACV in March of 2002, and

denied liability for RCV, arguing that the insured's recovery was limited to the ACV because the building had not been repaired or replaced.

The Court rejected this argument, explaining that because of the parties' disagreement over the ACV, the building was vacant for more than a year and the insured struggled to pay the mortgage. "By the time he received the actual cash value payment in March of 2002 he was behind on the mortgage payments and had no rental income. Pirtle had little choice but to use the funds to satisfy the mortgage at a loss to the mortgage holder, which left nothing to start the repairs." Noting that other courts chose to strictly construe similar policy provisions, the court held: "we are convinced that equitable principles win the day in this situation; otherwise, the repair or replacement endorsement paid for by Pirtle would be rendered illusory." Accordingly, the doctrine of prevention of performance excused the insured's obligation to repair or replace before full RCV was due. *See also McCahill v. Commercial Union Insurance Co*., 446 N.W. 2d 579, 585 (Mich. App. 1988)(insured was excused from condition precedent of completing repair because the insurer's actions hindered the insured); *Zaitchick v. American Motorists Insurance Co*. 554 F. Supp. 209, 217 (S.D.N.Y. 1982)(equitable considerations supported the decision to award replacement costs even though repair and replacement had not been completed because the insureds were paid nothing by the insurer and had no money to begin rebuilding.); *Ferguson v. Lakeland Mut. Ins. Co.*, 596 A.2d 883 (Pa. Super. 1991)(requirement of repair and replacement was unconscionable because insurance policies are contracts of adhesion and the replacement provision unreasonably favors the insurer. The policyholder was faced "with the unsavory choice of either accepting the lower actual cash value of the organ or expending a large sum of money in replacement costs without a guarantee of reimbursement.")

Buckley Towers demonstrates that in a large or complex loss a public adjuster alone may not be sufficient assistance. Buckley Towers retained a public adjuster who submitted the arguably ambiguous claim which the insurer chose to wrongly construe as a request for RCV benefits. Ultimately, the Court held that Buckley Towers did file a claim for ACV benefits, but the condominium received nothing from the insurer for five years after the loss and incurred the stress and expense of litigation. If Buckley Towers were a hotel rather than a condominium, it surely would be defunct. Had the condominium hired an attorney to deal directly with the insurer at the outset of the claim, the attorney might have been able to persuade the insurer that it benefited its financial interests to pay the ACV benefits owed rather than the ACV plus the costs and fees incurred in a breach of contract suit.

These cases also demonstrate problems that can occur in obtaining standard RCV benefits. Not only can the insurer's wrongful actions prevent the insured from receiving the full benefits owed (at least in the 11th Circuit), unless the policyholder receives assurance from the insurer that a certain sum in RCV benefits will be quickly paid, the policyholder may be unable to obtain the capital needed to finance the full repair. Many lenders and policyholders are unable or unwilling to begin a substantial repair project without an agreed amount of the RCV that the insurer will pay it when due. Policyholder advocates can be essential in negotiating and obtaining this assurance, persuading

unscrupulous insurers to provide the benefits they sold, and preparing a solid case for litigation if the insurer chooses to breach the contract and act in bad faith.

Issue 5: When Only Part of the Property is Damaged, Must the Insurer Replace All Like Property, Damaged and Not, to Restore Uniformity and Market Value?

Problems often arise when only part of a structure is damaged. If only part of a structure is to be repaired or replaced, can the repaired portion seamlessly blend with the undamaged structure or will the repairs be obvious and diminish the property's value? Although the language varies with each particular policy, commercial policies generally provide benefits to repair damaged property with materials of "like" or "similar" quality or construction. As the cases below demonstrate, this is usually a fact-driven question and the reasonableness of replacing an entire portion of the structure seems to be the overriding concern.

In *Eledge v. Farmers Mut. Home Ins. Co. of Hooper*, 571 N.W. 2d 105 (Neb. Ct. App. 1997), insured homeowners appealed the trial court's decision that to repair hail damage to a roof the insurer needed only to replace one portion of the roof. The roof leaked, causing damage to the interior of the house, and the homeowners contended that they were entitled to have the entire roof replaced. The policy at issue provided that the insurer would "*pay the cost to repair or replace, after application of deductible and without deduction for depreciation, using the replacement cost of that part of the building damaged for like construction and use on the same premises*." At trial, the parties presented expert testimony regarding the cost and effectiveness of replacing the entire roof or limiting repairs to the damaged shingles. The insured's expert testified that replacing the damaged shingles alone would not be adequate because the new shingles would be a different color than the old shingles and he would not be able to guarantee a proper seal. Notably, he did not testify that hail damage alone, and not normal wear and tear, caused the roof to leak. Further, the evidence presented indicated that the interior water damage was caused by a chimney leak and the generally poor condition of the roof, which had reached the end of its useful life. The Nebraska Court of Appeals rejected the insured's argument, holding: a "plain reading of the provision does not require the replacement of the whole when it is factually shown that the whole can be satisfactorily repaired by replacement of a part; so long as the building is returned to 'like construction and use' as a result." The court commented that it would be an unreasonable interpretation to require replacement of an entire roof where only "a single square [10 x 10 foot portion] of shingles is damaged and matching replacements can be found, and where the repair can be made without damage to the remainder of the roof."

In *Holloway v. Liberty Mut. Fire Ins. Co.*, 290 So. 2d 791 (La. Ct. App. 1st Cir. 1974), the Louisiana Court of Appeals affirmed a lower court judgment awarding insured homeowners the cost of replacing carpeting in the entire bedroom wing of their house after a leaking drain pipe caused water damage to the carpet in the master bedroom and adjacent hallway. The insured's interior decorator was qualified as an expert witness and testified that since the color and pattern of the damaged carpeting had been discontinued, it was impossible to replace the damaged carpeting without replacing all of the carpeting

in the bedroom wing of the house. Further, even if the same carpeting could be obtained, to replace only the damaged portions of the carpet, "would result in unsightly seams at the juncture point" and the contrast between the old and new carpeting would be readily apparent and would adversely affect the overall market value of the house. A realtor also testified that the market value of the house would diminish if the carpeting of the house's entire bedroom wing was not of the same texture and color.

Similarly, in *Mastin v. Sandy & Beaver Ins. Co.*, 461 N.E. 2d 332 (Ohio Misc. 2d 1983), the insured's plumbing under the kitchen floor was damaged. The insurer agreed the loss was covered but refused to pay for the replacement of the vinyl kitchen floor, which was damaged when a hole was cut into it to access the plumbing. The insurer argued it was obligated only to pay for a patch in the vinyl covering. The Ohio court rejected the insurer's argument, noting that vinyl covering can only be purchased in a roll. "[V]inyl flooring cannot be said to be repaired if an obvious patch is left, and that the whole floor ought to have been replaced."

As these cases demonstrate, the results are fact driven, so it is necessary to document the facts favorable to your case at the outset of the loss. Insurers usually frame arguments against full replacement on theories of unjust enrichment, but this is contrary to the terms and purpose of RCV benefits and the risk the insurer chooses to assume. ACV policies provide true indemnity; RCV policies, however, are different. As the Supreme Court of Washington succinctly explained:

> Historically, the underlying purpose of property insurance is indemnity. Traditional coverage was for the actual or fair cash value of the property. The owner was indemnified fully by payment of the fair cash value, in effect the market value, which is what the owner lost if the insured building was destroyed. ....However, it was recognized that an owner might not be made whole because of the increased cost to repair or to rebuild. Thus, replacement cost coverage became available. "***Replacement cost coverages ... go beyond the concept of indemnity and simply recognize that even expected deterioration of property is a risk which may be insured against***."[15]

The insureds in *Holloway* and *Mastin* got nothing more than they bargained for when their floors were replaced and not merely patched. The pre-loss condition of the floor in both cases was a uniform covering that maintained the value of the structures. Under the RCV policies, the insureds were entitled to that uniform covering. It was not unjust enrichment, but a risk the insurer chose to assume—likely at substantial cost to the insured.

On a similar note, many policies sold to businesses in the hospitality industry contain pair and set coverage, which generally provides that if business property is

[15] *Hess v. North Pacific Ins. Co.*, 859 P. 2d 586, 589 (Wash. 1993)(*internal citations omitted*).

damaged by a covered peril and the damaged property is part of a pair or set, the insurer can choose to pay the fair proportion of the pair or set's total value or the full value of the pair or set, provided the undamaged articles are given to the insurer for salvage. For example, if some of a hotel's furnishings are destroyed by a covered peril and the furnishings are no longer available, the policyholder is entitled to replace *all* the matching and coordinating furnishings in the hotel, subject to policy limits. Pair and set coverage takes special importance in the hospitality industry, where uniform furnishings and décor are essential to value of the business and are often custom made. As with the replacement coverage discussed above, insurer cries of windfall are insincere. It is the risk the insurer assumed, evidenced by the fact that most policies give the insurer the right to reduce its burden by salvaging the undamaged furnishings.

Recent Examples Which Demonstrate the Benefits of Retaining a Team of Professionals at the Outset of a Large or Complex Loss.

Unless one understands the nature of the insurance industry and the true benefits a team of professionals can provide to assist in the adjustment process, it can be difficult to justify the expense—especially in today's economy. Though the following examples concerned condominiums, the size and scope of the properties and coverage make the examples particularly relevant to hotels and resorts. Each shows that a small amount of professional preparation at the outset of a claim justify the time and expense.

Condominium 1

The property manager called Merlin Law Group *before* Hurricane Ivan hit. She received approval to retain a contractor before the storm devastated Destin. Financing was arranged, and construction started immediately on emergency repairs while the adjusters were contacted and kept informed of the plans for repair. The flood adjusters were arranged to be the same for the wind claim, so duplication was avoided.

The property manager fee was paid, in part, by the insurance company because she functioned as the "construction manager." Sandbagging costs before the storm were paid for as a mitigation expense. Housekeepers' salary for cleaning the rooms was reimbursed, as were overtime staff costs related to the hurricane.

Merlin Law Group immediately hired engineers to document the damages and provide a method of repair supported by the contractor. The insurance company's engineer was met by counsel and the contractor for an inspection, and the engineer approved all the proposed repair construction.

Condominium 2

The property manager was on site for less than a month when Frances, the first of two Hurricanes, hit this West Palm Beach Condominium. Residents remained inside units and some had to be rescued after windows and doors were blown open during the middle of the storm.

Debris was discarded into a dumpster without photographs and before the adjuster had a chance to see it. There was a shortage of air blowers, so the emergency crew hired after the storm had to find another less efficient way to dry out the building.

An out of state public adjusting firm was hired to determine the damage. No construction firm was hired to do the repairs. The property manger walked with the adjuster and indicated that the damage might not exceed the deductible. All carpeting was thrown out under the assumption that the insurance company would pay for it, damaged or not.

The property manager hired a company to tear out "damaged" drywall without consulting the insurance company for approval for the work. The owners had to move out during this process. They never moved back in because the insurer did not pay, contending that the removal was largely unnecessary.

The condominium association hired a friendly local attorney who had never represented a policyholder on such a large loss. The attorney never consulted with the public insurance adjuster.

Litigation ensued, but the local attorney never took a deposition after filing the lawsuit. The Association was on the brink of bankruptcy before eventually hiring experienced insurance counsel.

Condominium 3

This was the tallest Florida condominium north of Ft. Lauderdale. Hurricanes Frances and Jeanne ripped the outside walls. The structure sustained a significant amount of water damage, and the building was condemned from occupancy.

The insurer approved the repair process. Unfortunately, the insurer never indicated to the condominium association or its public insurance adjuster that when the policy limit was reached, it would not extend two policy limits even though two different hurricanes caused the damage. Construction came to a standstill as litigation started.

Merlin Law Group was retained on a contingency fee basis. The problem was two fold. First, the building was severely underinsured. Second, a Florida appellate opinion seemingly supported the insurer's legal position. The condominium association needed to win quickly to avoid the possibility of bankruptcy.

Merlin Law Group approached the litigation aggressively, requesting the court to expedite the matter to trial within a year. Insurance law experts and professors were retained to distinguish the condominium's policy form from the one unfavorably treated by prior Florida courts. Finally, insurance counsel hired a lobbyist and publicist to pressure the insurer's management to reconsider its position. The result was an approximate $40 million settlement seven months after suit was filed.

Conclusion

In the end, like everything in business, the decision to hire a team of professionals to see a business through a catastrophe is a cost/benefit analysis. When business is interrupted, customers are forced to go elsewhere, and there is always the chance that they will not return. The key to a full recovery is maximizing the benefits as quickly as possible before disputes arise and customers turn elsewhere. In this, a team of professional policyholder advocates can be essential.

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William F. "Chip" Merlin, Jr. represents policyholders. His practice focuses on insurance claim presentation and benefit recovery, insurance coverage, bad faith and wrongful claims conduct litigation. He is a Board Certified Civil Trial Lawyer and currently holds Bar certifications in Florida, Mississippi, Texas, Tennessee, and the District of Columbia.

A graduate of the University of Florida, School of Law in 1982 where he served as Executive Editor of the Law Review and on the Moot Court, he became a member of the Florida Bar in 1983. He briefly represented insurance companies in coverage litigation and since 1985 has dedicated his career to seeking justice for insurance policyholders in claim presentation and disputes with their insurance companies.

Mr. Merlin is the founder and President of the Merlin Law Group. The nineteen-attorney firm also limits its practice to the representation of policyholders. It maintains offices in Houston, TX, Coral Gables and West Palm Beach, FL, and its home office is in Tampa, FL. The firm represents

commercial, governmental, residential and private policyholders throughout the Gulf Region and as co-counsel nationwide.

Mr. Merlin was named a finalist and then received an Honorable Mention in the LexisNexis Insurance Law Center Person of the Year 2008 -Policyholder Attorney of the Year. He is routinely invited to be a featured speaker on insurance law at some of the nation's most prestigious conferences and seminars. He has addressed his peers at the American Bar Association, the American Association for Justice, and the Florida Justice Association. He has also presented before members of such organizations as the National Association of Public Insurance Adjusters (NAPIA), the Florida Association of Public Insurance Adjusters (FAPIA), the Community Associations Institute, and the Windstorm Network.

Because of the breadth and depth of his knowledge and experience, Mr. Merlin is frequently sought to provide comment and insight into current legal issues on the stage of the national media. He has appeared on Fox News, ABC News, CNN, and MSNBC on topics as diverse as freedom of speech, employee's and property owners' rights to privacy and slander and emotional distress.

Mr. Merlin has shared his wealth of knowledge of insurance law via articles he either authored or co-authored. Some of the titles include: Hurricane Coverage and Litigation Issues; Florida's New Valued Policy Law and the Question of Concurrent Causation; Rules of the Road – A Different Methodology For Proving Duty and Breach; Ten Things a Florida Public Adjuster Can Do to Raise Professionalism and Be More Successful; Disaster Preparedness: A Call to Action, Establishing the Right Trial Theme for Your Bad Faith Case. He contributes daily to discussion of property insurance law on his blog, propertyinsurancecoveragelaw.com.

Mr. Merlin's reputation for judiciously seeking fair and just treatment of those who put their faith in their insurance providers recently earned him a governor-appointed seat on Florida's Citizen's Property Insurance Corporation Mission Review Task Force.

Some of Mr. Merlin's other honors and peer recognition include:

- AV Rated by Martindale-Hubbell
- Best Lawyers in America
- Corporate Counsel's Best Lawyers in Insurance Law
- Florida Trend Magazine: Florida's Legal Elite
- Florida's SuperLawyers
- 2007 National Association of Public Insurance Adjusters Co-Person of the Year
- Outstanding Amicus Brief of the Year, United Policyholders,
- Eagle Talon Award, The Florida Justice Association (for upholding the highest ideals of Florida Trial Lawyers)

Berkshire's Corporate Performance vs. the S&P 500

	Annual Percentage Change		
Year	in Per-Share Book Value of Berkshire (1)	in S&P 500 with Dividends Included (2)	Relative Results (1)-(2)
1965	23.8	10.0	13.8
1966	20.3	(11.7)	32.0
1967	11.0	30.9	(19.9)
1968	19.0	11.0	8.0
1969	16.2	(8.4)	24.6
1970	12.0	3.9	8.1
1971	16.4	14.6	1.8
1972	21.7	18.9	2.8
1973	4.7	(14.8)	19.5
1974	5.5	(26.4)	31.9
1975	21.9	37.2	(15.3)
1976	59.3	23.6	35.7
1977	31.9	(7.4)	39.3
1978	24.0	6.4	17.6
1979	35.7	18.2	17.5
1980	19.3	32.3	(13.0)
1981	31.4	(5.0)	36.4
1982	40.0	21.4	18.6
1983	32.3	22.4	9.9
1984	13.6	6.1	7.5
1985	48.2	31.6	16.6
1986	26.1	18.6	7.5
1987	19.5	5.1	14.4
1988	20.1	16.6	3.5
1989	44.4	31.7	12.7
1990	7.4	(3.1)	10.5
1991	39.6	30.5	9.1
1992	20.3	7.6	12.7
1993	14.3	10.1	4.2
1994	13.9	1.3	12.6
1995	43.1	37.6	5.5
1996	31.8	23.0	8.8
1997	34.1	33.4	.7
1998	48.3	28.6	19.7
1999	.5	21.0	(20.5)
2000	6.5	(9.1)	15.6
2001	(6.2)	(11.9)	5.7
2002	10.0	(22.1)	32.1
2003	21.0	28.7	(7.7)
2004	10.5	10.9	(.4)
2005	6.4	4.9	1.5
2006	18.4	15.8	2.6
2007	11.0	5.5	5.5
2008	(9.6)	(37.0)	27.4
2009	19.8	26.5	(6.7)
Compounded Annual Gain – 1965-2009	20.3%	9.3%	11.0
Overall Gain – 1964-2009	434,057%	5,430%	

Notes: Data are for calendar years with these exceptions: 1965 and 1966, year ended 9/30; 1967, 15 months ended 12/31.

Starting in 1979, accounting rules required insurance companies to value the equity securities they hold at market rather than at the lower of cost or market, which was previously the requirement. In this table, Berkshire's results through 1978 have been restated to conform to the changed rules. In all other respects, the results are calculated using the numbers originally reported.

The S&P 500 numbers are **pre-tax** whereas the Berkshire numbers are **after-tax**. If a corporation such as Berkshire were simply to have owned the S&P 500 and accrued the appropriate taxes, its results would have lagged the S&P 500 in years when that index showed a positive return, but would have exceeded the S&P 500 in years when the index showed a negative return. Over the years, the tax costs would have caused the aggregate lag to be substantial.

BERKSHIRE HATHAWAY INC.

To the Shareholders of Berkshire Hathaway Inc.:

Our gain in net worth during 2009 was $21.8 billion, which increased the per-share book value of both our Class A and Class B stock by 19.8%. Over the last 45 years (that is, since present management took over) book value has grown from $19 to $84,487, a rate of 20.3% compounded annually.*

Berkshire's recent acquisition of Burlington Northern Santa Fe (BNSF) has added at least 65,000 shareholders to the 500,000 or so already on our books. It's important to Charlie Munger, my long-time partner, and me that *all* of our owners understand Berkshire's operations, goals, limitations and culture. In each annual report, consequently, we restate the economic principles that guide us. This year these principles appear on pages 89-94 and I urge all of you – but particularly our new shareholders – to read them. Berkshire has adhered to these principles for decades and will continue to do so long after I'm gone.

In this letter we will also review some of the basics of our business, hoping to provide both a freshman orientation session for our BNSF newcomers and a refresher course for Berkshire veterans.

How We Measure Ourselves

Our metrics for evaluating our managerial performance are displayed on the facing page. From the start, Charlie and I have believed in having a rational and unbending standard for measuring what we have – or have not – accomplished. That keeps us from the temptation of seeing where the arrow of performance lands and *then* painting the bull's eye around it.

Selecting the S&P 500 as our bogey was an easy choice because our shareholders, at virtually no cost, can match its performance by holding an index fund. Why should they pay us for merely duplicating that result?

A more difficult decision for us was how to measure the progress of Berkshire versus the S&P. There are good arguments for simply using the change in our stock price. Over an extended period of time, in fact, that is the best test. But year-to-year market prices can be extraordinarily erratic. Even evaluations covering as long as a decade can be greatly distorted by foolishly high or low prices at the beginning or end of the measurement period. Steve Ballmer, of Microsoft, and Jeff Immelt, of GE, can tell you about that problem, suffering as they do from the nosebleed prices at which their stocks traded when they were handed the managerial baton.

The ideal standard for measuring our yearly progress would be the change in Berkshire's per-share intrinsic value. Alas, that value cannot be calculated with anything close to precision, so we instead use a crude proxy for it: per-share book value. Relying on this yardstick has its shortcomings, which we discuss on pages 92 and 93. Additionally, book value at most companies understates intrinsic value, and that is certainly the case at Berkshire. In aggregate, our businesses are worth considerably more than the values at which they are carried on our books. In our all-important insurance business, moreover, the difference is huge. Even so, Charlie and I believe that our book value – understated though it is – supplies the most useful tracking device for changes in intrinsic value. By this measurement, as the opening paragraph of this letter states, our book value since the start of fiscal 1965 has grown at a rate of 20.3% compounded annually.

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*All per-share figures used in this report apply to Berkshire's A shares. Figures for the B shares are 1/1500th of those shown for A.

We should note that had we instead chosen *market prices* as our yardstick, Berkshire's results would look better, showing a gain since the start of fiscal 1965 of 22% compounded annually. Surprisingly, this modest difference in annual compounding rate leads to an 801,516% market-value gain for the entire 45-year period compared to the book-value gain of 434,057% (shown on page 2). Our market gain is better because in 1965 Berkshire shares sold at an appropriate discount to the book value of its underearning textile assets, whereas today Berkshire shares regularly sell at a premium to the accounting values of its first-class businesses.

Summed up, the table on page 2 conveys three messages, two positive and one hugely negative. First, we have never had *any* five-year period beginning with 1965-69 and ending with 2005-09 – and there have been 41 of these – during which our gain in book value did not exceed the S&P's gain. Second, though we have lagged the S&P in some years that were positive for the market, we have consistently done better than the S&P in the eleven years during which it delivered negative results. In other words, our defense has been better than our offense, and that's likely to continue.

The big minus is that our performance advantage has shrunk dramatically as our size has grown, an unpleasant trend that is *certain* to continue. To be sure, Berkshire has many outstanding businesses and a cadre of truly great managers, operating within an unusual corporate culture that lets them maximize their talents. Charlie and I believe these factors will continue to produce better-than-average results over time. But huge sums forge their own anchor and our future advantage, if any, will be a small fraction of our historical edge.

What We Don't Do

Long ago, Charlie laid out his strongest ambition: "All I want to know is where I'm going to die, so I'll never go there." That bit of wisdom was inspired by Jacobi, the great Prussian mathematician, who counseled "Invert, always invert" as an aid to solving difficult problems. (I can report as well that this inversion approach works on a less lofty level: Sing a country song in reverse, and you will quickly recover your car, house and wife.)

Here are a few examples of how we apply Charlie's thinking at Berkshire:

- Charlie and I avoid businesses whose futures we can't evaluate, no matter how exciting their products may be. In the past, it required no brilliance for people to foresee the fabulous growth that awaited such industries as autos (in 1910), aircraft (in 1930) and television sets (in 1950). But the future then also included competitive dynamics that would decimate almost all of the companies entering those industries. Even the survivors tended to come away bleeding.

  Just because Charlie and I can clearly see dramatic growth ahead for an industry does not mean we can judge what its profit margins and returns on capital will be as a host of competitors battle for supremacy. At Berkshire we will stick with businesses whose profit picture for decades to come seems reasonably predictable. Even then, we will make plenty of mistakes.

- We will never become dependent on the kindness of strangers. Too-big-to-fail is not a fallback position at Berkshire. Instead, we will always arrange our affairs so that any requirements for cash we may conceivably have will be dwarfed by our own liquidity. Moreover, that liquidity will be constantly refreshed by a gusher of earnings from our many and diverse businesses.

  When the financial system went into cardiac arrest in September 2008, Berkshire was a *supplier* of liquidity and capital to the system, not a supplicant. At the very peak of the crisis, we poured $15.5 billion into a business world that could otherwise look only to the federal government for help. Of that, $9 billion went to bolster capital at three highly-regarded and previously-secure American businesses that needed – *without delay* – our tangible vote of confidence. The remaining $6.5 billion satisfied our commitment to help fund the purchase of Wrigley, a deal that was completed without pause while, elsewhere, panic reigned.

We pay a steep price to maintain our premier financial strength. The $20 billion-plus of cash-equivalent assets that we customarily hold is earning a pittance at present. But we sleep well.

- We tend to let our many subsidiaries operate on their own, without our supervising and monitoring them to any degree. That means we are sometimes late in spotting management problems and that both operating and capital decisions are occasionally made with which Charlie and I would have disagreed had we been consulted. Most of our managers, however, use the independence we grant them magnificently, rewarding our confidence by maintaining an owner-oriented attitude that is invaluable and too seldom found in huge organizations. We would rather suffer the visible costs of a few bad decisions than incur the many invisible costs that come from decisions made too slowly – or not at all – because of a stifling bureaucracy.

  With our acquisition of BNSF, we now have about 257,000 employees and literally hundreds of different operating units. We hope to have many more of each. But we will never allow Berkshire to become some monolith that is overrun with committees, budget presentations and multiple layers of management. Instead, we plan to operate as a collection of separately-managed medium-sized and large businesses, most of whose decision-making occurs at the operating level. Charlie and I will limit ourselves to allocating capital, controlling enterprise risk, choosing managers and setting their compensation.

- We make no attempt to woo Wall Street. Investors who buy and sell based upon media or analyst commentary are not for us. Instead we want *partners* who join us at Berkshire because they wish to make a long-term investment in a *business* they themselves understand and because it's one that follows policies with which they concur. If Charlie and I were to go into a small venture with a few partners, we would seek individuals in sync with us, knowing that common goals and a shared destiny make for a happy business "marriage" between owners and managers. Scaling up to giant size doesn't change that truth.

  To build a compatible shareholder population, we try to communicate with our owners directly and informatively. Our goal is to tell you what we would like to know if our positions were reversed. Additionally, we try to post our quarterly and annual financial information on the Internet early on weekends, thereby giving you and other investors plenty of time during a non-trading period to digest just what has happened at our multi-faceted enterprise. (Occasionally, SEC deadlines force a non-Friday disclosure.) These matters simply can't be adequately summarized in a few paragraphs, nor do they lend themselves to the kind of catchy headline that journalists sometimes seek.

  Last year we saw, in one instance, how sound-bite reporting can go wrong. Among the 12,830 words in the annual letter was this sentence: "We are certain, for example, that the economy will be in shambles throughout 2009 – and probably well beyond – but that conclusion does not tell us whether the market will rise or fall." Many news organizations reported – indeed, blared – the first part of the sentence while making no mention whatsoever of its ending. I regard this as terrible journalism: Misinformed readers or viewers may well have thought that Charlie and I were forecasting bad things for the stock market, though we had not only in that sentence, but also elsewhere, made it clear we weren't predicting the market at all. Any investors who were misled by the sensationalists paid a big price: The Dow closed the day of the letter at 7,063 and finished the year at 10,428.

  Given a few experiences we've had like that, you can understand why I prefer that our communications with you remain as direct and unabridged as possible.

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Let's move to the specifics of Berkshire's operations. We have four major operating sectors, each differing from the others in balance sheet and income account characteristics. Therefore, lumping them together, as is standard in financial statements, impedes analysis. So we'll present them as four separate businesses, which is how Charlie and I view them.

Insurance

Our property-casualty (P/C) insurance business has been the engine behind Berkshire's growth and will continue to be. It has worked wonders for us. We carry our P/C companies on our books at $15.5 billion more than their net tangible assets, an amount lodged in our "Goodwill" account. These companies, however, are worth *far* more than their carrying value – and the following look at the economic model of the P/C industry will tell you why.

Insurers receive premiums upfront and pay claims later. In extreme cases, such as those arising from certain workers' compensation accidents, payments can stretch over decades. This collect-now, pay-later model leaves us holding large sums – money we call "float" – that will eventually go to others. Meanwhile, we get to invest this float for Berkshire's benefit. Though individual policies and claims come and go, the amount of float we hold remains remarkably stable in relation to premium volume. Consequently, as our business grows, so does our float.

If premiums exceed the total of expenses and eventual losses, we register an underwriting profit that adds to the investment income produced from the float. This combination allows us to enjoy the use of free money – and, better yet, get *paid* for holding it. Alas, the hope of this happy result attracts intense competition, so vigorous in most years as to cause the P/C industry as a whole to operate at a significant underwriting *loss*. This loss, in effect, is what the industry pays to hold its float. Usually this cost is fairly low, but in some catastrophe-ridden years the cost from underwriting losses more than eats up the income derived from use of float.

In my perhaps biased view, Berkshire has the best large insurance operation in the world. And I will absolutely state that we have the best managers. Our float has grown from $16 million in 1967, when we entered the business, to $62 billion at the end of 2009. Moreover, we have now operated at an underwriting profit for seven consecutive years. I believe it likely that we will continue to underwrite profitably in most – though certainly not all – future years. If we do so, our float will be cost-free, much as if someone deposited $62 billion with us that we could invest for our own benefit without the payment of interest.

Let me emphasize again that cost-free float is *not* a result to be expected for the P/C industry as a whole: In most years, premiums have been inadequate to cover claims plus expenses. Consequently, the industry's overall return on tangible equity has for many decades fallen far short of that achieved by the S&P 500. Outstanding economics exist at Berkshire only because we have some outstanding managers running some unusual businesses. Our insurance CEOs deserve your thanks, having added many billions of dollars to Berkshire's value. It's a pleasure for me to tell you about these all-stars.

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Let's start at GEICO, which is known to all of you because of its $800 million annual advertising budget (close to twice that of the runner-up advertiser in the auto insurance field). GEICO is managed by Tony Nicely, who joined the company at 18. Now 66, Tony still tap-dances to the office every day, just as I do at 79. We both feel lucky to work at a business we love.

GEICO's customers have warm feelings toward the company as well. Here's proof: Since Berkshire acquired control of GEICO in 1996, its market share has increased from 2.5% to 8.1%, a gain reflecting the net addition of seven million policyholders. Perhaps they contacted us because they thought our gecko was cute, but they bought from us to save important money. (Maybe you can as well; call 1-800-847-7536 or go to www.GEICO.com.) And they've stayed with us because they like our service as well as our price.

Berkshire acquired GEICO in two stages. In 1976-80 we bought about one-third of the company's stock for $47 million. Over the years, large repurchases by the company of its own shares caused our position to grow to about 50% without our having bought any more shares. Then, on January 2, 1996, we acquired the remaining 50% of GEICO for $2.3 *billion* in cash, about 50 times the cost of our original purchase.

An old Wall Street joke gets close to our experience:

Customer: Thanks for putting me in XYZ stock at 5. I hear it's up to 18.

Broker: Yes, and that's just the beginning. In fact, the company is doing so well now, that it's an even better buy at 18 than it was when you made your purchase.

Customer: Damn, I knew I should have waited.

GEICO's growth may slow in 2010. U.S. vehicle registrations are actually down because of slumping auto sales. Moreover, high unemployment is causing a growing number of drivers to go uninsured. (That's illegal almost everywhere, but if you've lost your job and still want to drive . . .) Our "low-cost producer" status, however, is sure to give us significant gains in the future. In 1995, GEICO was the country's sixth largest auto insurer; now we are number three. The company's float has grown from $2.7 billion to $9.6 billion. Equally important, GEICO has operated at an underwriting profit in 13 of the 14 years Berkshire has owned it.

I became excited about GEICO in January 1951, when I first visited the company as a 20-year-old student. Thanks to Tony, I'm even more excited today.

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A hugely important event in Berkshire's history occurred on a Saturday in 1985. Ajit Jain came into our office in Omaha – and I immediately knew we had found a superstar. (He had been discovered by Mike Goldberg, now elevated to St. Mike.)

We immediately put Ajit in charge of National Indemnity's small and struggling reinsurance operation. Over the years, he has built this business into a one-of-a-kind giant in the insurance world.

Staffed today by only 30 people, Ajit's operation has set records for transaction size in several areas of insurance. Ajit writes billion-dollar limits – and then keeps every dime of the risk instead of laying it off with other insurers. Three years ago, he took over huge liabilities from Lloyds, allowing it to clean up its relationship with 27,972 participants ("names") who had written problem-ridden policies that at one point threatened the survival of this 322-year-old institution. The premium for that single contract was $7.1 billion. During 2009, he negotiated a life reinsurance contract that could produce $50 billion of premium for us over the next 50 or so years.

Ajit's business is just the opposite of GEICO's. At that company, we have millions of small policies that largely renew year after year. Ajit writes relatively few policies, and the mix changes significantly from year to year. Throughout the world, he is known as the man to call when something both very large and unusual needs to be insured.

If Charlie, I and Ajit are ever in a sinking boat – and you can only save one of us – swim to Ajit.

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Our third insurance powerhouse is General Re. Some years back this operation was troubled; now it is a gleaming jewel in our insurance crown.

Under the leadership of Tad Montross, General Re had an outstanding underwriting year in 2009, while also delivering us unusually large amounts of float per dollar of premium volume. Alongside General Re's P/C business, Tad and his associates have developed a major life reinsurance operation that has grown increasingly valuable.

Last year General Re finally attained 100% ownership of Cologne Re, which since 1995 has been a key – though only partially-owned – part of our presence around the world. Tad and I will be visiting Cologne in September to thank its managers for their important contribution to Berkshire.

Finally, we own a group of smaller companies, most of them specializing in odd corners of the insurance world. In aggregate, their results have consistently been profitable and, as the table below shows, the float they provide us is substantial. Charlie and I treasure these companies and their managers.

Here is the record of all four segments of our property-casualty and life insurance businesses:

	Underwriting Profit		*Yearend Float*	
	(in millions)			
Insurance Operations	*2009*	*2008*	*2009*	*2008*
General Re	$ 477	$ 342	$21,014	$21,074
BH Reinsurance	349	1,324	26,223	24,221
GEICO	649	916	9,613	8,454
Other Primary	84	210	5,061	4,739
	$1,559	$2,792	$61,911	$58,488

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And now a painful **c**onfession: Last year your chairman closed the book on a very expensive business fiasco entirely of his own making.

For many years I had struggled to think of side products that we could offer our millions of loyal GEICO customers. Unfortunately, I finally succeeded, coming up with a brilliant insight that we should market our own credit card. I reasoned that GEICO policyholders were likely to be good credit risks and, assuming we offered an attractive card, would likely favor us with their business. We got business all right – but of the wrong type.

Our pre-tax losses from credit-card operations came to about $6.3 million before I finally woke up. We then sold our $98 million portfolio of troubled receivables for 55¢ on the dollar, losing an additional $44 million.

GEICO's managers, it should be emphasized, were never enthusiastic about my idea. They warned me that instead of getting the cream of GEICO's customers we would get the – – – – – well, let's call it the non-cream. I subtly indicated that I was older and wiser.

I was just older.

Regulated Utility Business

Berkshire has an 89.5% interest in MidAmerican Energy Holdings, which owns a wide variety of utility operations. The largest of these are (1) Yorkshire Electricity and Northern Electric, whose 3.8 million end users make it the U.K.'s third largest distributor of electricity; (2) MidAmerican Energy, which serves 725,000 electric customers, primarily in Iowa; (3) Pacific Power and Rocky Mountain Power, serving about 1.7 million electric customers in six western states; and (4) Kern River and Northern Natural pipelines, which carry about 8% of the natural gas consumed in the U.S.

MidAmerican has two terrific managers, Dave Sokol and Greg Abel. In addition, my long-time friend, Walter Scott, along with his family, has a major ownership position in the company. Walter brings extraordinary business savvy to *any* operation. Ten years of working with Dave, Greg and Walter have reinforced my original belief: Berkshire couldn't have better partners. They are truly a dream team.

Somewhat incongruously, MidAmerican also owns the second largest real estate brokerage firm in the U.S., HomeServices of America. This company operates through 21 locally-branded firms that have 16,000 agents. Though last year was again a terrible year for home sales, HomeServices earned a modest sum. It also acquired a firm in Chicago and will add other quality brokerage operations when they are available at sensible prices. A decade from now, HomeServices is likely to be much larger.

Here are some key figures on MidAmerican's operations:

	Earnings (in millions)	
	2009	*2008*
U.K. utilities	$ 248	$ 339
Iowa utility	285	425
Western utilities	788	703
Pipelines	457	595
HomeServices	43	(45)
Other (net)	25	186
Operating earnings before corporate interest and taxes	1,846	2,203
Constellation Energy *	—	1,092
Interest, other than to Berkshire	(318)	(332)
Interest on Berkshire junior debt	(58)	(111)
Income tax	(313)	(1,002)
Net earnings	$ 1,157	$ 1,850
Earnings applicable to Berkshire **	$ 1,071	$ 1,704
Debt owed to others	19,579	19,145
Debt owed to Berkshire	353	1,087

*Consists of a breakup fee of $175 million and a profit on our investment of $917 million.
**Includes interest earned by Berkshire (net of related income taxes) of $38 in 2009 and $72 in 2008.

Our regulated electric utilities, offering monopoly service in most cases, operate in a symbiotic manner with the customers in their service areas, with those users depending on us to provide first-class service and invest for their future needs. Permitting and construction periods for generation and major transmission facilities stretch way out, so it is incumbent on us to be far-sighted. We, in turn, look to our utilities' regulators (acting on behalf of our customers) to allow us an appropriate return on the huge amounts of capital we must deploy to meet future needs. We shouldn't expect our regulators to live up to their end of the bargain unless we live up to ours.

Dave and Greg make sure we do just that. National research companies consistently rank our Iowa and Western utilities at or near the top of their industry. Similarly, among the 43 U.S. pipelines ranked by a firm named Mastio, our Kern River and Northern Natural properties tied for second place.

Moreover, we continue to pour huge sums of money into our operations so as to not only prepare for the future but also make these operations more environmentally friendly. Since we purchased MidAmerican ten years ago, it has *never* paid a dividend. We have instead used earnings to improve and expand our properties in each of the territories we serve. As one dramatic example, in the last three years our Iowa and Western utilities have earned $2.5 billion, while in this same period spending $3 billion on wind generation facilities.

MidAmerican has consistently kept its end of the bargain with society and, to society's credit, it has reciprocated: With few exceptions, our regulators have promptly allowed us to earn a fair return on the ever-increasing sums of capital we must invest. Going forward, we will do whatever it takes to serve our territories in the manner they expect. We believe that, in turn, we will be allowed the return we deserve on the funds we invest.

In earlier days, Charlie and I shunned capital-intensive businesses such as public utilities. Indeed, the best businesses by far for owners continue to be those that have high returns on capital and that require little incremental investment to grow. We are fortunate to own a number of such businesses, and we would love to buy more. Anticipating, however, that Berkshire will generate ever-increasing amounts of cash, we are today quite willing to enter businesses that regularly require large capital expenditures. We expect only that these businesses have reasonable expectations of earning decent returns on the incremental sums they invest. If our expectations are met – and we believe that they will be – Berkshire's ever-growing collection of good to great businesses should produce above-average, though certainly not spectacular, returns in the decades ahead.

Our BNSF operation, it should be noted, has certain important economic characteristics that resemble those of our electric utilities. In both cases we provide fundamental services that are, and will remain, essential to the economic well-being of our customers, the communities we serve, and indeed the nation. Both will require heavy investment that greatly exceeds depreciation allowances for decades to come. Both must also plan far ahead to satisfy demand that is expected to outstrip the needs of the past. Finally, both require wise regulators who will provide certainty about allowable returns so that we can confidently make the huge investments required to maintain, replace and expand the plant.

We see a "social compact" existing between the public and our railroad business, just as is the case with our utilities. If either side shirks its obligations, both sides will inevitably suffer. Therefore, both parties to the compact should – and we believe will – understand the benefit of behaving in a way that encourages good behavior by the other. It is inconceivable that our country will realize anything close to its full economic potential without its possessing first-class electricity and railroad systems. We will do our part to see that they exist.

In the future, BNSF results will be included in this "regulated utility" section. Aside from the two businesses having similar underlying economic characteristics, both are logical users of substantial amounts of debt that is *not* guaranteed by Berkshire. Both will retain most of their earnings. Both will earn and invest large sums in good times or bad, though the railroad will display the greater cyclicality. Overall, we expect this regulated sector to deliver significantly increased earnings over time, albeit at the cost of our investing many tens – yes, tens – of billions of dollars of incremental equity capital.

Manufacturing, Service and Retailing Operations

Our activities in this part of Berkshire cover the waterfront. Let's look, though, at a summary balance sheet and earnings statement for the entire group.

Balance Sheet 12/31/09 (in millions)

Assets		*Liabilities and Equity*	
Cash and equivalents	$ 3,018	Notes payable	$ 1,842
Accounts and notes receivable	5,066	Other current liabilities	7,414
Inventory	6,147	Total current liabilities	9,256
Other current assets	625		
Total current assets	14,856		
Goodwill and other intangibles	16,499	Deferred taxes	2,834
Fixed assets	15,374	Term debt and other liabilities	6,240
Other assets	2,070	Equity	30,469
	$48,799		$48,799

Earnings Statement (in millions)

	2009	*2008*	*2007*
Revenues	$61,665	$66,099	$59,100
Operating expenses (including depreciation of $1,422 in 2009, $1,280 in 2008 and $955 in 2007)	59,509	61,937	55,026
Interest expense	98	139	127
Pre-tax earnings	2,058*	4,023*	3,947*
Income taxes and minority interests	945	1,740	1,594
Net income	$ 1,113	$ 2,283	$ 2,353

*Does not include purchase-accounting adjustments.

Almost all of the many and widely-diverse operations in this sector suffered to one degree or another from 2009's severe recession. The major exception was McLane, our distributor of groceries, confections and non-food items to thousands of retail outlets, the largest by far Wal-Mart.

Grady Rosier led McLane to record pre-tax earnings of $344 million, which even so amounted to only slightly more than one cent per dollar on its huge sales of $31.2 billion. McLane employs a vast array of physical assets – practically all of which it owns – including 3,242 trailers, 2,309 tractors and 55 distribution centers with 15.2 million square feet of space. McLane's prime asset, however, is Grady.

We had a number of companies at which profits improved even as sales contracted, always an exceptional managerial achievement. Here are the CEOs who made it happen:

COMPANY	*CEO*
Benjamin Moore (paint)	Denis Abrams
Borsheims (jewelry retailing)	Susan Jacques
H. H. Brown (manufacturing and retailing of shoes)	Jim Issler
CTB (agricultural equipment)	Vic Mancinelli
Dairy Queen	John Gainor
Nebraska Furniture Mart (furniture retailing)	Ron and Irv Blumkin
Pampered Chef (direct sales of kitchen tools)	Marla Gottschalk
See's (manufacturing and retailing of candy)	Brad Kinstler
Star Furniture (furniture retailing)	Bill Kimbrell

Among the businesses we own that have major exposure to the depressed industrial sector, both Marmon and Iscar turned in relatively strong performances. Frank Ptak's Marmon delivered a 13.5% pre-tax profit margin, a record high. Though the company's sales were down 27%, Frank's cost-conscious management mitigated the decline in earnings.

Nothing stops Israel-based Iscar – not wars, recessions or competitors. The world's two other leading suppliers of small cutting tools both had very difficult years, each operating at a loss throughout much of the year. Though Iscar's results were down significantly from 2008, the company regularly reported profits, even while it was integrating and rationalizing Tungaloy, the large Japanese acquisition that we told you about last year. When manufacturing rebounds, Iscar will set new records. Its incredible managerial team of Eitan Wertheimer, Jacob Harpaz and Danny Goldman will see to that.

Every business we own that is connected to residential and commercial construction suffered severely in 2009. Combined pre-tax earnings of Shaw, Johns Manville, Acme Brick, and MiTek were $227 million, an 82.5% decline from $1.295 billion in 2006, when construction activity was booming. These businesses continue to bump along the bottom, though their competitive positions remain undented.

The major problem for Berkshire last year was NetJets, an aviation operation that offers fractional ownership of jets. Over the years, it has been enormously successful in establishing itself as the premier company in its industry, with the value of its fleet far exceeding that of its three major competitors *combined*. Overall, our dominance in the field remains unchallenged.

NetJets' business operation, however, has been another story. In the eleven years that we have owned the company, it has recorded an aggregate pre-tax loss of $157 million. Moreover, the company's debt has soared from $102 million at the time of purchase to $1.9 billion in April of last year. Without Berkshire's guarantee of this debt, NetJets would have been out of business. It's clear that I failed you in letting NetJets descend into this condition. But, luckily, I have been bailed out.

Dave Sokol, the enormously talented builder and operator of MidAmerican Energy, became CEO of NetJets in August. His leadership has been transforming: Debt has already been reduced to $1.4 billion, and, after suffering a staggering loss of $711 million in 2009, the company is now solidly profitable.

Most important, none of the changes wrought by Dave have in any way undercut the top-of-the-line standards for safety and service that Rich Santulli, NetJets' previous CEO and the father of the fractional-ownership industry, insisted upon. Dave and I have the strongest possible personal interest in maintaining these standards because we and our families use NetJets for almost all of our flying, as do many of our directors and managers. None of us are assigned special planes nor crews. We receive exactly the same treatment as any other owner, meaning we pay the same prices as everyone else does when we are using our personal contracts. In short, we eat our own cooking. In the aviation business, no other testimonial means more.

