

COMMISSIONER'S BULLETIN NO. B-0045-98

June 12, 1998

TO: ALL PROPERTY AND CASUALTY INSURANCE COMPANIES

RE: *Calculation of Actual Cash Value Under the Texas Standard Homeowner's Policy – Form B*

The Department has learned that one or more insurers have interpreted language in the Texas Standard Homeowner's Policy – Form B to permit the deduction of contractor's overhead and profit, in addition to depreciation, from replacement cost in calculating actual cash value. This interpretation has generated two class action lawsuits and inquiries to the Department regarding the Department's position on this matter. The insurers are interpreting the following Loss Settlement provision of the Texas Homeowners Policy – Form B:

We will pay only the actual cash value of the damaged building structure(s) until repair or replacement is completed.

The purpose of this bulletin is to state the Department's position that actual cash value of a structure under a replacement cost policy, when the insurer does not repair or replace the structure, is the replacement cost with proper deduction for depreciation. The deduction of prospective contractors' overhead and profit and sales tax in determining the actual cash value under a replacement cost policy is improper, is not a reasonable interpretation of the policy language, and is unfair to insureds.

The Department's position is based on the following:

-- Indemnity is the basis and foundation of insurance coverage. The objective is that the insured should neither reap economic gain nor incur a loss if adequately insured. This objective requires that the insured receive a payment equal to that of the covered loss so that the insured will be restored to the same position after the loss as before the loss. The calculation of this payment results in under-compensation if an insurer deducts prospective contractors' overhead and profit and sales tax in determining the actual cash value under a replacement cost policy. Conversely, the inclusion of contractor's overhead and profit and sales tax on building materials does not over-compensate an insured for the amount of the loss because these items represent part of the insured's loss. Generally, the objectives of indemnity will be met if actual cash value is calculated as replacement cost with proper deduction for depreciation. In the rare situation that defies calculation of actual value on this basis, such as cases in which the structure has historical significance or the materials cannot reasonably be replaced, other factors may be considered. **However, there is no situation in which the deduction from replacement cost of depreciation and contractor's overhead and profit and/or sales tax on materials will be the correct measure of the insured's loss.**

--Premiums charged must not be excessive for the risks to which they apply. Under a replacement cost policy, the liability limits of the policy and the premium paid by the insured are determined on the basis of the replacement cost of the structure. The value of contractor's overhead and profit, as well as sales tax on building materials, has been included in the limit of liability for which the insured has paid premium. If the insurer in determining actual cash value excludes costs that are included in the determination of liability limits, on which the insured's

premium is based, the insurer reaps an illegal windfall because the insurer receives premium on insurable values for which loss may never be paid.

--To deduct costs other than depreciation from the estimated replacement cost of the damaged structure is contrary to historical industry norms and practices. Historically, insurers have determined actual cash value on the basis of repair or replacement cost less depreciation. Only recently have some insurers deducted contractor's overhead and profit and sales taxes on building materials. There has been no recent change in the language in the promulgated residential property policies to support such a change in determining actual cash value.

--The insurers' argument that the cost of contractor's overhead and profit and sales tax on building materials should be excluded from an actual cash value loss settlement because the insured has not incurred these expenses is not persuasive. Using this logic, an insured who opts not to repair or replace damaged property would not incur any of the expenses necessary to repair or replace the damaged property, including the costs of building materials, and would collect nothing under an actual cash value loss settlement. This result would be contrary to the purposes of the subject insurance policy.

The scope of this bulletin is limited to the calculation of actual cash value for dwelling coverage in replacement value policies by use of the practice described herein. This bulletin is not intended to, and does not, express any opinion of the Department as to the calculation of actual cash value in other contexts, such as personal property, or measures of the actual value of such property to the owners of such property.

The Department has concluded that an insurer providing property coverage under replacement cost residential policies that allow for the adjustment of covered losses to structures on an actual cash value basis may not calculate actual cash value on the basis of replacement cost with proper deduction for depreciation, less contractor's overhead and profit, nor may the insurer deduct sales tax on building materials. Any insurer that determines actual cash value on this basis may be subject to disciplinary action for violations of the Texas Insurance Code, including unfair claims practices pursuant to Article 21.21 § 4(10)(a) and Article 21.21-2.

Elton Bomer
Commissioner Of Insurance

September 29, 2008

TO: ALL INSURANCE COMPANIES, CORPORATIONS, EXCHANGES, MUTUALS, RECIPROCALLS, ASSOCIATIONS, LLOYDS, OR OTHER INSURERS WRITING PROPERTY AND CASUALTY INSURANCE IN THE STATE OF TEXAS AND TO AGENTS AND REPRESENTATIVES AND THE PUBLIC GENERALLY

RE: loss settlement calculation of actual cash value under an insurance policy that provides replacement cost coverage

The purpose of this bulletin is to remind insurers of the position of the Texas Department of Insurance (Department) when calculating actual cash value as outlined in Commissioner's Bulletin No. B-0045-98.

The bulletin set forth the Department's position that the standard method for determining actual cash value of a structure is the replacement cost with proper deduction for depreciation. The bulletin also stated that "the deduction of prospective contractors' overhead and profit and sales tax that determining the actual cash value under a replacement cost policy is improper, is not a reasonable interpretation of the policy language, and is unfair to insureds." Bulletin No. B-0045-98 is available online at the Department's website: <http://www.tdi.state.tx.us/bulletins/1998/b-0045-8.html>.

The Department's position has not changed. While individual company policy forms have been approved for use in Texas, the method set forth in Bulletin No. B-0045-98 continues to be a standard method of determining actual cash value under replacement cost policies. Thus, the insured continues to be entitled to reasonable and necessary expenses to repair or replace the damaged property, less proper deduction for depreciation. These expenses would include the services of a contractor. The deduction of prospective contractors' overhead and profit and sales tax, in addition to depreciation in calculating actual cash value, is an improper claim settlement practice on policies that provide coverage on an actual cash value or replacement cost basis.

The Department expects all property and casualty insurance companies to act in good faith and use fair claim settlement practices to effectuate "fair and equitable" settlements of claims and not engage in unfair settlement practices in determining the damages for a covered loss as required under the Insurance Code §541.060 and §542.003 and Texas Administrative Code Title 28, §21.203. However, the Department will not support attempts by contractors to charge for services that were not rendered nor attempts to charge twice for the payment of overhead and profit.

Additionally, these provisions require that estimates should be reasonable and not necessarily the product of a particular style, system or vendor exclusive of other reasonable alternatives. For example, insurers should not routinely eliminate from consideration certain estimate practices, concepts and tools that may be used in estimating damages for a covered loss.

The Department will investigate allegations of unfair claim settlement practices, both in context of individual cases and in context of general business practices, and will take appropriate enforcement action when evidence of unfair claim settlement practices is apparent.

Questions regarding this bulletin may be directed to Gary Julian, Personal Lines Division, at (512) 322-2266 or gary.julian@tdi.state.tx.us.

Mike Geeslin
Commissioner of Insurance