

**MEASURE & PROOF OF LOSS TO BUILDING
& STRUCTURES UNDER STANDARD FIRE
INSURANCE POLICIES – THE ALTERNATIVES
& PRACTICAL APPROACHES**

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I. INTRODUCTION

(a) The Policy Standard To Be Applied

The standard form of fire insurance policy which is presently extant in most jurisdictions within the United States provides for insurance against loss:

“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 . . .”

This policy standard of “actual cash value” was established some forty odd years ago and has never been changed by policy writers or legislatures of varying jurisdictions. Nevertheless, it is not always clear what is meant in a particular jurisdiction by the term, “actual cash value”. Moreover, while it should be clear that under the language of the standard policy, the cost to repair or replace property with material of like kind and quality is a measure and not a limit of liability, the foregoing words have taken on different connotations in different jurisdictions, not by application of legislative or industry intent, but rather by reason of judicial fiat.¹

In order to arrive at a fair definition of “actual cash value” and to permit a measure or standard which would enable an insured to be indemnified in dollars for that which he has lost in terms of building or structure by reason of a peril insured against, while at the same time attempting to prohibit an unreasonable windfall to the insured, the Courts have struggled at great length to define in understandable and easily applicable terms the measure of loss.

In discussing the phrase, “actual cash value” or “actual value”, one writer has stated:

“These terms, which are interchangeable, have no practical meaning. They are not subject to a precise definition, even though

¹ The standard form of fire insurance policy is legislatively mandated in most jurisdictions.

they are intended as the very foundation for determining the amount of insurance required and the amount of money payable to indemnify the insured in case of damage or destruction to the property. To say that the term actual cash value means actual value expressed in terms of money may provide a broad rule, but does not provide a workable formula for determining cash value.”²

Thus, the Courts in attempting to come up with a workable standard that can be applied by insured and insurer as well, in order not only to arrive at a fair figure in a particular loss situation, but also to bring some degree of certainty to the entire adjustment process, thereby precluding unnecessary litigation, have struggled with the concept and have struck different standards, each of which, it is thought, will accomplish the desired end. So it is that in some jurisdictions cash value is expressed in terms of replacement cost less physical depreciation; in other jurisdictions, it is equivalent to market value, while in still others, it has been equated to reasonable value.

(b) Different Rules & Approaches

It has become necessary for insurers and their adjusters, as well as insureds, brokers and agents to find some rational basis for determining the proper amount of insurance to be carried on the building, as well as the proper standard to be applied in determining loss.³

In the absence of a replacement cost policy (one which indemnifies the insured based upon the actual cost to replace or repair a damaged structure in accordance with current prices for material of like kind and quality), the rule in general use is replacement cost less depreciation to arrive at actual cash value, both for the purpose of evaluating the required limits of liability under a standard fire insurance policy insuring buildings and structures, as well as for the purpose of determining the amount of loss sustained from a peril insured against.

² Reed & Thomas, Adjustment of Property Losses, 3rd Ed., Page 160 (1969).

³ This paper will not seek to treat the issues of co-insurance, replacement cost coverage, appraisal and similar subjects, all of which could very easily form the basis for a separate dissertation.

Even in this area, there is much dispute because of the different views with regard to the definition of "depreciation." Everyone recognizes that "depreciation" connotes a decline in value, but there is disagreement as to whether the term applies solely to physical deterioration or has a broader concept which envisions some credit for obsolescence or economic depreciation.

This difference in approach has brought about a myriad of litigation in order to determine not the applicable definition of "actual cash value," but simply that portion of the standard which relates solely to the concept of depreciation.

The drafters of the standard form of fire insurance policy, anticipating that disputes would arise with respect to the scope and amount of loss, undertook to provide a vehicle for the disposition of such disputes short of litigation and did so by incorporating in the standard 165 line form, which is statutory in most jurisdictions, as appraisal clause.

While the very subject of appraisal would form the foundation for a separate detailed dissertation, which is certainly not the intent of this presentation, it should be recognized that as a practical matter, the appraisal clause has failed in its essential purpose and has, in fact, promoted more litigation than it has prohibited. The reason for such failure, however, is not premised upon the language of the appraisal clause itself, but on the underlying problem heretofore delineated; that is, the violent disagreement between adjusters for insureds and insurers as to the proper definition of actual cash value and, more particularly, the term "depreciation."

As a direct result of such differences of opinion, the "loss" side of the insurance industry (as opposed to the "casualty" end of the business) has, of necessity, established an entirely new cadre of personnel to deal with the problem of ultimate determination of amount of loss. So it is that we today deal, not only with the insurers' own staff adjusters, but extremely competent independent adjusters who specialize in particular areas (fire, marine, inland marine,

bailee losses, etc.), as well as the necessary supportive personnel. Such supportive personnel are generally totally independent persons who are expert in contracting, architecture, engineering, real estate appraisal and other related fields. This group is further subdivided into subcontracting specialties, such as mechanical, electrical, roofing, carpentry, plaster, concrete and building materials.