Finance and Financial Products

Our largest operation in this sector is Clayton Homes, the country's leading producer of modular and manufactured homes. Clayton was not always number one: A decade ago the three leading manufacturers were Fleetwood, Champion and Oakwood, which together accounted for 44% of the output of the industry. All have since gone bankrupt. Total industry output, meanwhile, has fallen from 382,000 units in 1999 to 60,000 units in 2009.

The industry is in shambles for two reasons, the first of which must be lived with if the U.S. economy is to recover. This reason concerns U.S. housing starts (including apartment units). In 2009, starts were 554,000, by far the lowest number in the 50 years for which we have data. Paradoxically, this is *good* news.

People *thought* it was good news a few years back when housing starts – the supply side of the picture – were running about two million annually. But household formations – the demand side – only amounted to about 1.2 million. After a few years of such imbalances, the country unsurprisingly ended up with far too many houses.

There were three ways to cure this overhang: (1) blow up a lot of houses, a tactic similar to the destruction of autos that occurred with the "cash-for-clunkers" program; (2) speed up household formations by, say, encouraging teenagers to cohabitate, a program not likely to suffer from a lack of volunteers or; (3) reduce new housing starts to a number far below the rate of household formations.

Our country has wisely selected the third option, which means that within a year or so residential housing problems should largely be behind us, the exceptions being only high-value houses and those in certain localities where overbuilding was particularly egregious. Prices will remain far below "bubble" levels, of course, but for every seller (or lender) hurt by this there will be a buyer who benefits. Indeed, many families that couldn't afford to buy an appropriate home a few years ago now find it well within their means because the bubble burst.

The second reason that manufactured housing is troubled is specific to the industry: the punitive differential in mortgage rates between factory-built homes and site-built homes. Before you read further, let me underscore the obvious: Berkshire has a dog in this fight, and you should therefore assess the commentary that follows with special care. That warning made, however, let me explain why the rate differential causes problems for both large numbers of lower-income Americans and Clayton.

The residential mortgage market is shaped by government rules that are expressed by FHA, Freddie Mac and Fannie Mae. Their lending standards are all-powerful because the mortgages they insure can typically be securitized and turned into what, in effect, is an obligation of the U.S. government. Currently buyers of conventional site-built homes who qualify for these guarantees can obtain a 30-year loan at about 5¼%. In addition, these are mortgages that have recently been purchased in massive amounts by the Federal Reserve, an action that also helped to keep rates at bargain-basement levels.

In contrast, very few factory-built homes qualify for agency-insured mortgages. Therefore, a meritorious buyer of a factory-built home must pay about 9% on his loan. For the all-cash buyer, Clayton's homes offer terrific value. If the buyer needs mortgage financing, however – and, of course, most buyers do – the difference in financing costs too often negates the attractive price of a factory-built home.

Last year I told you why our buyers – generally people with low incomes – performed so well as credit risks. Their attitude was all-important: They signed up to live in the home, not resell or refinance it. Consequently, our buyers usually took out loans with payments geared to their verified incomes (we weren't making "liar's loans") and looked forward to the day they could burn their mortgage. If they lost their jobs, had health problems or got divorced, we could of course expect defaults. But they seldom walked away simply because house values had fallen. Even today, though job-loss troubles have grown, Clayton's delinquencies and defaults remain reasonable and will not cause us significant problems.

We have tried to qualify more of our customers' loans for treatment similar to those available on the site-built product. So far we have had only token success. Many families with modest incomes but responsible habits have therefore had to forego home ownership simply because the financing differential attached to the factory-built product makes monthly payments too expensive. If qualifications aren't broadened, so as to open low-cost financing to *all* who meet down-payment and income standards, the manufactured-home industry seems destined to struggle and dwindle.

Even under these conditions, I believe Clayton will operate profitably in coming years, though well below its potential. We couldn't have a better manager than CEO Kevin Clayton, who treats Berkshire's interests as if they were his own. Our product is first-class, inexpensive and constantly being improved. Moreover, we will continue to use Berkshire's credit to support Clayton's mortgage program, convinced as we are of its soundness. Even so, Berkshire can't borrow at a rate approaching that available to government agencies. This handicap will limit sales, hurting both Clayton and a multitude of worthy families who long for a low-cost home.

In the following table, Clayton's earnings are net of the company's payment to Berkshire for the use of its credit. Offsetting this cost to Clayton is an identical amount of income credited to Berkshire's finance operation and included in "Other Income." The cost and income amount was $116 million in 2009 and $92 million in 2008.

The table also illustrates how severely our furniture (CORT) and trailer (XTRA) leasing operations have been hit by the recession. Though their competitive positions remain as strong as ever, we have yet to see any bounce in these businesses.

	Pre-Tax Earnings (in millions)	
	2009	*2008*
Net investment income	$278	$330
Life and annuity operation	116	23
Leasing operations	14	87
Manufactured-housing finance (Clayton)	187	206
Other income *	186	141
Income before investment and derivatives gains or losses	$781	$787

*Includes $116 million in 2009 and $92 million in 2008 of fees that Berkshire charges Clayton for the use of Berkshire's credit.

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At the end of 2009, we became a 50% owner of Berkadia Commercial Mortgage (formerly known as Capmark), the country's third-largest servicer of commercial mortgages. In addition to servicing a $235 billion portfolio, the company is an important originator of mortgages, having 25 offices spread around the country. Though commercial real estate will face major problems in the next few years, long-term opportunities for Berkadia are significant.

Our partner in this operation is Leucadia, run by Joe Steinberg and Ian Cumming, with whom we had a terrific experience some years back when Berkshire joined with them to purchase Finova, a troubled finance business. In resolving that situation, Joe and Ian did far more than their share of the work, an arrangement I always encourage. Naturally, I was delighted when they called me to partner again in the Capmark purchase.

Our first venture was also christened Berkadia. So let's call this one Son of Berkadia. Someday I'll be writing you about Grandson of Berkadia.

Investments

Below we show our common stock investments that at yearend had a market value of more than $1 billion.

		12/31/09		
Shares	*Company*	*Percentage of Company Owned*	*Cost **	*Market*
			(in millions)	
151,610,700	American Express Company	12.7	$ 1,287	$ 6,143
225,000,000	BYD Company, Ltd.	9.9	232	1,986
200,000,000	The Coca-Cola Company	8.6	1,299	11,400
37,711,330	ConocoPhillips	2.5	2,741	1,926
28,530,467	Johnson & Johnson	1.0	1,724	1,838
130,272,500	Kraft Foods Inc.	8.8	4,330	3,541
3,947,554	POSCO	5.2	768	2,092
83,128,411	The Procter & Gamble Company	2.9	533	5,040
25,108,967	Sanofi-Aventis	1.9	2,027	1,979
234,247,373	Tesco plc	3.0	1,367	1,620
76,633,426	U.S. Bancorp	4.0	2,371	1,725
39,037,142	Wal-Mart Stores, Inc.	1.0	1,893	2,087
334,235,585	Wells Fargo & Company	6.5	7,394	9,021
	Others		6,680	8,636
	Total Common Stocks Carried at Market		$34,646	$59,034

*This is our actual purchase price and also our tax basis; GAAP "cost" differs in a few cases because of write-ups or write-downs that have been required.

In addition, we own positions in non-traded securities of Dow Chemical, General Electric, Goldman Sachs, Swiss Re and Wrigley with an aggregate cost of $21.1 billion and a carrying value of $26.0 billion. We purchased these five positions in the last 18 months. Setting aside the significant equity potential they provide us, these holdings deliver us an aggregate of $2.1 billion annually in dividends and interest. Finally, we owned 76,777,029 shares (22.5%) of BNSF at yearend, which we then carried at $85.78 per share, but which have subsequently been melded into our purchase of the entire company.

In 2009, our largest sales were in ConocoPhillips, Moody's, Procter & Gamble and Johnson & Johnson (sales of the latter occurring after we had built our position earlier in the year). Charlie and I believe that all of these stocks will likely trade higher in the future. We made some sales early in 2009 to raise cash for our Dow and Swiss Re purchases and late in the year made other sales in anticipation of our BNSF purchase.

We told you last year that very unusual conditions then existed in the corporate and municipal bond markets and that these securities were ridiculously cheap relative to U.S. Treasuries. We backed this view with some purchases, but I should have done far more. Big opportunities come infrequently. When it's raining gold, reach for a bucket, not a thimble.

We entered 2008 with $44.3 billion of cash-equivalents, and we have since retained operating earnings of $17 billion. Nevertheless, at yearend 2009, our cash was down to $30.6 billion (with $8 billion earmarked for the BNSF acquisition). We've put a lot of money to work during the chaos of the last two years. It's been an ideal period for investors: A climate of fear is their best friend. Those who invest only when commentators are upbeat end up paying a heavy price for meaningless reassurance. In the end, what counts in investing is what you pay for a business – through the purchase of a small piece of it in the stock market – and what that business earns in the succeeding decade or two.

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Last year I wrote extensively about our derivatives contracts, which were then the subject of both controversy and misunderstanding. For that discussion, please go to www.berkshirehathaway.com.

We have since changed only a few of our positions. Some credit contracts have run off. The terms of about 10% of our equity put contracts have also changed: Maturities have been shortened and strike prices materially reduced. In these modifications, no money changed hands.

A few points from last year's discussion are worth repeating:

(1) Though it's no sure thing, I expect our contracts in aggregate to deliver us a profit over their lifetime, even when investment income on the huge amount of float they provide us is excluded in the calculation. Our derivatives float – which is not included in the $62 billion of insurance float I described earlier – was about $6.3 billion at yearend.

(2) Only a handful of our contracts require us to post collateral under any circumstances. At last year's low point in the stock and credit markets, our posting requirement was $1.7 billion, a small fraction of the derivatives-related float we held. When we do post collateral, let me add, the securities we put up continue to earn money for our account.

(3) Finally, you should expect large swings in the carrying value of these contracts, items that can affect our reported quarterly earnings in a huge way but that do not affect our cash or investment holdings. That thought certainly fit 2009's circumstances. Here are the pre-tax quarterly gains and losses from derivatives valuations that were part of our reported earnings last year:

Quarter	$ Gain (Loss) in Billions
1	(1.517)
2	2.357
3	1.732
4	1.052

As we've explained, these wild swings neither cheer nor bother Charlie and me. When we report to you, we will continue to separate out these figures (as we do realized investment gains and losses) so that you can more clearly view the earnings of our operating businesses. We are delighted that we hold the derivatives contracts that we do. To date we have significantly profited from the float they provide. We expect also to earn further investment income over the life of our contracts.

We have long invested in derivatives contracts that Charlie and I think are mispriced, just as we try to invest in mispriced stocks and bonds. Indeed, we first reported to you that we held such contracts in early 1998. The dangers that derivatives pose for both participants and society – dangers of which we've long warned, and that can be dynamite – arise when these contracts lead to leverage and/or counterparty risk that is extreme. At Berkshire nothing like that has occurred – nor will it.

It's my job to keep Berkshire far away from such problems. Charlie and I believe that a CEO must not delegate risk control. It's simply too important. At Berkshire, I both initiate and monitor *every* derivatives contract on our books, with the exception of operations-related contracts at a few of our subsidiaries, such as MidAmerican, and the minor runoff contracts at General Re. If Berkshire ever gets in trouble, it will be *my* fault. It will not be because of misjudgments made by a Risk Committee or Chief Risk Officer.

* * * * * * * * * * * *

In my view a board of directors of a huge financial institution is *derelict* if it does not insist that its CEO bear full responsibility for risk control. If he's incapable of handling that job, he should look for other employment. And if he fails at it – with the government thereupon required to step in with funds or guarantees – the financial consequences for him and his board should be severe.

It has not been shareholders who have botched the operations of some of our country's largest financial institutions. Yet they have borne the burden, with 90% or more of the value of their holdings wiped out in most cases of failure. Collectively, they have lost more than $500 billion in just the four largest financial fiascos of the last two years. To say these *owners* have been "bailed-out" is to make a mockery of the term.

The CEOs and directors of the failed companies, however, have largely gone unscathed. Their fortunes may have been diminished by the disasters they oversaw, but they still live in grand style. It is the behavior of these CEOs and directors that needs to be changed: If their institutions and the country are harmed by their recklessness, they should pay a heavy price – one not reimbursable by the companies they've damaged nor by insurance. CEOs and, in many cases, directors have long benefitted from oversized financial carrots; some *meaningful* sticks now need to be part of their employment picture as well.

An Inconvenient Truth (Boardroom Overheating)

Our subsidiaries made a few small "bolt-on" acquisitions last year for cash, but our blockbuster deal with BNSF required us to issue about 95,000 Berkshire shares that amounted to 6.1% of those previously outstanding. Charlie and I enjoy issuing Berkshire stock about as much as we relish prepping for a colonoscopy.

The reason for our distaste is simple. If we wouldn't dream of selling Berkshire in its entirety at the current market price, why in the world should we "sell" a significant part of the company at that same inadequate price by issuing our stock in a merger?

In evaluating a stock-for-stock offer, shareholders of the target company quite understandably focus on the market price of the acquirer's shares that are to be given them. But they also expect the transaction to deliver them the *intrinsic* value of their own shares – the ones they are giving up. If shares of a prospective acquirer are selling below their intrinsic value, it's impossible for that buyer to make a sensible deal in an all-stock deal. You simply can't exchange an undervalued stock for a fully-valued one without hurting your shareholders.

Imagine, if you will, Company A and Company B, of equal size and both with businesses intrinsically worth $100 per share. Both of their stocks, however, sell for $80 per share. The CEO of A, long on confidence and short on smarts, offers 1 ¼ shares of A for each share of B, correctly telling his directors that B is worth $100 per share. He will neglect to explain, though, that what he is giving will cost his shareholders $125 in intrinsic value. If the directors are mathematically challenged as well, and a deal is therefore completed, the shareholders of B will end up owning 55.6% of A & B's combined assets and A's shareholders will own 44.4%. Not everyone at A, it should be noted, is a loser from this nonsensical transaction. Its CEO now runs a company twice as large as his original domain, in a world where size tends to correlate with both prestige and compensation.

If an acquirer's stock is overvalued, it's a different story: Using it as a currency works to the acquirer's advantage. That's why bubbles in various areas of the stock market have invariably led to serial issuances of stock by sly promoters. Going by the market value of their stock, they can afford to overpay because they are, in effect, using counterfeit money. Periodically, many air-for-assets acquisitions have taken place, the late 1960s having been a particularly obscene period for such chicanery. Indeed, certain large companies were built in this way. (No one involved, of course, ever publicly acknowledges the reality of what is going on, though there is plenty of private snickering.)

In our BNSF acquisition, the selling shareholders quite properly evaluated our offer at $100 per share. The cost to us, however, was somewhat higher since 40% of the $100 was delivered in our shares, which Charlie and I believed to be worth more than their market value. Fortunately, we had long owned a substantial amount of BNSF stock that we purchased in the market for cash. All told, therefore, only about 30% of our cost overall was paid with Berkshire shares.

In the end, Charlie and I decided that the disadvantage of paying 30% of the price through stock was offset by the opportunity the acquisition gave us to deploy $22 billion of cash in a business we understood and liked for the long term. It has the additional virtue of being run by Matt Rose, whom we trust and admire. We also like the prospect of investing additional billions over the years at reasonable rates of return. But the final decision was a close one. If we had needed to use more stock to make the acquisition, it would in fact have made no sense. We would have then been giving up more than we were getting.

* * * * * * * * * * * *

I have been in dozens of board meetings in which acquisitions have been deliberated, often with the directors being instructed by high-priced investment bankers (are there any other kind?). Invariably, the bankers give the board a detailed assessment of the value of the company being purchased, with emphasis on why it is worth far more than its market price. In more than fifty years of board memberships, however, never have I heard the investment bankers (or management!) discuss the true value of what is being *given*. When a deal involved the issuance of the acquirer's stock, they simply used market value to measure the cost. *They did this even though they would have argued that the acquirer's stock price was woefully inadequate – absolutely no indicator of its real value – had a takeover bid for the acquirer instead been the subject up for discussion*.

When stock is the currency being contemplated in an acquisition and when directors are hearing from an advisor, it appears to me that there is only one way to get a rational and balanced discussion. Directors should hire a second advisor to make the case *against* the proposed acquisition, with its fee contingent on the deal *not* going through. Absent this drastic remedy, our recommendation in respect to the use of advisors remains: "Don't ask the barber whether you need a haircut."

* * * * * * * * * * * *

I can't resist telling you a true story from long ago. We owned stock in a large well-run bank that for decades had been statutorily prevented from acquisitions. Eventually, the law was changed and our bank immediately began looking for possible purchases. Its managers – fine people and able bankers – not unexpectedly began to behave like teenage boys who had just discovered girls.

They soon focused on a much smaller bank, also well-run and having similar financial characteristics in such areas as return on equity, interest margin, loan quality, etc. Our bank sold at a modest price (that's why we had bought into it), hovering near book value and possessing a very low price/earnings ratio. Alongside, though, the small-bank owner was being wooed by other large banks in the state and was holding out for a price close to three times book value. Moreover, he wanted stock, not cash.

Naturally, our fellows caved in and agreed to this value-destroying deal. "We need to show that we are in the hunt. Besides, it's only a small deal," they said, as if only *major* harm to shareholders would have been a legitimate reason for holding back. Charlie's reaction at the time: "Are we supposed to applaud because the dog that fouls our lawn is a Chihuahua rather than a Saint Bernard?"

The seller of the smaller bank – no fool – then delivered one final demand in his negotiations. "After the merger," he in effect said, perhaps using words that were phrased more diplomatically than these, "I'm going to be a large shareholder of your bank, and it will represent a huge portion of my net worth. You have to promise me, therefore, that you'll never again do a deal this dumb."

Yes, the merger went through. The owner of the small bank became richer, we became poorer, and the managers of the big bank – newly bigger – lived happily ever after.

The Annual Meeting

Our best guess is that 35,000 people attended the annual meeting last year (up from 12 – *no* zeros omitted – in 1981). With our shareholder population much expanded, we expect even more this year. Therefore, we will have to make a few changes in the usual routine. There will be no change, however, in our enthusiasm for having you attend. Charlie and I like to meet you, answer your questions and – best of all – have you *buy* lots of goods from our businesses.

The meeting this year will be held on Saturday, May 1st. As always, the doors will open at the Qwest Center at 7 a.m., and a new Berkshire movie will be shown at 8:30. At 9:30 we will go directly to the question-and-answer period, which (with a break for lunch at the Qwest's stands) will last until 3:30. After a short recess, Charlie and I will convene the annual meeting at 3:45. If you decide to leave during the day's question periods, please do so while *Charlie* is talking. (Act fast; he can be terse.)

The best reason to exit, of course, is to *shop*. We will help you do that by filling the 194,300-square-foot hall that adjoins the meeting area with products from dozens of Berkshire subsidiaries. Last year, you did your part, and most locations racked up record sales. But you can do better. (A friendly warning: If I find sales are lagging, I get testy and lock the exits.)

GEICO will have a booth staffed by a number of its top counselors from around the country, all of them ready to supply you with auto insurance quotes. In most cases, GEICO will be able to give you a shareholder discount (usually 8%). This special offer is permitted by 44 of the 51 jurisdictions in which we operate. (One supplemental point: The discount is not additive if you qualify for another, such as that given certain groups.) Bring the details of your existing insurance and check out whether we can save you money. For at least 50% of you, I believe we can.

Be sure to visit the Bookworm. Among the more than 30 books and DVDs it will offer are two new books by my sons: Howard's *Fragile*, a volume filled with photos and commentary about lives of struggle around the globe and Peter's *Life Is What You Make It*. Completing the family trilogy will be the debut of my sister Doris's biography, a story focusing on her remarkable philanthropic activities. Also available will be *Poor Charlie's Almanack*, the story of my partner. This book is something of a publishing miracle – never advertised, yet year after year selling many thousands of copies from its Internet site. (Should you need to ship your book purchases, a nearby shipping service will be available.)

If you are a big spender – or, for that matter, merely a gawker – visit Elliott Aviation on the east side of the Omaha airport between noon and 5:00 p.m. on Saturday. There we will have a fleet of NetJets aircraft that will get your pulse racing.

An attachment to the proxy material that is enclosed with this report explains how you can obtain the credential you will need for admission to the meeting and other events. As for plane, hotel and car reservations, we have again signed up American Express (800-799-6634) to give you special help. Carol Pedersen, who handles these matters, does a terrific job for us each year, and I thank her for it. Hotel rooms can be hard to find, but work with Carol and you will get one.

At Nebraska Furniture Mart, located on a 77-acre site on 72nd Street between Dodge and Pacific, we will again be having "Berkshire Weekend" discount pricing. To obtain the Berkshire discount, you must make your purchases between Thursday, April 29th and Monday, May 3rd inclusive, and also present your meeting credential. The period's special pricing will even apply to the products of several prestigious manufacturers that normally have ironclad rules against discounting but which, in the spirit of our shareholder weekend, have made an exception for you. We appreciate their cooperation. NFM is open from 10 a.m. to 9 p.m. Monday through Saturday, and 10 a.m. to 6 p.m. on Sunday. On Saturday this year, from 5:30 p.m. to 8 p.m., NFM is having a Berkyville BBQ to which you are all invited.

At Borsheims, we will again have two shareholder-only events. The first will be a cocktail reception from 6 p.m. to 10 p.m. on Friday, April 30th. The second, the main gala, will be held on Sunday, May 2nd, from 9 a.m. to 4 p.m. On Saturday, we will be open until 6 p.m.

We will have huge crowds at Borsheims throughout the weekend. For your convenience, therefore, shareholder prices will be available from Monday, April 26th through Saturday, May 8th. During that period, please identify yourself as a shareholder by presenting your meeting credentials or a brokerage statement that shows you are a Berkshire holder. Enter with rhinestones; leave with diamonds. My daughter tells me that the more you buy, the more you save (kids say the darnedest things).

On Sunday, in the mall outside of Borsheims, a blindfolded Patrick Wolff, twice U.S. chess champion, will take on all comers – who will have their eyes wide open – in groups of six. Nearby, Norman Beck, a remarkable magician from Dallas, will bewilder onlookers.

Our special treat for shareholders this year will be the return of my friend, Ariel Hsing, the country's top-ranked junior table tennis player (and a good bet to win at the Olympics some day). Now 14, Ariel came to the annual meeting four years ago and demolished all comers, including me. (You can witness my humiliating defeat on YouTube; just type in Ariel Hsing Berkshire.)

Naturally, I've been plotting a comeback and will take her on outside of Borsheims at 1:00 p.m. on Sunday. It will be a three-point match, and after I soften her up, all shareholders are invited to try their luck at similar three-point contests. Winners will be given a box of See's candy. We will have equipment available, but bring your own paddle if you think it will help. (It won't.)

Gorat's will again be open exclusively for Berkshire shareholders on Sunday, May 2nd, and will be serving from 1 p.m. until 10 p.m. Last year, though, it was overwhelmed by demand. With many more diners expected this year, I've asked my friend, Donna Sheehan, at Piccolo's – another favorite restaurant of mine – to serve shareholders on Sunday as well. (Piccolo's giant root beer float is mandatory for any fan of fine dining.) I plan to eat at both restaurants: All of the weekend action makes me *really* hungry, and I have favorite dishes at each spot. Remember: To make a reservation at Gorat's, call 402-551-3733 on April 1st (*but not before*) and at Piccolo's call 402-342-9038.

Regrettably, we will not be able to have a reception for international visitors this year. Our count grew to about 800 last year, and my simply signing one item per person took about 2½ hours. Since we expect even more international visitors this year, Charlie and I decided we must drop this function. But be assured, we welcome every international visitor who comes.

Last year we changed our method of determining what questions would be asked at the meeting and received many dozens of letters applauding the new arrangement. We will therefore again have the same three financial journalists lead the question-and-answer period, asking Charlie and me questions that shareholders have submitted to them by e-mail.

The journalists and their e-mail addresses are: Carol Loomis, of Fortune, who may be e-mailed at cloomis@fortunemail.com; Becky Quick, of CNBC, at BerkshireQuestions@cnbc.com, and Andrew Ross Sorkin, of The New York Times, at arsorkin@nytimes.com. From the questions submitted, each journalist will choose the dozen or so he or she decides are the most interesting and important. The journalists have told me your question has the best chance of being selected if you keep it concise and include no more than two questions in any e-mail you send them. (In your e-mail, let the journalist know if you would like your name mentioned if your question is selected.)

Neither Charlie nor I will get so much as a clue about the questions to be asked. We know the journalists will pick some tough ones and that's the way we like it.

We will again have a drawing at 8:15 on Saturday at each of 13 microphones for those shareholders wishing to ask questions themselves. At the meeting, I will alternate the questions asked by the journalists with those from the winning shareholders. We've added 30 minutes to the question time and will probably have time for about 30 questions from each group.

* * * * * * * * * * * *

At 86 and 79, Charlie and I remain lucky beyond our dreams. We were born in America; had terrific parents who saw that we got good educations; have enjoyed wonderful families and great health; and came equipped with a "business" gene that allows us to prosper in a manner hugely disproportionate to that experienced by many people who contribute as much or more to our society's well-being. Moreover, we have long had jobs that we love, in which we are helped in countless ways by talented and cheerful associates. Indeed, over the years, our work has become ever more fascinating; no wonder we tap-dance to work. If pushed, we would gladly pay substantial sums to have our jobs (but don't tell the Comp Committee).

Nothing, however, is more fun for us than getting together with our shareholder-partners at Berkshire's annual meeting. So join us on May 1st at the Qwest for our annual Woodstock for Capitalists. We'll see you there.

February 26, 2010

Warren E. Buffett
Chairman of the Board

P.S. Come by rail.

United States District Court,

E.D. North Carolina,

Eastern Division.
FOUNTAIN POWERBOAT INDUSTRIES, INC., Plaintiff,
v.
RELIANCE INSURANCE COMPANY, Defendant.
No. 4:00-CV-5-H(4).

June 20, 2000.

***554** Kenneth R. Wooten, Ward & Smith, New Bern, NC, for Fountain Powerboat Industries, Inc., plaintiffs.

Henry L. Anderson, Jr., Anderson, Daniel & Coxe, Bradley Coxe, Wrightsville Beach, NC, for Reliance Insurance Company, defendants.

ORDER

MALCOLM J. HOWARD, District Judge.

This matter is before the court to determine certain legal issues that must be resolved before moving the appraisal process forward in this insurance contract dispute. Both parties have filed memoranda with the court outlining their respective positions; therefore, this matter is ripe for ruling.

STATEMENT OF THE CASE

Plaintiff filed the complaint in this action in Beaufort County Superior Court on December 22, 1999. Plaintiff's first claim for relief asserted breach of insurance contract and plaintiff's second claim for relief asserted bad faith by defendant for its refusal to pay plaintiff's claims. Defendant timely removed this action to federal court.

In April 2000, the court conducted a Rule 16 conference with the parties. As a result of this conference, the court appointed an umpire to assist with the appraisal process of plaintiff's insurance claims. The court also established a time-line to guide the resolution of this matter. However, before completion of the appraisal process, the court must determine the meaning of certain policy provisions contained in the insurance policy issued to plaintiff by defendant.

STATEMENT OF THE FACTS

Plaintiff Fountain Powerboat Industries, Inc. is the parent company of Fountain Powerboats, Inc., (jointly referred to as “Fountain”) which manufactures, distributes and sells boats and boating equipment. Fountain's manufacturing facility and headquarters are located off of Whichard's Beach Road in Washington, North Carolina. Whichard's Beach Road is the only road leading to the Fountain facility. The sole means of reaching Whichard's Beach Road is United States Highway 17, which runs north and south.

On September 15, 1999, Hurricane Floyd struck eastern North Carolina dumping heavy, record-setting rainfall and causing devastating flooding throughout many of the eastern counties. The only roads leading to the Fountain facility, Whichard's Beach Road and Highway 17, were flooded for days according to reports filed by the North Carolina Department of Transportation (“D.O.T.”). According to the D.O.T., Whichard's Beach Road was closed from September 16 to 25.[FN1]

FN1. D.O.T.'s records do not indicate whether the highway was closed on September 18 and 24.

Due to the poor road conditions, for three days Fountain used large trucks to pick up workers from various “pick-up points” and transport them to the facility. As a result of displacement caused by the

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floods, production at the Fountain facility fell to 33 percent of full capacity. According to Fountain's Chief Executive Officer, Anthony Romersa ("Romersa"), production did not resume to normal, pre-flood capacity until October 25, 1999.

At the time of the flood, Fountain was insured by defendant Reliance Insurance Company ("Reliance"). The policy term ran from July 1, 1999 to July 1, 2000 with an annual premium of $175,000. Fountain's agent, Willis Corroon Corporation of Minnesota ("Willis Corp.") negotiated the terms of the policy with Reliance based on language from another policy previously negotiated between Willis Corp. and Reliance.

Fountain timely asserted a claim with Reliance for its flood-related losses from Hurricanes Dennis and Floyd. Reliance ***555** has paid Fountain nearly $1,000,000 in satisfaction of certain claims, but has refused to fully pay Fountain's claim for business interruption and reduction losses, Fountain's claim for lack of ingress/egress resulting from Hurricane Floyd and has failed to reimburse Fountain for its alleged claim preparation costs. Reliance contests each of Fountain's outstanding claims for coverage.

I. Construction of the Insurance Contract

[1] "An insurance policy is a contract to be construed under the rules of law applicable to other written contracts." *Chavis v. Southern Life Ins. Co.,* 76 N.C.App. 481, 484, 333 S.E.2d 559, 561 (1985). The intent of the parties guides interpretation of the policy. *See id.* While normal rules of construction for contracts govern insurance agreements, North Carolina courts have recognized a special relationship between the insured and the insurer. *See Great American Ins. Co. v. C.G. Tate Const. Co.,* 303 N.C. 387, 279 S.E.2d 769 (1981) ("An insurance contract is not a negotiated agreement; rather its conditions are by and large dictated by the insurance company to the insured.") Due to this special relationship, any ambiguity in the language of a policy must be construed to afford coverage, *see Wachovia Bank and Trust v. Westchester Fire Ins. Co.,* 276 N.C. 348, 172 S.E.2d 518 (1970), and any exclusions from, conditions on, or limitations contained within a policy are to be strictly construed. *See id.; see also Allstate Ins. Co. v. Shelby Mutual Ins. Co.,* 269 N.C. 341, 152 S.E.2d 436 (1967).

[2][3] However, when the parties to the insurance agreement are sophisticated and jointly negotiate the policy, there is no need to construe ambiguities against the insurance company. The intent of construction against the insurer arises from concern over the lack of bargaining power between the insurance company and the insured. Relying on *General Accident Fire and Life Assurance Corp., Ltd. v. Akzona,* 622 F.2d 90 (4th Cir.1980), Reliance insists that because the policy between it and Fountain was based on a policy presented to Reliance by Fountain's agent, Willis Corp., the court should construe any ambiguities in the policy against Fountain as the party that drafted the contract.

The Fountain policy is based on a policy issued by Reliance to another client, Metris Company. Reliance had negotiated the Metris policy with Willis Corp. Linda Hines ("Hines") of Willis Corp. negotiated the policy for Fountain and Dan Phelps ("Phelps"), a Reliance agent, negotiated the policy on behalf of Reliance. Although Reliance concedes that Phelps negotiated on its behalf, it insists that the phrases at issue before the court were not the subject of negotiation. However, Phelps testified that there were no provisions of the policy that were non-negotiable. The court concludes that both parties had an equal bargaining position and finds no reason to construe any ambiguous terms against Fountain, especially in light of the fact that no part of the policy was non-negotiable.[FN2] The court will now examine the contract provisions at issue.

FN2. Reliance's dependance on *Akzona,* is misplaced. In *Akzona,* the parties did not jointly negotiate the policy as did Reliance and Fountain. Additionally the case cited by the Fourth Circuit for the proposition of construing an insurance policy held that

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> the policy should be construed against the insurer that drafter the contract. This lends further support to the court's conclusion that when the parties have equal bargaining power and negotiate the contract there is no need to construe the policy against the drafter.

II. Ingress/Egress Provision

The ingress/egress provision of the Fountain policy falls under Section II, entitled "Coverage," and Article F, entitled, "Provisions Applicable to Business Interruption-Gross Earnings, Extra Expense, Rental Value and Royalties Coverage." Reliance contends that only a physical loss may trigger a business interruption coverage***556** and takes issues with the period of recovery claimed by Fountain.

The policy states as follows:

1. Period of Recovery-the length of time for which loss may be claimed:

a. Shall not exceed such length of time as would be required with the exercise of due diligence and dispatch to rebuild, repair, or replace such part of the property as had been destroyed or damaged; including time as may be required with the exercise of due diligence and dispatch to reproduce or reconstruct lost, damaged, or destroyed valuable papers or records, and time as may be required to recreate or reproduce (including research and engineering) lost, damaged, or destroyed data on electronic data processing media including film, tape, disc, drum, cell, and other magnetic recording or storage media for electronic data processing.

b. And, such additional length of time to restore the Insured's business to the condition that would have existed had no loss occurred, commencing with the later of the following dates:

i. the date on which the liability of the Insurer for loss or damage would otherwise terminate; or

ii. the date on which repair, replacement or rebuilding of such part of the property as has been damaged is actually completed;

but in no event for more than one year thereafter from said later commencement date;

...

6. Loss of Ingress or Egress: This policy covers loss sustained during the period of time when, as a direct result of a peril not excluded, ingress to or egress from real and personal property not excluded hereunder, is thereby prevented.

Fountain Policy at 9-10.

The "Perils Excluded" section of the policy fails to exclude hurricanes or other natural disasters.[FN3] Moreover, the Fountain facility is not excluded property. Therefore, substituting "hurricane" and the "Fountain facility" into the ingress/egress paragraph yields, "This policy covers loss sustained during the period of time when, as a direct result of a hurricane, ingress to or egress from the Fountain Facility is thereby prevented."

> FN3. The policy explicitly *includes* "floods." *See* Fountain policy at 27.

Both parties agree that the terms ingress and egress are unambiguous and generally mean "access" to the Fountain facility. Reliance asserts, however, that without property damage, Fountain cannot recover for a business interruption loss.

A. Business Interruption and Physical Loss

[4] In support of its contention that only physical loss or damage may trigger a business interruption loss, Reliance relies on an annotation from an ALR and on *Harry's Cadillac-Pontiac-GMC Truck Co., Inc. v. Motors Ins. Corp.,* 126 N.C.App. 698, 486 S.E.2d 249 (1997). Fountain agrees that business interruption coverage generally requires that the interruption be caused by damage to the covered

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property. However, Fountain insists that the ingress/egress clause in this case does not require damage to the insured property.

Harry's Cadillac dealt with a claim by the owner of a car dealership for business interruption after a snowstorm prohibited access to the dealership for one week. There is no indication that the policy in *Harry's Cadillac* contained an ingress/egress clause and the case is unhelpful in the instant dispute.

The court cannot find, and neither party has provided, any case in any jurisdiction that interprets an ingress/egress clause ***557** contained in the business interruption loss section of an insurance policy. The court believes that this is due to the fact the meaning of the clause is exceedingly clear. Loss sustained due to the inability to access the Fountain facility and resulting from a hurricane is a covered event with no physical damage to the property required. Moreover, in Section II part B. of the policy entitled "Business Interruption," the policy states,

This policy covers loss resulting from the necessary interruption or reduction of business operations conducted by the insured and *caused by loss,* damage, *or* destruction *by any of the perils* not excluded ...

Fountain Policy at 5, Section II. Part B. sub 1. (Emphasis added). The plain meaning of this language indicates an agreement between the parties that the contract for insurance cover any business interruption caused by loss by any peril not excluded. A "loss" is not predicated on physical damage but is one category of recovery along with damage and destruction as indicated by the use of the alternative coordinating conjunction "or." Flooding due to Hurricane Floyd is exactly the type of peril this business interruption loss was drafted to insure against.

Furthermore, Reliance was aware of the location of the Fountain facility and was aware that the facility had a limited access. (*See* Phelps Dep. 16-18). The court can only conclude that the parties intended that the policy would provide coverage not only when the property itself was inaccessible, but also when the only route to the Facility caused the property to be inaccessible. The court's conclusion that no physical loss is required to trigger business interruption coverage is further bolstered by the parties' inclusion of the following provision:

5. Interruption by Civil or Military Authority: This policy is extended to cover the loss sustained during the period of time when, as a direct result of a peril not excluded, access to real or personal property is prohibited by order of civil or military authority.

Fountain Policy at 10. This provision immediately precedes the loss of ingress/egress provision. Neither provision requires physical loss, but merely covers loss sustained due to lack of access to the property. Therefore, the court finds that no requirement for physical loss to the property is required under the contract of insurance in order to trigger business interruption coverage under the ingress/egress clause. Furthermore, the ingress/egress provision provides coverage from September 16, 1999, to September 26, 1999. FN4

FN4. The efforts of Fountain to pick up employees and drive them to work are extraordinary. The court finds that the ingress/egress provision relates only to reasonable access to the Fountain facility and does not therefore apply to extraordinary efforts by Fountain or its employees to get to work over closed and flooded roads. *See* *Marriott Financial Services, Inc. v. Capitol Funds, Inc.,* 288 N.C. 122, 144, 217 S.E.2d 551, 564 (1975). Additionally, the court attaches no significance to the fact that D.O.T. records are inconclusive as to whether the Fountain facility was accessible on September 18 and 24. The court finds from the surrounding evidence that the facility was not accessible on these two days. (*See e.g.* Romersa Aff.)

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B. Period of Loss

[5] Fountain contends that the period of the business interruption continued until October 25, 1999, nearly one month after the hurricane. Reliance disagrees, and asserts that the interruption ended when access to the Fountain facility was restored on September 25, 1999.

In the Fountain policy, the parties clearly set forth two periods of recovery applicable to business interruption. (*See* Fountain Policy at 9, II.F.1.a. and b., *supra*). Part a. of the "Period of Recovery" contemplates a period of recovery when physical damage occurs to the property. Section b. contemplates the period of recovery when additional time is required to "restore***558** the Insured's business to the condition that would have existed had no loss occurred ..." *See id.* Reliance insists that b. can only apply after the insured meets the condition of physical loss contained in a. The court cannot agree.

There is no indication that section b. is dependent on section a. The placement of b. as a separate subparagraph, rather than as a subsection of a., is also instructive. The contract outlines two periods of recovery in a. and b., not one period of recovery with an ancillary extension of time. The period of recovery for which an insured may claim loss in b. is "such additional length of time to restore the Insured's business to the condition that would have existed had no loss occurred" and "commencing with ... the date on which the liability of the Insurer for loss or damage would otherwise terminate." Fountain Policy at 9.

The loss claimed in this dispute is the loss of ingress/egress. The court finds that the length of time for which loss of ingress/egress may be claimed is the length of time to restore Fountain's business to the condition that would have existed had no loss of ingress/egress occurred.

Reliance admits that six days of business interruption loss are covered under the policy, and has already paid Fountain for this time period. Fountain contends that its business was not restored to the condition that would have existed had no loss of ingress/egress occurred until October 25, 1999. Reliance offers no alternative argument, other than pointing out that it already paid Fountain for six days of business interruption. The position of Reliance is that the business interruption ended when access to Fountain's facility was restored on September 25, 1999, according to Reliance, and September 27, 1999, according to Fountain. However, Reliance's conclusion of when the business interruption ended fails to consider the "the length of time for which loss may be claimed: [a]nd, such additional length of time to restore [Fountain's] business to the condition that would have existed had no loss occurred." Fountain Policy at 9.

In support of its contention that the business was not restored to the condition that would have existed had no loss occurred until October 25, 1999, Fountain relies primarily on the affidavit of Anthony Romersa. Romersa states that production did not resume to "normal pre-flood capacity until approximately October 25, 1999." (Romersa Aff. ¶ 10). Based on 1999 production levels, Fountain usually earned 24.6% gross profit on sales before sales, or $990,000 per month. *See id.* In September 1999, Fountain lost $79,028, but in October 1999, Fountain earned $1,220,390. *See id.* Romersa attributes the marked rise in income in October to employee overtime effort.

While there is no doubt that Fountain experienced business interruption loss for a period of time beyond September 25, 1999, the evidence presently before the court does not clarify the effective date of resumed production levels. The evidence clearly supports a business interruption throughout the end of September 1999, given Fountain's $79,0000 loss, but without more, the court cannot conclude how long such interruption lasted. Therefore, the court finds that the policy provides for Fountain's period of loss due to business interruption to some point past September 25, 1999. The court leaves to the

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adjusters to agree on an exact date and absent an agreement by the adjusters, the court leaves such determination to the umpire.

III. Claim Preparation Expenses

Section VII part O of the Fountain policy provides:

VII. Extension of Coverage

This policy covers:

...

O. Claim Preparation Expenses

Expenses incurred by the Insured or by the Insured's representative including Auditors, Accountants, Appraisers, Lawyers,***559** Consultants, Architects, Engineers or other such professionals in order to arrive at the loss payable under this policy in the event of a claim. This provision does not cover expenses incurred for the services of any public adjuster.

Fountain Policy at 14. Fountain contends that this section allows coverage for lawyers' expenses in preparing its claim to include the expenses of filing this lawsuit. Fountain concedes that paragraph O does not cover its costs of pursuing its bad faith claim against Reliance. Fountain also asserts that this section allows recovery for the expenses of Allan Klotsche (“Klotsche”), as a risk management consultant. Reliance counters that Klotsche is a public adjuster and explicitly excluded from paragraph O, and that the only lawyers' expenses included in paragraph O are those incurred in preparing the claim, not in suing on the policy.

The court finds that paragraph O is clear and unambiguous. The first clause of paragraph O is not a complete sentence, but defines the heading of paragraph O “Claim Preparation Expenses.” This drafting style is also used in Part VII paragraph B, C, E, F, G, H, I, K, L, M and N. The heading of the paragraph modifies the contents. By its plain language, claim preparation expenses cover lawyer fees incurred in arriving at the “loss payable” in the event of a claim. The proceedings in this action regarding the meaning of ingress/egress and its relation to business interruption loss have become necessary, due to the parties' failure to agree on their meanings, in order to determine the loss payable.

A. Lawyer Fees

[6] The only expenses included in paragraph O are those which are incurred in preparing the claim to arrive at the loss payable. As of yet, the parties have not been able to arrive at the loss payable. The reading encouraged by Reliance, that once the claim is prepared and either accepted or rejected the obligation of Reliance to pay claim preparation expenses ends, would hamstring the insured's ability to determine the loss payable and force the insured to accept all policy interpretations given by Reliance. Therefore, the court finds that Reliance is obligated to pay Fountain's attorney fees incurred in determining the loss payable, to include expenses after the filing of the present lawsuit, expenses incurred in preparing for and attending the claim preparation conferences, and expenses for presenting the instant legal question to the court for determination. These fees do not include Fountain's claim for bad faith. Should the adjusters not be able to agree on the amount of these fees, the umpire shall make the final determination.

B. Services of Allan Klotsche

[7] Paragraph O of Section VII excludes “expenses incurred for the services of any public adjuster.” The remaining question before the court is whether Klotsche is a public adjuster, or whether he is a “consultant” covered by the policy. Fountain asserts that Klotsche is not a public adjuster because he is not licensed as a public adjuster in North Carolina and because he did not perform the services of a public adjuster. Reliance disagrees and contends that while Klotsche may not be licensed as a public

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adjuster in North Carolina, he performed all the services of a public adjuster.

North Carolina law defines public adjusting as:

investigating, reporting to, and assisting an insured in relation to first party claims arising under insurance contracts ... that insure the real or personal property, or both, of the insured; ...

11 N.C.A.C. 6A.0901(2). A public adjuster is one: who, for salary, fee, commission, or other compensation, engages in public adjusting and who is licensed under ***560**G.S. 58-33-30 or who is authorized to adjust under G.S. 58-33-70 ...

11 N.C.A.C. 6A.0901(1). Reliance does not dispute that Klotsche fails to satisfy the 11 N.C.A.C. 6A.0901(1) requirement that an adjuster be licensed. Instead, Reliance asserts that Klotsche's actions fit squarely within the definition of public adjusting.

Klotsche is vice-chairman and CEO of T.E. Brennan Company, a risk management and employee benefits consulting firm. (*See* Klotsche Dep. at 5). He previously was employed as president and CEO of the Willis Corp., an international insurance brokerage firm. *See id.* Klotsche began his business relationship with Fountain nearly 10 years ago when he helped design an insurance program for Fountain. *See id.* at 8. At the time of the hurricane, Klotsche was employed by Willis Corp. and consulted with Fountain on insurance issues to include its insurance needs, sales of insurance products, service after the sale of insurance and claim assistance. (*See* Klotsche Aff. ¶ 4).

