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# The Rule of Insurable Interest and the Principle of Indemnity: Are They Measures of Damages in Property Insurance?

EMERIC FISCHER\*

An insurance contract has been defined as an agreement between two or more parties in which one party, the insured, pays a specific sum to the other, the insurer, in exchange for the latter's indemnification for losses incurred as a result of certain risks, contingencies or occurrences specified under the contract.<sup>1</sup> For such an agreement to be judicially enforceable, the insured must have an insurable interest<sup>2</sup> in the property insured. The rule of insurable interest<sup>3</sup> has developed to eliminate the

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<sup>1</sup> There are numerous definitions of insurance—judicial, legislative and encyclopedic. One early English court defined insurance as "a contract by which the one party in consideration of a price paid to him adequate to the risk, becomes security to the other that he shall not suffer loss, damage, or prejudice by the perils specified to certain things which may be exposed to them." *Lucena v. Craufurd*, 127 Eng. Rep. 630, 642 (1805) (Lawrence, J.). New York offers this legislative definition of insurance:

The term 'insurance contract' . . . shall . . . be deemed to include any agreement or other transaction whereby one party, herein called the insurer, is obligated to confer benefit of pecuniary value upon another party, herein called the insured or the beneficiary, dependent upon the happening of a fortuitous event in which the insured or beneficiary has, or is expected to have at the time of such happening a material interest which will be adversely affected by the happening of such event. A fortuitous event is any occurrence or failure to occur which is, or is assumed by the parties to be, to a substantial extent beyond the control of either party.

N.Y. INS. LAW § 41 (McKinney 1966). One commentator offers another definition:

In a general sense, "insurance" is a contract to pay a sum of money upon the happening of a particular event or contingency, or indemnity for loss in respect of a specified subject by specified perils; that is, an undertaking by one party to protect the other party from loss arising from named risks, for the consideration and upon the terms and under the conditions recited.

G. COUCH, *CYCLOPEDIA OF INSURANCE LAW* § 1:2 (2d ed. R. Anderson 1959) (footnotes omitted).

<sup>2</sup> This article does not document the lengthy and tortuous development of the concept of insurable interest. For excellent discussions of this topic, see Harnett & Thornton, *Insurable Interest in Property: A Socio-Economic Reevaluation of a Legal Concept*, 48 *COLUM. L. REV.* 1162 (1948); Pinzur, *Insurable Interest: A Search for Consistency*, 46 *INS. COUNSEL J.* 109 (1979); Note, *Insurable Interest in Property: An Expanding Concept*, 44 *IOWA L. REV.* 513 (1958).

<sup>3</sup> One definition of insurable interest, currently recognized and accepted is that:

[A] person has an insurable interest in property whenever he would profit by or gain some advantage by its continued existence and suffer some loss or disadvantage by its destruction. If he would sustain such loss, it is immaterial

element of wagering from insurance contracts. At common law, wagering contracts were enforceable,<sup>4</sup> and wagering contracts on marine cargo<sup>5</sup> and individual lives<sup>6</sup> were not abolished until 1746 and 1774, respectively.<sup>7</sup> As to property insurance, specifically fire insurance, wagering contracts were not legal even before 1746.<sup>8</sup> *Saddler's Co. v. Badcock*<sup>9</sup> offers the explanation. In that case, Lord Hardwicke indicated that fire insurance does not have the history or attributes of marine insurance and that an insurable interest must exist in the insured if he is to recover.<sup>10</sup>

Insurance contracts are aleatory contracts, that is, the insurer need perform only if a condition occurs. To that extent the insurance contract is contingent upon the chance of an event. That is not to say that an insurance contract is a wagering contract. A wagering contract is founded upon chance, not upon the chance of an event; it creates its own risk—win all or lose all. An insurance contract is founded upon dispersion of a risk<sup>11</sup>—the insured transfers a large risk for a small cost. He is not seeking a gain; he wants to avoid a possible future loss. Thus, the requirement of an insurable interest is the distinguishing element between a

whether he has, or has not, any title in, or lien upon, or possession of, the property itself.

G. COUCH, *supra* note 1, § 24:13 (footnotes omitted).

<sup>4</sup> See R. KEETON, BASIC TEXT ON INSURANCE LAW 90 (1971); S. MARSHALL, A TREATISE ON THE LAW OF INSURANCE 96 (American ed. 1805).

<sup>5</sup> See S. MARSHALL, *supra* note 4, at 100.

<sup>6</sup> *Id.* at 672.

<sup>7</sup> Wagering contracts on marine insurance were initially declared illegal by the Act of 1746, 19 Geo. 2, c. 37, and wagering contracts on life insurance were declared illegal by the Act of 1774, 14 Geo. 3, c. 48. The preamble to the Act of 1746, 19 Geo. 2, c. 37, reads:

Whereas, it hath been found by experience, that the making assurances, interest or no interest, . . . hath been productive of many pernicious practices, whereby great numbers of ships . . . have . . . been fraudulently lost . . . and by introducing a mischievous kind of . . . wagering, under the pretence of assuring the risque on shipping, . . . the institution and laudable design of making assurances hath been perverted . . . .

The gist of the operative words of the statute is that "no assurance . . . shall be made by any person . . . on any ship . . . by way of gaming or wagering . . . and . . . every such assurance shall be null and void to all intents and purposes." *Id.* § 1. The Act of 1774, 14 Geo. 3, c. 48, § 1, provides:

Whereas it hath been found by experience, that the making insurances on lives . . . wherein the assured shall have no interest, hath introduced a mischievous kind of gaming . . . after the passing of this act, no insurance shall be made by any person . . . on the life . . . of any person . . . wherein the person . . . for whose . . . benefit . . . such policy . . . shall be made, shall have no interest, or by way of gaming or wagering; and . . . every assurance made, contrary to the true intent and meaning hereof, shall be null and void, to all intents and purposes whatsoever.

<sup>8</sup> See notes 9-10 & accompanying text *infra*.

<sup>9</sup> 26 Eng. Rep. 733 (1743).

<sup>10</sup> "Now these insurances from fire have been introduced in later times, and therefore differ from insurance of ships, because there *interest or no interest* is almost constantly inserted . . ." *Id.* at 734 (emphasis added), quoted in S. MARSHALL, *supra* note 4, at 701.

<sup>11</sup> R. KEETON, *supra* note 4, at 2.

wagering contract and an insurance contract. Although insurance contracts are seemingly wagers, the concept developed that if there is an interest in the subject insured which is independent of the occurrence of the risk, then there is no wager. The authorities, however, are divided on the question of what relationship between the insured and the subject of insurance will produce an insurable interest. One view holds that there must be a legal relationship or property interest which a court of law or equity will recognize and enforce. Another view subscribes to the factual expectations theory under which an insurable interest exists when a person profits by the continued existence of a thing and would suffer some loss by its destruction whether or not he has any legal interest in it.<sup>12</sup> These two views crystallized in the famous cause of *Lucena v. Craufurd*,<sup>13</sup> Lord Eldon arguing for the former view and Judge Lawrence favoring the latter.<sup>14</sup> For a time, all jurisdictions relied upon

<sup>12</sup> This view comports with one well-recognized definition of insurable interest. See note 3 *supra*. The factual expectations and legal relationship theories are discussed at length in Pinzur, *supra* note 2, at 111-16.

<sup>13</sup> 127 Eng. Rep. 630 (1805).

<sup>14</sup> To illustrate his argument, Lord Eldon gave the following example:

Suppose A. to be possessed of a ship limited to B. in case A. dies without issue; that A. has 20 children, the eldest of whom is 20 years of age; and B. 90 years of age; it is a moral certainty that B. will never come into possession, yet this is a clear interest. On the other hand, suppose the case of the heir at law of a man who has an estate worth 20,000 [pounds] a-year, who is 90 years of age; upon his death-bed intestate, and incapable from incurable lunacy of making a will, there is no man who will deny that such an heir at law has a moral certainty of succeeding to the estate, yet the law will not allow that he has any interest, or anything more than a mere expectation.

*Id.* at 652.

Judge Lawrence explained his view this way:

That a man must somehow or other be interested in the preservation of the subject matter exposed to perils, follows from the nature of this contract, when not used as a *mode* of wager, but as applicable to the purposes for which it was originally introduced; *but to confine it to the protection of the interest which arises out of property, is adding a restriction to the contract which does not arise out of its nature.*

*Id.* at 643 (emphasis added).

United States courts have also taken sides in the Eldon-Lawrence argument. In *Farmers Mut. Ins. Co. v. New Holland Turnpike Co.*, 122 Pa. 37, 15 A. 563 (1888), the insured had a policy covering a public bridge. Destruction of the bridge would cause pecuniary loss to the insured since travelers could not use its toll road. The court denied recovery to the insured, saying that "all the definitions of an 'insurable interest' import an interest in the property insured which can be enforced at law or in equity." *Id.* at 46, 15 A. at 565. That definition is consistent with Lord Eldon's legal relationship theory.

On the other hand, in *Liverpool & London & Globe Ins. Co. v. Bolling*, 176 Va. 182, 10 S.E.2d 518 (1940), the court ruled in favor of the insured even though she had no legally enforceable right in the property insured—she was a mere tenant at sufferance. The court said: "To hold that she had no pecuniary interests in continuing this business upon which she depended for support because she had no legal title is to stick in the bark. She was not only interested, she was vitally interested; her living hung upon it . . ." *Id.* at 190, 10 S.E.2d at 521. For an excellent discussion of the contrasting views of Lord Eldon and Judge Lawrence, see Pinzur, *supra* note 2, at 112-15.

judicial determinations of what constituted an insurable interest; during the past century, however, state legislatures have been codifying the meaning of insurable interest.<sup>15</sup> Most of these codifications adopt the factual expectation test.<sup>16</sup>

Regardless of the view subscribed to, all authorities hold that property insurance is a contract of indemnity.<sup>17</sup> Unfortunately, no universal agreement exists as to the meaning of the word indemnity, either conceptually or definitionally.<sup>18</sup> This lack of uniformity encourages the divergence

<sup>15</sup> See, e.g., ARK. STAT. ANN. § 66.3205(2) (1980); MD. ANN. CODE art. 48A, § 367(b) (1979); N.Y. INS. LAW § 148 (McKinney 1966); WASH. REV. CODE ANN. § 48.18.040 (1961).

<sup>16</sup> See, e.g., GA. CODE ANN. § 56-2405(2) (1977); VA. CODE § 38.1-331 (1976). Virginia defines insurable interest as "any lawful and substantial economic interest in the safety or preservation of the subject of insurance free from loss, destruction or pecuniary damage." *Id.*

Although CAL. INS. CODE § 282 (West 1972), would lead one to believe that California is also in the ranks of the followers of Judge Lawrence, the succeeding section, *id.* § 283, is more in accord with Lord Eldon's legal relationship theory. Section 283 provides: "A mere contingent or expectant interest in anything, not founded on an actual right to the thing, nor upon any valid contract for it, is not insurable." For a listing of other states adopting the legal relationship theory, see Pinzur, *supra* note 2, at 125.

