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S.C. SUPREME COURT

THE STATE OF SOUTH CAROLINA
In The Supreme Court

CERTIFIED QUESTION FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA

J. Michelle Childs, United States District Judge

Appellate Case No. 2020-001285

Miriam Butler and Evelyn Stewart, in her capacity as
personal representative of Joseph Stewart and
individually and on behalf of others similarly situated.....Plaintiffs

v.

The Travelers Home and Marine Insurance Company, and
The Standard Fire Insurance Company..... Defendants

PLAINTIFFS' OPENING BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes, Rules and Codes

Other Authorities

INTRODUCTION

This insurance dispute concerns the proper interpretation of two homeowners' insurance policies issued by The Travelers Home and Marine Insurance Company ("Travelers Home") and The Standard Fire Insurance Company ("Standard") (collectively, "Travelers"). Simply, the inquiry is whether a property insurer can depreciate labor when calculating the actual cash value ("ACV") of a structural loss when the terms "ACV" and "depreciation" are left undefined.

The parties agree that ACV should be calculated by first determining the replacement cost of the damaged property and then subtracting depreciation. The parties also agree on the replacement cost values for both materials and labor, and the depreciation percentages applied to all damaged materials. From there, the parties' legal positions diverge. The policyholders contend that only pre-loss "material depreciation" (the actual physical wear and tear of the building materials immediately before the loss) should be subtracted from the agreed-to replacement cost values. In contrast, Travelers argues it should be allowed to also withhold as depreciation an arbitrary amount of the post-loss labor needed to remove and dispose of the property damaged by the covered casualty, as well as reinstallation labor.

Travelers' interpretation is improper for a variety of reasons. First, if post-loss labor costs—needed to both remove and dispose of damaged construction materials and then to re-install replacement materials—are withheld, the policyholder is left in a worse position than before the loss. Under that scenario, the policyholder would be forced to not only pay the out-of-pocket delta between worn building materials and brand-new building materials (in addition to the deductible), but would also be forced to fund the removal and reinstallation of the building materials (which he or she just paid for) to return the property to its pre-loss condition. Such a result is illogical and antagonistic to the goal of indemnity—*i.e.*, to return the insured to his or her *status quo ante*.

Second, the insurance policies at issue do not permit the result Travelers seeks. If Travelers wanted to depreciate labor, it could have easily drafted its policies to clearly allow the practice. Indeed, many insurance companies in South Carolina did just that. Instead, Travelers purposely left the terms "actual cash value" and "depreciation" undefined in its policies, thereby creating ambiguity that requires this Court to apply a liberal policy construction in favor of the policyholders. Further, because Travelers' proposed interpretation is incompatible with a normal, everyday understanding of those policy terms and contrary to the reasonable expectations of its insureds, Travelers' position should be rejected.

This issue is of great importance to the citizens of South Carolina. As a coastal state prone to natural disaster, reliable and easily understood insurance products are critical to residents' ability to rebuild and recover. Most property insurance companies do not withhold labor as depreciation, but if they do, they do so only if express policy provisions allow for the practice. If Travelers prevails, property insurers operating in this state will now be allowed to unilaterally lower homeowner claim payments through highly prejudicial interpretations of undefined policy terms that have a dramatic impact on the amounts of claim payments. If the meaning of the undefined term "depreciation" is left to the sole discretion of a property insurer, South Carolina policyholders will not know what coverage they have purchased until after a claim arises. As a result, Plaintiffs request that this Court answer the certified question in the negative and hold that labor may not be depreciated when calculating actual cash value under policies of insurance that do not define the terms "depreciation" or "actual cash value."

STATEMENT OF THE CERTIFIED ISSUE PRESENTED FOR REVIEW

The Honorable J. Michelle Childs of the United States District Court for the District of South Carolina certified, and this Court accepted, the following question for review pursuant to Rule 244, SCACR:

> When a homeowners' insurance policy does not define the term "actual cash value," may an insurer depreciate the cost of labor in determining the "actual cash value" of a covered loss when the estimated cost to repair or replace the damaged property includes both materials and embedded labor components?

STATEMENT OF THE CASE

Plaintiffs Miriam Butler ("Butler") and Evelyn Stewart ("Stewart"), in her capacity as Personal Representative of the Estate of Joseph Stewart (collectively, "Plaintiffs"), sued Travelers for breaching its standard form homeowners insurance policies. Plaintiffs alleged Travelers underpaid property claims by withholding a percentage of otherwise undisputed repair labor necessary to return their properties to pre-loss conditions.

Butler filed suit on September 16, 2019. (Dkt. 1, Complaint).[1] The case was assigned to the Hon. J. Michelle Childs. On November 4, 2019, Butler amended her Complaint and added Stewart as a co-plaintiff. (Dkt. 13, First Amended Complaint). In Count I, Plaintiffs claim Travelers "breached its contractual duty to pay Plaintiffs and members of the proposed class the ACV of their claims by unlawfully withholding labor as depreciation." (*Id.* ¶ 107). In Count II, Plaintiffs seek "a declaration that [Defendants'] property insurance contracts prohibit the withholding of labor costs as depreciation when adjusting partial losses under the methodology employed here." (*Id.* ¶ 116).

[1] Reference to "Dkt." is to the Case Management/Electronic Case Filing System for the United States District Court for the District of South Carolina, which can be accessed at: https://ecf.scd.uscourts.gov/cgi-bin/login.pl using case number 3:19-cv-02621.

On November 4, 2019, Travelers moved to dismiss the operative complaint, arguing that, under its insurance policy interpretation, Travelers did not breach its contracts with Plaintiffs and that dismissal was appropriate. (Dkt. 16). On November 15, 2019, Plaintiffs filed their opposition, arguing that, under their policy interpretation, Travelers breached its contracts. (Dkt. 22). Alternatively, Plaintiffs asked the federal court to consider question certification to this Court pursuant to Rule 244, SCACR. (*Id.*).

