KALATHAS V. LITITZ MUTUAL INSURANCE CO. AND EVERETT CASH MUTUAL INSURANCE CO., (No. 2), C.P. Franklin County Branch, No. A.D. 1981 - 274

Declaratory Judgment - Fire Insurance Policy - Actual Cash Value - Co-insurance Clause

1. Where a fire insurance policy does not define the term "actual cash value" a building's depreciation may not be deducted from repair costs in determining the "actual cash value" of the building at the time of partial loss.

2. The co-insurance clause in insurance policies requires the insured to maintain insurance coverage to a specified value of the property, and to bear a proportionate share of any loss if the insured fails to maintain that required coverage.

3. Co-insurance clauses are valid but have been subject to strict construction.

4. An insurer may not rely on an exclusionary clause as a defense to liability unless it can be established that the effect of the exemption was explained to the purchaser and the insured understood the terms of the provision.

Thomas J. Finucane, Esq., Attorney for Plaintiff

Gerald Belz, Esq., Attorney for Defendants

ADJUDICATION AND DECREE NISI

KELLER, J., November 10, 1982:

This action was commenced by the plaintiff, Tom M. Kalathas, pursuant to the provisions of the Declaratory Judgments Act, 42 Pa. C.S. Sec. 7531 et seq. on September 2, 1981, when the plaintiff filed his Complaint naming Lititz Mutual Insurance Company as the defendant. On September 28, 1981, the defendant filed preliminary objections which were disposed of by this Court's Opinion and Order of January 19, 1982.* Pursuant to that Opinion and Order the plaintiff filed an Amended Complaint on February 3, 1982, wherein Everett Cash Mutual Insurance Company was named as a co-defendant. Both defendants filed their Answer with New Matter and Counterclaim through their joint counsel on March 12, 1982. Plaintiff's Answer to New Matter and Counterclaim was filed on March 25, 1982. By order of June 30, 1982, hearing on plaintiff's petition for declaratory judgment was set for July 19, 1982. Hearings were held on July 19 and August 2, 1982. Briefs were filed on behalf of the parties and oral arguments

*Editor's Note: Reported at 5 Franklin 119.

were heard on September 20, 1982. The matter is now ripe for disposition.

The facts in this case are crucial to its outcome. Therefore, they will be extensively reviewed prior to the analysis of the applicable law.

FINDINGS OF FACT

1. Tom M. Kalathas, hereafter plaintiff, resides at 72 W. Queen Street, Chambersburg, Pa., and is 32 years old.

2. Plaintiff was born in Greece. He had six years of formal eduction in Greece.

3. He emigrated to the United States in 1966 at the age of 17, and has resided in Chambersburg since that date.

4. The plaintiff has not attended any school in the United States. He speaks some English with a marked accent and testified that he understands more than he can speak of the English language. He can read very little written English.

5. Upon his arrival in the United States, the plaintiff worked for his uncle in the uncle's restaurant located at 102 Lincoln Way West, Chambersburg, Pa. Later the plaintiff leased the business and in 1981 he purchased it.

6. In 1976, the plaintiff purchased two separate buildings in Chambersburg, one situated at 136-142 Lincoln Way West, and the other at 144-146 South Main Street. The building on South Main Street contained a music store and five apartments which were leased to tenants. The Lincoln Way West building was also a rental property. Both rental properties were managed by persons other than the plaintiff.

7. The plaintiff was not represented by an attorney at the time of his purchase of the two properties.

8. Prior to settlement for the two properties, the plaintiff secured fire insurance through the Strickler Agency in the amount of the total purchase price to cover the interest of the plaintiff and the mortgagee. Someone from the agency "measured" the real estate but the plaintiff told the agent how much insurance coverage he wanted, and that was the amount of the policy which was issued.

9. The plaintiff and his brother, Charles, age 35, operate the Famous Texas Restaurant. Charles' ability to speak, comprehend and read English is approximately that of plaintiff's. A bookkeeper takes care of the business transactions of the restaurant.

10. Patrons of the restaurant give their orders to the waitresses who relay them to the Greek cooks; the customers then tell the cashier what they purchased. There are no written orders and no written bills. The business is unique and operates on a reliance of customer honesty.

11. Sometime after 1976, a fire occurred at the plaintiff's South Main Street property, and the insurance carrier secured through the Strickler Agency paid the entire repair bill for the fire damage.

12. The plaintiff continued to purchase his fire insurance from the Strickler Agency.

13. The plaintiff's fire insurance on the two properties became due for renewal on April 1, 1980.

14. No evidence was introduced as to the insurance coverage provided by the Strickler Agency for the two properties under the expiring policy or the identification of the companies which provided the coverage.