<sup>17</sup> R. KEETON, *supra* note 4, at 94; E. PATTERSON, ESSENTIALS OF INSURANCE LAW 137 (2d ed. 1957); G. RICHARDS, A TREATISE ON THE LAW OF INSURANCE § 24, at 29 (3d ed. 1909); W. VANCE, HANDBOOK ON THE LAW OF INSURANCE 160 (3d ed. B. Anderson 1951). One authority has commented on the nature of the property insurance contract: "At the very outset it must be noted that insurance is essentially a contract of indemnity, and that from this cardinal principle arise many of its distinctive characteristics, such as the rule requiring an insurable interest . . ." G. RICHARDS, *supra*, at 27-28 (footnotes omitted). Richards noted further that "[t]he doctrines of indemnity and of the necessity of an insurable interest are correlative and complementary in all branches of the law of insurance," *id.* at 29 (footnotes omitted), and concluded that "[n]o matter how large the amount of insurance, the recovery is restricted to the loss actually sustained," *id.* at 30.

<sup>18</sup> Keeton's version is expressed in the following language: "The principle that insurance contracts shall be interpreted and enforced consistently with this objective of conferring a benefit no greater in value than the loss suffered will be referred to in this book as the principle of indemnity." R. KEETON, *supra* note 4, at 88 (emphasis added). On the other hand, Vance states that "[u]nder the strict principle of indemnity, the actual value of the subject of insurance is always the limit of recovery." W. VANCE, *supra* note 17, at 102 (emphasis added). Patterson seems to question the nature of the indemnity aspect of insurance when he states: "If, and to the extent that, any particular insurance contract is a contract to pay indemnity, the insurable interest of the insured will be the measure of the upper limit of his provable loss under the contract." E. PATTERSON, *supra* note 17, at 109. Apparently, Keeton thinks of indemnity in terms of financial loss because he refers to it as "loss suffered," R. KEETON, *supra* note 4, at 88, whereas Vance, by referring to the "subject of insurance," treats the concept in terms of the physical value of the property. W. VANCE, *supra* note 17, at 102. Patterson takes an intermediate approach, speaking in terms of "provable loss." E. PATTERSON, *supra* note 17, at 109.

*Crisp v. Security Nat'l Ins. Co.*, 369 S.W.2d 326 (Tex. 1963), illustrates another approach. In discussing indemnity where the insured property was household goods, the court stated:

Indemnity is the basis and foundation of insurance coverage not to exceed the amount of the policy, the objective being that the insured should neither reap economic gain nor incur a loss if adequately insured.

. . . The measure of damage that should be applied in case of destruction of this kind of property is the actual worth or value of the articles to the owner for use in the condition in which they were at the time of the fire excluding any fanciful or sentimental considerations.

*Id.* at 328 (emphasis added).

of decisions in determining the quantum of damages when a property loss occurs. Although the definition of an insurable interest and its indemnification are interrelated,<sup>19</sup> the nature of the relationship between the subject insured and the insurable interest<sup>20</sup> does not necessarily affect the limit of recovery for losses incurred.

This article examines the wide variety of decisions involving insurable interests and indemnification and the question of whether the principles of insurable interest and indemnification determine the quantum of damages. To maintain a semblance of organization, the analysis will be compartmentalized according to legal relationships or issues.

## MEASURE OF DAMAGES IN LIMITED INTEREST SITUATIONS

### *Life Tenant and Remainderman*

In the marketplace, the value of a terminable interest is established either by actuarial longevity tables if, for example, a life estate is involved, or by the term of the interest if a lease is involved. Thus, if a life tenant and a remainderman sell a parcel of real estate in fee, the selling price will be apportioned between the sellers according to the actuarial value of the present interest and the future interest. Several courts have held that if property so held is damaged or destroyed, the life tenant, according to strict principles of indemnity, may only recover the value of his interest and not the value of the property, even if the insurance contract covered the fee value and premiums were paid accordingly.<sup>21</sup> However, the Michigan court in *Convis v. Citizens' Mutual Fire Insurance Co.*<sup>22</sup> strongly rejected this conclusion. It pointed out that the present monetary value of the insured's life estate would be insufficient to rebuild the destroyed building and, therefore, an award limited to that amount would "virtually destroy the use of her life-estate."<sup>23</sup> The insurance company had insured the property for its fee value knowing

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<sup>19</sup> See notes 17-18 *supra*. Harnett and Thornton observed:

The general statement that insurance is traditionally a contract of indemnity is significant in determining the measure of an insured's recovery, for the attempt is always to evaluate the insurable interest and the impairment of it through the occurrence of the insured event. Having then ascertained loss in terms of economic impairment, that impairment becomes the measure of recovery.

Harnett & Thornton, *supra* note 2, at 1176.

<sup>20</sup> The insurable interest might, for example, be a fee simple, term of years, equitable lien or legal title for security. For a more extensive list of property relationships which may give rise to an insurable interest, see Pinzur, *supra* note 2, at 119-20.

<sup>21</sup> See, e.g., *Glens Falls Ins. Co. v. Michael*, 167 Ind. 659, 79 N.E. 905 (1907); *Beekman v. Fulton & Montgomery Counties Farmers' Mut. Fire Ins. Ass'n*, 66 A.D. 72, 73 N.Y.S. 110 (1901).

<sup>22</sup> 127 Mich. 616, 86 N.W. 994 (1901).

<sup>23</sup> *Id.* at 623, 86 N.W. at 997.

that it was the insured's homestead for life, that she was entitled to the use of the property and that she would be entitled to the full amount of the insurance proceeds so that she could rebuild her home should it be destroyed. According to the court, the insurer's defense that, because the insured had only an interest in the life estate, she should be unable to recover more than the value of that interest, was "technical and without merit."<sup>24</sup>

*Home Insurance Co. v. Adler*<sup>25</sup> involved an even stronger claim for complete compensation. In *Adler*, the life tenant died in the fire, nineteen minutes after it had begun. The insurer admitted that had the life tenant survived the fire she would have been paid the full damage within the policy since the same premium is paid by an insured with a fee interest as by an insured with a life interest. Nevertheless, the insurer vehemently argued that since she died *during* the fire, she had a *de minimis* loss since she had no insurable interest the moment after death. The court held that since she was alive the moment the fire started, liability attached in her favor at that moment for the full damage caused by the fire.<sup>26</sup>

Where the instrument creating the life tenancy requires the life tenant to keep the property insured, it has been held that the proceeds of insurance must be used either to rebuild the property or to be kept at interest.<sup>27</sup> If the proceeds are used to rebuild the property, the remainderman will ultimately succeed to the property, and, if the proceeds are invested, he will succeed to the fund. Where there is no duty imposed on the life tenant, nor any agreement between the life tenant and remainderman that the life tenant keep the premises insured, the

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<sup>24</sup> *Id.* Similar reasoning was used in *Merrett v. Farmers' Ins. Co.*, 42 Iowa 11 (1875).

In *Houck v. American Eagle Fire Ins. Co.*, 198 N.C. 303, 151 S.E. 628 (1930), and *Welsh v. London Assurance Corp.*, 151 Pa. 607, 25 A. 142 (1892), the courts used estoppel to prevent the insurer from denying liability for the full value of the destroyed property. The life tenant became a trustee for the remainderman as to the excess of the judgment over the value of the life interest. Presumably, rebuilding the property would discharge the entire obligation of the life tenant. More recently, most states have held that a life tenant can recover the full replacement value within policy limits. See E. PATTERSON & W. YOUNG, *CASES AND MATERIALS ON INSURANCE LAW* 191 (4th ed. 1961).

<sup>25</sup> 269 Md. 715, 309 A.2d 751 (1973).

<sup>26</sup> *Id.* at 721, 309 A.2d at 754; cf. *Glens Falls Ins. Co. v. Sterling*, 219 Md. 217, 222, 148 A.2d 453, 456 (1959) (same court stating that "fire insurance . . . is a contract of personal indemnity . . . and the right to recover 'must be commensurate with the loss *actually* sustained' by the insured"); *Pruitt v. Hardware Dealers Mut. Fire Ins. Co.*, 112 F.2d 140, 142 (5th Cir. 1940) (holding that "if the event insured against is in progress when the insurance terminates, the final loss caused thereby is recoverable"); *Pfeiffer v. General Ins. Corp.*, 185 F. Supp. 605, 608-09 (N.D. Cal. 1960) (slow moving landslide affected safety of insured home and insurance company cancelled policy before any actual damage occurred; court declared that "the *contingency* having arisen the liability of the insurer became a contractual obligation and . . . cancellation of the policy could not affect rights which had already accrued").

<sup>27</sup> See *Green v. Green*, 50 S.C. 514, 27 S.E. 952 (1897).

life tenant, who has insured the premises for the whole fee value with his own funds for his sole benefit, is entitled to the entire proceeds.<sup>28</sup> Since the remainderman also has an insurable interest in the property, he too could insure it and keep the proceeds for himself<sup>29</sup> unless a fiduciary relationship or contractual obligation requires him to insure for the benefit of the life tenant.

### *Landlord and Tenant*

Certain lessor-lessee cases are analogous to life tenant situations. In one situation, the lessee improves the demised premises, and the lease provides that in case of damage during the term the lessor or lessee may restore the improvement. In another situation, the lease provides that the improvements shall revert to the lessor at the end of the term.<sup>30</sup> If the lessor and lessee have separately insured the improvements and the insurable event, such as a fire, occurs, what is the measure of recovery of the lessee or lessor against the insurer for damaged property which the *other* has repaired? Two often cited cases<sup>31</sup> reflect the irreconcilable split of authority on this issue. In *Ramsdell v. Insurance Co. of North America*,<sup>32</sup> the lessee remodeled the premises and the lessee and lessor separately insured their interests. After a fire damaged the structure, the lessee restored it, as he had a right to do under the lease, and his insurer reimbursed him. The lessor's insurer resisted the claim, and the court agreed, even though it found that the lessor had an insurable interest and that the damage is determined at the time of the fire rather than in the future when repairs have been made, saying: "The court looks to the substance of the whole transaction rather than to seek a metaphysical hypothesis upon which to justify a loss that is no loss."<sup>33</sup> The court in *Alexandra Restaurant, Inc. v. New Hampshire Insurance Co.*<sup>34</sup> arrives at the opposite result. In *Alexandra*, fire damaged the lessee's improvements and the lessor, in accordance with his obligation under the lease, repaired the damage. The lessee's insurer refused

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<sup>28</sup> See *In re Gorman's Estate*, 321 Pa. 292, 184 A. 86 (1936). For a collection of cases in other states which have confronted this issue, see *id.* at 295-96, 184 A. at 87-88.