On September 26, 2020, Judge Childs certified a single question to this Court and denied Travelers' motion to dismiss without prejudice. (Dkt. 40, Certification Order). Given the procedural posture of this case, the District Court's factual recital within the Certification Order is expressly based upon Plaintiffs' First Amended Complaint. (Dkt. 40, at 2, n.1). This Court subsequently accepted the certified question on October 16, 2020.

STATEMENT OF FACTS

I. Butler's And Stewart's Partial Losses And Travelers' ACV Payments

Butler owns a home in Columbia—insured by Travelers Home—that was partially damaged by fire. (Dkt. 13, ¶¶ 1, 11-18). Decedent Joseph Stewart owned a home in Columbia—insured by Standard—that was also partially damaged by fire. (*Id.* ¶¶ 2, 19-26). Evelyn Stewart is the personal representative for Joseph Stewart's estate. (*Id.* ¶ 2). Travelers Home and Standard are both subsidiaries of The Travelers Companies, Inc. (*Id.* ¶ 5).

Both Butler and Stewart timely notified Travelers of their partial losses, and Travelers determined ACV coverage existed for both claims.[2] (*Id.* ¶¶ 17-18, 25-26). For structural claims, the respective Travelers' homeowners insurance policies provide a two-step loss settlement

[2] This lawsuit only concerns property insurance coverage for structural loss coverage (*e.g.*, homes, buildings), and not for personal property (*e.g.*, clothes or furniture). (Dkt. 13, ¶ 13).

process. First, and at a minimum, Travelers is required to pay the ACV of the damaged portion of the property. (Dkt. 16-2, at 15-16; Dkt. 16-3, at 12-13). As explained below, ACV coverage is intended to return a policyholder to the *status quo ante*.

Second, under the respective Travelers' policies, if a policyholder chooses to later make actual repairs at her own expense, the policyholder may then seek payments under the replacement cost value ("RCV") provisions of their respective homeowner policies. (Dkt. 16-2, at 15-16; Dkt. 16-3, at 12-13). As will also be explained below, unlike ACV coverage, RCV coverage is intended to place a policyholder in a *better* condition than before a loss.

In this lawsuit, the parties dispute whether Travelers may withhold labor costs as "depreciation" from payments issued under Travelers' ACV coverage provisions. Plaintiffs respectfully submit that Travelers may not. The phrase "ACV" is not defined in either of the Travelers homeowners policies. (Dkt. 40, at 2 (citing Dkt. 13, ¶¶ 37, 49; Dkt. 16-1, at 14)). Travelers affirmatively chose to calculate Plaintiffs' ACV payments by first estimating the cost to repair or replace the damage with new building materials and then subtracting depreciation.[3] (*Id.* (citing Dkt. 13, ¶¶ 27, 39)). In this lawsuit, Plaintiffs agree with Travelers that this methodology was the appropriate methodology to use to calculate Plaintiffs' ACV losses. (Dkt. 13, ¶ 30).[4]

When Butler submitted her claim, Travelers estimated the RCV of the damage to Butler's home at $111,442.76. (*Id.* (citing Dkt. 13, ¶ 34)). After subtracting depreciation, Travelers made an ACV payment to Butler for $50,179.35. (*Id.* (citing Dkt. 13, ¶ 34)). Similarly, when Stewart submitted her claim, Travelers estimated the RCV of the damage at $2,617.26. (*Id.* (citing Dkt. 13,

[3] This methodology will be referred to throughout this brief as the "replacement cost less depreciation" methodology.

[4] Travelers did not and has not calculated any portion of Plaintiffs' losses by appraisal or fair market value. (Dkt. 13, ¶ 29).

¶¶ 19, 46)). After subtracting depreciation, Travelers made an ACV payment to the Stewart estate for $599.47. (*Id.* at 2-3 (citing Dkt. 13, ¶ 46)). Travelers' computer-generated estimates for Butler and Stewart's losses are appended to the First Amended Complaint. (Dkts. 13-1 and 13-2).

Butler and Stewart do not dispute any of Travelers' RCV valuations of the amounts of labor or materials necessary for the repair of their properties. (Dkt. 40, at 4-5). Plaintiffs further do not dispute Travelers' depreciated values of any of the damaged tangible property. (*Id.*) Rather, Butler and Stewart simply dispute whether portions of the agreed-to and undisputed amounts of labor, as determined by Travelers itself, may be withheld as "depreciation" from Plaintiffs' ACV payments under the terms of their respective homeowners policies. Succinctly, "the dispute here is simply whether [Defendants'] policy forms allow Defendants to withhold portions of the agreed-to amounts of labor as 'depreciation.'" (Dkt. 40, at 5 (quoting Dkt. 22, at 3); Dkt. 13, ¶¶ 36-37, 48-49). Plaintiffs respectfully submit that Travelers should not be permitted to withhold depreciation for the cost of labor when calculating ACV.

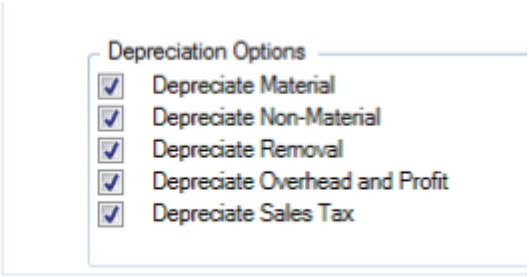
II. Overview Of Industry Practice And Commercial Claims Estimating Software

Traditionally, and prior to the advent of the computerized property insurance claims estimating software programs described below, insurance company adjusters handling structural damage claims were taught to depreciate only materials when calculating ACV, and not to withhold labor as "depreciation." *See, e.g.*, Don Wood *et al*., *Insurance Recovery After Hurricane Sandy: Correcting the Improper Depreciation of Intangibles Under Property Insurance Policies*, 42 TORTS, INS. & COMPENSATION L.J. 19, 24 (Winter 2013) ("I was taught many years ago that depreciation, when it was applied, must be done on a line-by-line, item-by-item basis…. I obtained charts of the average lifespans of materials…. Material lifespans shown in the attachment were derived from reports of product manufacturers. Nowhere in any of the lists of materials is any labor

item mentioned …") (Dkt. 22-2); *see also* Chip Merlin, *Few Judges and Insurance Regulators Worked In Property Claims: Understanding New Insurance Rulings,* PROP. INS. COV. LAW BLOG (August 16, 2017) ("when I was starting out, an older and experienced GAB [General Adjustment Bureau] adjuster told me they never depreciated labor") (Dkt. 22-3).