15. The plaintiff testified he did not receive his insurance policies or a bill for them from the agency. He called the agency office and inquired about the policy, and was told by a young lady that he was not to worry; that he was still covered. After several weeks he called again and was told the policy and bill would be sent to him pretty soon; and she also said something about a change but stated she didn't know what the changes were. Ultimately the plaintiff did receive two insurance policies and the premium notice in the mail. He did not read either of the policies but nevertheless paid the premium to the Strickler Agency and put the insurance policies in his drawer.

16. The plaintiff testified that at no time prior to January 2, 1981 did anyone from the Strickler Agency have any discussion with him to explain how the co-insurance policies worked or what they meant, and how they would operate in the event of a loss.

17. The policies received, identified by the plaintiff as received by him several months after April 1, 1980, were:

(a) Lititz Mutual Insurance Company policy No. F44 40 22, which provided $40,000 fire and extended coverage insurance on the property 136-142 Lincoln Way West, Chambersburg with 80% of co-insurance applicable and $45,000 fire and extended coverage insurance on 144-146 South Main Street, Chambersburg, Pa. with 80% of co-insurance applicable. The policy has an inception date of April 1, 1980, and an expiration date of April 1, 1981; is a renewal of F 43 54 81 and indicates a mortgage clause payable to Chambersburg Trust Company, Memorial Square, Chambersburg, Pa. The countersignature date is June 4, 1980. (Plaintiff's Exhibit 1).

(b) Everett Cash Mutual Insurance Company policy No. FP 249 268 has identical coverage to that of the Lititz Mutual policy; identical premium policy period and mortgage clause. Its date of issue is June 4, 1980. It notes "renewal replacement No. FP 247 418" (Plaintiff's Exhibit 2).

18. Each of the policies also provide inter alia:

(a) Section VIII-Valuations: "The following basis are established for valuation of property: 1. All property at actual cash value, except as provided below or by endorsement."

(b) Section IV-Co-Insurance Clause: "This company shall not be liable for a greater proportion of any loss to the property covered than the amount of insurance under this policy for such property bears the amount produced by multiplying the actual cash value of such property at the time of the loss by the co-insurance percentage applicable (specified in the first page of this policy, or by endorsement)."

19. The plaintiff testified that he returned the two policies above described to the envelope in which they had been delivered to him, and ultimately delivered that envelope containing the two policies to his attorney. The envelope was produced by counsel for the plaintiff and identified by the plaintiff, and admitted in evidence as plaintiff's Exhibit 4. It is postmarked July 11, 1980, and shows United States postage paid $.28, and return address to the Strickler Agency, Inc.

20. William Feasley is an insurance agent employed for eight years by the Strickler Agency. He has had his life insurance license since 1970, and his property and casualty insurance license since 1975. He works primarily on renewal of existing accounts plus sale of new accounts in property and casualty insurance for the Strickler Agency. He has had training and education in commercial property insurance. In 1980, he was the agent the Strickler Agency charged or assigned to handle the plaintiff's account.

21. Mr. Feasley testified that:

(a) In March 1980, insurance policies were issued on the Lincoln Way and Main Street properties and mailed to the plaintiff.

(b) Everett Cash Mutual Insurance Company policy No. FP 247 418 was issued on March 20, 1980 as a renewal replacement number FP 227 223 for the period from April 1, 1980 to April 1, 1981, and provided fire and extended coverage insurance in the amount of $48,000.00 on 136-142 Lincoln Way West, Chambersburg, Pa. with 80% of co-insurance applicable and $54,000.00 fire and extended coverage insurance on 144-146 South Main Street, Chambersburg, Pa. with 80% co-insurance applicable. The mortgage clause indicated the loss should be payable to Chambersburg Trust Company, Memorial Square, Chambersburg, Pa. The total premium for the policy was $323.00. The insurance policy was evidenced by the "sub-agent's copy" (Defendant's Exhibit 2).

(c) Lititz Mutual Insurance Company policy No. F 44 40 03 was a renewal of No. F 43 54 81 provided identical coverage for the same policy period, same premium, and with the same mortgage clause. The policy was evidenced by the "agent's copy" which bore no date of issue or counter signature date. (Defendant's Exhibit 4).

(d) The intent of the agency was to provide coverage for the South Main Street property in the total amount of $108,000.00, and $96,000.00 on the Lincoln Way West property.

(e) The $108,000.00 fire and extended coverage on the Main Street property as evidenced by defendant's Exhibits 2 and 4, above referred to, represented an increase in coverage from the prior policies issued by the same two companies in a prior year. The increase in coverage was to keep up with inflation and was recommended by either a person employed by the Strickler Agency or by one or both of the companies. He did not know who had recommended an increase in coverage nor did he know whether the increased coverage had ever been discussed with the plaintiff.