<sup>29</sup> See, e.g., *Harrison v. Pepper*, 166 Mass. 288, 44 N.E. 222 (1896); *Farmers' Mut. Fire & Lightning Ins. Co. v. Crowley*, 354 Mo. 649, 190 S.W.2d 250 (1945).

<sup>30</sup> The illustration here does not involve a "straight" lease, such as where the tenant simply rents the lessor's premises and insures his leasehold. In such cases, the tenant recovers only the difference between the market value of his lease and the actual rents he pays. Such recovery fully conforms to the principles of indemnity.

<sup>31</sup> See *Alexandra Restaurant, Inc. v. New Hampshire Ins. Co.*, 272 A.D. 346, 71 N.Y.S.2d 515 (1947); *Ramsdell v. Insurance Co. of N. America*, 197 Wis. 136, 221 N.W. 654 (1928).

<sup>32</sup> 197 Wis. 136, 221 N.W. 654 (1928).

<sup>33</sup> *Id.* at 139, 221 N.W. at 655.

<sup>34</sup> 272 A.D. 346, 71 N.Y.S.2d 515 (1947).



the claim of the lessee,<sup>35</sup> arguing that the lessee had not sustained any loss. The court ruled in favor of the lessee stating:

"The fact that improvements on land may have cost the owner nothing, or that if destroyed by fire he may compel another person to replace them without expense to him, or that he may recoup his loss by resort to a contract liability of a third person, in no way affects the liability of an insurer, in the absence of any exemption in the policy."<sup>36</sup>

The foregoing cases illustrate the landlord-tenant situations where one or the other repairs the damage and the claimant-insured has no actual loss. *Federowicz v. Potomac Insurance Co.*<sup>37</sup> illustrates the other situation, where upon the expiration of the lease the improvements made by the tenant revert to the landlord. The insuring clause at issue in *Federowicz* provided that the insured could recover "to the extent of the actual cash value of the property at the time of loss but not . . . 'in any event for more than the interest of the insured.'"<sup>38</sup> The landlord had the right to terminate the lease on thirty days' notice, in which event

<sup>35</sup> The lessor's insurer paid the lessor on his separate policy. *Id.* at 347-48, 71 N.Y.S.2d at 517.

<sup>36</sup> *Id.* at 349, 71 N.Y.S.2d at 519 (quoting *Foley v. Mfrs.' & Builders' Fire Ins. Co.*, 152 N.Y. 131, 135, 46 N.E. 318, 319 (1897)). It is possible that the court was influenced by one commentator's definition of indemnity which it quoted: "[Indemnity means] that the party insured is entitled to be compensated for such loss as is occasioned by the perils insured against, in precise accordance with the principles and terms of the contract of insurance." 272 A.D. at 351, 71 N.Y.S.2d at 521 (quoting 1 J. JOYCE, A TREATISE ON THE LAW OF INSURANCE § 24, at 123 (2d ed. 1917)). The court quoted Joyce further: "Nor are his damages to be diminished because he has collateral contracts or relations with third persons which relieve him wholly or partly from the loss against which the insurance company agreed to indemnify him." 272 A.D. at 351, 71 N.Y.S.2d at 521 (quoting 1 J. JOYCE, A TREATISE ON THE LAW OF INSURANCE § 24a, at 125 (2d ed. 1917)).

It is interesting to note that the *Alexandra* court came to this conclusion notwithstanding a prior, contrary decision on identical facts. See *Larner v. Commercial Union Assurance Co.*, 127 Misc. 1, 215 N.Y.S. 151 (1926). *Larner* was probably an aberration, since New York had already ruled in *Foley v. Mfrs.' & Builders' Fire Ins. Co.*, 152 N.Y. 31, 46 N.E. 318 (1897), that when a house under construction was damaged and the contractor, under a turn-key contract, repaired the damage at no cost to the owner-insured, the insured could recover the full amount of damage since at the time of loss the building had not been repaired. The subsequent action of the contractor had no bearing on the liability of the insurer under the policy. *Accord*, *American Ins. Co. v. Bateman*, 125 Ga. App. 189, 186 S.E.2d 547 (1971) (vendee's insurer liable even though vendee was not required to pay anything until house was completed).

In *Magulas v. Travelers Ins. Co.*, 114 N.H. 704, 327 A.2d 608 (1974), it was held that since 11/12 of the lease term was unexpired at the time of the loss, the tenant-insured could recovery only 11/12 of the loss to the improvements he made. For a similar result under a different setting, see *City of Carlsbad v. Northwestern Nat'l Ins. Co.*, 81 N.M. 56, 463 P.2d 32 (1970).

<sup>37</sup> 7 A.D.2d 330, 183 N.Y.S.2d 115 (1959).

<sup>38</sup> *Id.* at 331, 183 N.Y.S.2d at 117. This phrase was standard in New York fire policies after 1943. Act of April 20, 1943, ch. 671, § 1(6), 1943 N.Y. Laws 1337 [hereinafter cited as 1943 N.Y. Standard Policy] (current version at N.Y. INS. LAW § 168 (McKinney 1966)).

the insured had five days to remove the buildings he had placed on the land. Failure to do so would vest ownership of the buildings in the landlord. The defendant offered evidence to show that fire destroyed the buildings more than five days after the termination of the lease and that the buildings had not been removed by the insured. The court concluded: "Once it is found that the plaintiff had an insurable interest at the time of the fire he is entitled to recover the value of the building as it stood, without regard to the fact that he might shortly thereafter be required to remove it."<sup>39</sup>

Even though a life tenant or lessee may recover the replacement value of the damaged property, although such value may exceed the property interest held therein, such a rule should not apply to a tenant at sufferance. No unanimity exists on this point, however. In *Liverpool & London & Globe Insurance Co. v. Bolling*,<sup>40</sup> the insured possessed a mercantile store building with the oral permission of her ex-father-in-law that "she could have it as long as she wanted it."<sup>41</sup> While in her possession, the building burned. The court, with two justices dissenting, awarded her a full recovery, finding that she possessed an insurable interest<sup>42</sup> and characterizing her possession as a life tenancy.<sup>43</sup> The Alabama court in *Fidelity Phenix Fire Insurance Co. v. Raper*,<sup>44</sup> however, did not agree with such a view. The court pointed out: "[T]he plaintiff [insured] had no right which he could enforce so far as the building was concerned and could have been ousted at any time. . . . [A] person with no interest in the land other than that of a tenant by sufferance . . . has no insurable interest in the property."<sup>45</sup>

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<sup>39</sup> 7 A.D.2d at 334, 183 N.Y.S.2d at 119. In his concurring opinion, Justice Williams strongly opposes this conclusion and advocates that the insured only recover, if he may recover anything at all, his financial loss resulting from the destruction of the structure. *Id.* at 339, 183 N.Y.S.2d at 124 (Williams, J., concurring). *But cf.* *Girard Ins. Co. v. Taylor*, 6 A.D.2d 359, 177 N.Y.S.2d 42 (1958) (measure of loss was the actual cash value of property).

<sup>40</sup> 176 Va. 182, 10 S.E.2d 518 (1940).

<sup>41</sup> *Id.* at 190, 10 S.E.2d at 521.

<sup>42</sup> "It was her livelihood. . . . [S]he was vitally interested [in the continued existence of the building]; her living hung upon it." *Id.*

<sup>43</sup> "She had what was in substance a life estate . . . . She had no other means of support . . . . Common sense tells us that she will hold on to what she has." *Id.* at 193, 10 S.E.2d at 522-23.

<sup>44</sup> 242 Ala. 440, 6 So. 2d 513 (1941).

<sup>45</sup> *Id.* at 442, 6 So. 2d at 514. The unusual and confusing facts of the case, in simplified form, were that the owner of the land leased it to *B* who, contrary to the terms of the lease, sublet without the owner's permission to *F*, who built a building thereon. The building then became the property of the owner since the lease had no provision for erecting improvements. *F*, in turn, sold the building to the plaintiff-insured and sublet the land, again without permission of the owner, to the plaintiff. The building burned and the insurer refused to pay on the grounds that the insured had no insurable interest in the building. The court agreed with the insurer.

## MEASURE OF DAMAGES IN MISCELLANEOUS RELATIONSHIPS

*Husband and Wife*

An individual purchasing an insurance policy on his residence or farm usually does not seek the advice of an attorney; therefore, it is not unusual for a husband to insure property in his own name even though title is in his wife's.<sup>46</sup> Most of the cases in this area are old and involve the issue of whether the husband has an insurable interest in the wife's property as necessarily precedent to the question of how much he may recover. The jurisdictions are divided on the insurable interest issue with the cases turning mainly on the married women's property statutes. In most cases where an insurable interest is found to exist, recovery is allowed for the full value of the property rather than merely for the husband's limited interest. In *Merrett v. Farmers Insurance Co.*<sup>47</sup> and *Kludt v. German Mutual Fire Insurance Co.*,<sup>48</sup> the courts grounded their decisions on beneficial ownership. Since, in each case, the homestead which was owned by the wife was used for the welfare of the whole family, the husband was held to have had the entire beneficial ownership and was, therefore, able to recover the full value, rather than merely the value of his interest as a tenant by curtesy. In *Trade Insurance Co. v. Barrackliff*,<sup>49</sup> the court found that the husband was an implied agent of the wife who was an implied undisclosed principal and that, as such an agent, he could sue in his own name for the full value. Absent intentional misrepresentation by the spouse in insuring in his own name the property of the other spouse, the courts generally find for the insured on either one of these theories. This is not always the case, however. In *Bassett v. Farmers' & Merchants' Insurance Co.*,<sup>50</sup> the court denied recovery. Relying on the Nebraska rule which allowed a married woman to dispose of her real estate without her husband's assent and by her sole deed to convey clear title, free even of his inchoate rights, the court found that the husband in whose name her property (a farm which was not their homestead) was insured did not have an insurable interest and, therefore, did not allow him to recover at all.<sup>51</sup> *Doyle v.*

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<sup>46</sup> This was the case in earlier days more often than it is now. Today, most dwellings and farms are mortgaged, and the lender ensures that the insurance is issued in the proper name.

<sup>47</sup> 42 Iowa 11 (1875).

<sup>48</sup> 152 Wis. 637, 140 N.W. 321 (1913).

<sup>49</sup> 45 N.J.L. 543 (1883).

<sup>50</sup> 85 Neb. 85, 122 N.W. 703 (1909).

<sup>51</sup> Although the court indicated that if the evidence had shown that there was an agreement between the husband and wife that he could have the use of the land during his lifetime, then an insurable interest could have been found, it stated: "There is not a scintilla of evidence to indicate that the fire was of incendiary origin, and we dislike very much to reverse the judgment before us, but the failure of proof referred to is clear and our duty imperative." *Id.* at 88-89, 122 N.W. at 704.

