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Reimbursement Of Advance Benefits

A Practical Guide

By Shaundra M. Schudmak

Insurance companies are often required to decide whether to pay benefits under the policy before sufficient information is known about the claim to determine whether there will ultimately be coverage. So, what happens if it is later discovered that payments were made for non-covered claims? Can an insurer seek reimbursement? Although a plethora of case law exists on an insurer's right to seek reimbursement of defense costs and settlement payments on non-covered claims, rendering mixed results on these issues nationwide, there is a dearth of decisions on reimbursement of advance benefits. Two recent decisions suggest that an insurer can seek reimbursement, albeit under differing theories of law, leaving open the conundrum of how an insurer can preserve its rights. A review of the differing theories allowing recovery and suggestions on how an insurer can protect its rights to reimbursement follows.

Equitable Remedies

In *Bridger Lake*, a federal court in Louisiana held that an insurer was allowed to seek reimbursement of advanced funds under a theory of unjust enrichment if it later determined there was no coverage under the

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The Diminishing Value of Depreciation Defenses

By Paul A. Rose and Elizabeth E. Collins

Although the value of a third-party liability insurance claim often can be determined in a straightforward way by simply adding the amount of a judgment or settlement to the costs of defending the claim, the amount of a first-party insurance claim like a property claim may be subject to varying valuation approaches. These varying approaches often will depend upon whether the policyholder repairs or replaces the damaged property, and the range of valuation options will be established by the policy language, as that language has been or should be construed under the law of the applicable jurisdiction.

Parties may agree upon the history of a claim and the provisions of the policy that will control, but a valuation dispute nonetheless may arise. Sometimes a dispute will occur because the policy language at issue may be susceptible to differing interpretations. A dispute may also arise because the insurer argues for an underwriting intent that does not appear evident in the language of its policy or because, in the insurer's view, the policyholder will enjoy a windfall if the policy language is enforced as written. Regardless of the reason, such disputes are fairly common. An examination of cases in a few jurisdictions will provide some insight into the issues these disputes present, and may provide some basis for predicting their outcomes. As importantly, such an examination may offer insight into the benefits of avoiding such disputes.

If a policyholder does not repair or replace damaged property, or if a policyholder has not purchased a policy that would cover the full costs to repair or replace, insurers often will be required to pay only a reduced amount determined through application of some depreciation approach. While depreciation arguments may be valid and have proven successful for insurers in many cases, it is important to remember that depreciation is not a wild card. Depreciation is not always applicable to property losses and, even when applicable, it may not apply in the manner the insurer advocates.

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Typically, the limits on depreciation are clearly defined in policies. For instance, depreciation often is not considered if a policyholder purchases replacement cost coverage and proceeds to replace the damaged property in compliance with that coverage. Similarly, depreciation is not to be applied when the measure of the loss is the cost of repair, as repair costs usually are expenses to be incurred after the loss, which distinguishes them qualitatively from property values, which often derive from past valuations that have depreciated over time. If such limitations are not evident in the language of the policy, depreciation nonetheless may be inapplicable if a court finds that an ambiguity exists, which it will resolve in favor of the policyholder.

Insurers, therefore, must take care not to overreach, as overreaching has the potential to backfire. Counsel for policyholders, correspondingly, should watch for insurers that attempt to over-play depreciation arguments to the detriment of policyholders' interests. The following cases provide examples of insurers' unsuccessful attempts to overreach and serve as a reminder to both sides to be thoughtful in regard to deprecation arguments.

Ohio Law

In jurisdictions like Ohio, it is especially important for insurers not to overreach in their depreciation arguments because of Ohio's insurance contract interpretation rules. Ohio law does not require that policyholders establish that their interpretation is the only reasonable interpretation, or even that their interpretation is more reasonable than the insurers'. Rather, policyholders will prevail merely if theirs is a reasonable interpretation, even if only one among many. *See generally Andersen v. Highland House Co.*, 93 Ohio St.3d 547, 549-50 (Ohio 2001) ("It will not suffice for [the insurer] to demonstrate that its interpretation is more reasonable than the policyholder's."). Accordingly, any overreaching on the part of an insurer may result in a finding in favor of the policyholder.

