Replacement Cost and Actual Cash Value

Presented on March 14, 2018 by

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Paper

For IIBC March 14, 2018 at Vancouver:

Replacement Cost and Actual Cash Value[1]

Replacement Cost: when is it payable?

1. It is a fundamental principle of insurance law that on suffering a property loss an insured is entitled to indemnity for no more than the "actual cash value" (ACV) of its loss (the meaning of ACV will be addressed at the end of this paper). To qualify for replacement cost value (RCV) an insured's policy must contain an endorsement or clause permitting recovery for it. A typical wording for this is:

> "In the event of loss or damage to the building(s), at the option of the insured, the insurer agrees to make settlement on the basis of the cost of repairs to or the replacement cost of the building(s), whichever is the lesser, with material of like kind and quality, without deduction for depreciation, subject to the exclusions, terms and conditions of the policy, provided that replacement must be on the same site and the repair or replacement must be effected with due diligence and dispatch."

2. As a general rule the courts have held that to qualify for RCV an insured must have actually replaced the damaged property: *Campbell v Guardian Insurance*, 2001 NSSC 110, citing *Derwood Realties Limited v General Accident Assurance Company of Canada*, [1984] N.S.R. (2d) 317. In *Derwood*, the court said,

> "The burden is on the insured to request the settlement and to replace the building 'with due diligence and dispatch' and that, if the insured does not carry that burden, the endorsement is void and the insured cannot recovery anything more than the actual cash value of the building."

3. But it is not always that simple. As there is sometimes a considerable difference in value between a settlement based on RCV than ACV it is not surprising when insurers insist on a literal interpretation of the replacement cost endorsement or clause. This was the case in *Carlyle v Elite Insurance Co.* [1984] B.C.J. No. 3034 (BCSC); appeal allowed at [1986] B.C.J. No. 135 (BCCA).

4. In *Carlyle* the insured's house was destroyed by fire in January of 1983. His policy had a replacement cost clause similar to the one illustrated above. The City required that in order for the house to be rebuilt it would have to be 20%

larger and have a concrete foundation it hadn't had before the fire. The insured was intent on replacing the house but could not afford to rebuild it to the City's specifications. He could not obtain a construction loan without an assurance from the insurer the rebuilding cost would be covered by the policy. The insurer took the position the policy excluded coverage for bylaws upgrades, but the insured took the position the bylaws upgrades exclusion did not apply to the replacement cost clause. They took this dispute to court in 1984, where the insured argued the replacement cost clause required the insurer to fund the replacement, which included the City's bylaws upgrades. The insurer argued the RC clause only required it to indemnify the insured after replacement had been completed, and would not cover for the City's upgrades requirements. It also argued that with all the time that had gone by, the insured had failed to satisfy his obligation to replace 'with due diligence and dispatch'.

5. The trial judge held the insurer was obliged to fund the replacement, the insured's failure to replace 'with due diligence and dispatch' was not a bar to recovery, the bylaws exclusion did not apply to the RC clause, and the insurer's liability for breach of the policy was not confined to the policy limits (damages could exceed the limits). The insurer appealed. The BC Court of Appeal reversed the first and last findings but upheld the bylaws finding. The parties did not challenge the trial judge's decision on 'due diligence and dispatch'.

6. *Carlyle* was significant for the development of property insurance law in several respects: (1) the insured could be excused for not meeting the 'due diligence and dispatch' condition in circumstances where the delay is not within its control alone; (2) the insurer was not obliged to 'fund' replacement (unless the policy clearly allowed for this); (3) the insurer's liability for breach of contract (policy) are confined to the policy limits; and (4) the bylaws exclusion did not apply in cases where the RC clause was elected.

7. The Court of Appeal's ruling on the bylaws exclusion is troublesome. It was based on the particular wording of the exclusion in Elite's policy:

> "This Rider does not insure:
>
> (f) loss or damage directly or indirectly, proximately or remotely, resulting from or contributed to by, the operation of any by-law, ordinance or law regulating zoning or the demolition, repair or construction of buildings or structures, unless the liability is otherwise specifically assumed by endorsement hereon;"

The Court did not consider the additional costs resulting from the City's upgrade requirements to be "loss or damage" because, it said, the cost of rebuilding was not loss or damage—it was simply an alternative method of settling the loss.

8. Some insurers reacted by adjusting the wording of their replacement cost clauses to prevent the type of result seen in *Carlyle*. An example of a revised wording would read:

> "In determining the cost of repairs or replacement we will not pay or include the increased costs of repair or replacement due to the operation of any law regulating the zoning, demolition, repair or construction of buildings and their related services."

An insured would have to buy special coverage for bylaws upgrade costs, if desired. Similar limiting wording had been in effect before *Carlyle* it should be noted: see *Glad Tidings Temple Missionary Society of Vancouver v. Wellington Fire Insurance Company* (1964) 48 W.W.R. (N.S.) 385.

9. *Carlyle* provides us with guidance on the meaning of 'with due diligence and dispatch'. When does an insurer have grounds, in good faith, to deny settlement on the basis of replacement cost for failure to repair or replace *with due diligence and dispatch*?

10. In *Carlyle* the insured and insurer were in dispute over whose obligation it was to fund the replacement and for how much (whether bylaw upgrades were covered)? Both the Supreme Court at trial and the Court of Appeal agreed that the dispute contributed to the delay and should excuse the insured for not satisfying the due diligence and dispatch requirement. Although the court impliedly took notice of the insured's financial inability to secure a loan for the replacement, it did not go so far as to decide whether this was grounds alone for relieving the insured of his 'due diligence and dispatch' obligation because the failed loan was based on the insurer's refusal to guarantee coverage for replacement with bylaws upgrades. In other words, *Carlyle* left it undecided whether an insured's inability to qualify for lending will excuse it of having to replace 'with due diligence and dispatch'.