*American Fire Insurance Co.*<sup>52</sup> merely limited the insured's recovery. The court noted that under Massachusetts law a husband has a tenancy by the curtesy initiate in the property of his wife and cannot be deprived of it without his consent. He has an insurable interest in her property, but the amount he can recover where such property is insured in his sole name is limited to the value of his inchoate right as a tenant by curtesy. The court strictly observed the principles of indemnity.

#### *Bailor and Bailee*

Cases involving insurance policies covering property held by bailees turn on the question of whether the bailee can recover not only the value of his interest but also the interest of the bailor. These issues necessitate an analysis of the specific wording of the coverage clause in the insurance contract.<sup>53</sup> Where the bailee can recover the bailor's interest, he holds such recovery in trust for the bailor. In bailor-bailee cases the principle of indemnity is observed and no extensive discussion of the subject is necessary.

#### *Mortgagor and Mortgagee*

The mortgagor-mortgagee cases similarly adhere to the indemnification principles. Where the mortgagor only insures his own interest, he can recover the full value thereof within the limits of the policy.<sup>54</sup> Since he continues to be liable on the debt, he recovers his net "equity." Where the mortgagor insures for the benefit of the mortgagee and himself,<sup>55</sup> the proceeds of the policy—the lesser of the debt or damage—are paid to the mortgagee.<sup>56</sup> Since the debt is then reduced by such pay-

<sup>52</sup> 181 Mass. 139, 63 N.E. 394 (1902).

<sup>53</sup> Certain phrases in the coverage clauses have been given highly technical interpretations. For examples of such phrases, see *United States v. Globe & Rutgers, Ins. Co.*, 104 F. Supp. 632, 633 (N.D. Tex. 1952), *aff'd*, 202 F.2d 696 (5th Cir. 1953) ("[property], their own, and provided the insured is legally liable therefor, this policy shall also cover [property of others]"); *Pacific Fire Ins. Co. v. Murdoch Cotton Co.*, 193 Ark. 327, 328, 99 S.W.2d 233, 234 (1936) ("[property], their own or held in trust . . . or for which assured may be liable"); *Aaro Packaging Corp. v. Fire Ins. Exch.*, 280 Minn. 159, 160, 158 N.W.2d 586, 587 (1968) ("personal property . . . held in trust"); *B.N. Exton & Co. v. Home Fire & Marine Ins. Co.*, 249 N.Y. 258, 260, 164 N.E. 43, 44 (1928) ("property of the assured held in trust or on commission"); *Brooklyn Clothing Corp. v. Fidelity-Phenix Fire Ins. Co.*, 205 A.D. 743, 747, 200 N.Y.S. 208, 211 (1923) ("legal liability for . . . property held by them . . . in trust"); *McCoy v. Home Ins. Co.*, 170 Pa. Super. Ct. 38, 41, 84 A.2d 249, 251 ("property held by the insured . . . in trust, . . . or otherwise held").

<sup>54</sup> See *Bryan v. Old Colony Ins. Co.*, 213 N.C. 391, 196 S.E. 345 (1938).

<sup>55</sup> This is the usual situation and is most frequently accomplished through the inclusion of a standard mortgagee clause in the policy.

<sup>56</sup> See *Savarese v. Ohio Farmers Ins. Co.*, 260 N.Y. 45, 182 N.E. 665 (1932). This is true even if the property has been repaired and the mortgagee's security has been fully restored. *Id.* at 54, 182 N.E. at 667; cf. *Ben-Morris Co. v. Hanover Ins. Co.*, 3 Mass. App. Ct. 779, 333 N.E.2d 455 (1975) (proceeds of foreclosure were properly applied in reduction of in-

ment,<sup>57</sup> the mortgagee does not receive a double recovery. Where the mortgagee insures for his sole benefit, the proceeds of insurance do not inure to the benefit of the mortgagor,<sup>58</sup> and the debt is not reduced. Through subrogation,<sup>59</sup> the insurer will collect that portion of the debt from the mortgagor and prevent the mortgagee's double recovery.<sup>60</sup>

### *Vendor and Vendee*

Entering into a binding executory contract for a sale of real property does not deprive the seller of his insurable interest, and, conversely, the purchaser acquires an insurable interest in such property.<sup>61</sup> Thus, both vendor and vendee have a concurrent insurable interest in the same subject at the same time. Usually, the seller carries insurance, and the purchaser does not obtain insurance at the time of entering into the executory contract. The executory contract rarely contains an insurance provision, leaving the question of liability and recovery in event of damage for judicial determination.<sup>62</sup> These circumstances produce a unique situation. The vendor, who merely has a naked legal title for security, has insurance on the property to its full value, unless he is underinsured, and he also has the right to specific performance if the property has been destroyed or damaged.<sup>63</sup> On the other hand, the buyer, who has the full equitable title, and who generally does not possess the property during the period prior to conveyance,<sup>64</sup> has no insurance even though he would bear the loss.<sup>65</sup>

The natural question arises as to whether the proceeds of the vendor's insurance are to be credited toward the purchase price, making the uninsured vendee the beneficiary of the vendor's policy, or whether the vendor may retain the money, giving him a windfall.<sup>66</sup> The New

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suror's liability to the mortgagee). See also *Grady v. Utica Mut. Ins. Co.*, 94 Misc. 2d 558, 404 N.Y.S.2d 979 (1978).

<sup>57</sup> See *Walter v. Marine Office of America*, 537 F.2d 89, 99 (5th Cir. 1976) (mortgagee holds excess for mortgagor); *Hartford Fire Ins. Co. v. Bleedorn*, 235 Mo. App. 286, 132 S.W.2d 1066 (1939); *Waring v. Loder*, 53 N.Y. 581 (1873).

<sup>58</sup> See *Le Doux v. Dettmering*, 316 Ill. App. 98, 109, 43 N.E.2d 862, 867 (1942).

<sup>59</sup> For a thorough discussion of the concept of subrogation, see R. KEETON, *supra* note 4, at 147-68.

<sup>60</sup> See *Le Doux v. Dettmering*, 316 Ill. App. 98, 111, 43 N.E.2d 862, 868 (1942).

<sup>61</sup> The purchaser acquires this interest either under the doctrine of equitable conversion or under a broad definition of an insurable interest. For one definition of insurable interest, see note 3 *supra*.

<sup>62</sup> Of course, if there is a stipulation covering such an event in the contract, it will be given effect.

<sup>63</sup> This is only true absent contractual or statutory modification of such a right.

<sup>64</sup> Because the buyer does not possess the property during this time, he is generally unable to protect it.

<sup>65</sup> This liability may, of course, be modified by contract or statute.

<sup>66</sup> Although insurers have attempted to resist any payment on the ground that the insurable interest of the vendor has terminated or that the policy terms require an endorse-

York court in *Brownell v. Board of Education*,<sup>67</sup> relying on the old English rule of *Rayner v. Preston*,<sup>68</sup> answered the question in favor of the vendor. *Brownell* stated: "Insurance is a mere personal contract . . . to protect the interest of the insured."<sup>69</sup> Responding to the argument that the money should be credited toward the purchase price since in equity the vendee is the beneficial owner of the land, the court replied: "These reasons may savor of layman's ideas of equity, but they are not law."<sup>70</sup> Most states, however, hold that the insurance proceeds are to be credited toward the purchase price. Although there are earlier cases, *Dubin Paper Co. v. Insurance Co. of North America*<sup>71</sup> is a frequently cited case supporting this view. The court in *Dubin* stated:

The problem before us is clarified if the fact is noted that as between the insured and the insurance companies the insured remains the owner of the property until the sale is completed, but as between the vendor and vendee the vendor holds only the legal title and if he receives the proceeds of the insurance policy on his property *he holds these as trustee for the buyer*. The vendee's interest was not insured by the defendants; the vendor's was. The vendee's right to a part of the policy's proceeds in the vendee's [*sic*] hands is derived from the agreement of sale when that is given the meaning which under the circumstances of this case the "conscience of equity" says it must be given.<sup>72</sup>

It is possible to argue that *Brownell* can be reconciled with the majority view. According to the terms of the contract in *Brownell*, the vendor was to bear the loss in the event of a casualty to the structure and the vendee was limited to recovery of a sum equal to the amount of his downpayment.<sup>73</sup> This argument is inconsistent with the statement in the

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ment any time a change in the interest of the insured occurs, it has been consistently held that the insurer is liable to the vendor, except where a forfeiture provision of the policy has been found effective. For an informative discussion of cases construing these provisions, see Goble, *The Moral Hazard Clauses of the Standard Fire Insurance Policy*, 37 COLUM. L. REV. 410 (1937). Such provisions no longer exist since the wording of the standard New York fire policy was introduced in 1943. See 1943 N.Y. Standard Policy, *supra* note 38, § 1, pt. 6. For a review of the history and effect of the pertinent forfeiture phrases and their elimination from the 1943 Standard New York Fire Policy, see *Federowicz v. Potomac Ins. Co.*, 7 A.D.2d 330, 183 N.Y.S.2d 115 (1959); 42 COLUM. L. REV. 1227 (1942).

<sup>67</sup> 239 N.Y. 369, 146 N.E. 630 (1925).

<sup>68</sup> 18 Ch. Div. 1 (1881). Dissatisfaction with this rule brought about the enactment of the Law of Property Act, 1922, 12 & 13 Geo. 5, c. 16, § 105, which applies the vendor's insurance proceeds toward the purchase price.

<sup>69</sup> 239 N.Y. at 374, 146 N.E. at 632 (citing *Rayner v. Preston*, 18 Ch. Div. 1 (1881)).

<sup>70</sup> 239 N.Y. at 374, 146 N.E. at 632.

<sup>71</sup> 361 Pa. 68, 63 A.2d 85 (1949).

<sup>72</sup> *Id.* at 85-86, 63 A.2d at 94 (emphasis added). The *Dubin* case relied on the constructive trust doctrine to support the duty of the vendor to hold the insurance proceeds for the vendee. *Id.* at 87-92, 63 A.2d at 95-97. One court noted a commentator's suggestion "that in the business world insurance runs with the land, and that the courts should give effect to that understanding." *Brownell v. Board of Educ.*, 235 N.Y. 369, 373, 146 N.E. 630, 632 (1925) (citing Vance, *Vendee's Claim to Insurance Money Received By Vendor*, 34 YALE L.J. 87 (1924)). The *Brownell* court did not follow that suggestion.