Klotsche provided input regarding Fountain's claim for its destroyed yacht mold, the extended period of indemnity and loss of ingress and egress. (*See* Klotsche Dep. at 15, 19). However, Klotsche did not prepare any of the documents presented to Reliance in support of Fountain's claim. *See id.* at 18. Klotsche's initial activity after the hurricane was to attend a meeting between Fountain and Sponberg, the expert Reliance had retained to examine the yacht mold. At this meeting Klotsche "listened and observed." *Id.* at 14-15. Relating to the ingress/egress provision, Klotsche discussed with Fountain the meaning of the policy with respect to the facts of the claim. *See id.* at 20. Klotsche contends that he did not personally investigate Fountain's property damage or business interruption losses, but provided Fountain with names of experts who could investigate the losses. (Klotsche Aff. ¶ 7). However, he did "collect and organize[ ] claim data" and requested documentation on items included in Fountain's claim. (*See* Klotsche Dep. 14-17). He also organized claim data that was provided to him by Fountain employees. (*See* Klotsche Aff. ¶ 7). Klotsche used the information provided by Fountain to negotiate on Fountain's behalf with Reliance. (*See* Klotsche Dep. at 25-28). Klotsche also acted on Fountain's behalf by presenting data and documentation as well as coordinating a presentation for Fountain in a settlement conference with Reliance. *See id.* at 29.

Klotsche clearly assisted Fountain in the preparation of its claim and reported to Fountain. The main point of difference is whether Klotsche investigated the claim. To investigate means "to inquire[ ] into or track [ ] down through inquiry." Black's Law Dictionary 825 (6th ed.1990). The evidence supports a conclusion that Klotsche's actions are more in line with a consultant than a public adjuster. There is no evidence that Klotsche independently tracked down information through inquiry. Rather, Klotsche took information given to him by Fountain and gave Fountain his professional advice and services. Therefore, the fees of Klotsche as a consultant are covered expenses under the policy.

CONCLUSION

For the above stated reasons, the court finds as follows on Fountain's motion for resolution of disputed legal issues. The ingress/egress provision of the policy provides coverage from September 16, 1999, to September 26, 1999. The court finds that

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the policy provides for Fountain's period of loss due to business interruption to some point past September 25, 1999. The court leaves to the adjusters to agree on an exact date and absent an agreement by the adjusters, the court leaves such determination to the umpire. The court finds that Reliance is obligated to pay Fountain's attorney fees incurred in determining the loss payable, to include expenses after the filing of the present lawsuit, expenses incurred in preparing for and attending the claim preparation conferences, ***561** and expenses for presenting the instant legal question to the court for determination. These fees do not include Fountains claim for bad faith. Should the adjusters not be able to agree on the amount of these fees, the umpire shall make the final determination. Finally, the court finds that the services of Allan Klotsche were those of a consultant and are covered by the policy. The clerk is directed to serve a copy of this order on the umpire in this case, Louis P. Hornthal, Jr., Esq., 301 E. Main St., P.O. Box 220, Elizabeth City, N.C. 27909-0220.

E.D.N.C.,2000.
Fountain Powerboat Industries, Inc. v. Reliance Ins. Co.
119 F.Supp.2d 552

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UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

CSX CORPORATION and
CSX INSURANCE COMPANY,

Plaintiffs,

v. CASE NO. 3:08-CV-00531-J-25MCR

NORTH RIVER INSURANCE COMPANY, AMERICAN RE-INSURANCE COMPANY, n/k/a MUNICH REINSURANCE AMERICA, INC., WESTCHESTER SURPLUS LINES INSURANCE COMPANY, STEADFAST INSURANCE COMPANY,[1] HARTFORD FIRE INSURANCE COMPANY, LANDMARK AMERICAN INSURANCE COMPANY, FARADAY CAPITAL LIMITED, and ASPEN INSURANCE UK LIMITED,

Defendants.
_________________________________/

ORDER

THIS CAUSE is before the Court on Plaintiffs CSX Corporation's and CSX Insurance Company's Motion for Summary Judgment, Memorandum in

[1] Plaintiffs' claims against Defendant Steadfast Insurance Company and Steadfast's Counterclaim against Plaintiffs were dismissed pursuant to the Court's April 8, 2009 Order (Dkt. 74).

Support and Request for Oral Argument[2] (Dkt. 60), Defendant-Insurers' Memorandum of Law in Opposition thereto (Dkt. 65), and Plaintiffs' Reply Memorandum in Support of Plaintiffs' Motion for Summary Judgment (Dkt. 71); Defendant-Insurers' Motion for Summary Judgment and Memorandum of Law in Support as to All Counts of Plaintiffs' Amended Complaint[3] (Dkt. 62), Plaintiffs' Memorandum in Opposition to Insurer-Defendants' Motions for Summary Judgment and Request for Oral Argument (Dkt. 67), and Defendant-Insurers' Reply Memorandum (Dkt. 70); and the parties' Joint Request for Oral Argument on Motions for Summary Judgment (Dkt. 64).

I. Background

Plaintiffs, CSX Corporation ("CSX") and CSX Insurance Company ("CSXIC") (collectively, "Plaintiffs"), bring this declaratory judgment action against Defendants, North River Insurance Company ("North River"),

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[2] Plaintiffs' Motion for Summary Judgment (Dkt. 60) is incorporated in Plaintiffs' Memorandum in Opposition to Insurer-Defendants' Motions for Summary Judgment and Request for Oral Argument (Dkt. 67). Therefore, the Court will consider the arguments made in Plaintiffs' Motion and Reply when it addresses Defendant-Insurers' Motion for Summary Judgment (Dkt. 62).

[3] Defendant-Reinsurers Faraday and Aspen's Motion for Summary Judgment as to their Counterclaim for Declaratory Judgment (Dkt. 63) incorporates Defendant-Insurers' Motion for Summary Judgment and Memorandum of Law (Dkt. 62) and, specifically, those portions that deal with the Time Element issue. Therefore, the Court will not separately address Defendant-Reinsurers Faraday and Aspen's Motion (Dkt. 63).

American Re-Insurance Company ("Am Re"), Westchester Surplus Lines Insurance Company ("Westchester"), Hartford Fire Insurance Company ("Hartford"), Landmark American Insurance Company ("Landmark"), Faraday Capital Limited ("Faraday"), and Aspen Insurance UK Limited ("Aspen") (collectively, "Insurer-Defendants" or "Defendants"), who provided property or reinsurance coverage to Plaintiffs from February 1, 2005 to February 1, 2006. (Dkts. 24 and 27.)

Plaintiffs' losses were caused by Hurricane Katrina in August 2005, which damaged the property of two CSX subsidiaries — CSX Transportation, Inc. ("CSXT") and CSX Intermodal, Inc. ("CSXI"). (Dkts. 24, 27, and 59.) By February 2006, major repairs to the property of CSXT and CSXI have been completed and, as of April 1, 2006, CSXT and CSXI have resumed unrestricted operations on all relevant lines. (Dkt. 59.) CSX submitted an insurance claim to Insurer-Defendants for both property damage and time element (business interruption). (*Id.*)

Plaintiffs' damaged property that is the subject of this action includes two B30 diesel locomotives owned by CSXT, which were partially submerged in water. (*Id.*) The total cost of repairing these locomotives was $1,600,000. (*Id.*) As of August 2005, they were no longer in manufacture. (*Id.*) CSXT

elected to replace them with two new diesel locomotives in current manufacture of the next highest capacity for a total cost of $3.4 million. (*Id.*) The parties dispute the construction of the policy form CSX-P2-05. (*Id.*)

Plaintiffs also seek declaratory relief concerning the expenses that were incurred in retaining the consulting firm PriceWaterhouseCoopers ("PwC") to assist in the collection and analysis of data to help prepare CSX's Hurricane Katrina claim. (*Id.*) Insurer-Defendants retained Jim Ratcliff of Ratcliff Property Adjusting to adjust CSX's claim on Insurer-Defendants' behalf. (*Id.*) CSX provided and directed PwC to provide Insurer-Defendants or their agents, including Mr. Ratcliff, with certain information and materials produced by PwC. (*Id.*) CSX submitted the fees and expenses it paid to PwC as part of its insurance claim, but the parties dispute whether these expenses constitute "claims adjustments expenses" under policy form CSX-P2-05. (*Id.*)

In addition, a portion of CSX's claim is presented under the Time Element provision (Section (7)(B)) of policy form CSX-P2-05 on a customer-by-customer basis and includes over one hundred customers. (*Id.*) The services that are subject of the Time Element claim are transportation services provided by CSXT or CSXI. (*Id.*)

II. Relevant Contractual Provisions

The insurance policy in this case, CSX-P2-05, provides in relevant part:

(1) INSURED CSX Corporation and all subsidiary or affiliated companies as now exist or are hereafter constituted, ATIMA.

(2) TERM This policy attaches at 12:01 a.m., Local Standard Time, February 1, 2005 and expires 12:01 a.m., Local Standard Time February 1, 2006.

. . .

(7) COVERAGE

(A) Property Damage

(1) This policy insures:

(a) the Insured's interest in all property owned, used, or intended for use by the Insured . . . . This policy also covers the Insured's interest in property of others . . . .

(b) the expense of debris removal, rerail, salvage, defense, claims adjustments expenses and rerouting of insured property damaged by an insured peril;

. . .

(3) Valuation - the basis of adjustment shall be as follows:

. . .

(e) Loss or damage to buildings, structures, or other property shall be adjusted at the replacement cost on the date of loss if actually repaired or replaced. If any building or structure or other property is not repaired or replaced, loss shall be adjusted based on the actual cash value. . . .

For the purposes of this section, replacement cost shall mean the full cost to repair or replace with like kind and quality on the date of loss. However, this Insurer's liability for loss on a replacement cost basis shall not exceed the smallest of the following amounts:

i. the amount of this policy applicable to the damaged or destroyed property; or

ii. the replacement cost of the property or any part thereof identical with such property and intended for the same occupancy and functional use; or

iii. the amount actually and necessarily expended in repairing or replacing said property or any part thereof.

For the purpose of this section, actual cash value shall mean full cost to repair or replace with like kind and quality with proper deduction for physical depreciation on the date of loss. . . .

(f) Rolling Stock - All questions affecting

value, depreciation and repairs in connection with losses to rolling stock shall be settled as follows:

i. Owned Rolling Stock

Loss or damage to owned rolling stock, including locomotives, shall be adjusted at the replacement cost at the time of loss if actually replaced. If the above mentioned rolling stock is not replaced, the loss shall be adjusted at the actual cash value.

With respect to this Section (f) replacement cost shall mean the Insured's cost of units of like kind and quality on the date of loss. If units of like kind and quality are neither in production nor available for purchase as new equipment, the Insured's cost of current similar types of units will be replacement cost.

It is understood and agreed that in respect of loss to or claim for Diesel Locomotive(s) of a type or model no longer in manufacture, the loss settlement(s) shall be based the [sic] cost of a new unit in current manufacture equal to or the next higher capacity than the involved unit.

With respect to this Section (f) actual cash value of locomotives

shall mean the replacement cost as defined above depreciated by straight line depreciation of 2.5% per year subject to a maximum depreciation of 25%. Actual cash value shall in no event exceed what it would then cost to repair or replace the lost or damaged property with material of like kind and quality.

The above notwithstanding, when values and expenses cannot be reasonably determined, all questions affecting values, depreciation, repairs, salvage, and dismantling costs shall be settled in accordance with the factors published by the Association of American Railroads in effect at the time of loss, or factors later put into effect retroactive to the time of loss.

<u>Loss or damage to units will be considered as total when the cost of repair and/or replacement exceeds 80% of the replacement cost of that unit</u>.

The basis of loss settlement for Leased or Rented rolling stock shall be the same as that for Owned Rolling Stock except to the extent of the Insured's liability therefor.

. . .

(h) In case of loss or damage to any part of a

machine or unit consisting of two or more parts when complete either for sale or use, the liability of the Insurer shall be limited to the value of the part or parts lost or damaged, or, at the Insured's option, to the cost and expense of replacing or duplicating the lost or damaged part or parts, or of repairing the machine or unit.

. . .

(B) Time Element

(1) This policy insures loss resulting from <u>partial, complete, or potential suspension of business</u> conducted by the Insured (including research and development) <u>caused by loss, damage, or destruction to</u>:

(a) all property, except finished stock, as described in Section 7(A);

. . .

(d) real or personal property of others appurtenant to the premises of the Insured;

. . .

(j) real or personal property of others upon whom the Insured may be dependent for continued supply (or purchase) of services (including but not limited to electronic data processing services), raw materials, component parts, merchandise, or finished products;

(k) real or personal property of a receiver of goods or services from the Insured.

. . .

(4) Loss, shall be computed:

(a) from the time of the occurrence to the time when with due diligence and dispatch the property could be repaired and restored to normal operations not to be limited by the date of expiration named in this policy;

. . .

(d) for a period of time equivalent to the time in which, with due diligence and dispatch, property in the course of construction, erection, installation or assembly could be repaired or replaced.

(e) for such additional time as may be required to restore revenue to the same level as would have existed had no loss occurred, not to be limited by the date of expiration named in the policy.

. . .

(9) PERILS EXCLUDED

This policy does not insure:

. . .

(H) Delay, loss of market, bankruptcy, foreclosure.

. . .

(15) ARBITRATION

> If the Insured and Insurers fail to agree on the amount of adjusted loss, each, upon the written demand either of the Insured or of Insurers made within thirty (30) days after receipt of proof of loss by the Insurer, shall select a competent and disinterested appraiser. The appraisers will then select a competent and disinterested umpire.

(Dkt. 59-2 (emphasis added).)

III. Summary Judgment Standard

Summary judgment is proper "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Fed.R.Civ.P. 56(c). Issues are genuine if a reasonable jury could find for the non-movant and facts are material if they can affect the outcome. *Scottsdale Ins. Co. v. Cutz, LLC*, 543 F. Supp. 2d 1310, 1313 (S.D. Fla. 2007) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986)).

> The moving party bears the initial burden of stating the basis for its motion and identifying those portions of the record demonstrating the absence of genuine issues of material fact. . . . Once the moving party has discharged its burden, the nonmoving party must designate specific facts showing that there is a genuine issue of material fact. . . . All doubt as to the existence of a genuine issue of material fact must be resolved against the moving party. The court may not weigh the credibility of the parties on summary judgment.

Id. (internal citations omitted). The movant need not negate the other party's

claim. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Where the nonmoving party fails to prove an essential element of its case, the movant is entitled to summary judgment. *Id.*

Where cross motions for summary judgment are filed, the "court must rule on each party's motion on an individual and separate basis, determining, for each side, whether a judgment may be entered in accordance with the Rule 56 standard." *Scottsdale Ins. Co.*, 543 F. Supp. 2d at 1313-14 (internal quotations omitted). Cross-motions may be probative of the lack of a factual dispute if the parties generally agree on the material facts and controlling legal theories. *Id.* at 1314.

IV. Discussion

A. Time Element or Business Interruption Losses (Count I of the Amended Complaint)[4]

Defendants, North River, Am Re, Westchester, Hartford, Landmark, Faraday, and Aspen, argue that CSX's claim for "continuing" loss does not meet the plain requirements of the business interruption provision. (Dkt. 62.) Defendants assert that CSX must establish that (1) the property damage that

[4] Those parts of Defendant-Insurers' Motion for Summary Judgment (Dkt. 62) that deal with the Time Element issue are incorporated in Defendant-Reinsurers Faraday and Aspen's Motion for Summary Judgment as to their Counterclaim for Declaratory Judgment (Dkt. 63).

is alleged to have interrupted its business falls within one of the categories specified in the business interruption provision, (2) the property damage caused the suspension of business, (3) the suspension was a complete cessation of part of CSX's operations that prevented CSX from earning revenue, and (4) the claim extends no longer than the time hypothetically required to repair any covered property damage and restore the suspended operations plus such additional time as may be required to restore revenue. (Dkt. 70.)

Plaintiffs respond that the undisputed facts show: (i) Hurricane Katrina caused damage to covered property; (ii) CSXT and CSXI had business relationships with each of the fifteen customers at issue prior to Hurricane Katrina; (iii) business conducted by CSXT and CSXI with each of these fifteen customers was partially, completely, or potentially suspended as a result of the above property damage; (iv) since Hurricane Katrina, CSXT and CSXI have either not resumed business with the customers at issue or have resumed business at levels asserted to be lower than what would have existed had Hurricane Katrina not occurred; and (v) CSX suffered resulting loss. (Dkt. 71.) Plaintiffs explain that at issue here is that small number of their pre-Katrina business relationships that they were not able to resume to

the point required to restore revenue to the same level as would have existed had no loss occurred. (*Id.*) Plaintiffs also assert that the policies cover business interruption losses resulting not only from damage to the property of CSX, but also from damage to the property of third parties that are not directly related to CSX. (*Id.*)

Insurance contracts are interpreted as a whole and in context, and the plain language of the policy is followed unless the language is ambiguous, in which case it is construed in favor of the insured. *Swire Pac. Holdings, Inc. v. Zurich Ins.*, 845 So.2d 161, 165 (Fla. 2003). Whether a term is ambiguous is a question of law. *Escobar v. United Auto. Ins. Co.*, 898 So.2d 952, 954-55 (Fla. Dist. Ct. App. 2005). Language is not ambiguous for being complex or requiring analysis, but it is ambiguous for being "susceptible to more than one reasonable interpretation." *Swire*, 845 So.2d at 165. The absence of a definition does not make a term ambiguous, *Id.* at 166, but rather requires construction under its ordinary meaning, *Hyman v. Nationwide Mut. Fire Ins. Co.*, 304 F.3d 1179, 1188 (11th Cir. 2002). "Where a critical term is not defined in an exclusionary clause of the policy, it will be liberally construed in favor of an insured." *Westmoreland v. Lumbermens Mut. Cas. Co.*, 704 So.2d 176, 180 (Fla. Dist. Ct. App. 1997). Exclusionary clauses are

construed strictly, while coverage clauses are interpreted broadly to achieve the greatest possible coverage. *Id.* at 179. If a clause can be reasonably interpreted as both extending and excluding coverage, it will be construed as extending coverage. *Id.*

As a preliminary matter, Defendants correctly point out that some of the properties that were damaged by Hurricane Katrina are not covered under the Time Element provision because they do not fall under Section (7)(B)(1)(a), (d), (j), or (k). First, the cold storage facilities in Gulfport, Mississippi that were used by Global Trading, Calhoun Enterprises, and Ona Foods, were not owned, used, or intended for use by the Insured, were not appurtenant to the premises of the Insured, and were not the property of Global Trading, Calhoun Enterprises, or Ona Foods. (*See* Dkt. 59.) Therefore, these facilities are not property covered under Section (7)(B)(1).

Similarly, the warehouse facility located in Pearlington, Mississippi is not a covered property under the Time Element provision as it was used, but not owned, by IKEA, whose products were transported by Intermodal Management Services ("IMS"), a customer of CSXI.[5] (*Id.*) The MRGO is also

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[5] Plaintiffs' Memorandum in Opposition to Insurer-Defendants' Motions for Summary Judgment indicates that the facility in Pearlington, Mississippi was used by "IMS i.r.o. IKEA." (Dkt. 67.)

not covered under the Time Element provision because it was used, but not owned, by Lone Star. (*See* Dkts. 60-3, 62, and 67.) Further, since "[n]o property of Crowley, Matson or Birdsall experienced loss, damage or destruction as a result of Hurricane Katrina" (Dkt. 59), Plaintiffs also cannot recover for the effect of Hurricane Katrina on the business relationships between these three entities and CSXI. In addition, the Pass Christian, Mississippi facility used by Luxco Wax Co. ("Luxco") does not qualify as covered property under the Time Element provision because it was not owned by Luxco. (*See id.*)

In contrast, the Gulf Atlantic facility in Mobile, Alabama that was damaged as a result of Hurricane Katrina was owned by Gulf Atlantic Refining ("Gulf Atlantic"). (*See id.*) The Stipulated Facts demonstrate, however, that the Gulf Atlantic facility went out of business in September 2005 and Gulf Atlantic filed for bankruptcy in November 2006. (*Id.*) Importantly, Plaintiffs have not demonstrated that the suspension of business was "caused by loss, damage, or destruction to [Gulf Atlantic's property]" due to Hurricane Katrina as required by Section (7)(B).

The exhibits filed in this case show that Gulf Atlantic's "performance was prevented or delayed by two events that . . . are force majeure

events—hurricane Emily and hurricane Katrina." (Dkt. 69-2.) Moreover, the complaint filed by CSX Transportation, Inc. against Gulf Atlantic indicates that Gulf Atlantic breached their contract for the twelve-month period ending on December 31, 2005. (Dkt. 61-2.) In sum, Plaintiffs have not demonstrated that Hurricane Katrina was the sole, or even predominant, cause for the suspension of business. *See Dictiomatic, Inc. v. U.S. Fidelity & Guar. Co.*, 127 F. Supp. 2d 1239, 1242-43 (S.D. Fla. 1999) ("Dictiomatic failed to prove that but/for the 20 day suspension of operations, it sustained an actual loss of business income which was caused solely by the hurricane and not by other factors.").

With respect to Cargill Salt ("Cargill"), the property that was damaged belonged to CSXT and, thus, it seems to qualify as covered property under Section (7)(B)(1)(a). The Stipulated Facts demonstrate that by December 2005 the "damage to CSXT property that was used to provide services to Cargill" was repaired, but that "Cargill's demand for CSXT's services has not returned to the level that CSXT believes would have existed in the absence of Hurricane Katrina." (Dkt. 59 (emphasis added).)

The Court notes that to the extent Plaintiffs seek to recover for the lessened demand for CSXT's services, there could be no recovery under the

Time Element provision because the lessened demand does not constitute a suspension of business. *See Ramada Inn Ramogreen, Inc. v. Travelers Indem. Co. of Am.*, 835 F.2d 812, 813 (11th Cir. 1988) (affirming the district court's judgment that "the hotel's decrease in room occupancy due to the loss of its restaurant by fire is not a covered loss under the defendant insurance company's business interruption policy"); *see also Apt. Movers of Am., Inc. v. Onebeacon Lloyd's of Tex.*, 2005 U.S. Dist. LEXIS 695, at *9 (N.D. Tex. Jan. 19, 2005) (stating that suspension of operations "must come, not from a lack of customer demand, but of an inability to meet customer demand"); *Home Indem. Co. v. Hyplains Beef, L.C.*, 893 F. Supp. 987, 991 (D. Kan. 1995) (explaining that suspension means "a temporary, but complete, cessation of activity" and concluding the insured is not entitled to coverage on its claim for loss of business income because the policy requires "necessary suspension" rather than "a slowdown or reduction in operations").

On the other hand, to the extent CSX seeks to recover for interruption to the business of CSXT and CSXI based on the damage to their property,[6]

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[6] The Stipulated Facts demonstrate that Hurricane Katrina caused damage to "certain CSXT property that was used to provide services to Lone Star, which was repaired by February 2006" (¶ 35), "CSXT property that was used to provide services to Global Trading, which was repaired by September 2005" (¶ 47), "CSXT property that was used to provide services to Calhoun Enterprises and Ona Foods, which was repaired by February 2006" (¶ 47), "CSXI property that was used to provide shipping

Defendant-Insurers state they have paid that portion of CSX's claim. (Dkt. 70.) Plaintiffs counter that "Insurer-Defendants' contention that CSX has been 'fully compensated' by CSX's insurers and CSXIC's reinsurers for its business interruption loss 'linked to CSX's property damage through March 2006' finds no support in the stipulated facts." (Dkt. 71.) Plaintiffs point out that paragraph 13 of the Fact Stipulation, which does not include Defendants Faraday and Aspen, shows only that portions of CSX's time element claim have been paid. (*Id.*) Defendant-Insurers respond that "[t]o the extent there is any dispute as to the details of the measurement linked to damage to property of CSX and its subsidiaries, the parties have agreed those matters are to be submitted to appraisal." (Dkt. 65.)

Paragraph 13 of the Stipulated Facts provides that "[t]o date, the Insurer-Defendants participating on the third layer of insurance and/or reinsurance have paid portions of the Hurricane Katrina claim submitted by CSX, involving both property damage and portions of CSX's time element

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services to IMS . . . and Hub City . . ., which was repaired by February 2006" (¶ 55), "CSXI property that was used to provide shipping services to Crowley, Matson and Birdsall, which was repaired by February 2006" (¶ 62), "CSXT property that was used to provide shipping services to Gulf Atlantic, which was repaired by September 2005" (¶ 69), "CSXT property that was used to provide shipping services to Luxco, which was repaired by February 2006" (¶ 76), and "CSXT property that was used to provide services to Cargill, which was repaired by December 2005" (¶ 82). (Dkt. 59.)

claim." (Dkt. 59.) Section 15 of the policy provides that in the event "the Insured and Insurers fail to agree on the amount of adjusted loss, each . . . shall select a competent and disinterested appraiser." (Dkt. 59-2.) Although the Stipulated Facts show that CSX has been paid for *portions* of its Time Element claim (Dkt. 59), it is unclear whether those portions include, in whole or in part, the business interruption losses incurred as a result of damage to the property of CSXT and CSXI. Therefore, a genuine issue of a material fact exists and summary judgment will not be entered in favor of either party on this particular question.

In sum, as to Count I, Defendants' Motions for Summary Judgment (Dkts. 62 and 63) are due to be denied with respect to the issue of recovery for interruption to the business of CSXT and CSXI based on damage to their property, and the Motions are due to be granted with respect to the remaining issues. Plaintiffs CSX Corporation's and CSX Insurance Company's Motion for Summary Judgment (Dkt. 60) is due to be denied as to Count I.

B. Diesel Locomotive Losses (Count II of the Amended Complaint)

Defendants claim that as to a damaged locomotive, the policy contemplates either repair, replacement, or payment of actual cash value. (Dkt. 62.) Defendants argue that as a threshold matter it must be determined

whether the locomotive is a "total" loss. (Dkt. 65.) If the damage does not exceed 80% of a unit of like kind and quality, the locomotive is not a "total" loss and, therefore, the Insured is entitled to the cost of repair. (Dkts. 62 and 65.) Because the damage here did not exceed 80%, Defendants argue CSX is entitled to the cost of repair. (*Id.*)

Plaintiffs respond that Section (7)(A)(3)(f)(i) allows only two possible outcomes — replacement or actual cash value. (Dkts. 67 and 71.) Since CSXT replaced the two locomotives, Plaintiffs assert they are entitled to replacement costs. (Dkt. 60.) Unlike Sections (7)(A)(3)(e) and (7)(A)(3)(h), Plaintiffs argue Section (7)(A)(3)(f) does not provide for adjustment based on repair. (Dkts. 67 and 71.) Plaintiffs also claim that the reference to total loss in Section (7)(A)(3)(f)(i) does not bar recovery because, *inter alia*, the reference appears in that part of the section that shows how to calculate the actual cash value of diesel locomotives that are not replaced. (Dkt. 67.)

The plain language of Section (7)(A)(3)(f)(i) provides that "[l]oss or damage to owned rolling stock, including locomotives, shall be adjusted at the replacement cost at the time of loss if actually replaced." (Dkt. 59-2 (emphasis added).) This language does not require the loss or damage to be

total.[7] *Cf. Compagnie Des Bauxites De Guinee v. Three Rivers Ins. Co.*, 2:04-CV-393, at *15 (W.D. Penn. June 7, 2007) ("The parties likewise carefully segmented those forms of property loss that would be valued at replacement cost new, regardless of whether such property could be repaired."). Therefore, when CSXT elected to replace the two diesel locomotives that were damaged, it was entitled to the replacement cost at the time of loss.

The replacement cost is defined as "the Insured's cost of units of like kind and quality on the date of loss," but where, as here, there is a "loss to or claim for Diesel Locomotive(s) of a type or model <u>no longer in manufacture</u>, the loss settlement(s) shall be based the [sic] cost of a new unit in current manufacture equal to or the next higher capacity than the involved unit." (Dkt. 59-2.) Because CSXT was entitled to receive the cost of a new unit in current manufacture equal to <u>or the next higher capacity</u> than the involved unit and CSXT purchased two new diesel locomotives in current manufacture of the

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[7] Section (7)(A)(3)(f)(i) contains only one reference to "total" loss or damage. The sentence that contains the reference states as follows: "Loss or damage to units will be considered as <u>total</u> when the <u>cost of repair and/or replacement</u> exceeds <u>80%</u> of the <u>replacement cost</u> of that unit." (Dkt. 59-2 (emphasis added).) It is unclear how the cost of <u>replacement</u> can exceed 80% of the <u>replacement</u> cost. In light of this ambiguity, which must be construed in favor of the Insured, the lack of any other reference to total loss or damage in Section 7(A)(3)(f)(i), and the plain language of Section 7(A)(3)(f)(i), the Court finds Defendants' argument that CSX is entitled only to the cost of repair because the damage did not rise above the 80% threshold, to be unpersuasive.

next highest[8] capacity, the plain language of Section (7)(A)(3)(f)(i) requires that CSXT be reimbursed for the replacement costs.

In sum, as to Count II of Plaintiffs' Amended Complaint, Defendant-Insurers' Motion for Summary Judgment (Dkt. 62) is due to be denied and Plaintiffs CSX Corporation's and CSX Insurance Company's Motion for Summary Judgment (Dkt. 60) is due to be granted.

C. PwC Expenses (Count III of the Amended Complaint)

Defendants argue CSX should not be allowed to recover for its claim preparation expenses because the term "adjustment" is an activity undertaken on behalf of the Insurers in response to a claim prepared and submitted by the Insured. (Dkt. 65.) Defendants also point out there has been no contention that PwC was acting as a public adjuster or was qualified and licensed to do so. (Dkt. 70.)

Plaintiffs respond the plain meaning of the term "adjustments" is not restricted to activity undertaken on behalf of the Insurers in response to a claim submitted by the Insured, but rather includes the preparation of a claim

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[8] Although the Stipulated Facts include the phrase "next highest capacity," rather than "next higher capacity" as required by Section (7)(A)(3)(f)(i), the Court believes the parties actually intended to use the word "higher" due to their use of the word "next" and also because neither party argues the two new locomotives were not of the "next higher capacity."

on behalf of a policyholder. (Dkts. 67 and 71.) Plaintiffs also argue that it would make little sense to construe the policy as being limited to the expenses of Insurer-Defendants' claims adjuster because CSX would never incur those expenses. (Dkt. 60.)

Section (7)(A)(1)(b) provides that "claims adjustments expenses" are insured under the policy. (Dkt. 59-2.) The term "adjustments" is not defined in the policy; therefore, it will be construed under its ordinary meaning. *See Hyman*, 304 F.3d at 1188. "In the insurance industry, the phrase 'loss adjustment expenses' generally means the expense incurred by the insurer to investigate and settle a claim." *Woodliff v. Cal. Ins. Guar. Ass'n*, 3 Cal. Rptr. 3d 1, 3 (Cal. Ct. App. 2003). "Simply stated, an insured does not incur loss adjustment expenses because the insured does not initiate or control the loss adjustment process." *Id.*

Under Florida law, a qualified person can be either a public adjuster, an independent adjuster, or a company employee adjuster. Fla. Stat. § 626.864 (1990). "A 'public adjuster' is any person . . . who . . . prepares, completes, or files an insurance claim form for an insured . . . ." Fla. Stat. § 626.854 (2009). The "public adjuster is the only one who is limited by definition to act on behalf of an insured. The [other types of adjusters], by definition,

represent insurers." *Larson v. Lesser*, 106 So.2d 188, 190 (Fla. 1958).

In the present case, the Stipulated Facts show that PwC is a consulting firm, not an adjuster, and that it was retained by CSX. (*See* Dkt. 59.) In order to recover its expenses, CSX needs to show PwC is a public adjuster. Since CSX has failed to demonstrate that, it is not entitled to recover its expenses.

In sum, as to Count III of Plaintiffs' Amended Complaint, Defendant-Insurers' Motion for Summary Judgment (Dkt. 62) is due to be granted and Plaintiffs CSX Corporation's and CSX Insurance Company's Motion for Summary Judgment (Dkt. 60) is due to be denied.

Accordingly, it is **ORDERED**:

1. Plaintiffs CSX Corporation's and CSX Insurance Company's Motion for Summary Judgment (**Dkt. 60**) is **GRANTED in part and DENIED in part**. The Motion is granted as to Count II and denied as to Counts I and III.

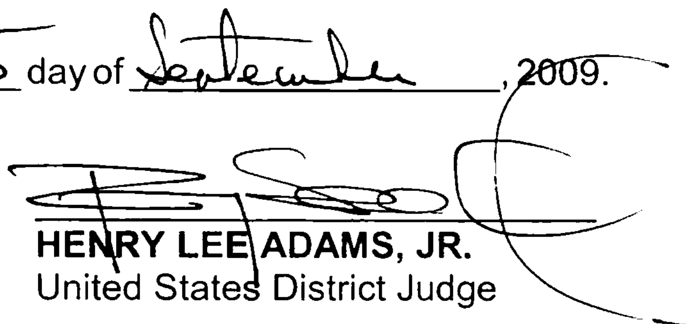
2. Defendant-Insurers' Motion for Summary Judgment (**Dkt. 62**) is **GRANTED in part and DENIED in part**. As to Count I, the Motion is denied with respect to the issue of recovery for interruption to the business of CSXT and CSXI based on damage to their property, and granted with respect to the remaining issues in Count I. The Motion is denied as to Count II and granted

as to Count III.

3. Defendant-Reinsurers Faraday and Aspen's Motion for Summary Judgment as to their Counterclaim for Declaratory Judgment (**Dkt. 63**) is **GRANTED in part and DENIED in part.** The Motion is denied with respect to the issue of recovery for interruption to the business of CSXT and CSXI based on damage to their property, and granted with respect to the remaining issues.

4. The Joint Request for Oral Argument on Motions for Summary Judgment (**Dkt. 64**) is **DENIED**.

DONE AND ORDERED this 25 day of September, 2009.



HENRY LEE ADAMS, JR.
United States District Judge

Copies to: Counsel of Record

Supreme Court of South Carolina.
The COLUMBIA COLLEGE, Appellant,
v.
The PENNSYLVANIA INSURANCE COMPANY, Respondent.
No. 18709.

Oct. 9, 1967.

***240 **418** Edens, Woodward & Butler, Roberts, Jennings & Thomas, Columbia, for appellant.

***241** Leatherwood, Walker, Todd & Mann, Greenville, for respondent.

LITTLEJOHN, Justice.

The defendant issued eight separate fire insurance policies on 28 buildings and their contents located on the campus of Columbia College, plaintiff herein, for a total face amount of $3,094,200.

In February, 1964, the dormitory-auditorium building, valued at $550,000 in the policy, and the administration building, valued at $200,000 in the policy, were completely destroyed, along with the contents, by fire.

***242 **419** Each policy provided a different amount of insurance coverage, and each of the buildings had an agreed value in the policies as required by State law (Sec. 37-154).

The defendant has paid $750,000 applicable to the two buildings and contends that this amount is the whole sum due under the terms of all the policies. In addition, personal property losses have been paid and are of no concern in this appeal.

The plaintiff-insured brings this action alleging that under the policies defendant is liable, by reason of the new Public and Institutional Property Plan and the replacement endorsement, for replacement costs (new) of the buildings, a total of $1,355,736 (less, however, $750,000 already paid), and prays judgment for the difference, to wit, $605,736.

The issues involved in this proceeding are the same as relate to each of the policies and the policies are attached to the plaintiff's amended complaint, marked as Exhibit A, and they are likewise incorporated by reference in the plaintiff's second amended complaint. Each of these policies is issued pursuant to a Public and Institutional Property Plan. Such an insurance plan is relatively new and has been in effect in South Carolina only since the year 1960. In that year the South Carolina Insurance Commissioner approved a proposal filed by the South Carolina Inspection and Rating Bureau.

Such an insurance plan is available to institutions such as Columbia College and provides blanket coverage for the insured's properties. The proper definition of ‘blanket coverage’ is in dispute and will be referred to later.

The original complaint was served August 19, 1965. Thereafter on September 3, 1965, plaintiff, as a matter of course, served an amended complaint to which were added copies of the eight fire insurance policies hereafter referred to as Exhibit A.

On September 15, 1965, defendant served a notice of motion to require the plaintiff to make the amended complaint***243** more definite and certain by identifying by numbers, as shown on Valuation Clause, No. 882, of policies, the two buildings alleged to have been burned

On October 15, 1965, plaintiff served upon defendant a notice of motion for leave to further amend its amended complaint by incorporating the filing with the Insurance Commissioner for approval of the Public and Institutional Property Plan. Such filings are hereinafter referred to as Exhibit B.

On October 21, 1965, the judge heard oral arguments on all outstanding matters. He did not consider the pleadings ripe for consideration of the de-

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murrer, but granted the defendant's motion to require that the amended complaint be made more definite and certain, such order being dated October 27, 1965. No mention is made in the order of plaintiff's motion to add the filings to the complaint.

On November 5, 1965, plaintiff, reserving its rights to later seek a review of the intermediate order of October 27, 1965, served a second amended complaint, indicating the numbers, as shown on Valuation Clause, No. 882, of the burned buildings, reincorporating the policies (Exhibit A), and including as a part of the second amended complaint the filings made by the South Carolina Inspection and Rating Bureau with the Insurance Commissioner (Exhibit B).

Defendant's demurrer, dated September 15, 1965, to the amended complaint was considered as applying to the second amended complaint. The demurrer submitted that the plaintiff's complaint ‘fails to state facts sufficient to constitute a cause of action upon which the relief demanded in the Complaint can be granted * * *.’ The essence of the demurrer is a contention by the defendant that it appears on the face of the complaint that the limit of liability under the policies made a part of the complaint for the loss of the two buildings involved is a total of $750,000, and it is ****420** admitted in the complaint that such amount has been paid.

The basic contention of the plaintiff is that blanket coverage is provided and that under the policies and endorsements***244** the insurance company is liable for total replacement cost of the two buildings destroyed by fire up to a maximum of $3,094,200, such that, notwithstanding the Valuation Clause, No. 882, agreeing upon the actual values of these two buildings as $750,000, an amount sufficient to replace these burned structures would be collectible so long as total payments remain less than $3,094,200.

It is the contention of the defendant that under no circumstance can an amount be collected for any one building greater than the amount indicated as the agreed actual value in Valuation Clause, No. 882.

The trial judge sustained the demurrer and construed the policies in keeping with the defendant insurance company's contention. The policies as relate to this controversy consist of the following:

(1) The insurance agreement (Standard S.C. Form)

(2) Valuation Clause, No. 882

(3) The Public and Institutional Property Form, P.I.Form No. 1

(4) Public and Institutional Property Replacement Cost Endorsement, P.I. Form No. 4

(5) Endorsement-General, No. 282.

Statement of Values, P.I. Form No. 6, is not a part of any policy but was apparently filed at the inception of the policies and annually thereafter by the plaintiff with the Inspection and Rating Bureau. One such filing of this form was exhibited to the lower court and was printed over the objection of the plaintiff in settling the record for appeal.

Schedule Conversion Endorsement (blank), P.I. Form No. 2, included as a part of Exhibit B, is not a part of any policy and it is the contention of the plaintiff that this is the endorsement which should have been used by the defendant in order to limit the defendant's liability in keeping with its contentions in this suit.

The case is now on appeal and appellant states three questions raised by the basic issue involved, and one question as ***245** relates to the granting of the motion to make more definite and certain, and one question as relates to the settlement of the record.

The issues as set forth by the questions stated in appellant's brief are as follows:

‘1. Did not the blanket replacement cost insurance afforded under each policy (P.I. Forms Nos. 1 and

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4) provide for recovery to the full extent of the face amount of each policy as to all of the property of every description damaged or destroyed by fire (apart from any effect of its Valuation Clause, No. 882, considered in Question 2)?

'2. Is the Valuation Clause, No. 882, in any policy to be construed on Demurrer as converting the blanket replacement cost coverage to a schedule listing of specific buildings, with a limited amount of replacement cost insurance on each building?

'3. Was there any proper evidence before the court to support His Honor's finding that the amounts set out in the Valuation Clause, No. 882, were based on the College's filing (Statement of Values) with the Inspection and Rating Bureau?

'4. Did His Honor err in requiring the College to amend its Complaint to describe the insured property in a manner different from the way it was described in the policies so that the Insurance Company could assert by Demurrer its construction of the policies?

'5. Did His Honor err in requiring the Appellant to print as an exhibit in the Transcript, a paper or document which **421 was neither a part of the Complaint nor before the Court on stipulation?'

The five instruments forming the insuring contracts and relevant to the issues have been enumerated above. In order to understand the issues, it is necessary to set forth portions of at least some of the instruments.

The insurance agreement is the standard fire insurance policy for South Carolina and none of its terms is determinative of the issues involved.

***246** The second instrument reads in part as follows:

'P.I. Form No. 1

Edition April 1960

'PUBLIC AND INSTITUTIONAL PROPERTY FORM

'(FOR USE ONLY WITH RATING PLAN FOR COVERING PUBLIC PROPERTY OR EDUCATIONAL INSTITUTIONS, CHURCHES AND HOSPITALS)

'SECTION I

'(A) $537,254 on all property of every description (except as otherwise limited or excluded) owned by the Insured, including architects fees, and on personal property of others for which the Insured assumed liability prior to loss, on the Insured's liability imposed by law for loss to personal property of others and on the Insured's interest in personal property belonging in whole or in part to others, all while situated at locations shown on the latest Statement of Values filed by the Insured with the South Carolina Inspection & Rating Bureau. (The $537,254 figure is taken from one policy. The eight policies totaled $3,094,200.)

SECTION II

'(A) In the determination of any loss under this policy caused by the peril(s) insured against, occuring after the inception date of this policy and prior to March 24, 1964/(Expiration Date of this Clause) this Company shall not be liable for a greater proportion of any loss than the amount of insurance under this policy bears to $3,094,200.' (The date and figure shown are not included in the original policy but are made effective by an endorsement dated July 3, 1963.)

The third instrument, No. 882, Valuation Clause, required by Section 37-154 of the South Carolina Code in all fire insurance policies whatsoever, reads in part as follows:

'Does NOT apply to any of the Perils named in the Extended Coverage.

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***247** 'Insurance under this policy is effected subject to the following agreements and provisions:

'Valuation Clause-The Insured and the Insurer hereby agree that the Value of buildings described herein is-and hereby fix the amount of insurance to be carried thereon (including this policy)-respectively, as follows:

'Agreed Value of Buildings'

'Building No. 1 $550,000.00

'Building No. 3 $200,000.00

'The agreed values as stated above are established for Insurance purposes only.'

The fourth instrument if:

'P. I. Form No. 4

Edition March 1960

'PUBLIC AND INSTITUTIONAL PROPERTY REPLACEMENT COST ENDORSEMENT

'(FOR USE ONLY WITH RATING PLAN FOR COVERING PUBLIC PROPERTY, OR EDUCATIONAL ****422** INSTITUTIONS, CHURCHES AND HOSPITALS)

'(1) In consideration of One Dollar ($1.00), the provisions of this policy are amended to substitute the term 'replacement cost' for the term 'actual cash value' wherever it appears in this policy and in Section II(B) of the form attached thereto, thereby eliminating any deduction for depreciation, subject, however, in all other respects to the provisions of this endorsement and of the policy to which this endorsement is attached.

'(2) It is a condition of this policy that when this endorsement is attached, the amount set forth in Section II(A) of the form attached to this policy shall be based upon 'replacement cost' and not 'actual cash value.'

'(3) * * *

'(4) The Insured may elect to make claim under this policy in accordance with its provisions, disregarding this ***248** endorsement and the Insured may make further claim for any additional liability brought about by this endorsement in accordance with its provisions, provided this Company is notified in writing within a reasonable time after loss of the Insured's intent to make such further claim.

'(5) THIS COMPANY'S LIABILITY FOR LOSS UNDER THIS POLICY INCLUDING THIS ENDORSEMENT SHALL NOT EXCEED THE SMALLEST OF THE FOLLOWING AMOUNTS (a), (b) or (c):

'(a) The amount of this policy applicable to the damaged or destroyed property;

'(b) The replacement cost of the property to which this endorsement applies, or any part thereof, identical with such property on the same premises and intended for the same occupancy and use;

'(c) The amount actually and necessarily expended in repairing or replacing such property or any part thereof.

'* * *'

As to the fifth instrument:

ENDORSEMENT-GENERAL-No. 282 has been used on the several policies to change the amount of coverage supplied by particular policies, as indicated in SECTION I(A) of P.I. Form No. 1, and to change the expiration date and the total coverage applicable through all policies, as indicated in SECTION II(A) of the same form. On all the General Endorsement Forms there is space to indicate the type of insurance: 'Specific,' 'Blanket,' or 'Reporting.' All Endorsements indicate 'Blanket' insurance.

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P.I. Form No. 6 is entitled 'STATEMENT OF VALUES.' Its filing is required before the policy is issued and annually thereafter by the insured with the Inspection and Rating Bureau to serve as the basis for the determination of the premium rate to be charged the insured under the Public and Institutional Property Plan. The same is not a part of any of the policies involved in this action, but a blank form is included as a part of the second amended complaint ***249** in Exhibit B. One such form, dated October 19, 1962, and executed by the insured, was exhibited to the judge in the course of the hearing and was printed in the transcript by the judge over the objection of counsel for the plaintiff. On the Statement of Values, space is provided to show 'Actual Cash Value' or 'Replacement Cost.' 'Replacement Cost' was indicated.

[1] Section 37-154 of the Code provides as follows:

'No company writing fire insurance policies * * * shall issue a policy for more than the value stated in the policy or the value of the property to be insured, the amount of insurance to be fixed by the insurer and the insured at or before the time of issuing the policy.' (This makes No. 882 necessary in all fire insurance policies whatsoever.)