(f) The insurance policies of the defendant companies which had provided coverage for the South Main Street and Lincoln Way West properties in periods prior to April 1, 1980, had provided "flat insurance" which would provide coverage on any loss to the extent of the policy limits. The policy identified as plaintiff's Exhibits 1 and 2, and defendant's Exhibits 2 and 4 shifted from "flat insurance" to "co-

FIRST NATIONAL
bank and trust co.

13 West Main St.
WAYNESBORO, PA. 17268
717 - 762 - 3161

TRUST SERVICES
COMPETENT AND COMPLETE

CITIZENS OF National Bank AND TRUST COMPANY
WAYNESBORO, PENNSYLVANIA
17268

Telephone (717) 762-3121

THREE CONVENIENT LOCATIONS
POTOMAC SHOPPING CENTER — CENTER SQUARE
WAYNESBORO MALL

defense be filed within said time, judgment may be entered against you for the whole claim and the property described in the claim to be sold to recover the amount thereof.

WITNESS the Honorable George C. Eppinger, President Judge of our said Court this 10th day of December, 1982.

Raymond Z. Hussack, Seriff
Franklin County

12-24, 12-31, 1-7

insurance." The defendant was never consulted concerning the shift or specifically advised how the two types of insurance operated on a comparison basis.

(g) The expression "actual cash value" appears in the insurance policy but is nowhere defined in those policies.

(h) At an unidentified date but after March 27, 1980, the Strickler Agency received a "criticism notice" from the Middle Atlantic Regional Auditing Office of Philadelphia, Pa. which indicated that the agency had incorrectly calculated the insurance premium payable on the insurance coverage in the amount of $108,000.00 issued by Lititz Mutual Insurance Company on the plaintiff's two properties because there were more than four rental units in each of the two buildings. (Defendant's Exhibit 5). (Since the same insurance premium had been charged for the same coverage on a policy issued by Everett Cash Mutual Insurance Company, it is assumed that the criticism notice was equally applicable to the co-insurer, Everett Cash Mutual.)

(i) When the agency recalculated the premium on the basis of the correct rating, it was determined that the additional bill was $902.00 making the total premium over $1,500.00.

(j) In early June 1980, he went to the plaintiff's restaurant and asked to talk to him. He and the plaintiff sat down at the counter and he told the plaintiff that the policies had been incorrectly rated, and there would be another $902.00 over what the additional bills were or a total of $1,500.00. The plaintiff indicated astonishment and stated that he couldn't afford that amount of money, and was going to reduce the coverage.

(k) In response to plaintiff's statement that he was going to reduce coverage, he told him that he had co-insurance and would be penalized if he was under insured, and then gave him an example of how co-insurance worked. The plaintiff stated that he understood but couldn't afford the premium and requested he be given the premium on $90,000.00 worth of coverage on the Main Street property, and $80,000.00 worth of coverage on the Lincoln Way West property.

(l) The plaintiff stated that he knew he needed more insurance but didn't have the money from rental income to afford it, and then requested the lower coverage.

(m) Either the following day or two days later, he telephoned the plaintiff and advised him that the total one-year premium for the coverage he had requested would be $1,288.00, and the plaintiff stated he would be happy with that figure.

(n) He told the plaintiff he would have the policies rewritten and bring them to him and exchange them for the two original policies.

(o) The insurance policy identified as plaintiff's Exhibits 1 and 2 were prepared by the Strickler Agency and he hand-delivered them with the revised bills to the plaintiff at his restaurant approximately the first week in June, and requested the return of the incorrect policies (Defendant's Exhibits 2 and 4). The plaintiff reached under the counter and delivered the policies and bills in an envelope to him.

22. No evidence was introduced that Mr. Feasley or any representative of the Strickler Agency or representative of the two insurance companies exchanged the policies providing the higher insurance coverage (Defendant's Exhibits 2 and 4) for the lower insurance coverage policies (Plaintiff's Exhibits 1 and 2) held by the Chambersburg Trust Company as mortgagee.

23. No evidence was introduced as to which policies were in effect from April 1, 1980 to April 1, 1981 or held by the Chambersburg Trust Company as mortgagee.

24. No evidence was introduced as to what disposition was made of the policies written with the higher coverage after they were allegedly picked-up by Mr. Feasley, and exchanged for the lower coverage policies.

25. No records were introduced of the cancellation of the higher coverage policies either by the Strickler Agency or by the issuing companies.