<sup>73</sup> 235 N.Y. at 374-75, 146 N.E. at 632. See also R. KEETON, *supra* note 4, at 202-05.

later New York case of *Raplee v. Piper*.<sup>74</sup> In *Raplee*, the court cited *Brownell* and said: "If . . . the vendor at his own cost, for his own protection and not because of any agreement, has taken out fire insurance, then such contract is personal to him and he need not credit the proceeds against the price."<sup>75</sup> As indicated above, nearly all other jurisdictions, with the possible exception of Louisiana<sup>76</sup> and Wisconsin,<sup>77</sup> follow the equitable rule that insurance proceeds are to be applied toward the purchase price.<sup>78</sup>

Although the principle of indemnity is generally observed in vendor insured cases, when the vendee is insured, courts deviate from that principle.<sup>79</sup> For example, in *Cooke v. Fireman's Insurance Co.*,<sup>80</sup> the vendee, who had insured for his exclusive benefit, was not limited to the value of his actual investment at the time of the fire but recovered the full amount of the loss within the policy limits. The vendee-insured had expended \$1,750 toward the purchase and repair of the premises. The loss due to the fire was \$7,938. Although title impediments existed at the time of the fire, their presence did not preclude the insured from acquiring title. The court permitted the insured to recover the full \$7,938, plus interest, citing, *inter alia*, *Federowicz v. Potomac Insurance Co.*<sup>81</sup>

There has been a divergence of decisions involving damage to or destruction of personal property subject to a contract of sale or held as security interests.<sup>82</sup> Some have followed the equitable rule,<sup>83</sup> while

<sup>74</sup> 3 N.Y.2d 179, 143 N.E.2d 919 (1957).

<sup>75</sup> *Id.* at 181, 143 N.E.2d at 920.

<sup>76</sup> See *King v. Preston*, 11 La. Ann. 95 (1856).

<sup>77</sup> See *Smith v. Hardware Dealers Mut. Fire Ins. Co.*, 253 Wis. 129, 33 N.W.2d 206 (1948).

<sup>78</sup> A federal court interpreting Pennsylvania law reached a decision which could be described as an "overkill." In *Vogel v. Northern Assurance Co.*, 219 F.2d 409 (3d Cir. 1955), the vendor and vendee agreed on a \$15,000 price. The vendor obtained insurance in the amount of \$6,000 and the vendee obtained insurance in the amount of \$9,000. Before conveyance, the house sustained damage amounting to \$12,000. The vendee, having thereafter paid the purchase price, received an assignment from the vendor of the vendor's rights in his fire policy. The court, finding an insurable interest in both the vendor and vendee, held that the vendee could collect from the two insurers the full \$15,000 since the vendee bore the risk of loss at the time of the fire and the seller held his interest in trust for the purchaser. One year later, however, the Pennsylvania Supreme Court in *Insurance Co. of N. America v. Alberstadt*, 383 Pa. 556, 119 A.2d 83 (1956), apportioned the amount of the loss between the insurance companies, where the vendor and vendee had separate policies, the sum of which, as in *Vogel*, exceeded the loss, and by such apportionment avoided the result in *Vogel*.

<sup>79</sup> See, e.g., *Hartford Fire Ins. Co. v. Cagle*, 249 F.2d 241 (10th Cir. 1957); *Martinson v. Morton Farmers Mut. Ins. Ass'n*, 217 Iowa 335, 251 N.W. 503 (1933); *Deming Inv. Co. v. Dickerman*, 63 Kan. 728, 66 P. 1029 (1901); *Milhouz v. Globe & Rutgers Fire Ins. Co.*, 161 S.C. 96, 159 S.E. 506 (1931).

<sup>80</sup> 119 N.J. Super. 248, 291 A.2d 24 (1972).

<sup>81</sup> 7 A.D.2d 330, 183 N.Y.S.2d 115 (1959); see text accompanying notes 37-39 *supra*.

<sup>82</sup> See *In re Future Mfg. Coop., Inc.*, 165 F. Supp. 111, 115-16 (N.D. Cal. 1958) (court noted that jurisdictions were split on this issue).

<sup>83</sup> See, e.g., *Automatic Sprinkler Corp. of America v. Robinson-Slagle Lumber Co.*, 147 So. 542 (La. App. 1933).

others have followed the personal contract theory.<sup>84</sup>

## MEASURE OF DAMAGES IN PARTICULAR SITUATIONS

### *Demolition and Condemnation Cases*

In demolition cases, the scenario is usually as follows: the owner of an insured building enters into a contract to have the structure demolished, and, *mirabile dictu*, the premises burn before demolition begins. In condemnation cases, a fire destroys the insured property after condemnation proceedings have begun, but before the condemnor accepts title or a condemnation award. In these situations, the insurer usually raises as a defense the lack of an insurable interest and the complementary argument of *de minimis* value.<sup>85</sup> A mere executory contract to demolish, without any additional legally binding agreement enforceable by specific performance does not deprive the owner of his insurable interest in the property.<sup>86</sup> Similarly, the owner of property which is the subject of condemnation proceedings retains his insurable interest until condemnation has been completed.<sup>87</sup> Thus, the issue of whether an insurable interest exists requires no further discussion. The defense of *de minimis* value is merely a portion of the larger issue of the meaning of the term "actual cash value"—a standard limitation of the insurer's liability contained in fire insurance policies.<sup>88</sup>

<sup>84</sup> See, e.g., *Interstate Ice & Power Corp. v. United States Fire Ins. Co.*, 243 N.Y. 95, 152 N.E. 476 (1926) (vendee defaulted on purchase agreement; vendor awarded insurance proceeds when machinery was damaged by fire).

<sup>85</sup> There may be other specific defenses, such as violations of the policy provision against an increase in the hazard. A discussion of these defenses, however, is beyond the scope of this article.

<sup>86</sup> See, e.g., *American Ins. Co. v. Treasurer, School Dist. No. 37*, 273 F.2d 757 (10th Cir. 1959); *Paterson-Leitch Co. v. Insurance Co. of N. America*, 366 F. Supp. 749 (N.D. Ohio 1973); *St. Paul's Roman Catholic Church v. Westchester Fire Ins. Co.*, 65 Misc. 2d 975, 319 N.Y.S.2d 239 (1971); *Leggio v. Millers Nat'l Ins. Co.*, 398 S.W.2d 607 (Tex. Civ. App. 1965); *Eagle Square Mfg. Co. v. Vermont Mut. Fire Ins. Co.*, 125 Vt. 221, 212 A.2d 636 (1965); cf. *Royal Ins. Co. v. Sisters of the Presentation*, 430 F.2d 759 (9th Cir. 1970) (insurable interest terminated even though the demolition contract was not specifically enforceable).

<sup>87</sup> See, e.g., *American Nat'l Bank & Trust Co. v. Reserve Ins. Co.*, 38 Ill. App. 2d 315, 187 N.E.2d 343 (1962); *Patrick v. Kentucky Farm Bureau Mut. Ins. Co.*, 413 S.W.2d 340 (Ky. 1967); *Rosenbloom v. Maryland Ins. Co.*, 258 A.D. 14, 15 N.Y.S.2d 304 (1939); *Heidisch v. Globe & Republic Ins. Co.*, 368 Pa. 602, 84 A.2d 566 (1951); *Home Ins. Co. v. Dalis*, 206 Va. 71, 141 S.E.2d 721 (1965); cf. *Van Cure v. Hartford Fire Ins. Co.*, 435 Pa. 163, 253 A.2d 663 (1969) (condemnee, after bond has been filed, has no insurable interest when he remains on condemned property with consent of condemnor for purpose of reducing damages).

<sup>88</sup> The language of limitation in the New York Standard Fire Policy reads as follows: "[T]his 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 cost to repair or replace the property . . . , nor in any event for more than the interest of the insured . . ." 1943 N.Y. Standard Policy, *supra* note 38, § 1, pt. 6. For a discussion of problems involving valuation, see text accompanying notes 97-133 *infra*.



Whether, under principles of indemnity, an owner who has committed his structure to demolition should recover any amount when the structure burns prior to demolition, and whether an owner whose structure has been condemned should recover when the structure burns before the completion of the statutory condemnation proceedings and the condemnor pays the condemnee in any event, are issues which bear discussion. In *Garcy Corp. v. Home Insurance Co.*,<sup>89</sup> the owner of five buildings contracted to have them demolished. Demolition was in progress on several buildings, but not on a seven story one; it was still used as a warehouse and had not been stripped of salvageable materials. The court permitted recovery when the building burned before demolition. Even though it might have subjected him to liability for breach of the demolition contract, the owner could have halted the demolition before the wrecking crew reached it. Therefore, the building was not actually in the process of demolition when fire destroyed it and the insurer was liable for the actual cash value of the building to the insured owner. The court reasoned that until the building is abandoned to an irrevocable commitment to demolish it, the owner is entitled to recover the actual cash value in case of damage or destruction by a casualty covered by the policy. This is the prevailing view.<sup>90</sup> Where, however, the commitment to demolish is irrevocable, the insured loses his insurable interest and cannot recover.<sup>91</sup>

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<sup>89</sup> 496 F.2d 479 (7th Cir. 1974).

<sup>90</sup> See, e.g., *Bailey v. Gulf Ins. Co.*, 406 F.2d 47 (10th Cir. 1969); *American Ins. Co. v. Treasurer, School Dist. No. 37*, 273 F.2d 757 (10th Cir. 1959); *Knuppel v. American Ins. Co.*, 269 F.2d 163 (7th Cir. 1959); *Paterson-Leitch Co. v. Insurance Co. of N. America*, 366 F. Supp. 749 (N.D. Ohio 1973); *St. Paul's Roman Catholic Church v. Westchester Fire Ins. Co.*, 65 Misc. 2d 975, 319 N.Y.S.2d 239 (1971); *Leggio v. Millers Nat'l Ins. Co.*, 398 S.W.2d 607 (Tex. Civ. App. 1965); *Eagle Square Mfg. Co. v. Vermont Mut. Fire Ins. Co.*, 125 Vt. 221, 212 A.2d 636 (1965); cf. *Royal Ins. Co. v. Sisters of the Presentation*, 430 F.2d 759 (9th Cir. 1970) (insurable interest terminated even though the demolition contract was not specifically enforceable).

In *Leggio v. Millers Nat'l Ins. Co.*, 398 S.W.2d 607 (Tex. Civ. App. 1965), and *Eagle Square Mfg. Co. v. Vermont Mut. Fire Ins. Co.*, 125 Vt. 221, 212 A.2d 636 (1965), it was held that the process of demolition had not begun despite the removal of flooring, plumbing, light fixtures, windows, wood paneling and doors from the buildings.

<sup>91</sup> *Royal Ins. Co. v. Sisters of the Presentation*, 430 F.2d 759 (9th Cir. 1970); *Lieberman v. Hartford Ins. Co.*, 6 Ill. App. 3d 948, 287 N.E.2d 38 (1972); *Board of Educ. v. Hartford Ins. Co.*, 124 W. Va. 163, 19 S.E.2d 448 (1942).

In *Lieberman v. Hartford Ins. Co.*, 6 Ill. App. 3d 948, 287 N.E.2d 38 (1972), the demolition was in its early stages when fire destroyed the building. The court emphasized the binding nature of the demolition contract without explaining how it was binding and stated that "[t]he destruction of the building was not 'economically disadvantageous' to plaintiff." 6 Ill. App. 3d at 950, 287 N.E.2d at 40. The plaintiff consequently had no insurable interest at the time of the fire.