****423** [2] Section 37-155 provides in part as follows:

'* * * riders or endorsements may, in consideration of an adequate premium or premium deposit, be attached to policies insuring property, indemnifying the insured for the difference between the actual value stated in the policy and the amount actually expended to repair, rebuild or replace with new materials of like size, kind and quality such insured property as has been damaged or destroyed by fire or other perils insured against.' (This allows replacement value policies notwithstanding Section 37-154.)

The first three questions set forth above as worded by counsel for the appellant raise actually only one question, as indicated by respondent's brief as follows:

'Has the Defendant paid to the Plaintiff because of the destruction by fire, on February 12, 1964, of Plaintiff's dormitory-auditorium and administration buildings all sums which it was obligated to pay by virtue of its contracts of insurance?'

The court below has held that the Valuation Clause, No. 882, determined the maximum amount of coverage and insurance collectible on the respective items set forth.

***250** The plaintiff contends that the dollar amount set forth in Property and Institutional Form P.I. Form No. 1, SECTION I, to wit, a total of $3,094,200, for the eight policies is the amount of the policy and that it is 'the amount of this policy applicable to the damaged or destroyed property,' as contemplated by Replacement Cost Endorsement, P.I. Form No. 4, Paragraph (5) (a), and contends that Valuation Clause, No. 882, is actually irrelevant to the issues involved in this case.

In order to understand the problems involved herein, it is necessary to discuss some of the instruments which together make up the whole contract of insurance.

[3] Section 37-155 allows an endorsement to be added to a fire insurance policy to indemnify an insured for the difference between the actual value stated in the policy (No. 882) and the amount actually expended to repair, rebuild, or replace the insured property. It is commonly referred to as replacement cost insurance, and previously called depreciation insurance. If one is paid actual cash value for the destruction of a building which is, by reason of depreciation, worth only one-half of its replacement cost, the insured is in no financial condition to replace the building. Replacement cost insurance was devised to provide money for reconstruction. In effect, the insurer, under this plan, agrees to pay not only actual value but also the difference between actual cash value and full replacement cost.

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[4] Section 37-155 contemplates and requires that actual value be inserted in the policy as a foundation for replacement costs coverage. The section permits an endorsement to indemnify 'the insured for the difference between The actual value stated in the policy and the amount actually expended to repair, rebuild or replace * * *.' (Emphasis added.)

Sections 37-674 and 37-691, relating to approvals of new plans of insurance, read as follows:

'Section 37-674. Rate filings required.-Every insurer shall file with the Commissioner, * * *, every manual, ***251** minimum or class rate, rating schedule or rating plan and every other rating rule and every modification of any of the foregoing which it proposes to use. Every such filing shall state the proposed effective date thereof and shall indicate the character and extent of coverage contemplated.'

'Section 37-691. No insurance issued except on rates filed.-No insurer shall make or issue a contract or policy except in accordance with the filings which are in effect for such insurer as provided in this chapter * * *.'

****424** [5] Pursuant to these sections, the South Carolina Inspection and Rating Bureau submitted to the Insurance Commissioner a Public and Institutional Property Plan in 1960, which was approved. This filing has been made a part of the second amended complaint by the lower court and we think properly so, and, therefore, the filing is a part of this complaint and appropriate for our consideration of the demurrer. Pursuant to such filing and approval the instant policies were issued.

[6][7] P.I. Form No. 1 as written provides for blanket insurance and compensates for actual cash value of property destroyed. (P.I. Form No. 4, discussed hereafter, may be used to convert P.I. Form No. 1 to replacement cost insurance.)

[8] P.I. Form No. 1, denominated 'Public and Institutional Property Form,' is not, standing alone, an insurance policy. There must first exist a valid insuring agreement to which it can be attached. Under the terms of 37-151 there can be no valid fire insurance policy until and unless Valuation Clause, No. 882, has been made a part of the same.

P.I. Form No. 1 brings into being what is commonly referred to as blanket coverage, or sometimes called blanket insurance. Its definition is stated in the Rules and Regulations of the Insurance Commission, page 327, Volume 17, of the South Carolina Code, as follows:

'Blanket coverage-Insurance which contemplates that the risk is shifting, fluctuating or varying, and which ***252** covers a class of property or persons rather than any particular thing or persons.'

The definition is almost identical with the definition given in National Bank of Burlington v. Fidelity & Casualty Co. of New York, 4 Cir., 125 F.2d 920, 140 A.L.R. 694.

It is similar to the definition included in Schmaelzle v. London & L. Fire Insurance Co., 75 Conn. 397, 53 A. 863, 60 L.R.A. 536.

'The characteristic features of a blanket policy are well understood. Its very essence is that it covers to the full amount every item of property described in it. If the loss upon one portion or item of the property exhausts the full amount of the policy, the whole insurance must be paid. There can be no apportionment of it. In the absence of a prorating clause, one blanket insurer among many insurers, whether blanket or specific, may be sued, and he must pay the whole loss, if it is not in excess of his policy.'

The Valuation Clause, No. 882, is an agreement by the insured and the insurer at the inception of the policy of the actual cash value of property insured and is a fixed amount continuing throughout the policy unless amended by endorsement. It is completely inconsistent with replacement cost insurance because the very nature of replacement cost insurance involves a fluctuating figure and can never be

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determined until after the loss has actually occurred and replacement cost figures procured.

It is of significance that Valuation Clause, No. 882, is not a Public and Institutional Property Plan form and is not among those forms submitted by the South Carolina Inspection and Rating Bureau to the Insurance Commissioner for approval.

[9][10] There is no doubt that the insurer considered this blanket insurance or blanket coverage, as is indicated by the fact that 'Blanket' in designating the type of insurance on its General Endorsement Form, No. 282, was checked by the insurer each time an ***253** endorsement was added. A space on this form is provided for either 'Specific' insurance or 'Reporting' insurance, but neither of the last two was checked. The insurer, having elected to denominate its policy 'Blanket' insurance, should be bound by the ordinary definition unless the same is inconsistent with the terms of the whole insuring agreement. It is not sufficient to say, as contended by counsel for the insurer, that under the law of South Carolina there is no requirement ****425** that blanket insurance have any certain features. This court attaches significance to the company's own designation of its policy along with all of the other contents of the policy and endorsements.

[11] The designation of type of insurance cannot make the contract, but the designation does indicate intent of the parties.

[12][13][14] Counsel for the insurance company argues that the term 'blanket insurance', as used in the endorsements, applies to only the personal property and that a distinction is made between real estate valued by No. 882 and personal property, for which no agreed valuation is required, and submits that replacement cost is applicable to the personal property insured because there is no agreed valuation to which the replacement cost endorsement can attach. This is a strained construction and if the insurer would make a distinction, such should be spelled out in the contract or be brought about by the use of P. I. Form No. 2. The Public and Institutional Property P.I. Form No. 1 provides an over-all amount to cover 'all property of every description * * * owned by the insured * * * at locations shown on the latest Statement of Values filed by the Insured with the South Carolina Inspection & Rating Bureau.' Under the universal rule adopted in our State, an ambiguity must be resolved in favor of the insured and construed most strongly against the insurer. Harleysville Mutual Casualty Company v. Nationwide Mutual Insurance Company, 248 S.C. 398, 150 S.E.2d 233.

***254** Replacement Cost Endorsement, P.I. Form No. 4, is not necessary in every case where blanket coverage is provided by P.I. Form No. 1. Blanket coverage as contemplated by P.I. Form No. 1 may provide the insured with actual cost value reimbursement or this Form No. 1 may provide the insured with replacement cost insurance when and if P.I. Form No. 4 is added as an endorsement. A study of P.I. Form No. 4 shows that its basic purpose is to substitute 'replacement cost' for the term 'actual cash value' wherever it appears in the policy. It is obviously held out to the insurance buyer as an increased benefit to bridge the gap between the value of a used building and the cost of replacing the same.

[15] It is the contention of the insurance company that it may elect under partgraph (5), subsection (a), to discharge its obligation by paying only the actual agreed values set forth in Valuation Clause, No. 882, as relate to buildings 1 and 3. We think, however, after P.I. Form No. 4 is attached, that 'the amount of this policy applicable to the damaged or destroyed property,' as used in paragraph (5), subsection (a), relates to the figure used in P.I. Form No. 1, SECTION I, or, in this case, the total of the eight figures in the eight policies, or $3,094,200.

P.I. Form No. 6, entitled 'Statement of Values,' is a part of the filing with the Insurance Commissioner and provides blanks to be filled in by the insured and sworn to showing the estimated values of the respective properties insured. This form is required

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before the policy is issued and annually thereafter.

It provides space for both personal property and real estate and has space for insured to indicate 'Actual Cash Value' or 'Replacement Cost.'

[16] Among such forms was one dated October 19, 1962, and filed by the insured with the South Carolina Inspection and Rating Bureau. It is used solely for the purpose of assisting the Rating Bureau in determining an appropriate premium to be charged. Such Statement of ***255** Values need not necessarily be adopted as a true basis for the premium and is subject to verification by the Bureau. See Rule 58-A, paragraph 5c, filed with the Insurance Commission by the Rating Bureau.

[17] A blank form is part of the filing (Exhibit B) and a part of the complaint, ****426** but the completed form which was filed with the Rating Bureau is not a part of the complaint, and is not relied upon by the plaintiff at this time. The same is not, therefore, appropriate for consideration of a demurrer and should have been disregarded by the lower court and will be disregarded by this court in making the determination as relates to the demurrer.

Among the forms submitted to the Rating Bureau and approved by the Insurance Commissioner is one entitled 'Schedule Conversion Endorsement,' P.I. Form No. 2. It is the contention of the insured that this is the form which should have been used if the insurance company would limit its liability along the line of its contentions in this case. This form is not a part of the policy, but a blank was submitted to the Insurance Commissioner and approved, and it is the form designed to bring about scheduled listings of specific or multiple items. In Rule No. 58-A, filed with the Insurance Commissioner, we find the following from Exhibit B:

'b. Schedule Conversion Endorsement, P.I. Form No. 2-

'(1) Only this endorsement may be used to convert P.I. Form No. 1 to provide schedule listing of specific or multiple items.'

The fact that this approved form was not used is helpful in determining intent of the parties.

[18] In interpreting the insuring agreement, which includes consideration of all the instruments, we have considered the intent and reasonable expectation of the parties. We think that the insured was justified in ***256** believing that blanket coverage was provided for both the real estate and the personal property referred to in P. I. Form No. 1.

[19] We conclude that Valuation Clause, No. 882, does not determine the extent of liability of the insurer under the policies and the lower court erred when it held that it did. The demurrer should have been overruled.

By exception, appellant challenges the correctness of the lower court's ruling in requiring the plaintiff to amend its complaint by indicating by numbers the burned buildings as they appear in Valuation Clause, No. 882. For the purpose of the demurrer we have held, in effect, that this form is not controlling on the issue of liability. However, we cannot anticipate what issues may be raised when the case is tried on its merits and at that time the trial judge can rule upon the relevancy of the matters allowed by the amendment in the light of the issues as they come to be developed.

[20][21] The allowance of amendments is largely a matter of discretion of the trial judge and we cannot say that he abused his discretion. Accordingly, this exception is overruled.

[22] By further exception, counsel for the plaintiff submits that the lower court erred in requiring the appellant to print as an exhibit in the transcript a copy of Statement of Values, P.I. Form No. 6, filed by the insured with the Rating Bureau. We have referred to this matter above and since the form was not a part of the complaint, same was not appropriate for consideration of the lower court or this court on demurrer. It was appropriate for the judge to

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consider the same as relates to the motion to make more definite and certain. We would, therefore, hold that it was not error to print the form solely as it might relate to consideration of the motion.

The order as relates to the demurrer is reversed. Let the defendant have 20 days from filing of the remittitur to answer.***257** On other issues the lower court is affirmed as indicated above.

Reversed in part; affirmed in part.

MOSS, C.J., and LEWIS, BUSSEY and BRAILSFORD, JJ., concur.
S.C. 1967.
Columbia College v. Pennsylvania Ins. Co.
250 S.C. 237, 157 S.E.2d 416

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WILLIAM T. CONWAY et al., Plaintiffs and Appellants,
v.
FARMERS HOME MUTUAL INSURANCE COMPANY, Defendant and Respondent.
No. D016627.

Court of Appeal, Fourth District, Division 1, California.
Jul 18, 1994.

SUMMARY

The trial court granted summary judgment for an insurer in an action against it by its insured seeking to recover the replacement cost of property damaged by fire for use in the purchase of another home, rather than the actual cash value of the property destroyed, as offered by the insurer. The policy provided for payment of “the amount actually and necessarily spent to repair or replace the damaged building” or “the actual cash value of the damage until actual repair or replacement is completed.” In ruling in the insurer's favor, the court reasoned that because the damaged house could have been repaired, the insured was not entitled to the replacement cost of the loss. (Superior Court of San Diego County, No. 634846, Alpha L. Montgomery, Judge.)

The Court of Appeal reversed and remanded for further proceedings. The court held that an insured homeowner may recover the replacement cost of property damaged by fire by purchasing another home at a different location. The court held that the provision for payment of “the actual cash value of the damage until actual repair or replacement is completed” does not require repair or replacement of an identical building on the same premises, but places that rebuilding amount as one of the measures of damage to apply in calculating liability under the replacement cost coverage. It comes into play when the insured desires to rebuild either a different structure or on different premises. The court further held that although the term “replace” includes rebuilding at the same premises, it also includes the notion of purchasing another structure at a different location. At best, the policy was ambiguous, and that ambiguity had to be resolved in the insured's favor. The insurer, having failed to clearly and unmistakably restrict payment of replacement cost to replacement on the same premises, could not contend that the insured would nonetheless have understood that such a limitation existed. (Opinion by Benke, Acting P. J., with Froehlich and Nares, JJ., concurring.)

HEADNOTES

Classified to California Digest of Official Reports

(**1a**, **1b**) Insurance Contracts and Coverage § 103--Extent of Loss of Insured and of Liability of Insurer--Fire Insurance--Replacement Cost Provision--Construction.
With respect to provisions in a fire insurance policy for payment of “the amount actually and necessarily spent to repair or replace the damaged building” or “the actual cash value of the damage until actual repair or replacement is completed,” the first measure limits the amount available for replacement to the policy limits, while the second relates to a theoretical or hypothetical measure of loss: that is, the replacement cost of rebuilding the identical structure as one limitation of the insurer's liability. This limitation does not require repair or replacement of an identical building on the same premises. Instead, it places that rebuilding amount as one of the measures of damage to apply in calculating liability under the replacement cost coverage. The effect of the limitation comes into play when the insured desires to rebuild either a different structure or on different premises. In those instances, the insurer's liability is not to exceed what it would have cost to replace a structure identical to the one lost on the same premises. Although liability is limited to rebuilding

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costs on the same site, the insured may then take that amount and build a structure on another site, or use the proceeds to buy an existing structure as the replacement, paying any additional amount from his or her own funds. [Construction and effect of property insurance provision permitting recovery of replacement cost of property, note, 1 **A.L.R.5th** 817.]

(**2a**, **2b**, **2c**) Insurance Contracts and Coverage § 103--Extent of Loss of Insured and of Liability of Insurer--Fire Insurance--Replacement Cost Provision--Construction--Provision as Permitting Use of Proceeds to Purchase Other Premises.
The trial court erred in granting summary judgment for an insurer in an action against it by its insured seeking to recover the replacement cost of property damaged by fire for use in the purchase of another home, rather than the actual cash value of the property destroyed. The policy provided for payment of "the amount actually and necessarily spent to repair or replace the damaged building" or "the actual cash value of the damage until actual repair or replacement is completed." Although the term "replace" includes rebuilding on the same premises, it also encompasses the notion of purchasing another house at a different location. At best, the provisions were ambiguous, and that ambiguity had to be resolved in the insured's favor. While one of the provisions limited recovery to replacement cost for equivalent construction on the same premises, the other provision did not refer to the same premises and limited replacement cost to the actual amount spent. The insured could easily have understood this to contemplate, rather than eliminate, the possibility of replacement at another premises. Having failed to clearly and unmistakably restrict payment of replacement cost to replacement on the same premises, the insurer could not contend that the insured would nonetheless have understood that such a limitation existed.

(**3**) Insurance Contracts and Coverage § 15--Rules in Aid of Interpretation of Contracts--Interpretation Against Insurer--Ambiguities.
While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply. The fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties, and, if contractual language is clear and explicit, it governs. However, if the terms of a promise are in any respect ambiguous or uncertain, they must be interpreted in the sense in which the promisor believed the promisee understood them at the time the parties entered into the contract. This rule, as applied to a promise of coverage in an insurance policy, protects not the subjective beliefs of the insurer but, rather, the objectively reasonable expectations of the insured. Only if this rule does not resolve the ambiguity is it then resolved against the insurer.
[See 1 **Witkin,** Summary of Cal. Law (9th ed. 1987) Contracts, §§ 699-704.]
COUNSEL

Hugh D. McLean for Plaintiffs and Appellants.

Kane & Whelan and Mark C. Kane for Defendant and Respondent.

BENKE, Acting P. J.

Consistent with all of the out-of-state authorities which have considered the issue, in this case we hold an insured homeowner may recover the replacement cost of fire damage to an insured home by purchasing another home at another location. Accordingly, we reverse the judgment entered in favor of the defendant insurer.

Factual and Procedural Summary

The facts which give rise to this appeal are, in all material respects, undisputed. In November 1989 plaintiffs and appellants William Conway ***1188** and Ken Whalen (Conway) purchased a house at 252 Daisy Avenue in Imperial Beach. Conway paid $230,000 for the house and subsequently rented it to tenants. Conway obtained $100,000 in fire insur-

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ance on the property from defendant and respondent Farmers Home Mutual Insurance Company (Farmers).

On March 11, 1990, the house was damaged by fire. Although the house could have been repaired, Conway decided not to make any repairs because Conway believed it made more economic sense to develop the Daisy Avenue parcel in conjunction with development of an adjacent parcel Conway owned. Instead of repairing the damage on Daisy Avenue, within three months of the fire Conway paid $230,000 for another single-family home on Ebony Avenue in Imperial Beach.

Following the fire Conway and Farmers submitted the amount of the fire loss to a panel of appraisers. The appraisers found the replacement cost of the fire loss was $90,721 but the actual cash value of the property destroyed was $76,279.44. Thereafter Farmers paid Conway $76,279.44.

On March 8, 1991, Conway filed a declaratory relief action against Farmers. Conway's complaint alleged Farmers was obligated to pay the replacement value of the loss, rather than the actual cash value.

Sitting without a jury, the trial court found in favor of Farmers. The trial court reasoned that because the Daisy Avenue house could have been repaired, Conway was not entitled to the replacement cost of the loss. Judgment was entered in favor of Farmers and Conway filed a timely notice of appeal.

Discussion

(1a) The policy Farmers issued to Conway promises that in the event of a fire at the insured premises, Farmers will pay for: “c. Buildings under Coverage A or B at replacement cost without deduction for depreciation, subject to the following: [¶] (1) 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 prior to the loss, we will pay the cost of repair or replacement, without deduction for depreciation, but not exceeding the smallest of the following amounts: [¶] (a) the limit of liability under this policy applying to the building; [¶] (b) the replacement cost of that part of the building damaged for equivalent construction and use on the same premises; or [¶] (c) the amount actually and necessarily spent to repair or ***1189** replace the damaged building.... [¶] (4) When the cost to repair or replace the damage is more than $1000 or more than 5% of the amount of insurance in this policy on the building, whichever is less, we will pay no more than the actual cash value of the damage until actual repair or replacement is completed.”

(2a) The parties vigorously dispute the meaning of the terms “replace” and “replacement” in paragraphs c.(1)(c) and c.(4). Farmers argues that when a building may be repaired, these terms require that any replacement of damaged property occur at the same location as the damaged building. Conway argues the policy places no restriction on where an insured may replace a damaged building.

In resolving this conflict we begin by noting there is no reported California case which discusses whether the replacement cost of a fire loss may be recovered where the insured decides to replace a damaged building by purchasing another building at a different location. However Conway's interpretation of the Farmers policy is supported by all of the out-of-state authorities which have considered the issue. (See, e.g., *S and S Tobacco v. Greater New York Mut.* (1992) 224 Conn. 313 [617 A.2d 1388, 1391]; *Huggins v. Hanover Ins. Co.* (Ala. 1982) 423 So.2d 147, 150; *Smith v. Michigan Basic Property Ins. Assn.* (1992) 441 Mich. 181 [490 N.W.2d 864, 868]; *Ruter v. Northwestern Fire & Marine* (1962) 72 N.J.Super. 467, 471-473 [178 A.2d 640, 643]; *Johnson v. Colonial Penn Ins. Co.* (1985) 127 Misc.2d 749, 751-752 [487 N.Y.S.2d 285]; *Blanchette v. York Mut. Ins. Co.* (Me. 1983) 455 A.2d 426, 427-428; see also *Hess v. North Pacific Ins. Co.* (1993) 122 Wn.2d 180 [859 P.2d 586, 588] [*Hess*].)

The court in *Hess* explained the genesis of the re-

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placement cost provisions of fire policies: “Traditional coverage was for the actual or fair cash value of the property. The owner was indemnified fully by payment of the fair cash value, in effect the market value, which is what the owner lost if the insured building was destroyed. [Citation.] [¶] However, it was recognized that an owner might not be made whole because of the increased cost to repair or to rebuild. Thus, replacement cost coverage became available. 'Replacement cost coverages ... go beyond the concept of indemnity and simply recognize that even expected deterioration of property is a risk which may be insured against.' ” (*Hess*, *supra*, 859 P.2d at p. 587.)

Significantly the policy in *Hess* contained standard limitations on the recovery of replacement costs identical to the ones in Farmers's policy. Although writing in the context of a dispute over whether the recovery of ***1190** replacement costs is permissible where an insured has not actually made any replacement, the court adopted the following interpretation of those limitations: (1b) “ 'The first measure, of course, limits the amount available for replacement to policy limits, while the second relates to a theoretical or hypothetical measure of loss: that is, the replacement cost of rebuilding the identical structure as one limit of the company's liability. *This particular limitation does not require repair or replacement of an identical building on the same premises, but places that rebuilding amount as one of the measures of damage to apply in calculating liability under the replacement cost coverage. The effect of this limitation comes into play when the insured desires to rebuild either a different structure or on different premises. In those instances, the company's liability is not to exceed what it would have cost to replace an identical structure to the one lost on the same premises. Although liability is limited to rebuilding costs on the same site, the insured may then take that amount and build a structure on another site, or use the proceeds to buy an existing structure as the replacement, but paying any additional amount from his or her own funds.*

“Finally, the third limitation of liability strengthens the requirement that liability of the company does not exist until repair or replacement is made. The purpose of this limitation is to limit recovery to the amount the insured spent on repair or replacement as yet another measure of the loss liability of the insurer. This third valuation method is intended to disallow an insured from recovering, in replacement cost proceeds, any amount other than that actually expended.' [Citation].” FN1 (*Hess*, *supra*, 859 P.2d at p. 588, italics added.)

FN1 The interpretation adopted by the court in *Hess* was taken from Jordan, *What Price Rebuilding*? (Spring 1990) 19 The Brief 17, 19-20.

(2b) We believe the result reached by the out-of-state authorities is the same one required under principles of contract interpretation established by our Supreme Court. In *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 821-822 [274 Cal.Rptr. 820, 799 P.2d 1253], the court stated: “Under statutory rules of contract interpretation, the mutual intention of the parties at the time the contract is formed governs interpretation. [Citation.] Such intent is to be inferred, if possible, solely from the written provisions of the contract. [Citation.] The 'clear and explicit' meaning of these provisions, interpreted in their 'ordinary and popular sense,' unless 'used by the parties in a technical sense or a special meaning is given to them by usage' [citation], controls judicial interpretation. [Citation.] Thus, if the meaning a layperson would ascribe to contract language is not ambiguous, we apply that meaning. [Citations.] [¶] If there is ambiguity, however, it is resolved by ***1191** interpreting the ambiguous provisions in the sense the promisor (i.e., the insurer) believed the promisee understood them at the time of formation. [Citation.] If application of this rule does not eliminate the ambiguity, ambiguous language is construed against the party who caused the uncertainty to exist. [Citation.] In the insurance context, we generally resolve ambiguities in favor of coverage. [Citations.] Similarly, we

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generally interpret the coverage clauses of insurance policies broadly, protecting the objectively reasonable expectations of the insured. [Citations.] These rules stem from the fact that the insurer typically drafts policy language, leaving the insured little or no meaningful opportunity or ability to bargain for modifications. [Citations.] Because the insurer writes the policy, it is held 'responsible' for ambiguous policy language, which is therefore construed in favor of coverage."

(3) In summarizing these rules the court in *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, 1264-1265 [10 Cal.Rptr.2d 538, 833 P.2d 545], stated: "While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply. [Citation.] The fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties. [Citation.] If contractual language is clear and explicit, it governs. [Citation.] On the other hand, '[i]f the terms of a promise are in any respect ambiguous or uncertain, it must be interpreted in the sense in which the promisor believed, at the time of making it, that the promisee understood it.' [Citations.] This rule, as applied to a promise of coverage in an insurance policy, protects not the subjective beliefs of the insurer but, rather, 'the objectively reasonable expectations of the insured.' [Citation.] Only if this rule does not resolve the ambiguity do we then resolve it against the insurer. [Citation.]"

(2c) In applying these principles to the instant dispute, we find no support for Farmers's interpretation. First, we note the ordinary and popular sense of the policy provisions does not clearly and explicitly include the restrictions on payment of replacement value which Farmers suggests. The dictionary definition of "replace" is: "1: to place again: restore to a former place, position, or condition 2: to take the place of: serve as a substitute for or successor of: Succeed, Supplant 3: to put in place of: provide a substitute or successor for 4: to fill the place of: supply an equivalent for." (Webster's New Internat. Dict. (3d ed. 1968) p. 1925.)

The dictionary definition does not draw any distinction between what can be repaired and what cannot be repaired. More importantly, although the term replace certainly includes rebuilding on the same premises, the term ***1192** also includes the notion of substituting for an original item another item which serves the same function as the original but is different in nature from the original. This broader and widely accepted meaning would certainly encompass the purchase of another house at a different location. Thus at best, Farmers can only contend there is an ambiguity in the policy with respect to the limitations on replacement of a damaged home.

In the absence of a clear and explicit meaning, we turn to what Farmers believed its insured would understand were the restrictions on recovery of replacement cost. (*AIU Ins. Co. v. Superior Court, supra*, 51 Cal.3d at p. 822.) Again we find nothing in the record or on the face of the policy which supports Farmers's interpretation. The policy promises that, subject to enumerated limitations, payment for damaged buildings will be at replacement cost without any deduction for depreciation. Moreover, taken together the limitations in paragraphs c.(1)(b) and c.(1)(c), suggest that purchase of a replacement home is a permissible alternative. Paragraph c.(1)(b) limits recovery to the replacement cost for equivalent construction on the same premises; without reference to the same premises paragraph c.(1)(c) further limits replacement cost to the actual amount spent on repair or replacement. The reference in one limitation to the same premises and the absence of such a reference in the other limitation might easily be understood as contemplating, rather than eliminating, the possibility of replacement at another premises. Having failed to clearly and unmistakably restrict payment of replacement cost to replacement on the same premises, Farmers cannot contend that the insured would nonetheless understand that such a limitation exists. (See *Reserve Insurance Co. v. Pisciotta* (1982) 30 Cal.3d 800, 809

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[180 Cal.Rptr. 628, 640 P.2d 764].)

Because the ordinary and popular use of "replace" includes the purchase of a replacement dwelling at another location and no other provision of the policy alerts the insured to a narrower limitation on payment of replacement costs, Farmers's argument brings us to the rule which requires that ambiguities are to be resolved in favor of the insured. (*AIU Ins. Co.*v. *Superior Court*, *supra*, 51 Cal.3d at pp. 822-823.) Under this rule of construction we reach the same result as the other courts which have considered the issue: the insured's purchase of a replacement dwelling at another location did not prevent recovery of the replacement cost of the insured loss.

Aside from Conway's failure to repair the house at Daisy Avenue, no other defense to payment of the replacement cost of Conway's loss appears on the record; thus the judgment entered in favor of Farmers must be reversed. Accordingly, the judgment is reversed and remanded for further ***1193** proceedings consistent with the views expressed in this opinion. Appellants to recover their costs of appeal.

Froehlich, J., and Nares, J., concurred. ***1194**

Cal.App.4.Dist.
Conway v. Farmers Home Mut. Ins. Co.
26 Cal.App.4th 1185, 31 Cal.Rptr.2d 883

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United States Court of Appeals,
Eighth Circuit.
GEORGIA-PACIFIC CORPORATION, Appellee,
v.
ALLIANZ INSURANCE COMPANY, Appellant.
No. 92-1635WA.

Submitted Sept. 14, 1992.
Decided Oct. 19, 1992.
Rehearing Denied Dec. 2, 1992.

***460** Dennis L. Shackleford, El Dorado, Ark., argued (William P. Linhoff, Jr. and John P. Bovich, Newport Beach, Cal., on the brief), for appellant.

Richard Griffin, Crossett, Ark., argued (Gary M. Draper, on the brief), for appellee.

Before RICHARD S. ARNOLD, Chief Judge, HENLEY, Senior Circuit Judge, and FAGG, Circuit Judge.

RICHARD S. ARNOLD, Chief Judge.

Georgia-Pacific brought this action against its insurer, Allianz Insurance Co., after Allianz denied coverage for damage to one of Georgia-Pacific's Yankee dryers. The jury found the loss was covered and awarded Georgia-Pacific the full amount of its claim, over four million dollars. The District Court FN1 denied Allianz's motion for a new trial and granted Georgia-Pacific's motion for prejudgment interest, attorneys' fees, and a twelve per cent. penalty under state law. Allianz appeals.

FN1. The Hon. Oren Harris, Senior United States District Judge for the Eastern and Western Districts of Arkansas.

Georgia-Pacific, which operates industrial facilities throughout the United States, maintained a boiler and machinery policy with Allianz, effective from April 1, 1986, through April 1, 1989. The policy insured Georgia-Pacific against damage to defined "objects" at Georgia-Pacific's facilities caused by an "accident," as that term was defined in the policy. The policy also covered business-interruption losses sustained as a result of an accident.

One of the facilities insured under this policy was a pulp and paper mill in Crossett, Arkansas. Georgia-Pacific operates four paper-making machines at this facility, each machine containing a Yankee dryer. (The Yankee dryer is a large rotating drum used to dry tissue paper.) On February 15, 1989, Georgia-Pacific discovered a crack in one "head" of Yankee Dryer No. 7. Georgia-Pacific immediately shut down the entire machine, removed the dryer, and stored it. To mitigate its business-interruption loss, Georgia-Pacific refurbished an old dryer, Yankee Dryer No. 6, which had been taken out of service in 1981, and installed it in the paper machine as a temporary substitute. For the permanent replacement, rather than repairing Yankee Dryer No. 7, Georgia-Pacific chose to buy a new dryer with a larger capacity. Georgia-Pacific has received the new dryer, but has not yet installed it.

In July of 1989, Georgia-Pacific filed a claim with Allianz. The claim requested coverage for (1) the cost to remove, repair, and reinstall Yankee Dryer No. 7, including extra expense to expedite the repairs; (2) the cost to refurbish and install Yankee Dryer No. 6; (3) the business-interruption loss sustained from the date of the accident until Dryer No. 6 was refurbished and installed as a replacement; and (4) the estimated business-interruption loss to remove Dryer No. 6 and reinstall the repaired Dryer No. 7. Allianz denied the claim, and Georgia-Pacific brought this action. After the jury awarded Georgia-Pacific all of the damages it requested, Allianz appealed.

The dispute in this case is not whether the policy covers the claim, but how much of the claim is covered. Allianz argues that the cost to reinstall Dryer No. 7 and the cost to expedite the physical

repair of Dryer No. 7 are not recoverable, since Dryer No. 7 not only was never repaired, but will never be reinstalled. In addition, Allianz objects to the recovery of the estimated business-interruption loss which would have occurred when No. 6 was being removed and No. 7 was being reinstalled, since, having never been sustained, the loss is not "actual." We reject Allianz's arguments and affirm the judgment of the District Court.

I.

[1] Allianz's first claim is that it is not responsible for the cost to remove Dryer ***461** No. 6 and reinstall Dryer No. 7, since this has not and never will occur. Allianz did not, however, appeal the award of damages for the repair of Dryer No. 7, even though Dryer No. 7 has not been and never will be repaired. We hold that the policy covers both of these costs for the same reason. That is, both would have been necessary had Georgia-Pacific chosen to repair, as it was entitled to do under the policy, rather than replace, Dryer No. 7. The fact that the insured chose a more expensive option-to replace the damaged dryer with a new, larger-capacity dryer-does not mean that it cannot recover the cost of the cheaper option allowed by the policy.

For covered losses, which this loss is, the policy provides as follows:

g. Valuation

(1) We will pay you the amount you spend to repair or replace your property directly damaged by an "accident." Our payment will be the smallest of:

(a) The Limit of Insurance;

(b) The cost at the time of the "accident" to repair the damaged property with property of like kind, capacity, size and quality;

(c) The cost at the time of the "accident" to replace the damaged property on the same site with other property:

(i) Of like kind, capacity, size and quality; and

(ii) Used for the same purpose;

(d) The amount you actually spend that is necessary to repair or replace the damaged property.

* * * * * *

(3) We will not pay you:

(a) ...

(b) For any extra cost if you decide to repair or replace the damaged property with property of a better kind or quality or of larger capacity.

Appellant's Appendix 62.

The policy makes it clear that Allianz will pay the lesser of repairing or replacing the property. If the insured decides to replace the property with property of a better kind or quality or of a larger capacity, Allianz will not pay for the extra cost. This provision suggests that Allianz at least anticipates such an occurrence. Although Allianz will not pay the extra cost in such a situation, it is in no way released from its obligation to pay what it otherwise would be required to pay had the insured not upgraded the property. In the case before us, had Georgia-Pacific not chosen to upgrade its dryer, Allianz would have had to pay all of the costs associated with repairing Dryer No. 7, including removing Dryer No. 6 and reinstalling Dryer No. 7. Allianz also argues that Georgia-Pacific never intended to replace Dryer No. 6 with Dryer No. 7 or any other dryer, but intended No. 6 to function as a permanent replacement. Therefore, reinstallation of Dryer No. 7 never would have occurred. The jury rejected this argument, and its finding is sufficiently supported in the record.

This situation is analogous to that of wrecking a

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car. If you wreck your car, you may choose to repair it, replace it, or do neither. The insurer, on the other hand, is generally obligated to pay you either the cost to repair the car or the car's value, whichever is less. The fact that you decide to replace the car or to ride the bus and do nothing to the car in no way changes the insurer's duty to pay you. Similarly, in this case, Allianz must pay the cost of repairing and reinstalling Dryer No. 7 even though Georgia-Pacific has chosen instead to replace it.

II.

[2] Allianz next argues that the $57,000 cost to expedite the repairs for Dryer No. 7 is not recoverable, because the expense was never incurred. The policy provides that Allianz will pay "the reasonable extra cost to ... expedite permanent repairs...." Uncontradicted testimony at trial indicated that, had Dryer No. 7 been repaired, it would have been more economical to expedite the manufacturing of the head. Allianz does not dispute this, but argues that since no new head was actually manufactured, Georgia-Pacific never paid extra to expedite anything. Therefore, Allianz reasons, it has no duty to cover such an expense.

***462** Once again, the amount recoverable is not the amount spent. Otherwise, the judgment would be significantly greater to account for the new larger-capacity dryer the insured actually purchased to replace Dryer No. 7. The amount recoverable is determined from the policy language. The policy provides that Allianz will pay the cost to replace the property, repair the property, or the amount the insured actually spends to repair or replace it, whichever is less. If the jury had found that Dryer No. 6 was meant to be a permanent, rather than a temporary, replacement, then the amount the insured spent to replace the property (with Dryer No. 6) would be the smallest amount. Consequently, Allianz would not have been obligated to pay the expediting expense or, for that matter, any of the other costs it disputes. The jury did not find that Dryer No. 6 was intended to be a permanent replacement, however. Thus, the entire cost of repairing Dryer No. 7, the least expensive option, including the cost to expedite the manufacturing that would have been necessary to accomplish the repair, is recoverable.

III.

[3] Finally, Allianz argues that the award representing the estimated business-interruption loss that will be sustained when Dryer No. 6 is replaced is not recoverable because it is not an "actual loss sustained." The business-interruption part of the policy provides that Allianz will pay the following costs:

> a. Your "actual loss" from a total or partial interruption of business; and
>
> b. The reasonable extra expense incurred by you or us to reduce or avert interruption of business. The amount we pay for extra expense is limited to the extent that our payment under paragraph a. is reduced.

Appellant's Addendum 23. The policy defines actual loss as

> a. The net profits you fail to earn because of business interruption resulting from an "accident"; and
>
> b. Whatever part of the following fixed charges and expenses the business failed to earn but would have earned if there had been no "accident"....
>
>> In calculating the "actual loss," we will take into account the actual experience of your business before the "accident" and the probable experience you would have had without the "accident".

Appellant's Addendum 24.

We note first that the disputed loss was calculated as if Georgia-Pacific had chosen to repair and reinstall Dryer No. 7, and not on the basis of the installation of the new larger dryer, which, presumably,

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will take more time to install. Allianz's principal argument is that Georgia-Pacific has admitted that the loss has not yet been sustained and may never be sustained. It points to the testimony of Robert Wright, Georgia-Pacific's comptroller, who admitted that if Dryer No. 6 were never replaced, no business-interruption loss would occur. Appellant's Appendix 44. This is an obvious answer to a hypothetical question. Allianz mischaracterizes this answer by calling it an admission by the insured that it may never sustain the loss. Once again, we remind Allianz that the jury believed Georgia-Pacific's claim that it intended Dryer No. 6 to be a temporary replacement. The question then is not whether there will be an interruption, but what it would have cost Georgia-Pacific-in the form of a loss from business interruption-to reinstall Dryer No. 7. The jury determined that Georgia-Pacific proved it would have cost $824,100. This finding is supported by the evidence.

Allianz also claims the amount of the loss is speculative for several reasons: the insured does not know exactly how long it would have taken to remove Dryer No. 6 and replace it with Dryer No. 7, what the economy or paper market will be like when the swap occurs, or whether the plant will already be down for maintenance when the swap occurs. Since the loss has not occurred, and these factors make the amount of the loss a mere guess, Allianz argues, the loss is not an "actual loss." The jury estimated the amount of the loss on the ***463** basis of the evidence presented. Its estimate is not unreasonable.

Allianz also cites cases for the proposition that a business-interruption loss must be actually experienced before the insured can recover. See *Metalmasters of Minneapolis, Inc. v. Liberty Mutual Ins. Co.,* 461 N.W.2d 496 (Minn.App.1990); *Royal Indemnity Co. v. Little Joe's Catfish Inn, Inc.,* 636 S.W.2d 530 (Tex.App.1982); *Berkeley Inn, Inc. v. Centennial Ins. Co.,* 282 Pa.Super. 207, 422 A.2d 1078 (1980). As the able opinion of the District Court points out, these cases all involved businesses which were not profitable and, for that reason, experienced no loss. Allianz argues that a business which has sustained no loss because it is unprofitable is equivalent under the policy to a business which has sustained no loss because there has been no interruption. We disagree. An unprofitable business cannot prove it failed or will fail to earn net profits because of a business interruption. The more likely reason it will fail to earn net profits is that it was an unprofitable business to begin with. A profitable business like Georgia-Pacific, on the other hand, can prove it will fail to earn net profits because of the interruption based on the business's "actual experience ... before the 'accident' and the probable experience [it] would have had without the 'accident.' " Appellant's Addendum 24. This is exactly the evidence Georgia-Pacific presented to the jury. We reject Allianz's argument that to be an "actual loss" covered by the policy, the loss must have already been experienced. The business-interruption loss here will never be experienced since it is based on an event-reinstallation of Dryer No. 7-that will never occur. But Georgia-Pacific did prove that $824,100 was a reasonable estimate of the loss that would have been sustained if it had chosen the least expensive option available to it under the policy.

We have upheld the District Court's award of damages in all respects. It follows that the award of fees and statutory penalty, which depends on the insured's recovery of 80% of the amount demanded in its amended complaint, must also be affirmed.

Affirmed.

C.A.8 (Ark.),1992.
Georgia-Pacific Corp. v. Allianz Ins. Co.
977 F.2d 459

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BUSINESS INCOME (AND EXTRA EXPENSE) COVERAGE FORM

Various provisions in this policy restrict coverage. Read the entire policy carefully to determine rights, duties and what is and is not covered.

Throughout this policy the words "you" and "your" refer to the Named Insured shown in the Declarations. The words "we", "us" and "our" refer to the Company providing this insurance.

Other words and phrases that appear in quotation marks have special meaning. Refer to Section **G.** – **Definitions.**

A. Coverage

1. Business Income

Business Income means the:

a. Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred; and

b. Continuing normal operating expenses incurred, including payroll.

For manufacturing risks, Net Income includes the net sales value of production.

Coverage is provided as described and limited below for one or more of the following options for which a Limit of Insurance is shown in the Declarations:

a. Business Income including "Rental Value".

b. Business Income other than "Rental Value".

c. "Rental Value".

If option **a.** above is selected, the term Business Income will include "Rental Value". If option **c.** above is selected, the term Business Income will mean "Rental Value" only.

If Limits of Insurance are shown under more than one of the above options, the provisions of this Coverage Part apply separately to each.

We will pay for the actual loss of Business Income you sustain due to the necessary "suspension" of your "operations" during the "period of restoration". The "suspension" must be caused by direct physical loss of or damage to property at premises which are described in the Declarations and for which a Business Income Limit of Insurance is shown in the Declarations. The loss or damage must be caused by or result from a Covered Cause of Loss. With respect to loss of or damage to personal property in the open or personal property in a vehicle, the described premises include the area within 100 feet of the site at which the described premises are located.

With respect to the requirements set forth in the preceding paragraph, if you occupy only part of the site at which the described premises are located, your premises means:

a. The portion of the building which you rent, lease or occupy; and

b. Any area within the building or on the site at which the described premises are located, if that area services, or is used to gain access to, the described premises.

2. Extra Expense

a. Extra Expense coverage is provided at the premises described in the Declarations only if the Declarations show that Business Income coverage applies at that premises.

b. Extra Expense means necessary expenses you incur during the "period of restoration" that you would not have incurred if there had been no direct physical loss or damage to property caused by or resulting from a Covered Cause of Loss.

We will pay Extra Expense (other than the expense to repair or replace property) to:

(1) Avoid or minimize the "suspension" of business and to continue operations at the described premises or at replacement premises or temporary locations, including relocation expenses and costs to equip and operate the replacement location or temporary location.

(2) Minimize the "suspension" of business if you cannot continue "operations".

We will also pay Extra Expense to repair or replace property, but only to the extent it reduces the amount of loss that otherwise would have been payable under this Coverage Form.

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3. Covered Causes Of Loss, Exclusions And Limitations

See applicable Causes of Loss Form as shown in the Declarations.

4. Additional Limitation – Interruption Of Computer Operations

a. Coverage for Business Income does not apply when a "suspension" of "operations" is caused by destruction or corruption of electronic data, or any loss or damage to electronic data, except as provided under the Additional Coverage – Interruption Of Computer Operations.

b. Coverage for Extra Expense does not apply when action is taken to avoid or minimize a "suspension" of "operations" caused by destruction or corruption of electronic data, or any loss or damage to electronic data, except as provided under the Additional Coverage – Interruption Of Computer Operations.

c. Electronic data means information, facts or computer programs stored as or on, created or used on, or transmitted to or from computer software (including systems and applications software), on hard or floppy disks, CD-ROMs, tapes, drives, cells, data processing devices or any other repositories of computer software which are used with electronically controlled equipment. The term computer programs, referred to in the foregoing description of electronic data, means a set of related electronic instructions which direct the operations and functions of a computer or device connected to it, which enable the computer or device to receive, process, store, retrieve or send data.

5. Additional Coverages

a. Civil Authority

We will pay for the actual loss of Business Income you sustain and necessary Extra Expense caused by action of civil authority that prohibits access to the described premises due to direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss.

The coverage for Business Income will begin 72 hours after the time of that action and will apply for a period of up to three consecutive weeks after coverage begins.

The coverage for Extra Expense will begin immediately after the time of that action and will end:

(1) 3 consecutive weeks after the time of that action; or

(2) When your Business Income coverage ends;

whichever is later.

b. Alterations And New Buildings

We will pay for the actual loss of Business Income you sustain and necessary Extra Expense you incur due to direct physical loss or damage at the described premises caused by or resulting from any Covered Cause of Loss to:

(1) New buildings or structures, whether complete or under construction;

(2) Alterations or additions to existing buildings or structures; and

(3) Machinery, equipment, supplies or building materials located on or within 100 feet of the described premises and:

(a) Used in the construction, alterations or additions; or

(b) Incidental to the occupancy of new buildings.