For example, in *Peterson v. Progressive Corp.*, the Court of Appeals for the Eighth District of Ohio rejected an insurer's attempt to depreciate repair costs, finding that the insurer's limitations on depreciation were clearly defined in the insurance contract. *See* 8th Dist. Cuyahoga No. 87676, 2006 Ohio App. LEXIS 6144, 2006-Ohio-6175 (Nov. 22, 2006). In *Peterson*, the loss at issue was damage to a boat, including the motor, by an underwater object. *Id.* at ¶ 2. The policy gave Progressive the options of paying "actual cash value," "the amount necessary to replace," or "the amount necessary to repair the damaged property to its pre-loss condition … ." *Id.* at ¶ 7. The insurer elected to repair the boat to its pre-loss condition by replacing the motor and other related parts, but it also attempted to deduct depreciation from these repair costs, referring to the deprecation as the amount of the "betterment." *Id.* at ¶ 8.

The court, however, would not permit such a deduction. *Id.* at ¶ 10. Notably, the *Peterson* court began its analysis by considering Ohio's rules of insurance policy construction. Thereafter, the court stated, "We agree with [the policyholder] that the [depreciation] condition does not apply when Progressive elects … 'to repair the damaged property to its pre-loss condition.'" *Id.* at ¶ 3. The court reasoned:

> Nowhere in the aforementioned provision, nor anywhere else in the Progressive ... policy that Peterson purchased, does it specify or explain that Progressive, upon electing to repair a watercraft to its pre-loss condition,

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> is permitted to take an additional deduction from repair costs for … "depreciation" … .
>
> *Id*.

The *Peterson* court concluded its reasoning as follows:

> In sum, Progressive's watercraft policy does not allow it to take a deduction for betterment or depreciation to account for any increase in value over the pre-loss value that may result from the repairs it is obligated to make. Progressive thus breached its contract with Peterson when, after electing to repair his boat to its pre-loss condition, it deducted from the repair cost the amount it determined the repair would increase the value of the motor beyond its pre-loss value.
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> *Id*. at 4.

In another Ohio case, a depreciation provision was construed to benefit the policyholder. In *Jones v. Auto-Owners Mut. Ins. Co.*, an insured's rental house was destroyed by fire, and the cost to repair or replace the house was over $56,000. 6th Dist. Lucas No. L-98-1297, 1999 Ohio App. LEXIS 2013, 1999 WL 435103, *4-5 (Ohio Ct. App. June 30, 1999). In that case, the policyholder sought to recover $21,500, the full policy limit, but the insurer paid only $7,000 based on its calculation of actual cash value. *Id*. At issue was whether the proper measure of loss was the market value of the house just prior to the loss or the cost of replacement less depreciation. *Id*. at *6. The court applied the rule of construction that "'[w]here provisions of a contract of insurance are reasonably susceptible of more than one interpretation, they will be construed strictly against the insurer and liberally in favor of the insured.'" *Id*. at *10 (citing *King v. Nationwide Ins. Co.*, 35 Ohio St.3d 208, 519 N.E.2d 1380 (1988)). Accordingly, the court found that the insured was entitled to its full policy limits of $21,500. *Id*. at *12. Somewhat counter-intuitively, the policyholder benefitted from having the loss valued in accordance with the actual cash value provision, which included depreciation. *See Id*.