26. No evidence was introduced explaining why neither Mr. Feasley nor any other representative of the Strickler Agency contacted the plaintiff concerning the error in the rating of the higher coverage insurance policy until the first week in June 1980, despite the fact that the criticism notice of the Middle Atlantic Regional Auditing Office of Philadelphia, Pa. is stamped "received APR-7-1980."

27. The plaintiff testified that promptly upon receiving his insurance policies and premium notices from the Strickler Agency, he caused the premiums to be paid but no evidence was received from the Strickler Agency as to the date of receipt of the plaintiff's payment and the amount of that payment.

28. On January 2, 1981 there was a fire at 144-146 South Main Street, Chambersburg, Pa., and the building was partially destroyed.

FIRST NATIONAL
bank and trust co.

13 West Main St.
WAYNESBORO, PA. 17268
717 - 762 - 3161

TRUST SERVICES
COMPETENT AND COMPLETE

CITIZENS OF National Bank
AND TRUST COMPANY
WAYNESBORO, PENNSYLVANIA
17268

Telephone (717) 762-3121

THREE CONVENIENT LOCATIONS

POTOMAC SHOPPING CENTER — CENTER SQUARE
WAYNESBORO MALL

If a party or his counsel fails to attend the pre-trial conference or fails to comply with the requirements of these rules or any pre-trial order or stipulation, the Court may, with or without motion by any party, impose such penalty or sanction as it deems appropriate, including but not limited to the dismissal of the complaint or counterclaim, exclusion of a claim or defense or a part thereof, exclusion of the use of certain witnesses or exhibits, removal from the trial list, or imposition of counsel fees incurred as a result of non-compliance.

By the Court,
George Eppinger, P.J.

29. Subsequent to the fire loss the plaintiff met with Mr. Feasley and one or more representatives or adjustors of the insurance companies, and was advised that he did not have sufficient insurance coverage and the co-insurance clauses in the policies would apply after determination had been made of the actual value of the property.

30. The testimony of the plaintiff that he only received two insurance policies from the Strickler Agency, viz. plaintiff's Exhibits 1 and 2; that he paid the premiums for which he was billed; and that he never received any explanation of the co-insurance clause or the meaning of the words "actual value" as used in the policies is entirely credible.

31. The defendants having failed to introduce any evidence of the disposition and cancellation of the higher coverage policies allegedly issued, delivered, and received back from the plaintiff (Defendants' Exhibits 2 and 4), the exchange of the higher coverage policies for the lower coverage policies with the mortgagee, and the failure to justify the delay of almost two months between receipt of criticism notice and alleged conversations with plaintiff, renders the defendants' contention that higher coverage policies were issued and delivered to the plaintiff, notice given of a rating error, and a decision made to accept lesser coverage, not credible. It, therefore, follows that there was no explanation of the effect of co-insurance clauses in the policies or even tangentially an explanation of "actual value."

32. Notwithstanding the plaintiff's lack of education, his inability to read the English language, his problems with the comprehension and speaking of English, he is an eminently successful businessman in the Borough of Chambersburg, and there is no persuasive evidence that he would have for the saving of approximately $260.00, more or less, insisted upon the $34,000.00 reduction in insurance coverage with the attendant potential application of the co-insurance clause to him had it been explained.

33. The plaintiff had a reasonable expectation that if he suffered a fire loss during the policy period of the fire insurance policies issued and delivered to him (Plaintiff's Exhibits 1 and 2) the issuing companies would to the extent of the coverage provided pay him for such losses.

DISCUSSION

In his declaratory judgment action, it appears there are two separate issues requiring adjudication. The first is whether or not the defendant insurers are entitled to deduct depreciation or betterment from the cost to repair or replace the partially destroyed building in determining the amount recoverable by the plaintiff under the policy sued upon. The second is whether or not the co-insurance provisions set forth in the policy are applicable to plaintiff's claim.

I.

DEPRECIATION AS A DEDUCTION FROM REPAIR OR REPLACEMENT COSTS IN DETERMINING ACTUAL CASH VALUE IN CASES OF PARTIAL LOSS

The face sheets of the defendant's fire insurance policies each provide inter alia:

> "In consideration of the provisions and stipulations therein or added thereto and of the premiums above specified, this company...has insured the insured named above and legal representatives, to the extent of the actual cash value of the property at the time of loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time after such loss, without allowance for any increased cost of repair or reconstruction by reason of any ordinance or law regulating construction or repair,...against all direct loss by fire, lightning and by removal from premises endangered by the perils insured against in this policy, except as hereinafter provided, to the property described therein while located or contained as described in the policy..."

As hereinbefore found as facts:

(a) The policies provide for the valuation of the property "actual cash value."