11. In the Alberta case of *319107 Alberta Ltd. (Receiver/Manager of) v New Hampshire Insurance Co.* [1993] A.J. No. 315 (Q.B.), a fire destroyed the plaintiff's hotel in 1985. An ongoing dispute with the vendor of the hotel had led to the insured's default on its mortgage and to its receivership. After the fire, the

dispute continued. The receiver attempted to secure plans to rebuild the hotel but these could not be completed due to the dispute with the vendor. Six months after the fire the receiver (insured) was informed the hotel could not be rebuilt because of a land use bylaw. The receiver decided to 'replace' the hotel by attempting to buy another hotel on a different site. The insurer refused to agree that this would constitute 'replacement' under the policy, frustrating the receiver's attempts to purchase a replacement hotel until 1990. Meanwhile, the insurer obtained a court order to pay the actual cash value of the building into court, despite a replacement cost clause in the policy, which read:

> In the event of loss, damage or destruction to property covered by this Policy, settlement shall at the option of the Insured be based on Replacement Cost (as described below).
>
> "Replacement Cost" is defined as whichever is the lessor of:
>
> (1)The cost to repair, rebuild or replace (whichever is the least) with new materials of like kind and quality;
>
> (2)The actual expenditure incurred in repairing, rebuilding, or replacing on the same or another site;
>
> and shall be subject to all the terms, conditions and limitations of this policy including endorsements thereon and to the following:
>
> (a)the liability of the Insurer(s) shall be limited to "Actual Cash Value" of the damaged or destroyed property at the time of loss unless and until the damaged or destroyed property is repaired or replaced and unless repair or replacement is executed with due diligence and dispatch by the Insured…

The first question to be decided was whether buying another hotel on a different site was 'replacement' under the policy. The court held it was, based in part on the particular wording of the RC clause which allowed for "replacing on the same or another site", and based in part on the *Chemainus* case in B.C. (see below). The second question was whether the delay of five years in perfecting the replacement was 'with due diligence and dispatch'. The court held the insured had satisfied this requirement because the insurer had "failed to cooperate with the insured to determine whether a proposed replacement would qualify under the contract".

12. This last point is a telling one. There is no question the courts will be disinclined to allow insurers to deny replacement cost coverage when the insured's failure to

replace with due diligence and dispatch, or at all, has been due, at least in part, to the insurer's wrong interpretation of what the policy yields. This message is clear from *Carlyle* and *319107 Alberta Ltd.*

13. A key element running through the cases where courts refuse to find a breach of the 'with due diligence and dispatch' condition is the fact that reasonably soon after the loss the insured will have expressed an intent to rebuild.

14. In the B.C. case of *Chemainus Properties Ltd. v The Continental Insurance Company* [1990] I.L.R. 1-2574 (B.C.S.C.) the insured's building was destroyed by fire. The insured's main tenant said it did not plan to continue its lease, although the insured informed the tenant it intended to rebuild. As a result the insured was reluctant to rebuild and began to explore the idea of purchasing a different building. The insurer "was aware" of the insured's intent. The policy's replacement endorsement read,

> 2. In the event of loss, destruction or damage to the property insured, the Insurer agrees to make settlement on the basis of replacement cost subject to the following provisions:
>
> (a) replacement shall be effected by the Insured with due diligence and dispatch;
>
> ...
>
> (c) settlement on a replacement cost basis shall be made only when replacement has been effected by the Insured and in no event shall it exceed the amount actually and necessarily expended for such replacement;
>
> ...
>
> In this endorsement,
>
> (a) "replacement cost" means the cost of replacing, repairing, constructing or re-constructing (whichever is the least) the property on the same site, with materials of like kind and quality and for like occupancy without deduction for depreciation; and
>
> (b) "replacement" includes repair, construction or re-construction with materials of like kind and quality.

The trial judge decided 'replacement' included the purchase of a different building on another site. His conclusion was based on the particular wording of the endorsement, which admittedly allowed for this interpretation.

Chemainus is a useful guide for how the courts will interpret the 'like kind and quality' condition. On this issue, *Chemainus* held that it was sufficient that the replacement building had comparable qualities, including the same usable area, 'substantially the same utility', 'equivalent' heating, lighting, plumbing and electrical services, and showed 'comparable' construction and finish.

15. Several useful points are worth noting from the case law. First, as is generally true for all insurance policy disputes, the specific wording of the endorsement and policy will be crucial to determining coverage.

16. Second, if the insurer takes the position the replacement cost endorsement does not apply, or disputes the extent of coverage it affords, it may be later prevented from asserting the insured's failure to replace with due diligence and dispatch, if the court later finds its position on coverage to be wrong. As the court said in *319107 Alberta Ltd.,*

> Thus an insurer may not rely on lack of due diligence of an insured in replacing a loss if the insurer has failed to cooperate with the insured in a substantive way to determine whether a proposed replacement might or would qualify under the contract. This would include consulting with an insured concerning whether a generic type of replacement, such as an existing hotel, or a specific proposed replacement, such as the Barrhead Neighborhood Inn, would qualify under the contract. If an insurer wrongly informs the insured that a replacement does not qualify, failure of an insured to follow through with that replacement cannot be construed as lack of due diligence.

17. Third, it is clear that insurers have an understandable interest in confining replacement cost recovery to those situations where the insured actually replaces. This condition serves to check on the moral hazard that would exist if the insured were free to spend the insurance proceeds as s/he sees fit. In keeping with this principle there is still a body of case law which holds that actual replacement must take place before the insurer is obliged to make any payment: for example, in *Anastasov v Halifax Insurance*, [1987] B.C.J. No. 1437.

18. Fourth, there are legitimate reasons for upholding the 'with due diligence and dispatch' requirement. Insurers have an interest in preventing increased loss settlements due to delays in construction. In the B.C. Supreme Court decision in *Folk v Saskatchewan Mutual Insurance Co.,* [1992] B.C.J. No. 2205, the court said,

> The policy requires the insured to proceed with construction "with due diligence and dispatch". Clearly, one of the main reasons for the inclusion of such a clause is to protect the insurer from the increased costs of reconstruction or repair that often result when delay occurs. In this case the estimate obtained by the insurer in July of 1991 indicated that the cost of reconstruction was already in excess of the policy limits. The burden of rising construction costs will, in these circumstances, be borne by the insured.