Pennsylvania Law

Not unlike Ohio, Pennsylvania courts have found in favor of policyholders when depreciation provisions are not explicit and clear in insurance contracts. In *Peltz v. Nationwide Mut. Ins. Co.*, a Pennsylvania court was faced with the issue of whether Nationwide was entitled to deduct depreciation under an actual cash value policy when compensating an insured property owner for repairing a partial fire loss to a building. 2001 Pa. Dist. & Cnty. Dec. LEXIS 158, 63 Pa. D. & C.4th 85, 86 (Aug. 13, 2001). Nationwide estimated the replacement cost of the building to be $42,055, but deducted $5,207.90 for depreciation. *Id*. at 87. The court ultimately found in favor of the policyholder, determining that Nationwide was not entitled to deduct depreciation costs when calculating actual cash value. *Id*. at 112.

In coming to its conclusion, the Pennsylvania court stated:

> While Pennsylvania Superior Court decisions on the general subject of depreciation deductions are less than clear, the Pennsylvania Supreme Court has spoken clearly on the issue in two cases, and numerous courts in Pennsylvania and elsewhere have followed its reasoning and applied its principles. On the basis of these decisions, the court concludes that the policy and the circumstances set forth in the stipulation do not permit depreciation deductions … ."
>
> *Id*. at 88.

The *Peltz* court cited several Pennsylvania cases, holding that Pennsylvania case law generally prohibits an insurer from deducting depreciation costs when compensating a policyholder for partial loss repairs. *Id*. at 92 (citing *Fedas v. Insurance Co. of the State of Pennsylvania*, 300 Pa. 555, 563-64, 151 A. 285 (1930) (holding that actual cash value means "the real value to replace" the damaged item "with the same or similar property")); *Metz v. Traveler's Fire Ins. Co.*, 355 Pa. 342, 346, 49 A.2d 711, 713 (1946) (finding that the policyholder was entitled to replacement of the property, even if the cost of replacement exceeded the actual cash value after depreciation); *Patriotic Order Sons of America Hall Ass'n v. Hartford Fire Ins. Co.*, 305 Pa. 107, 112, 157 A. 259, 260 (1931); *Farber v. Perkiomen Mut. Ins. Co.*, 370 Pa. 480, 88 A.2d 776 (1952) (holding that the policyholder was entitled to the full amount necessary to repair a building partially destroyed by a fire to its pre-loss condition, despite the insured's argument that this exceeded actual cash value after depreciation); *Snader v. London & Lancashire Indem. Co.*, 360 Pa. 548, 551, 62 A.2d 835, 836 (1949) (noting that insurance contracts are contracts of adhesion, and therefore the insurer was required to compensate the policyholder for the amount required to restore a building to its condition prior to a fire) (additional citations omitted).

Another Pennsylvania case has taken a similar view. *See Kane v. State Farm Fire & Cas. Co.*, 203 Pa. Super. 502, 841 A.2d 1038, 2003 Pa. Super LEXIS 4588 (Dec. 22, 2003). In *Kane*, the Pennsylvania Supreme Court found that policyholders were entitled to full repair or replacement costs for their losses, as opposed to actual cash value for the losses after depreciation, with respect to an insurer whose insurance contract did not contain clear language. *Id*. The court found that the policyholder's complaint was not premature as to one insurer, and it stated as to that insurer that "in the absence of clear language to the contrary … an insurer may not deduct depreciation from the replacement cost of a policy and … 'actual cash value' may not be interpreted as including a depreciation deduction, where such deduction would thwart the insured's expectation to be made whole." *Id*. at 24. Therefore, the court reversed summary judgment granted in favor of Erie Insurance Company, finding that Erie was not entitled to deduct depreciation from the policyholder's recovery. *Id*. at 30-32.