In order to keep pace with the insurance companies, we further find that in the last 25 years, organizations representing insureds (known as public adjusters) have grown and flourished. These companies, or individuals, many times operating from an economic base of virtual equanimity with the local office of the insurer, have availed themselves of the identical expert services which are utilized by their insuring counterparts.

It is not, therefore, unusual for one to come across architects, engineers, machinery experts, mechanical engineers, electrical engineers and specialists in each subtrade in the adjustment of even the most usual fire loss -- not in terms of the amount involved which obviously limits the use of expert personnel -- but in terms of the nature of the building or structure insured and the extent of the damage by the peril insured against.

As will be discussed in greater detail hereinafter, the implementation of such aforesaid expert services usually results in the presentation of a claim under a standard fire insurance policy in one of two ways. Once the scope of the damage has been delineated and agreed upon (an essential first step in establishing the amount of loss), one might expect to have submitted a detailed estimate delineating as to each trade the specific cost to repair the damage done. For instance, one might expect to receive a schedule of value and loss, which sets forth the cost of demolition and debris removal, the cost to repair carpentry, repainting, replacement of cinderblock walls and so forth. Another approach is the unit measure approach in which the cubic footage or square footage of the premises is taken and a unit price is applied thereto in

order to determine the value of the structure, and the loss is then determined by simply reducing such value by the value of the salvageable items. Whether or not the loss is a total loss, a constructive total loss or a partial loss will, in most cases, play a significant role in determining the method of estimation approach to be utilized.

(c) Looking Ahead To Subrogation⁴

As a result of the facts and circumstances surrounding individual fire, explosion or structural collapse losses, the insurer may determine that it is in its best interest to pursue its contractual subrogation rights by making payment to the insured, stepping into the shoes of the insured and seeking reimbursement for the amount paid from some third-party tortfeasor.

It appears, therefore, that it would be inadequate to treat the subject of measure and proof of loss under fire insurance policies and to, at the same time, ignore the necessity for the preservation of such proof once the adjustment process has been completed and the subrogation process commences. This is not to say that both processes should not be concurrent since it is the belief here that a prompt recognition of subrogation potential may result in perhaps the greatest amount of salvage recovery by all property insurers. The point is, however, that one may not adjust a property insurance claim without taking into consideration the potential subrogation claim which might follow. Such consideration requires some forethought with regard to the preparation and preservation of that testimony which will be required in the proof of damages during the course of the trial of the subrogation action.

For instance, where it is apparent that the limits of liability under the fire insurance policy are inadequate to fully compensate an insured for his total loss, it may be considered to be a cost saving for the insurer not to engage a general contractor to make a detailed estimate or to take photographs of the damage. The insurer may determine simply to

⁴ It is not the intent of this paper to expound upon the total field of subrogation.

calculate actual cash value by arriving at replacement cost less depreciation through the application of the square footage or cubic footage method. As will be more fully discussed hereinafter, while this might be an acceptable method of adjustment under the policy, it would not be an acceptable method, both legally and practically, of proof of damages in the subrogation action.

Consequently, it is as important to consider the subrogation aspects of a particular losses early as possible in terms of proof of damages in a subsequent litigation against a third-party tortfeasor as it is to consider the measure and proof of loss under the policy upon which claim is being made.

With these thoughts in mind, we must pass to a consideration of the rules which govern recovery for damage or destruction to buildings and structures under standard fire insurance policies.

II. ACTUAL CASH VALUE

(a) The Rule In Pennsylvania

The Supreme Court of Pennsylvania has had occasion since the landmark decision in the case, Fedas v. Insurance Company of the State of Pennsylvania⁵, to clarify the application of the generally accepted principle in the Commonwealth of Pennsylvania that actual cash value means replacement cost less depreciation.

In view of many, rather than clarifying the applicable standard with respect to the measure and proof of loss under standard fire insurance policies, the Supreme Court has skirted the issue, failed to make a statement in clear and unambiguous terms of the standard to be applied and has, instead, treated such issues on a case-by-case basis.

