

**IN THE COURT OF APPEALS OF IOWA**

No. 7-192 / 06-0437  
Filed May 23, 2007

**R & C INDUSTRIES, INC.,**  
Plaintiff-Appellant/Cross-Appellee,

**vs.**

**NATIONWIDE MUTUAL INSURANCE COMPANY,**  
Defendant-Appellee/Cross-Appellant.

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Appeal from the Iowa District Court for Poweshiek County, Dan F. Morrison, Judge.

Insured appeals district court's decision granting judgment notwithstanding the verdict for insurance company on insured's bad faith claims. **AFFIRMED.**

Stephen R. Eckley of Belin, Lamson, McCormick, Zumbach, Flynn, P.C. of Des Moines, for appellant/cross-appellee.

John B. Grier of Cartwright, Druker & Ryden of Marshalltown, for appellee/cross-appellant.

Heard by Huitink, P.J., and Zimmer and Vaitheswaran, JJ.

**HUITINK, P.J.**

This dispute concerns insurance coverage for damage to the roof of a large warehouse operated by R&C Industries, Inc. (RCI). The warehouse was built in 1962 out of concrete block. It was initially used as a manufacturing facility, but was later converted to a warehouse. Over the years, several steel additions were added to the facility to double its original capacity.

On May 10, 2003, a hail storm severely damaged the roof of the warehouse. RCI filed a claim with its insurer, Nationwide Mutual Insurance Company. The insurance policy between RCI and Nationwide had a coverage limit of \$1,100,000 and contained a coinsurance<sup>1</sup> provision that imposed a penalty if the covered property was underinsured.

Nationwide estimated the cost to replace the roof would be \$295,674.75; however, it only paid RCI \$160,011 after it applied the coinsurance penalty. Nationwide calculated this penalty based upon its conclusion the replacement cost to build a new warehouse, out of materials of a like kind and quality, was approximately \$2,500,000.

RCI made several attempts to convince Nationwide the true replacement cost was only \$1,300,000 because a functionally equivalent (and far superior) facility could be made entirely from steel, without any need for the more expensive concrete block. RCI also claimed the insurance policy gave it the

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<sup>1</sup> "The term 'coinsurance' means a relative division of the risk between the insurer and the insured." Lee R. Russ & Thomas F. Segalla, *Couch on Insurance 3d*, § 220:3, at 220-8 (2005).

Coinsurance clauses are provisions in insurance policies that require the insured to maintain coverage to a specified value of the property, and stipulate that, upon his or her failure to do so, he or she becomes a coinsurer and must bear his or her proportionate part of the loss.  
*Id.* at 220-9.

option to have its claim paid on an actual cash value basis, rather than a replacement cost basis.

Nationwide refused to reduce the amount of the coinsurance penalty, so RCI filed the present petition claiming breach of contract and bad faith. RCI claimed Nationwide used an inflated replacement cost estimate to reduce its insurance coverage and refused to permit RCI to elect coverage on an actual cash value basis. Nationwide filed a motion for declaratory ruling asking the court to define the term “replacement cost” as requiring replacement of an insured structure with “materials of like kind and quality.” The district court overruled Nationwide’s motion and decided as a matter of law that the term “replacement cost” required a replacement value based on a functionally equivalent building rather than a building of materials of like kind and quality.

A jury found Nationwide breached the contract, acted in bad faith, and had a willful and wanton disregard for the rights of another. The jury assigned the following damages: \$560,000 to repair the roof, \$100,000 for mitigation of damages, and \$450,000 in lost profits. In a later hearing, the jury also awarded RCI \$60,000 in punitive damages.

Nationwide filed a motion for judgment notwithstanding the verdict (JNOV) and a motion for a new trial. The court upheld the breach of contract verdict, but granted the JNOV motion concluding Nationwide had a reasonable basis for its interpretation of the policy and also concluding there was no evidence Nationwide knew or had reason to know of any lack of reasonable basis for its interpretation. The court also eliminated the judgment for lost profits, eliminated

the judgment for punitive damages, and reduced the remaining judgment by the amount previously paid by Nationwide.

