

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS
FOR THE COMMISSIONER OF COMMERCE

In the Matter of the Certificate of Authority
of State Farm Fire and Casualty
Company

**RECOMMENDED ORDER FOR
SUMMARY DISPOSITION**

The above-entitled matter is before Administrative Law Judge (ALJ) George A. Beck on cross-motions for Summary Disposition filed by the Department of Commerce ("Department") and by State Farm Fire and Casualty Company ("State Farm"). Each party filed its initial motion with the Office of Administrative Hearings on April 13, 2000. Each party filed a reply memorandum on May 5, 2000. As a part of their filings the parties submitted a Stipulation of Facts. On May 12, 2000 the parties filed proposed Conclusions. The record closed on May 12, 2000, when the last written filing was received.

The Department is represented by Jennifer Shea Kenney, Assistant Attorney General, 1200 NCL Tower, 445 Minnesota Street, St. Paul, MN 55101-2130. State Farm is represented by R. Gregory Stephens, Esq. and Richard L. Pemberton, Jr., Esq. of the firm of Meagher and Geer, P.L.L.P., 4200 Multifoods Tower, 33 South 6th Street, Minneapolis, MN 55402.

Based upon all of the filings of the parties, and for the reasons set out in the accompanying Memorandum,

IT IS RECOMMENDED:

- (1) That the Commissioner of Commerce grant the Department's Motion for Summary Disposition as to the issue of liability.
- (2) That the Commissioner of Commerce grant State Farm's Motion for Summary Disposition as to the issue of whether liability was "reasonably clear" or as to whether the denial was in "good faith."
- (3) That the Commissioner not take disciplinary action.

Dated this 7th day of June 2000.

GEORGE A. BECK
Administrative Law Judge

Reported: No Hearing

NOTICE

This Report is a recommendation, not a final decision. The Commissioner of Commerce will make the final decision after a review of the record. Under Minn. Stat. § 14.61, the final decision of the Commissioner shall not be made until this Report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by this Report to file exceptions and present argument to the Commissioner. Parties should contact James C. Bernstein, Commissioner, MN Department of Commerce, 133 East 7th Street, St. Paul, MN 55101 to ascertain the procedure for filing exceptions or presenting argument.

MEMORANDUM

Each party has moved for a summary disposition of this matter in its favor. Summary disposition is the administrative equivalent of summary judgment in district court practice. It is appropriate in cases where there is no genuine dispute about the material facts, and one party must necessarily prevail when the law is applied to those undisputed facts.^[1] A genuine issue is considered to be one that is not a sham or frivolous, and a material fact is one whose resolution will affect the result or outcome of the case.^[2] The parties to this case have agreed that there is no material fact in dispute and that it may be properly decided as a matter of law.

The stipulated facts submitted by the parties disclose that this dispute arose from hail damage to houses in May and June of 1998, that were insured by State Farm. In 1999 State Farm received notification of the six roof damage claims involved in this case that were attributable to the May-June 1998 storms. Each claim was submitted by a State Farm insured who owned the house at the time of the storms. However, in each case the State Farm insured had subsequently sold the house, without any claim made to State Farm for damage prior to the sale. The original owners (the State Farm insureds) did not discover any damage to their roofs when they were occupying their houses or when their policies were in effect on the house. The new or current owners discovered damage to their roofs after the sale had been completed and they were living in the houses. The sale price of the houses was not reduced due to the undiscovered roof damage and no legal action has been brought against any of the

original owners based upon the roof damage. Notice of the claims were given to State Farm by the original owners at the request of and on behalf of the current owners.^[3]

The allegations made by the Department against State Farm in this proceeding were based upon letters received from the current homeowners rather than the six State Farm policyholders. Affidavits from two of the policyholders indicate that in their opinion they have not sustained a loss. State Farm does not dispute that hail damage is a named peril in its policy. It has paid out over 55,000 such claims arising out of the 1998 hailstorms in a total amount that exceeds \$369,000,000. The difference between those claims and those at issue in this proceeding is that in this case the homes were sold before any damage was discovered.^[4] State Farm therefore claims that any physical damage to the property did not produce a financial loss to its insured and that there is accordingly no coverage under its policy.

Under Section 1 of the homeowners policy in question State Farm provides first party coverage “for accidental direct physical loss to the property” including damage by windstorm or hail.^[5] The “Losses Not Insured” section of the policy contains no specific exclusion due to sale of the property, nor does it specifically provide that the loss must be financial. An insured is entitled to “the cost to repair or replace with similar construction”, under the policy. There is no requirement that the insured actually incur the cost to repair in order to recover under the policy. Rather the insured is entitled to “the actual cash value at the time of the loss of the damaged part of the property...”^[6]

Section 2 of the homeowners policy is entitled “liability coverages” and would apply, for example, if there were a lawsuit against the former homeowners based on the storm-damaged roofs. This “third party coverage” is not involved in this proceeding. State Farm believes that the Department is attempting to apply third party coverage in this case by requiring a payment to a non-insured.