In Fedas, there was an action on an insurance policy for the partial destruction of a dwelling. While the opinion of the Court dwells on issues of waiver and estoppel for the most part, the case is recognized as a landmark decision on the definition of "actual cash value." On this issue, the Court stated:

"Generally speaking, actual cash value does not mean market value, as the term is understood. Market value, as here urged, embodies what a purchaser willing to buy feels justified in paying for property which one is willing but not required to sell. Market value includes factors of time, place, circumstance, use and benefit; depreciation is included, but one figure is the result of these considerations, the price to be paid. Ordinarily, actual cash value has no relation to any of these factors; it is value under all times, such as the cost of manufacturing or building or book value. The policy intended something different from market value; the later includes 'depreciation' while the 'actual cash value' of the policy is to be diminished by 'depreciation.' Actual cash value in a policy of insurance means what it would cost to replace a building or a chattel as of the date of the fire. Where a building is entirely destroyed, the application of the rule is simple: where a building is partially destroyed, it may be difficult to arrive at actual cash value, less depreciation, if it is to be considered; but difficulties cannot prevent the right to compensation. There enters into actual

⁵ 300 Pa. 555 (1930).

cash value of the part destroyed the fact that it was a part of an entire property and the use made of it. It is summed up in the idea 'the cost of replacing in as nearly as possible the condition as it existed at the date of the fire.' The actual cost of new material, with deduction for depreciation, which is not sufficient to replace the building as nearly as it could be as of the date of the fire, does not comply with the policy, which was to insure against loss not exceeding the amount named in the insurance. If the new material is to be depreciated to reach the actual cash value contemplated by the policy, the timber or part destroyed must be considered in connection with the whole structure and valued accordingly and should reflect the use in place. The result reached is that called for in the policy -- replacement as nearly as possible, or its cost. If part of the building destroyed cannot be replaced with material of like kind and quality, then it should be substantially duplicated within the meaning of the policy."⁶

The foregoing language has been interpreted in the field as requiring a standard of replacement cost less depreciation to arrive at actual cash value, not only of the building or structure, but of the loss itself. The language of the Curt, however, is unclear and certainly is not an explicit statement approving the replacement cost less depreciation standard. A reasoned reading of the foregoing language would certainly indicate to one that market value is not the standard, but that the insured must be indemnified by being put in a position to have back exactly what he had at the time of the fire -- nothing better, but certainly nothing worse. Whether one treats the concept of depreciation as physical deterioration or as an improvement or betterment that must be subtracted from the cost to replace and repair, the same result may be arrived at.

This analysis seems to be correct when the conclusion of the Court is thereafter read:

To sum up, actual cash value means the actual value expressed in terms of money of the thing for the purpose for which it was used - - in other words, the real value to replace. The rule established by our decisions seeks a result which will enable the parties to restore the property to as near the same condition as it was at the time of the fire, or pay for it in cash; that was the loss insured against."⁷

⁶ 300 Pa. at 562-563.

⁷ 300 Pa. at 564-565.

More than 20 years after the Fedas decision, the Supreme Court of Pennsylvania again had the opportunity to consider the definition of actual cash value in the case of Farber v. Perkiomen Mutual Insurance Co.⁸ The main issue in the Farber case was the application of a co-insurance clause and the Court determined that for purposes of deciding whether or not the co-insurance clause was applicable, it was, indeed, proper to arrive at actual cash value by establishing replacement cost less depreciation. The Court held, however, that the same blanket rate of depreciation which was utilized in arriving at actual cash value for purposes of determination of co-insurance could not be applied to the loss itself in a situation in which there was a partial loss and less than the total building or structure was destroyed.

The Court stated that the sole question was whether the loss determined by reproduction cost new of the restoration should be depreciated by a percentage of depreciation applicable to the building as a whole in determining its actual cash value immediately prior to the fire.

In holding that one could not validly apply a blanket rate of depreciation to establish the actual cash value of a loss as opposed to the actual cash value of the building or structure itself for insurance purposes, the Court relied upon the language of its prior decision in the Fedas case.

It is the position of most legal scholars in Pennsylvania that the Farber case does not stand for the proposition that one may not depreciate a partial loss, but simply for the proposition that the blanket rate of depreciation taken for purposes of determining actual cash value of the insured structure may not be applied on blanket basis to the loss. This does not mean that in order to arrive at a fair figure for indemnity, one may not consider the depreciation applicable to each trade, i.e., painting 15%, plaster 10%, carpentry 25%, etc.

⁸ 370 Pa. at 480 (1952).

Continuing to espouse the rule of replacement cost less depreciation, the Supreme Court has continued to cast doubt upon the rule and its application.

In the case of Metz v. Travelers Fire Insurance Co.⁹, the Supreme Court stated:

"If part of the building destroyed cannot be replaced with material of like kind and quality, the nit should be substantially duplicated within the meaning of the policy."

The question is, of course, whether or not "substantial duplication" does, in fact, take into consideration the concept of depreciation or improvement and betterment. For purposes of application in the field, that is, in the actual adjustment of fire losses, insurers and insureds alike grasping for a standard which they can consistently apply have assumed that the concept of depreciation must be considered in the adjustment of a loss.