(b) Neither policy defines "actual cash value."

The critical determination to be made concerning this issue is what the term "actual cash value" encompasses. In the absence of any guidance in the insurance policy, we must look to the applicable case law.

It appears that in this country in analagous cases the courts have generally measured "actual cash value" for partial loss cases

in one of three ways: (1) by determining the market value of the property; (2) by determining the replacement cost minus depreciation; or (3) by considering every fact and circumstance which would logically tend to the formation of a correct estimate of the loss (commonly called the broad evidence rule). *Elberon Bathing Co., Inc. v. Ambassador Insurance Co., Inc.,* 77 N.J. 1, 389 A. 2d 439 (1978).

In Pennsylvania the seminal case is *Fedas v. Insurance Company of the State of Pennsylvania,* 300 Pa. 555, 151 A. 285 (1930). In that case which involved a partial destruction of a dwelling the Supreme Court of Pennsylvania in discussing the meaning of the term "actual cash value" held:

> "Actual cash value in a policy of insurance means what it would cost to replace a building or a chattel as of the date of the fire." (Page 562)
>
> "There enters into actual cash value of the part destroyed the fact that it was a part of an entire property and the use made of it. It is summed up in the idea 'the cost of replacing in as nearly as possible the condition as it existed at the date of the fire.'" (Page 563)
>
> "If part of the building destroyed cannot be replaced with material of like kind and quality, then it should be substantially duplicated within the meaning of the policy." (Page 563)
>
> "To sum up, actual cash value means the actual value expressed in terms of money of the thing for the purpose for which it was used, - in other words, the real value to replace. The rule established by our decision seeks a result which will enable the parties to restore the property to as near the same condition as it was at the time of the fire, or pay for it in cash; that was the loss insured against." (Pages 563-564)

Clearly, the Supreme Court in *Fedas* adopted the rationale employed by those courts which decline to allow depreciation to be deducted from the cost of repair or replacement. Presumably that rationale is predicted upon the policy decision that if depreciation is deducted, the insured receives a sum which is sufficient to pay the costs of repairing the property to its prior condition and use, and consequently, the building will stand in a state of incomplete repair. 8 A.L.R. 4th 533-552.

Twenty-two years later in *Farber v. Perkioman Mutual Insurance Co.,* 370 Pa. 480, 88 A. 2d 776 (1952), the Pennsylvania Supreme Court again was called upon to determine whether depreciation deductions would be allowed in a partial loss case in the determination of actual cash value. The court specifically followed the decision in *Fedas,* supra, holding inter alia:

> "The policies of insurance here involved, like those in the *Fedas, P.O.S. of A.* and the *Metz* cases, supra, contain a clause insuring against loss '...to the extent of the actual cash value of the property at the time of loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time after such loss...' The legal meaning of that clause having been determined and established by prior decisions of this court, we cannot nw depart therefrom without impairing the obligation of the contracts as written. Nor is there any legally meritorious basis for suggesting the necessity for a change in the interpretation of the contracts. The defendant companies prepare their own policy forms and presumably exclude therefrom anything for which they desire not to assume liability. Moreover, insurance companies are of course, conversant with the germane court decisions." (Page 486)

The Supreme Court also held at page 484:

> "The pertinent inquiry is, - what is the amount of the insured's loss? As is well known, present-day cost of labor and materials greatly increase the expense of building-restoration which, necessarily, must be done with the labor and materials currently available. If new conditions make the repair work more costly, the extent of the damage to the insured is automatically the greater by so much. And, as it is a part of the insurer's undertaking to make the insured whole insofar as possible within the limits of the policy, the augmented damage due to increased costs of restoration is the liability of the insurer up to the specified amount of the insurance..."

The*Fedas* and *Farber cases are discussed in Couch on Insurance,* 2d, Section 54: 101, 248 and 250. *Farber* is specifically interpreted as standing for the proposition that the percentage of depreciation applicable to the building as a whole in case of total loss cannot logically be used to depreciate the cost of repair even if the cost of repair exceeded the depreciation value of the building.

FIRST NATIONAL
bank and trust co.

13 West Main St.
WAYNESBORO, PA. 17268
717 - 762 - 3161

TRUST SERVICES
COMPETENT AND COMPLETE

CITIZENS National Bank
OF
AND TRUST COMPANY
WAYNESBORO, PENNSYLVANIA
17268

Telephone (717) 762-3121

THREE CONVENIENT LOCATIONS

POTOMAC SHOPPING CENTER — CENTER SQUARE
WAYNESBORO MALL

EDITORIAL

This has been an extremely eventful winter, with some sad events and some happy ones. Among the latter was the appointment of our former Journal director and County Commissioner, Ed Beck, to a high level advisory post with the Federal Government. Another was the appointment of our Journal President, Denny Zeger, to complete the term of the late County Commissioner, J. Byers Schlichter. These appointments are particularly happy ones to your editor, and I think, our entire Journal staff, because we know these are capable people who will serve the public well. Congratulations and best wishes for success to them both.