In contrast to the traditional property insurance industry approach, and over the past ten to fifteen years, commercially-available claims estimating software programs began to provide a property insurer with the option to withhold—or not withhold—a portion of the labor needed to repair a structure as "depreciation" at the same time the program calculated the depreciation arising from the physical deterioration of building materials. (Dkt. 13, ¶ 53). The new option was created as property insurers realized that withholding labor as "depreciation" could dramatically lower ACV payments. (*Id.*).

Property insurers typically change the depreciation option settings for an entire state. *See, e.g., Mitchell v. State Farm Fire and Cas. Co.*, 327 F.R.D. 552, 561 (N.D. Miss. 2018) ("In Mississippi, the default appears to depreciate labor in all claims."), *aff'd* 954 F.3d 700 (5th Cir. 2020). The claims estimating computer programs that provide an insurance company with the option to withhold labor as depreciation include not only the software program used by Travelers in this case, Xactimate®, but also most of the prevalent claims estimating software programs used today. (Dkt. 13, ¶ 53). A screen shot of the Xactimate® depreciation option settings are as follows:



Id. Competing claims estimating software programs also provide for the option of withholding labor as depreciation by simply checking or unchecking a box with a computer mouse. (*See* Dkt. 13-3 (screen shots of claims estimating software depreciation option settings allowing the insurer to choose to depreciate materials only or labor and materials)).

The claim estimating computer software program's option to withhold or not withhold labor as depreciation results in a tremendous difference between the amount a property insurer will pay for the ACV of identical claims. Assume, for example, a hypothetical, simple property claim in which a Columbia policyholder's laminate wood floor, totaling 1500 square feet, was destroyed in June 2019. The property adjuster determines that the laminate floor had depreciated by one-third of its useful life at the time of loss. If the insurance company adjusts the claim under the traditional, "materials-only" approach using Xactimate® software (and using Xactimate®'s June 2019 price list for Columbia, South Carolina), the flooring would be depreciated by $1,559.25, and the company would issue an ACV payment for $7,861.50, as reflected by the Xactimate® screen shot below:

Dwelling - Raw Sewage Example

DESCRIPTION	QUANTITY	UNIT PRICE	TAX	RCV	DEPREC.	ACV
1a. Remove Laminate - simulated wood flooring	1,500.00 SF	0.83	0.00	1,245.00	<0.00>	1,245.00
1b. Replace Laminate - simulated wood flooring	1,500.00 SF	5.23	330.75	8,175.75	<1,559.25>	6,616.50
Totals: Dwelling - Raw Sewage Example			**330.75**	**9,420.75**	**1,559.25**	**7,861.50**

(Dkt. 13, ¶ 56).

However, if the same insurance company, using the identical measurements and condition conclusions, toggles on the "depreciate removal" and "depreciate non-material" option settings within Xactimate®'s software (which now withholds portions of the labor necessary to both remove and then reinstall replacement flooring), the flooring is now depreciated by $2,999.70.

This results in an ACV payment for only $6,421.05, as reflected by the Xactimate® screen shot below:

Dwelling - Raw Sewage Example

DESCRIPTION	QUANTITY	UNIT PRICE	TAX	RCV	DEPREC.	ACV
1. R&R Laminate - simulated wood flooring	1,500.00 SF	6.06	330.75	9,420.75	<2,999.70>	6,421.05
Totals: Dwelling - Raw Sewage Example			**330.75**	**9,420.75**	**2,999.70**	**6,421.05**

(Dkt. 13, ¶ 57).

III. Policy Forms Addressing Labor Depreciation

In September 2008, with the advent of an insurer's ability to withhold labor under the claims estimating computer software as shown above, the National Association of Insurance Commissioners conducted research into the "labor depreciation" practice by surveying state regulators throughout the United States. The NAIC published a copyrighted study of these results. (Dkt. 13, ¶ 58; Dkt. 13-4).

Twenty-six states, including South Carolina, did not respond to the survey. Of the jurisdictions that did respond, there were no consistent positions. (Dkt. 13, ¶ 59). Further, in the 2008 survey, industry regulators from Tennessee, Texas and Washington noted that property insurers were already addressing the issue of labor depreciation within their insurance policy forms. (Dkt. 13, ¶ 60).

As a result, by 2008, property insurers had two primary options with which to proceed concerning labor depreciation. First, property insurers could create restricted insurance policy coverage forms to expressly allow for the new practice of withholding labor as depreciation. Property insurers who chose this option had the obvious benefit of substantially lowering ACV claim payments but risked losing market share based upon newly introduced coverage forms which restricted the amount of coverage provided. (*Id.* ¶ 61).

Several property insurers operating in South Carolina chose this option. (*Id.* ¶ 62). For example, in November 2015, Foremost Insurance Company filed an endorsement for approval with the South Carolina Insurance Department, including a statement in the definition of "actual cash value" that depreciation applies to "the cost of labor." (Dkt. 13-5). As another example, in March 2016, South Carolina's largest homeowners insurer by state market share, State Farm Fire and Casualty Company, filed an endorsement for all of its personal lines property insurance policies for approval with the South Carolina Insurance Department that defined "actual cash value" and stated "labor … is subject to depreciation." (Dkt. 13-6).