The replacement cost less depreciation rule has been adopted by the trial courts is the state of Pennsylvania which have defined actual cash value as being not market value, but what it would cost to replace or repair a building as of the date of loss with materials of like kind and quality so as to put the insured back in the same position that he was prior to the loss.¹⁰

Moreover, the Superior Court of Pennsylvania (an intermediate appellate court) has similarly defined actual cash value. In the case of Varano v. Home Mutual Fire Insurance Co.¹¹, the Court held that in the action on a fire insurance policy, the measure of damages is the actual cash value ascertained with proper deductions for depreciation of the property at the time of loss or damage, but not exceeding the amount which it would cost to repair or replace the same with material of like kind and quality within a reasonable time after such loss or damage.

⁹ 355 Pa. 342 (1946).

¹⁰ Rizzo v. Nationwide Mutual Insurance Co., 61 Luz. L. Reg. 147 (1971).

¹¹ 164 Pa. Super. 228 (1949).

Unfortunately, all appellate courts in Pennsylvania have taken the occasion to side step the issue of what constitutes depreciation even though as stated above, this is in essential element of the rule to be applied in measuring fire insurance losses.

(b) The Rule In New York

The law in the State of New York has not changed since the landmark decision in the case of McAnarney v. Newark Fire Insurance Company¹² in 1928.

The rule as enunciated by the Curt of Appeals is one which permits a fact finder to take into consideration all factors which are relevant in the determination of actual cash value. That would include market value, single purpose use, physical depreciation, obsolescence, rental value and any other factors which have a bearing upon the true value of the premises. While this rule is difficult in its application in the field, it is the view here that it permits one to arrive most closely to the true intent of indemnity upon which the standard fire insurance policy is premised.

Moreover, the rule enunciated in McAnarney is one which is equally applicable to modern newly construed buildings as well as to old outmoded structures.

In McAnarney, plaintiff had purchased seven large buildings from a brewing company designed for the manufacture of malt in 1919. Thereafter, the National Prohibition Act came into being and the manufacture of malt was discontinued. In April of 1920, the buildings were destroyed by fire. The buildings had been purchased for the total sum of \$8,000 based upon their market value as brewery structures during Prohibition. The insured had taken out fire insurance policies in the sum of \$42,750.00 and, t the trial of the action, the jury, having determined that the actual cash value of the structures was \$55,000.00, returned a verdict in the full amount of the insurance policies. The jury's determination of value was in answer to a written interrogatory by the trial judge which asked:

¹² 247 N.Y. 176 (1928).

"What was the intrinsic or depreciated structural value of the building burned?"

The defendant insurance carriers argued that the market value of the buildings destroyed was the exclusive measure of the plaintiff's loss. The Court rejected such contention and stated:

"We cannot agree with the defendant that under this clause the market value of the buildings destroyed was the exclusive measure of plaintiff's loss. Insurance is thereby limited to 'actual cash value (ascertained with proper deduction for depreciation) of the property at the time of loss or damage.' Value ascertained by market price is necessarily expressive of a suitable deduction for depreciation. If 'actual cash value' were synonymous with 'market value,' the words in parentheses, to have force, would require depreciation to be twice subtracted. No such anomalous result could have been intended. In order that the parenthetical words should have force, therefore, 'actual cash value' must be interpreted as having a broader significance than 'market value.' Moreover, if market value were the rule, property for which there was no market would possess no insurable value, a proposition which is clearly untenable. We think it manifest that the clause was not intended to restrict a recovery for this insurance loss, to the market value of the insured buildings. We interpret 'actual cash value' to have no other significance than 'actual value' expressed in terms of money. For methods by which actual value may be ascertained, we must look beyond the terms of the policy to general principles of the law of damages."¹³

Having rejected the "market value" approach, the Court also rejected the replacement cost less depreciation approach.

Judge Kellogg stated:

"We do not agree with the plaintiff that, under the standard clause, the sole measure of damage was cost of reproduction less physical depreciation. The words 'not exceeding the amount which it would cost to repair or replace the same with material of like kind and quality within a reasonable time after such loss or damage' afford no remedy to the assured. They merely express a privilege granted to the insurer. The insurer might, if it so elected, reconstruct the destroyed buildings upon their ancient pattern with materials of like kind and quality or pay the assured the necessary cost of such reconstruction. If the insurer so elected, it could be allowed nothing for the difference between the value of the old and new building. . .the clause makes no allusion to depreciation, except as

¹³ 247 N.Y. at 181.

it provides for the recovery of 'actual cash value' to be 'ascertained with proper deductions for depreciation.' This provision, while it doubtless comprehends cost of reproduction, does not restrict the field of investigation to such cost or provide that with depreciation, it shall constitute an exclusive measure of recovery."¹⁴