RCI appeals claiming (1) the court erred in finding Nationwide did not act in bad faith when defining replacement cost by materials of like kind and quality; (2) Nationwide acted in bad faith when it refused to acknowledge the policy gave RCI the express right to elect either replacement cost or actual cash value coverage; (3) the court erred in overruling the jury's finding of lost profits; (4) the court erred in excluding evidence that would have clearly explained the bad faith claim; and (5) the evidence did support the jury's punitive damages award.

Nationwide cross-appeals claiming the district court misinterpreted the policy by defining replacement cost as the cost of building a "functionally equivalent" structure. Nationwide also claims the court should have granted a new trial because the jury verdict was inconsistent.

### **I. Replacement Cost**

Nationwide's cross-appeal addresses the principal issue in this case: how to determine the value of the covered property for purposes of calculating the coinsurance penalty. When reviewing the construction of a contract, our review is at law. *Maxim Techs., Inc. v. City of Dubuque*, 690 N.W.2d 896, 900 (Iowa 2005).

The valuation section of the policy states the value of the covered property is the "actual cash value as of the time of the loss or damage." However, because RCI chose to make this a "replacement cost" policy, rather than an "actual cash value" policy, an optional provision instructs the reader to replace the phrase "actual cash value" with the phrase "Replacement Cost (without

deduction for depreciation)” in the valuation section of the policy. Consequently, the value of the property is to be determined by the “Replacement Cost (without deduction for depreciation) as of the time of the loss or damage.”

The district court concluded the phrase “Replacement Cost (without deduction for depreciation)” was not expressly defined in the policy. Therefore, the court looked to the ordinary meaning of the phrase and decided as a matter of law that replacement cost was “the cost of acquiring an asset that is as equally useful or productive as an asset currently held; a functionally equivalent asset.”

On appeal, Nationwide claims the court erred by ruling as a matter of law that replacement cost referred to a functionally equivalent property. Nationwide contends the policy explicitly defines replacement cost as the amount it would cost to repair or replace the covered property, at the time of loss or damage, with material of like kind and quality. Nationwide arrives at this definition by first applying an amendment to the valuation provision of the policy. This amendment adds the following paragraph to any provision that uses the term “actual cash value”:

Actual cash value is calculated as the amount it would cost to repair or replace Covered Property, at the time of loss or damage, with material of like kind and quality, subject to a deduction for deterioration, depreciation and obsolescence. Actual cash value applies to valuation of Covered Property regardless of whether that property has sustained partial or total loss or damage.

Nationwide claims the amendment adds this definition to the valuation section in the original policy. Then, because RCI selected replacement cost coverage, the phrase “Replacement Cost (without deduction for depreciation)” replaces the phrase “actual cash value” resulting in the following valuation provision:

We will determine the value of Covered Property in the event of loss or damage as follows:

- a. At Replacement Cost (without deduction for depreciation) as of the time of loss or damage . . . .

Replacement Cost (without deduction for depreciation) is calculated as the amount it would cost to repair or replace Covered Property, at the time of loss or damage, with material of like kind and quality, subject to a deduction for deterioration, depreciation and obsolescence. Replacement Cost (without deduction for depreciation) applies to valuation of Covered Property regardless of whether that property has sustained partial or total loss or damage.

The insurer has the responsibility to clearly and explicitly define any limitations or exclusions in coverage. *A.Y. McDonald Indus., Inc. v. Insurance Co. of N. Am.*, 475 N.W.2d 607, 619 (Iowa 1991). Our supreme court has established a process for interpreting undefined or ambiguous terms in an insurance contract. *Id.* “Because insurance policies are in the nature of adhesive contracts, we construe their provisions in a light favorable to the insured.” *Id.* Also,

[w]hen words are left undefined in a policy we do not give them a technical meaning. Rather we give them their ordinary meaning, one which a reasonable person would understand them to mean. We do not give them the meaning only a specialist or expert would understand. And if such words are susceptible to two interpretations, the interpretation favoring the insured is adopted.

*Id.* (internal citations omitted).