19. As a matter of practice insurers will often make advance payments, up to or including the ACV of the loss, where there is no dispute over the application of the RC endorsement. But as the B.C. Court of Appeal noted in *Carlyle* there is actually no legal obligation for insurers to do so. This principle has received mixed interpretation by the courts, as will be explained further below.

20. The insured's obligation to rebuild may not be triggered until the insurer acknowledges its reciprocal obligation to pay on the policy: *Peters v Commonwealth Insurance Co.*, [1990] O.J. No. 1125, quoting from *Jureidini v National British and Irish Millers Ins. Co. Ltd.*, (1915) A.C. 499:

> "…when there is repudiation which goes to the substance of the whole contract I do not see how the person setting up that repudiation can be entitled to insist on a subordinate term of the contract still being enforced."

21. This raises a potential 'Catch 22': where the insurer denies coverage, must the insured still comply with the conditions of the replacement endorsement before it can recover for replacement cost? The answer generally is no, especially if the denial can be said to have affected the insured's ability to effect the replacement: see *Olynyk v Advocate General Insurance Co. of Canada* (1984), 32 Man. R (2d) 171 (Man.Q.B.); affirmed on appeal at (1985), 33 Man. R. (2d) 234 (Man.C.A.) which remains a leading authority for the following proposition:

> However, an insurance company which wrongfully repudiates the contract and refuses to make any payment at all cannot defeat the claim of the insured to be indemnified against the costs of actual replacement simply because the insured has not exercised due diligence in getting on with the rebuilding. The breach by the insured is overshadowed by the much more basic breach by the insurer. In this case the repudiation by the insurance company, however understandable, turned out to be unjustifiable, and it is very much a smudged finger which the company points at the insured for delaying the decision to rebuild. It is not inequitable that an insured person who has paid the premium set by the company for replacement indemnity should be able, when the risk materializes, to have a fair opportunity of deciding what to do in the light of the funds which will

be available. Complete repudiation by the insurance company cripples the anticipated freedom of action of the insured.

22. Taking matters further, the court in *Fright v Zurich Insurance Co.* [1986] B.C.J. No. 2687 held, that even when the insured had the funds to do so, it's "ability to cover the replacement costs should not impose an obligation of 'due diligence and dispatch' where liability is denied and the policy remains in jeopardy." In effect, *Fright* suggests an expansion of the principle in *Olynyk*, above, to say that even in cases where the insured's freedom of action is not "crippled" by the insurer's repudiation, s/he should not be obliged to replace with due diligence and dispatch. But *Fright* has not been cited in subsequent jurisprudence and, as will be seen, there are limitations to this proposition.

The 'Chicken or the Egg'

23. In *843547 Ontario Ltd. v Zurich Insurance Co.*, [1993] O.J. No. 419, the insurer insisted it was not obliged to make any payment on the loss until the replacement cost was determined by actual replacement. Which must come first, the chicken or the egg? The court referred to the reciprocal obligation principle in *Peters*, above, but did not interpret it to mean that payment by the insurer is a condition precedent to the insured's obligation to rebuild. Rather it held there must be evidence of a 'binding intention' to replace the insured property before any moneys are payable. The court was satisfied that the insurer met its reciprocal obligation to pay by expressly acknowledging its duty under the policy and because it was prepared to pay on receiving evidence of the insured's binding intention to replace.

24. In *J.I.L.M. Enterprises and Investments Ltd. v Intact Insurance Co.*, [2017] O.J. No. 436 (Ont. S.C.J.) the insurer delayed its decision to pay for one year after the date of loss to pursue its investigation of arson. Two years after its investigation was (or should have been) concluded it paid the ACV of the loss. The court found it was reasonable for the insurer to have taken one year to complete its investigation, but found its continued delay for two years after that to be a breach of the insurance contract. Meanwhile, the insured had taken no steps to rebuild. At trial the insured argued it should be entitled to replacement cost, regardless whether it rebuilt or not, based on the conduct of the insurer, citing *Pardhan v. American Home Insurance Co.*, (1993) 13 O.R. (3d) 642 and (1997) 31 O.R. (3d) 641 (C.A.). In *Pardhan* the hearing judge would have awarded replacement cost without the obligation to replace on this reasoning:

> Had the insurer paid promptly, the insureds would have replaced the stolen equipment and continued in business. The insurer, by its conduct, effectively put the insureds out of business. In these circumstances, the insurer cannot benefit from its own wrong and rely on a provision which significantly limits its obligations to the insureds.

25. *Pardhan* is arguably the furthest extreme to which the courts have strayed from the principle laid down in cases like *Carlyle* and *Peters*, that replacement cost will only be paid after replacement, and can be considered outnumbered by more recent decisions, such as *Argo's Foods Inc. v. Economical Mutual Insurance Co.*, [2016] O.J. No. 1508, *Bahniwal v. Mutual Fire Insurance Co. of British Columbia*, [2016] B.C.J. No. 494 and *Evangeline Savings and Mortgage Co. v. General Accident Assurance Co. of Canada*, [1984] N.S.J. No. 65, all of which stand for the proposition that replacement cost can only be awarded following replacement. Thus, the weight of authority favours the rule that replacement must actually occur before replacement cost is payable.

26. The facts in *Evangeline Savings* provide a good example of the problems that can arise in settling replacement cost claims. A fire destroyed a multi-residential building in March 1981. The policy contained an RC endorsement. The insured requested a commitment from the insurer that "if" the building were rebuilt it would settle the claim on a replacement cost basis. Instead, the insurer responded with an offer to settle, which the insured rejected as too low. In the end, the insured did not rebuild because it was reluctant to take the financial risk that the cost might not be paid by the insurer. The Nova Scotia Supreme Court considered the insurer's failure to commit to a replacement cost settlement to be "not a display of … good faith" but did not agree that its conduct could relieve the insured of its duty to rebuild before being entitled to an RC settlement. Further, the court held the delay of almost 3 years until trial, without rebuilding, to be not 'with due diligence and dispatch' and were grounds for refusing settlement on a replacement cost basis. The result was to limit the insured's settlement to ACV.