Second, property insurers could also reject the new practice of withholding labor as depreciation from ACV payments by simply not engaging in the practice. (Dkt. 13, ¶ 63). This second category of insurers did not withhold labor as depreciation. As a result, they did not have to risk their market share by notifying policyholders that they would provide a lesser quality ACV coverage (by depreciating labor) by way of the introduction of restricted coverage forms and policyholder notices. (*Id.*)

Unfortunately, to obtain an advantage over their competitors and policyholders, a small minority of property insurers rejected both of these two approaches. (*Id.* ¶ 64). These insurers chose not to risk their market share by notifying policyholders, through restricted ACV coverage forms, that they would pay less for ACV payments. *Id.* At the same time, these insurers went ahead and withheld labor as depreciation from ACV payments—without a change of policy forms and without informing policyholders. (*Id.*). Travelers took this approach in South Carolina. (*Id.*).[5]

[5] Travelers' practice is not isolated to South Carolina. For example, after the Tennessee Supreme Court decision in *Lammert v. Auto-Owners (Mutual) Insurance Company*, 572 S.W.3d 170, 179 (Tenn. 2019), holding that labor may not be depreciated when the insurer calculates the ACV of a property using the replacement cost less depreciation method without a coverage form expressly addressing labor depreciation, Travelers issued refunds to 1,600 Tennessee policyholders from

Travelers' conduct is unfair to both South Carolina policyholders and competing property insurers. Travelers' competitors: (1) continued to pay higher claims rates under policies like Travelers'; or (2) risked losing market share by creating and disclosing restricted policy forms notifying policyholders that they would begin to pay less for ACV claims. (*Id.* ¶¶ 61, 63-65). In contrast, when calculating Plaintiffs' ACV payments, Travelers withheld the costs of labor without using a coverage form that expressly permitted the practice. (*Id.* ¶ 66). Travelers' withholding of labor costs resulted in Plaintiffs receiving a lower payment for their losses—a fact which Plaintiffs could not have known when they purchased the insurance because their policies did not contain any language indicating that labor would be depreciated. (*Id.* ¶ 67).

STANDARD OF REVIEW

The following, well-settled contract interpretation principles govern the resolution of the certified question before the Court:

- "It is a question of law for the court whether the language of a contract is ambiguous." *Whitlock v. Stewart Title Guar. Co.*, 399 S.C. 610, 614, 732 S.E.2d 626, 628 (2012) (internal quotation marks and citations omitted).
- "A contract is ambiguous when the terms are reasonably susceptible to more than one interpretation." *S.C. Dep't of Nat. Res. v. Town of McClellanville*, 345 S.C. 617, 623, 550 S.E.2d 299, 302 (2001).
- "Where the words of an insurance policy are capable of two reasonable interpretations, that construction will be adopted which is most favorable to the insured." *Greenville Cnty. v.*

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which it withheld labor from ACV payments. (Dkt. 13-7). Travelers similarly issued payments to Arkansas policyholders after the Arkansas Supreme Court decision in *Adams v. Cameron Mutual Ins. Co.*, 430 S.W.3d 675 (Ark. 2013). (*See* Dkt. 13-8).

Ins. Reserve Fund, 313 S.C. 546, 547, 443 S.E.2d 552, 553 (1994) (internal quotation marks and citation omitted).

- A "split of authority amongst the other courts that have addressed [an] issue militates in favor of a finding of ambiguity and an interpretation in favor of the insured." *Helena Chem. Co. v. Allianz Underwriters Ins. Co.*, 357 S.C. 631, 639, 594 S.E.2d 455, 460 (2004). This is because the fact that "different courts have construed the language of an insurance policy differently is some indication of ambiguity." *Greenville Cty.*, 313 S.C. at 548.

Applying these rules of construction, this Court has held that where an insurance policy does not *unambiguously* conform to the insurer's proposed interpretation, the Court "need look no further than the general rule that ambiguities in an insurance contract must be construed in favor of the insured." *Whitlock*, 399 S.C. at 615-16; *accord Lammert v. Auto-Owners (Mutual) Ins. Co.*, 572 S.W.3d 170, 179 (Tenn. 2019) ("Ultimately, it is not necessary for this Court to reach the decision of whether labor can logically depreciate or whether indemnity is accomplished. It is enough that we find the contracts ambiguous and that under our standard of review, the interpretation of the insured must prevail.").

For example, in answering a certified question in *Whitlock v. Stewart Title Guaranty Co.*, concerning the interpretation of a title insurance policy, this Court held that the absence of "clear language" in the policy compelled a ruling in favor of the policyholder:

> The insurance policy here simply fails to … provide clear language that would require a valuation date in line with Defendant's position. The well-established rule concerning construction of ambiguous terms in insurance contracts compels a result adverse to Defendant's position.
>
> In sum, although we acknowledge the apparent inequity in our answer to the certified question, the resolution of this question is not a matter of equity. Rather, this Court is faced with the task of construing an insurance policy, and in presence of an ambiguity we are constrained to interpret it most favorably to the insured.

Whitlock, 399 S.C. at 616.

These contract interpretation principles support Plaintiffs' interpretation that insurers should not be permitted to depreciate the cost of labor in determining ACV payments, and, as discussed below, are consistent with many appellate decisions across the county.

ARGUMENT

This Court should hold that insurers are not permitted to depreciate the cost of labor when calculating ACV payments under South Carolina law absent policy language expressly allowing the practice. Such a determination is consistent with this Court's decision in *S.C. Elec. & Gas Co. v. Aetna Ins. Co.*, 238 S.C. 248, 120 S.E.2d 111 (1961), as well as other jurisdictions that have considered similar laws and policy language. Travelers should not be permitted to surreptitiously depreciate labor costs when its policies do not define the term "actual cash value" and do not expressly provide for the depreciation of labor costs in calculating ACV. This practice effectively allows Travelers to take unfair advantage of its consumers without their knowledge. Plaintiffs therefore respectfully request that this Court answer the question certified here in the negative, stating that insurers may not depreciate the cost of labor in determining ACV payments absent clear and unambiguous policy language to that effect.