If such direct physical loss or damage delays the start of "operations", the "period of restoration" for Business Income Coverage will begin on the date "operations" would have begun if the direct physical loss or damage had not occurred.

c. Extended Business Income

(1) Business Income Other Than "Rental Value"

If the necessary "suspension" of your "operations" produces a Business Income loss payable under this policy, we will pay for the actual loss of Business Income you incur during the period that:

(a) Begins on the date property (except "finished stock") is actually repaired, rebuilt or replaced and "operations" are resumed; and

(b) Ends on the earlier of:

(i) The date you could restore your "operations", with reasonable speed, to the level which would generate the business income amount that would have existed if no direct physical loss or damage had occurred; or

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(ii) 30 consecutive days after the date determined in **(1)(a)** above.

However, Extended Business Income does not apply to loss of Business Income incurred as a result of unfavorable business conditions caused by the impact of the Covered Cause of Loss in the area where the described premises are located.

Loss of Business Income must be caused by direct physical loss or damage at the described premises caused by or resulting from any Covered Cause of Loss.

(2) "Rental Value"

If the necessary "suspension" of your "operations" produces a "Rental Value" loss payable under this policy, we will pay for the actual loss of "Rental Value" you incur during the period that:

(a) Begins on the date property is actually repaired, rebuilt or replaced and tenantability is restored; and

(b) Ends on the earlier of:

(i) The date you could restore tenant occupancy, with reasonable speed, to the level which would generate the "Rental Value" that would have existed if no direct physical loss or damage had occurred; or

(ii) 30 consecutive days after the date determined in **(2)(a)** above.

However, Extended Business Income does not apply to loss of "Rental Value" incurred as a result of unfavorable business conditions caused by the impact of the Covered Cause of Loss in the area where the described premises are located.

Loss of "Rental Value" must be caused by direct physical loss or damage at the described premises caused by or resulting from any Covered Cause of Loss.

d. Interruption Of Computer Operations

(1) Under this Additional Coverage, electronic data has the meaning described under Additional Limitation – Interruption Of Computer Operations.

(2) Subject to all provisions of this Additional Coverage, you may extend the insurance that applies to Business Income and Extra Expense to apply to a "suspension" of "operations" caused by an interruption in computer operations due to destruction or corruption of electronic data due to a Covered Cause of Loss.

(3) With respect to the coverage provided under this Additional Coverage, the Covered Causes of Loss are subject to the following:

(a) If the Causes Of Loss – Special Form applies, coverage under this Additional Coverage – Interruption Of Computer Operations is limited to the "specified causes of loss" as defined in that form, and Collapse as set forth in that form.

(b) If the Causes Of Loss – Broad Form applies, coverage under this Additional Coverage – Interruption Of Computer Operations includes Collapse as set forth in that form.

(c) If the Causes Of Loss Form is endorsed to add a Covered Cause of Loss, the additional Covered Cause of Loss does not apply to the coverage provided under this Additional Coverage – Interruption Of Computer Operations.

(d) The Covered Causes of Loss include a virus, harmful code or similar instruction introduced into or enacted on a computer system (including electronic data) or a network to which it is connected, designed to damage or destroy any part of the system or disrupt its normal operation. But there is no coverage for an interruption related to manipulation of a computer system (including electronic data) by any employee, including a temporary or leased employee, or by an entity retained by you or for you to inspect, design, install, maintain, repair or replace that system.

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(4) The most we will pay under this Additional Coverage – Interruption of Computer Operations is $2,500 for all loss sustained and expense incurred in any one policy year, regardless of the number of interruptions or the number of premises, locations or computer systems involved. If loss payment relating to the first interruption does not exhaust this amount, then the balance is available for loss or expense sustained or incurred as a result of subsequent interruptions in that policy year. A balance remaining at the end of a policy year does not increase the amount of insurance in the next policy year. With respect to any interruption which begins in one policy year and continues or results in additional loss or expense in a subsequent policy year(s), all loss and expense is deemed to be sustained or incurred in the policy year in which the interruption began.

(5) This Additional Coverage – Interruption in Computer Operations does not apply to loss sustained or expense incurred after the end of the "period of restoration", even if the amount of insurance stated in **(4)** above has not been exhausted.

6. Coverage Extension

If a Coinsurance percentage of 50% or more is shown in the Declarations, you may extend the insurance provided by this Coverage Part as follows:

Newly Acquired Locations

a. You may extend your Business Income and Extra Expense Coverages to apply to property at any location you acquire other than fairs or exhibitions.

b. The most we will pay under this Extension, for the sum of Business Income loss and Extra Expense incurred, is $100,000 at each location.

c. Insurance under this Extension for each newly acquired location will end when any of the following first occurs:

(1) This policy expires;

(2) 30 days expire after you acquire or begin to construct the property; or

(3) You report values to us.

We will charge you additional premium for values reported from the date you acquire the property.

This Extension is additional insurance. The Additional Condition, Coinsurance, does not apply to this Extension.

B. Limits Of Insurance

The most we will pay for loss in any one occurrence is the applicable Limit of Insurance shown in the Declarations.

The limit applicable to the Coverage Extension is in addition to the Limit of Insurance.

Payments under the following coverages will not increase the applicable Limit of Insurance:

1. Alterations and New Buildings;
2. Civil Authority;
3. Extra Expense; or
4. Extended Business Income.

C. Loss Conditions

The following conditions apply in addition to the Common Policy Conditions and the Commercial Property Conditions.

1. Appraisal

If we and you disagree on the amount of Net Income and operating expense or the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser.

The two appraisers will select an umpire. If they cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the amount of Net Income and operating expense or amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will be binding. Each party will:

a. Pay its chosen appraiser; and

b. Bear the other expenses of the appraisal and umpire equally.

If there is an appraisal, we will still retain our right to deny the claim.

2. Duties In The Event Of Loss

a. You must see that the following are done in the event of loss:

(1) Notify the police if a law may have been broken.

(2) Give us prompt notice of the direct physical loss or damage. Include a description of the property involved.

(3) As soon as possible, give us a description of how, when, and where the direct physical loss or damage occurred.

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(4) Take all reasonable steps to protect the Covered Property from further damage, and keep a record of your expenses necessary to protect the Covered Property, for consideration in the settlement of the claim. This will not increase the Limit of Insurance. However, we will not pay for any subsequent loss or damage resulting from a cause of loss that is not a Covered Cause of Loss. Also, if feasible, set the damaged property aside and in the best possible order for examination.

(5) As often as may be reasonably required, permit us to inspect the property proving the loss or damage and examine your books and records.

Also permit us to take samples of damaged and undamaged property for inspection, testing and analysis, and permit us to make copies from your books and records.

(6) Send us a signed, sworn proof of loss containing the information we request to investigate the claim. You must do this within 60 days after our request. We will supply you with the necessary forms.

(7) Cooperate with us in the investigation or settlement of the claim.

(8) If you intend to continue your business, you must resume all or part of your "operations" as quickly as possible.

b. We may examine any insured under oath, while not in the presence of any other insured and at such times as may be reasonably required, about any matter relating to this insurance or the claim, including an insured's books and records. In the event of an examination, an insured's answers must be signed.

3. Loss Determination

a. The amount of Business Income loss will be determined based on:

(1) The Net Income of the business before the direct physical loss or damage occurred;

(2) The likely Net Income of the business if no physical loss or damage had occurred, but not including any Net Income that would likely have been earned as a result of an increase in the volume of business due to favorable business conditions caused by the impact of the Covered Cause of Loss on customers or on other businesses;

(3) The operating expenses, including payroll expenses, necessary to resume "operations" with the same quality of service that existed just before the direct physical loss or damage; and

(4) Other relevant sources of information, including:

(a) Your financial records and accounting procedures;

(b) Bills, invoices and other vouchers; and

(c) Deeds, liens or contracts.

b. The amount of Extra Expense will be determined based on:

(1) All expenses that exceed the normal operating expenses that would have been incurred by "operations" during the "period of restoration" if no direct physical loss or damage had occurred. We will deduct from the total of such expenses:

(a) The salvage value that remains of any property bought for temporary use during the "period of restoration", once "operations" are resumed; and

(b) Any Extra Expense that is paid for by other insurance, except for insurance that is written subject to the same plan, terms, conditions and provisions as this insurance; and

(2) Necessary expenses that reduce the Business Income loss that otherwise would have been incurred.

c. Resumption Of Operations

We will reduce the amount of your:

(1) Business Income loss, other than Extra Expense, to the extent you can resume your "operations", in whole or in part, by using damaged or undamaged property (including merchandise or stock) at the described premises or elsewhere.

(2) Extra Expense loss to the extent you can return "operations" to normal and discontinue such Extra Expense.

d. If you do not resume "operations", or do not resume "operations" as quickly as possible, we will pay based on the length of time it would have taken to resume "operations" as quickly as possible.

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4. Loss Payment

We will pay for covered loss within 30 days after we receive the sworn proof of loss, if you have complied with all of the terms of this Coverage Part and:

a. We have reached agreement with you on the amount of loss; or

b. An appraisal award has been made.

D. Additional Condition

Coinsurance

If a Coinsurance percentage is shown in the Declarations, the following condition applies in addition to the Common Policy Conditions and the Commercial Property Conditions.

We will not pay the full amount of any Business Income loss if the Limit of Insurance for Business Income is less than:

a. The Coinsurance percentage shown for Business Income in the Declarations; times

b. The sum of:

(1) The Net Income (Net Profit or Loss before income taxes), and

(2) Operating expenses, including payroll expenses,

that would have been earned or incurred (had no loss occurred) by your "operations" at the described premises for the 12 months following the inception, or last previous anniversary date, of this policy (whichever is later).

Instead, we will determine the most we will pay using the following steps:

1. Multiply the Net Income and operating expense for the 12 months following the inception, or last previous anniversary date, of this policy by the Coinsurance percentage;

2. Divide the Limit of Insurance for the described premises by the figure determined in Step **1.;** and

3. Multiply the total amount of loss by the figure determined in Step **2.**

We will pay the amount determined in Step **3.** or the limit of insurance, whichever is less. For the remainder, you will either have to rely on other insurance or absorb the loss yourself.

In determining operating expenses for the purpose of applying the Coinsurance condition, the following expenses, if applicable, shall be deducted from the total of all operating expenses:

1. Prepaid freight – outgoing;

2. Returns and allowances;

3. Discounts;

4. Bad debts;

5. Collection expenses;

6. Cost of raw stock and factory supplies consumed (including transportation charges);

7. Cost of merchandise sold (including transportation charges);

8. Cost of other supplies consumed (including transportation charges);

9. Cost of services purchased from outsiders (not employees) to resell, that do not continue under contract;

10. Power, heat and refrigeration expenses that do not continue under contract (if Form **CP 15 11** is attached);

11. All ordinary payroll expenses or the amount of payroll expense excluded (if Form **CP 15 10** is attached); and

12. Special deductions for mining properties (royalties unless specifically included in coverage; actual depletion commonly known as unit or cost depletion – not percentage depletion; welfare and retirement fund charges based on tonnage; hired trucks).

Example No. 1 (Underinsurance):

When:	The Net Income and operating expenses for the 12 months following the inception, or last previous anniversary date, of this policy at the described premises would have been	$	400,000
	The Coinsurance percentage is		50%
	The Limit of Insurance is	$	150,000
	The amount of loss is	$	80,000
Step **1:**	$400,000 x 50% = $200,000 (the minimum amount of insurance to meet your Coinsurance requirements)		
Step **2:**	$150,000 ÷ $200,000 = .75		
Step **3:**	$80,000 x .75 = $60,000		

We will pay no more than $60,000. The remaining $20,000 is not covered.

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Example No. 2 (Adequate Insurance):

When:			
	The Net Income and operating expenses for the 12 months following the inception, or last previous anniversary date, of this policy at the described premises would have been	$	400,000
	The Coinsurance percentage is		50%
	The Limit of Insurance is	$	200,000
	The amount of loss is	$	80,000

The minimum amount of insurance to meet your Coinsurance requirement is $200,000 ($400,000 x 50%). Therefore, the Limit of Insurance in this Example is adequate and no penalty applies. We will pay no more than $80,000 (amount of loss).

This condition does not apply to Extra Expense coverage.

E. Optional Coverages

If shown as applicable in the Declarations, the following Optional Coverages apply separately to each item.

1. Maximum Period Of Indemnity

a. The Additional Condition, Coinsurance, does not apply to this Coverage Form at the described premises to which this Optional Coverage applies.

b. The most we will pay for the total of Business Income loss and Extra Expense is the lesser of:

(1) The amount of loss sustained and expenses incurred during the 120 days immediately following the beginning of the "period of restoration"; or

(2) The Limit of Insurance shown in the Declarations.

2. Monthly Limit Of Indemnity

a. The Additional Condition, Coinsurance, does not apply to this Coverage Form at the described premises to which this Optional Coverage applies.

b. The most we will pay for loss of Business Income in each period of 30 consecutive days after the beginning of the "period of restoration" is:

(1) The Limit of Insurance, multiplied by

(2) The fraction shown in the Declarations for this Optional Coverage.

Example:

When:			
	The Limit of Insurance is	$	120,000
	The fraction shown in the Declarations for this Optional Coverage is		1/4
	The most we will pay for loss in each period of 30 consecutive days is:		
	$120,000 x 1/4 = $30,000		
	If, in this example, the actual amount of loss is:		
	Days 1-30	$	40,000
	Days 31-60		20,000
	Days 61-90		30,000
		$	90,000
	We will pay:		
	Days 1-30	$	30,000
	Days 31-60		20,000
	Days 61-90		30,000
		$	80,000

The remaining $10,000 is not covered.

3. Business Income Agreed Value

a. To activate this Optional Coverage:

(1) A Business Income Report/Work Sheet must be submitted to us and must show financial data for your "operations":

(a) During the 12 months prior to the date of the Work Sheet; and

(b) Estimated for the 12 months immediately following the inception of this Optional Coverage.

(2) The Declarations must indicate that the Business Income Agreed Value Optional Coverage applies, and an Agreed Value must be shown in the Declarations. The Agreed Value should be at least equal to:

(a) The Coinsurance percentage shown in the Declarations; multiplied by

(b) The amount of Net Income and operating expenses for the following 12 months you report on the Work Sheet.

b. The Additional Condition, Coinsurance, is suspended until:

(1) 12 months after the effective date of this Optional Coverage; or

(2) The expiration date of this policy;

whichever occurs first.

c. We will reinstate the Additional Condition, Coinsurance, automatically if you do not submit a new Work Sheet and Agreed Value:

(1) Within 12 months of the effective date of this Optional Coverage; or

(2) When you request a change in your Business Income Limit of Insurance.

d. If the Business Income Limit of Insurance is less than the Agreed Value, we will not pay more of any loss than the amount of loss multiplied by:

(1) The Business Income Limit of Insurance; divided by

(2) The Agreed Value.

Example:

When:	The Limit of Insurance is	$	100,000
	The Agreed Value is	$	200,000
	The amount of loss is	$	80,000
Step **(a):**	$100,000 ÷ $200,000 = .50		
Step **(b):**	.50 x $80,000 = $40,000		

We will pay $40,000. The remaining $40,000 is not covered.

4. Extended Period Of Indemnity

Under Paragraph **A.5.c.,** Extended Business Income, the number "30" in Subparagraphs **(1)(b)** and **(2)(b)** is replaced by the number shown in the Declarations for this Optional Coverage.

F. Definitions

1. "Finished Stock" means stock you have manufactured.

"Finished stock" also includes whiskey and alcoholic products being aged, unless there is a Coinsurance percentage shown for Business Income in the Declarations.

"Finished stock" does not include stock you have manufactured that is held for sale on the premises of any retail outlet insured under this Coverage Part.

2. "Operations" means:

a. Your business activities occurring at the described premises; and

b. The tenantability of the described premises, if coverage for Business Income including "Rental Value" or "Rental Value" applies.

3. "Period of Restoration" means the period of time that:

a. Begins:

(1) 72 hours after the time of direct physical loss or damage for Business Income coverage; or

(2) Immediately after the time of direct physical loss or damage for Extra Expense coverage;

caused by or resulting from any Covered Cause of Loss at the described premises; and

b. Ends on the earlier of:

(1) The date when the property at the described premises should be repaired, rebuilt or replaced with reasonable speed and similar quality; or

(2) The date when business is resumed at a new permanent location.

"Period of restoration" does not include any increased period required due to the enforcement of any ordinance or law that:

(1) Regulates the construction, use or repair, or requires the tearing down of any property; or

(2) Requires any insured or others to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of "pollutants".

The expiration date of this policy will not cut short the "period of restoration".

4. "Pollutants" means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

5. "Rental Value" means Business Income that consists of:

a. Net Income (Net Profit or Loss before income taxes) that would have been earned or incurred as rental income from tenant occupancy of the premises described in the Declarations as furnished and equipped by you, including fair rental value of any portion of the described premises which is occupied by you; and

b. Continuing normal operating expenses incurred in connection with that premises, including:

(1) Payroll; and

(2) The amount of charges which are the legal obligation of the tenant(s) but would otherwise be your obligations.

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6. "Suspension" means:

a. The slowdown or cessation of your business activities; or

b. That a part or all of the described premises is rendered untenantable, if coverage for Business Income including "Rental Value" or "Rental Value" applies.

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United States Court of Appeals,
Eighth Circuit.
HAMPTON FOODS, INC., Appellee,
v.
The AETNA CASUALTY AND SURETY CO., Appellant.
No. 87-1038.

Submitted Oct. 14, 1987.
Decided April 6, 1988.
Rehearing Denied May 4, 1988.

***1141** Gary P. Paul, Clayton, Mo., for appellant.

John A. Walsh, Jr., St. Louis, Mo., for appellee.

Before LAY, Chief Judge, and ARNOLD and BOWMAN, Circuit Judges.

BOWMAN, Circuit Judge.

The Aetna Casualty and Surety Company (Aetna) appeals from an order of the District Court holding Aetna liable under a business interruption insurance policy for accrued interest on the indebtedness of the insured, Hampton Foods, Inc. (Hampton).

This case is before us for the second time. The first appeal was from the District Court's decision that Aetna's policy provided coverage for losses suffered by Hampton when Hampton was forced to vacate a building that was in danger of collapsing, but that denied recovery to Hampton for lost profits and accrued interest on alleged corporate indebtedness, as well as prejudgment interest and penalties for vexatious refusal to pay. We affirmed the finding of coverage, the denial of liability for lost profits, prejudgment interest, and penalties for vexatious refusal to pay, and reversed and remanded on the issue of Aetna's liability for accrued interest on Hampton's alleged corporate indebtedness. *Hampton Foods, Inc. v. Aetna Casualty and Sur. Co.,* 787 F.2d 349 (8th Cir.1986) (*Hampton Foods I*). A more detailed discussion of the factual background pertinent to the present appeal is contained in that opinion. *See Hampton Foods I,* 787 F.2d at 351.

On remand the District Court was to determine whether and to what extent Aetna should be held liable for the accrued interest on Hampton's alleged corporate indebtedness. In order to make that determination, the District Court needed to resolve the following issues: 1) whether the relevant loans were used for Hampton's business purposes; 2) whether Hampton incurred interest expenses from the loans and, if so, the magnitude of those expenses; 3) the extent to which Hampton would have been able to pay its interest charges had its business not been interrupted; and 4) the time period for which Hampton's accrued interest charges are recoverable. *See Hampton Foods I,* 787 F.2d at 354-55. Aetna contends that the District Court erroneously resolved the first, second, and fourth issues and failed to deal with the third.

***1142** The principal issues on appeal are whether the District Court's findings of fact are adequate with respect to the issues we remanded and, if so, whether the findings are clearly erroneous. *See* Fed.R.Civ.P. 52(a). FN1

FN1. Each of the issues is entirely an issue of fact, except the fourth issue, which involves, in addition to purely factual questions, the question of whether the District Court properly applied *Omaha Paper Stock Co. v. Harbor Ins. Co.,* 445 F.Supp. 179 (D.Neb.1978), *aff'd,* 596 F.2d 283 (8th Cir.1979).

I.

In *Hampton Foods I* we held that Aetna could be held liable only "for interest on that portion of the loans used for Hampton's business purposes." *Hampton Foods I,* 787 F.2d at 354. Thus, the District Court was to determine on remand whether the

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loans underlying the interest charges at issue were used for the business purposes of Hampton. The District Court found that the loans were so used.

A number of loans were made to Don and Joyce Hipp, the principals of Hampton, and apparently were used in their business. But insofar as this appeal is concerned, the argument is over a single $140,000 loan from the Bank FN2 to the Hipps. FN3 The District Court found that this loan was used for Hampton's business purposes, a finding Aetna attacks as clearly erroneous. We disagree with Aetna.

FN2. The “Bank” in this opinion refers to Hampton Metro Bank.

FN3. Appellant presents no arguments specifically addressing any loans other than the $140,000 loan.

[1] Shortly after receiving this loan, the Hipps loaned $140,000 to Hampton. Aetna argues that the $140,000 Bank loan could not have been “used for Hampton's business purposes” because it was made to the Hipps in their individual capacities before Hampton was established. This argument is, of course, a non sequitur. As Hampton points out, the entire $140,000 later was loaned by the Hipps to Hampton to be used in the business. The question we asked the District Court to answer on remand was not, as Aetna suggests, to whom the Bank made the loan, but whether the loan was “used for Hampton's business purposes.” *Hampton Foods I,* 787 F.2d at 354. The District Court answered that question affirmatively. Since the entire $140,000 was put into Hampton's business, we cannot say that the District Court's finding is clearly erroneous.

II.

On remand the District Court was to determine whether Hampton in fact had incurred interest expenses and, if so, the magnitude of those expenses. *See Hampton Foods I,* 787 F.2d at 354. The District Court found that Hampton had incurred an interest obligation on the loan extended by the Hipps to Hampton. The court also determined the amount of that obligation.

[2] Aetna contends that Hampton did not incur any interest obligation. Having reviewed the record, however, we do not believe that the District Court's finding is clearly erroneous. It is undisputed that the Hipps extended Hampton a loan of the same size and at the same rate of interest as was provided to the Hipps by the Bank. The Hipps, practically speaking, simply served as a conduit for the funds. There is evidence that Hampton became liable for principal and interest, and even made payments on the loan directly to the Bank. We therefore have no basis for overturning as clearly erroneous the finding that Hampton incurred an interest obligation commensurate with the interest obligation on the loan from the Bank to the Hipps.

III.

[3] In *Hampton Foods I* we held that Hampton's interest expenses “are includable in its damages to the extent Hampton would have been able to pay these charges [out of its business income] had the building difficulties not occurred” and remanded this issue to the District Court for resolution. *Hampton Foods I,* 787 F.2d at 354.

***1143** On remand the District Court failed to make a finding of fact on this crucial issue. We agree with Aetna that this was error. Apparently, the District Court did not realize that the issue needed to be decided. *See* Designated Record (D.R.) at 243. (District Court states that “Eighth Circuit held that two issues ... needed to be resolved by this trial court,” the first being whether the loan was for business purposes and the second being the duration of the theoretical period of restoration).

[4] This factual issue must be resolved before liability may be imposed on Aetna. Aetna's liability for interest charges is limited to the interest charges that Hampton would have been able to pay from in-

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come generated by its business had the building problems not arisen. To the extent that Hampton could not have met its interest obligations even if it had remained open for business, Aetna cannot be held liable for the interest charges that Hampton incurred while its business was closed. As factfinding is the basic responsibility of the district courts, this crucial issue should not be dealt with for the first time on appeal. *See Pullman-Standard v. Swint,* 456 U.S. 273, 291-92, 102 S.Ct. 1781, 1791, 92, 72 L.Ed.2d 66 (1982); *DeMarco v. U.S.,* 415 U.S. 449, 450 n., 94 S.Ct. 1185, 1186 n., 39 L.Ed.2d 501 (1974). In circumstances where, as here, the necessary findings of fact have not been made at trial, “the appropriate course of action is to vacate the judgment and remand the case to the District Court.” *Rule v. International Ass'n of Bridge Workers Local 396,* 568 F.2d 558, 568 (8th Cir.1977). *See Pullman-Standard,* 456 U.S. at 292 n. 22, 102 S.Ct. at 1792 n. 22 (1982); *Fogarty v. Piper,* 767 F.2d 513, 515 (8th Cir.1985); 5A J. Moore & J. Lucas, Moore's Federal Practice ¶ 52.06[2] (2d ed. 1987). We therefore remand this case to the District Court with directions that it make a finding on this pivotal question of fact.

IV.

In *Hampton Foods I* we remanded the issue of “the time period for which Hampton's continuing interest charges are recoverable.” *Hampton Foods I,* 787 F.2d at 355. But before doing so, we discussed the approach the District Court was to use to resolve this issue. We first examined the period of coverage contemplated by the insurance policy and noted:

The policy covers losses “during the period of restoration.” Part III, subsection C [of the policy], defines “period of restoration” as

[t]he length of time, commencing with the date of damage or destruction, which would be required, with the exercise of due diligence or dispatch, to repair, or rebuild or replace the damaged or destroyed property.

It is clear that this language contemplates the “*theoretical* time period it would have taken to” reenter business. *Omaha Paper Stock Co. v. Harbor Ins. Co.,* 596 F.2d 283, 290 (8th Cir.1979).

Hampton Foods I, 787 F.2d at 355 (emphasis in original). We then indicated that the time period for which interest charges are recoverable could extend beyond the theoretical period of restoration under the approach taken by the court in *Omaha Paper Stock Co. v. Harbor Ins. Co.,* 445 F.Supp. 179 (D.Neb.1978), *aff'd,* 596 F.2d 283 (8th Cir.1979). In that case “the court used the standard of a theoretical period of restoration but allowed a reasonable extension of that period where restoration delay was due to actions of the insurance company.” *Hampton Foods I,* 787 F.2d at 355. This was the approach that the District Court was to apply on remand.

[5] Under the *Omaha Paper Stock* approach, Aetna should be liable for business interruption coverage for the duration of the reasonable period of time needed for Hampton to reenter business plus any delay attributable to Aetna's failure to perform its duties under the policy, but not for any period of delay caused by other obstacles to restoration such as Hampton's alleged lack of due diligence or poor financial condition. The District Court concluded that “the record clearly indicates that [Aetna's] refusal to pay [Hampton] amounts owed to it under the terms of the insurance policy prevented the prompt restoration***1144** of [Hampton's] business,” D.R. at 244, and noted that it believed that Hampton would have received financing to restore the business had Aetna paid what it owed under the insurance policy. D.R. at 244. The District Court rejected Aetna's contention that the delay was (even partly) due to Hampton's failure to act with due diligence or to its poor financial condition. In short, the District Court found that but for Aetna's refusal to pay the amount it owed Hampton under the policy, Hampton could have promptly restored its business and, therefore, the delay in restoration was

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attributable to Aetna.

[6] Aetna argues that even if it had paid what it owed under the policy, the Bank would not have provided the financing needed to restore Hampton's business. Citing Hampton's outstanding debts and lack of assets, Aetna maintains that Hampton's poor financial condition precluded such a loan and that the District Court's finding to the contrary is clearly erroneous.

The record, however, provides support for the District Court's finding. A letter from the Bank indicates that had Aetna promptly paid what it owed Hampton, and had Hampton in turn used the insurance proceeds to reduce what was owed to the Bank, the Bank would have provided the Hipps with financial assistance to restore their business. The letter, dated August 10, 1983 and written by Paul Siebels, then a Bank vice president, states in pertinent part:

Under the policy of our bank, had the Hipps, operating as Hampton Foods, Inc., been able to reduce the outstanding obligation by one-hundred-thousand dollars ($100,000.00), or more, within a few months after their loss in the summer of 1980, the bank would have assisted the Hipps with financing to reestablish a retail grocery business, based on the satisfactory performance on their credit with the bank.

Plaintiff's Exhibit no. 11. The evidence indicates that during the summer of 1980 Hampton had assets, consisting largely of its claim against Aetna, worth approximately $100,000. In other words, had Aetna paid Hampton's claim, Hampton would have had approximately $100,000 at its disposal, which it could have used to satisfy the Bank's conditions for new financing to restore the business.

Aetna argues that Siebels's letter should not be given much evidentiary weight. Pointing to Siebels's testimony before the District Court, Aetna emphasizes that Siebels says, contrary to his letter, that there was no guarantee that the Bank would have provided the financing. But the weighing of the evidence and the assessment of apparent inconsistencies or conflicts in the evidence is for the trier of fact, not for a court of appeals. Even if we would have weighed the evidence differently, under the clearly erroneous standard of review of Fed.R.Civ.P. 52(a), we would not be entitled to reverse the finding of the District Court. *Anderson v. City of Bessemer City,* 470 U.S. 564, 573-74, 105 S.Ct. 1504, 1511-12, 84 L.Ed.2d 518 (1985). While it may not have been a certainty that the Bank would have provided the financing, the evidence sufficiently supports the finding made by the District Court. Because the District Court's view of the evidence is plausible in light of the record viewed in its entirety, we hold that its finding is not clearly erroneous. *See Anderson,* 470 U.S. at 573-74, 105 S.Ct. at 1511-12.

[7] Nor are we persuaded by Aetna's argument that as a matter of law Hampton failed to act with due diligence. Aetna maintains that in addition to attempting to find financing the Hipps should have taken “other steps” to restore the business. These “other steps” are, presumably, such things as arranging for a building, equipment, suppliers, a work force and so on. *See* Brief of Appellant Aetna at 29. But as the District Court observed, restoration of the business required financing, and to obtain financing Hampton needed the money owed it under the insurance policy. Thus, when Aetna refused to pay, Hampton had no opportunity to restore the business. D.R. at 245. We do not believe that “due diligence” requires the doing of useless acts, and, for that reason, do not believe ***1145** that Hampton was required to locate a building, suppliers, equipment, et cetera, for a business that, absent payment by Aetna, had no chance of being restored.[FN4] Moreover, there is nothing in the record to suggest that Hampton could not have obtained the other things needed for the restoration of its business had the necessary financing been available.

FN4. The conduct of Hampton sharply contrasts with that of the insured in *Omaha*

> *Paper Stock,* where the insured was found to have acted without due diligence. There the insured added to the delay in restoration by "consciously ignor[ing] an apparent mistake made by the insurer" and failing to act in a manner "dictated by good business practice." *Omaha Paper Stock,* 445 F.Supp. at 187.

[8] Having found that the delay in restoration resulted from Aetna's conduct and not from Hampton's financial condition or lack of due diligence, the District Court held Aetna liable for interest expenses accruing during the delay. Additionally, the District Court found Aetna liable for the interest expenses accruing over a six-month theoretical period of restoration, to begin upon payment by Aetna of its interest expense obligation. D.R. at 245-46. We find this consonant with the approach in *Omaha Paper Stock.* In essence, it puts Hampton in the position it would have been in had Aetna not caused a delay in restoration.

The District Court also states, however, that the amount it adjudges Aetna to owe Hampton "includes $6,550.20 for a 180-day extension of the restoration period at $36.64 per day. The 180 days shall begin upon entry of the Court's order." D.R. at 246. We have questions regarding this 180-day extension, such as, what the basis is for it and whether it was intended to run concurrently with the six-month theoretical period of restoration. We agree with the District Court that application of the *Omaha Paper Stock* approach would require Aetna to pay for the interest expenses accruing during the period of delay found to have been caused by Aetna and the six-month theoretical period of restoration. But because we do not understand (nor apparently do the parties) the purpose or meaning of the 180-day extension, and because it is not apparent to us how this extension can be justified under *Omaha Paper Stock,* we ask the District Court to re-think this aspect of any judgment it may award to Hampton after further proceedings on remand.

V.

In summary, we hold that the District Court's findings of fact concerning the purpose of the $140,000 loan, the magnitude of Hampton's interest obligation, and the causal connection between Aetna's failure to pay Hampton's claim and the delay in the restoration of Hampton's business are not clearly erroneous. However, the question of the extent to which Hampton could have paid its interest expenses had it remained open for business must be answered before liability may be imposed on Aetna. For this reason, the District Court's order must be vacated and the case remanded for further proceedings.

If on remand the District Court finds that had Hampton remained open for business it nevertheless would have been unable to meet its interest obligations, then Aetna cannot be held liable for Hampton's interest expenses. On the other hand, to the extent that the District Court finds Hampton could have paid its interest expenses had it remained in business, Aetna is liable for those expenses. In ordering this remand, we point out that Hampton's total recovery of interest expenses should not exceed (1) its interest expenses for the period of delay caused by Aetna's failure to pay, plus (2) its interest expenses for the theoretical six-month period of restoration once payment is made.

The order of the District Court is vacated and the case is remanded for further proceedings consistent with this opinion.

C.A.8 (Mo.),1988.
Hampton Foods, Inc. v. Aetna Cas. and Sur. Co.
843 F.2d 1140

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United States District Court, D. Nebraska.
OMAHA PAPER STOCK COMPANY, INC., Plaintiff,
v.
HARBOR INSURANCE COMPANY, Defendant.
Civ. No. 75-0-454.

Jan. 11, 1978.

***181** Clayton O. Byam, Omaha, Neb., for plaintiff.

Thomas Walsh, Omaha, Neb., for defendant.

MEMORANDUM OPINION

SCHATZ, District Judge.

This litigation results from a major fire which destroyed substantial stock and also damaged equipment and buildings of plaintiff, Omaha Paper Stock at 1401 Laird Street, Omaha, Nebraska. The different categories of types of damage were separately insured under different policies by different insurers. The insurance policy involved here was written by Harbor Insurance Company to cover the "use and occupancy" of the 1401 Laird Street plant. (This coverage has also been referred to as "business interruption" coverage.) Plaintiff's operations at the Laird Street plant were suspended from the time of the fire, April 20, 1975, until October 21, 1975, a total of 152 days. At issue is whether the suspension of operations at Laird Street is covered under the use and occupancy policy and if so, whether Harbor Insurance Company must pay the per diem rate for the full 152 days or for only a portion thereof.

The facts are these: plaintiff Omaha Paper Stock Company (hereafter OPS) processes waste paper for sale. It operates two plants in this city: the Laird Street plant which processes large quantities of low-grade papers and a plant at 18th Street which processes higher grades of paper and requires more personal handling in the operations than does the Laird Street plant.

Prior to the fire, the paper market became severely depressed. As a result, OPS decided to stockpile its waste paper until the market conditions changed for the better. At the time of the fire, OPS had approximately sixteen thousand tons of paper at the Laird Street plant. The fire in question destroyed the entire stock. Eight million gallons of water were required to extinguish the fire and as a direct result, the physical plant, aside from the ground surrounding the buildings, was flooded.

OPS was unable to operate the Laird Street plant until the grounds were cleared of debris and the equipment was back in working condition. The plant equipment consisted in part of a baling machine and several conveyor belts of various sizes which fed the paper into the baler. The conveyors were continuous belts that approached the baler from several directions. In the case of three of these conveyors, the lower half of the continuous belt moved in a pit which was below ground or floor level. During the time that the fire was being extinguished, these pits filled with water, thus submerging the metal belts and causing extensive rust and corrosion of the belts. In order for the plant to resume operation, the damage to the conveyor belts had to be remedied either by repair or replacement. On April 30, following the fire, the insurance adjusters for all companies insuring the various losses, General Adjustment Bureau (hereafter GAB), OPS personnel, the public adjuster hired by OPS (Mr. Conant) and the original installers of the equipment in question met to survey the damage. The installer's opinion was that the conveyor belts were beyond repair and should be replaced. He estimated that the conveyor belts could be delivered within twelve to fourteen weeks. GAB, through its engineer (Mr. Rogers) felt that the belts could be dismantled, cleaned, oiled and repaired.***182** No decision to repair or replace was made at that point. During the next two weeks, GAB explored

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both the possibility of repair as well as of replacement, securing estimates for both.

By May 15, power had been restored to the building. GAB's engineer, accompanied by the OPS equipment service man, attempted to operate the conveyor belts to ascertain the extent of damage. Upon discovering that the rust was causing the belts to buckle on their tracks, the conveyor belts were shut off, having only operated for somewhere between half a minute to three minutes.

By letter of May 19, Economy Baler Company (hereafter Economy), one of the companies contacted, confirmed its offer of a delivery time of four to six weeks for new replacement conveyor belts. Economy also agreed to install the equipment. However, no order was placed at that time.

Approximately a week later, GAB authorized the replacement of the belts and instructed Robert Epstein, president of OPS, to place the order with Economy as per the earlier quotation stated in the letter sent by Economy to GAB. Epstein telephoned Economy and placed the order. It is unclear whether Epstein or his public adjuster Conant had seen the quotation confirmation at the time that Epstein referred to it in placing his order.

The belts arrived in Omaha on June 27, 1975. When they arrived OPS notified GAB of their arrival so that installation could proceed. However, Economy had forgotten about its role concerning the installation contract and had made no arrangements. On July 14, its installer, Edward Cavanaugh, Jr., arrived in Omaha, but without men or equipment, expecting OPS to provide both. OPS was unaware of its intended participation in the installation role and was unable to supply either manpower or equipment. Unable to begin work, Cavanaugh left the next day and did not return. GAB assumed the responsibility to provide another installer and asked Epstein to contact Charles Cook, the original installer of the equipment, to ascertain whether Cook could install the equipment. Cook agreed but only in light of pre-existing commitments to finish other jobs.

Cook arrived on July 23 to begin installation. In tearing down some of the machinery, it was then discovered that one of the drive shafts had been bent and needed replacement. Epstein ordered a replacement from Economy on July 26. A mistake was made in the order which was corrected on July 29. Cook worked the week of July 23 and was able to install one of the belts. On August 5, Cook discovered that the belt which had been installed thus far was a cleated belt as opposed to a non-cleated belt. A decision was made the next day by Cook, GAB and the public adjuster, Conant, to order replacement sections for the belt. The order was placed with Economy on August 8, but Economy did not ship the belts until late September and they were received by OPS on September 30. Consequently, Cook was unable to replace that belt until after October 1.

The entire installation process by Cook covered two and a half months since his crew was interrupted from time to time with previous commitments. Cook worked July 23 through 25, August 12 through 15, August 19 through 22, September 22 through 27, and finally, October 6 through the 10th. The only delay caused by the mistaken order of the cleated belt was in the final five days in October since the belt did not arrive until September 30. The reason that Cook did not work between August 22 and September 19 was because Cook had other commitments to meet and was uncertain about who was responsible to pay for the installation in question. After the cleated belt sections had been replaced with non-cleated sections, the equipment was tested on October 10. After the conveyors were completely assembled, the serviceman for the plant equipment finished checking the baler itself so that it was in workable order. It was impossible to make final repairs on the baler and to test it until conveyors were in operation and could feed the baler itself.

***183** The insurance policy in question provides $586,800 insurance on the “use and occupancy of all buildings and/or structures and/or machinery

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and/or equipment and/or raw stock or stock in process contained therein upon the premises owned and/or leased and/or occupied by the assured, and situated at 1401 Laird Street, Omaha, Nebraska . . . ." This insurance is subject inter alia to the following conditions:

The conditions of this contract of insurance are that if the said buildings and/or structures and/or machinery and/or equipment and/or stock or stock in process contained therein shall be destroyed or damaged . . . so as to necessitate a total suspension of business then this insurance shall be liable at a rate of $3,260 per working day for such total suspension.

If the property damage due to perils insured against results in partial suspension of business, then this insurance shall be liable for such portion of $3,260 per working day which the proportion of reduction in output bears to the total production which would, but for partial suspension, have been obtained during the period of partial suspension.

It is a condition of this insurance that buildings, surplus machinery or duplicate parts thereof, equipment, raw stock or stock in process which may be owned, controlled or used by the Assured, shall in the event of loss be used to expedite the continuance or resumption of business.

[1] This policy is a "valued" policy and where the "bona fides of the transaction is not assailed, and neither fraud nor mistake is charged, the valuation is conclusive upon the parties as the amount which the assured is entitled to receive upon the happening of the condition of the policy." Michael v. Prussian National Insurance Company, 171 N.Y. 25, 63 N.E. 810 (1902). The first question that must be addressed in this case is whether the "happening of the condition" of the policy occurred.

The insurer, Harbor Insurance Company (hereafter Harbor) contends that under these policy provisions, OPS had "substantial 'buildings, surplus machinery or duplicate parts thereof, equipment, raw stock or stock in process' which it owned, controlled or used 'to expedite the continuation or resumption of its business' and that defendant (sic) in fact had no total suspension of business but conducted its business as usual during the entire period for which suspension is claimed." The building, surplus machinery and duplicate parts thereof to which Harbor refers include both the plant at 18th Street and a portable conveyor belt which Harbor claims could have been used to resume operations at the Laird Street plant. OPS contends that the policy provisions refer only to the suspension of business at 1401 Laird Street and do not incorporate the operations of 18th Street in the determination of partial or total suspension of business. OPS also contends that reference to surplus machinery, etc., refers only to the buildings and equipment available at Laird Street. In short, OPS seeks to limit the policy provisions to the Laird Street operations.

[2] It cannot be disputed that operations at Laird Street were totally interrupted. What remains for analysis is whether the availability of production capacity at the 18th Street plant demonstrated by the increased production at that plant after the fire in any way affects the determination that total suspension had occurred under the terms of the policy. This Court finds that it does not.

Rules of statutory construction for insurance policies are applicable and helpful in this case. "It is a well-established rule that an insurance contract will be interpreted in accordance with the reasonable expectations of the insured at the time of the contract, and in case of doubt, the policy will be liberally construed in favor of the insured. (Citations omitted.)" Neal v. St. Paul Fire & Marine Insurance Company, 197 Neb. 718, 720, 250 N.W.2d 648, 650 (1977). In addition, "an insurance policy should be considered as any other contract and be given effect according to the ordinary sense of the terms used, and if they are clear, they will be applied according to ***184** their plain and ordinary meaning. (Citation omitted.)" Pettid v. Edwards, 195 Neb. 713, 716, 240 N.W.2d 344, 346 (1976).

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Several factors are important in this determination: first, the policy itself refers only to the Laird Street plant without mention of the 18th Street operation. The evidence shows that Harbor was aware of the 18th Street plant when the insurance coverage was established. However, there is no mention of the 18th Street plant in the policy itself. Secondly, the operations at the two plants are different: 18th Street processes high grades of paper by means of a conveyor system, but with substantial manual handling; Laird Street processes low grades of paper with little manual sorting. The 18th Street plant production increased substantially after the Laird Street fire: the record indicates that 18th Street began to process a small percentage of the total production of lower grades of paper (newspaper and corrigated paper) which had been processed at Laird Street. But there is also evidence that OPS, in order to maintain customers, continued to collect the lower grades of paper and paid to have the paper disposed of at the city dump. Thus, while it is true that the surplus production capacity at the 18th Street plant was utilized, that utilization was to enable OPS to maintain its customers during the period when the Laird Street plant was closed. That utilization of surplus production capacity did not and could not expedite the resumption or continuance of business at the Laird Street plant itself.

In City Tailors, Ltd. v. Evans, 126 L.T.N.S. 439 (1921), the English court interpreted a similar provision in an insurance contract covering a wholesale and retail clothier business. A fire destroyed the original factory and temporary premises were let at substantial expense to the business in order to continue production. The insurance company sought to decrease their per diem liability by considering the output from the temporary plant in determining the loss of business. Scrutton, Lord Judge, stated:

If the assured cannot by reasonable exertions produce an output at (the original factory) there is a total loss; to the extent to which, acting reasonably, his output at (the original factory) diminished, there is a partial loss. In other words, the subject matter of the insurance is limited locally; it is profits at (the original factory) derived from output at the (original factory). The insurance is on a business carried on at (the original factory), not elsewhere; and it is interruption of, or interference with, that business at (the original factory) by fire which causes the loss.

Hartford Fire Insurance Co. v. Wilson & Toomer Fertilizer Co., 4 F.2d 835 (5th Cir. 1925), concerned business interruption insurance for a manufacturing facility. In that case the plaintiff had a use and occupancy insurance policy for its fertilizer factory. Following a fire in the plaintiff's plant, in an effort to diminish its loss, the plaintiff constructed a temporary building in which it continued to mix fertilizers rather than manufacturing the ingredients. In discounting the profits earned at the second temporary plant, the court stated:

Plaintiff did not continue in the same business in which it had been engaged before the fire. The manufacturers of fertilizers as theretofore conducted entirely ceased, and the plaintiff, by purchasing, instead of manufacturing, the ingredients of its fertilizers, engaged in a different kind of business, in an effort to diminish its own as well as defendant's loss. Defendant was not entitled to have the loss under the policy reduced, unless net profits were earned by the plaintiff. . . . If as contended by the defendant, there should be an adjustment in the proportion that the fertilizers bought and mixed by the plaintiff during the period of suspension of business bore to the full normal production of fertilizers manufactured and mixed during such period, even though no net profits were earned, then the policy would be of no value to an insured, because it would be possible, by multiplying temporary plants, to produce the full, normal output, although the cost might be prohibitive. We do not think the policy is open for such a construction.