MANAGING EDITOR

In *Elberon Bathing Co., Inc. v. Ambassador Insurance Co., Inc.,* supra, the New Jersey Court interpreted the Pennsylvania case law and specifically *Fedas* and *Farber* to mean only that the blanket rate of depreciation taken for purposes of determining actual cash valu of the insured structure may not be applied on a blanket basis to (such) loss. (Page 242) The defendants strenuously urge us to adopt the interpretation given these Pennsylvania cases by the New Jersey Supreme Court.

We find the analysis presented on the issue by the New Jersey Supreme Court most interesting and persuasive. If this were a case of first impression in the Commonwealth of Pennsylvania, we would adopt the broad evidence rule as the New Jersey Supreme Court did in the *Elberon* case. However, this is not a case of first impression and the Supreme Court of Pennsylvania has in both *Fedas* and *Farber* explained with great clarity the broad rationale behind our highest court's decision not to allow depreciation to enter the "actual cash value" determination. The primary concern of the Pennsylvania Supreme Court in both cases was to make the insured whole within the limits of the policy recognizing that repair costs escalate over time, and that the insured has no choice but to use the currently available labor and materials.

Under applicable Pennsylvania case law the only proper determinations to be made in the case at bar are that the insurers failed to include any mention of depreciation deductions in their policy, failed to define the term "actual cash value" and there is no credible evidence that the application of a depreciation deduction to the explanation of "actual cash value" was given to the plaintiff-policyholder. Depreciation may not be deducted from repair costs in determining the "actual cash value" of the plaintiff's property at the time of the partial loss.

II

APPLICABILITY OF THE COINSURANCE CLAUSE

The coinsurance clause in insurance policies requires the insured to maintain insurance coverage to a specified value of the property, and to bear a proportionate share of any loss if the insured fails to maintain that required coverage. 43 A.L.R. 3d 566-590. Coinsurance clauses are generally recognized as valid. *Miller v. Home Insurance Company,* 108 Pa. Super. 278, 164 A. 819 (1933). However, forfeitures under insurance policies are generally to be avoided if possible. Therefore, coinsurance clauses have been held to be subject to strict construction. 43 Am. Jr. 2d, Insurance Sec. 278.

The law in general and insurance law in particular is in a constant state of change. To determine whether the coinsurance clauses in the two fire insurance policies issued to the plaintiff were applicable, we must consider the developing trends in the present law of insurance.

The decision and the opinion of the Superior Court in *Hionis v. Northern Mutual Insurance Company,* et al., 230 Pa. Super. 511, 327 A. 2d 363 (1974) is a bench mark in insurance law in the Commonwealth of Pennsylvania, and illustrative of a developing trend in that law. At pages 516-517 the Superior Court held:

> "Insurance contracts have been viewed under the law as contracts of 'adhesion,' where the insurer prepares the policy for a purchaser having no bargaining power. Where a dispute arises, such contracts are construed strictly against the insurer. *Eastcoast Equipment Company v. Maryland Casualty Company,* 207 Pa. Superior Ct. 383, 218 A. 2d 91 (1966). In Eastcoast, we affirmed the decision of a court en banc on the basis of the lower court opinion which provided in part: 'The policy behind this rule [construction against the insurer] is sound; the insurer wrote the policy, and the individual purchaser is concerning primarily with monetary benefits. Concern with definitional clauses and exclusions is minimal; therefore, if they do become material, they should be strictly construed against the insurer.' 38 Pa. D&C 2d at 511. When a defense is based on an exception or exclusion in a policy, our Supreme Court has held that such a defense is an affirmative one, and the burden is upon the defendant to establish it. *Weissman v. Prashker,* 405 Pa. 226, 233, 175 A. 2d 63 (1961). Even where a policy is written in unambiguous terms, the burden of establishing the applicability of an exclusion or limitation involves proof that the insured was aware of the exclusion or limitation and that the effect thereof was explained to him. See, e.g., *Frisch v. State Farm Fire and Casualty Co.,* 218 Pa. Superior Ct. 211, 275 A. 2d 849 (1971); *Purdy v. Commercial Union Insurance Co. of New York* 50 Pa., D&C 2d 230, 235 (1970)."