I. Understanding Replacement Cost Coverage, Actual Cash Value And Depreciation

Homeowners insurance policies typically offer two forms of coverage: ACV and RCV. In simple terms, under an RCV policy, a policyholder is intended to be placed in a *better* position than he or she was in before a loss. In other words, the policyholder's building is replaced with all new building materials regardless of cost. "Replacement cost coverage … in contravention of the general rule that an insured cannot profit through insurance, results in the insured being better off than he or she was prior to the loss, since the insured ends up with a more valuable property."

Allan D. Windt, INS. CLAIMS AND DISPUTES § 11:35 (6th ed. April 2020 Update); *see also Arnold v. State Farm Fire & Cas. Co.*, 268 F. Supp. 3d 1297, 1309 n.17 (S.D. Ala. 2017) ("the very point of an RCV policy is to place the insured in a better position than she previously occupied").

On the other hand, ACV coverage is intended to return the policyholder's building to the same condition that it was in right before the loss, or "*status quo ante*."[6] In *S.C. Elec. & Gas Co. v. Aetna Ins. Co.*, this Court held that, under ACV coverage, the policyholder must receive enough money to return the building to its pre-loss condition with materials of like kind and quality. This means the value of new materials can be depreciated, but labor to return the materials "in place" cannot be depreciated:

> An ACV payment "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. The actual cost of new material, with a deduction for depreciation, which is not sufficient to replace the building as nearly as it could be as of the date of the fire, does not comply with the [ACV] policy…
>
> If the new material is to be depreciated to reach the actual cash value contemplated by the policy, the timber or part destroyed must be considered in connection with the whole structure and valued accordingly, *and should reflect the use in place*. The result is that called for in the policy, replacement as nearly as possible, or its cost. 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.

S.C. Elec., 238 S.C. at 262 (internal quotation marks and citation omitted; emphasis added).

[6] The term "status quo ante" is defined as "the state of affairs that existed previously." *See* Merriam-Webster Dictionary, Definition of "status quo ante", available at https://www.merriam-webster.com/dictionary/status%20quo%20ante (last accessed November 16, 2020). Courts have referred to an ACV interpretation requiring monies sufficient to return a property to its condition right before the casualty loss as the "*status quo ante*." *Mitchell v. State Farm Fire & Cas. Co.*, 954 F.3d 700, 706-07 (5th Cir. 2020) ("Mitchell's definition, which results in paying the costs necessary to place a homeowner in the *status quo ante*, is reasonable."), *reh'g and reh'g en banc denied* (5th Cir. May 13, 2020); *Coleman v. Penn. Fire Ins. Co. of Philadelphia, Pa.*, 41 So.2d 477, 478 (La. Ct. App. 1949).

Stated differently, "ACV is determined prospectively at the time of the loss as an estimate of what it would cost to repair—that is, what it would cost to return the structure to its state prior to the loss[,]" whereas RCV "is determined retrospectively, and is paid subsequent to the completion of repairs, in the amount of the actual cost of repairs." *Johnson v. Hartford Cas. Ins. Co.*, No. 15-04138, 2017 WL 2224828, at *5 (N.D. Cal. May 22, 2017).

Finally, in the property insurance context, depreciation is "the amount an item has lessened in value since it was purchased, taking into account age, wear and tear, market conditions, and obsolescence. Although depreciation has been defined in several ways, *the principal definition attributable to that term refers to 'physical deterioration.'*" Richard J. Cohen, et al., 5 NEW APPLEMAN ON INS. LAW LIBRARY ED. §47.04[2][a] (2020) (emphasis added; hereinafter "APPLEMAN"); *see also id.* at [2][b][iii] ("Depreciation in the insurance context is often used interchangeably with physical deterioration."). Further, while "economic depreciation" may be one possible definition of depreciation, physical deterioration is the preferred definition in the insurance property context. *See Dickler v. CIGNA Prop. and Cas. Co.*, 957 F.2d 1088, 1099 (3d Cir. 1992) (citing Note, *Valuation and Measure of Recovery Under Fire Insurance Policies*, 49 COLUM. L. REV. 818, 823 (1949) ("Insurance law is not concerned with the estimated depreciation charged off on the books of business establishments, but rather with the actual deterioration of a structure by reason of age and physical wear and tear, computed as of the time of loss.")).

An example can illustrate the differences between RCV and ACV, the interplay between the two, and the role of depreciation and its impact on labor. Assume a residential home has a 25-year old siding (with a normal life span of 50 or more years). Further assume that all the siding was properly installed at the time the policyholder buys actual cash value coverage. Then, a large portion of the properly installed siding is destroyed in a hailstorm.

Determining the replacement cost value is simple, *i.e.*, the cost to remove and then replace all damaged siding with brand new materials. For purposes of this hypothetical, assume that replacement cost to be an undisputed $30,000. To determine actual cash value, the next step is to determine the proper depreciation. When determining the appropriate deduction for depreciation, it is critical to keep the goal of indemnity at the heart of the calculation, *i.e.*, to restore the insured to her pre-loss condition. To do this, the goal must be to give the insured what she had before the loss, which was 25-year old, properly installed siding. Actual cash value, therefore, requires payment of the value of 25-year old siding already properly installed, *i.e.*, siding "in place." The siding was not sitting in a garage.

How is this accomplished? First, the damaged 25-year old siding has to be removed and disposed of, and that labor cost must be ascertained. Then, the diminution in value of 25-year old siding materials at the time of the loss must be determined. Finally, the labor cost of cutting and re-installing siding back to the same way it was installed before the loss must be calculated. This calculation puts the insured right back where she was before the loss (a residential home with installed siding minus wear and tear value to the siding).

