Jim's Perspective…

Valued Policy Law

The insured's home is rendered a total loss due to fire. As you may know, the amount the insurer must pay to the insured for this total loss of the house, is the face amount of insurance for the house as shown on the Declarations Page of the homeowners policy. This is required pursuant to Nebraska's valued policy law, Section 44-501.02, which provides:

> Whenever any policy of insurance is written to insure any real property in this state against loss by fire, tornado, windstorm, lightning or explosion and the property insured is wholly destroyed without criminal fault on the part of the insured or his or her assignee, the amount of the insurance written in such policy shall be taken conclusively to be the true value of the property insured and the true amount of loss and measure of damages.

The first valued policy law was enacted in Wisconsin in 1874 and other states followed suit, adopting their own laws in the early 1900s. There are roughly 17 states that have valued policy laws today. States enacted valued policy laws to curb the perceived practice of insurance carriers deliberately overestimating the value of insured property to boost the premiums they could collect. The overvaluing, which was thought to encourage arson, resulted in perceived excessive litigation over the value of the insured property. Valued policy laws were created to fix in advance the value of property being insured and to place upon the insurer the burden of inspecting the property to assure its proper valuation. Nebraska enacted a valued policy law in 1913.

Assume a new customer visits your agency and requests coverage to be bound on a house he just bought. You ask him various questions about the house and then issue a one-month binder in the amount of $60,000.00. This new client is in the business of buying and refurbishing old homes. He paid only $5,000.00 for this dilapidated old house, however, the cost to restore the house and its value after restoration, would be $60,000.00. A few days after binding coverage, the house was destroyed beyond repair by fire.

This scenario came before the Nebraska Supreme Court in the case of Heady v. Farmers Mutual Insurance Company, 217 Neb. 172, 349 N.W.2d 366 (1984). This case came before the Court on appeal from a District Court judgment in favor of Farmers Mutual. The Court reversed the decision of the District Court and sent the matter back to District Court for a new trial. One issue before the Supreme Court was whether the valued policy law operated to preclude the insurer from arguing an "overvaluation defense." The Court held that Nebraska's valued policy law precludes Farmers Mutual from asserting as a defense to liability on its fire insurance contract the fact that the insured either affirmatively misrepresented or intentionally overvalued the actual value of the subject property. The Court provided a good summary of the purpose and legislative intent of this law as follows:

> It is a well-known fact that it has been the practice of some fire insurance companies to insure property at any value the insured cared to put thereon without any investigation as to such value. The natural impulse of the insured was toward amply sufficient or even over valuation. The higher the valuation, the greater the premium. If there were no loss, the insurance company profited through the high valuation. If loss occurred, the insurer would contest the value or amount of recovery and the insured might recover less than the value stipulated in the policy although he had honestly estimated the value at the time the insurance was taken and had paid premiums on the basis of such estimated value. This situation produced dissatisfaction and litigation. It was to correct this condition, that the valued policy law was enacted. Also, overvaluation was a temptation to commit arson, which might endanger lives or other property. The statute is not merely for the protection of the insured but rests on consideration of public policy, and it is probable that the insured could not, even by express contract, relinquish the benefit of the valued policy law provisions.
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> The method of this law is to have the value liquidated in the policy by the parties to the contract and removed from dispute and determination by evidence, agreement or arbitration. The statute is confined to real property because values thereof are relatively fixed and certain. The result of this method of making the policy valuation binding was to place on the insurer the duty to make its own investigation and binding determination of value before such is agreed upon and placed in the contract. Neither party can evade the statute by avoiding this duty. If the insurer performs its full duty, in this respect, it is bound by its estimate of value based thereon unless conditions reducing value, not ascertainable by a reasonably careful inspection and known to the insured, are withheld by the insured. But the insurer cannot close its eyes, make no reasonable investigation, take the bare word of the insured as to value and thereafter challenge such value. To permit this would be to nullify the good effect intended by the statute. It would reinstate the very situation and condition which the statute sought to destroy and prevent.