Despite Nationwide’s claims to the contrary, we find the phrase “Replacement Cost (without deduction for depreciation)” is not clearly defined in the policy. In order to arrive at the definition proffered by Nationwide, one must ignore the fact the definition of actual cash value is identical to the definition of “Replacement Cost (without deduction for depreciation).” One must also conclude the resulting definition expressly contradicts the very phrase it

defines—“Replacement Cost (without *deduction for depreciation*) [using] material of like kind and quality, *subject to a deduction for . . . depreciation and obsolescence.*” (Emphasis added.)

While we understand how Nationwide chose to value the covered property under this provision, and that RCI decided to cover the property for only \$1,100,000, rather than for the larger amount suggested by the agent selling the policy, we, like the district court, conclude the resulting policy provision is ambiguous and does not define the relevant term.

When searching for the ordinary meaning of an undefined term in an insurance policy, we commonly refer to dictionaries. *Id.* Black’s Law Dictionary defines replacement cost as “[t]he cost of a substitute asset that is equivalent to an asset currently held. The new asset has the same utility but may or may not be identical to the one replaced.” Black’s Law Dictionary 372 (8th ed. 2004). The definition set forth by the district court—“the cost of acquiring an asset that is as equally useful or productive as an asset currently held; a functionally equivalent asset”—comports with this definition. The district court’s definition also conforms to Iowa case law describing replacement cost insurance. In *Pierce v. Farm Bureau Mutual Insurance Co.*, 548 N.W.2d 551, 553-54 (Iowa 1996) (quoting *Higgins v. Insurance Co. of North America*, 469 P.2d 766, 772 (Oregon 1970)), our supreme court stated:

Replacement cost insurance, sometimes called depreciation insurance, ‘pays for full replacement cost new of the insured property, without deduction for depreciation. It provides indemnity for the expenditures the insured is obligated to make over and above the amount of the loss covered by full insurance under the standard fire policy *in order to restore the property to its full usefulness as before the loss or damage.*’

Because the district court's definition complied with both common usage and Iowa case law, we find no error in the court's definition and accordingly deny Nationwide's cross-appeal on this issue.

## **II. Bad Faith**

RCI claims the court erred in granting Nationwide's JNOV motion. RCI claims there is substantial evidence to support the jury's conclusion Nationwide acted in bad faith in refusing to acknowledge that "replacement cost" meant the cost of functionally equivalent property and that Nationwide acted in bad faith when it refused to acknowledge RCI's right to elect actual cash value coverage.

Appellate review of the grant of a motion JNOV is for correction of errors at law. *Maxim Techs.*, 690 N.W.2d at 900. To the extent the appeal concerns a challenge to the sufficiency of the evidence, we view the evidence in the light most favorable to the party against whom the challenge is made, taking into consideration every legitimate inference that may fairly and reasonably be made. *Midwest Home Distrib., Inc., v. Domco Indus. Ltd.*, 585 N.W.2d 735, 738 (Iowa 1998).

To establish its bad faith tort claim, RCI had to prove (1) Nationwide had no reasonable basis for denying RCI's demand to pay a greater share of the cost of repairing the roof, and (2) Nationwide knew or had reason to know its denial or refusal was without reasonable basis. *Sampson v. American Standard Ins. Co.*, 582 N.W.2d 146, 149 (Iowa 1998).

### **A. Failure to Acknowledge RCI's Definition of Replacement Cost**

A reasonable basis exists for denial of policy benefits if the insured's claim is fairly debatable as a matter of fact or law. *Id.* at 150. A claim is fairly

debatable when it is open to dispute on any logical basis. *Bellville v. Farm Bureau Mut. Ins. Co.*, 702 N.W.2d 468, 473 (Iowa 2005). “Stated another way, if reasonable minds can differ on the coverage—determining facts or law, then the claim is fairly debatable.” *Id.* Our focus is not on which party was ultimately correct, but whether there was a debatable issue.

Upon our review of the underlying record, we conclude the definition of replacement cost was a debatable issue in this case. Nationwide had a reasonable basis from which to argue replacement cost was the amount it would cost to repair or replace the covered property, at the time of loss or damage, with material of like kind and quality. Even though we ultimately conclude the phrase was not clearly and explicitly defined in the policy, we find Nationwide had a reasonable basis to interpret the policy in this manner. Accordingly, RCI’s bad faith claim fails.