***185** [3] The contract provision requiring that surplus machinery and buildings be utilized must be read in conjunction with the "total suspension of

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business" clause. In light of the rules of construction and the facts concerning the nature of this particular business operation, the Court interprets that clause to mean that the assured must use such buildings and machinery to expedite resumption or continuance of the business operation that was interrupted, in this case, production of low grades of paper at the Laird Street plant. The assured in the instant case decided to rebuild the Laird Street plant to its former capacity. Any surplus machinery or buildings that it had available should have been used to resume that operation. If, for instance, OPS owned replacement belts for its conveyor or an additional baler, OPS would be required to use that machinery to expedite the reopening of the plant. Whether surplus production capacity at another and different plant is used is irrelevant since the utilization of such capacity would have no effect on the resumption or continuation of the plant covered by the insurance policy. Surplus production capacity at another and different plant affects only the extension or enlargement of production at that other and different plant.

The conclusion that operations at another existing plant are not relevant to the insurance coverage is consistent with the logic underpinning cases where a plant, covered by such insurance, chooses not to reopen at the same location, but does reopen at a different location. In Beautytuft, Inc. v. Factory Insurance Association, 431 F.2d 1122 (6th Cir. 1970), a fire destroyed the factory of a copper manufacturer. The policy contained a theoretical replacement time for the computation of the loss. The company recommenced operations at a different plant within three and a half months, though the theoretical replacement time for the original plant would have been much longer. The Court held that:

Although a substitute plant of potentially equivalent capacity was promptly obtained, appellees' actual losses as shown by the proof continued beyond that date; and appellees were entitled to reimbursement for such losses for the term of the theoretical replacement period as provided by the contract.

The Court in Beautytuft did not consider the reopening date at the substitute plant as having any bearing on the length of replacement time at the premises insured.

[4] Another case considering this point is Hawkinson Tread Tire Service Co. v. Indiana Lumbermens Mutual Insurance Company of Indianapolis, 362 Mo. 823, 245 S.W.2d 24 (1951). The insured in that case opened its operations in a new location after a fire destroyed the insured's premises. The Court stated:

There was no applicable provision of the policy limiting the extent of defendant's liability to a resumption of normal operations in some "obtainable" property other than that of the Twelfth Street address (the insured premises). We bear in mind the liability under the policy was expressly the actual loss sustained for the "length of time" which would be required to rebuild, repair or replace the property destroyed.

Coverage, under this interpretation, continued as long as it would have taken to repair the insured premises. Since it was an actual loss policy as opposed to a valued policy which exists in the instant case, the net profits from the other new plant were considered to reduce the loss sustained. Since this case concerns a valued policy, the profits at other plants need not be considered.

Harbor offered a thirty-three day settlement on the business interruption claim on the basis that thirty-three days, plus the seven-day waiting period in the contract, would be sufficient to have the power restored to the building, test the equipment and run the conveyors temporarily until installation could proceed. This was rejected as a final settlement by OPS but payment was made and accepted of thirty-three days coverage or $107,580 as a partial settlement. GAB agreed to wait until installation had been completed before making further recommendations to Harbor Insurance Company.

***186** [5] The inadequacy of this settlement offer is

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clear from the claim adjustment reports from GAB to Harbor. On June 3, 1975, GAB stated:

We might mention again that it is impossible for insured to operate due to the condition of the lot adjacent to insured's building. Removal of the debris is a momentous task and is hampered by the condition of the soil resulting from the use of eight million gallons of water during the first night and subsequent continuous discharge of the two-and-a-half inch line for approximately four weeks to prevent the smoldering remaining debris from flaming. The Omaha City Government has also prohibited insured from operating under present conditions. We have made it clear to the public adjuster and to insured in writing that this coverage is not involved in any suspense resulting to damage from finish stock, water-soaked ground or civil authority.

This report was made forty-four days after the fire. Were it possible to operate the plant temporarily using the damaged equipment, such operations could not even begin until some time after June 3, 1975. In addition, GAB's assertion that the suspension resulted from water-soaked ground or civil authority and is, therefore, not compensable, ignores the obvious: the water-soaked ground and directives by civil authorities are the direct result of the fire, a risk covered by the policy.

In weighing testimony of the witnesses, the evidence establishes that the belts could not have been used on a temporary basis while the replacements were ordered and installed. Given that finding, this Court must determine how many days of total time that operations were suspended are covered by the business interruption policy. In making this determination, the Court must consider the respective duties of the parties under the contract and whether those duties were fulfilled.

On May 27, 1975, the attorney for OPS wrote to GAB informing them of the following:

In order that we may avoid any future controversy with respect to the exercise of due diligence on the part of our client, we respectfully request that you advise us by letter as to any matter which will expedite resumption of operations by Omaha Paper Stock.

GAB failed to respond to the letter. In the second claim progress report from GAB to Harbor Insurance, GAB stated:

We call your attention to insured's attorney's letter of May 27, 1975, regarding this claim. We do not expect a reply to this letter for obvious reasons. It would be impossible to anticipate every way in which the insured could fail to exercise due diligence.

[6] OPS asserts that their request shifted the burden to Harbor to inform OPS when it was not duly diligent. OPS contends by inference, that Harbor's failure to affirmatively reject the shift of responsibility led OPS to rely on Harbor's silence as an indication that OPS was meeting the due diligence requirement under the insurance policy. OPS argues that Harbor is estopped from contending that any delay is attributable to lack of due diligence by OPS. The facts in this case do not provide a foundation for the application of an estoppel theory. Estoppel might operate where the insured had agreed to act in the event of a particular contention. But that situation does not exist in this case. GAB never responded to the letter of May 27, 1975, nor did they verbally accept the responsibility to inform OPS of any failure by OPS to perform as required under the contract. OPS cannot rely on silence as an acceptance of the attempt to shift the burden of responsibility under the due diligence clause of the contract.

[7] The logic of this conclusion is closely analogous with the principles of offer and acceptance in contract: OPS made a proposed shift of responsibility or burden to which GAB either did not respond at all, or rejected. As stated in W. Wright, Inc. v. Korshoj Corp., 197 Neb. 692, 705, 250 N.W.2d 894, 901 (1977):

***187** It is the law that if a party to an existing con-

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tract proposes a modification thereof, the mere silence of the other party leaves the contract as before without modification. Elgin Mills, Inc. v. Melcher, 181 Neb. 17, 146 N.W.2d 573 (1966).

See also J. A. Markel Company v. D. L. Stokes & Co., 197 F.2d 933 (5th Cir. 1952); Restatement, Contracts 2d, Section 72; Williston on Contracts, Section 91; David City Hospital v. Teckla Gilmore, et al., 184 Neb. 342, 167 N.W.2d 397 (1969).

In view of this analysis, the Court finds that OPS was not relieved of its contractual obligation to proceed with due diligence to "resume full operation of their business . . . ."

[8] The insurance company asserts that the delay is attributable to a failure by OPS to proceed with due diligence in acquiring and installing the equipment. The facts demonstrate, however, that much of the delay is attributable to the decisions made by Harbor and its adjusters. Harbor cannot argue that its liability is limited to the theoretical time for replacement if, due to its own actions, the actual replacement time far exceeds the theoretical number of days.

Within eight days of the fire, Charles Cook the original installer, had arrived in Omaha at the request of OPS and recommended replacement of the belts and agreed, if his recommendation was accepted, to perform the installation. However, the insurance company did not authorize the replacement until May 23, 1975, almost a month later. GAB chose to order the belts through Economy and to have Economy perform the installation. The belts arrived in Omaha on June 27, 1975, fifty-one days into the coverage period. Economy's installer did not arrive at OPS until July 14, sixty-four days into the coverage period, but was totally unprepared to begin work. When it was clear that the Economy installer would be unable to perform the installation, GAB authorized Cook to do the installation. However, since Cook was given no advanced warning, he agreed to perform the installation subject to his prior commitments. Cook began installation on July 23, 1975, the seventy-second day of the coverage period. With the exception of the week of August 4 through 9, Cook worked steadily until August 22. However, due to prior commitments and a misunderstanding concerning who was responsible to pay for the installation, Cook did not work again until September 22, and then worked through September 27, the one hundred twenty-eighth day of the coverage period.

Therefore, due to the actions (and inactions) of GAB adjusters and Harbor in regard to matters under their direct control, complete installation was delayed for at least one hundred twenty-eight days after the initial waiting period.

[9] The requirement of due diligence on the part of the insured must be juxtaposed with the actions of the insurer. Harbor, through its adjusters at GAB essentially took over the decision of whether to repair or replace the belts. However, that assumption of responsibility by the insurer to make the actual decision did not eliminate the duty of the insured to perform functions that are peculiarly within its province. The insured cannot consciously ignore an apparent mistake made by the insurer in this type of a claim adjustment. Nor can an insured fail to inquire when such an inquiry is dictated by good business practice.

[10] The OPS plant had five conveyor belts, four of which were cleated belts and the fifth was a smooth belt. A total of four belts were replaced, including the non-cleated forty-two inch belt. Mistakenly, a cleated belt was ordered to replace the non-cleated one. This cleated belt was the first belt installed in late July. After the mistake was discovered, a replacement was ordered, which arrived at OPS on September 30, 1975. That belt was installed during the week of October 6 through 10. The Court must decide which party must bear the responsibility for that mistake.

After GAB decided that the belts should be replaced, they instructed Epstein, president of OPS, to place the order for the belts with the supplier.

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While it has been established***188** that one of the adjusters had provided a description of the needed parts to the supplier several weeks earlier for a price quotation, there is no evidence that those adjusters checked with either Epstein or the OPS plant manager or the designer and installer of the original belts to ascertain exact specifications. Indeed Epstein specifically denies ever having seen the letter which delineated the specifications. Epstein simply referred to that earlier order and did not review the belt specifications with the supplier at the time of the order. When the belts arrived in Omaha in late June, they were piled on two flatbed trucks and were moved to a storage warehouse until installation. There was no "specific effort" made by OPS personnel to ascertain whether the belts which had been ordered had been delivered or whether the correct belts had been ordered in the first place. The belts remained untouched from June 27 to July 23 when the installation crew began work. By August 1 the crew had installed the incorrect forty-two inch cleated belt. The mistake was discovered by OPS personnel after the belt had been installed.

Had Epstein checked the specifications when he placed the order, the attendant delay would have been avoided. The belts that Epstein was ordering were to be exact duplicates of the existing belts. These belts were essential to the OPS operation and Epstein and his manager were the only persons involved in this transaction who were familiar with the specifications for the necessary equipment. Good business practice under the facts in this case would have been to check the specifications before ordering.

The conclusion that OPS was not sufficiently diligent in this regard is strengthened by the fact that ample opportunity existed for OPS to check the equipment that arrived to make certain that what had been ordered had indeed been shipped. Had OPS checked during the month that the belts were stored prior to installation, the mistaken order would have been discovered and some, if not all, delay attributable to the mistake would have been avoided. Therefore, had the correct belt been ordered, a mistake which is attributable to OPS, it would have been unnecessary for Cook to return after September 27, 1975, for additional installation work. OPS must bear the burden of this error.[FN1]

FN1. The evidence also established that the bent tail pulley shaft resulted when GAB's engineer operated the belts in May. Accordingly, Harbor must bear the burden of that mishap. However, since no evidence was introduced which establishes a delay beyond September 30, 1975, as a result of this error, Harbor's liability is not altered.

The evidence established that after the installation crew finished its work on October 10, 1975, the plant remained inoperative until the baling equipment was checked. The serviceman for the equipment testified that in order to test the baling equipment one needed to be able to load material into the baler and test it under actual working conditions. The plant manager, however, testified that together with the sixty-inch conveyor and the ninety-six inch conveyor (which was not damaged or replaced), a portable forty-two inch conveyor could be used and material could be loaded into the baler. This portable conveyor had been used in the past to help unload rail cars as fast as possible. The work records of the installation crew show that the sixty-inch conveyor was completely rebuilt by September 22, 1975. By using the portable conveyor in addition to the sixty-inch and the ninety-six inch conveyors, OPS personnel could have begun testing the equipment on September 22, 1975, and have been finished by the end of the month.

[11] In conclusion, while it has been established that OPS is responsible for the delays caused by the mistaken order of the cleated belt and by not attempting to test the baler as soon as equipment was available for such a procedure, Harbor is liable for business interruption coverage through September 30, 1975, the date when, but for the delays attributable to OPS, the plant could have been back in op-

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eration. Under the terms of the policy and the per diem valuation of the policy, Harbor is liable for $423,800, less $107,580 already paid in partial***189** settlement of the claim, or a total of $316,220, plus interest and attorney fees yet to be determined. In light of this decision, the counterclaim of Harbor for $107,580 plus interest, the amount already paid to OPS in partial settlement, is denied.

An order herein, according to this memorandum, will not be entered until such time as the parties are heard with reference to attorney fees and interest. To that end, if the parties are unable to agree and stipulate as to those two items, without prejudice to their respective rights to appeal, within ten (10) days from date hereof, they shall so notify this Court so that a hearing date may be scheduled and the matter presented to the Court for determination.

D.C.Neb. 1978.
Omaha Paper Stock Co., Inc. v. Harbor Ins. Co.
445 F.Supp. 179

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Third District Court of Appeal

State of Florida, January Term, A.D. 2010

Opinion filed June 2, 2010.
Not final until disposition of timely filed motion for rehearing.

No. 3D09-2034
Lower Tribunal No. 08-70128

First Home Insurance Co.,
Appellant,

vs.

Jean Marc Fleurimond,
Appellee.

An Appeal from a non-final order of the Circuit Court for Miami-Dade County, Barbara Areces, Judge.

Conroy, Simberg, Ganon, Krevans, Abel, Lurvey, Morrow & Schefer and Hinda Klein and Carlos D. Cabrera, for appellant.

Paul B. Feltman and Benjamin Alvarez, for appellee.

Before RAMIREZ, C.J., and COPE and GERSTEN, JJ.

COPE, J.

This is an appeal of an order compelling appraisal. We affirm.

Plaintiff-appellee Jean Marc Fleurimond is the named insured on a homeowners insurance policy issued by First Home Insurance Company. By the terms of the policy his wife Marie Fleurimond is also an insured.

The home sustained damage during Hurricane Wilma in 2005. The insured submitted a claim. The insurer inspected the home and paid slightly under $12,000, an amount the insured deemed inadequate to repair the damage. Although the timing is not entirely clear, at some point part of the roof collapsed, causing flooding in the interior of the home. The insured retained a public adjuster who submitted an additional claim.

The insurer made a written request for the insured and his wife to appear for an Examination Under Oath (EUO). The insured and his wife appeared without counsel at the specified time and place. The insured had asked his public adjuster to appear with him at the EUO, but the public adjuster failed to appear. According to the insured, during the examination the examiner badgered him and yelled at him. After answering the examiner's questions in English, the examiner stated that he thought there was a language problem and asked an interpreter to join them. The examiner repeated all of the same questions which were translated into Creole. After answering the second series of questions, the insured and his wife left during a break and did not reappear.

Thereafter the insured retained counsel. Counsel contacted the insurer and offered to resume the EUO. The insurer replied that it was too late and refused the offer.

The insured filed suit under the policy and demanded appraisal. The insurer opposed the appraisal demand, saying that the insured had breached his policy obligations. The trial court conducted an evidentiary hearing at which the insured testified. As already stated, the insured testified that he had been berated and yelled at, and subjected to two examinations, one in English and the other in Creole. The insured's counsel also testified that he made the offer to the insurer for resumption of the EUO, and that the insurer refused the offer. The EUO had been transcribed and was before the trial court. Counsel who had conducted the EUO appeared as counsel for the insurer.[*] The trial court entered an order compelling appraisal. This appeal followed.

The insurance policy in this case provides, in part:

> **2. Your Duties After Loss.** In case of a loss to covered property, you must see that the following are done:
>
> . . . .
>
> f. As often as we reasonably require:
>
> . . . .
>
> (3) Submit to examination under oath, while not in the

[*] Appellate counsel for the insurer was not trial counsel below.

presence of any other "insured," and sign the same[.]

The policy also states, "No action can be brought unless the policy provisions have been complied with . . . ."

The insurer maintains that the insured and his wife failed to submit to a complete EUO, thus breaching their policy obligations. The insurer also maintains that since there was no complete EUO by the insured and his wife, it follows that the insured could not file suit under the policy.

We have held that "the insured must meet all of the policy's post-loss obligations before appraisal may be compelled." U.S. Fid. & Guar. Co. v. Romay, 744 So. 2d 467, 468 (Fla. 3d DCA 1999) (en banc). This includes the obligation to submit to an EUO. Id. at 469. Our court has said, "'[T]he failure to submit to an examination under oath is a material breach of the policy which will relieve the insurer of its liability to pay.'" Stringer v. Fireman's Fund Ins. Co., 622 So. 2d 145, 146 (Fla. 3d DCA 1993). The insurer argues that, at a minimum, the lawsuit must be dismissed and appraisal must be denied.

We agree with the trial court in rejecting the insurer's arguments. First, the insured and his wife appeared for the EUO at the designated time and place. The substantial issue before the trial court was whether the insured and his wife were justified in leaving the EUO. The insured testified that he was badgered and yelled

at, and that he was required to answer the identical series of questions twice, once in English and once in Creole.

After the insured's exit from the EUO, he obtained counsel who offered to present the insured and his wife for a resumption of the EUO. This was **before** the insured filed suit against the insurer. The insurer refused the offer. It was not until after the insurer refused the offer that the insured filed suit. On these facts we entirely agree with the trial court that the lawsuit was not premature, and appraisal was properly ordered.

The insurer also contends that the insured failed to file a timely sworn proof of loss. That argument is without merit. The insurance policy requires the filing of a sworn proof of loss within sixty days after the insurance company requests it. The insurer never requested a sworn proof of loss prior to suit being filed.

Affirmed.

[DO NOT PUBLISH]

IN THE UNITED STATES COURT OF APPEALS

FOR THE ELEVENTH CIRCUIT

FILED
U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
SEPT 14, 2010
JOHN LEY
CLERK

No. 09-13247

D. C. Docket No. 07-22988-CV-RWG

BUCKLEY TOWERS CONDOMINIUM, INC.,

Plaintiff-Appellee-
Cross-Appellant,

versus

QBE INSURANCE CORPORATION,

Defendant-Appellant-
Cross-Appellee.

Appeals from the United States District Court
for the Southern District of Florida

(September 14, 2010)

Before BARKETT and MARCUS, Circuit Judges, and HOOD,[*] District Judge.

[*] Honorable Joseph M. Hood, United States District Judge for the Eastern District of Kentucky, sitting by designation.

MARCUS, Circuit Judge:

Appellee/cross-appellant Buckley Towers Condominium, Inc. (Buckley Towers), the owner of a pair of condominium buildings in Miami-Dade County, Florida, purchased hurricane insurance from appellant/cross-appellee QBE Insurance Corp. (QBE), but when Hurricane Wilma struck South Florida in October 2005, QBE did not pay. Buckley Towers sued and, after trial in federal district court, a jury awarded it nearly $20 million in damages. At issue in this case is whether the district court erred in denying QBE's post-trial motion for judgment as a matter of law, motion to amend or alter the judgment, and motion for a new trial.

The insurance contract clearly required that Buckley Towers make actual repairs before seeking Replacement Cost Value (RCV) and law and ordinance damages. Although Buckley Towers made no such repairs, the district court held that the doctrine of prevention of performance permitted Buckley Towers to recover RCV and law and ordinance damages. QBE asserts that this was reversible error under Florida law. We agree, and hold that Buckley Towers had no right to recover these damages under the policy. We also agree with QBE that the contract between these parties did not allow for the provision of prejudgment interest, and hold that it was error for the district court to award it as well.

QBE further claims that it was error for the district court to allow Actual Cost Value (ACV) damages, because there was no evidence that Buckley Towers ever submitted a proper claim for ACV damages. As we read the trial record, however, there was sufficient evidence to sustain the jury's award as to ACV damages. Moreover, it was not an abuse of discretion for the district court to deny QBE's motion for a new trial on the basis of juror misconduct. Accordingly, we reverse the district court's judgment in part, affirm it in part, and remand in part for further proceedings consistent with this opinion.

I.

Hurricane Wilma hit South Florida in October 2005, badly damaging Buckley Towers, a pair of condominium buildings in Miami-Dade County. Buckley Towers first contacted QBE about the loss it sustained in February 2006, four months after the hurricane hit. Buckley's public adjuster, Denise Valderamma, sent a letter to QBE asking for an "advance payment due to the amount of major and structure damage the property suffered due to Hurricane Wilma accordingly [sic] to the policy provisions and endorsements."

Buckley submitted its first Sworn Proof of Loss in April 2006. When QBE rejected the first claim due to various errors, Buckley Towers in June 2006 submitted a second Sworn Proof of Loss, consisting of a form that contained

information applicable to both RCV damages and ACV damages. Buckley Towers designated the "Full Cost of Repair or Replacement" as $5,187,388.03, the "Applicable Depreciation" as $12,503.43, and the "Actual Cash Value Loss" as $5,174,885.50. Buckley Towers designated the "Net Amount Claimed" as $4,238,708.50. QBE never paid the claim, nor fully rejected it, construing it to be a demand for RCV damages and, therefore, not due until repairs were complete.

After determining that QBE was unlikely to pay its claim, Buckley Towers sued QBE in the United States District Court for the Southern District of Florida, invoking its diversity jurisdiction and seeking ACV damages, RCV damages, law and ordinance damages, and a declaratory judgment. Buckley Towers conceded that it had not completed repairs before requesting damages and that repair was required under the contract before claiming RCV damages. Nevertheless, the trial court instructed the jury that QBE may be obliged to pay RCV damages if it found that QBE had prevented Buckley Towers' performance under the RCV provision of the contract by denying ACV damages.

After trial, the jury found that Buckley Towers had submitted a request for ACV damages and awarded the building $11,395,665 in ACV damages. Pursuant to the trial court's prevention of performance instruction, the jury also awarded Buckley Towers $18,708,608 for RCV damages. The jury also awarded Buckley

Towers $803,500,000 in law and ordinance damages per building. The district court entered final judgment for Buckley Towers in the amount of $19,379,431, the sum of RCV damages and law and ordinance damages. After Buckley Towers moved for an amended judgment to add prejudgment interest, the district court added $5,607,319.87 in interest to the jury award, amounting to a final award of $24,986,750.87. QBE moved for a judgment as a matter of law as to RCV damages, ACV damages, and law and ordinance damages, moved for a new trial on the basis of juror misconduct, and moved to alter or amend the judgment to remove the prejudgment interest. The district court denied all of QBE's motions and this timely appeal ensued.

II.

QBE argues that the district court's most fundamental error was applying the doctrine of prevention of performance, thereby allowing Buckley Towers to claim RCV damages, even though, under the express terms of the contract, Buckley Towers had failed to repair or replace the damaged property. Under Florida law, the doctrine of prevention of performance may be applied when one party to a contract prevents another from performing its obligations under a contract; it bars the preventing party from availing himself of the other party's nonperformance. Knowles v. Henderson, 22 So. 2d 384, 385-86 (Fla. 1945). However, we think the

district court erred in applying prevention of performance in this case for several reasons.

In the first place, the insurance contract unambiguously requires the insured to repair its property before receiving RCV damages. The insurance contract specifically provides that QBE "will not pay on a replacement cost basis for any loss or damage (1) Until the lost or damaged property is actually repaired or replaced; and (2) Unless the repairs or replacement are made as soon as reasonably possible after the loss or damage." Condominium Association Coverage Form, provision G(3)(d). **[DX-1, p. 13-14 out of 14]** The insurance contract contains no allowances for advance payments to fund repairs. Both parties agree, and the record undeniably establishes, that Buckley Towers never completed repairs and, thus, would be barred from recovering RCV damages under the plain terms of the contract. We must accept the unambiguous terms of this contract because "[i]nsurance contracts are construed in accordance with the plain language of the policies as bargained for by the parties." Prudential Prop. & Cas. Ins. Co. v. Swindal, 622 So. 2d 467, 470 (Fla. 1993).

Applying the doctrine of prevention of performance in this case would impermissibly rewrite the insurance contract on the equitable theory that it would be too costly for Buckley Towers to comply with the terms of the agreement.

Under Florida's binding law, however, courts are not free to rewrite the terms of an insurance contract and where a policy provision "is clear and unambiguous, it should be enforced according to its terms." Acosta, Inc. v. Nat'l Union Fire Ins. Co., 39 So. 3d 565, 573 (Fla. Dist. Ct. App. 2010) (citation and quotation marks omitted). Allowing Buckley Towers to claim RCV damages without repairing or replacing entirely removes the plaintiff's obligations under the Replacement Cost Value section of the contract. The parties freely negotiated for that contractual provision and it is not the place of a court to red-line that obligation from the contract.

Nor is it a defense to say that it would be costly for Buckley Towers to comply with the insurance contract as written. "Inconvenience or the cost of compliance [with contractual terms], though they might make compliance a hardship, cannot excuse a party from the performance of an absolute and unqualified undertaking to do a thing that is possible and lawful." N. Am. Van Lines v. Collyer, 616 So. 2d 177, 179 (Fla. Dist. Ct. App. 1993). Although Buckley Towers may be unable to receive the full range of benefits of their contract without an advance payment under Florida law, that cost and inconvenience may not relieve them of repairing the building prior to claiming RCV damages.

Indeed, the Florida courts have upheld similar contracts that expressly require repair before claiming RCV damages. The Florida Supreme Court has explained that, with contracts such as the one in this case, replacement cost damages do not "arise until the repair or replacement has been completed." Ceballo v. Citizens Prop. Ins. Corp., 967 So. 2d 811, 815 (Fla. 2007) (citation and quotation marks omitted). See also State Farm Fire and Cas. Co. v. Patrick, 647 So. 2d 983, 983 (Fla. Dist. Ct. App. 1994) (per curiam). And, by example, the First District Court of Appeal recently held that a trial court had erred by allowing an insured homeowner who had chosen to sell his property rather than repair the structures appurtenant to the house to claim RCV damages instead of ACV damages for the structures. Citizens Prop. Ins. Corp. v. Hamilton, -- So. 3d --, No. 1D09-4128, 2010 WL 2671808, *8 (Fla. Dist. Ct. App. July 7, 2010).

Buckley Towers has been unable to cite us to any Florida case in a first-party insurance action that has employed the doctrine of prevention of performance to vitiate a plaintiff's contractual obligation to repair or replace damaged property before applying for RCV damages. The doctrine of prevention of performance applies, generally, when a party to a contract is ready, willing and able to perform, but the other party prevents him from performing by imposing obstacles not contemplated within the contract. See, e.g., Walker v. Chancey, 117 So. 705, 707-

08 (Fla. 1928) (applying the doctrine of prevention of performance where an owner sold a house on which a broker had secured another "ready, willing and able" buyer, preventing the broker from collecting the commission); Crane v. Barnett Bank of Palm Beach County, 698 So. 2d 902, 904 (Fla. Dist. Ct. App. 1997) (explaining that "the bank prevented the borrower's performance by refusing the borrower's payments (on advice of counsel) until the borrower's wife signed mortgage modification documents although she was not legally obligated to do so"). But there is no indication that Florida courts would apply the doctrine to change the basic terms of the underlying contract. And it is not the role of a federal court, sitting in diversity jurisdiction, and bound by the command of Erie Railroad Co. v. Tompkins, 304 U.S. 64 (1938), to do so without some palpable foundation in the law of Florida.

Buckley Towers suggests, however, that two suretyship cases might provide the necessary precedent for employing prevention of performance in this case: Continental Casualty Co. v. Reddick, 196 So. 2d 239 (Fla. Dist. Ct. App. 1967), and Allied Fidelity Insurance Co. v. Scott, 516 So. 2d 315 (Fla. Dist. Ct. App. 1987).[1] We are not persuaded that these cases apply. In the two suretyship cases

[1] Buckley Towers also says that Kovarnik v. Royal Globe Insurance Co., 363 So. 2d 166 (Fla. Dist. Ct. App. 1978), provides precedent for the application of the doctrine of prevention of performance in an insurance contract. However, Kovarnik is not an application of prevention of performance, but rather another equitable doctrine. In Kovarnik, the insurer denied coverage.

cited to us, the plaintiffs had prevented the "ready, willing and able" defendant, Reddick, 196 So. 2d at 241, from performing under the contract by imposing obstacles outside of the scope of the parties' agreement. See id. at 240 (plaintiff prevented defendant from performing unless he first secured a $50,000 bond, something he was not obligated to do under the contract); Scott, 516 So. 2d at 317 (plaintiff prevented defendant from performing by removing files from his office). In sharp contrast, here, QBE was enforcing its express rights under the contract. Whatever obstacles the language of this policy created, the obstacles were not imposed on account of conduct falling outside the scope of the parties' agreement itself. The insurance contract clearly provides for the possibility of a lawsuit to determine the right to payment. What's more, the insurance contract provides for another means of seeking reimbursement for hurricane damage, without any need to repair or replace anything -- the requirement of the insurer to honor a properly made ACV claim. But nothing in this insurance contract, or in Florida law for that matter, requires QBE to fund the repairs before the building claims RCV damages. In short, as we read Florida law, the doctrine of prevention of performance may not

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The insured then settled with the third-party tortfeasor, without first informing the insurer. When the insurer sought to rely upon that failure to notify in a subsequent suit between the insurer and insured, the court held that the insurer was estopped from benefitting from the insured's noncompliance with the terms of the insurance contract after the insurer's denial of her claim. Id. at 169. But the insurer's denial of the claim did not prevent the insured from complying with a condition precedent in the contract: the denial did not prevent the insured from telling the insurer about the settlement.

be wielded as a sword in a case like this one where the insured is required first to meet its obligations to repair under the policy provision.

In the absence of any square Florida precedent to the contrary, we hold that it was error for the district court to instruct the jury that they could award Buckley Towers RCV damages notwithstanding the clear terms of the insurance contract under the doctrine of prevention of performance. QBE was entitled to a grant of its motion for judgment as a matter of law on replacement cost value damages.

III.

Having held that the doctrine of prevention of performance cannot excuse Buckley Towers from its obligation to repair to obtain RCV damages, it follows that Buckley Towers' award of law and ordinance damages must also be reversed. Under the terms of the insurance contract, Buckley Towers is not entitled to law and ordinance damages unless "such damage results in enforcement of the ordinance or law." Ordinance or Law Coverage, Provision B.2. **[DX-1].** Nevertheless, the district court denied QBE's motion for a judgment as a matter of law, again on the theory that QBE had prevented Buckley Towers from repairing by failing to provide ACV damages. However, under Florida law and under the terms of the contract, Buckley Towers is not entitled to law and ordinance damages because it never repaired the property and never actually incurred increased

damages due to the enforcement of laws or ordinances. Ceballo, 967 So. 2d at 815 (holding that an insured was required by the insurance company to repair property and "incur[] an additional loss in order to recover" law and ordinance damages); Citizens Prop. Ins. Corp. v. Ceballo, 934 So. 2d 536, 538 (Fla. Dist. Ct. App. 2006) (same). For the reasons we have already explained, the doctrine of prevention of performance provides no excuse from Buckley Towers' obligation to perform its duties under the contract.[2]

IV.

It was also error to award Buckley Towers prejudgment interest contrary to the express terms of the insurance contract. Although the district court's factual findings in calculating damages are ordinarily reviewed for clear error, where the error inheres in the court's interpretation of the insurance policy, we review the calculation of damages de novo. Golden Door Jewelry Creations, Inc. v. Lloyds Underwriters Non-Marine Ass'n, 117 F.3d 1328, 1339 (11th Cir. 1997).

Under Florida law, "for the purpose of assessing prejudgment interest, a claim becomes liquidated and susceptible of prejudgment interest when a verdict

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[2] Our holdings on RCV damages and law and ordinance damages dispose of two other grounds for appeal that QBE has raised. First, we need no longer answer whether the law and ordinance damages are duplicative of RCV damages. Neither has been sustained. Second, we need not address whether the district court's jury instruction about prevention of performance entitled QBE to a new trial. The jury instruction was limited to RCV and law and ordinance damages; it did not infect the remainder of the jury verdict.

has the effect of fixing damages as of a prior date." Taylor v. N.H. Ins. Co. of Manchester, 489 So. 2d 207, 207 (Fla. Dist. Ct. App. 1986). Not surprisingly, Florida law holds that prejudgment interest is governed by the terms of the insurance contract. Columbia Cas. Co. v. Southern Flapjacks, Inc., 868 F.2d 1217, 1219-20 (11th Cir. 1989). This insurance contract provides that damages are only due either "(1) 20 days after [QBE] receives the sworn proof of loss, and [QBE] has reached agreement with [Buckley Towers]" on the amount of loss, or (2) "within 30 days after [QBE] receive[s] a sworn proof of loss and [t]here is an entry of a final judgment." Florida Changes, Provision D. **[DX-1].** Because neither of those conditions were satisfied until final judgment, Buckley Towers is not entitled to prejudgment interest under Florida law. Citizens Property Ins. Corp v. Hamilton, -- So. 3d --, No. 1D09-4128, 2010 WL 2671808, *9 (Fla. Dist. Ct. App. July 7, 2010) (holding that the trial court had erred in awarding prejudgment interest where the contract allowed "the insurer 60 days from the date a judgment is entered to make a loss payment").

V.

As for ACV damages, however, we conclude that the jury had sufficient evidence from which to reasonably find that Buckley Towers had made an ACV damages request, and that it was entitled to ACV damages. According to QBE, the

district court erred in denying its motion for a judgment as a matter of law concerning the ACV damages because Buckley Towers' paperwork showed that they were actually claiming RCV damages. QBE first points to Valderamma's February letter, asking for an "advance payment." Because ACV damages are due before repair, the term "advance" implies, the appellant argues, that Buckley Towers were seeking damages not yet due, that is, RCV damages. QBE also says that the second Sworn Proof of Loss was inadequate as an ACV claim because Buckley Towers had entered a sum on the Proof of Loss form in the category "Full Cost of Repair or Replacement," a category only relevant to RCV claims. Finally, QBE claims that the absence of any appropriate depreciation on the second Sworn Proof of Loss indicated that the proof of loss was actually an RCV claim.

We review the denial of a motion for a judgment as a matter of law de novo and apply the same standard as the district court. Mee Indus. v. Dow Chem. Co., 608 F.3d 1202, 1210-11 (11th Cir. 2010). "The motion should be denied only if reasonable and fair-minded persons exercising impartial judgment might reach different conclusions." Id. at 1211.

Although QBE has shown that Buckley Towers may have submitted an inartfully drafted claim for damages, we think the jury could have found on this record that Buckley Towers sought ACV damages. In the first place, even if we

read the letter to be a demand for "advance" RCV damages, the jury was not precluded from finding that the second Sworn Proof of Loss -- the legally operative document -- was a demand for ACV damages.

Second, even though depreciation is necessarily part of actual cash value damages, Goff v. State Farm Fla. Ins. Co., 999 So. 2d 684, 689 (Fla. Dist. Ct. App. 2008), the insurance contract does not affirmatively obligate the insured to include depreciation in its initial proof of loss. Instead, depreciation may be calculated as part of the appraisal process. Am. Reliance Ins. Co. v. Perez, 689 So. 2d 290, 292 (Fla. Dist. Ct. App. 1997) ("The dollar amount of value, cost, and depreciation are all factors to be considered through accepted appraisal practices."). Nor did the insurance contract clearly explain that depreciation was an element of actual cash value; nowhere did it define the term "actual cash value." Imposing on Buckley Towers the affirmative obligation to set forth depreciation in the Sworn Proof of Loss would add a new term to the insurance contract, which we are not free to do. Royal Ins. Co. v. Latin Am. Aviation Servs., Inc., 210 F.3d 1348, 1351 (11th Cir. 2000).

Moreover, and most significantly, Buckley Towers' second Sworn Proof of Loss included a typewritten entry for cash value loss in the amount of $5,174,885.50 next to the category "Actual Cash Value Loss," arguably putting the

insurance company on notice that the insured was seeking actual cash value from QBE. In short, a jury could find, as it plainly did, that Buckley Towers made an ACV claim. The district court properly denied QBE's motion for judgment as a matter of law on that theory of damages.

VI.

QBE also claims that the trial court erred in denying a new trial on the ground of juror misconduct, because a juror failed to reveal potentially relevant information during voir dire on his employment, insurance claims, litigation history and condominium ownership. We review the district court's denial of a motion for a new trial for an abuse of discretion. St. Luke's Cataract & Laser Inst., P.A. v. Sanderson, 573 F.3d 1186, 1200 n.16 (11th Cir. 2009), and its factual findings for clear error. Sacred Heart Health Sys., Inc. v. Humana Military Healthcare Servs., Inc., 601 F.3d 1159, 1169 (11th Cir. 2010). We find no abuse of discretion here.

After trial, QBE investigated the juror and moved for a new trial on the basis of alleged misconduct. The district court conducted an evidentiary hearing to investigate the allegations. At that hearing, in response to the judge's questions, the juror explained under oath various omissions and alleged inconsistencies found in his voir dire. After observing the juror, the district court concluded that the

juror had made honest mistakes and omissions because he misunderstood some of the questions and others were not stated with sufficient clarity. The district court also found that none of the responses, had they been given in a more fulsome manner at voir dire, would have been grounds to excuse the juror. On this record, we cannot say that the district court clearly erred in fact-finding or abused its considerable discretion in denying QBE's motion for a new trial. See, e.g., United States v. Carpa, 271 F.3d 962, 967 (11th Cir. 2001) ("To obtain a new trial for juror misconduct during voir dire, a party must: 1) demonstrate that a juror failed to answer honestly a material question on voir dire, and then 2) show that a correct response would have provided a valid basis for a challenge for cause.").[3]

VII.

In sum, we reverse the district court's denial of QBE's motion for judgment as a matter of law as to Replacement Cost Value damages and law and ordinance damages, but affirm its denial of QBE's motion for judgment as a matter of law as to Actual Cash Value Damages. We also hold that the district court erred in

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[3] Buckley Towers raises two issues on cross-appeal. First, it claims that the district court erred by dismissing Buckley Towers' claim that QBE breached an implied warranty of good faith and fair dealing. Second, it says that the district court erred by dismissing the part of its declaratory judgment claim pertaining to QBE's violation of Fla. Stat. § 627.701(4)(a), a law that regulates the typeface and type size required for the hurricane deductibles in insurance policies. However, another panel of this Court has already certified both of these questions to the Florida Supreme Court, Chalfonte Condominium Apartment Ass'n, Inc. v. QBE Ins. Corp., 561 F.3d 1267, 1274-75 (11th Cir. 2009), and we reserve judgment on them until the Florida Supreme Court has definitively answered the questions.

applying prejudgment interest in the amended final judgment. We affirm the district court's denial of QBE's motion for a new trial and reserve judgment on the two issues raised on cross-appeal.

REVERSED in part, AFFIRMED in part, and REMANDED in part for proceedings consistent with this opinion.

Court of Appeals of Indiana.
ROCKFORD MUTUAL INSURANCE COMPANY, Appellant-Defendant,
v.
Terrey E. PIRTLE, Appellee-Plaintiff.
No. 77A01-0802-CV-94.

Aug. 11, 2009.
Rehearing Denied Oct. 28, 2009.
Transfer Denied March 4, 2010.

***62** David P. Friedrich, Wilkinson, Goeller, Modesitt, Wilkinson, & Drummy, LLP, Terre Haute, IN, Attorney for Appellant.

David W. Stone IV, Stone Law Office & Legal Research, Anderson, IN, John P. Nichols, Anderson & Nichols, Terre Haute, IN, Attorneys for Appellee.

OPINION

KIRSCH, Judge.

Rockford Mutual Insurance Company ("Rockford") appeals from a jury verdict in favor of Terrey E. Pirtle in his action against Rockford for breach of contract. Rockford raises the following issues for our review:

I. Whether Pirtle's recovery under the policy is limited to the actual cash value of the building because of Pirtle's failure to comply with the repair and replacement cost policy provision of his policy;

II. Whether Pirtle's suit was barred by the contractual one-year-limitation period provision in the policy; and

III. Whether Pirtle's damages can include consequential damages and amounts exceeding policy limits.

We affirm.

FACTS AND PROCEDURAL HISTORY

Pirtle purchased an historic building located at 900 Maple Avenue in Terre Haute, Indiana by obtaining a mortgage ***63** for $140,250.00 and insured the building through a policy with Rockford. The building was used as a rental property while Pirtle was restoring it. By early 1999, the historic building was valued at $165,000.00; however, it was damaged in an accidental fire on November 11, 2000.

After the fire, Pirtle made a claim under his policy, and Rockford assigned the claim to one of its claim supervisors, who hired an independent adjuster to prepare a damage estimate for the building. The independent adjuster estimated the damage to the building at $79,907.49. Rockford's claim supervisor gave the independent adjuster authority to settle the claim for $80,000.00. Pirtle rejected the claim because it was not enough to satisfy the mortgage or to repair the building. Because of the damage to the building, Pirtle was unable to continue to lease the building to tenants.

Pirtle hired a contractor, Kevin Maher, who estimated the damage to the building at $232,915.39 in 2001.[FN1] A second Rockford claims supervisor, Andy Clark, was assigned to Pirtle's claim and accepted Maher's damage estimate after noticing that no other contractors had submitted a quote or would complete repairs using the independent adjuster's damage estimate. Clark then obtained authority to settle Pirtle's claim for up to $193,000.00, Rockford's policy limits for the dwelling.

FN1. Maher submitted a repair estimate in 2005 of $330,111.00.

Pirtle hired an attorney, David Bolk, who received an offer from Clark of $69,874.62, representing what Rockford considered to be the "actual cash value" of the building. Clark explained to Bolk that he arrived at this number by using Maher's estimate

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less depreciation. Bolk made a demand for the policy limits under Coverage A less a 10% discount. Clark informed Bolk that he could not pay the Coverage A policy limits because he was only authorized to offer the actual cash value of the building. Clark explained that, while Pirtle's policy included replacement cost coverage, Pirtle would only be entitled to payment under the replacement cost coverage once repairs or replacement of the building had been completed. Clark told Bolk that the actual cash value was an arbitrary figure used if the building was going to be repaired, and was often used as seed money to start repairs to insured buildings. Again, Clark offered what he considered to be the actual cash value of the building and proposed hiring a certified real estate appraiser to resolve the dispute over the actual cash value amount. Bolk did not respond to the offer.

The independent adjuster completed a comparative analysis in May 2001, which set the actual cash value of the building at $86,146.66. Pirtle retained other counsel [FN2] and filed suit against Rockford on September 24, 2001. Pirtle's complaint alleged breach of contract and bad faith. The bad faith claim was dismissed with prejudice when Rockford paid $86,146.66 for the building's actual cash value, which Pirtle accepted while continuing to contest the actual cash value used.

> FN2. Pirtle's original counsel, David Bolk, currently presides over Vigo Superior Court Division III/Vigo Circuit Court.

Rockford filed a motion for summary judgment alleging that Pirtle's recovery was limited to actual cash value because the building had not been repaired or replaced. Rockford argued that Pirtle was ineligible to receive payment for replacement cost coverage because he had not repaired or rebuilt the building. The motion for summary judgment was denied.

***64** Rockford filed a motion in limine seeking 1) to limit Pirtle's recovery to applicable policy limits and 2) to bar consequential damages. The trial court's order on the parties' motion in limine pleadings denied Rockford's attempts to limit Pirtle's recovery of consequential damages and amounts above policy limits.

At the conclusion of the jury trial, Rockford was found to be in breach of contract. The jury awarded Pirtle $124,149.55 under the insurance policy and $406,136.58 in consequential damages for an aggregate award of $524,286.13. Rockford's motion to correct error again sought to have Pirtel's award capped at policy limits. The trial court denied the motion to correct error. Rockford now appeals.

DISCUSSION AND DECISION

[1][2][3] A jury is to be afforded great latitude in making damage award determinations. *City of Carmel v. Leeper Elec. Servs., Inc.,* 805 N.E.2d 389, 393 (Ind.Ct.App.2004). A verdict will be upheld if the award falls within the bounds of the evidence. *Id.* On review of such an award, the appellate court will neither reweigh the evidence nor judge the credibility of the witnesses. The evidence will be looked at in a light most favorable to the judgment. *Id.* (quoting *City of Elkhart v. No-Bi Corp.,* 428 N.E.2d 43, 45 (Ind.Ct.App.1981)).

I. Actual Cash Value

[4] Rockford argues that Pirtle is limited to recovering only the actual cash value of the building because Pirtle failed to repair and replace the building after the fire, a condition precedent to receiving payment under that coverage. In March of 2002, Rockford paid Pirtle $86,146.66, which was Rockford's calculation of the actual cash value.

Rockford's insurance policy provided Pirtle with replacement coverage up to $193,000.00 for the building, up to $8,000.00 for personal property, and up to $19,300.00 for fair rental value. Rockford's policy further provided as follows:

> 5. Loss Settlement. Covered property losses are

settled as follows:

(c) Buildings under coverage A or B at replacement cost without deduction for depreciation, subject to the following:

(4)When the cost to repair or replace the damage is more than $1,000 or more than 5% of the amount of the insurance in this policy on the building, whichever is less, we will pay no more than the actual cash value of the damage until actual repair or replacement is completed.

Appellant's App. at 198-99. The parties appear to agree that the cost to repair or replace the building falls within the conditions of paragraph 5(c)(4) of Rockford's policy.