27. In hindsight, in *Evangeline Savings* the insured and insurer were each trying to 'do the dance'—hedging their respective positions by having the other 'show me first'. In the end, the resulting delay ended up defeating the insured's claim for RCV. But this result may not always be guaranteed to follow.

28. The potential challenges facing both insured and insurer are illustrated well in the B.C. case of *Folk v Saskatchewan Mutual Insurance Co.*, [1992] B.C.J. No. 2205. A fire destroyed the insured's building, leaving the foundation intact, but the City's bylaws would not permit rebuilding without a new foundation due to the age of the building. The policy included a replacement cost endorsement and an exclusion for loss arising from the operation of municipal bylaws. The insurer denied coverage on the basis of the bylaws exclusion. The principle of *stare decisis* required the B.C.S.C. to consider the B.C.C.A.'s ruling in *Carlyle* (reviewed above) binding on it to find the bylaws exclusion did not apply to the replacement cost endorsement; in other words, subject to the policy limits there would be coverage for replacement costs, including a new foundation. Fifteen months elapsed between the date of the fire and the hearing of the insured's court application for coverage under its policy. In the meantime, the insured had started reconstruction. The trial judge found this to be proceeding with replacement 'with due diligence and dispatch' and expressly considered the insurer's continuous denial to be "a factor" in reaching this finding. He then addressed the challenge of rendering a judgment for the insured when he had not yet completed the replacement.

29. The trial judge in *Folk* referred to the Manitoba decision in *Gannon & Assoc. Ltd. v. Advocate Gen. Ins. Co. of Can.* (1984), 32 Man. R. (2d) 1 (Q.B.) where the court said,

> The standard provisions of the policy provide for payment of actual cash value; however, with the addition of a replacement cost endorsement an insured may seek indemnity for replacement if the repairs or replacement [are] effected in accordance with the terms of the endorsement. I see nothing in the endorsement or policy terms which negates or modifies the insurer's obligation to pay actual cash value within 60 days of proof while settlement for the additional costs of replacement or repair is delayed until replacement has been effected.
>
> The policy and statutory conditions contemplate the filing of only one proof. The standard form of proof of loss as given to the insured in this case does not contemplate a two stage payment, that is, one payment initially for actual cash value and a supplementary payment when replacement has been completed. The proof does not contain separate columns to show actual cash value and replacement costs. An insured, because only one proof is allowed, must claim replacement cost in the proof, although recognizing there is no obligation to indemnify until the replacement has been done. In the meantime no provision is made for immediate payment of the actual cash value. Obviously this is an area that is worthy of clarification and rectification.

30. This was the same predicament as the B.C. Court of Appeal had wrestled with in *Carlyle.* In that case, Esson, J.A. said,

> As a matter of practice it appears that insurers will generally pay the actual cash value where that is less and may make other progress payments, but the policy does not, as I read it, require them to do so.

One of the other two justices, Hutcheon J.A., in *Carlyle* questioned this legal conclusion, saying he did "not necessarily agree with it". The third justice, Seaton J.A., expressly refrained from commenting on it.

31. This left the trial judge in *Folk* with the possibility that *Carlyle* was not binding on him and thus giving him the opportunity to find the 'creative' solution of an interim award of ACV. He said,

> The structure of the policy subordinates the rider to the policy. While the rider is part of the policy, its terms do not modify the obligations of the insurer created by the portion of the policy requiring the payment of actual cash value. The statutory conditions of the policy create a requirement for a proof of loss. This requirement specifies that the proof of loss show the actual cash value claimed. That was not done in this case. The form of proof of loss used by the insurer in this case, unlike that before Simonsen J. [in *Gannon,* above] does contain separate columns for actual cash value and replacement cost. The insured is entitled to submit a proof of loss claiming the actual cash value of the building and claiming, as well, reimbursement under the optional loss settlement clause. The claim for reimbursement of the actual cash value will trigger an obligation on the part of the insurer to pay that amount within the time limited following the delivery of the proof of loss.
>
> The wording of the policy before me leads me to a conclusion different from that reached by Esson J.A. in Carlyle. I am satisfied that the policy does give rise to an obligation on the part of the insurer to pay the actual cash value of the property destroyed up to the limits of the policy or the insured's interest, whichever is less. A further obligation remains: to pay any additional amount expended by the insured to repair or replace the building up to the limits of the policy provided that the insured elects to proceed under that clause and complies with its terms and conditions.

32. Unfortunately, the insured in *Folk* had neglected to submit a proof of loss claiming ACV and the court had to dismiss his claim for actual cash value; although it did grant declaratory judgment for replacement cost as follows:

> The plaintiff is entitled to a declaratory judgment that upon compliance with all the terms, conditions and obligations on his part contained in the optional loss settlement clause of the policy he is then entitled to be paid by the defendant on the basis of the provisions of that endorsement up to the maximum monetary limit therein provided, namely, $62,000.00.

33. In other words, the court granted what is obviously a conditional judgment. The risk of this approach is that it opens the door to future disputes and litigation over whether there is "compliance with all the terms, conditions and obligations on [the insured's] part". A more careful rewording the replacement cost endorsement in property policies would be a better alternative to such a judicial solution, I would submit, with respect. In the meantime, we can expect that this is the most likely result in court.

34. A case in point is the 2017 decision of the B.C.S.C. in *J.I.L.M. Enterprises*; the court used a similar approach as in *Folk*. There the solution was to settle the amount to be paid as replacement cost, but only after replacement has been "undertaken": see *J.I.L.M. Enterprises* at para 81. This creative judicial approach has its obvious benefits for the insured, but puts the insurer at potential disadvantage if the insured delays in replacing. In doing so, the court may inadvertently prevent the prophylactic purpose of the 'with due diligence and dispatch' requirement. It is submitted that such rulings should try to fix a deadline for "undertaking" the replacement.