### **B. Refusal to Acknowledge RCI’s Right to Elect Coverage**

At trial, RCI also argued Nationwide acted in bad faith because it refused to acknowledge the insurance policy gave RCI the express right to elect either replacement cost or actual cash value coverage. RCI claimed the following provision gave it the right to choose between replacement cost coverage or actual cash value coverage:

c. You may make a claim for loss or damage covered by this insurance on an actual cash value basis instead of on a replacement cost basis. In the event you elect to have loss or damage settled on an actual cash value basis, you may still make a claim for the additional coverage this Optional Coverage provides if you notify us of your intent to do so within 180 days after the loss or damage.

Nationwide refuted this argument claiming the disputed paragraph did not allow RCI to choose between replacement cost or actual cash value *coverage*. Instead, it allowed RCI to have the *loss* determined on an actual cash value basis. Nationwide noted this paragraph did not amend the coinsurance provision and it did not indicate that covered property would be valued on an actual cash value basis, rather than the replacement cost basis. Without such an amendment, Nationwide argues the policy still dictates that value, for purposes of the coinsurance penalty, is determined by the replacement cost value of the covered property.

While we do not decide whether the disputed provision refers to the claimed loss or the overall policy,<sup>2</sup> we recognize this issue is fairly debatable, and therefore affirm the district court's judgment notwithstanding the verdict.

Because we find Nationwide had a reasonable basis for denying RCI's demand to pay a greater share of the cost of repairing the roof, we need not address RCI's claims the district court erred in excluding evidence on the dictionary definitions of replacement cost because this evidence goes toward whether nationwide should have known its definition was unreasonable. Similarly, because Nationwide had a reasonable basis to apply the coinsurance penalty, there was no basis for the bad faith claim or for the finding of willful and wanton behavior. The court correctly removed the award of damages for lost profits and punitive damages because both remedies are not available in the absence of bad faith or willful and wanton conduct. See *Seastrom v. Farm*

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<sup>2</sup> On appeal, RCI does not claim it should have recovered under the actual cash coverage option. It only claims Nationwide acted in bad faith in not acknowledging its right to do so.

*Bureau Life Ins. Co.*, 601 N.W.2d 339, 347 (Iowa 1999) (punitive damages); *Brown Twp. Mut. Ins. Ass'n v. Kress*, 330 N.W.2d 291, 298 (Iowa 1983) (consequential damages).

### **III. Inconsistent Jury Verdict**

In its motion for a new trial, Nationwide alleged three distinct errors by the jury. Nationwide argued (1) the damages awarded by the jury relating to the cost to repair the roof were not supported by substantial evidence, (2) the jury's response to the first four questions on the verdict form were inconsistent and irregular because the jury answered each different question with the same amount of damages, and (3) the jury's verdict contained excessive damages that appeared to be influenced by passion or prejudice.

In its ruling addressing this motion, the district court addressed the alleged errors in the jury verdict with one sentence: "The court finds the evidence submitted at trial is sufficient to support the jury's verdicts on cost of repair and mitigation of damages and the amounts are not excessive or based on passion or prejudice." As evidenced by the plain language of this ruling, the court did not address Nationwide's argument that the jury verdicts were internally inconsistent. Nevertheless, Nationwide raises this very issue on appeal.

Our rules of error preservation are well established. Before an issue may be raised and adjudicated on appeal, the issue must have been raised before and decided by the district court. *Benavides v. J.C. Penney Life Ins. Co.*, 539 N.W.2d 352, 356 (Iowa 1995). When the district court fails to rule on an issue properly raised by a party, that party must file a post-ruling motion bringing the omission to the court's attention. *Meier v. Senecaut*, 641 N.W.2d 532, 537 (Iowa

2002). If the party fails to do so, error will not be preserved. *Id.* at 537-38. Here, the district court did not rule on Nationwide's claim that the verdicts were inconsistent. Nationwide did not bring the omission to the court's attention via a post-ruling motion. Accordingly, error on this issue has not been preserved.

**AFFIRMED.**