Rockford argues that the terms of the insurance contract are clear and unambiguous and must be given effect. Rockford urges this court to review the interpretation of this contract *de novo* because it is unambiguous. *See Liberty Ins. Corp. v. Ferguson Steel Co.,* 812 N.E.2d 228, 230 (Ind.Ct.App.2004) (review of unambiguous contracts is *de novo).* Rockford claims that Pirtle received all that he was entitled to receive from Rockford because he did not follow the terms of the contract. Rockford takes issue with Pirtle's alleged failure to first seek the actual cash value of the building, and once he received payment of the actual cash value, his use of the funds to satisfy the mortgage instead of commencing to repair or replace the building.

Here, the parties disputed the actual cash value. Clark testified that when there is a dispute over actual cash value of ***65** a building, Rockford usually obtains a certified real estate appraisal to determine the actual cash value of the property. *Tr.* at 306-07. Rockford did not do that here. Because of the impasse, Pirtle struggled to meet his obligations under the mortgage. Pirtle was trapped in a no win situation. By the time he received the actual cash value payment in March of 2002 he was behind on the mortgage payments and had no rental income. Pirtle had little choice but to use the funds to satisfy the mortgage at a loss to the mortgage holder, which left nothing to start the repairs.

[5][6][7] An actual cash value policy is a pure indemnity contract, the purpose of which is to make the insured whole but never to benefit him because a fire occurred. *See Travelers Indem. Co. v. Armstrong,* 442 N.E.2d 349, 352 (Ind.1982) (citing *APPLEMAN ON INSURANCE 2d* § 3823, at 218-19). “Replacement cost coverage reimburses the insured for the full cost of repairs, *if the insured repairs or rebuilds the building,* even if that results in putting the insured in a better position than he was before the loss.” *Travelers,* 442 N.E.2d at 352 (emphasis in original). Replacement cost coverage is an optional coverage that may be purchased and added to a basic fire policy by endorsement and is more expensive because the rate of premiums is higher and the amount of insurance to which that rate applies is usually higher. *Id.* Replacement cost coverage meets the need expressed as follows:

Since fire is an unwanted and unplanned for occurrence, why can't the owner of an older home buy insurance to cover the full cost of repair even if those repairs make it a better or more valuable building? Since at the time of fire the homeowner may be least able to pay for improvements, why can't that hazard be insured too? Instead of apportioning the cost of repair after a fire between the actual cash value, to be paid by the insurer, and the betterment to be paid by the insured, why can't the policyholder simply pay a higher premium each year but not have to pay anything more to have his home fully repaired in the event of fire?

Id. at 353. Any purported windfall to an insured who purchases replacement cost insurance is precisely what the insured contracted to receive in the event of a loss. *See Nahmias Realty, Inc. v. Cohen,* 484 N.E.2d 617, 622 (Ind.Ct.App.1985).

[8] The dispute here is over Pirtle's failure to repair or replace the building. *COUCH ON INSURANCE* contains the following observation: “Even where

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actual replacement is mandated, compliance may be excused by the insurer's actions. The insurer's failure to advance the necessary funds to rebuild may have this effect." *COUCH ON INSURANCE* (3d ed.1995) § 176:59 at 176-52 "Replacement cost coverage was devised to remedy the shortfall in coverage which results under a property insurance policy compensating the insured for actual cash value alone. That is, while a standard policy compensating an insured for the actual cash value of damaged or destroyed property makes the insured responsible for bearing the cash difference necessary to replace old property with new property, replacement cost insurance allows recovery for the actual value of property at the time of loss, without deduction for deterioration, obsolescence, and similar depreciation of the property's value." *Id.* § 176:56 at 176-49.

Our courts have yet to address the issue of whether an insured could be excused from performance of a condition precedent contained in a fire insurance policy. *See Nahmias,* 484 N.E.2d at 623 (defense that completed rebuilding or replacement is required before liability for that coverage attaches available only to party to insurance***66** contract). However, in *McCahill v. Commercial Union Insurance Co.,* 179 Mich.App. 761, 775, 446 N.W.2d 579, 585 (1988), the Court of Appeals of Michigan found that the insured was excused from performing the condition precedent, i.e., completion of rebuilding or repair, because the insurer's actions hindered performance by the insured. Further, in *Zaitchick v. American Motorists Insurance Co.* 554 F.Supp. 209, 217 (U.S.D.C.S.D.N.Y.1982) the District Court for the Southern District of New York held that case law and equitable considerations supported the decision to award replacement costs under the endorsement to the fire policy even though repair and replacement had not been completed. The insureds were paid nothing by the insurer and had no money with which to begin rebuilding. *Id.*

Here, Pirtle indicated to Rockford that he wanted his replacement costs paid. Rockford offered Pirtle $80,000 in January 2001, that was to "cash out" the insurance policy, meaning that would be all the money Pirtle would receive, even though the policy limit under Coverage A was $193,000. *See Appellant's App.* at 295. Pirtle refused this offer as there was no contractor who could repair the building for that amount. Nearly six months later in May 2001, only after the mortgage foreclosure process had started (*Tr.* at 181), and the property had been condemned by the city (*Appellant's App.* at 336), did Rockford offer $69,874 with the balance of the $193,000 to be paid when the property was repaired. This is the *first* time Rockford made an actual cash value offer to Pirtle under 5(c)(4), and it came six months after the fire, at which time the property was already in jeopardy. At this point, Pirtle was in a very bad position to start any repairs.

The jury was instructed as follows:

> When one party prevents the other from performing any part of the contract, the other party is excused from the remainder of his duties. The party excused may also recover for any work and any other damages sustained as a direct result of the prevention of performance.

Appellant's App. at 383 (Final Instruction No. 12). Rockford did not object to this instruction. In finding in favor of Pirtle, the jury, pursuant to Final Instruction No. 12, must have found that Pirtle was excused from repairing the property due to Rockford's actions in handling Pirtle's claim. Final Instruction No. 12 is consistent with the equitable principles previously cited to in *COUCH ON INSURANCE* (*3d ed.1995*) § 176:59 at 176-52. It thus appears that Pirtle proceeded under provision 5(c)(4) of the insurance policy, which requires completion of repairs or replacement, but because of Rockford's actions in handling Pirtle's claim, specifically its actions in regards to the actual cash value payment, the jury excused the requirement, as Final Instruction No. 12 allowed it to do.

We acknowledge that other courts, including our own Seventh Circuit, have held that the contract

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must be strictly construed to require the completion of the repair or replacement before liability under the replacement cost endorsement attaches. *See e.g. Bourazak v. N. River Ins. Co.,* 379 F.2d 530, 532(7th Cir.1967)(complaint dismissed because insured failed to satisfy condition precedent for claim of loss); *W. Suburban Bank of Darien v. Badger Mut. Ins. Co.,* 947 F.Supp. 333, 336-37 (N.D.Ill.1996) (replacement cost valuation does not apply until repair or replacement of destroyed property). However, we are convinced that equitable principles win the day in this situation; otherwise, the repair or replacement endorsement paid for by Pirtle would be rendered illusory. Rockford had the ability***67** to advance sums of money under that endorsement to assist in commencement of the rebuilding, and could have joined Pirtle in agreements entered into for repairs.

As for Rockford's argument that Pirtle should have proceeded under provision 5(c)(5) of the policy, which requires him to make a claim for loss or damage to the buildings on an actual cash value basis and then make a claim within 180 days after loss for any additional liability on a replacement cost basis, we do not need to address this argument since the jury apparently excused Pirtle's requirement to repair or replace under provision 5(c)(4) of the policy.

II. Contractual One-Year Limitation Period

Rockford argues that Pirtle's suit against them was barred by a contractual one-year limitation period contained in the insurance policy. The provision reads as follows:

> **Suit Against Us.** No action shall be brought unless there has been compliance with the policy provisions and the action is started within one year of the loss.

Appellant's App. at 148-49.

[9] Rockford is correct that one-year limitation periods in insurance contracts are valid and enforceable. *See Meridian Mut. Ins. Co. v. Caveletto,* 553 N.E.2d 1269, 1270 (Ind.Ct.App.1990). Rockford claims that although Pirtle's suit was brought within the one-year limitation period, Pirtle did not comply with the policy provisions requiring him to complete replacement or repair of the building. Because of our resolution of the previous issue, Rockford's argument here must fail.

III. Policy Limits For Consequential Damages

[10] Rockford claims that its liability should be capped at the policy limits. As previously discussed, Rockford paid Pirtle $86,146.66 in March 2002 for the actual cash value of the dwelling, and $8,659.20 for lost rents. Rockford claims that its dispute with Pirtle over the actual cash value was in good faith, thereby precluding an award of consequential damages. The jury awarded, and the trial court entered judgment of, $124,149.55 on the breach of contract claim and $406, 136.58 for consequential damages for a total verdict of $524,286.13.

[11][12][13] A party injured by a breach of contract may recover consequential damages. *Thor Elec., Inc. v. Oberle & Assocs., Inc.,* 741 N.E.2d 373, 381 (Ind.Ct.App.2000). Consequential damages may be awarded when the non-breaching party's loss flows naturally and probably from the breach and was contemplated by the parties when the contract was made. *Thor,* 741 N.E.2d at 381. The party seeking damages must prove by a preponderance of the evidence that the breach was the cause in fact of its loss. *Id.* This generally limits consequential damages to reasonably foreseeable economic losses. *Berkel & Co. Contractors, Inc. v. Palm & Associates, Inc.,* 814 N.E.2d 649, 658 (Ind.Ct.App.2004) .

Rockford claims that while consequential damage awards might be “recoverable as a matter of contract law, they might likely be precluded on a public policy analysis.” *Reply Br.* at 8. Rockford disputes the trial court's reliance on *Indiana Insurance*

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Co. v. Plummer, 590 N.E.2d 1085 (Ind.Ct.App.1992).

Plummer is a case involving the award of consequential damages to an insured for costs incurred during the course of seeking to recover under a fire policy. Rockford attempts to distinguish the cases upon which *Plummer* depends for the resolution of that case from the case at bar. Like ***68** the insurer in *Plummer,* Rockford claims, in addition to its claim that damages should be restricted to policy limits, that 1) the consequential damages award should not stand because Rockford's dispute was in good faith, and 2) Pirtle's damages were not proximately caused by Rockford's conduct in handling Pirtle's claim. *See id.,* 590 N.E.2d at 1089. Rockford's argument must fail.

This court in *Plummer* examined the cases cited by the insurer in its efforts to limit its liability. We found that *Lloyds of London v. Lock,* 454 N.E.2d 81 (Ind.Ct.App.1983), a case later modified to cap the damage award at liability limits, had been abandoned to follow a different line of reasoning. In *Liberty Mutual Insurance Co. v. Parkinson,* 487 N.E.2d 162, 165 (Ind.Ct.App.1985), *abrogated on other grounds by, Erie Insurance Co. v. Hickman by Smith,* 622 N.E.2d 515 (Ind.1993), we held that although the insurer had settled with the insured for all of the benefits due under the insurance policy, the insurer was liable for damages to compensate the insured for the insurer's breach. While *Liberty* is a case involving breach of contract by failing to deal with its insured in good faith, the compensatory damage award was for expenditures proximately caused by the breach of contract. In *Burleson v. Illinois Farmers Insurance Co.,* 725 F.Supp. 1489, 1496 (S.D.Ind.1989), the court, quoting *Lawton v. Great Southwest Fire Insurance Co.* 118 N.H. 607, 392 A.2d 576, 579 (1978), stated, " 'the policy limits restrict the amount the insurer may have to pay in the performance of the contract, not the damages that are recoverable for its breach.' " This court in *Plummer* found that the *Burleson* court erroneously interpreted *Vernon Fire & Casualty Insurance Co. v. Sharp,* 264 Ind. 599, 349 N.E.2d 173 (Ind.1976) as restricting the recovery of consequential damages under a public policy analysis when they arise from a good faith dispute. We held, in *Plummer,* that the holding in *Vernon* applied in the context of punitive damages, not consequential damages. 590 N.E.2d at 1091. Consequently, we find that the trial court did not err by awarding consequential damages in excess of policy limits, as the award was for Rockford's breach.

[14] Lastly, we reject Rockford's argument that consequential damages were erroneously awarded because 1) the dispute was a good faith dispute and 2) the damages were not proximately caused by Rockford's breach. Our Supreme Court noted in *Vernon,* "a promisor's *motive* for breaching his contract is generally regarded as *irrelevant* because the promisee will be compensated for all damages proximately resulting from the promisor's breach." 349 N.E.2d at 180 (emphasis added). Here, Rockford's motive for delayed payment is irrelevant, therefore this argument as to good faith fails. Rockford further argues that its breach of contract was not the proximate cause of Pirtle's consequential damages, i.e., that the recovery for property taxes, utility bills, and an increase in the Maher quote in particular, were not reasonably foreseeable at the time the insurance contract was entered into. This argument too must fail.

> Delayed payment, whether as a result of good or bad faith, will undoubtedly result in the failure of the owner's business. He cannot generate sufficient income to pay his bills because he has no business. The damages incurred from such inability to pay bills flow directly, and are proximately caused by, the insurer's failure to pay.

Plummer, 590 N.E.2d at 1092.

The fire occurred on November 11, 2000, and the jury trial concluded on October 17, 2007. The cost of repairs, utilities, and property taxes were likely to increase during***69** the seven-year period

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between the damage to the building and the jury's award. Those damages flow directly from and are proximately caused by Rockford's failure to pay. Had Pirtle been able to use the building as a rental property during those years, the rent likely would have increased.

[15] By analogy, in a wrongful death action, this court held that "[a]n awareness of general inflation and a constant depreciation and cheapening of money is within the zone of discretion given to the trier of facts when assessing damages." *See State v. Daley,* 153 Ind.App. 330, 337, 287 N.E.2d 552, 556 (Ind.Ct.App.1972). In order to justify a reversal on grounds of excessive damages, the amount of damages assessed must appear to be so outrageous as to impress the court as being motivated by passion, prejudice, and partiality. *Id.* Reversal is not justified, however, if the amount of damages awarded is within the scope of the evidence before the court. *Id.*

[16][17] Here, the jury verdict included $124,149.55 under the insurance policy, and consequential damages of $406,136.58. The award under the insurance policy was the remainder of the contractual damages Pirtle was eligible to receive. Accordingly, that award is within the scope of the evidence. The net bid by Maher Construction was $205,962.27; the utilities and debris removal award was $16,262.31; and the loss of rental income was $177,912.00. Evidence of the loss of personal property in excess of $6,000.00 was admitted. Accordingly, the jury's award was within the scope of the evidence.

Affirmed.

VAIDIK, J., and CRONE, J., concur.
Ind.App.,2009.
Rockford Mut. Ins. Co. v. Pirtle
911 N.E.2d 60

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Court of Appeals of Nebraska.
Roger D. ELEDGE and Barbara Eledge, husband and wife, nd wife, Appellants,
v.
FARMERS MUTUAL HOME INSURANCE COMPANY OF HOOPER, NEBRASKA, Appellee.
No. A-96-465.

Nov. 10, 1997.

*****107** Syllabus by the Court*

1. **Insurance: Contracts: Appeal and Error.** The interpretation and construction of an insurance contract ordinarily involve questions of law in connection with which an appellate court has an obligation to reach conclusions independent of the determinations made by the court below.

2. **Judgments: Appeal and Error.** In reviewing a judgment awarded in a bench trial, an appellate court does not reweigh the evidence, but considers the judgment in a light most favorable to the successful party and resolves evidentiary conflicts in favor of the successful party, who is entitled to every reasonable inference deducible from the evidence.

3. **Damages: Appeal and Error.** On appeal, the fact finder's determination of damages is given great deference.

4. **Damages: Appeal and Error.** The amount of damages to be awarded is a determination solely for the fact finder, and its action in this respect will not be disturbed on appeal if it is supported by evidence and bears a reasonable relationship to the elements of the damages proved.

***141** 5. **Insurance: Contracts: Intent.** In interpreting an insurance contract, the court construes the policy as any other contract, giving effect to the parties' intentions at the time the contract was made.

6. **Judgments: Appeal and Error.** An appellate court, in reviewing a judgment of the district court for errors appearing on the record, will not substitute its factual findings for those of the district court where competent evidence supports those findings.

7. **Proximate Cause: Appeal and Error.** Proximate cause is a question of fact to be determined by the trial court as fact finder, and will not be disturbed on appeal unless clearly wrong.

8. **Trial: Witnesses.** A trial court, as the trier of fact, is the sole judge of credibility of the witnesses and the weight to be given their testimony.

9. **Trial: Expert Witnesses.** A fact finder is free to reject the opinion of experts and to choose which witness to believe.

10. **Statutes: Appeal and Error.** Statutory interpretation is a matter of law in connection with which an appellate court has the obligation to reach an independent, correct****108** conclusion irrespective of the decision made by the court below.

11. **Statutes: Legislature: Intent: Appeal and Error.** When settling upon the meaning of a statute, an appellate court must determine and give effect to the purpose and intent of the Legislature as ascertained from the entire language of the statute considered in its plain, ordinary, and popular sense, it being the court's duty to discover, if possible, the Legislature's intent from the language of the statute itself.

12. **Judgments: Costs.** As a general rule, an award of costs in a judgment is a part of the judgment.

13. **Insurance: Contracts: Judgments: Costs: Attorney Fees.** Under Neb.Rev.Stat. § 44-359 (Reissue 1993), in determining whether the insured has obtained judgment for more than the amount offered under Neb.Rev.Stat. § 25-901 (Reissue 1995), costs, excluding attorney fees allowed there-

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under, are included in the judgment in addition to the recovery under the insurance policy in question.

T.J. Hallinan, of Cobb & Hallinan, P.C., Lincoln, for appellants.

Charles H. Wagner and Maureen Freeman-Caddy, of Edstrom, Bromm, Lindahl, Wagner & Miller, Wahoo, for appellee.

MILLER-LERMAN, C.J., and SIEVERS and MUES, JJ.

MUES, Judge.

INTRODUCTION

Roger D. Eledge and Barbara Eledge appeal from an order of the Butler County District Court awarding them $1,000 under their homeowner's insurance policy with Farmers Mutual Home Insurance Company (Farmers). The Eledges sought recovery of ***142** $6,331 for damage to the roof and interior ceilings of their home allegedly resulting from a hailstorm or series of hailstorms occurring in May 1991. The trial court awarded them $1,000 for roof damage only. The Eledges appeal the sufficiency of that award, the failure to award ceiling damages, and the denial of attorney fees. Because we conclude that the trial court's findings concerning the damage to the roof and its finding that the hail damage did not cause damage to the interior ceilings are not clearly erroneous, we affirm the district court's order in those particulars. We reverse the denial of attorney fees and remand the cause for further proceedings in that regard.

FACTUAL BACKGROUND

In 1980, the Eledges purchased a home at 510 C Street in Ulysses, Nebraska, for $7,000. Over the next 2 years, they spent approximately $30,000 renovating the home so that they could move into it. These repairs included putting new ceilings and walls in the second floor bedrooms, fixing a basement wall, and replacing the furnaces. The Eledges did not make repairs to the roof because the seller told them the roof was new and also because no repairs appeared to be necessary. After all the renovations were completed, the Eledges moved into the house in 1982.

In August 1990, the Eledges applied for homeowner's insurance with Farmers through its agent, Terry Kirby. They requested, received, and paid for a replacement cost policy on their home. To qualify for such policy, they had to insure their home for at least 80 percent of its actual replacement cost. Kirby helped the Eledges determine this amount to be $73,000, and the Eledges were issued an “Elite 3” policy from Farmers. The clause in issue reads as follows:

> 3. **Loss Settlement.** Covered property losses are settled as follows:
>
> ....
>
> b. Buildings under Coverage A [the dwelling] or B [other structures] at replacement cost without deduction for depreciation, subject to the following:
>
> (1) If, at the time of loss, the amount of insurance in this policy on the damaged building is 80% or more of the full ***143** replacement cost of the building immediately before the loss, *we will pay the cost to repair or replace,* after application of deductible and without deduction for depreciation,****109** but not more than the least of the following amounts:
>
> (a) the limit of liability under this policy that applies to the building;
>
> (b) *the replacement cost of that part of the building damaged for like construction and use* on the same premises; or
>
> (c) the necessary amount actually spent to repair or replace the damaged building.

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(Emphasis supplied.)

After hailstorms in May 1991, the Eledges noticed that their roof was leaking around the chimney. They asked their friend and neighbor, Gary Davis, a roofer employed by American Roofing with 10 to 12 years of experience, to repair the damage. Davis installed new flashing around the chimney and replaced a few shingles immediately around the chimney. While he was on the roof, he noticed what was, in his opinion, hail damage across the entire roof, and suggested that the Eledges contact their insurance agent about the damage. After inspecting the interior of their home and discovering water damage on several of the second floor ceilings, the Eledges contacted Farmers through its agent, Terri Novak, and were told to get estimates to repair the damage.

The Eledges again contacted Davis and asked him for an estimate to repair the roof and the ceilings. Davis measured the roof and took pictures of some of the damaged areas. Mike McNair, American Roofing's estimator, then estimated the cost to replace the roof at $5,170. This estimate included tearing off the old layers of shingles that were on the roof and installing new felt, edge metals, flashing on the plumbing pipes, and asphalt shingles. Davis testified that the only workmanlike way to repair the hail damage and ensure that the roof would not continue to leak was to tear off the old shingles and replace the edge metals, felt, flashing, and shingles with new materials. Because there were already two layers of shingles on the roof, at least one of which had been damaged by hail, he testified that it would not be good workmanlike procedure to overlay the roof ***144** with a third layer of shingles. Davis also testified that it was possible to simply tear out and replace the damaged shingles, but that he did not feel this was an adequate way to repair the Eledges' roof because those shingles would be a different color than the old shingles and he would not be able to guarantee a proper seal.

Davis also inspected the water damage to the interior or ceilings shortly after the storms in May 1991. He testified that some of the stains looked fresh and some looked older, but he could not be certain how long any of them had been there. Davis also testified that he could not tell where the water was entering the house and concluded that it could be an entirely different point from where the ceiling was stained. He admitted that it was possible that all of the water damage originated from the chimney leak. Davis further testified that in his opinion the chimney leak was not caused by hail, and he could not say for sure that the hail damage to the roof caused the roof to leak, but in his opinion the damage was sufficient to cause leaking. The Eledges testified that after Davis fixed the chimney leak, it stopped leaking in that area, but the upstairs ceiling continued to suffer water damage in other areas. American Roofing estimated the cost to fix the water damage to the interior ceilings to be $1,161.

McNair testified that the estimates reflected the fair and reasonable cost to repair the hail and water damage and that each item on the estimates was necessary to make the repairs in a proper, workmanlike manner. Based upon these estimates, the Eledges submitted a proof of loss statement to Farmers in the amount of $6,231 ($6,331 less the $100 deductible).

Farmers contacted Midlands Claim Service and asked that an adjuster be sent to the Eledges' home to adjust the loss. Adjuster Jack Young was sent. Young is a teacher who had adjusted claims for damage caused by summer storms for approximately 8 years before he inspected the Eledges' roof. Young had also done some construction work, including a little roofing during his college years and during the summers. He received on-the-job training for adjusting storm damage by riding along with his boss during his first summer as an adjuster.

****110** Young inspected the roof in June 1991 by climbing onto the roof and counting the hail-damaged spots or “hits” per 10-by ***145** 10-foot square. He found some hail damage across the entire roof, but after counting only three to four hits

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per square, he concluded that there was insufficient damage to replace the entire roof. This was based on an industry custom or standard that 10 hits per square would normally entitle the insureds to have their entire roof replaced. The basis for this standard was not explained. Young determined that it would take 29 squares of shingles to cover the entire roof.

Because the damage was minor, he adjusted the claim by allowing a 33-percent damage allowance. In 1991, it cost approximately $65 per square to replace a roof; thus, Young took $65 times 33 percent and allowed $22 per square to repair the Eledges' roof. This allowed $638 for roof repair. According to Young, his estimate did not allow for the old shingle layers to be torn off and replaced; rather, his estimate was based upon the cost to tear out and replace only the shingles that were damaged by the hail. Young also inspected the interior ceilings and allowed $444 to repair that damage. His complete repair estimate, including the roof and the interior ceilings, was for $982 ($1,082 less the $100 deductible).

Based upon Young's investigation, Farmers offered to pay the Eledges $982 for the hail damage. They rejected the offer. After the Eledges' rejection, Leland Belcher, Young's boss, then did a reinspection to make sure Young was correct in his assessment of the damage and in his offer. In Belcher's opinion, only one slope of the roof had received any hail damage; thus, he felt that it was necessary to repair only that one damaged slope. Belcher did not feel that the hail damage had affected the whole roof and observed that the roof was old and had substantial deterioration prior to the hailstorm. He conceded that “wear and tear” was another term for depreciation. Thus, he admitted that the most appropriate way to repair the damaged slope would be to tear off at least one layer of shingles and put down a new layer on the entire slope, a process which he testified Young's $638 estimate would cover.

Approximately 2 years after the damage was reported, Farmers contacted James Belina, an engineer who specializes in analyzing structural failure due to storm damage. Belina inspected the Eledges' roof in July 1993 and took photographs ***146** of the roof. In his testimony, prior to Belina's, Davis was shown these 1993 photographs taken by Belina and agreed that the roof was in essentially the same condition at the time of Belina's 1993 inspection as it was when Davis inspected it in 1991. Belina found that the roof was at the end of its useful life and found no evidence of hail damage. He found no craters or dents, which were characteristic of hail damage, in the roof or the flashing. In fact, he stated that he found nothing on the roof that was characteristic of hail damage. However, he admitted that he deviated from standard industry procedure in inspecting the roof in that he did not get onto the roof and examine each slope; instead, he used a telephoto lens and binoculars to examine parts of the roof. Belina had never been a roofer and conceded that an inspection for hail damage should occur as soon after the damage as is possible. He also testified that he had been told by Midlands Claim Service that an inspection in June 1991 had revealed no hail damage.

During trial, Roger Eledge testified that he assumed the damage occurred during two hailstorms in May 1991 because it was shortly after these storms that he noticed a leak around the chimney. He testified that the Eledges had no problems with the roof before May 1991, but had continually had problems since that time because the roof had not been fixed. Prior to trial, Farmers offered to settle the Eledges' claim for $1,100. This offer was also rejected, and trial was held to the court. The trial court found in favor of the Eledges in the amount of $1,000 for damages to the roof and taxed costs of $399.85 to Farmers, rejecting Farmers' defense that the Eledges did not have adequate replacement value coverage. The court further found that the leakage around the chimney was not caused by hail and that there was insufficient evidence to prove the interior damage was caused by the hailstorms. The court denied the Eledges attorney fees ****111** because the Eledges had failed to recover more than the amount offered by Farmers to settle the claim prior to trial.

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The Eledges timely appeal.

ASSIGNMENTS OF ERROR

The Eledges allege that the trial court erred in (1) awarding them $1,000 to repair the roof when the only competent evidence shows that the fair and reasonable cost to repair/replace ***147** the roof in a workmanlike manner was $5,170; (2) failing to find that the water damage to the interior ceilings was caused by the hail damage to the roof; and (3) failing to award attorney fees pursuant to Neb.Rev.Stat. § 44-359 (Reissue 1993).

STANDARD OF REVIEW

[1] The interpretation and construction of an insurance contract ordinarily involve questions of law in connection with which an appellate court has an obligation to reach conclusions independent of the determinations made by the court below. *Luedke v. United Fire & Cas. Co.,* 252 Neb. 182, 561 N.W.2d 206 (1997); *Kast v. American-Amicable Life Ins. Co.,* 251 Neb. 698, 559 N.W.2d 460 (1997); *Burke v. Blue Cross Blue Shield,* 251 Neb. 607, 558 N.W.2d 577 (1997).

[2] In reviewing a judgment awarded in a bench trial, an appellate court does not reweigh the evidence, but considers the judgment in a light most favorable to the successful party and resolves evidentiary conflicts in favor of the successful party, who is entitled to every reasonable inference deducible from the evidence. *Sherrod v. State,* 251 Neb. 355, 557 N.W.2d 634 (1997).

[3] On appeal, the fact finder's determination of damages is given great deference. *Nichols v. Busse,* 243 Neb. 811, 503 N.W.2d 173 (1993). The amount of damages to be awarded is a determination solely for the fact finder, and its action in this respect will not be disturbed on appeal if it is supported by evidence and bears a reasonable relationship to the elements of the damages proved. *World Radio Labs. v. Coopers & Lybrand,* 251 Neb. 261, 557 N.W.2d 1 (1996).

DISCUSSION

Roof Damage.

The Eledges' first assignment of error is that the award of $1,000 for hail damage to the roof was insufficient. They contend that the policy obligated Farmers to pay the reasonable cost necessary to replace their entire roof. Their evidence was that this amount was $5,170. Farmers argues that the policy entitles the Eledges only to sums necessary to repair or replace the part of the house damaged by hail-in this case, portions of the roof and individual shingles. The pertinent portion of the policy reads as follows:

> ***148** 1) ... [W]e will pay the cost to repair or replace, after application of deductible and without deduction for depreciation, but not more than the least of the following amounts:
>
> ....
>
> (b) *the replacement cost of that part of the building damaged for like construction and use* on the same premises....

(Emphasis supplied.)

[4][5] The interpretation and construction of an insurance contract ordinarily involve questions of law in connection with which an appellate court has an obligation to reach conclusions independent of the determinations made by the court below. *Luedke v. United Fire & Cas. Co., supra.* In interpreting an insurance contract, the court construes the policy as any other contract, giving effect to the parties' intentions at the time the contract was made. Where the terms of such contract are clear, they are to be accorded their plain and ordinary meaning. *Burke v. Blue Cross Blue Shield, supra.*

[6] The Eledges argue, somewhat inconsistently, that the policy is ambiguous and also that the plain

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and ordinary meaning of the "replacement cost" provision compels their recovering the cost of replacing the entire roof in this case. We do not agree that the "plain and ordinary meaning" of this policy provision compels replacing the entire roof in every instance where hail damages only a part of the roof. For example, where a single square of shingles is damaged and ****112** matching replacements can be found, and where the repair can be made without damage to the remainder of the roof, such interpretation would mean that an insured was nevertheless entitled to the cost of replacing the whole roof as a matter of law. We do not believe a reasonable person would place such an interpretation on this policy. A plain reading of the provision does not require the replacement of the whole when it is factually shown that the whole can be satisfactorily repaired by replacement of a "part," so long as the building is returned to "like construction and use" as a result. The policy language obligates Farmers to pay the reasonable cost to repair or replace, but no more than the replacement cost of that "part of the building damaged." No deduction may be ***149** taken for depreciation of the part damaged by the covered occurrence. Moreover, as a matter of law, we find no ambiguity as to what "replacement cost" means under the policy.

In reality, we believe the Eledges recognize that the result here does not depend so much on contract interpretation as it does on the facts. In essence, their argument is that the evidence shows that the only workmanlike way to repair the hail damage would be to replace the entire roof.

[7] An appellate court, in reviewing a judgment of the district court for errors appearing on the record, will not substitute its factual findings for those of the district court where competent evidence supports those findings. *Records v. Christensen,* 246 Neb. 912, 524 N.W.2d 757 (1994).

[8] The district court made no specific findings regarding the hail damage to the roof. However, several such findings are implicit in its award; first and foremost, that the May 1991 hailstorm caused damage of some kind to the Eledges' roof, obviously less than Davis opined, but more than attested to by Belina, who found none. Proximate cause is a question of fact to be determined by the trial court as fact finder, and will not be disturbed on appeal unless clearly wrong. See *Bean v. State,* 222 Neb. 202, 382 N.W.2d 360 (1986).

[9] Considering the evidence in a light most favorable to Farmers, as we must, Farmers' adjuster Belcher attested that only one slope of the roof sustained minor hail damage, and Farmers' expert, Belina, testified that the roof was badly deteriorated due to its age. While we agree that under the policy the age and deteriorated condition of the Eledges' roof does not itself preclude replacing the whole roof, it does have a bearing on the issue of causation. In other words, while the policy clearly prohibits any "deduction for depreciation," the damage must result from a covered occurrence-here, the hail. Damage caused from normal wear and tear or depreciation is obviously not covered.

[10][11] As stated, the trial court obviously rejected the testimony of both Davis and Belina, and this it was free to do. A trial court, as the trier of fact, is the sole judge of credibility of the witnesses and the weight to be given their testimony. *Sherrod v. State,* 251 Neb. 355, 557 N.W.2d 634 (1997). A fact finder is ***150** free to reject the opinion of experts and to choose which witness to believe. See *Sheridan v. Catering Mgmt., Inc.,* 5 Neb.App. 305, 558 N.W.2d 319 (1997).

The district court also implicitly found that a reasonable and workmanlike method to repair the hail damage was to replace only a part of the roof. The Eledges contend that this finding was clearly erroneous because Davis, the only roofer called as a witness, testified that the only workmanlike method to repair the hail damage to the Eledges' roof, and to guarantee that it would not continue to leak, was to tear off the existing shingles down to the subdecking or plywood underneath, and then replace the felt, edge metals, flashing, and shingles with new materials. Davis testified that tearing out and

replacing only the damaged shingles was possible, but he could not guarantee a leak-free roof if repaired in such manner. Moreover, the new individual shingles would not match the older ones.

[12] It is true that the policy requires that the repair or replacement must be sufficient for "like construction and use." In other words, the repair must return the structure as nearly as possible to its predamage**113 condition, and no deduction can be taken for depreciation. This plainly requires that if hail damage causes roof leaks, the method of repair must include eliminating these leaks. But a "replacement cost" policy does not, in every case, entitle the insured to a guarantee of a "leak-free" roof. If the roof leaked *before* any hail damage, and if the method to repair the area damaged can otherwise be done in a workmanlike manner, including its being made "leak-free," that the roof might continue to leak from a non-hail-damaged area does not render that method unworkmanlike.

It is implicit in the award below that the district court found that the roof, which, according to witnesses, was 15 to 20 years old and near the end of its useful life and had defective chimney flashing, leaked for reasons unrelated to the hail damage. Davis testified that the chimney leak was unrelated to the hailstorm and that some of the ceiling waterstains, whatever their source, looked "older."

The Eledges cite *Higginbotham v. New Hampshire Indem. Co.,* 498 So.2d 1149 (La.App.1986), as authority for the position that they were entitled to the replacement cost of a new roof ***151** rather than to the cost of repairing the roof as allowed. *Higginbotham* is, in many respects, similar to the case here. The trial court found that the amounts tendered by the insurer were sufficient to repair the hail damage. The appellate court amended the trial court's award, finding "manifest error," *id.* at 1151, in the trial court's factual conclusions. The appellate court found that the replacement cost of a new roof was the proper method of valuation based on the evidence presented. In so doing, it relied heavily on the undisputed evidence that spot replacement, while possible, would not guarantee a leak-free roof. The *Higginbotham* court stated: "The testimony of all experts revealed that the proper standard of repair ... would be to remove and replace the roof." *Id.* at 1153. As here, the main dispute was whether the roof could be repaired or whether the severity of the damage was such that replacement was necessary. There, all experts testified that to guarantee a leak-free roof, the entire roof needed to be replaced. The opinion is silent on predamage leaks.

We believe that the facts in *Higginbotham* make it distinguishable from the case before us. Here, both Young and Belcher testified to repair methods other than replacing the roof. While Young's estimate was based on spot-replacing shingles, Belcher testified that the most appropriate way to fix the damaged area was to tear off the top layer of shingles on the damaged slope and replace it with a new layer, a method which he attested could be accomplished at a cost within Young's estimate of $638. This alternative method took into account the insurance department directive that a third layer not be placed over two or more existing layers and eliminated spot replacement of individual shingles and the leakage and "mismatch" problems that spot replacement would cause according to Davis. Here, unlike in *Higginbotham,* all the experts did not agree on the type or degree of repair necessary to correct the hail damage.

In an action tried to the court, the factual findings of the court will not be disturbed on appeal unless clearly wrong. *Bachman v. Easy Parking of America,* 252 Neb. 325, 562 N.W.2d 369 (1997). An appellate court, in reviewing a judgment of the district court for errors appearing on the record, will not substitute ***152** its factual findings for those of the district court where competent evidence supports those findings. *Records v. Christensen,* 246 Neb. 912, 524 N.W.2d 757 (1994). The trial court's implicit finding that the proper standard of repair in this case did not require replacing the whole roof is not clearly erroneous.

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The court's award of $1,000 was almost 50 percent higher than the roof damage figure of $638 attested to by Young and Belcher. There is nothing to suggest that the trial court diminished the cost of repair because of the predamaged condition of the roof, that is, for depreciation. The reason for awarding more than the witnesses attested to goes unexplained, but Farmers does not cross-appeal. The amount of damages to be awarded is a determination solely for the fact finder, and its action in this respect will not be disturbed on appeal if it is supported by ****114** evidence and bears a reasonable relationship to the elements of the damages proved. *World Radio Labs. v. Coopers & Lybrand,* 251 Neb. 261, 557 N.W.2d 1 (1996). We find no error on the record in the trial court's award for the roof damage.

Damage to Interior Ceilings.

The trial court found that there was insufficient evidence to prove the interior damage was caused by the hailstorm. As stated, proximate cause is a question of fact to be determined by the trial court as fact finder, and will not be disturbed on appeal unless clearly wrong. See *Bean v. State,* 222 Neb. 202, 382 N.W.2d 360 (1986).

Roger Eledge testified that the roof had not leaked prior to the purchase of the insurance policy from Farmers and that he first noticed the wet ceiling around the fireplace shortly after the May 1991 hailstorms. After Davis repaired the chimney flashing, Roger Eledge looked for other ceiling problems and noticed that several of the second floor ceilings had waterstains. He testified that the waterstains on the ceilings were not present prior to May 1991 and were still occurring at the time of trial. Barbara Eledge testified that the leak and staining around the fireplace had stopped after Davis fixed the flashing. Young, the adjuster, included an amount for water damage to the interior ceilings in his appraisal of $1,082. However, Davis testified that when he looked at the ceilings shortly after the May 1991 storms, some of the ceiling damage looked fresh and some ***153** looked older. He also testified that he could not tell where the water was entering the house and that it was possible all the damage originated from the chimney leak, a leak undisputedly unrelated to hail damage. As stated, Farmers' expert, Belina, testified that the roof was at the end of its useful life and described the cracking and curling of shingles due to age.

[13] The trial court obviously was not persuaded that the damage to the interior ceilings was caused by the hail damage to the roof. The evidence supports the conclusion that it was just as likely due to the chimney leak and the age and condition of the roof. As already stated, the findings of the trial court on the question of proximate cause will not be disturbed on appeal unless clearly wrong, see *Bean v. State, supra,* and in reviewing a judgment of the district court for errors appearing on the record, we may not substitute our factual findings for those of the district court where competent evidence supports those findings, *Records v. Christensen,* 246 Neb. 912, 524 N.W.2d 757 (1994). We cannot say that the trial court's findings were clearly erroneous. Thus, we affirm the decision denying recovery to the Eledges for repair to the interior ceilings of their home.

Attorney Fees.

Section 44-359 states in pertinent part:

> In all cases when the beneficiary ... brings an action upon any type of insurance policy ... the court, upon rendering judgment against such company ... shall allow the plaintiff a reasonable sum as an attorney's fee in addition to the amount of his or her recovery, to be taxed as part of the costs ... except that *if the plaintiff fails to obtain judgment for more than may have been offered by such company ... then the plaintiff shall not recover the attorney's fee provided by this section.*

(Emphasis supplied.)

Neb.Rev.Stat. § 25-901 (Reissue 1995) provides in

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pertinent part that “[t]he defendant in an action for the recovery of money only, may, at any time before the trial, serve upon the plaintiff, or his attorney, an offer in writing to allow judgment to be taken against him for the sum specified therein.”

The facts concerning the attorney fees are not in dispute. The trial court awarded the Eledges a judgment of $1,000 plus costs, ***154** the amount of costs not stated. The trial court also found that the Eledges had refused Farmers' pretrial offer to confess judgment in the amount of $1,100, and the court thus denied the request for attorney fees. The Eledges' costs were later taxed at $399.85. Farmers' written pretrial offer stated that it offered “to allow Judgment to be taken ... for the sum of $1,100.” Costs were not mentioned.

The Eledges argue that the trial court erred in failing to award reasonable attorney fees pursuant to § 44-359, because they obtained****115** a judgment for $1,399.85 ($1,000 recovery plus $399.85 costs) which exceeds the $1,100 offer made by Farmers under § 25-901. Therefore, the Eledges argue, § 44-359 mandated an award of fees, since it is only if a plaintiff fails to obtain judgment for more than that offered by the insurer that attorney fees are not recoverable.

[14] The issue is whether costs are included in the term “judgment” as used in § 44-359 for purposes of determining whether the judgment exceeds an offer made under § 25-901. We find no Nebraska case specifically addressing this issue. Farmers first argues that the issue was not presented to the trial court and may not be raised for the first time on appeal. See, e.g., *Hanigan v. Trumble,* 252 Neb. 376, 562 N.W.2d 526 (1997). We disagree. While the Eledges did not make the specific *argument* they now pose, clearly the *issue* of attorney fees under § 44-359 was pled and argued below. Given the sequence of events below, including the taxing of costs after the motion for new trial was argued and denied, we conclude that the issue is properly before us.

[15] Statutory interpretation is a matter of law in connection with which an appellate court has the obligation to reach an independent, correct conclusion irrespective of the decision made by the court below. *Bank of Papillion v. Nguyen,* 252 Neb. 926, 567 N.W.2d 166 (1997); *Moore v. Eggers Consulting Co.,* 252 Neb. 396, 562 N.W.2d 534 (1997); *State v. Thieszen,* 252 Neb. 208, 560 N.W.2d 800 (1997).

Farmers contends that the Eledges *recovered* less than was offered prior to trial. Farmers argues that § 44-359 should be interpreted to segregate costs from the judgment. Section 44-359 does state that attorney fees allowed under its provisions are to be taxed as costs and that such attorney fees are to be “in addition***155** to” the “recovery.” It is apparently Farmers' contention that since the Legislature requires allowed attorney fees to be segregated from the recovery, and since attorney fees are costs, then § 44-359 should be interpreted to also require “segregation” of costs in general from “judgment.” We disagree.

[16] When settling upon the meaning of a statute, an appellate court must determine and give effect to the purpose and intent of the Legislature as ascertained from the entire language of the statute considered in its plain, ordinary, and popular sense, it being the court's duty to discover, if possible, the Legislature's intent from the language of the statute itself. *Kerrigan & Line v. Foote,* 5 Neb.App. 397, 558 N.W.2d 837 (1997). The pertinent part of § 44-359 provides that it is only if the plaintiff fails to obtain *judgment* for more than may have been offered by the company under § 25-901 that attorney fees are precluded. We must assume that the Legislature's selection of the word “judgment” in this portion of the statute rather than the word “recovery,” as found in the earlier part, was intentional. Recovery obviously refers to the amount of money determined to be due the insured under the insurance policy in question. By choosing the term “judgment” and placing it in the equation for determining whether the plaintiff has obtained more

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than that offered under § 25-901, we thus assume the Legislature intended judgment to mean something other than simply that amount found due under the policy. Recovery, as found in § 44-359, is not synonymous with judgment, and we must determine whether the term "judgment," in its plain and ordinary meaning, includes court costs such as those awarded to the Eledges here.

Farmers asserts that "[c]osts have never been considered a portion of the judgment in Nebraska." Brief for appellee at 16. Farmers cites *Metcalf v. Hartford Acc. & Ind. Co.,* 176 Neb. 468, 126 N.W.2d 471 (1964), to support that proposition. *Metcalf* interpreted a predecessor statute to § 44-359 and held that, thereunder, the fees allowed were taxable as costs and constituted no part of the judgment for purposes of accruing interest on the judgment. As stated, the current version of § 44-359 also provides that attorney fees allowed are taxed as costs and are in addition to the recovery. That attorney fees, as costs, are ***156** not included in the judgment for purposes of interest accrual does not answer the question of whether costs in general****116** should be included in the judgment for purposes of § 44-359.

[17] As a general rule, an award of costs in a judgment is a part of the judgment. See, e.g., *Muff v. Mahloch Farms Co., Inc.,* 186 Neb. 151, 181 N.W.2d 258 (1970) (award of costs in judgment is part of judgment, and power of court to change such award is coextensive with its power to vacate or modify judgment); *Rehn v. Bingaman,* 152 Neb. 171, 173-74, 40 N.W.2d 673, 675 (1950) (" 'award of costs to the successful party is as much a part of the judgment entered as the damages allowed, and the court cannot, after the term, change this award except for some statutory cause allowing the court to set aside or modify its judgments at a subsequent term' ") (citing *Smith v. Bartlett,* 78 Neb. 359, 110 N.W. 991 (1907)).

Other jurisdictions have interpreted statutes similar to § 44-359 and have determined that the judgment includes costs. In *Carlson v. Blumenstein,* 293 Or. 494, 651 P.2d 710 (1982), a case strikingly similar to the one at hand, the Oregon Supreme Court interpreted an attorney fees statute in connection with an offer of compromise statute similar to § 25-901. In that case, the defendants offered to allow judgment against them for $3,000. The plaintiffs rejected the offer and were awarded $2,717.04 plus interest, making the total award greater than $3,000. They were awarded $2,000 in attorney fees. This award was upheld on appeal, with the court stating that judgment normally includes an award of damages, costs, disbursements, and attorney fees. The *Carlson* court held that in comparing an offer with the judgment received, a court must compare the offer of compromise against the sum of the award plus the costs and recoverable attorney fees incurred up to the time of service of the offer. In addition, California courts have repeatedly held in several contexts that in determining whether a plaintiff has obtained a more favorable judgment than the settlement offered, attorney fees and costs are included in the judgment. See, e.g., *Wickware v. Tanner,* 53 Cal.App.4th 570, 61 Cal.Rptr.2d 790 (1997); *Wilson v. Safeway Stores, Inc.,* 52 Cal.App.4th 267, 60 Cal.Rptr.2d 532 (1997).