The policyholder in this hypothetical is not receiving replacement cost coverage because he or she must fully pay, out of his or her own pocket, the delta between 25-year old and brand-new materials. The concept of physical depreciation fairly penalized the policyholder for all the roof's pre-loss wear and tear.

Of course, in the real world, there is oftentimes no store that a person can visit to purchase "used" 25-year old siding. As a result, the concept of depreciation was born to hypothetically determine the cost of used materials. In the above hypothetical, if we simplistically assumed the cost of the $30,000 siding was half labor ($15,000) and half materials ($15,000), then the proper

ACV payment would be 100% of the labor costs ($15,000) and 50% of the value of siding ($7,500), resulting in a total ACV payment of $22,500. In contrast, if labor was also depreciated by 50%, the ACV payment would decrease to $15,000.

Finally, if the labor for removing the damaged siding and re-installing replacement siding is also partially withheld, this leaves the policyholder in a worse position—even if she can afford to pay the difference between the worn 25-year old siding and brand-new siding out-of-pocket, the ACV payment does not enable her to remove the damaged siding and then reinstall the siding she just paid for. This double deduction is unfair. It does not accomplish indemnity and is the ultimate reason why Travelers' logic and arguments fail. Travelers' theory leaves the insured in a worse condition than before the loss. Such a result is the opposite of indemnity. *See Hicks v. State Farm Fire & Cas. Co.*, 751 Fed. App'x. 703, 706 (6th Cir. 2018) ("depreciating labor does not make the policyholder whole but rather frustrates the indemnity purpose of [ACV] coverage … [because] the cost of labor to install a new garage would be [the] same as installing a garage with 10 year old materials." (internal quotation marks and citation omitted)).

II. Travelers' Policies Do Not Unambiguously Permit The Withholding Of Labor Costs From ACV Payments

Travelers' policies do not define "actual cash value" or "depreciation," nor do they detail the way ACV is to be calculated. The policies certainly do *not* inform the insured that ACV will be calculated as replacement cost less depreciation for the costs of *both* materials *and* labor.

Nevertheless, the parties agree that the appropriate methodology to calculate ACV under the policies at issue—*and the methodology, in fact, used by Travelers*—is to estimate the cost to repair and replace the damaged property and to subtract depreciation—*i.e.*, the "replacement cost less depreciation" methodology. (Dkt. 40, at 6; Dkt. 22, at 3). The parties agree that Travelers could depreciate the cost of materials when calculating ACV. Plaintiffs also agree with Travelers'

RCV valuations of the amount of repair labor and materials necessary to return Plaintiffs' respective properties to their pre-loss conditions. (Dkt. 40, at 4-5; Dkt. 22, at 3). The parties do, however, have a significant dispute regarding what should be depreciated, as perhaps best stated by the Fifth Circuit Court of Appeals:

> But where the two parties differ is on the question that necessarily follows: what costs of the loss should be depreciated? [The insurer argues that in calculating the [ACV] payment, *both* the cost of materials *and* the cost of the labor should be depreciated. [The policyholders], by contrast, argue[] that *only* the cost of physical materials should be depreciated, not the cost of labor.

Mitchell v. State Farm Fire & Cas. Co., 954 F.3d 700, 703 (5th Cir. 2020), *reh'g and reh'g en banc denied* (5th Cir. May 13, 2020) (holding that a policy with similar two-step loss settlement language did not unambiguously permit labor depreciation in calculation of ACV based on replacement cost less depreciation methodology).

Based on South Carolina law regarding interpretation of insurance policies, this Court should conclude that Travelers' policies are ambiguous and must be construed in favor of the policyholder Plaintiffs. More specifically, this Court should find that in the context of South Carolina homeowners policies referring to "actual cash value" and "depreciation" without further definition, and where both parties agree that ACV is to be calculated based on the "replacement cost less depreciation" methodology, the insurer may not withhold a portion of repair labor as depreciation.

A. This Court's Decision in *S.C. Electric* Supports Plaintiffs' Interpretation Of ACV As Not Permitting The Withholding Of Labor Costs As Depreciation

As the District Court's Certification Order recognizes, this Court's opinion in *S.C. Elec. & Gas Co. v. Aetna Ins. Co.* is particularly relevant to the instant case. (Dkt. 40, at 6). In *S.C. Elec.*, an electrical utility suffered loss to 20-year old copper coils within an electrical generator, whose primary components were: (1) a stator (a seven foot tall iron drum); (2) the damaged 384 copper

coils lining the stator; and (3) a rotor, a rod that generated electricity upon rotation within the stator. *S.C. Elec.*, 238 S.C. at 256. The insurance policy at issue provided for payment of "the actual cash value 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." *Id*. at 258.

A verdict was rendered for $87,000. *Id*. at 255. The property insurer appealed, arguing that the trial court's instructions may have allowed the jury to render an excessive verdict for the actual cash value of the stator, which was not destroyed, as opposed to the coils, which were damaged.

This Court summarized the evidence and, in doing so, addressed the appropriate formula for calculating ACV. Twice, and through two examples with differing depreciation percentages, this Court affirmatively stated that the costs of labor (winding and installation) were "undepreciable" while the replacement cost of the materials, the copper coils, were depreciable:

> There was testimony to the effect that the actual cost of the new coils, in place, was $132,181, of which $90,300, representing *the cost of materials, would be depreciable, and the balance, $41,881*, representing cost of winding and installation, *would not be depreciable*.
>
> The cost of the new materials, depreciated to sixty (60%) per cent to conform with the depreciated life of the old as above mentioned, would be $54,180. Addition to this figure *of the undepreciable $41,881 of replacement cost*, would indicate that the actual cost of the new coils, *in place*, after depreciation, was $96,061, a figure substantially higher than the jury's verdict…
>
> Based on a forty per cent depreciation, the actual cost of the new coils in place, as before mentioned, was $96,061. *Calculating depreciation at fifty per cent (as suggested by the testimony of Mr. Kindelberger, the field service engineer of Westinghouse), the actual cost of the new coils in place was $87,031*. The verdict, $87,000, is in our opinion not vulnerable to the charge of excessiveness requiring a new trial absolute.