The Department alleges that State Farm’s handling of the six claims violates Minnesota law in two respects.^[7] Minn. Stat. § 72A.20, subd. 12(6) provides that it is an unfair, deceptive or fraudulent act concerning any claim if the insurer is:

- (6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;

Secondly, the Department argues that State Farm has violated Minn. Stat. § 72A.201, subd. 4(10) which makes it an unfair settlement practice:

- (10) Unless expressly permitted by law or the policy, refusing to settle a claim of an insured on the basis that the responsibility should be assumed by others;

Based upon these alleged violations the Department argues that State Farm has subjected itself to potential revocation or suspension of its certificate of authority, censure, and/or imposition of civil penalties, under Minnesota insurance law.^[8]

The Department has the burden of proof to show by a preponderance of the evidence that State Farm has violated the cited statutory provisions.^[9] In order to prevail, the Department must show that State Farm's liability to pay for the hail damage has become "reasonably clear." Although the Department has maintained that coverage is not an issue in this case, it cannot show that liability is reasonably clear without demonstrating that the policy likely covered the damage, at least where, as here, the Respondent is denying liability.

Generally the homeowners policy requires State Farm to pay for accidental direct physical loss to property, including hail damage. State Farm argues, however, that it has no liability in this unique situation because there is no financial loss to its insureds since they have sold the property without a loss in market value due to the hail damage. It argues that under Minnesota law an insured cannot recover first party insurance benefits if he has sustained no loss.^[10] State Farm points out that its insureds will incur no repair costs in this situation and that any payment to the insured would constitute a windfall. State Farm supports its argument by submitting two affidavits from its insureds who state that they do not believe that they have suffered any loss.^[11] It suggests that a payment to the insured under these circumstances is not a "reasonable expectation" under Minnesota case law.^[12] State Farm asserts that neither the former insureds nor State Farm reasonably expected the homeowners policy to provide a payment reflecting repair costs incurred by a non-party to the insurance contract, such as the buyers of the houses in question.

The homeowners policy obligates State Farm to "insure against accidental direct physical loss". The policy does not define "insure" or "loss". Based upon dictionary definitions, State Farm argues that "to insure" means to indemnify another against a specified loss and that "indemnify" means to make compensation for a loss suffered. State Farm then interprets "loss" to be "the amount of financial detriment" caused by an insured's property damage. It suggests that houses sustain damage, but only people sustain losses.

In response to State Farm's argument the Department points out that there is no requirement of a financial loss anywhere in the homeowners policy. The policy speaks in terms of "accidental direct physical loss to property". The Department therefore argues that under the terms of the policy the loss is damage to the house rather than "financial" loss as proposed by State Farm. And in fact the case law cited by State Farm to support a requirement of financial loss only speaks in terms of "loss".^[13] Generally, any reasonable doubt as to the meaning of an insurance policy is resolved in favor of the insured.^[14] Accordingly "loss" should not be rewritten to mean "financial loss".

The Department convincingly argues that even if a financial loss is required, that loss is the cost of repair of the roof and not, as State Farm suggests, a loss in the market value of the home. The loss of market value in a house is, of course, a subjective determination which cannot be precisely measured. Significantly, insureds under the policy are not required to repair or replace damaged property. Rather they are entitled to the actual cash value at the time of the loss. This constitutes a loss

within the meaning of the policy. Neither does the doctrine of “reasonable expectations” deny coverage in this situation. As the Department points out the insureds may well have had a reasonable expectation that having paid an insurance premium they would be able to recover for damage during the policy.

State Farm also argues that the six insureds in this case cannot recover because they no longer have an insurable interest. It argues that a claimant must have an insurable interest in the property at the time of an insurable loss in order to recover. State Farm suggests that under the “principle of indemnity” insurance contracts cannot confer a benefit greater in value than the loss suffered by the insured. It also argues that generally the vendor of a house loses interest in the homeowners policy when the house is sold.^[15] However, the case law cited by the Department indicates that an insured has an insurable interest if, by the destruction of the property, he will suffer a loss whether he has or has not any title to the property itself.^[16] The insureds have at least a potential legal liability to the buyers of the property that might cause them a loss. The State Farm insureds also had an insurable interest in the property at the time they sustained the physical loss, that was capable of measurement by the cost of repair.