Obviously, under our statute, the attorney fees allowed thereunder are not included in the judgment for purposes of determining***157** whether the judgment exceeds the offer, because attorney fees are allowed only *if* the judgment exceeds the offer. Nonetheless, the reasoning of the above cases is persuasive on the issue of whether costs should be included in the amount of the judgment obtained for purposes of determining whether that judgment exceeds the offer under § 25-901.

[18] We hold that under § 44-359, in determining whether the insured has obtained judgment for more than the amount offered under § 25-901, costs, excluding attorney fees allowed thereunder, are included in the judgment in addition to the recovery under the insurance policy in question. The Eledges' judgment, consisting of the $1,000 recovery and $399.85 in costs, is greater than the $1,100

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offered by Farmers in its offer made pursuant to § 25-901. Therefore, we reverse the lower court's denial of attorney fees and remand the cause for determination of reasonable attorney fees to be awarded the Eledges.

CONCLUSION

For the foregoing reasons, we hereby affirm the district court's decision as it relates to the award of $1,000 for damage to the roof and to the refusal to award any sum for damage to the interior ceilings. The district court's denial of attorney fees is reversed and the cause is remanded for determination of reasonable attorney fees to be awarded to the Eledges.

AFFIRMED IN PART, AND IN PART REVERSED AND REMANDED FOR FURTHER PROCEEDINGS.

Neb.App.,1997.
Eledge v. Farmers Mut. Home Ins. Co. of Hooper, Nebraska
6 Neb.App. 140, 571 N.W.2d 105

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Court of Appeal of Louisiana, First Circuit.
Frank Eden HOLLOWAY et ux.
v.
LIBERTY MUTUAL FIRE INSURANCE COMPANY.
No. 9722.

Feb. 11, 1974.
Rehearing Denied March 18, 1974.
Writs Refused April 29, 1974.

***792** John S. White, Jr., Baton Rouge, for appellants.

Robert J. Vandaworker, Baton Rouge, for appellee.

Before SARTAIN, TUCKER and WATSON, JJ.
***793** PER CURIAM.FN*

FN* This opinion was authored by TUCKER, J. prior to his death on the 25th day of January, 1974, and is concurred in by the remaining members of the panel.

This is a suit by Frank Eden and Virginia Rogers Holloway on Homeowners' Policy No. H32-291-49690-009BR covering the dwelling in which they reside at 1232 Sherwood Forest Boulevard in Baton Rouge, Louisiana. In June, 1972, a leaking drain pipe caused water damage to the carpeting and sheetrock in their master bedroom and in the adjacent hallway. The carpeting in this house was approximately six years old at the time of the damage. Furthermore its style had been discontinued. Plaintiffs made proof of loss and requested from its insurer, Liberty Mutual Fire Insurance Company, the cost of replacing the carpeting in the entire bedroom wing of the house. Defendant insurance company engaged an appraiser to appraise the damage and subsequently tendered plaintiffs two payments of Two hundred eighty-four and 50/100 ($284.50) Dollars and Fifty-four and 91/100 ($54.91) Dollars in payment for the loss of the specific carpeting damaged, less depreciation. Plaintiffs accepted these two payments for the carpeting as partial payments on the total amount due them. There was no dispute as to the cost of replacing the sheetrock damaged in repairing the leak.

In the trial court judgment was given for the plaintiffs in the amount of One Thousand twenty-one and 21/100 ($1,021.21) Dollars as follows:

Total Damages		$1,610.62
Less Deductible	$250.00	
Payment by Lib. Mut.	284.50	
Payment by Lib. Mut.	54.91	589.41
Balance Due.........................		

Plaintiffs have appealed from this judgment asking in addition for Twelve per cent (12%) penalties and reasonable attorney fees of One Thousand seven hundred fifty and no/100 ($1,750.00) Dollars under L.R.S. 22:658 for defendant's alleged arbitrary and capricious refusal to make payment to plaintiffs under their policy.

Defendant insurance company answered the appeal, charging error by the trial court in awarding plaintiffs anything, on the basis of defendant's having satisfied all contractual obligations to plaintiffs by making payment to them for the specific carpet damaged, less sixty per cent (60%) depreciation.

Kenneth McKay, plaintiffs' interior decorator, was qualified as an expert in the field of interior design. He testified that, since the color and pattern of the carpeting originally used in plaintiffs' house had been discontinued, it was impossible to replace the damaged carpeting

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without replacing all of the carpeting in the bedroom wing of the house. Even if the same color and texture of carpeting could be obtained, to replace only the damaged portions of the carpet, would result in unsightly seams at the juncture point, according to Mr. McKay, and contrast between the old and the new carpeting would be readily apparent and would have an adverse effect on the overall market value of the house. Mr. McKay likened the replacement of the damaged carpet to the effect of replacing a sleeve in a suit with other than the same material with which the whole suit had been tailored originally. He also testified that it was the general practice in Baton Rouge in houses of the type of plaintiffs to use one kind of carpeting and one color in all of the bedrooms, and that to do otherwise would depreciate the value of the house. Mr. McKay testified further that he had been consulted by 50-100 homeowners in Baton Rouge who had sustained water damage to their carpeting, and that he always recommended replacement of the carpet in the entire bedroom wing, if the damage had been in any part of that area.

W. W. Wilkinson, a qualified realtor, also testified that if carpeting of the same texture and color is not used in the entire bedroom wing of houses such as the Holloways' house, it diminishes the value of the house by $1,000 to $2,000.

***794** [1][2] In the light of the testimony of the expert witnesses in this case we find no error in the judgment of the trial judge in awarding plaintiffs the cost of the replacement of the carpeting in the entire bedroom wing of their house. Furthermore we agree with the trial judge that there is no merit in defendant insurance company's argument that a proportional value is the proper figure to be used in extimating plaintiffs' damage under ‘Additional Condition’ No. 1 of their policy. Part (b) provides as follows:

'If at the time of loss the whole amount of insurance applicable to said building structure for the peril causing the loss is less than 80% Of the full replacement cost of such building structure, this company's liability for loss under this policy shall not exceed the larger of the following amounts (1) or (2):

(1) the actual cash value of that part of the building structure damaged or destroyed; or

(2) that proportion of the full cost of repair or replacement without deduction for depreciation of that part of the building structure damaged or destroyed, which the whole amount of insurance applicable to said building structure for the peril causing the loss bears to 80% Of the full replacement cost of such building structure.'

This condition is preceded however, by an exclusionary preface which provides as follows:

'This condition shall be applicable only to a building structure covered hereunder excluding outdoor radio and television antennas and aerials, Carpeting, awnings, including their supports, domestic appliances and outdoor equipment, all whether attached to the building structure or not.' (Emphasis the Court's)

Defendant contends that this exclusion applies only to outdoor carpeting, and that the instant carpeting involved is indoor carpeting; hence the exclusion does not apply. This Court agrees with the reasoning of the trial judge as follows: ‘The first adjective ‘outdoor’ clearly refers only to ‘radio and television antennas and aerials.’ This is made evident by the subsequent use of the adjective ‘outdoor’ in reference to ‘equipment,‘ which adjective would be entirely unnecessary if the first ‘outdoor’ applied to all subsequent nouns. This Court holds that the exclusionary clause in ‘additional condition No. 1’ applies to all carpeting, whether indoor or outdoor, and the measure of replacement cost for this carpeting is not controlled by ‘Additional Condition (1)(b).“

Defendant insurer's obligation to its insured is governed by the following provision of the policy:

'. . . this Company . . . does insure 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 after such loss. . . .

[3] Defendant contends, however, that the ‘actual cash

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value of the property at the time of loss' is not only limited to the carpeted area actually damaged by seepage, but that it should reflect depreciation of the carpet replaced.

The Valued Policy Statutes LSA-R.S. 22:695(B), provides that:

'Under any fire insurance policy, which may be written hereafter, and which is intended to take effect, at or after 12 o'clock noon, Central Standard Time, on the first day of August, 1964, on any inanimate property, immovable by nature or destination, situated within the State of 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***795** of such insurer, As will permit the insured to restore the damaged property to its original condition . . ..' (emphasis added)

The carpeting at issue in this case is the kind which is applied directly to the concrete slab upon which the house is built and becomes immovable by destination. Reading the Valued Policy Statute provision given above, which took effect August 1, 1964, with the pertinent provision of plaintiffs' policy also quoted above, this court finds the trial judge eminently correct in finding plaintiffs 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. There is no mention of allowance for depreciation in the case of damage to an immovable by destination. As pointed out above we agree with the trial judge in holding that replacement of carpeting in the entire bedroom wing of the plaintiffs' house was necessary to restore the damaged property to its original condition.

We must now determine the validity and propriety of plaintiffs' contention that the failure of the defendant to pay and discharge the liability under its policy within sixty days from the receipt of proofs of loss was arbitrary, capricious and unreasonable, and, in consequence thereof, would impose upon the defendant company liability for penalties and reasonable attorney fees under the provision of LSA-R.S. 22:658. The trial court refused to allow this statutory penalty and attorney fee based upon its holding that there was a bona fide dispute between the parties as to whether the carpet loss was partial or total under the provisions of the policy.

[4] Had the delay in payment of the full amount due plaintiff involved the mere determination of whether the loss under the policy was whole or partial, and although we have concurred with the trial judge that the obligation under the policy imposed payment for the entire loss, we would be disposed to absolve the defendant from the payment of the penalty and attorney fee as did the trial judge on the ground that there was a bona fide dispute which negated unreasonableness, caprice and arbitrariness on the part of the company. However, here the defendant company, despite being reminded and charged with knowledge of the provisions of its own policy and the terms of the Valued Policy Statute, R.S. 22:695(B), chose to make a settlement with the plaintiff on the basis of the value of the carpeting damaged less a 60% Depreciation factor. On the basis of our holding neither the terms of the policy nor the recited and pertinent statutory law justified a reduction for depreciation on the loss. See Gibsland Supply Co. v. American Employers Ins. Co., 242 So.2d 310 (La.App.2d Cir. 1970)

Cases in which courts have held that delays in payment of the full amount of the benefits provided by a policy beyond the prescribed period, and subjecting the company to penalties and attorney fees, are Albert v. Cuna Mutual Insurance Society, 255 So.2d 170 (La.App.3d Cir. 1971); Rushing v. American Income Insurance Company, 274 So.2d 458 (La.App.3d Cir. 1973), and Heinman v. Insurance Company of State of Pennsylvania, 270 So.2d 185 (La.App.1st Cir. 1972), writ refused, La., 271 So.2d 873. In the Heiman case quoted from the Albert decision as follows:

'An insurer must take the risk of misinterpreting its policy provisions. If it errs in interpreting its own insurance contract, such an error will not be considered as a reasonable ground for delaying the payment of benefits, and it will not relieve the insurer of the payment of penalties and attorney's fees.'

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Of course, it is an accepted precept that whether a failure or refusal to pay constitutes a violation of the Valued Policy Statute is a question of fact to be determined in the light of each individual case. Nonetheless, it appears to us that the overall evidence in this record did not justify the delay ***796** in payment to the plaintiff, and defendant's failure to pay an amount in excess of that tendered was unreasonable, arbitrary and capricious, subjecting the defendant to the penalty and attorney fees imposed by R.S. 22:658.

By virtue of this holding we do not think we have done violence to our decision in Ranzino v. Allstate Insurance Company, 210 So.2d 907 (La.App.1st Cir. 1968), since in the cited case the facts revealed a real and bona fide dispute with respect to the sole question of whether the loss was total or partial. There were several errors and miscalculations made by the insurer in the instant case, including the misinterpretation of its own policy, its failure to take into account the applicability of R.S. 22:695(B), and its failure to properly apprise and inform its adjusters of the methods needing to be used in making the loss appraisals under the policy terms.

[5][6] Having reached the determination that the trial court erred in its refusal to award the penalty and attorney fees under R.S. 22:658, the next problem is to fix the amount to be exacted as attorney fees. As stated in Sensat v. State Farm and Casualty Company, 176 So.2d 804 (La.App.3d Cir. 1965), writ refused, 248 La. 419, 179 So.2d 17 (1965), and Cannizzaro v. Great American Insurance Company, 223 So.2d 704 (La.App.4th Cir. 1969) much discretion is left to the court in arriving at the amount, but such fees should be reasonable and based upon the attorney's time, skill and effort in representing his client. We also think that the magnitude of the litigation with respect to the issues raised as well as the sums involved should be considered in arriving at a just, reasonable and proper award for this item. After reviewing the record, keeping in mind the factors to be considered, we have concluded that the plaintiff should be awarded the sum of $600.00 as an attorney fee and the 12% Statutory penalty.

For the foregoing reasons the judgment of the trial court is reversed insofar as it failed to award penalty and attorney fees, and there is now judgment in favor of the plaintiffs, Frank Eden Holloway and Virginia Rogers Holloway and against the defendant, Liberty Mutual Fire Insurance Company, in the additional sums of $600.00 as attorney fees and a penalty of $122.55, with interest at the rate of 7% Per annum from judicial demand until paid; in all other respects the judgment of the trial court is affirmed.

The appellee, Liberty Mutual Fire Insurance Company, is cast with all costs.

Affirmed in part; reversed in part; and rendered.

La.App., 1974.
Holloway v. Liberty Mut. Fire Ins. Co.
290 So.2d 791

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Brown County Court of Ohio,
Small Claims Division.

MASTIN
v.
SANDY & BEAVER INSURANCE CO. et al.
No. 2-1135-284.

Dec. 2, 1983.

****332 *23** Charles K. Mastin, pro se.

Carl Fetter, Marion, for defendant.

CLARK, Judge.

Plaintiff, Charles K. Mastin, alleges $450 is owed to him by defendants by reason of a storm which damaged his property, said storm being a covered hazard under plaintiff's insurance policy with defendant Sandy & Beaver Insurance Co., for whom defendant Carl Fetter is an agent. Fetter agrees plaintiff's loss is covered, but claims his alleged damages are unreasonable. Specifically, defendants decline to pay for the replacement of plaintiff's kitchen floor. The floor was damaged when a hole was cut in it to gain access to the plumbing system in the house. Evidently, there is no basement or crawl space otherwise accessible. It was uncontroverted that plaintiff's home was in fact damaged by the storm and that it was truly necessary to go through the kitchen floor to repair the damage. Defendants, however, wish only to pay for the floor to be patched, and not replaced. The floor is of vinyl covering such as is purchased in a roll. It is not tile.

Plaintiff's insurance agreement states defendant company is obliged to repair or replace damaged property. The court finds that vinyl flooring cannot be said to be repaired if an obvious patch is left, and that the whole floor ought to have been replaced. Presumably defendants had inspected plaintiff's premises and knew that access to the plumbing was difficult and that plaintiff's floor would be expensive to replace. Defendants were in a position to adjust plaintiff's premiums accordingly; ****333** for the defendants to allege now that plaintiff's damages are too high is not persuasive to the court. The time to adjust the premiums was before the policy was issued.

Judgment for plaintiff in the amount of $450.

Judgment for plaintiff.

Ohio Co.,1983.
Mastin v. Sandy & Beaver Ins. Co.
10 Ohio Misc.2d 22, 461 N.E.2d 332, 10 O.B.R. 301

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Supreme Court of Washington,
En Banc.

Timothy K. HESS and Georgianne H. Hess, husband and wife, Respondents,
v.
NORTH PACIFIC INSURANCE COMPANY, Petitioner,
and
Oregon Automobile Insurance Company, Defendant.
No. 60026-1.

Sept. 2, 1993.

***181 **586** Helsell, Fetterman, Martin, Todd & Hokanson, William A. Helsell, Robert N. Gellatly, Seattle, for petitioner.

Winston & Cashatt, Fred C. Pflanz, Beverly L. Anderson, Carl E. Hueber, Spokane, for respondents.

William R. Hickman, Sandra Pailca, Seattle, amicus curiae, for petitioner on behalf of United Services Auto. Ass'n.

Sidney R. Snyder, Jr., Ronald S. Dinning, Seattle, amicus curiae, for petitioner on behalf of Pemco, Safeco, and Unigard Ins.

***182** J. Tucker Miller, Seattle, amicus curiae, for petitioner on behalf of Safeco Insurance Co.

Mark S. Cole, Seattle, amicus curiae.

BRACHTENBACH, Justice.

This case concerns the amount payable under the replacement clause of a homeowners insurance policy when the destroyed building is not repaired or replaced and the insured has no intent to repair or replace. This is the first occasion for this court to interpret such a replacement clause.

The facts are stipulated. Defendant, North Pacific Insurance Company, insured a summer cabin of plaintiffs Timothy K. and Georgianne H. Hess. The cabin was destroyed by fire. The agreed actual cash value was $20,000. The agreed replacement cost was $43,182.10. The insureds did not replace the cabin, nor do they intend to do so. Defendant paid the actual cash value to plaintiffs. Clerk's Papers, at 114-15. Plaintiffs sued for $23,182.10, the difference between the full replacement cost and the actual cash value.

The sole issue is whether, under the terms of the policy, the insureds can collect ****587** the full replacement cost when they have not replaced the destroyed insured cabin and stipulated they do not intend to replace it.

The trial court granted summary judgment for said $23,182.10 to the insured plaintiffs, plus prejudgment interest. The Court of Appeals affirmed. *Hess v. North Pac. Ins. Co.,* 67 Wash.App. 783, 841 P.2d 767 (1992), *review granted,* 121 Wash.2d 1008, 852 P.2d 1091 (1993). We reverse, and thereby join the virtually unanimous holdings in other jurisdictions which have considered the same or similar replacement clauses.

Before analyzing the policy clauses, a brief history of replacement clauses is helpful. Historically, the underlying purpose of property insurance is indemnity. Traditional coverage was for the actual or fair cash value of the property. The owner was indemnified fully by payment of the ***183** fair cash value, in effect the market value, which is what the owner lost if the insured building was destroyed. 6 J. & J. Appleman, *Insurance* § 3823 (1972).

However, it was recognized that an owner might not be made whole because of the increased cost to repair or to rebuild. Thus, replacement cost coverage became available. "Replacement cost coverages ... go beyond the concept of indemnity and simply recognize that even expected deterioration of property is a risk which may be insured against."

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Jordan, *What Price Rebuilding?,* 19 The Brief 17 (Spring 1990) (cited hereafter as the Jordan report).

A Washington statute prohibits “overinsurance”, *i.e.,* insurance in excess of the “fair value” (defined as cost of replacement *less* depreciation), RCW 48.27.010. However, replacement insurance is authorized specifically by RCW 48.27.020:

[T]he insurer may in connection with a special provision or endorsement made a part of the policy insure the cost of repair or replacement of such property, if damaged or destroyed by a hazard insured against, and without deduction of depreciation....

In this case, the relevant provisions of plaintiffs' policy are as follows:

3. *Loss Settlement.* Covered property losses are settled as follows:

a. (1)-(3) [relate to property not involved here].

b. Buildings under Coverage A or B at replacement cost without deduction for depreciation, subject to the following:

(1) 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 deductible and without deduction for depreciation, but not more than the least of the following amounts:

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

(b) the replacement cost of that part of the building damaged for like construction and use on the same premises; or

(c) the necessary amount actually spent to repair or replace the damaged building.

***184** [Subparagraphs (2) and (3) relate to determination of the 80 percent of full replacement coverage and are not relevant here.]

(4) We will pay no more than the actual cash value of the damage unless:

(a) actual repair or replacement is complete; or

(b) the cost to repair or replace the damage is both:

(i) less than 5% of the amount of insurance in this policy on the building; and

(ii) less than $1000.

(5) You may disregard the replacement cost loss settlement provisions and make claim under this policy for loss or damage to buildings on an actual cash value basis. You may then make claim within 180 days after loss for ****588** any additional liability on a replacement cost basis.

Clerk's Papers, at 59-60.

[1] A careful examination of these clauses, read together and in context as we must do, does not reveal any ambiguity. Stated generally, subparagraphs 3.b.(1)(a), (b), and (c) set the limits of maximum liability, *i.e.,* the lesser of (a) or (b) or (c). Those amounts reflect (a) the policy limits, (b) the replacement cost of like construction and use on the same premises, more fully explained hereafter, or (c) the amount actually spent to repair or replace the damaged building.

The Jordan report, cited above, cogently explains:

The first measure, of course, limits the amount available for replacement to policy limits, while the second relates to a theoretical or hypothetical measure of loss: that is, the replacement cost of rebuilding the identical structure as one limit of the company's liability. This particular limitation does not require repair or replacement of an identical building on the same premises, but places that rebuilding amount as one of the measures of damage to apply in calculating liability under the replacement cost coverage. The effect of this limitation comes into play when the insured desires to rebuild either a different structure or on different premises. In those

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instances, the company's liability is not to exceed what it would have cost to replace an identical structure to the one lost on the same premises. Although liability is limited to rebuilding costs on the same site, the insured may then take that amount and build a structure on another site, or use the proceeds to buy an existing structure as the replacement, but paying any additional amount from his or her own funds.

***185** Finally, the third limitation of liability strengthens the requirement that liability of the company does not exist until repair or replacement is made. The purpose of this limitation is to limit recovery to the amount the insured spent on repair or replacement as yet another measure of the loss liability of the insurer. This third valuation method is intended to disallow an insured from recovering, in replacement cost proceeds, any amount other than that actually expended.

(Footnotes omitted.) Jordan, at 19-20.

The Court of Appeals somehow concluded that the insurer's interpretation, *i.e.,* pay actual cash value unless replaced or repaired, "clearly implies that an insured who elects not to rebuild is entitled to no settlement at all." *Hess v. North Pac. Ins. Co.,* 67 Wash.App. 783, 787, 841 P.2d 767 (1992), *review granted,* 121 Wash.2d 1008, 852 P.2d 1091 (1993). The Court of Appeals found that to be an ambiguity when related to subparagraph 3.b.(4): "We will pay no more than the actual cash value of the damage unless: (a) actual repair or replacement is complete". *Hess,* at 787, 841 P.2d 767.

It appears quite clear that despite the measures of possible liability set forth in 3.b.(1)(a), (b), and (c), subparagraph (4)(a) conditions payment of any one of those amounts upon *completion of "actual repair or replacement* ". (Italics ours.) The insurer has never contended that it does not owe, at a minimum, the actual cash value of the destroyed insured building, and, indeed, promptly paid that amount after the parties agreed that such in fact was the actual cash value.

The insurer well answers the Court of Appeals reasoning in this manner:

Paragraph 3.b.(1) deals with alternative measurers of *replacement cost.* When an insured does not replace, the least of the three alternative measures of loss (amount actually spent) is zero. Thus, the insured is not entitled to *replacement cost.* He is, however, entitled to actual cash value under paragraph 3.b.(4).

Supplemental Brief of Appellant, at 3-4.

The Jordan report summarizes the purpose of this clause:

This requirement for actual repair or replacement by the insured does not affect the company's liability to pay for ****589** actual cash value loss, but only for the difference between that figure ***186** and the higher replacement cost. The purpose of that limitation, obviously, is to prevent an insured from directly profiting through the receipt of cash funds beyond the actual cash value of the loss, thus forcing the insured to rebuild in order to recover amounts withheld as depreciation.

Jordan, at 19.

The Court of Appeals seemed to find some ambiguity because the policy does not define "replacement cost" or "actual cash value". However, the policy does provide an appraisal method if the parties do not agree on the amount of the loss (Clerk's Papers, at 60). In any event, the issue seems irrelevant here because the parties stipulated to both the replacement cost and actual cash value.

[2] We turn to general principles of interpretation of insurance policies.

The interpretation of insurance policies is a question of law. In construing the language of an insurance policy, the entire contract must be construed together so as to give force and effect to each clause. If the language in an insurance contract is clear and unambiguous, the court must enforce it as

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written and may not modify the contract or create ambiguity where none exists.

(Citations omitted.) *Transcontinental Ins. Co. v. Washington Pub. Utils. Dists.' Util. Sys.,* 111 Wash.2d 452, 456, 760 P.2d 337 (1988). That opinion goes on to summarize the applicable rules of interpretation if the provisions of a policy are ambiguous. *Transcontinental,* at 456-57, 760 P.2d 337. Complexity or the necessity to interrelate policy provisions does not alone render a policy ambiguous. *McDonald v. State Farm Fire & Cas. Co.,* 119 Wash.2d 724, 734, 837 P.2d 1000 (1992).

[3] Applying the quoted provisions of *Transcontinental,* we must give effect to subparagraph 3.b.(4): "*We will pay no more than the actual cash value of the damage unless: (a) actual repair or replacement is complete* ". (Italics ours.) Clerk's Papers, at 60. When the definitions of the limits of liability which immediately precede the clearly stated condition and limitation of 3.b.(4) are read together and each clause given meaning, it is evident that only the actual cash value is owed unless actual repair or replacement is undertaken***187** and completed. It should be noted that paragraph 3.b., which refers to replacement cost, contains the phrase "subject *to the following* ". One of the *following* subparagraphs is 3.b.(4). In other words, the very paragraph upon which the insureds rely makes itself subject to the limitation of 3.b.(4).

The following subparagraph, 3.b.(5), buttresses this conclusion by providing the insured "may disregard the replacement cost loss settlement provisions and make claim ... for loss or damage to buildings on an actual cash value basis." Clerk's Papers, at 60. Obviously, rebuilding or replacement recovery remains an option for the insured because that subparagraph goes on to provide: "You may then make claim within 180 days after loss for any additional liability on a replacement cost basis." Clerk's Papers, at 60. This optional method of loss settlement would be superfluous if an insured were entitled to replacement cost without making the replacement.

Our holding is consistent with the holdings of other courts. In a recent annotation, the rule is summarized: "Generally, actual replacement of damaged or destroyed property has been held to be a prerequisite to collection of proceeds under a replacement cost endorsement of an insurance policy...." Annot., *Construction and Effect of Property Insurance Provision Permitting Recovery of Replacement Cost of Property,* 1 A.L.R.5th 817, 829 (1992). The annotation cites only two cases to the contrary which will be discussed later.

A recognized text makes the following comment: "Certainly, considering the purpose of [the replacement cost provisions], it is reasonable to deny recovery for replacement costs where the insured is not going to replace the property as he would then ****590** make a profit out of his loss...." 6 J. & J. Appleman, *Insurance* § 3823 n. 66.57 (Supp.1992).

The cases reach the same result. In *Huggins v. Hanover Ins. Co.,* 423 So.2d 147 (Ala.1982), the relevant policy clauses were virtually identical to those in this case, including***188** a provision that "we will pay no more than the actual cash value of the damage until actual repair or replacement is completed." *Huggins,* at 149. The court stated:

Provisions like those contained in subparagraph c.(4) [quoted immediately above] have been interpreted as providing a condition precedent to an insurer's duty to pay repair or replacement costs of an insured building. A party who has not repaired or replaced his insured building has not complied with the condition precedent to recovery under the policy and so cannot recover. See *Kolls v. Aetna Casualty & Surety Co.,* 503 F.2d 569 (8th Cir.1974) ; *Bourazak v. North River Insurance Company,* 379 F.2d 530 (7th Cir.1967).

Huggins, at 150. *Accord, Hilley v. Allstate Ins. Co.,* 562 So.2d 184, 1 A.L.R.5th 1167 (Ala.1990).

The replacement cost clause in *Paluszek v. Safeco Ins. Co. of Am.,* 164 Ill.App.3d 511, 515-16, 115 Ill.Dec. 154, 517 N.E.2d 565 (1987) contained this

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language: " '[T]his company shall not be liable for more than the actual cash value of the damaged property unless and until actual repair or replacement is completed.' " The court held:

Unless and until an actual loss is sustained and proved by the insured, he is not entitled to reimbursement by the insurer.

In the present case, defendant paid plaintiff the actual cash value of her house.... Under the terms of the policy, this was all defendant was obligated to pay unless and until repairs were completed.

Paluszek, at 516, 115 Ill.Dec. 154, 517 N.E.2d 565.

Snellen v. State Farm Fire & Cas. Co., 675 F.Supp. 1064 (W.D.Ky.1987) is in point. The three amounts of possible recovery were essentially identical to those in this case. A following paragraph provided: "We will pay the cash value of the damage, up to the policy limit, until actual repair or replacement is completed." *Snellen,* at 1066. The insured did not replace the home and evidenced no intent to do so, but she claimed the policy was ambiguous so she should recover the replacement cost. The court held:

The policy in question is not ambiguous with respect to the insurer's obligation to pay replacement cost. Actual replacement, and the incurrence of costs in that endeavor, is clearly a condition precedent to such a claim.

....

***189** To hold otherwise in this case would necessitate ignoring the plain terms of the policy. It would also be contrary to the obvious provisions of the loss settlement clause taken as a whole, and would result in enlarging the coverage of the policy beyond its natural and obvious meaning.

(Citations omitted.) *Snellen,* at 1067.

The policy in *Higgins v. Insurance Co. of North Am.,* 256 Or. 151, 469 P.2d 766, 66 A.L.R.3d 871 (1970) did not contain a specific limitation, as in this case, *i.e.,* that the company would only pay the actual cash value until repair or replacement was completed. However, after carefully tracing the history and purpose of replacement coverage, the court held:

We conclude that since plaintiffs have not expended anything in repairing or replacing the insured building they are not eligible to recover under the "Replacement Cost" extension of the policy. For a similar conclusion see *Bourazak v. North River Insurance Company,* 379 F2d 530 (7th Cir.1967).

(Footnote omitted.) *Higgins,* at 166-67, 469 P.2d 766.

Plaintiffs-insureds dismiss this very substantial line of authorities with the unhelpful statement that "[t]he cases from other ****591** jurisdictions have no bearing on the interpretation of this ambiguous policy." Brief of Respondent, at 9.

The annotation cited above cites only two cases in the United States which purportedly hold replacement is not a prerequisite to collection of replacement proceeds. Those two cases are *Reese v. Northern Ins. Co.,* 207 Pa.Super. 19, 215 A.2d 266 (1965) and *National Fire Ins. Co. v. Solomon,* 96 Wash.2d 763, 638 P.2d 1259 (1982). Because of a broad statement by Justice Dore in *National Fire Ins. Co. v. Solomon, supra,* examination of that opinion is necessary. That statement is:

The replacement cost method of payment does not require the rebuilding of the structure as a condition precedent to the payment of the proceeds under such policy. We rely on the rationale of *Reese v. Northern Ins. Co. of N.Y.,* 207 Pa.Super.Ct. 19, 22, 215 A.2d 266 (1965).

Solomon, at 770, 638 P.2d 1259.

***190** Before examining the policy in *Solomon* to determine its relevance here, it is necessary to reevaluate the reliance on *Reese,* the Pennsylvania Superior Court case which is the only authority cited

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by Justice Dore as author of the *Solomon* opinion. *Reese* has been cited by only one other court, outside of Pennsylvania. In that case, *Higgins v. Insurance Co. of North Am., supra,* the Oregon Supreme Court, in reaching a contrary holding, simply said: "We think [*Reese*] ... was wrongly decided...." *Higgins,* 256 Or. at 167 n. 5, 469 P.2d 766 n. 5. In the 28 years since *Reese* was decided, it has never been cited by the Pennsylvania Supreme Court. It has been cited only three times in superior court cases and only in passing. In one of those cases the trial court had held that the insurance policy provision providing for payment of only the cash value until replacement was completed was consistent with Pennsylvania statutes and judicial interpretations. Obviously such holding is directly contrary to *Reese.* On appeal, the Superior Court held only that the trial court ruling was but a partial and interlocutory resolution of the issues, and thus not appealable. *Canulli v. Allstate Ins. Co.,* 315 Pa.Super. 460, 462 A.2d 286 (1983). In another case, *Reese* was cited solely for the definition of "replacement costs". *Ditch v. Yorktowne Mut. Ins. Co.,* 343 Pa.Super. 22, 493 A.2d 782 (1985). In the third case, *Reese* was cited solely for the general rule of construction that ambiguous policy language is to be construed against the insurer and in favor of the insured and coverage. *Slate Constr. Co. v. Bituminous Cas. Corp.,* 228 Pa.Super. 1, 5, 323 A.2d 141 (1974).

Careful reading of the *Reese* opinion reveals it does not support the broad rule for which it is cited in *Solomon.* The policy in *Reese* contained the same three measures of loss as in this case, but *there was no clause* providing for the payment of cash value only until repair or replacement was completed. Even though the company had paid the cash value, it argued that since the insured had not repaired or rebuilt the lesser amount under the replacement clause was zero. The court noted that under such interpretation, carried to its logical conclusion, the insured would not even be ***191** entitled to the cash value, already paid. The court distinguished a New Jersey case where the policy required actual replacement before there was any sum due. Significantly, the court said:

That clause [in the New Jersey case] expressly requires the insured to replace and [then] he is entitled to recover replacement value. *Had such a clause been included in the present policy, there would be some justification for the defendant's contention but such was not the case.*

(Italics ours.) *Reese v. Northern Ins. Co., supra* 207 Pa.Super. at 24-25, 215 A.2d 266. Without further analysis, the court held that the insured was entitled to the replacement cost without rebuilding.

Analysis of the 2 1/2 -page *Reese* opinion and its subsequent history casts substantial doubt upon the validity of the statement in *National Fire Ins. Co. v. Solomon, supra* 96 Wash.2d at 770, 638 P.2d 1259, that: "The replacement cost method of payment does not require the rebuilding of the structure as a condition precedent to ****592** the payment of the proceeds under such policy." We disapprove of the statement as a general rule of interpretation of insurance policies. The first thing wrong with it is that it ignores the possibility of different provisions which may exist in other policies, as in this case. Second, the statement ignores all the substantial, well-reasoned authorities to the contrary. Third, the *Reese* case is not persuasive authority, but is the only authority cited.

The facts in *National Fire Ins. Co. v. Solomon,* 96 Wash.2d 763, 638 P.2d 1259 (1982) mandate limiting whatever its holdings may be to those facts and the policy involved. The case arose from the trial court's denial of the insurer's motion to enforce the appraisal provisions in the policy. Yet the court considered the merits. Relying on a *California statute,* the court held that actual cash value meant fair market value *without* depreciation. Another state's statutory definition should not control our interpretation.

Most significantly, *Solomon* simply does not apply or control in this case because the policy here spe-

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cifically provides that the insurer will pay no more than actual cash value ***192** unless actual repair or replacement is complete. This clause alone completely distinguishes *Solomon.*

We hold that the policy at issue is not ambiguous; its conditions plainly limit recovery to actual cash value under these facts.

The Court of Appeals is reversed. The matter is remanded to the trial court with directions to enter summary judgment in favor of the defendant.

ANDERSEN, C.J., and UTTER, DOLLIVER, DURHAM, SMITH, JOHNSON and MADSEN, JJ., concur.
Wash.,1993.
Hess v. North Pacific Ins. Co.
122 Wash.2d 180, 859 P.2d 586

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Case Study: After the Flood

Not all claims happen at an existing property.   Builder's Risks are often the subject of complex claims.

A Project under construction and nearing completion was inundated with water when newly installed water pipes burst overnight. Poor workmanship and inadequate adhesive caused several of the joints to give way and thousands of gallons of water rained down onto four floors.   Forty of the completed suites were destroyed.

The General Contractor was very cooperative at first and began the daunting task of managing the cleanup and re-construction.   The plumber's insurance company was engaged and responded immediately with an adjuster. Time was of the essence as the brand deadline (Hyatt) for opening was approaching quickly. It seemed as if this was just a bump in the road.

Only this bump quickly took on the characteristics of a mountain. The GC presented a budget that was outrageously high. The plumber's insurance adjuster bailed out when he realized that this was growing out of control. Mold started growing in the building in the hidden areas of water infiltration that were not remediated. The project came to a screeching halt!

The broker for the all risk policy, Gallagher, got involved in the claim when the customer reached out for their help. Gallagher came in to assess and recommend a course of action. They recommended a CM be engaged as that was their right under the terms of the policy.

The CM was able to mobilize in 24 hrs, evaluate the situation and develop a plan of action. Within 48 hours, a staff was on site and a complete assessment of all damage was done including the hidden water damage behind cabinetry and in areas that water had travelled some distance from the actual loss area. A new work schedule was developed, revised budgets from all contractors were agreed upon and the restoration went into full swing.

Additional vendors and local resources were utilized to expedite the necessary items and the owner started to release money as they had regained confidence that the claim would be covered and the work was proceeding in the right direction.

The deadlines were met and the brand accepted the franchise of the property on time, saving the owner fines and reputation. The CM then managed the all the financial considerations of the project and brought all parties to agreement which expedited payment of the claim and provided the Gallagher placement risk underwriter (with built in builders risk coverage) with compelling documentation to subrogate to the plumbers carrier.

Once again the concept of the proper team to manage a claim satisfied all sides and proved essential to the successful conclusion of the project.

Case Study: Don't Let Them Bury Your Head In The Sand

Facts: Sandpiper Condominium is a 19 story concrete structure built in 1984 containing 72 units on the beach of Marco Island Florida. Hurricane Wilma passed nearby on 10/25/2005 with measured winds of about 100 MPH.

The condominium was insured by a now defunct carrier named Southern Family (closing doors shortly after the hurricane) for Windstorm coverage along with other perils at suitable limits for the value of the building and the Association. Separately, each unit owner had their own condominium unit owner's policy providing windstorm and other perils to their contents and interior spaces as required to insure under the FL Condo Statute.

The insurance was placed by a prominent independent Agent located in Naples Florida The loss was reported and soon there after, Southern Family was taken into receivership by the Florida Insurance Guarantee Association, the safety net for admitted carriers in the State of Florida. Under the Guarantee provisions, there was about $7.5 million in coverage for this event since it is a condominium Association.

Appointment of Gallagher
After nearly two years of frustration and delays by the assigned adjuster and FIGA, Gallagher was hired to manage the claim and provide brokerage services on a go forward basis. It is important to note that during the two years between the date of loss and our assignment, little had been done by the placing agent in the management of the loss or advocacy, and even policy documentation was lacking. At the same time, FIGA was inundated with losses from this insurer and other defunct carriers as a result of the storms in 2004 that pummeled Florida

Gallagher began an early assessment of coverages and policy terms as well as prior correspondence from the adjuster, as well as scope and cost calculations completed by the Association and adjuster at that time. As of 2007 the association had received about $2 million in advances from FIGA on what was then an estimate of about $3.5 million. The Association was at a loss of direction since the board had no prior experience with losses of this magnitude and certainly not FIGA. More importantly their agent had all but abandoned the client relationship despite renewing coverage with Citizens (Florida Wind Pool). The board assigned a new insurance committee head to deal with the loss going forward.

It became clear to Gallagher that the current estimates by the assigned FIGA were suspect and a number of issues were contested among them, the replacement of the main roof and the garage roof.

Engagement of a competent CM
Gallagher contacted Doug DePhillips a senior member of Turner Construction to review the situation. DePhillips had provided CM work for Gallagher's large resort client that suffered losses to 5 Florida properties in the 2004 storms and his capabilities and effectiveness were well established.

First Steps
All parties met at the site shortly after the CM was engaged on 10/07. It was determined that in addition to the roof issues, the entire exterior cladding (stucco) was delaminated though still attached. It was also clear that the position of FIGA and their adjuster were entrenched at their scope and cost level and we were at a stalemate.

Retaining a Coverage Lawyer
A coverage lawyer from Seattle was retained by the Association at the recommendation of Gallagher. Gallagher had many prior successful resolutions on other complex losses, dating back to the late 80's with this coverage lawyer. Once the lawyer was retained, it became apparent that additional experts were required to advance the concept that the delamination of the building was the result of the hurricane and not poor application or deterioration due to age as maintained by FIGA and their adjusters.

Over the next several months our opinion and position solidified and suite was filed against Southern Family on 5/29/2008 in the twentieth Circuit Court.

End Result
Legal proceedings continued for more than one year and finally going to appraisal. On 5/16/2009 nearly 5 years after the loss, the case was settled. The end result was a finding for the Association in the amount of $7.4 million plus legal fees, near the maximum allowable under the FIGA law.

Key factors which resulted in a favorable outcome

1. Hiring a insurance broker familiar with the resources needed to resolve a complex property loss
2. A competent CM who understood building construction as well as the insurance process who acted as part of the overall team
3. A competent coverage attorney armed with new experts to perfect causation theory on the delamination of the building.

Without each of these critical elements, the Association would have been left to settle the loss for about $3.5 million.

Case Study: Let it Snow….

An interesting look at a complex loss and how a CM can be of vital importance. The property in question is a 4 story building in a resort setting. The building, which is the subject of this discussion and the loss, was added to the original resort about 25 years ago and was designed to replicate the original early 1900's architecture.

The construction of the building is typical of 1980's technology, block and plank construction floors and a wood truss roof construction to create a 4/12 pitched roof. The roof structure is comprised of 2x4 trusses with plywood sheathing and imitation slate shingles. Typical of wood truss for commercial construction was the application of a fire retardant treatment (FRT). Given the right conditions FRT causes the wood to become brittle and lose strength. The FRT treated trusses at this property is the root cause for this complex claim.

While the structure may have been designed for the "50 year" storm, the structure was weakened due to the FRT on the trusses. The trusses were used in a high temperature attic space at a location that experiences high humidity, the two catalysts needed for the FRT to weaken the material.

Unusual snow fall last winter created a excessive roof loading condition, and the trusses began to exhibit signs of failure. A forensic engineering analysis was done and it was determined the structure was in a state of imminent collapse. This is where the complexity of the claim begins.

A deal to sell the property was now in jeopardy due the imminent collapse state of the roof structure. The seller was able to negotiate the completion of the deal with the caveat that seller would make all necessary repairs to the roof. The seller engaged a PA and a contractor, along with a number of design professionals to provide the most economically feasible and expeditious solution.

After several months of confusion as to strategy, and lack of expert construction leadership and experience, the owner decided to engage a CM to handle the entire process.

The CM first established clear lines of communication by presenting itself as the central point of contact for all parties to share information. A protocol was then installed that included regularly scheduled conference calls with written meeting minutes to document the open issues. Additional resources were added to the project to further clarify the extent of the issues.

The CM took the leadership role for the entire design team to keep all interested parties focused on the goal. Contractual milestones were at risk of slipping, so deadlines were established for all required information to get back on track. Within the first several weeks an

estimate for the cost of the project was developed to assist the clients financial planning. A key deliverable, attributable to decision to engage a CM, is the final bids and estimated total construction costs were reduced by 40-50% from the original estimates as provided by the team in control prior to the hiring of the CM. This fact alone contributed to a close working relationship between the CM and the designated adjuster, developing a trust in the process and the total cost of the claim.

A Request for Proposal was developed and qualified contractors were sought to prepare bids for the work which entailed a roof replacement project during the winter while maintain a watertight building. The RFP process delivered the most qualified contractor at the best price to execute the work.

The RFP process was particularly important for the CM to describe the logistical parameters of the physical property as well as the safety requirements for working in an occupied hotel. By creating a comprehensive bid package the CM was able to manage the expectations of the cost of the work without concern for unexpected creep during the life of the project. During the actual construction phase the benefit of the CM is on-site management of all interested parties. The CM assures a project that remains within the original consideration that were agreed upon by all parties i.e. work hours, work areas, acceptable noise levels, housekeeping, guest experience, etc. By providing this leadership role the CM is able to remain the central point of contact and assure that quality control is enforced as well as the rules and regulations regarding the property.

The CM also acts as the financial manager of the project assessing all invoicing and recommending approval of all expenditures. This is a crucial feature because often times the hotel staff or maintenance /facilities team are not familiar with large projects and can be easily manipulated by inventive contractors.

Finally, the CM is essential to the proper closeout of the project. As with any construction project, closeout is a difficult stage. The CM will act as the owner's agent to collect all warranties and contractor guarantees, gather all final lien waivers, and prepare the billing in a way that the adjusters will easily understand all costs associated with the claims construction operations. The CM will assure the property is left without a trace of the construction operations that had previously occupied the property.

In conclusion, there are many reasons cited above how a CM is essential in the actual process of the claim additionally, from a broader perspective, there are a number of qualitative benefits to hiring a CM on a complex loss also. They are:

I. A highly qualified CM who is knowledgeable about, and plays an integrated team role in the adjustment process and loss settlement adds a higher level of trust and credibility

for the insured's position in a loss where causation maybe an issue, scope of loss is debated, or when total costs are discussed.

II. The CM acts as an owner's representative with a stake in the communication, assembly of documents, and in fact negotiations with the adjuster in either an adversarial or non adversarial circumstance.

III. A qualified CM will often play an integral role in working with the coverage attorney, broker and other experts in determining the cause of loss consistent with policy coverage terms

IV. A CM with the capabilities above is a stakeholder in obtaining a fair settlement, not just making certain the repairs are executed properly.

V. A qualified CM can be written into the policy and their fees, if usual and customary will be paid as part of the loss by insurers.

VI. In short a qualified CM with the attributes above can be a game changing component in the insured's adjustment, brokerage, and legal team.