Recognizing that indemnity is the basis and foundation of all insurance law, the Court held that where insured buildings have been destroyed, a trier of fact may and should call to its aid in order to effectuate complete indemnity every fact and circumstance which would logically tend to the formation of a correct estimate of the loss. The Court stated that the trier of fact may and should consider original cost and cost of reproduction; the opinions upon value given by qualified witnesses; the gainful use to which buildings might have been put; as well as any other fact reasonably tending to throw light upon the subject.¹⁵

The trial courts in New York have continued to follow the rule laid down in the McAnarney case. In the most recent case of Balen Developing Corporation v. American Home Assurance Company¹⁶, the Court reaffirmed the proposition that market value is not the test of actual cash value, but merely a consideration in the determination of actual cash value.

It there stated:

"Actual cash value is not always a simple determination to make. As plaintiff's counsel himself told this Court, it is made up of a myriad of considerations. Some of these things were costs of reconstruction, depreciation, particular condition of the property at the time of the loss, purchase price of the property close to the time of the loss, the nature and condition of the area or location, market price, opinions of experts and any other considerations which would logically affect value...Generally speaking, the principle is that the insurer would put the insured in as good condition, as far as practical, as the assured would have been if a fire had occurred."

The New York Courts have, perhaps, sacrificing an easily applied standard at the expense of a potentially greater amount of litigation on the issue, but a far more equitable result,

¹⁴ 247 N.Y. at 184-184.

¹⁵ Compare: Eshan Realty Corp. v. Stuyvesant Insurance Company of New York, 202 N.Y.S.2d 899 (1960).

¹⁶ 1975 Fire & Casualty Cases, page 825 (New York Supreme Court).

adopted the "all actors" rule which does not prohibit, but rather requires, consideration of both the market value rule as well as the replacement cost less depreciation rule.

(c) The Rule in California

The rule in California with respect to actual cash value may best be viewed in the context of the case of Jefferson Insurance Company of New York v. Superior Court of Alameda County.¹⁷

In a proceeding for a Writ of Mandate to compel the Superior Court to set aside an award vacating an appraisal award, the Supreme Court of California held that "actual cash value" as used in the standard statutory language of a fire insurance policy means fair market value, not replacement cost less depreciation. As a result of such holding, the Court vacated an appraisal award based upon a misconception of the law on the part of the appraisers. The underlying facts were that the insured owned a hotel building which has fair market value excluding the value of the land of \$65,000. The insured obtained policies of fire insurance containing an "average clause" or as it is more generally known, a co-insurance clause. The policies were written in the total amount of \$45,000, which was approximately 70% of the fair market value of the building. The parties agreed that the amount of the loss was \$24,102.05, which was the cost of repairs less an amount for betterment. The insurers, however, refused to pay that amount contending that the property was substantially underinsured according to the average clause or co-insurance clause. Their theory was that actual cash value did not mean fair market value, but rather, meant the replacement cost of the building less depreciation. Since the replacement cost of the building less reasonable depreciation was approximately \$170,000, it was apparent that the insured would only be entitled under the defendant's theory to a small percentage of its loss. Pursuant to demand by the insurers, appraisers were appointed and made a

¹⁷ 90 Cal. Rptr. 608, 475 P.2d 880 (1970).

determination as to actual cash value. The evidence established that the appraisers had determined as a matter of law that actual cash value was equivalent to replacement cost less depreciation and had refused to consider income, location or any other relevant factor tending to show the fair market value of the property.

The Supreme Court, in vacating the appraiser's award, held specifically that "actual cash value" is synonymous with "fair market value."

The logic applied by the Supreme Court of California is set forth in its opinion as follows:

"The latter clause insures 'the extent of the actual cash value of the property at the time of loss but not exceeding...cost to repair or replace the property...' Since replacement cost less depreciation can never exceed replacement cost, it would not be logical to interpret this clause to mean 'to the extent of the replacement cost less depreciation, but not exceeding the...cost to repair or replace the property.' If 'actual cash value' had been intended to mean replacement cost less depreciation, the legislature would not have used 'the cost to...replace the property' as a limiting factor and would have specified as a limiting factor only the cost to repair the property."¹⁸

In the view of many, the California Supreme Court misconstrued the standard statutory language of the fire insurance policy. The error, it is contended, came about by reason of the fact that the Court treated the policy language as supplying a measure of loss rather than a limit of liability.

Regardless of the view taken, it is clear that in California, losses under standard fire insurance policies will be adjusted according to the fair market value concept.

