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# Is a Coinsurance Penalty Based Upon ACV or RCV?

By Steven Plitt | November 4, 2013

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The question of whether a coinsurance penalty in a commercial property policy was based upon ACV or RCV was recently addressed by the United States Eighth Circuit Court of Appeals in *Buddy Bean Lumber Co. v. Axis Surplus Ins. Co.*, 715 F.3d 695 (8th Cir. 2013). The *Buddy Bean* case involved a claim brought by the insured seeking to recover ACV of electrical wiring that was stolen from the saw and planing mills at the insured's lumberyard. The insurer refused to pay the full claim value based upon the insurance policy's coinsurance provision which required the insured to maintain a policy limit equal to at least 90 percent of the mills' value, penalizing the insured for any shortfall. The case was decided under Arkansas law.

The Court began its analysis by recognizing that coinsurance provisions in insurance policies had long been enforceable in Arkansas. 715 F.3d at 698 citing *Commodity Credit Corp. v. American Equitable Assur. Co.*, 198 Ark. 1160, 133 S.W.2d 433 (1939). The coinsurance provision in question stated that the insurer would "not pay the full amount of any loss if the *value of Covered Property* at the time of loss times the Coinsurance percentage shown for it in the Declarations is greater than the Limit of Insurance for the property." The policy defined "value of Covered Property" as the property's "actual cash value as of the time of loss or damage." The insured could also choose to purchase optional expanded coverages under the policy. If the optional expanded coverages were purchased, the definition of the "value of Covered Property" could change. The insured, Buddy Bean, did purchase optional replacement cost coverage. The optional coverage allowed Buddy Bean to file claims for the replacement costs of any losses, a figure which could be higher than the ACV of the loss.

Buddy Bean argued that the proper interpretation of the term "value of Covered Property" in the coinsurance provision depended on the type of claim that Buddy Bean filed. Buddy Bean relied upon the Washington Court of Appeals decision in *Wetmore v. Unigard Ins. Co.*, 125 Wash.App. 938, 107 P.3d 123 (2005) where the Court interpreted the same policy language and concluded that the proper interpretation of the coinsurance provision varied depending upon whether the insured filed an actual cash value claim or replacement cost claim.

According to the *Wetmore* Court, if the insured's claim was for ACV, the ACV of the relevant property would be used. On the other hand, if the insured filed an RCV claim, then the coinsurance provision would be calculated using the relevant property's replacement cost. Relying upon the Washington Appellate Court's decision *Wetmore*, Buddy Bean then argued that while it paid for optional RCV coverage, the claim Buddy Bean submitted was not an RCV claim. Buddy Bean emphasized that it purchased basic insurance coverage plus the optional expanded coverage it could elect to use under certain circumstances. Buddy Bean argued that there would be no point in purchasing RCV coverage if the insured would then be penalized on claims made under its basic coverage. Buddy Bean sought only the ACV of the stolen wire and, therefore, only the ACV of the saw and planing mills was relevant in calculating the coinsurance penalty.

The insurance company argued that the term "value of Covered Property" should mean the RCV of Buddy Bean's saw and planing mills.

After considering the arguments made by both parties, the Eighth Circuit concluded that the proper interpretation of the coinsurance provision depended upon whether the insured had filed an ACV or an RCV claim. The Court agreed with Buddy Bean that its choice to purchase a type of expanded coverage was not intended to vitiate its basic coverage. The expanded coverage simply gave Buddy Bean the ability to file both ACV basis and RCV basis claims. According to the Court, under Buddy Bean's insurance policy, a decision to buy RCV coverage would automatically change how to calculate the coinsurance provision, and the insured would always suffer a substantial coinsurance penalty even on ACV claims which would render the replacement cost section of the expanded coverage to be irrelevant.



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