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BE PREPARED: COMMON CAT ADJUSTING ISSUES IN THE CAROLINAS AND VIRGINIA

Tropical Storm Arthur is expected to impact the coast of the Carolinas and continue up the Eastern seaboard possibly as a Category I Hurricane. Given the storm's projected path and size, insurers will receive a host of claims in a number of different states. Nearly 35 years' experience in first-party coverage teaches us that most, if not all, of these issues will arise from Arthur, including: Wind vs. water, flood insurance, ensuing loss, appraisal, valued policy laws, public adjusters, code upgrades, orders of civil authority, off-premises power interruption, business interruption, extra expenses and more.

Although we are unable to discuss in detail all of these issues in this correspondence, we have highlighted some relevant topics and case law from North Carolina, South Carolina and Virginia, as they may offer you guidance in the upcoming days and weeks. In the meantime, we stand ready to apply our vast experience and legal acumen to address your coverage concerns.

VALUED POLICY LAWS

Generally, "valued policy" statutes add to insurance policies a provision that the amount insured (i.e. the policy limit), is the conclusive amount of loss when the property is completely destroyed by a covered peril. Although neither Virginia nor North Carolina is a "valued policy" state, to some extent, South Carolina is. *See cf. Williford v. So. Fire Ins. Co.*, 248 N.C. 549, 103 S.E.2d 804 (1958) (holding that both open and "valued" policies are enforceable).

For instance, in North Carolina and Virginia, a claim is to be adjusted and paid in conformity with the relevant policy's provisions. *See Sharpe v. Nationwide Mutual Fire Insurance Company*, 62 N.C. App. 564, 302 S.E. 2d 893 (N.C. App. 1983); *Whitmer v. Graphic Arts Mut. Ins. Co*., 242 Va. 349, 354, 410 S.E.2d 642, 645 (1991). In other words, consistent with most policies' loss settlement provisions, an insured in North Carolina and Virginia must comply with the replacement cost provisions before being entitled to the value of the policy. *Gilbert v. North Carolina Farm Bureau Mut. Ins. Companies*, 574 S.E. 2d 115 (N.C. App. 2002); *Edmund v. Fireman's Fund Ins. Co.*, 256 S.E. 2d 268 (N.C. App. 1979); *Whitmer*., 242 Va. at 354, 410 S.E.2d at 645. In North Carolina and Virginia, the "broad evidence rule" is applied to allow for all evidence logically tending to establish value to be utilized. *See Surratt v. Grain Dealers Mutual Ins. Co.,* 74 N. C. App. 288 (1985); *Harper v. Penn Mut. Fire Ins. Co.,* 199 F.Supp. 663 (E.D. Va. 1961).

South Carolina, however, is a valued-policy state, but only in the event of losses caused by fire. Specifically, S.C. Code Ann. §38-75-20 provides the following:

> In case of total loss by fire the insured is entitled to recover the full amount of insurance. In case of a partial loss by fire the insured is entitled to recover the actual amount of the loss but in no event more than the amount of the insurance

> stated in the contract. If two or more policies are written upon the same property, they are considered to be contributive insurance, and, if the aggregate sum of all such insurance exceeds the insurable value of the property, as agreed by the insurer and the insured, each insurer, in the event of a total or partial loss, is liable for its pro rata share of insurance. This section does not apply to insurance on chattels or personal property.

Thus, if a South Carolina residence is determined to be a total loss as a result of a fire, *e.g.*, ignited by a lightning strike during Arthur, Coverage A limits are immediately owed regardless of the actual market value of the residence. *See South Carolina Ins. Co. v. Price*, 432 S.E. 2d 508, 315 S.C. 212 (S.C. App. 1993).

POST-LOSS CONDITIONS

A. Proof of Loss

Blank proofs of loss should immediately be sent to insureds making new claims, in the Carolinas and Virginia. In North Carolina and Virginia, unless an insurer provides a blank sworn statement in proof of loss form within 15 days of a written request to an insured for compliance with the same, this post-loss condition is waived. *See* N.C. Gen Stat. §58-3-40 and Va. Code Ann. §38.2-320. Similarly, in South Carolina, an insured is deemed to have complied with a proof of loss requirement unless an insurer furnishes a blank proof of loss within 20 days after receipt of the claim, absent a shorter time dictated by the policy. S.C. Code Ann. §38-59-10. While these statutory provisions are very narrow in scope, compliance is easily done by routinely supplying blank proofs of loss with the acknowledgment of claim.