(d) The Best of All Worlds

To arrive at a useable standard in terms of legal analysis and applicability in the courts is far less of a burden than to arrive at a useable standard which can be applied in the filed

¹⁸ 90 Cal. Rptr. at 610-611.

on a day-to-day basis. While there can be substantial arguments made for each of the three rules previously enunciated in terms of legal analysis, it is desirable for the courts to come to a uniform determination as to the definition of actual cash value which cannot only be easily verbalized, but can be easily applied to thousands of loss adjustments which take place every day. One can conceive of the difficulties attendant to a nationwide corporation with buildings in Pennsylvania, New York and California. IT is inexplicable to the average insured, even a sophisticated corporate insured with an insurance manager and insurance department, that a different rule as to the measure and proof of loss shall apply when a building is destroyed by fire in Philadelphia than that which would apply if a similar building was damaged or destroyed by fire in San Francisco. One may find, based upon the definition of “actual cash value” in a particular jurisdiction, that a building situate in Philadelphia is underinsured while a similar structure situate in San Francisco is overinsured. To insureds who have buildings in different states to insure each building separately or to insure all building under a replacement cost endorsement with the attendant additional premium expense involved is to take away from the insured the benefit of modern plans of insurance which permit blanket, rather than specific insurance, of all building structures wherever situate owned by a single insured. The rippling effect reaches far beyond the insured itself and goes to the very fiber of the industry. That is, it affects agents and brokers alike. Consequently, it is here suggested that representatives of the insurance industry should attempt to arrive at a definition of actual case value which they believe is consistent with the concept of indemnity, which will neither ignore nor elevate the factor or market value or replacement cost less depreciation over any other equally probative factor. Such a definition, once arrived at, should be implemented, if possible, through the legislative branch of government. Historically, the term “actual cash value”, as it appears on the standard fire insurance policy, came about by reason of legislation, which was thereafter adopted in almost all

jurisdictions. In order to bring about uniformity, it is here suggested that the legislation approach is the only sensible approach. As an alternative, it is suggested that in the absence of legislation, each insurer should attempt to define by endorsement to the standard fire insurance policy the term “actual cash value” and to have the same approved by the appropriate regulatory agency in the jurisdiction in which the policy is marketed. At the very least, under this approach, the consumer is forewarned with respect to the measure of loss to be applied.

III. ADJUSTMENT TECHNIQUES¹⁹

(a) Detailed Estimates vs. Unit Estimation

In order to arrive at a quick approximation of the cost of replacing or repairing a particular structure which has been damaged or destroyed by fire or other insured casualty, there are two systems in common use: the cost per cubic foot or cost per square foot method. Both systems are premised upon the concept that similar buildings of similar size, design and construction will cost approximately the same amount per cubic foot of content or per square foot of ground or floor area. This is what is known as the unit approach to loss estimation. Naturally, there will be variations in the cost per square foot or cubic foot which will come about as the size of the building increases or decreases from the “norm” which is utilized, as well as from the architectural design or layout of the building and the nature of the building materials. One would, of course, not apply the same unit cost to a 100 year old ornate church as one would apply to a modern office building structure.

The unit basis for estimation is, nevertheless, an easy method of estimation, particularly when one is dealing with a loss wherein it is agreed that the scope of the loss is virtually total. In addition, the adjuster or practitioner is aided by various published manuals

¹⁹ There is no intent in this presentation to expand upon the subject of adjustment techniques which are more fully and at length set forth in available publications in the field.

which supply corrective factors to take care of the variables that might exist. It is obvious that neither system is as accurate as the detailed estimate even when it is utilized or applied by an experienced adjuster or lawyer. But both systems are reliable, particularly as tests against the credibility of detailed estimates. It is here suggested that no unit estimation system is a valuable tool, however, to use on smaller or partial losses. Such unit estimations, however, can be utilized in conjunction with reliable records which demonstrate the original cost of buildings and structures. These can be updated by applying cost index figures which are generally published on a unit basis.

The detailed estimate is the best method for arriving at a valid loss figure. It not only provides back-up in terms of subcontractors' estimates for damages occasioned to each trade (painting, electrical, roofing, carpentry, plaster, concrete, debris removal, etc.), but also forms the ground work or basis, not only for a more specific and less arguable attempt at adjustment, but also for use in potential subrogation claims which may later arise.

(b) Preparation & Preservation of Potential Testimony

Whether a unit estimation or detailed estimate is utilized to arrive at a loss adjustment, care should be taken to preserve all evidence which might be necessary in the event that attempts at adjustment fail and it is necessary to go to appraisal or to litigation under the policy. Such evidence will also be necessary should subrogation litigation come about as a result of the particular loss. While unit estimations prepared by competent adjusters may be helpful in settling a claim under a policy, they are not at all helpful in proving damages in a subrogation action against a third-party tortfeasor. Thus, it is recommended that photographs be taken of each section of a damaged premises for which claim is made; estimates in detail by general contractors for builders be obtained; all estimates should be supported by subcontractors' estimates, and in jurisdictions which utilize the fair market value approach, not only to determine

losses under fire insurance policies, but as part of the measure of loss in tort cases in general, it may well be wise to obtain real estate appraisals. Additionally, where factors of salvage might be involved, separate and distinct estimates from more than one contractor with respect to the salvage value of the remains of a destroyed or damaged premises should be obtained.