*Royal Ins. Co. v. Sisters of the Presentation*, 430 F.2d 759 (9th Cir. 1970), involved a convent. The Sisters had already moved to a new convent and abandoned the old one, under a binding agreement with the bishop to surrender the old building for demolition in exchange for the new convent built on land deeded to them by the bishop. Since all the bishop's con-

Whether an insured can recover for loss to property which has been condemned turns on the question whether the condemnation proceedings have been completed. The statutory scheme regulating condemnations is determinative. In *Patrick v. Kentucky Farm Bureau Mutual Insurance Co.*,<sup>92</sup> the condemnor paid the condemnee and, under the statute, could have evicted him at the time of payment. However, the condemnor permitted the condemnee to remain. Fifteen days after the payment, fire destroyed the insured property. In her suit against the insurer, the condemnee argued that she had an insurable interest in the property at the time of loss since the condemnor had the right to wholly abandon the condemnation proceedings after the fire. The court, in analyzing the pertinent Kentucky statutes, determined that the condemnor could not abandon the proceedings after it paid the award. Although the condemnee could appeal the amount awarded, the insured had no insurable interest at the time of loss. Under the statute the condemnation proceedings terminated at the time of payment of the award. In *Home Insurance Co. v. Dalis*,<sup>93</sup> the Virginia court interpreted the per-

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tractual obligations had been performed, the Sisters were legally bound to permit the razing of the old building and, therefore, had no insurable interest therein at the time of the fire.

*Board of Educ. v. Hartford Ins. Co.*, 124 W. Va. 163, 19 S.E.2d 448 (1942) presented an interesting "twist." A new school building was needed because the old one had become uninsurable. Financial assistance was granted by the Public Works Administration (PWA). One requirement for such advances was that the contractor must be in the process of work. To obtain the first advance, the Board, on December 29, ordered the contractor to proceed, and notified the PWA that demolition of the old school building had begun. The contractor merely staked out the location of the new school, embracing that of the old. On January 16, the contractor was notified that the old building would be vacated on January 23. On January 20, fire completely destroyed the building. At the time of fire no acts of demolition had begun. The court found that since the PWA had been notified that demolition had started on January 1, the Board was bound by that conduct and that abandonment of the building had taken place before the fire. The court concluded: "[T]here is sufficient proof, together with the reasonable inference to be drawn therefrom, to sustain the finding that the board of education prior to January 20, 1938 had permanently stopped using the New Cumberland School building for its intended purpose, and had begun the physical work of its removal." 124 W. Va. at 169, 19 S.E.2d at 451 (emphasis added).

The prevailing view that, once demolition has begun, the insured may not recover where the structure is destroyed by fire or other insured casualty prior to completion of the demolition, is well expressed by *Aetna State Bank v. Maryland Cas. Co.*, 345 F. Supp. 903, 909 (N.D. Ill. 1972):

We therefore find that actual cash value is not the proper criteria [*sic*] for determining the amount of loss for property which is *in the process* of being demolished and whose demolition at the time of loss is no longer a matter of conjecture or speculation and we hold that . . . there is nevertheless no . . . compensable loss in view of the fact that there is no value to buildings *in the process* of demolition.

<sup>92</sup> 413 S.W.2d 340 (Ky. 1967) (construing S.B. 138, ch. 49, §§ 6(2)(C), 7(6); 1952 Ky. Acts 86; S.B. 299, ch. 219, § 1, 1962 Ky. Acts 762 (repealed 1976)).

<sup>93</sup> 206 Va. 71, 141 S.E.2d 721 (1965) (Act of March 29, 1958, ch. 581, § 1, 1958 Va. Acts 875 (repealed 1970)).

minent Virginia statute to reach a different outcome. The State Highway Department condemned the property of the insured and filed a certificate of recordation which, under the Virginia statute, vested title in the condemnor, even though no agreement had been reached as to compensation and there had not been condemnation proceedings instituted. Fire destroyed the two structures, but the insurance company, relying on the statute, denied liability. The court noted that the statute provided for defeasible title until the Commissioner of the highway department and condemnee could agree on a price or until such price was determined by condemnation proceedings. Since such agreement was not reached prior to the fire, the insured recovered his loss. In *American National Bank & Trust Co. v. Reserve Insurance Co.*,<sup>94</sup> an Illinois court reached a similar result. Although condemnation proceedings were pending, the condemnor could, under the statute, abandon its petition altogether. Thus the insured owner whose property had been condemned had an insurable interest at the time of the fire and recovered his loss.

A most benevolent decision was rendered in *Wolf v. Home Insurance Co.*<sup>95</sup> Before a fire, the insured owner agreed, in lieu of condemnation proceedings, to sell the property to the potential condemnor who then took possession. The sale was not finalized until five months after the fire, the insured receiving the full original price agreed upon. The court, however, rejected the insurer's defense of equitable ownership in another.<sup>96</sup> The court agreed with the prevailing view: until the condemnation is completed, the owner may recover for the physical loss to the property, regardless of the absence of financial loss.

### PROBLEMS IN VALUATION

Three methods for the valuation of real property<sup>97</sup> have evolved under judicial interpretation of the phrase "actual cash value," a limiting phrase which was included in the insuring clause of the 1943 statutorily formulated New York Standard Fire Insurance Policy<sup>98</sup> which has been adopted by a vast majority of state legislatures or administrative regulators.<sup>99</sup> The three approaches are: first, market value

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<sup>94</sup> 38 Ill. App. 2d 315, 187 N.E.2d 343 (1962). See also ILL. ANN. STAT. ch. 47, § 10(a) (Smith-Hurd Supp. 1980).

<sup>95</sup> 100 N.J. Super. 27, 241 A.2d 28 (1968).

<sup>96</sup> *Id.* at 50, 241 A.2d at 41 (citing *Heidisch v. Globe & Republic Ins. Co.*, 368 Pa. 602, 84 A.2d 566 (1951)).

<sup>97</sup> Attention here is focused on real property only. For an extensive discussion on valuation of personal property, see Annot., 61 A.L.R.2d 711 (1958).

<sup>98</sup> 1943 N.Y. Standard Policy, *supra* note 38, § 1, pt. 6. For a fuller quotation of the limiting language in the New York Standard Policy, see note 88 *supra*.

<sup>99</sup> See R. KEETON, *supra* note 4, at 70. Some statutes use the synonymous phrase "actual value." See *id.* at 143.

or fair market value; second, replacement cost less depreciation; and third, the broad evidence rule.

To establish a market value, there must be a means to arrive at an objective appraisal of the object sought to be valued. "It has been said that value does not inhere in the thing to be valued; that it is a subjective conception; that identity of belief, on the part of many traders, as indicated in a market, causes the conception to assume the objective quality of an established fact."<sup>100</sup> To establish a market price, many traders and many transactions are required. A single sale does not establish a market value. Land and the improvements thereon are considered unique; therefore, a "market" for a particular building cannot be established.<sup>101</sup> Nevertheless, some courts have adopted the market value criterion for both real and personal property.<sup>102</sup> The California court in *Jefferson Insurance Co. v. Superior Court*<sup>103</sup> may have given this valuation concept a boost when it interpreted a California statute<sup>104</sup> equating actual cash value and market value.<sup>105</sup> *Aetna State Bank v. Maryland Casualty Co.*<sup>106</sup> illustrates the pragmatic difference between the choice of "market value" or "replacement cost less depreciation" as a method for valuation. The replacement less depreciation value of the structure was \$300,000; its market value was zero. Although Illinois had con-

<sup>100</sup> *McAnarney v. Newark Fire Ins. Co.*, 247 N.Y. 176, 182, 159 N.E. 902, 904 (1928).

<sup>101</sup>

Clearly, where no sales have been made, the opinion of an expert that the property in question "will sell" for a given sum does not establish "market value," in the sense of an exclusive criterion of value. "There cannot be an established market value for barges, boats, and other articles of that description, as in cases of grain, cotton, or stock."

*Id.* at 182-83, 159 N.E. at 904 (quoting *The Granite State*, 70 U.S. (3 Wall.) 310, 314 (1865)).

<sup>102</sup> See, e.g., *Forer v. Quincy Mut. Fire Ins. Co.*, 295 A.2d 247 (Me. 1972); *Grantham v. Farmers Mut. Ins. Co.*, 174 Neb. 790, 119 N.W.2d 519 (1963); *Bartindale v. Aetna Ins. Co.*, 7 N.J. Misc. 399, 145 A. 633 (1929); *McAnarney v. Newark Fire Ins. Co.*, 247 N.Y. 176, 159 N.E. 902 (1928); *Butler v. Aetna Ins. Co.*, 64 N.D. 764, 256 N.W. 214 (1934); cf. *Agoos Leather Cos. v. American & Foreign Ins. Co.*, 342 Mass. 603, 174 N.E.2d 652 (1961) (market value of real property in itself not an accurate measure of indemnity for loss by fire).

<sup>103</sup> 3 Cal. 3d 398, 475 P.2d 880, 90 Cal. Rptr. 608 (1970).

<sup>104</sup> Act of April 14, 1950, ch. 5, § 1, 1950 Cal. Stats. 1st Extr. Sess. 432 (current version at CAL. INS. CODE § 2071 (West 1972)).

<sup>105</sup> The court did not consider the broad evidence rule, and rejected the replacement cost less depreciation method outright:

The latter clause insures "to the extent of the actual cash value of the property at the time of loss, but not exceeding the . . . 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.

3 Cal. 3d at 402, 475 P.2d at 882-83, 90 Cal. Rptr. at 610-11.

<sup>106</sup> 345 F. Supp. 903 (N.D. Ill. 1972).

sistently followed the replacement cost rule since 1920,<sup>107</sup> the courts in *Aetna*, as well as in *Lieberman v. Hartford Insurance Co.*,<sup>108</sup> would not permit a windfall to the insured. The courts carved out an exception to the rule and, in effect, applied the market value method. As was stated in *Chicago Title & Trust Co. v. United States Fidelity & Guarantee Co.*:<sup>109</sup>

It appears from the *Lieberman* case that the *Smith* rule is limited by the policy of the law that requires an insurable interest as a condition to recovery on a contract of insurance. If, at the time of the fire, the building no longer has any economic value, there can be no insurable interest and therefore no recovery of damages.<sup>110</sup>

One restrictive phrase in the standard fire policy limits the insurer's liability for loss to actual cash value "not exceeding the amount which it would cost to repair or *replace* the property."<sup>111</sup> A majority of the courts, relying on the word "replace," concluded that actual cash value should be determined by replacement cost less depreciation.<sup>112</sup> One court expressed this view:

While some of these authorities do say that the cost of replacement is not the measure of the loss but a limitation upon the recovery, all of them recognize that replacement cost, with physical depreciation for age, wear, and tear, is not only evidence of the amount of the loss, but is perhaps the most potent factor, among all the others in ascertaining the amount.<sup>113</sup>

An advantage of the replacement rule is the certainty of measurement.<sup>114</sup> Dissatisfaction with the replacement method's inflexibility,<sup>115</sup>

<sup>107</sup> See *Chicago Title & Trust Co. v. United States Fidelity & Guar. Co.*, 511 F.2d 241, 244-45 (7th Cir. 1975). The source of the rule was *Smith v. Allemannia Fire Ins. Co.*, 219 Ill. App. 506 (1920).

