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Insurance Law

What is 'actual cash value?'

By Michael H. Fabian, Esq.,
and Patrick A. King, Esq.

Every homeowner's and business owner's policy of insurance issued in Michigan provides that the insurer shall make payment of a property loss based on the "actual cash value" of the property.

Some insurers have defined actual cash value as replacement cost less depreciation; some insurers believe that actual cash value is the market value of the property; and others insist that you must use a "broad evidence" approach to valuation of actual cash value.

Surprisingly, neither the policy of insurance, which dictates how a claim is to be paid, nor the Michigan Insurance Code which mandates that all policies provide coverage based on at least the "actual cash value" of the loss, define the term.

So what does actual cash value mean and how does the attorney answer his client's question, "How do I calculate my claim and how much am I going to be paid?"

A review of the policy to determine how claim payment is calculated will reveal that even when a policyholder has "replacement cost" coverage, prior to actual repair or replacement of the property, payment will be based upon the "actual cash value" of the damaged property.

Unfortunately, a review of the insurance contract will reveal that there is no definition of the term actual cash value in the

section of the policy referring to how a loss is paid. Turning to the "definitions" section of the policy, the term "actual cash value" remains undefined there, as well.

The Michigan Insurance Code requires that each fire insurance policy issued or delivered in Michigan shall provide, at a minimum, coverage for the actual cash value of the property at the time of loss (MCL 500.2833), and that non-conforming policies are void (MCL 500.2860).

However, the legislature has never defined the term, and most property insurance policies have also failed to provide a definition of actual cash value for the policyholder.

Therefore, the term "actual cash value" has been the subject of debate over the decades, especially since the definition has evolved in Michigan case law.

The Michigan Insurance Code has required actual cash value coverage since the late 1800s. At that time, appellate authority in Michigan used "market value" as the sole definition of actual cash value.

While this definition has some logic regarding the valuation of real property, applying market value to determine the value of personal property made little sense, since much used personal property has no recognized secondary market.

During the mid 20th century, as insurance products became more sophis-

ticated, and package policies (such as a homeowner's policy) became the norm, many states including Michigan adopted the so-called Broad Evidence Rule.

In *Davis v. National American Ins. Co.*, the court rejected using market value alone and adopted the Broad Evidence

Rule approach to actual cash value, holding that insurers and policyholders could use any relevant factors—such as replacement cost, depreciation, market value, state equalized value, and income derived from the property—as guides to establish value.

While attractive, the Broad Evidence Rule approach led to numerous disputes in practice, because there were no standards for weighting the actual cash value factors, creating uncertainty as to how to establish payment.

That uncertainty was resolved in 1992, when the Michigan Supreme Court in *Smith v. Michigan Basic*, stated: "Actual cash value means replacement cost less depreciation."

In *Salesin v. State Farm Fire & Casualty Co.*, the Michigan Court of Appeals stated that "actual cash value" of either real or personal property in the property insurance context is "replacement cost less depreciation."

The term "actual cash value" has been the subject of debate over the decades, especially since the definition has evolved in Michigan case law.

Since the Supreme Court defined actual cash value as replacement cost less depreciation in *Smith*, there have been no Michigan appellate cases that have followed the holding in the *Davis* case that broad evidence should be used to determine actual cash value.

While many Michigan insurers quickly adopted the Broad Evidence Rule approach after *Davis*, some insurers have ignored the *Smith* and *Salesin* decisions and have attempted to use solely market value as a measure of actual cash value, sometimes rationalizing the use of market value as part of a “Broad Evidence Rule” valuation.

Simply put, market value is not actual cash value, and the use of market value as the sole method to determine actual cash value has been specifically rejected by the Michigan courts.

Further, since *Smith*, there is little to support the notion that any use of the Broad Evidence Rule in Michigan is proper.

A review of other authorities further supports the position that “replacement cost less depreciation” should be utilized to calculate actual cash value.

One portion of the Michigan Insurance Code (pertaining to creditor placed insurance), specifically defines actual cash value as the cost of replacing damaged or destroyed property with

comparable new property, minus depreciation and obsolescence.

Further, the National Association of Insurance Commissioners (NAIC), an organization comprised of the chief insurance regulatory officials of the 50 states, defined actual cash value as “Actual cash value is the amount it would take to repair or replace damage to a home and its contents after depreciation.”

Using replacement cost less depreciation as a standard for actual cash value provides a number of benefits over other measures. It reflects, as the NAIC release indicates, the insurance industry practice in general. It also is a measure associated with computerized analysis, allowing both insurance adjusters and policyholders to determine loss using a uniform methodology, and eliminates the need to hire third parties such as real estate appraisers.

Also, most insurers utilize a replacement cost less depreciation approach to determine actual cash value when issuing the policy. One would expect an insurer to utilize the same methodology when it pays a claim as that used in underwriting and pricing the policy.

While the answer to the questions “How do I calculate my claim?” and “What is ‘actual cash value?’” are not readily found in either the policy of insurance or the

Michigan Insurance Code, a review of the case law and an analysis of the evolution of the term and its general usage yields that the property owner should first determine the property replacement cost, then apply depreciation when calculating the actual cash value of their loss.



Michael H. Fabian and Patrick A. King are shareholders at Fabian, Sklar & King, P.C., a Farmington Hills, Mich.-based law firm that specializes in representing business owners and homeowners in fire, explosion and other property damage claims. The firm also represents persons injured and the families of persons killed as a result of fires or explosions. Fabian is an editor of Michigan Insurance Law and Practice, published by the Institute for Continuing Legal Education (ICLE), and with King, authored the chapter on property insurance law. King is a Certified Fire and Explosion Investigator and has lectured extensively on a variety of topics relating to the origin and cause of fires and explosions, including presentations to insurance professionals. Contact them at (248) 553-2000 or mfabian@fabiansklar.com or pking@fabiansklar.com.