It is important to note that the Court did confirm that Farmers Mutual could submit evidence of the actual value of the house to show a motive of the insured for possible arson. So even though overvaluation cannot be used to contest the amount due under the policy, it is admissible as evidence of arson. Also, I think the outcome in this case on appeal, in part, was influenced by the fact that the insured had already started repairing the house several days before he bought it, and so even by the time of the fire, the value of the house had gone up beyond what he paid for the house. It is not clear from the opinion, the extent of the agent's knowledge about the condition of the house.

The valued policy law applies only to a total loss. Courts have used one of two different tests to determine if the house is a total loss, one of which is the "identity" test and the other is the "restoration" test. Under the identity test, a structure is a total loss if it has lost its identity and character as a building, even though a portion of the building's components remain and could be utilized for some useful purpose. Under the restoration test, a structure is a total loss if a reasonably prudent owner would not use the remains of the structure after a fire loss as a basis for restoring the building to its pre-loss condition.

The courts have also found that other policy provisions are waived to the extent those provisions contradict the purpose of the valued policy law, particularly regarding the establishment of damages in the event of a total loss. Therefore, a proof of loss is not a necessary prerequisite to payment of policy limits, and the arbitration or appraisal provision of a policy has no application.

In some total loss claims, the insured may only have a partial interest in the property. If there is a mortgage on the destroyed house, the insured will have a limited interest in the equity in the house, with the lending institution having an interest for the balance due on the mortgage. There are various approaches applied in different states to this problem involving an insured with only a limited interest, but in Nebraska, the insured recovers under the valued policy law only the value of his interest in the destroyed property and the balance of the insurance proceeds would be paid to the lender.

Generally, valued policy laws have not been applied to builder's risk policies. It doesn't make sense to require application of the valued policy law to builder's risk policies, since an insurer cannot inspect a risk which has not yet been built. The purpose of the valued policy law is to fix the value when the insurer is able to conduct an inspection of the structure. In the case of a structure being built, the purpose of these laws cannot be achieved since the value of the structure changes each day additional work is completed.

And so we see some of the numerous legal issues that have developed over the years after enactment of a law which was simply intended to require insurers to pay the face amount of the policy when the structure was totally destroyed. There are even more issues related to this law involving multiple policies that might apply to a loss and matters involving multiple causes of loss, some of which fall under the valued policy law and some that do not. It all reminds me of one characteristic of insurance which I find very interesting. The financial services provided by insurance are often, really, not so simple! All of which makes it very interesting!

One last example

The valued policy law has even been applied to a grain storage bin. Typically, the valued policy law applies to homes destroyed by fire or tornado. However, the valued policy law extends to "any real property." The Nebraska Supreme Court discussed application of this law to structures other than homes in Calnon v. Fidelity – Phenix Fire Ins. Co., 114 Neb. 194, 206 N.W.2d 765 (1925). Calnon involved a single grain storage bin located on a railroad right of way. The bin was constructed on a cement foundation. It was leased and the owner of the ground intended to demolish the bin once the lease expired. The bin was totally destroyed by fire. The insurer argued that since the bin was not permanent, existed only for the term of the lease, and could not be occupied, it was more like personal property and not real property that is subject to the valued policy law.

The court explained that the valued policy law was remedial in character. The definition of real property should be consistent with the legislative remedy associated with the valued policy law.

The remedy was intended to end the loss adjusting practice of arguing that totally destroyed property was really not worth as much as the face amount of coverage written on the property. The court said,

> . . . Where property was of a substantial nature, permanent, fixed, and immovable, which might be inspected and which was not subjected to sudden change in condition when insured for a consideration based upon a certain valuation, and after due inspection by the insurer, the amount which should be paid in the event of total loss, is the amount stated in the policy.

The court explained the terms "real property," "real estate" and "lands" mean all buildings, fixtures and improvements to the land. In contrast, personal property in its general sense means simply movable, transitory or that which may be carried about with the person. Black's Law Dictionary makes a similar distinction. The term "real" relates to a thing as distinguished from a person. "Real" things at common law are permanent, fixed, and immovable and cannot be carried out of their place.

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