Id. at 262-63 (emphasis added).

In reaching this conclusion, the Court twice used the "replacement cost less depreciation" formula for calculating ACV—*not* a market value methodology or the broad evidence rule. Further, only the value of materials was reduced by the depreciation percentage, but 100% of the repair labor (for winding and installation of the copper coils) was allowed. More specifically, the precise formula used by the Court to approve the verdict was:

Cost of replacement materials	$90,300
Depreciation to conform to depreciated life of old materials	50%
Value of old materials on date of loss ($90,300 x 50%)	$45,150
Value of winding and installation of replacement materials	$41,881
Actual cash value under supreme court's formula ($45,150+$41,881)	$87,031
Approved verdict for policyholder	$87,000

Id.

The appellate record in *S.C. Elec*., including the trial transcript, was provided to the District Court in the instant case. (Dkt. 22-4). The *S.C. Elec*. trial transcript demonstrated that this Court's statements concerning the "undepreciable" nature of labor were *not* derived from any witnesses' testimony. Rather, this Court found labor not depreciable on its own accord.

The appellate record in *S.C. Elec*. reflected that the case involved: (1) a casualty (fire) loss; (2) under the ACV terms of a property insurance policy; (3) that required the purchase of new replacement materials (copper coils); (4) which had to be depreciated by 50% of their useful life; and (5) the necessary reinstallation and repair labor to return the coils to their pre-loss placement were not subject to depreciation. *See generally id.*; *S.C. Elec.*, 238 S.C. at 251, 261-263. This Court relied upon the same ACV formula advanced by Plaintiffs here.

This Court's holding that repair labor is undepreciable when calculating ACV under a property policy that does not define ACV should equally apply in this case because, at the least, it shows that it is a reasonable interpretation of ACV if otherwise left undefined. This Court's opinion in *S.C. Elec.* is entirely consistent with Plaintiffs' arguments and, as discussed below, with numerous other decisions from "replacement cost less depreciation" jurisdictions. Consequently, the answer to the certified question here should be that an insurer may not depreciate the cost of labor in determining ACV payment obligations.

B. Travelers' Undefined Policy Terms "ACV" And "Depreciation" Are Ambiguous In This Context And Must Be Construed Against Travelers To Preclude Labor Depreciation

Even if this Court concludes that its prior opinion in *S.C. Elec.* does not help resolve the certified question, the Court should nevertheless conclude that labor may not be depreciated in the absence of a policy form expressly permitting the practice. This is consistent with well-established South Carolina law regarding the interpretation of insurance contracts and a growing spate of state and federal appellate and trial court decisions from similar jurisdictions.

Where, as here, a property insurance policy is silent on how ACV is to be calculated, and a dispute arises concerning precisely what comprises ACV, a substantial number of courts have found that the phrase does *not* unambiguously permit an insurer to withhold labor costs from ACV payments as "depreciation." Succinctly, Travelers' position to the contrary has been flatly rejected by the Tennessee and Arkansas Supreme Courts, the Sixth Circuit in three separate decisions addressing Kentucky and Ohio law, and the Fifth Circuit interpreting Mississippi law. *Lammert v. Auto-Owners (Mut.) Ins. Co.*, 572 S.W.3d 170, 171, 179 (Tenn. 2019) ("the language in the policies is ambiguous and must be construed in favor of the insured parties…. The insurer may not withhold a portion of repair labor as depreciation"); *Adams v. Cameron Mut. Ins. Co.*, 430 S.W.3d 675, 678

(Ark. 2013) (undefined term "actual cash value" in insurance policy is fairly susceptible to more than one reasonable interpretation and is, therefore, ambiguous); *Mitchell*, 954 F.3d at 707 (holding policy did not unambiguously permit labor depreciation in calculation of ACV based on replacement cost less depreciation methodology); *Cranfield v. State Farm Fire & Cas. Co*., 798 Fed. App'x 929, 930 (6th Cir. Mar. 23, 2020) (holding an "insurer may not deduct the cost of labor depreciation pursuant to an actual cash value insurance policy that does not expressly provide for such deductions"); *Perry v. Allstate Indemn. Co*., 953 F.3d 417, 423 (6th Cir. 2020) ("Because Perry's interpretation of 'depreciation' is a fair reading of an ambiguous term, her interpretation prevails against the insurer. We accordingly hold as a matter of law that it was improper for Allstate to depreciate labor costs to arrive at its net payment to Perry for the damage to her home."); *Hicks*, 751 F. App'x. at 710-11 (holding policy did not unambiguously permit withholding labor costs as "depreciation" in calculating ACV).[7]