B. Examination Under Oath

In North Carolina, if an insured fails to appear for an examination under oath, that failure bars recovery under the policy and prohibits the insured from maintaining a breach of contract action against an insurance carrier. *Baker v. Independent Fire Ins Co.*, 405 S.E. 2d 778 (N.C. App. 1991) (willingness to provide examination under oath after filing suit did not satisfy policy's post-loss condition); *Fineberg v. State Farm Fire & Cas. Co.*, 438 S.E. 2d 754 (N.C. App. 1994) (a recorded statement is not sufficient to comply with the Examination Under Oath provision); *Pool v. State Farm Fire & Cas*. Co., 2002 WL 31510756 (4th Cir. 2002).

In South Carolina, however, courts are reluctant to prevent recovery when an insured fails to comply with post-loss conditions absent a finding of prejudice to the insurance carrier. The Supreme Court of South Carolina determined that an examination under oath was not a condition precedent to bringing a lawsuit. *Puckett v. State Farm Gen Ins Co.*, 444 S.E. 2d 523 (S.C. 1994) (the Court noted that forfeiture of coverage is disfavored.) As a result, in South Carolina, an insurance carrier must prove prejudice stemming from the insured's failure to comply with post-loss conditions. *Shiftlet v. Allstate Ins. Co.*, 451 F.Supp. 2d 763 (D. S.C. 2006). Thus, if an insured refuses to comply with post-loss conditions and sues the insurer, a jury will determine whether such refusal actually prejudiced the insurer's ability to adjust the claim. In contrast, the same facts would result in a summary judgment in favor of the insurance carrier in North Carolina. Therefore, it is critical with South Carolina losses to document not only when an insured has not complied with a post-loss condition but also how such failure has adversely affected or hindered the adjustment process.

In Virginia, similar to North Carolina, an insured may be found to have breached its policy by willfully failing to submit to an examination under oath ("EUO"), after an insurer has made reasonable efforts to secure the insured's cooperation. *Hurst v. State Farm Mut. Auto Ins. Co.*, 2008 WL 4394759 (W.D. Va. 2008). Further, an EUO may encompass "any matter material to the insurer's liability and the extent thereof." *Powell v. USF & G Co.*, 88 F.3d 271 (4th Cir. 1996). The statutory EUO language "is broad enough to encompass financial motivations for suspected fraudulent conduct." *Id* at 274 ("the Fifth Amendment does not abrogate an insured's duty to provide an EUO"); *U.S. Specialty Ins. Co. v. Skymaster of Va., Inc.*, 26 Fed. Appx., 154 2001 WL 1602030 (4th Cir. 2001). Thus, in Virginia, when an insurer has undertaken sensible efforts to ensure an insured's cooperation at an EUO and that insured has failed to comply, an insurer may properly disclaim coverage.

C. Appraisal

In North Carolina, appraisal is a means by which an insurer and insured may resolve an "actual and honest" dispute amount the amount of loss at issue—not determine coverage. *Hailey v. Auto-Owners Ins. Co.,* 181 N.C. App. 677, 640 S.E. 2d 849 (2007) (quoting 14 *Couch on Insurance* 2d § 50:56 (rev. ed.1982)). For instance, in *Hailey*, the Appellate Court held that the insured "could not invoke [the commercial policy's] appraisal provision in response to insurer's letter that allegedly was [a] blanket denial of claims, where the insured failed to substantiate the amount of loss he allegedly sustained for each property. *Id.*, 181 N.C. App. at 687, 640 S.E. 2d at 855. This decision was recently reiterated by the North Carolina Supreme Court, which held that an insurer "retains the right to determine...what portion of that loss is covered by the policy" before paying an appraisal award. *North Carolina Farm Bureau Mut. Ins. Co. v. Sadler*, 365 N.C. 178, 711 S.E. 2d 114 (2011). There, the court held that an insurer may reduce an appraisal award or even not pay it at all depending upon the policy limitations. In other words, the "appraisal process is limited to a determination of the amount of loss and is not intended to interpret the amount of coverage or resolve a coverage dispute." *Id* at 117; *see also Patel v. Scottsdale Ins. Co*., 728 S.E.2d 394, 399 (N.C. Ct. App. 2012) (deeming insured's suit premature, as insured failed to first comply with policy's loss settlement provisions.).

Similarly, in Virginia, a plain reading of the statutory appraisal clause reveals that appraisal is to resolve disputes as to the amount of the loss; not the existence of coverage. *HHC Associates v. Assurance Co. of America*, 256 F. Supp. 2d 505 (E.D. Va. 2003) (failure to participate in appraisal under Va. Code §38.2-2105 after denial of coverage was not an inference of bad faith).