35. This leads to the question of how to protect insurers from the hazard of coverage in cases where the insured has not proven a genuine intention of replacing its property. This was the focus of the court's decisions in two recent cases, *Number 216 Holdings Ltd. v Intact Insurance Co.*, 2013 BCSC 1267 and *Bahniwal v Mutual Fire Insurance Co. of British Columbia*, 2016 BCSC 422.

36. In *Number 216 Holdings Ltd.*, the B.C.S.C. trial judge said,

> **423** The defendant points out that there was considerably more evidence in the above two cited authorities than there is in this case that the plaintiff was in fact making serious efforts to rebuild or had a realistic plan to do so.
>
> **424** In the *Peters* case, the court found as a fact that it was the insurer's refusal to pay or to commit to pay that directly prevented replacement. In other words, the facts in that case were clear that but for the insurer's failure to pay, the plaintiff would have been able to obtain financing and would have rebuilt the building.

425 In the *Folk* case the insured was proceeding with reconstruction at the time of summary trial. The court considered that the insurer's refusal to commit to coverage was a relevant factor in determining whether the insured met his obligation. The court concluded that the insured had moved with reasonable dispatch.

426 Here, the plaintiff moved quickly to prepare and file an interim proof of loss. The plaintiff also obtained a quote to rebuild soon after the fire. The plaintiff then learned that the cost to rebuild was going to be close to $1 million in order to meet modern building code standards. That this is close to the statutory appraisal of replacement cost provides me with some confidence that the cost to rebuild was in this range.

427 The plaintiff's position seems to ask the court to assume that the plaintiff would choose to rebuild had the policy been affirmed, despite the fact that the replacement cost payout under the policy would have fallen far short of the funds necessary to be able to rebuild a building of "like kind and quality".

428 The plaintiff's evidence does not address how or why the plaintiff would have chosen to rebuild, given the fact that the cost far exceeded any available insurance. If replacement cost proceeds of $572,000 were confirmed payable or paid out, and only $312,500 was paid on the mortgage debt (less than the full amount of the second mortgage debt), that would have left only $259,500 available to the plaintiff to rebuild.

429 The plaintiff company had no operations or significant assets other than the bare land, the value of which there is no direct evidence but in cross-examination by plaintiff's counsel of Mr. Warrington was suggested to be in the range of $67,500 based on an appraisal that was not put into evidence. I am unable on the evidence to infer that the plaintiff, or Sean or Rose Millns, had the financial wherewithal to be able to obtain financing for the plaintiff on the scale needed to rebuild, even if the plaintiff had received approximately $259,500 in cash from net insurance proceeds to put towards the effort. The plaintiff would still have needed to raise close to $740,000 to reach the anticipated construction costs.

430 The plaintiff did not call evidence of any plans to rebuild at a cost less than the quoted approximately $1 million.

431 I also have no evidence that a reasonable business person, or bank, would consider it worthwhile to invest between $740,000 to $1 million in a new commercial rental building in downtown Prince George. There is no evidence of a business plan, for example, to suggest that a new building would have generated sufficient rental income to pay anticipated financing costs. The fact that the Millns did not present such evidence is telling.

432 I conclude that it is more likely than not that had the insurer not breached the insurance policy, and instead confirmed that coverage was payable, that

nevertheless the plaintiff would have chosen not to rebuild or replace the building on the property.

433 The result is that the damages that flow from the breach of the insurance contract amount to the insurance coverage payable under the actual cash value terms of the policy, and not the replacement cost endorsement.

37. In *Bahniwal*, the trial judge said,

62… [I]n the present case, I conclude that while the Policy required the defendant to pay the cost of replacement after replacement is complete if the conditions were met, it did not require the defendant to fund the cost of replacement in advance. Furthermore, in this case I have found, as a fact, that the plaintiff failed to exercise due diligence and dispatch with regard to replacement, which constituted a breach of a condition that is fundamental to its application.

61 In *Anastasov v. Halifax Insurance Co.*, [1987] B.C.J. No. 1437 (C.A.), the insured claimed for items destroyed in a house fire on the basis of a replacement cost endorsement. The insured submitted a schedule of loss in which they claimed that the items had been replaced. In fact, the items had not been replaced; they had merely been set aside by merchants on the understanding that once the insurance monies had been provided, the purchases would be completed. On appeal from a judgment holding the insurer liable, the judgment was set aside. Macfarlane J.A. held that the claim was vitiated by the material misrepresentation. He went on to refer to *Carlyle* as authority for the proposition that there is no obligation on an insurer to fund the replacement and said at p. 7:

> In my opinion, that disposes not only of the plaintiffs' claim for damages, but also the plaintiffs' claim for judgment in the amount of the replacement cost. The defendant is not liable in damages because it has no obligation under the policy to pay any monies under the replacement cost coverage unless the replacement has been made. On the facts of this case no replacement had been made.
>
> Similarly, in the absence of proof of replacement of items lost there is no liability on the insurer to pay the insured the cost of replacement. The policy wording is plain on that point, it reads in part:
>
> > "We agree to pay on the basis of replacement cost provided that -- you have repaired or replaced the property promptly."

Summary: Navigating Replacement Cost

38. The following points may be taken from the varying treatment of replacement cost coverage by the cases examined above:

    a. It is still a general rule that in order to qualify for RCV an insured must effect replacement;
    b. The insurer is not required to fund the replacement in advance (*Carlyle*)—although this is often done as a matter of practice where there is no dispute over coverage;
    c. Courts have been prepared to award ACV as an interim measure to assist the insured in funding actual replacement (*Folk*);
    d. In cases where the insured has had to sue the insurer for RC coverage, but has not yet effected replacement, the court may grant a conditional award for replacement cost to take effect when the insured shows replacement has been "undertaken" (*J.I.L.M. Enterprises*);
    e. The wording of the RC endorsement or clause is crucial to its interpretation—for example, to determine whether replacement must be on the same site;
    f. The courts may allow the insured to escape from the requirement to replace *with due diligence and dispatch* when the delay is due to the insurer's wrongful refusal to extend coverage (in *Carlyle* the delay was five years);
    g. Some courts have held the insured's requirements under the RC endorsement do not have to be fulfilled until the insurer acknowledges its obligation to cover (e.g., *Peters*);
    h. But the insured must show at least a "binding intention" to replace before the insurer's reciprocal obligation (to acknowledge coverage) arises (*843547 Ontario Ltd.*);
    i. Where the insured has shown no evidence it intended to replace, it will only be entitled to ACV (*Number 216 Holdings Ltd.*);
    j. "Like kind and quality" has been held to mean that the replacement building has comparable qualities, including the same usable area, 'substantially the same utility', 'equivalent' heating, lighting, plumbing and electrical services, and shows 'comparable' construction and finish.