The policy argument advanced by State Farm is that allowing a recovery by an insured in the absence of a financial loss creates a windfall and is likely to drive up the cost of premiums for first party property insurance. It suggests that the third party purchasers of the homes have no legal means to obtain payment from the former policyholders due to the doctrine of *caveat emptor*. The record does not, however, support the conclusion that a large number of claims would be involved. Rather, this appears to be a quite unique situation. Neither would the doctrine of *caveat emptor* prevent a lawsuit or a settlement. And, as the Department points out, State Farm has collected a premium to cover the loss in question but argues that it should not be required to make any payment. There is continuous owners’ coverage for the residences in question, but under State Farm’s interpretation, no payment would be made for the property damage. In one case, in fact, State Farm provided coverage for both the seller and the buyer of the property but maintains that there is no coverage for the hail damage. As was suggested by one of State Farm’s adjusters,^[17] collecting a premium in anticipation of a hailstorm without paying for the property damage could be construed as an unfair windfall to State Farm.

Resolving the question of coverage does not resolve the outcome of this contested case proceeding, however. In order to prevail the Department must show that liability was reasonably clear and that the Respondent did not proceed in good faith in denying these claims. The Department believes that the Respondent’s lack of good faith is demonstrated by its failure to adjust these claims. In other words, the Department believes that coverage is so clear or “logical”, that a failure to adjust the claims is necessarily evidence of bad faith. However, State Farm contends that the record demonstrates that it had a legitimate good faith disagreement about insurance coverage in this situation.^[18] The insurer’s position must be shown to be unreasonable, not merely unsuccessful.

The record does indicate that State Farm's failure to consider these claims was not done in bad faith. What is available in the record indicates that it believed that its insured had suffered no loss and that the insured no longer had any insurable interest in the property. After all, State Farm's own policyholders have not filed any complaints about its claim handling practices in regard to the hail damage. The complaints were filed by the current homeowners.^[19] In fact two policyholders have filed affidavits indicating that they have suffered no loss. Obviously, State Farm has paid a very large number of claims relating to the hail damage in Minnesota in May and June of 1998. This demonstrates good faith, especially when compared to the handful of claims involved in this proceeding. Furthermore, State Farm has advanced a plausible legal argument against coverage. The Department has not demonstrated that coverage was "reasonably clear".

It is therefore, recommended that the Commissioner determine that although liability exists in this situation, it was not reasonably clear within the meaning of Minn. Stat. § 72A.20, subd. 12(6), nor was State Farm proceeding in bad faith, so as to make its actions an unfair deceptive or fraudulent act. It follows from this determination that State Farm's actions cannot be characterized as attempting to shift the responsibility for the damage to others within the meaning of Minn. Stat. § 72A.201, subd. 4(10), so as to constitute an unfair settlement practice.

G.A.B.

^[1] Minn. Rule pt. 1400.5500K; Minn. Rule Civ. Proc. 56.03.

^[2] Highland Chateau v. Minnesota Department of Public Welfare, 356 N.W. 2d 804, 808 (Minn Ct. App. 1984) *rev.denied*, (Minn. Feb. 6, 1985).

^[3] The full stipulation of facts is set out at the Department's April 13, 2000 Memorandum of Law at p. 2 and State Farm's April 13, 2000 Memorandum of Law at p. 3.

^[4] It should be noted, however, that State farm has paid post sale claims where there was a deduction in the sale price due to hail damage during the policy period. Ex. 22.

^[5] Ex. M, Sec. 1-Losses Insured, Cov. A.

^[6] Ex. M, Sec. I-Loss Settlement, Cov. A.1.A1.

^[7] The Department agreed to proceed only on Counts I and III of the Notice of Hearing.

^[8] Minn. Stat. § 45.027, subd. 6 and 7; Minn. Stat. § 60A.052, subd. 1.

^[9] Minn. Rule pt. 1400.7300, subp. 5.

^[10] Marshall Produce Co. v. St. Paul Fire & Marine Insurance Co., 256 Minn. 404, 413; 98 N.W. 2d 280, 288 (1959).

^[11] Ex. 5, Ex. 12.

^[12] See Grossman v. American Family Mutual Insurance Co., 461 N.W. 2d 489 (Minn. Ct. App. 1990), *rev. denied* (Minn. December 20, 1990).

^[13] State Farm's Memorandum of Law dated April 17, 2000, p. 12.

^[14] O'Shaughnessy v. Smuckler Corp., 543 N.W. 2d 99, 101 (Minn. Ct. App. 1996).

^[15] Culbertson v. Cox, 29 Minn. 309, 311; 13 N.W. 177, 178 (Minn. 1882).

^[16] Crowell v. Delafield Farmers Mutual Fire Insurance Co., 463 N.W. 2d 737, 738 (Minn. 1990). (farmer retained insurable interest even after mortgage foreclosure and expiration of redemption period).

^[17] Ex. L.

^[18] Morris v. American Family Insurance Co., 386 N.W. 2d 233, 237 (Minn. 1986). In Re Insurance Agents Licenses 473 N.W. 2d 869, 877 (Minn. 1991).

[\[19\]](#) Ex. A-E.