In *Rempel v. Nationwide Life Insurance Co., Inc.,* 471 Pa. 404, A. 2d (1977), the Supreme Court affirmed the reformation expectations and beliefs of the unsured, and the judgment in favor of the insured's widow for the amount of the reformed insurance contract. The opinion of Justice Manderino discusses the posture of consumers, their protection and their right to rely upon their insurance agents. The court specifically held:

> "The idea that people do not read or are under no duty to read a written insurance policy is not novel...the point made by these cases and by Keeton, Insurance Law Rights at Variance with Policy Provisions, 83 Harv. L. Rev. 961, 968 (1970) is that the policyholder has no duty to read the policy unless under the circumstances it is unreasonable not to read it." (Page 410, 411).

In *Collister v. Nationwide Life Insurance Co.,* 479 Pa. 579, 594, 388 A. 2d 1346 (1978), a life insurance case, the Supreme Court again addressed itself to the rights of and protection to be provided consumers in the following language:

> "The reasonable expectation of the insured is the focal point of the insurance transaction involved here. E.g., *Beckham v. Travelers Ins. Co.,* 424 Pa. 107, 117-18, 225 A. 2d 532, 537 (1967). Courts should be concerned with assuring that the insurance purchasing public's reasonable expectations are fulfilled. Thus, regardless of the ambiguity, or lack thereof, inherent in a given set of insurance documents (whether they be applications, conditional receipts, riders, policies, or whatever), the public has a right to expect that they will receive something of comparable value in return for the premium paid. Courts should also keep alert to the fact that the expectations of the insured are in large measure created by the insurance industry itself. Through the use of lengthy, complex, and cumbersomely written applications, conditional receipts, riders and policies to name just a few, the insurance industry forces the insurance consumer to rely upon the oral representations of the insurance agent. Such representations may or may not accurately reflect the contents of the written document and therefore the insurer is often in a position to reap the benefit of the insured's lack of understanding of the transaction."

In *Oliver B. Cannon and Son, Inc. v. Fidelity and Casualty Co. of New York,* 484 F. Supp. 1375 (1980), the United States District Court for the State of Delaware was called upon to interpret Pennsylvania insurance law where the defendnt sought to avoid liability under the insurance policy on the grounds of exclusions in the policy. The court declined to permit the insurer to invoke the exclusions holding:

> "This is so because under Pennslvania law, in order to invoke the application of an exclusion, the insurer must first prove that at the time the insurance contract was made, the insured knew of the exclusion and understood its meaning, and thus intended to be bound by it. *Hionis v. Northern Mutual*

> *Insurance Company,* supra. The reasoning behind this rule is sound. An insurance contract is written by the insurer and at the time the insured signs the contract, he is primarily interested in monetary matters such as the amount of coverage, the broad areas of coverage and the premiums. Concern over definitional clauses and exclusions is minimal. Hence, if such clauses become material, they are strictly construed against the insurer and must be raised by the insurer as an affirmative defense. In order to establish such an affirmative defense, the insurer must prove that the insured was aware of the exclusion and that it had been explained to him." (Page 1384).

On a similar note the United State District Court for the Middle District of Pennsylvania in *Mattes v. National Fidelity Life Insurance Company and Aviation Insurance Agency,* 506 F. Supp. 955,958 (1980) held:

> "Pennsylvania law requires that an insurer 'ordinarily' may not rely on an exclusionary clause as a defense to liability unless it can be established that: (1) the effect of the exemption was explained to the purchaser and (2) the insured understood the terms of the provision."

The defendants generally appear to agree with the trend of the law as enunciated in the foregoing cases. However, they correctly assert that there are two recognized exceptions to the mandate of *Hionis* and its progeny, and they contend the facts in the case at bar bring them within either or both of the exceptions. In *Brokers' Title Company v. St. Paul Fire & Marine Insurance Co.,* 610 F. 2d 1174 (1979), the plaintiff, a relatively large title insurance company, invoked the rule of *Hionis* seeking to avoid an exclusionary condition in the insurance contract which otherwise would have absolved the insurer. The Court of Appeals held that *Hionis* is limited to cases where the parties lack equal bargaining power and the policy included terms dictated by the stronger, i.e., the insurer. In such situations the court held the arrangement is entitled to special protection. However, where the insurer and the insured are on comparable footing and able to negotiate the terms fairly, *Hionis* does not apply.

The second exception to *Hionis* was promulgated by the Superior Court of Pennsylvania in *Miller v. The Prudential Insurance Company of America,* 239 Pa. Super. 467, 362 A. 2d 1017 (1976), where the facts demonstrated that the insured clearly understood the terms of the exclusion independent of any explanation offered by the insurer. The two necessary factors to establish this exception to *Hionis* are: (1) the terms and structure of the policy must clearly explain the exclusion on which the insurer intends to

FIRST NATIONAL
bank and trust co.