Actual Cash Value

39. In *Evangeline Savings* the Nova Scotia Supreme Court asked "What is 'actual cash value'?":

> **32** What is "actual cash value"? The view of Disbery, J., in Ziola v. Co-operative Fire and Casualty Company, [1976] 6 W.W.R. 159 (Sask. Q.B.) has found favour in our court and I am also prepared to accept it. At pp. 164-5, it is stated:
>
> In my opinion the law as it is found in the aforementioned authorities is that neither the replacement cost less depreciation test nor the market value test is, per se, a conclusive test for finding the actual cash value of the insured property at the time of the loss. The law takes a much broader view. Evidence seeking to establish a value on the basis of such tests or either of them is, of course, admissible, but the values so arrived at are to be considered along with all other evidence logically tending to show the actual cash value. In the case of buildings such other relevant evidence would, for example, include, inter alia, the use being made of the same, the purchase price, its sale value, age and obsolescence, condition, location and the opinions of experts.

40. In *Evangeline Savings* the expert evidence included calculations of ACV using valuations based on the “cost approach”, the “income approach” and the “direct sales approach”. The court’s comments in making its assessment of the evidence in *Evangeline Savings* can give us a good example of how the court might approach the question, “what is the ACV?”. The court’s comments are extracted in their entirety below

> **33** Each party submits that its calculation of actual cash value is the correct one and, in support of their submissions, both parties introduced evidence including that of expert witnesses.
>
> **34** Philson, J. Kempton, A.A.C.I., F.R.I., an accredited appraiser, prepared a report and gave evidence on behalf of the plaintiffs. His report is lengthy and there is no point trying to re-produce it, but I will summarize its highlights. The report treats three traditional valuation methods, namely, the cost approach, direct sales comparison and the income approach.
>
> **35** Cost Approach. The site is valued at $20,000; landscaping is valued at $5,000. The reproduction or replacement cost is estimated as follows: the indicated cost per square foot of $36.15 obtained by reference to Boeckh Valuation Manual is applied to the calculated area of the building (i.e. 17,100 square feet) to obtain a replacement cost of $630,600. From this is subtracted the value of depreciation, estimated by the Age Life Method; physical depreciation is calculated at $31,530 and economic obsolescence is calculated at $24,624, totalled to a rounded figure of $56,200. These figures yield a market value of $600,000.
>
> **36** Direct Sales Comparison. Nine properties which the appraiser considered to be somewhat comparable are analyzed. These reveal a price per apartment unit of $23,000 and a gross rent multiplier of 6.0 times income. Applying those figures to the destroyed building yields a range of value between $552,000 and $631,700. After deducting

$25,000 for site and site improvements, the appraiser estimates a market value of $605,000.

37 Income Approach. Assuming full occupancy, gross income of $107,784 is estimated by adding rental, laundry and ARP income. From this is deducted $4,805 (i.e. 5% of gross income excluding ARP) as a vacancy allowance. This calculation yields estimated effective gross income of $102,979. From this figure is deducted estimated net operating income of $69,579. Applying a market place capitalization rate of 11%, the appraiser calculates a market value of $633,000.

38 In reconciling the three approaches and arriving at a final estimate of value, Mr. Kempton gives most weight to the income approach, primarily because the destroyed building was an investment type property. In so doing, he arrives at final opinions as follows:

- Market value ..... $608,000 Replacement cost ... $630,600

39 The defendant submits that Mr. Kempton's appraisal contains a number of errors and statements that are incapable of substantiation including the following:

- 1.The area of the building is 20,825 square feet and not 17,100 square feet.
- 2.He assumed rents of $325 per month (without heat) when, in fact, rents were substantially less than that. Also, he did not consider serious incurable locational drawbacks. Both of these errors led him to select a factor for economic obsolescence which was too low.
- 3.In selecting comparables, he did not include four Yarmouth properties which had lower unit costs or lower gross rental multipliers, or both.
- 4.The actual gross rents were approximately $62,000 and not $105,284.
- 5.Estimated operating expenses of $69,579 were stated. Actual expenses, rather than estimated expenses, should have been used.
- 6.An 11% capitalization rate, found in the marketplace, is used. That rate was pulled out of the air and cannot be justified.

40 Charles, J.L. Hardy, B.Sc., A.R.I.C.S., A.A.C.I., an accredited appraiser, prepared an appraisal report and gave evidence on behalf of the defendant. As with Mr. Kempton's report, I will summarize the highlights. This report treats only the cost approach and the income approach.

41 Cost Approach. Based on the prices of recent sales of land in the area, the site is valued at $3,100. Calculations based upon the estimated cost of construction of two

other similar buildings indicate rates of $28.09 per square foot and $27.84 per square foot respectively; calculations based upon figures set out in Boeckh's Manual indicate a rate of $24.76 per square foot. Preferring the local rates, the appraiser uses a rate of $28 per square foot to arrive at the indicated value of the building with appliances in the amount of $653,748. From that is deducted incurable functional obsolescence which is calculated to be $246,610. This yields an indicated value of the building of $407,000.

42 Income Approach. A rental rate of $250 per month is used to maximize occupancy. That yields annual rents of $72,000 per year. Washer/dryer income of $3,000 per year is added. A vacancy factor is deducted. Since operating statements of the building are not available, the appraiser uses expense information from two comparable buildings to estimate expenses per apartment of $1,100 per year or $26,400 for the whole building; this is also deducted. The net operating income is calculated at $41,100. Applying a calculated capitalization rate of 14.12% to this figure yields an indicated value of the building of $291,000.