<sup>108</sup> 6 Ill. App. 3d 948, 287 N.E.2d 38 (1972).

<sup>109</sup> 511 F.2d 241 (7th Cir. 1975).

<sup>110</sup> *Id.* at 246. In *Jefferson Ins. Co. v. Superior Court*, 3 Cal. 3d 398, 475 P.2d 880, 90 Cal. Rptr. 608 (1970), the difference between the values determined under the two methods was not quite as large as in *Aetna*, yet it was very substantial—\$170,000 for replacement cost less depreciation and \$65,000 for market value. Such large differences are not unusual under the two methods.

<sup>111</sup> 1943 N.Y. Standard Policy, *supra* note 38, § 1, pt. 6 (emphasis added). For other restrictive phrases in the standard policy, see note 88 *supra*.

<sup>112</sup> See, e.g., *Knuppel v. American Ins. Co.*, 269 F.2d 163 (7th Cir. 1959) (applying Illinois law); *Paterson-Leitch Co. v. Insurance Co. of N. America*, 366 F. Supp. 749 (N.D. Ohio 1973); *Wisconsin Screw Co. v. Fireman's Fund Ins. Co.*, 193 F. Supp. 96 (E.D. Wis. 1961); *Sperling v. Liberty Mut. Ins. Co.*, 258 So. 2d 475 (Fla. App. 1972); *Boise Ass'n of Credit Men v. United States Fire Ins. Co.*, 44 Idaho 249, 256 P. 523 (1927). *But see* *Farber v. Perkiomen Mut. Ins. Co.*, 370 Pa. 480, 88 A.2d 776 (1952).

<sup>113</sup> *Braddock v. Memphis Fire Ins. Co.*, 493 S.W.2d 453, 459 (Tenn. 1973) (quoting *Third Nat'l Bank v. American Equitable Ins. Co.*, 27 Tenn. App. 249, 272, 178 S.W.2d 915, 924-25 (1943)).

<sup>114</sup> Note, *Valuation and Measure of Recovery Under Insurance Policies*, 49 COLUM. L. REV. 818, 821 (1949).

<sup>115</sup> *Id.*

however, encouraged a trend toward use of the broad evidence rule instead.<sup>116</sup>

*McAnarney v. Newark Fire Insurance Co.*<sup>117</sup> is the leading case favoring the use of the broad evidence rule. It does not reject the replacement rule or the market rule, but includes them in a very broad panoply of factors to be considered in arriving at a determination of the actual cash value of the loss.

[The trier of fact] may consider original cost and cost of reproduction; the opinions upon value given by qualified witnesses; the declarations against interest which may have been made by the assured; the gainful uses to which the buildings might have been put; as well as any other fact reasonably tending to throw light upon the subject.<sup>118</sup>

From the standpoint of the principle of indemnity, the broad evidence rule measures the loss better than the replacement rule, but it introduces an element of uncertainty for the insured and the insurer. The trend to adopt this method of valuation has long been looked on in a favorable light.<sup>119</sup>

[T]he courts, when faced with a choice between applying some standardized rigid rule such as replacement cost minus physical depreciation or of adopting some more flexible test which can be modified in such a way as to accord more nearly with the principle of indemnity, have generally preferred the latter alternative even though it has involved the sacrifice of administrative convenience and of simplicity.<sup>120</sup>

The element of depreciation is a factor under both the replacement rule and the broad evidence rule. A strong minority view holds that in case of partial losses where only repairs and not total replacement is required, depreciation should not be considered.<sup>121</sup> "If depreciation were

<sup>116</sup> See note 118 *infra*; cf. *Jefferson Ins. Co. v. Superior Court*, 3 Cal. 3d 398, 475 P.2d 880, 90 Cal. Rptr. 608 (1970) (in discarding the replacement rule the court could have adopted the broad evidence rule but instead opted for the fading market value criterion).

<sup>117</sup> 247 N.Y. 176, 159 N.E. 902 (1928).

<sup>118</sup> *Id.* at 184, 159 N.E. at 905. As of 1971, 23 states had adopted some form of the broad evidence rule. Schalliol, *The Broad Evidence Rule and Fire Insurance and Tort Recoveries for Household Goods*, 1973 Ins. L.J. 365, 369. Cases which specifically express the consideration of the market value factor and replacement cost less depreciation factor within the broad evidence rule include *Eagle Square Mfg. Co. v. Vermont Mut. Fire Ins. Co.*, 125 Vt. 221, 223, 212 A.2d 636, 638 (1965) ("Both market value and replacement cost are permissible standards for determining loss by fire—'but they are standards, not shackles.'"), and *Messing v. Reliance Ins. Co.*, 77 N.J. Super. 531, 534, 187 A.2d 49, 51 (1962) ("In applying this rule it is not necessary to abandon consideration of either market or reproduction values, but they must be viewed merely as guides and not the sole determinative in arriving at 'actual cash value.'").

<sup>119</sup> See note 118 *supra*.

<sup>120</sup> *Bonbright & Katz, Valuation of Property to Measure Fire Insurance Losses*, 29 COLUM. L. REV. 857, 899 (1929).

<sup>121</sup> See, e.g., *Commercial Union Ins. Co. v. Ryals*, 355 So. 2d 684 (Ala. 1978); *Glens Falls Ins. Co. v. Gulf Breeze Cottages, Inc.*, 38 So. 2d 828 (Fla. 1949); *Travelers Indem. Co. v. Armstrong*, \_\_\_ Ind. App. \_\_\_, 384 N.E.2d 607 (1979). Cases discussing this issue deal

allowed, it would cast upon the owner an added expense which we do not believe was contemplated by the parties when they entered into the insurance contract."<sup>122</sup>

The *McAnarney* broad evidence rule<sup>123</sup> was created before the present standard fire policy incorporated the phrase "nor in any event for more than the interest of the insured."<sup>124</sup> This phrase should bolster the broad evidence rule and allow the admission of a demolition contract or an order of condemnation to limit the amount of recovery on a building destroyed by fire before commencement of the demolition. The same court that gave birth to the *McAnarney* rule, however, denied admissibility of such evidence. As the court in *Federowicz v. Potomac Insurance Co.*<sup>125</sup> stated: "[*McAnarney*] . . . construed that portion of the policy providing that insurance was afforded to the extent of the actual cash value of the property."<sup>126</sup> Furthermore, it explained: "Once it is found that the plaintiff had *an* insurable interest at the time of the fire he is entitled to recover the value of the building as it stood, without regard to the fact that he might shortly thereafter be required to remove it."<sup>127</sup> The *Federowicz* court reviewed the history of the pertinent phrase, tracing the appropriate wording in the 1887 and 1917 standard forms which were forerunners of the 1943 form, and concluded that the pertinent deletions and additions did not alter the determinants affecting the amount of loss:

[T]he pertinent clause in the policy should be interpreted upon the basis that this was insurance against physical loss and not against financial loss. The contract was one of insurance against loss by fire to a building owned by plaintiff. It was not an agreement to indemnify him to the extent of his financial loss.<sup>128</sup>

*McAnarney* supports the financial loss theory, and the replacement cost less depreciation rule expresses the physical loss theory. Therefore, the court in *Federowicz* retreated from the *McAnarney* position.<sup>129</sup>

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within the framework of the present wording of the standard insuring clause. For the text of this clause, see note 88 *supra*.

<sup>122</sup> *Glens Falls Ins. Co. v. Gulf Breeze Cottages, Inc.*, 38 So. 2d 828, 830 (Fla. 1949).

<sup>123</sup> See text accompanying notes 117-18 *supra*.

<sup>124</sup> 1943 N.Y. Standard Policy, *supra* note 38, § 1, pt. 6. For the remainder of the restrictive language, see note 88 *supra*.

<sup>125</sup> 7 A.D.2d 330, 183 N.Y.S.2d 115 (1959).

<sup>126</sup> *Id.* at 332-33, 183 N.Y.S.2d at 118.

<sup>127</sup> *Id.* at 334, 183 N.Y.S.2d at 119.

<sup>128</sup> *Id.* at 336, 183 N.Y.S.2d at 121.

<sup>129</sup> It is interesting to note that there is a dearth of cases where the phrase "nor in any event for more than the interest of the insured" is at issue. It receives cursory attention in a few cases, but the courts reach the same result in determining actual cash value as if the phrase were not in the policy. New Jersey, however, does give effect to the phrase and distinguishes between an ownership interest and a creditor interest. When an ownership interest is involved, the New Jersey courts apply the physical loss theory giving the insured recovery for the full value of the property and not merely his financial interest therein. See

*Valued Policies*

Valued policies, relative to the concept of indemnity, present another aspect of valuation. In a valued policy, the value of the subject covered by the policy is, in case of *total loss*, *fixed* by the terms of the contract or by statutory requirement.<sup>130</sup> The amount of recovery is not determined according to the actual loss;<sup>131</sup> in fact, absent fraud, no proof of loss is necessary<sup>132</sup> since the value of the property is immaterial.<sup>133</sup> Thus, the temptation on the part of the insured to overvalue is great, and cases involving such situations are many. Absent fraud, the courts allow recovery according to the amount in the insurance policy.<sup>134</sup>

*Coinsurance*<sup>135</sup>

A coinsurance clause provides that unless the insured has provided insurance on the property covered by the policy in an amount which is at least a specific percentage (usually 80%) of the value of the property, the insured will bear a pro rata share of any loss.<sup>136</sup> Although, at first

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Cooke v. Firemen's Ins. Co., 119 N.J. Super. 248, 291 A.2d 24 (1972). In Flint Frozen Foods, Inc. v. Firemen's Ins. Co., 8 N.J. 606, 86 A.2d 673 (1952), however, the court denied recovery for destroyed goods held as collateral security after the insured creditor had been fully paid by the debtor. Since the debt had been extinguished, the creditor did not incur a loss.

In McWilliams v. Farm & City Mut. Ins. Ass'n, 248 Iowa 233, 80 N.W.2d 320 (1957), the court without discussion reached the financial loss result, stating: "Where the contract, as here, is limited to 'the interest of the insured in the property' it simply assures reimbursement for his actual loss not exceeding a stated sum." *Id.* at 235, 80 N.W.2d at 322.

