

# DTCI: Justin K. Curtis: Assignment of Claims for Recoverable Depreciation

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Consent-to-assignment clauses are virtually boilerplate in most contracts of insurance. The general consent-to-assignment clause reads, “Your rights and duties under this policy may not be transferred without our written consent except in the case of death of an individual named insured.” The purpose of consent-to-assignment clauses is to protect the insurer from unforeseen exposure and increased liability that may ensue if the policy were assigned to an entity that the insurer would prefer not to insure or would have insured only for a higher premium. An assignment of the policy, or rights under the policy, transfers the insurer’s contractual relationship to a party with whom it never intended to contract. “Insurance providers have a legitimate business interest in restraining assignment — the provisions protect them from a material increase in the risk for which they did not bargain, specifically because of a change in the nature of the insured.” *Travelers Casualty & Surety Co. v. United States Filter Corp.*, 895 N.E.2d 1172, 1178 (Ind. 2008).

Most jurisdictions recognize an exception to the enforcement of consent-to-assignment clauses made after a loss has occurred. *Travelers Casualty & Surety Co. v. United States Filter Corp.*, 895 N.E.2d 1172, 1178-79 (Ind. 2008). “The majority rule in the United States is that a provision that prohibits the assignment of an insurance policy, or that requires the insurer’s consent to such an assignment, is void as applied to an assignment made after a loss covered by the policy has occurred.” *Givaudan Fragrances Corp. v. Aetna Casualty & Surety Co.*, 151 A.3d 576, 586 (N.J. 2017) (citing *Conrad Bros. v. John Deere Insurance Co.*, 640 N.W.2d 231, 237-38 (Iowa 2001)).

After a covered loss has occurred, the policyholder ordinarily may assign the claim to another person or entity regardless of whether the policy contains a consent-to-assignment clause. The rule prohibiting assignments aims to prevent an insurer from bearing increased and unanticipated liability as a result of covering a new insured party. However, once a covered loss has occurred, the insurer’s liability is fixed and the claim

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increase. After a covered loss has occurred, the insurer's risk cannot be increased by a change in the identity of the party to whom a payment is made.

In general, the discussion regarding post-loss assignments refers to the assignment of a payment that has been reduced to a specific amount owed by the insurance company and there is nothing more the policyholder must do to be entitled to the payment. Many states have not addressed the situation where a policyholder attempts to assign rights and benefits that the policyholder is not yet entitled to — either because they have yet to satisfy certain conditions under the policy or because the claim has not been reduced to a fixed and certain amount (“contingent benefits”).

In the property insurance context, this situation arises when a policyholder attempts to assign its right to seek recoverable depreciation under a replacement cost insurance policy. When a covered loss occurs under a replacement cost policy, two different values are considered: actual cash value (ACV) and the replacement cost value (RCV). ACV is the amount required to replace or repair property *minus depreciation*. When a covered loss occurs, an insurer will determine the ACV and pay this amount to the policyholder without the policyholder taking any additional action. Under most replacement cost policies, the policyholder may recover the depreciation holdback from the ACV payment only when she repairs or replaces the property. Before the property is repaired or replaced, the right to seek the recoverable depreciation is a contingent benefit because it depends upon the policyholder satisfying specific conditions under the policy.

### ***Sherard v. Safeco Insurance Co. of America***

As noted above, few states have considered whether a policyholder may assign contingent policy benefits in contravention of a consent-to-transfer clause. Following the example above, what happens if a policyholder attempts to assign her rights to recover RCV benefits before the covered property has been repaired or replaced? This question was directly addressed by a federal district court in Washington. In *Sherard v. Safeco Insurance Co. of America*, the policyholder's property was damaged by a fire and a claim was made under the policyholder's replacement value policy. 2015 WL 5918397, \*2 (W.D. Wash. 2015). The insurer paid the policyholder the ACV for the property and then the policyholders sought to assign the claim for recoverable depreciation to his daughter. *Id.* at \*3. The insurer denied the policyholder's attempt to assign the RCV claim and the policyholder filed suit. *Id.* at 4.

In evaluating whether the assignment of the RCV claim was valid, the court noted that Washington, like Indiana and a majority of the states, follows the rule that consent-to-assignment clauses apply only to assignments before loss and do not prevent assignment after loss. *Id.* In evaluating the policy language, the court determined that the language “... we will pay the difference between the actual cash value and the replacement cost only after the damaged or destroyed property has actually been repaired or replaced” meant that no claim for the replacement cost accrued until “actual repair or replacement” had taken place. *Id.* Reading the two strands of law together, the court concluded that it was “clear a claim for the replacement cost holdback cannot be

the policy provision limiting the replacement cost payment to no more than the amount ‘actually and necessarily incurred’ in repair or replacement would not function as a limit on recovery, as the parties intended.” *Id.*