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Florida Law

Florida law also protects policyholders and prevents insurers from making depreciation deductions in certain circumstances. Mandated by statute, insurers must make repairs of structures without taking any deduction for depreciation when policyholders have purchased replacement cost insurance policies. *See* Fla. Stat. § 627.7011. In 2013, the Supreme Court of Florida interpreted this statute in the context of fire damage to a home. *See Trinidad v. Fla. Peninsula Ins. Co.*, 121 So.3d 422, 38 Fla. L. Weekly S 397 (2013). The *Trinidad* court held that an insurer was required to pay all replacement costs for a home under a replacement cost policy, including the cost of profit and overhead for a general contractor. *Id.* at 435-36. Further, the court took an expansive view of the costs recoverable by policyholders and found that Florida law and the policy at issue did not require the insured actually to repair property as a condition precedent to payment recovery, and it required the insurer to pay replacement cost regardless of whether the policyholder actually repaired his property. *Id.* at 435-37.

Conclusion

As demonstrated by these cases from Ohio, Pennsylvania and Florida, courts can be quite wary of insurers' depreciation deduction arguments. The law in these jurisdictions is by no means atypical. Because courts tend to take the view that the purpose of insurance policies is to make policyholders whole, they generally will apply depreciation deductions to the full extent insurers might wish to limit the insurers' payment obligations only when the language of the policies clearly and explicitly permits such outcomes. If a clear-eyed and objective assessment by an insurer suggests that it is bending its policy language to maximize its depreciation deduction, the insurer often will be well served to avoid such an interpretation. Insurer forbearance from asserting creative depreciation arguments very well may save the insurer and policyholder significant litigation expenses, the court a considerable burden, and will likely preserve a significant amount of good will in the business relationship between the insurer and the policyholder.

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Reimbursement

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policy. *Bridger Lake, LLC v. Seneca Ins. Co. Inc.*, 11-0342, (W.D. La. 3/4/14); 2014 WL 849893. After receiving notice of a claim, Seneca made an advance under the policy to assist with immediate remediation costs following a ruptured pipeline. When the money was forwarded to Bridger Lake, Seneca included a reservation of rights letter stating, "[t]his advance is not to be construed as a[n] admission of coverage, and [Seneca] expressly reserves its right to seek reimbursement of the $100,000 from [Bridger Lake] in the event that … there is no coverage for this loss." The letter further stated that if coverage did exist, the advance would be taken out of the $1 million coverage limit. Seneca then refused to make any further payments under the policy.

Thereafter, Bridger Lake filed suit against Seneca seeking the remaining $900,000 under the policy. Seneca answered the suit and filed a counter-claim seeking the return of the $100,000. On summary judgment practice, applying Wyoming law, the court held the insurance policy did not provide coverage for Bridger Lake's claims. *Id.* On the issue of reimbursement, the court noted that when Seneca advanced the money, neither party knew whether the policy mandated coverage, which is why Seneca expressly reserved its rights to argue that no coverage existed. The court held that Seneca was entitled to reimbursement as Bridger Lake had been unjustly enriched due to the undeserved advance. *Id.*

Bridger Lake opposed the motion, in part, by arguing that Seneca was not entitled to reimbursement because its reservation of rights letter was an impermissible attempt to alter the terms of the policy. Bridger Lake pointed to a prior Wyoming Supreme Court decision prohibiting an insurer from recovering defense costs expended for uncovered claims as support for its position. In refusing to allocate costs between covered claims and uncovered claims in an action involving both, a "mixed action," the Wyoming Supreme Court held that "unless an agreement to the contrary is found in the policy, the insurer is liable for all of the costs of defending the action." *Shoshone First Bank v. Pac. Employers Ins. Co.*, 2 P.3d 510, 514 (Wy.2000).

The *Shoshone* court likened a reservation of rights to recoup costs to a unilateral modification of the policy. *Id.* at 515-16. However, the *Bridger Lake* court distinguished *Shoshone* as it dealt with an insurer seeking allocation of defense costs, and although the policy in *Shoshone* was silent on the issue of allocation, there is a legal requirement under Wyoming law that an insurer defend all claims under the policy unless the policy expressly states otherwise. *Bridger Lake*, *supra* at 3.

Equity and public policy considerations ultimately guided the *Bridger*

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