In South Carolina, if an appraisal is not a condition precedent in the policy, compliance with the demand for appraisal is not required before a lawsuit can be maintained. If the policy identifies appraisal as a condition precedent, appraisal is required before the insured can maintain a lawsuit, unless the insurer waives appraisal by its conduct. *Harwell v. Home Mut. Fire Ins. Co.*, 91 S.E. 2d 273 (S.C. 1956); *Miller v. British America Assur. Co.*, 238 S.C. 94, 119 S.E. 2d 527 (S.C. 1961).

BAD FAITH

The Carolinas follow the majority of states in recognizing that a bad faith cause of action (as well as an Unfair Trade Practices action) may be brought *concurrently* with a breach of contract action. In other words, there is no requirement that the insured first prevail in a breach

of contract action before bringing a bad faith lawsuit.

Under North Carolina law, to prevail on a claim of bad faith, a plaintiff must establish that there was (a) a refusal to pay after recognition of a valid claim, (b) "bad faith," and (c) aggravation or outrageous conduct. *Topsail Reef Homeowners Assn. v. Zurich Specialties London Ltd.*, 11 Fed. Appx. 225, 237, 2001 WL 56537 (4th Cir. 2001). Bad faith occurs when decisions or actions are not based upon legitimate, honest disagreement as to the validity of the claim. Similarly, aggravated conduct entails include fraud, malice, gross negligence, insult or acting in a manner which evinces a reckless and wanton disregard of the insured's rights. *Lovell v. Nationwide Mutual Insurance Co.,* 424 S.E. 2d 181 (N.C. App. 1993). An insured can recover punitive damages and attorney's fees in a bad faith action. *Id.* at 184; *Lloyd v. Grain Dealers Mut. Ins. Co.*, 645 S.E. 2d 230 (N.C. App. 2007).

In the alternative, an insured may elect to proceed with its claim under the Unfair and Deceptive Trade Practices Act. Trade practices of the insurance business are regulated by Chapter 58, Article 63, of the North Carolina Statutes, and Unfair and Deceptive Claim Settlement Practices are specifically prohibited under N.C. Stat. §58-63-15(11). The statute enumerates specific instances of unfair or deceptive practices. If an insured prevails in this statutory claim, punitive damages are not available. However they can recover treble damages and attorney's fees via N.C. Stat. §75-16. *High Country Arts and Craft Guild v. Hartford Fire Ins. Co.*, 126 F.3d 629 (4th Cir. 1997). Accordingly, it is important to note that an insured cannot recover under both theories of liability. Rather, the insured must elect a remedy and the damages recoverable under that cause of action.

South Carolina only recognizes common law bad faith based upon an insurer's duty to its insured or violations of the statutorily enumerated unfair claims practices. (The South Carolina Code identifies the prohibited practices but does not create a private cause of action.) This tort action is based upon the duty that an insurer owes to its insured of good faith and fair dealing. *Nichols v. State Farm Mut. Auto. Ins. Co*., 279 S.E. 2d 616 (S.C. 1983). If an insured can demonstrate bad faith (or unreasonable action by the insurer in adjusting the claim), the insured can recover consequential damages and is not limited to contractual damages. *Id.* at 619. That duty does not extend beyond the insurer to an independent adjuster, but their actions may be imputed to the insurer. *Charleston Dry Cleaners & Laundry, Inc. v. Zurich American Ins. Co.*, 586 S.E. 2d 586 (S.C. 2003).

In Virginia, there is no common law first-party bad faith. *See A & E Supply Co. v. Nationwide Mut. Fire Ins. Co.*, 798 F.2d 669, 676 (4th Cir.1986); *Douros v. State Farm Fire & Cas. Co*., 508 F.Supp. 2d 479, 484 (E.D.Va. 2007). Rather, there is a statutorily created bad faith cause of action, as set forth in Va. Code 38.2-209, whereby an insured may recover attorney's fees and costs if the insurer acted in bad faith. *Styles v. Liberty Mut. Fire Ins. Co.*, 2006 WL 1890104 *1 (W.D. Va. 2006). Virginia uses a "reasonableness" standard for evaluating bad faith claims. *Cuna Mut. Ins. Soc. v. Norman*, 375 S.E. 2d 724 (Va. 1989).

CONCLUSION

Butler has nearly 35 years of experience assisting insurers in the adjustment and, where necessary, litigation of hundreds of hurricane claims throughout the Gulf States and the Atlantic coast. We have handled a broad range of claim issues, whether involving minor homeowner and condominium losses or large commercial losses in excess of $200 million.

For immediate assistance, identifying and avoiding potential pitfalls during the claim and adjustment process, contact Andy Watson in our Charlotte, N.C. office (704) 543-2321 awatson@butler.legal. In addition to having worked hurricanes in our Miami office for over ten years, Andy is a member of the Bar of both North Carolina and South Carolina. Our other property partners have extensive hurricane experience as well.