As such, at least one federal district court has concluded that the assignment of a claim for replacement cost holdback is invalid if the claim is assigned before the approved repairs or replacement is completed. The timing of the assignment appears to be a significant factor in determining whether the assignment was valid. As outlined above, it is generally accepted that a policyholder may assign her claim to recover noncontingent benefits after a covered loss has occurred. The amount of the noncontingent benefit, such as an ACV payment, is a fixed amount and the policyholder does not need to take any additional action or satisfy any policy conditions before she is entitled to receive the payment. Unlike an ACV payment, the insurer is not obligated to pay the RCV portion of a claim until the covered property is repaired or replaced. The RCV payment is contingent upon the insured actually completing repairs or replacement and the amount of the RCV claim is not set until such action occurs. Allowing the assignment of the RCV portion of the claim before repair or replacement forces the insurer into a contractual relationship with an individual it may not have insured in the first place.

### ***Edgewood Manor Apartment Homes LLC v. RSUI Indemnity Co.***

While the issue of assignment of the RCV portion of a claim has not been directly addressed by our federal appellate court, the Seventh Circuit’s decision in *Edgewood* is nonetheless instructive. In *Edgewood*, the 7th Circuit Court of Appeals was asked to determine whether “a claim for ‘replacement cost’ proceeds under a property insurance policy survive the insured’s sale of the damaged property in its unrepaired state?” 733 F.3d 761, 764 (7th Cir. 2013). As background, an apartment complex owned by Southland was badly damaged in Hurricane Katrina. *Id.* A claim was filed and the insurer paid ACV proceeds to Southland. *Id.* Southland thereafter notified the insurer of its intention to sell the property to Edgewood and assign its RCV claim to Edgewood. *Id.* The insurer responded that if Southland sold the property before completing the repairs, both Southland and Edgewood would be precluded from recovering RCV proceeds. *Id.* Southland moved forward with the sale and both Southland and Edgewood filed suit against the insurer in federal court seeking a declaration that the insurer was obligated to pay the RCV claim. *Id.*

At the district court level, both Southland and Edgewood’s claims were dismissed. It was revealed that Southland never assigned the RCV claim to Edgewood, and the court therefore dismissed Edgewood’s claim for lack of standing. The district court also dismissed Southland’s claim because it sold the property before effecting repairs.

On appeal, the district court’s dismissal of Edgewood’s claim was upheld. Edgewood lacked standing to seek RCV proceeds because the insurance claim was never assigned at the time of the sale. *Id.* at 765. While the assignment of the RCV claim was not directly at issue, the court addressed several topics relevant to the consideration of whether an RCV claim can be assigned before repair or replacement of the damaged property.

With regard to Southland's claim, the insurer, applying Mississippi law, argued that Southland could not recover RCV proceeds because it lost its insurable interest in the property at the time of the sale. *Id.* at 772. "To allow persons without insurable interests to procure such insurance would create economic incentives in such persons to cause loss." *Id.* (quoting Jeffery Jackson, *Mississippi Insurance Law and Practice*, § 4:1 (2012)). However, the 7th Circuit noted that insurable interest is measured at the time of contract formation, the time of loss or both. *Id.* at 772-73. No legal authority "requires that an insured continue to maintain an insurable interest in the property while the claim is being negotiated or through litigation." *Id.* at 773.

Moving forward, the insurer argued that its insured, Southland, not the buyer, Edgewood, was required to "repair or replace" the property themselves prior to the sale. The court identified that the policy language did not specify who had to effect the "repair or replacement" of the property. "The repair requirement has a more concrete function: It ensures that replacement cost is valued accurately. In the absence of actual repair, the claim would be based on estimates; when actual repairs are completed, the replacement cost valuation becomes certain and verifiable. The reasonable-time condition adds a requirement of promptness." *Id.* at 775. The 7th Circuit reversed the trial court's dismissal of Southland's claim.

Extending the legal reasoning in *Edgewood* to the question whether a claim for RCV proceeds can be assigned to a third party before repair or replacement arguably supports the conclusion that the timing of such an assignment is a critical factor. The court noted the repair requirement served the function of fixing the monetary value of the RCV claim and ensuring the repair or replacement of the damaged property was done in a reasonable time frame. As noted above, courts have freely permitted the assignment of claims in contravention of consent-to-assignment clauses when the insurer's liability is fixed. When the insurer's liability is not fixed, or when policy conditions remained unfulfilled, courts have been less inclined to permit the assignment of a claim. This is because the contingent claim has yet to accrue.

Considering the authority cited above, it appears likely that timing is an essential factor in the assignment of a claim for RCV proceeds. If the assignment is made before the repair or replacement of the damaged property is complete, the assignment may be subject to scrutiny. However, once the repair or replacement is complete, the amount of the RCV claim is fixed and likely can be freely assigned regarding of a consent to assignment clause. •

■ **Justin K. Curtis** is a partner in the Hammond office of HeplerBroom and chairs the DTCL Insurance Law Section. The opinions expressed in this article are those of the author.