IV. MEASURE & PROOF OF LOSS IN SUBROGATION CASES

(a) The General Rule

While it is not the intent of this presentation to delineate or even to discuss in general terms all of the problems that might arise in connection with the proof of damages in subrogation cases involving damage or destruction to buildings or structures, it is helpful, it seems, to consider the generally applicable rules regarding the measure of proof of loss in such cases. Such a discussion should place into greater perspective the difficulty of accommodating the rules with respect to recovery under fire insurance policies to those which apply in tort cases in general.

Generally speaking, most jurisdictions have adopted a rule under which the measure of damages for injuries to buildings and improvements upon real estate is not the difference between the market value thereof prior to and subsequent to the injury, but rather the cost of repairing the damage and thus restoring the property to its former condition unless such cost would equal or exceed the actual value of the property, in which case the value of the property immediately before the injury is the measure of damages.²⁰

Two Pennsylvania cases appear to delineate most conveniently the measure of damages referred to above.

²⁰ Showers v. United States, 13 F. Supp. 350 (M.D. Pa. 1953); Dussell v. Kaufman Construction Co., 398 Pa. 369 (1960); Kosco v. Hachmeister, Inc., 396 Pa. 288 (1959). See also Durante v. Alba, 266 Pa. 444 (1920); Jones v. Monroe Electric Co., 350 Pa. 539 (1944).

The case of Durante v. Alba involved the negligent removal of lateral support and consequent injury to plaintiff's building. The Supreme Court of Pennsylvania held that the trial judge erred in applying the measure of damages applicable only to permanently injured real estate, i.e., the difference in value before and after the injury. The Court held that:

“The cost of repair or restoration is obviously the measure of damage.”

The Court continued:

“Hence, if enough (of the building) was left to justify its repair at a cost not exceeding its value immediately prior to the injury, this would be the measure of plaintiff's damage. Otherwise, it would be the actual value of the building itself taking into consideration its age, condition and any other circumstances affecting it and less anything salvaged from it.”²¹

In Jones v. Monroe Electric Company, the plaintiff's barn was totally destroyed by fire and suit was brought alleging that the defendant was negligent in failing to properly ground electric lines and transformers which when struck by lightning transmitted the charge over the wires to plaintiff's barn.

Quoting extensively from the Durante case, supra, the Court held that the cost of restoration or value prior to the injurious event is the proper measure of damages, rather than diminution in the market value of the property. It was further pointed out that in cases such as Jones, whether reconstruction cost or actual value was the measure, damages for detention for the wrongful withholding of the funds by the defendant might be allowed.

There are two problems which immediately come to mind which arise at the time of loss adjustment under the fire insurance policy and carry over into the subrogation action.²²

²¹ 266 Pa. At 488. See also: Leebov v. U.S. Fidelity & Guaranty Co., 401 Pa. 477 (1960).

²² There are actually many more problems than are mentioned in the body of the presentation, but it would be inappropriate to attempt to consider all of them within the context of this paper.

In jurisdictions which apply the replacement cost less depreciation rule as to actual cash value, the question often arises in the subrogation case whether or not it is the burden of the plaintiff to demonstrate, not only the reasonable cost of repairs, but also the actual value of the premises prior to the loss. It has been validly argued that since the measure of damages is the cost to restore or repair or the actual value of the structure, whichever is less, it is only the burden of the plaintiff to demonstrate the repair costs and it is the burden of the defendant to demonstrate that the actual value is less than such repair costs. Some courts have taken the position, however, that the measure of damages is the lesser of restoration costs or value and that the plaintiff must initially come forward with proof as to both subject matters. It makes better sense to conclude that the burden of coming forward with satisfactory evidence of depreciation or value is that of the defendant who is seeking to decrease the recoverable amount.

Additionally, a problem arises where the structure has either not been rebuilt or has been rebuilt in a fashion completely contrary to that in which it was originally built. The best argument seems to be that damage to buildings and structures must be measured as of the date of loss and the fact that the injured party chooses not to rebuild or to rebuild in some other fashion is not probative evidence of the extent of loss suffered. Where, however, an interested party chooses to rebuild identically, then it may be that the best evidence of actual loss is the actual cost of repairs and not estimates prepared by competent contractors.