43 In reconciling those two approaches and arriving at a final estimate of value, Mr. Hardy considered that the most reliance should be placed upon the income approach because it was his opinion that the building cost approximately $137,000 in excess of the economic cost at which a developer would be willing to build. In so doing, he arrived at a final opinion of $291,000.

44 Mr. Hardy's appraisal is dated May 4, 1981. On March 11, 1983, he prepared and submitted an amended report. The amendment concerns the income potential of the property. It is intended to replace, to a large extent, the material as to the income approach set forth in the previous appraisal report. This amended report states that the original report was -

> - ... carried out with a minimal amount of financial data and a survey of properties as similar as possible in the Yarmouth market was necessary to arrive at estimated rents and expenses. The information now provided is somewhat different to our estimates which has resulted in this submission. ... In order to provide a good understanding of the circumstances relating to the value of the subject, various possible scenarios have been investigated together with the reasons for our final opinion.

This report is lengthier than the original report. I can but try to summarize its most important aspects.

45 The destroyed building was occupied until September 1980 when notice was given to the tenants making them responsible for payment of heat and power, after which occupancy was reduced to eleven units and remained in that area until the fire. The early occupancy of the twin building did not exceed 50% until the original building was destroyed by fire whereupon occupancy increased to the point where the average occupancy during 1982 was 79%. In Mr. Hardy's opinion, that percentage should be

considered as the most optimistic potential occupancy of the original building at the date of the fire.

46 It is not clear whether the landlord or the tenants were responsible for payment of power and heat. The expense statements for the two buildings show a wide difference between the two buildings for those two item of expense.

47 All actual operating expense information is not available, therefore, normal operating expenses are estimated. Those expenses are adjusted so that normalized expenses are used in the report.

48 Particularly because of the existing occupancy rate, it is considered to be unrealistic to project income based on the actual occupancy at the date of the fire; therefore, the appraiser has chosen as the most appropriate method of valuation what is known as the 'net present value' approach. Two key elements of the approach are the capitalization rate and the discount rate. Based upon knowledge and experience, the rate of 14.12% is chosen for the former and the rate of 18% is chosen for the latter. Projections are made for a four-year period. Projected net income in each of those years is:

1982 ..... $40,493.53

1983 ..... $43,063.80

1984 ..... $45,773.37

1985 ..... $48,626.50

Cash flow is analyzed for a four-year period indicating a net present value of $282,000 (rounded).

49 Finally, the appraiser carries out some additional calculations. Assuming that the landlord is responsible for payment of light and power, the net present value would be $127,500. Assuming that the tenants are responsible for light and power, the net present value would be $272,260. Assuming the same as well as full occupancy of the building, the net present value would be $426,850.

50 Just as the defendant criticized the appraisal of Mr. Kempton, the plaintiffs submit that Mr. Hardy's appraisal is defective in a number of respects including:

- 1.The entire thrust of his report assumes that the building could never reach an occupancy rate greater than 79%. That assumption cannot be substantiated.
- 2.In analyzing locational obsolescence, he discounted rents by 30.75% to $225 per month based upon his understanding of representations made

to an assessment appeal court; however, the evidence of Mr. Kempton and Mr. Homburg indicate that rents in the area range from $265 to $350.

- 3.He ignored management problems as the cause of the high vacancy rate prior to the fire and, thereby, treated vacancy as a long-term problem which it was not.
- 4.He rejected the comparables contained in the Kempton report based on his assumptions as to future optimum occupancy levels.
- 5.In arriving at a capitalization rate, he used an interest rate in excess of the actual rate in the Evangeline mortgage and dividend rate substantially above normal, based upon his own personal judgment.
- 6.He used a very high discount rate of 18%.
- 7.He used inflated expense figures.
- 8.He undervalued the MURB and ARP features of the building.

51 In addition to the appraisal reports, there are two other indications of the value of the building in the evidence.

52 First, the twin building was sold in October, 1983. The property was foreclosed by CMHC which bought it in at the sheriff's sale, advertised it widely and eventually re-sold it for $350,000.

53 Second, Homburg International Ltd. was retained by Durward as a consultant to cure the high vacancy factor and its perceived cause of difficulties created by resident managers. It was prepared to purchase the building. The amount of the offer is not in evidence, but the testimony of the company president indicates that rentals were represented as being $325 per month including heat and lights and that, if the purchase was consummated, it intended to charge approximately $365 per month inclusive of utilities. It was his opinion that the building could have achieved full occupancy.

54 It is interesting to note the great disparity between the expert opinion of the plaintiffs' witness, Mr. Kempton, and that of the defendant's witness, Mr. Hardy. The former expressed the opinion that the market value of the building on the date of its destruction by fire was $608,000, while the latter's opinion of its then market value was $282,000. For a building that was only sixteen months old and had a construction cost of $570,000, that disparity seems almost unbelievable. If Mr. Kempton is correct, the value of the building increased by some 6% in that brief period of time. If Mr. Hardy is correct, it shrank by over 50% during the same period. Both of them are highly qualified by education, training and experience. They gave every indication of being professionals in the field of valuation. That there can be differences of professional opinion between expert witnesses should not be surprising, we experience that phenomenon in court with increasing frequency, but here the difference appears to be more marked than usual. It Is difficult to believe that valuation of a building can give rise to two opinions which are so divergent. It is equally difficult to believe that appraisals and valuations can be considered as a suitable field of professional study and practice when its practitioners

are unable to agree upon value within reasonable limits. It seems to me that there is a disturbing tendency on the part of appraisers towards advocacy rather than the expression of objective and independent opinions.