<sup>130</sup> Many states have enacted valued policy statutes. *See, e.g.*, CAL. INS. CODE § 412 (West 1972); KAN. STAT. ANN. § 40-905 (1973); N.D. CENT. CODE § 26-03-03 (1978); OHIO REV. CODE ANN. § 3929.25 (Page Supp. 1980).

<sup>131</sup> *See, e.g.*, Interstate Fire Ins. Co. v. James, 252 Ark. 638, 480 S.W.2d 341 (1972); Harvey v. General Guar. Ins. Co., 201 So. 2d 689 (La. App. 1967); Brooks Realty, Inc. v. Aetna Ins. Co., 276 Minn. 245, 149 N.W.2d 494 (1967); Zack Metal Co. v. Federal Ins. Co., 26 A.D.2d 54, 271 N.Y.S.2d 1 (1966); Loftis v. Stuyvesant Ins. Co., 54 Tenn. App. 371, 390 S.W.2d 722 (1964); Tribble v. Tower Ins. Co., 43 Wis. 2d 172, 168 N.W.2d 148 (1969).

<sup>132</sup> *See* Zuraff v. Empire Fire & Marine Ins. Co., 252 N.W.2d 302 (N.D. 1977); Commercial Union Ins. Co. of America v. Stanmike Inv. Co., 475 S.W.2d 295 (Tex. Civ. App. 1971).

<sup>133</sup> The rule for partial losses is generally the same under valued policies as under non-valued (open) policies, provided there are no specific statutory provisions regulating the matter. For a collection of cases involving partial loss, *see* Annot., 36 A.L.R.2d 619 (1954).

<sup>134</sup> *E.g.*, Harvey v. General Guar. Ins. Co., 201 So. 2d 689, 691 (La. App. 1967).

<sup>135</sup> A discussion of the *reasons* for the introduction of the coinsurance clause into land based casualty policies is not within the scope of this article. For a concise explanation, *see* R. KEETON, *supra* note 4, at 137-40.

<sup>136</sup> A coinsurance clause that has become known as the New York Standard Coinsurance Clause reads as follows:

This company shall not be liable for a greater proportion of any loss or damage to the property described herein than the sum hereby insured bears to the percentage specified on the first page of this policy of the actual cash value of said property at the time such loss shall happen, nor for more than the proportion which this policy bears to the total insurance thereon.

R. KEETON, *supra* note 4, at 138. The operation of this clause may be illustrated as follows:



blush, it would appear that the coinsurance clause results in a deviation from the indemnity principle, further reflection indicates otherwise. The insured, for a commensurate premium adjustment, contractually binds himself to insure to a minimum amount; failing that, he voluntarily assumes the risk of becoming a coinsurer.<sup>137</sup>

### LEGISLATIVE RECOMMENDATIONS

As the preceding sections have demonstrated, many judicial decisions have deviated from the principle of indemnity. In various contexts, the courts have failed to evaluate the insured's insurable interest properly and have failed to establish the appropriate amount of recovery based upon the impairment of that interest which results from the occurrence of the insured-against event. The following recommendations should be adopted in order to eliminate such judicially created deviations from the principle of indemnity. In the life tenant and remainderman situation, the insurance proceeds should be either invested or used to rebuild the property. When the life tenant is required to keep the property insured and the insurance proceeds are used to rebuild the property, the life tenant will retain the use of the property and the remainderman will ultimately succeed thereto. If the proceeds are invested, the life tenant may use the income to rent a dwelling and the remainderman will succeed to the fund. In both situations, equity will be served; the life tenant will realize his expectancy since mere recovery of the present value of his life interest would not provide him with a home and the principle of indemnity will have been followed.<sup>138</sup> If the life tenant and remainder-

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Assume the value of the insured property at the time of the loss is \$10,000, the coinsurance requirement is 80% and the actual insurance carried is \$6,000. If damage occurs to the extent of \$4,000, how much will the insured recover? The minimum requirement of coverage is \$8,000 (80% of \$10,000); therefore, the insured will recover his proportionate share of the \$4,000, that is, \$3,000:  $(\$6,000/\$8,000) \times \$4,000 = \$3,000$ . The coinsurance clause is effective only when the loss is partial. For a total loss, the insured will recover the face value of the policy, since that amount will always be less than his proportionate amount would have been. If the loss had been total in the above illustration, the formula would have worked out:  $(\$6,000/\$8,000) \times \$10,000 = \$7,500$ . Since his coverage is only \$6,000, that is all that the insured will recover. For other examples, see R. KEETON, *supra* note 4, at 138-40.

<sup>137</sup> The coinsurance clause can become a trap for the unwary. The value to which the clause refers is the value at the time of the loss. See note 136 *supra*. During inflationary periods, it is possible for the value of the property to rise sufficiently between the inception of the policy and the time of loss to trigger the clause. One way to overcome this problem is to have an inflation endorsement attached to the policy, whereby the company will automatically increase the amount of coverage each year by a certain percentage in exchange for an additional premium, thereby relieving the owner from having to redetermine the amount of insurance that he will need to carry. For other solutions, see R. KEETON, *supra* note 4, at 139-40.

<sup>138</sup>

The very foundation . . . of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire

man acquire separate insurances on the property, the loss should be apportioned between the insurers and the proceeds applied as suggested.

In the cases involving lessees and lessors, the statutory scheme should provide for distribution of the loss consonant with the various obligations and relationships under the lease and insurance policies covering the risk. If the lessee is obligated to repair or replace under the lease and only the lessee insures the improvements, the lessee's insurer should bear the loss without regard being given to the term remaining. If, on the other hand, the lessor was the only one to insure the improvements, the lessor's insurer and the lessee should apportion the loss.<sup>139</sup> If the lessor and the lessee separately insure the improvements, the two insurers should apportion the loss. Where the lessor, rather than the lessee, is bound to repair or replace under the lease, the lessor's insurer should bear the loss when only the lessor insures the improvements, and the lessee's insurer and the lessor should apportion the loss when only the lessee insures the improvements. Again, if the lessor and lessee both insure the improvements, the two insurers would apportion the loss. If the lease is silent regarding the obligation to repair or replace in case of damage and either the lessor or the lessee insured the improvements, the insurer should bear the loss without contribution from the uninsured party. If both parties insure the improvements, their insurance carriers should apportion the loss between themselves.<sup>140</sup>

In automobile liability insurance policies, the spouse of the named insured is, by definition, also a named insured. A similar device could be legislatively adopted to remedy the deviation from the principle of indemnity which occurs when one spouse insures property to which the other spouse holds title. Such a statutory solution would provide that in casualty policies on homesteads, both spouses are deemed named insureds even though only one is actually named in the policy. Both spouses have an insurable interest in the home<sup>141</sup> and the insurer would not be disadvantaged by such a requirement.

A statutory solution to the demolition and condemnation case problems would be to require that evidence relative to the pending demoli-

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policy as a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified.

*Castellian v. Preston*, 11 Q.B. 380, 386 (1883).

<sup>139</sup> If two or more insurers sustain a loss on the same risk, they apportion the damages between them subject to the provisions of the "other insurance" clause in the contracts. Similarly, the lessee who assumed the obligation to repair or rebuild is a coinsurer.

<sup>140</sup> This discussion of statutory solutions to the issues raised in situations involving lessors and lessees considers only the contractual aspects of the problem. The lessor's or lessee's liability to the other for negligence is not within the scope of this article. In such situations, the rule of subrogation may affect the insurers' obligations.

<sup>141</sup> For a definition of "insurable interest," see note 3 *supra*.

tion contract and condemnation proceedings be admitted. The rule that the measure of damages is determined at the moment of loss and future events may not be considered is too inflexible and results in unrealistic recoveries. The broad evidence rule, coupled with the standard policy phrase "not in any event for more than the interest of the insured"<sup>142</sup> demands the admission of such evidence.

### CONCLUSION

The vast majority of claims for casualty losses involve property wholly owned by the insured and not involved in condemnation proceedings or demolition contracts. The measure of recovery in these cases conforms to the principles of indemnity, subject only to differences in dollar amount arising from the method of valuation used.<sup>143</sup> Whether the loss is total or partial, depreciation is a factor which must be considered under any of these methods. The minority view which does not consider depreciation in partial loss cases<sup>144</sup> violates the principle of indemnity; the insured makes a profit on his loss, receiving something new for something that was old.<sup>145</sup>

Claims involving property in which the insured has only a partial interest also result in recoveries that violate the indemnity principle. Both a life tenant and a remainderman may recover the full value of the destroyed property.<sup>146</sup> A lessee who has improved the demised premises may, in some states, recover the full value—not merely the present value—of the term even if the lessor repairs the damage.<sup>147</sup> Some jurisdictions permit a husband who insures the wife's homestead property in his sole name to recover the full value thereof.<sup>148</sup>

The demolition and condemnation cases<sup>149</sup> illustrate the most blatant judicial deviation from the principle of indemnity. In the former, the argument is that until demolition has begun, the insured is entitled to the value of the structure without regard to the pending demolition. Courts disregard the economic fact that a building about to be demolished is a liability rather than an asset because of the cost of demolition and

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<sup>142</sup> 1943 N.Y. Standard Policy, *supra* note 38, § 1, pt. 6.

<sup>143</sup> See text accompanying notes 97-137 *supra*.

<sup>144</sup> See text accompanying notes 121-22 *supra*.

<sup>145</sup> Insurance proceeds in a replacement cost contract enable the insured to repair or rebuild a damaged old building with new materials; thus, depreciation is not deducted. Premiums for such policies reflect the additional liability assumed by the insured; therefore, the questions of conformity to or violation of indemnity principles in such situations is not relevant to the issues discussed in this article.

<sup>146</sup> See text accompanying notes 21-29 *supra*.

<sup>147</sup> See text accompanying notes 30-45 *supra*.

<sup>148</sup> See text accompanying notes 46-52 *supra*.

<sup>149</sup> See text accompanying notes 85-96 *supra*.

removing debris and that the expectancy of any recovery for fire loss encourages arson. In condemnation cases, the judicial view that until condemnation has been completed the insured is entitled to recovery, gives the insured a windfall.

In the cases involving vendors and vendees, the vendee benefits from the vendor's insurance.<sup>150</sup> This disposition of the funds technically violates the principle of indemnity,<sup>151</sup> yet any other course would be inequitable. If the vendor retained the insurance proceeds and also retained the sale price, he would receive a windfall. If the insurer were excused from paying because the vendor collected from the vendee, the insurer would receive a windfall. Crediting the proceeds to the purchase price is the most equitable solution.

To eliminate these judicially created deviations from the fundamental principle of insurance law, that of indemnity, legislation is needed. The recommendations for legislative solutions which are outlined above provide a model for the equitable disposition of damages in each of these situations which conforms to the fundamental principle of indemnity.

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<sup>150</sup> See text accompanying notes 61-84 *supra*.

<sup>151</sup> The principle of indemnity is violated because the vendee receives indemnification even though he does not carry any insurance on the property.