(b) Witnesses

There appears to be no doubt that an expert witness is competent to testify as to value and loss where his opinion is based upon familiarity with the objects in question, either from firsthand observation or from information supplied to him by others. It is also accepted

doctrine that proof of damages may be based solely upon a reasonable estimate of the loss.²³ It has been widely held that a defendant whose wrongful conduct has rendered difficult the ascertainment of the precise damages suffered by the plaintiff is not entitled to complain that they cannot be measured with the same exactness and precision as would otherwise be possible.

Moreover, an owner of property, though not technically qualified as an expert, may properly testify with regard to his opinion of the value of the property destroyed and the loss sustained. Testimony as to damages from expert witnesses (contractors, builders, real estate appraisers, machinery experts, engineers and architects) is naturally preferable since the weight of their testimony before the jury is a good deal more acceptable than that of the untrained person, even though his relationship be that of owner of the property. It is, of course, not a very wise idea to call upon adjusters for the insurance carriers to testify as to damages. It is almost certain that if such adjusters testify, their relationship to the plaintiff will be demonstrated and the fact of subrogation will be before the jury.

In most jurisdictions, it is cause for a mistrial to introduce evidence of insurance and the fact that the case being heard is a subrogation case. It was for this very reason of potential prejudice that the device of loan receipts came about. While this paper will not consider issues of real party in interest, loan receipts and subrogation receipts, suffice it to say that resort to insurance adjusters, be they adjusters for the insurer or the insured, in a subrogation case for purposes of proof of loss, is the least desirable method of proof. It is again for this reason that it is previously stated that while the cubic footage or square footage unit estimation system may be an easy way of adjusting losses and preparing a statement of loss to be submitted

²³ Commonwealth Trust Company v. Hachmeister Lind Company, 320 Pa. 233 (1935); H.K. Porter Co. v. Halperin, 297 F.2d 442 (3rd Cir. 1961); Western Show Company, Inc. v. Mix, 308 Pa. 215 (1932); Chauvin v. Superior Fire Insurance Co., 283 Pa. 397 (1925); 25 C.J.S. §88, page 973.

to the insurer for approval, such estimates prepared by insurance adjusters are of little or no benefit in the trial of subrogation case.

(c) An Overview

Being knowledgeable concerning the legal principles applicable in the measure of proof of loss in subrogation cases is not nearly as important as being willing to devote the time and effort to the painstaking task of scrutinizing each and every piece of evidence which goes into the presentation of such testimony. While it may certainly be acceptable to produce only a general contractor who has solicited bids on a detailed estimate basis from competent subcontractors and who can verify, not only the necessity for the specific work, but the fairness and reasonableness of the values set forth in such estimates, it is often and probably, more often than not, necessary to present testimony from each of the subcontractors as well. Thus, a working knowledge of engineering, building materials, construction administration and methods of construction are a necessary pre-requisite to the proper preparation for a trial on damages in cases involving damage or destruction to buildings and structures. The matching up of evidence is a time consuming but necessary task. A photograph tells a thousand words, particularly when what is depicted in the photographs is explained by a competent contractor. One must, nevertheless, always keep in mind that in most instances the owner of the building, while he may not be technically qualified, is usually the best person from whom to obtain information concerning the structure itself.

Finally, from a practical point of view, a good and thorough documentation of damages in a subrogation case, particularly in light of the recent trend toward bifurcated trials, has a tendency to lead to stipulations of damage, thus avoiding a trial on damages and permitting the practitioner to, therefore, concentrate all of his efforts on the proof of liability which is by far the more difficult part of the trial lawyer's task.

V. CONCLUSION

A working knowledge of the language of the standard fire insurance policy is an essential pre-requisite to the preparation of advice to insured or insurer regarding the presentation of claim under such policy, regardless of the nature of the loss. Since there are so many variables in terms of the fact situations which might arise with respect to any one particular building or structure in any jurisdiction, it is preferable that the practitioner be knowledgeable concerning the different definitions of actual cash value which are extant throughout the Country. With such knowledge, the practitioner may be in a position to put forth the most cogent and well reasoned argument for a measure of loss which is most beneficial to his client. For those of us who practice within the context of the fire insurance industry, the job of the practitioner neither begins nor ends with an understanding of the rules of law, legal interpretation and legal analysis. While it is not impossible, it is impractical and certainly not in the best interest of one's client to view the measure of proof of loss under fire insurance policies solely from the point of view of a lawyer. One must become cognizant of the various adjustment techniques which are utilized in the field on a day-to-day basis in order to properly advise a client, be it an insured or an insurer, as to the proper method of approach in a particular fact situation. One must also keep in mind that the proof of damages may very well not terminate with the adjustment of the insured loss. The preservation of proper documentation and the preparation of a provable claim to be pursued in a subsequent subrogation action should be in the mind of anyone who wishes to practice within this most challenging and rewarding area of the law.