55 The opinion of both experts cannot be correct. Indeed, in view of their criticisms of each other's report, it is unlikely that either of them is. I am inclined to favour the report and opinion of Mr. Kempton. He valued in an apparently normal manner by three usual methods of valuation, the results of which correlated well. He was criticized for his use of what might be termed idealized income figures; yet the adjusted figures used by Mr. Hardy are open to a similar kind of criticism. He was criticized for his choice of comparables; yet those used by Mr. Hardy are no better and, in my opinion, are not as good. He was criticized for not giving sufficient weight to economic or locational obsolescence; yet Mr. Hardy's opinion in that regard is equally a matter of individual judgment. He was criticized for attributing certain value to the MURB feature and to the subsidy coming from the ARP program; in my opinion, both were of substantial value up to the date of the fire. Mr. Kempton's treatment of the cause of the high vacancy factor at the time of the fire seems to be more balanced than that of Mr. Hardy. Indeed, comparison of the reports of the two appraisers indicates clearly that their respective opinions of value are dependent to a substantial extent upon their individual judgments on various factors such as appropriate capitalization rate, mortgage interest rate, quantum of depreciation, rentals in the area, the likelihood of future vacancies and general economic conditions. All too often the basis of a particular factor cannot be stated because, there can be no doubt, it is simply the product of the knowledge and experience of the individual appraiser.

56 We cannot expect perfection and, consequently, it is likely that neither appraisal is completely right or completely wrong. It is the duty of the court to weigh the opinion of each expert appraiser with respect to each of the various factors analyzed and with respect to the final opinion of value and, after giving consideration to all aspects of the competing appraisal reports as well as other evidence relevant to the question of value, to arrive at a fair and reasonable figure that is appropriate to the building described in evidence. That is what I have done in this particular case and, after considering the evidence and the submissions of counsel, I set $549,000 as the actual cash or market value of the building as of the date of its destruction on March 17, 1981.

41. In *Short v. Guardian Insurance Co. of Canada*, [1984] N.S.J. No. 74, 62 N.S.R. (2d) 1, 4 C.C.L.I. 193, [1984] I.L.R. 6819, [1984] I.L.R. para. 1-1770 at 6819, the Nova Scotia Court of Appeal held that actual cash value should be determined as follows:

> **27** The phrase "actual cash value" is defined by Black's Law Dictionary (4th Ed.), p. 53:
>
> - The fair or reasonable cash price for which the property could be sold in the market, in the ordinary course of business, and not at forced sale; the price it will bring in a fair market after reasonable efforts to find a purchaser who will give the highest price. ... What property is worth in money, allowing for

depreciation. ... Ordinarily, 'actual cash value,' 'fair market price,' and 'market value' are synonymous terms. ...

28 The actual cash value of a building or article is prima facie its market value -- the price obtainable in a sale by a willing vendor to a willing purchaser. It is also synonymous with "actual value", "fair cash price" or" exchangeable value" and is a standard which has been applied throughout Canada and the United States as "the most practical indicator of value": O'Halloran, J.A., in Stock Exchange Building Corp. v. Vancouver, [1945] 2 D.L.R. 663 (B.C.C.A.), at p. 665. It is not "value" in the abstract but the value to the insured at the time of the loss, having regard to the nature of the property and to all the conditions and circumstances then existing. See general statement in Leger v. Home Insurance Co. (1968), 1 N.B.R. (2d) 1 (N.B.C.A.) per Limerick, J.A., at p. 7.

29 When real property is only partly damaged, a market price often cannot even speculatively be calculated; what is the "actual cash value", for example, of part of the roof of my house? What must then be done, simply because no alternative exists, is to estimate the present cost to repair or replace the loss and from that deduct a reasonable amount for the physical depreciation which the property has suffered before the loss, whether from age or use.

30 Thus in Vanderburg v. Oneida Farmers' Mutual Fire Ins. Co., [1935] 1 D.L.R. 257 (Ont. C.A.), two old barns were destroyed by fire. The Court of Appeal approved payment of the cost of a new barn less depreciation of about 25% because the barns had been used for forty years. Davis, J.A., at p. 258 said:

> ... There are, of course, many cases where replacement cost less depreciation is obviously no measure of the loss. Old buildings are not infrequently a detriment, or at least of little value, in the sale of land, and it would be wrong to estimate loss in such cases by ascertaining replacement cost. One of such cases was Canadian Nat'l Fire Ins. Co. v. Colonsay Hotel Co., [1923] 3 D.L.R. 1001. It is in every case the actual loss that is to be ascertained though different methods of arriving at that loss may be appropriate in different cases.

31 Similarly, where buildings were extensively damaged in Davis v. Nationale Fire Insurance Co. of Paris, [1947] O.W.N. 783 (Ont. H.C.), Gale, J. (as he then was), held that, since he could not determine the market value of the property damaged, he had no alternative "but to regard the cost of re-instatement [less reasonable depreciation] as the only available measure of indemnity ... That method will not give an exact result but it is the only one which may be employed in the circumstances."

32 When chattels have been lost, how can "actual cash value" be determined? Normally no market exists where used goods may be bought or sold or by which a value could be determined. The original cost paid is usually irrelevant. It may have been much more or much less than the article was worth when lost. It, of

course, does not allow for depreciation since purchase; use and age may have rendered the article almost useless.

Third party claims for property damage

42. For comparison, our discussion now moves from first party property insurance to damages which may be awarded in third party claims for property damage.

43. The B.C. Court of Appeal decision in *Nan v Black Pines Manufacturing Ltd.*, [1991] B.C.J. No. 910 (C.A.) has been the seminal case in determining how the law measures the damages to which a third party is entitled for property damage caused by an tortfeasor and provides a guide for insurers to assess the exposure their insured's liability policy might face.

44. In *Nan* a fire resulting from Black Pines' negligent installation of a fireplace destroyed the Nan family home. Black Pines was defended by its insurer under its liability policy. Nan argued he should be awarded the full replacement of his home without any discount for depreciation. Black Pines argued the proper measure of damages should be the cost of replacement less depreciation. Both the trial judge and the Court of Appeal held that damages should be awarded for full replacement without any discount for depreciation.

45. *Nan* has been distinguished in subsequent decision in B.C.: *Taylor v King*, [1993] B.C.J. No. 1709 (C.A.); and *Prince George (City) v Rahn Bros. Logging Ltd.* [2003] B.C.J. No. 77 (C.A.) where the property damage was not related to a family's principal residence (*Taylor)* or involved commercial property (*Rahn)*.

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Charlotte Manning,
Blair Driedger,