13 West Main St.
WAYNESBORO, PA. 17268
717 - 762 - 3161

TRUST SERVICES
COMPETENT AND COMPLETE

CITIZENS National Bank OF
AND TRUST COMPANY
WAYNESBORO, PENNSYLVANIA
17268

Telephone (717) 762-3121

THREE CONVENIENT LOCATIONS

POTOMAC SHOPPING CENTER — CENTER SQUARE
WAYNESBORO MALL

BAR NEWS ITEMS

Welcome aboard, to the following: Merle W. Helsel, Esq.; Richard L. Bushman, Esq.; Melinda N. Finucane, Esq.; Eileen F. Schoenhofen, Esq.; Jill A. McCracken, Esq.; and Richard J. Walsh, Esq. Admitted to the Bar of the Franklin County Division at ceremonies in Courtroom No. 1 of the Franklin County Courthouse on Wednesday, January 19, 1983, these new attorneys have the distinction, together, according to Franklin County Bar Association President John McD. Sharpe, of increasing our ranks by approximately eight (8%) percent and being the largest group of admittees administered the oath in a single occurrence in remembered Franklin County history. We wish them every success in their practice of the profession of the law.

At its annual reorganizational meeting held on Thursday, January 20, 1983, at 10:00 o'clock, A.M., in the Conference Room of the Franklin County Courthouse Law Library, the Board of Directors of Franklin County Legal Journal reelected its entire slate of officers for the corporation for the current year. They are:

President: Dennis A. Zeger
Vice President: Kenneth E. Hankins, Jr.
Secretary: Philip S. Cosentino
Treasurer: Deborah K. Hoff
Assistant Secretary: Jay H. Gingrich
Assistant Treasurers: Joel R. Zullinger and Philip S. Cosentino.

In addition, the Managing Editor announced that the material for Bound Volume 5 of the Journal is now in the hands of the printer. He stated that past experience indicates it may be two months before the material is returned from the bindery in Philadelphia, for distribution.

NOTICE TO FRANKLIN COUNTY BAR ASSOCIATION MEMBERS

Our Association is entitled to a 12% discount on Pennsylvania Bar Association dues for the current year, if WE HAVE 100% PAYMENT BEFORE MARCH 31.

Treasuer Paul Mower, therefore, urges that you all get those dues in, so as to help our County Bar Association.

vast inequality of bargaining power between the insurer and the typical purchaser of insurance. As a direct result of that disparity, the insurer may dictate the terms and conditions of the policy. Whether the policy is clear and precise or whether it is oblique and ambiguous, the disparity between the parties remains the same. Moreover, the insured's primary interest, which is obtaining the maximum coverage for his insurance dollar, is no less valid when the policy is umambiguous than it is when the policy is obscure. The policies served by Hionis are particularly pertinent when, as here, the insured buys insurance expecting to be covered for certain risks.

"If insurance companies find this procedure too burdensome, it would be no great difficulty for them to take the necessary time to fully inform purchasers in simple language, [and] if printed, easily readable, exactly what the purchaser is buying. The purchase of insurance contracts should not be governed by the maxim of 'caveat emptor,' but rather by the same mutuality of understanding as governs any other contract situation.

"*Purdy v. Commecial Union Insurance Co. of New York,* supra at 236-37. Accord, *Brokers Title Co. v. St. Paul Fire & Marine Insurance Co.* 466 F. Supp. 1174, 1179 (E.D. Pa.), rev'd, 610 F. 2d 1174 (3d Cir. 1979) (because plaintiff was sophisticated in matters of insurance, Hionis does not apply). Insurers are not unduly burdened by a requirement that they explain the exclusions of their policies to insureds so that the insured can make an informed decision either to assume the exluded risks or to obtain additional insurance to protect against them."

Tom M. Kalathas, plaintiff, purchased fire and extended coverage insurance from the defendants expecting to be fully covered to the amount of coverage appearing on the defendants' policies in the event of loss, and he will be fully covered to those policy limits.

DECREE NISI

NOW, this 10th day of November, 1982, the Court orders and decrees that fire and extended coverage insurance shall be available to the plaintiff, Tom M. Kalathas, on Lititz Mutual Insurance Co. policy #F44 40 22, and Everett Cash Mutual Insurance Co. policy #FP 249 268 to the extent of the coverage set forth in the face sheet of each of said policies, and the coinsurance clauses appearing in Section IV of the general property form attached to each of the said policies shall not be applicable to reduce the plaintiff's claim for the fire loss suffered