

MERLIN

LAW GROUP

DENVER, CO
999 18TH STREET
SUITE 3000
DENVER, CO 80202
TELEPHONE: (303) 357-2374
FAX: (303) 357-2377

January 25, 2019

Michael Conway
Division of Insurance
1560 Broadway, Ste. 850
Denver, CO 80202

RE: Dora Bulletin B-5.1

Dear Commissioner Conway,

This letter is against the proposal to eliminate the longstanding Colorado Insurance Bulletin prohibiting insurance companies to withhold agreed upon General Contractor Profit and Overhead when paying replacement cost benefits under property insurance policies. We believe that such a measure is against Colorado policyholder interests, promotes delayed and underpayment of insurance claims, has no logical basis and is anti-consumer because it would allow insurance companies to market their insurance replacement cost insurance products with the consumer's expectation of being paid replacement cost when they will not be paid those sums.

The Merlin Law Group is almost a 60-lawyer firm representing only policyholders throughout the United States. We have an office in Denver with three full time attorneys working on property insurance claims in Colorado for hundreds of policyholders. I am a Board Member of United Policyholders which is the nation's largest and longest existing non-profit association representing policyholders' interests in front of legislative and regulatory bodies throughout the United States. I have been fortunate enough to be elected as President of the Windstorm Insurance Network, which has over a 1000 members of diverse backgrounds including a majority who work for insurance companies. I have dedicated my professional life's work to the field of insurance and primarily property insurance law since 1981. Some of my publish works and presentations are noted at <https://www.merlinlawgroup.com/attorneys/william-f-chip-merlin-jr-esq/>.

In our public comment, we provided a simple example to show how unfair it would be to remove this current protection afforded Colorado policyholders:

A retired pilot saves his money for a retirement home and builds it on the side of a hill on land he has long owned in Colorado Springs. The home is built for a cost of \$750,000. He buys Replacement Cost Insurance for \$750,000. Two days after the construction is complete, a jet which ran out of fuel crashes into the home, destroys it and a guest of his in the house died. The retired pilot makes a claim for \$750,000—the cost to rebuild the structure. The insurance company agrees, but says that the Colorado Division of Insurance has removed a bulletin requiring it to pay the contractor's overhead and profit until he rebuilds the house. So, they deduct

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the approximate 20% amount per the estimate and pay him \$600,000 as the Replacement Cost less the contractor's overhead and profit. To add insult to injury, the retired pilot, decides he never wants to rebuild at that site because of the emotional incident. In summary, he just paid \$750,000 for the house, bought insurance for \$750,000 and the Colorado Division of Insurance is allowing the insurance company to pay an amount less than the agreed Replacement Cost.

While our firm represents consumers of the insurance product, Barry Zalma, a prominent attorney who represents insurance companies, has even written in the American Bar Association Tort and Insurance Journal that General Contractor Overhead and Profit must not be withheld:

“There is no basis for simply withholding profit and overhead as a means of calculating actual cash value. In fact, modern insurance policies that actually provide a definition for actual cash value define it as (1) replacement cost less physical depreciation, (2) replacement cost less betterment, (3) fair market value, or (4) a combination of the various definitions. When there is no policy definition, courts will apply one or more of the four definitions above.”

Florida published an insurance bulletin prohibiting the withholding of Overhead and Profit stating in part:

“This authority is specifically applicable to the practice by insurers of imposing a “holdback” of insurance proceeds greater than actual cash value until replacement has taken place. While this practice is appropriate for personal property, this bulletin serves to place insurers on notice that for partial losses on real property, the “holdback” is inconsistent with established precedent.

The application of a “holdback” to repair of real property can particularly cause hardship to the insured when the actual cash value payment is insufficient to enter into a contract to make repairs. In such an instance, the insured may be forced to seek other funding sources, at his expense, in order to contract for repairs.

Insurers who have been applying “holdbacks” in claims for partial loss on real property should pay the actual amount of the loss. The best indicator of actual loss is the contract for repair entered into by the insured. Once an actual amount of loss is determined by contract, the full loss payment should be made with no hold back applied. This arrangement satisfies the public policy interests both in timely and sufficient claim payments, and in encouraging rebuilding. In instances where a holdback is currently being applied and a repair contract has been executed, the holdback should be released.”

The Texas Department of Insurance has a very similar Bulletin to the one currently in force in Colorado which provides in part:

“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 profit and/or sales tax on materials will be the correct measure of the insured's loss.

...

To deduct costs other than depreciation from the estimated replacement cost of the damaged property 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.”

This 1998 Bulletin was reaffirmed as being the proper method of property insurance again in 2008.

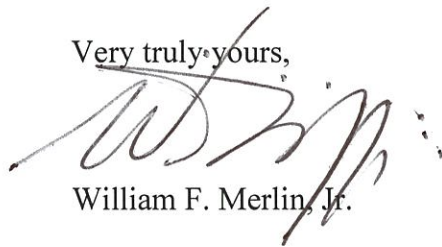
Our experience is that policyholders are extremely upset and frustrated when insurance companies withhold depreciation until replacement is made. They argue, "we paid for replacement cost and the insurer gave us something else." Most property insurance companies market these products as Replacement Cost when they are actually something less because those insurers cite the small print language which requires repair or replacement to be made. We suggest that the department mandate that such marketing practices are deceptive and should not allow agents nor insurers to market such policies as "replacement cost" policies unless they immediately pay replacement cost.

Some insurance companies, like Chubb and AMICA, sell Replacement Cost policies and pay full replacement right away. It is not fair to those companies that sell a better quality and true replacement cost product to allow inferior competitors to market their products as replacement when those competitors deduct depreciation and make their customers wait to get full replacement benefits and only upon replacement.

If Colorado consumers are already upset and angry about not getting paid the full replacement because some depreciation might be deducted, can you imagine how upset they will be to find that the Department has changed its position and now allows the Contractor's Overhead and Profit to be deducted and withheld from a property loss payment calculation?

From our position and experience, Colorado policyholders and those supporting consumer interests should be upset and protest if the current Bulletin is removed. There is no logical basis and public policy supporting the position to make this change. Indeed, after studying the situation, we suggest the opposite occur and the old bulletin be reaffirmed and a study started to determine if there are needed changes to require insurance agents and companies to warn that their Replacement Cost products withhold depreciation.

Very truly yours,



William F. Merlin, Jr.

WFM/tb

Cc: *Amy Bach, United Policyholders* amy.bach@uphelp.org
The Honorable Jared Polis, Governor of Colorado
c/o Lisa Kaufmann, Chief of Staff
4 On Your Side - John Montgomery jmontgomery@cbs.com
Contact 7 Investigates Contact7@thedenverchannel.com