[7] *Accord Huey v. Allstate Vehicle and Prop. Ins. Co.*, No. 19-00153, 2020 WL 5370950, at *3 (N.D. Miss. Sept. 8, 2020) (holding "the term 'actual cash value,' as it relates to the depreciation of labor costs, is ambiguous and thus is construed against the drafter of the policy, the insurer."); *Donofrio v. Auto-Owners (Mutual) Ins.*, No. 19-58, 2020 WL 1470865, at *4 (S.D. Ohio Mar. 26, 2020) ("the Policy in this case does not define 'depreciation.' As such, the Policy is ambiguous, Plaintiff's 'interpretation of 'depreciation' is a fair reading of an ambiguous term' and 'her interpretation prevails against the insurer.'") *Titan Exteriors, Inc. v. Certain Underwriters at Lloyd's*, 297 F. Supp. 3d 628, 634 (N.D. Miss. 2018) (same); *Brasher v. Allstate Indem. Co.*, No. 18-00576, 2018 WL 5629918, at *4 (N.D. Ala. Sept. 7, 2018) (concluding Allstate's policy did not unambiguously allow labor depreciation when calculating ACV; ambiguity construed against Allstate); *Arnold*, 268 F. Supp. 3d at 1312 (holding undefined term "ACV" did not unambiguously include depreciation of labor costs); *Lains v. Am. Family Mut. Ins. Co.*, No. C14-1982, 2016 WL 4533075, at *1-2 (W.D. Wash. Feb. 9, 2016) (insurer "improperly depreciated labor costs when determining actual cash value of Plaintiff's home" since policy did not unambiguously permit withholding labor costs in calculating ACV); *Sproull v. State Farm Fire & Cas. Co.*, --- N.E.3d ---, 2020 WL 4251702 (Ill. Ct. App. 2020) (holding depreciation may not be applied to intangible labor where ACV is determined pursuant to replacement cost less depreciation methodology and the policy itself does not define ACV); Order Overruling Defendant's Motion for Summary Judgment and Granting Plaintiff's Cross-Motion for Partial Summary Judgment at 12-13, *McLaughlin v. Fire Ins. Exchange*, No. 1316-CV11140 (Mo. Cir. Ct., Jackson Cty. Aug. 10, 2020) ("The ambiguity of its policy definition of ACV, and application of the ordinary definition of

Beyond quoting its policies at-length, and positing that "an ordinary person would understand that 'actual cash value' means actual economic value,"[8] Travelers failed to offer any textual analysis of its loss settlement provisions before the district court to demonstrate that the policies unambiguously permit withholding of labor costs from ACV payments. *Arnold*, 268 F. Supp. 3d at 1310 (denying motion to insurer's motion to dismiss breach of contract claim for withheld labor depreciation). Rejecting a similarly non-textual argument, the *Arnold* court stated:

> Again, however, that *language must be given its ordinary sense and construed as a reasonable lay insured would construe it, not how an insurer, a court, or another with specialized knowledge of what ACV and RCV are "supposed" to accomplish would view it*. The defendant has offered no textual analysis of the Policy to demonstrate that a reasonable insured would unambiguously understand that she could not receive undepreciated labor until after completing the repairs/replacement…. What the Policy actually says is that the defendant will pay "the cost to repair or replace" the damaged property, with an initial payment of "actual cash value" (whatever that means) before repair/replacement is completed, and a second payment of "the covered additional amount" (whatever that is) once repair/replacement is timely completed and proof of same presented. *** This language clearly means that the two payments add up to the total cost of repair or replacement, but it does not say or even suggest that depreciation is paid only at the second step. *The defendant's textual argument thus does nothing to advance its position that the Policy unambiguously calls for depreciation of labor from the initial payment of ACV*.

Id. (emphasis added; internal citation omitted).

Likewise, in deciding a similar certified question in favor of the policyholders, the Tennessee Supreme Court stated:

> [A]n insured should not have to consult a long line of case law or law review articles and treatises to determine the coverage he or she is purchasing under an insurance policy. Policy language should be given its plain meaning, unless a technical meaning is clearly provided in the insurance policy.

'depreciation' here requires that Fire may not deduct 'depreciation for labor' from its payment of Actual Cash Value to policyholders.") (hereinafter "*McLaughlin* Order"); *Jenkins v. State Farm Fire & Cas. Co.*, No. 15-CH-8242 (Cook Cir. Ct. Feb. 4, 2016) (Dkt. 22-13); *Ingram v. Liberty Ins. Co.*, No. 16CVH06-5538, slip. op. at 5-6 (Ohio Cir. Ct. Mar. 13, 2018) (holding policy did not unambiguously permit withholding labor costs in calculating ACV) (Dkt. 22-14).

[8] (Dkt. 16-1, at 3-5, 9).

Lammert, 572 S.W.3d at 179 (citation omitted); *see also Sproull v. State Farm Fire & Cas. Co.*, --- N.E.3d ---, 2020 WL 4251702, at *9 (Ill. Ct. App. 2020) ("Courts will not adopt an interpretation which rests on fine distinctions that the average person, for whom the policy is written, cannot be expected to understand").

Here, Travelers' policies state that the insurer will pay the damaged property's "replacement cost without deduction for depreciation" with an initial payment of ACV "until actual repair or replacement is complete." (Dkt. 16-2, at 15-16; Dkt. 16-3, at 12-13). Additional payments may be made *if* the insured repairs or replaces the damaged property, but the policies make clear that such payments are only owed "[o]nce actual repair or replacement is complete." (Dkt. 16-2, at 15-16; Dkt. 16-3, at 12-13).

As in *Arnold*, this language clearly means that the two payments add up to the total cost of repair or replacement, and nothing in the policy language even remotely suggests that labor is not fully paid until the second step. 268 F. Supp. 3d at 1310. Travelers simply failed to draft policy language to convey a purported intention to permit labor depreciation in contrast to numerous other South Carolina insurers. (*See, e.g.*, Dkt. 13-6 (State Farm South Carolina policy form explicitly defining ACV as "the value of the damaged part of the property at the time of loss, calculated as the estimated cost to repair or replace such property, less a deduction to account for pre-loss depreciation. For this calculation, all components of this estimated cost including … materials … labor and … overhead and profit are subject to depreciation."); Dkt. 13-5 (Farmers Insurance Group South Carolina policy form, stating "[o]ur adjustment for physical deterioration, depreciation, and obsolescence applies to all costs, including the costs of labor and materials.")).

If Travelers "thought that labor should be depreciated under the policy … it was in the best position to clarify the ambiguity of the term 'actual cash value' when it drafted the policy." *Adams*,

430 S.W.3d at 677; *see also Perry*, 953 F.3d at 423 ("Allstate 'could have removed any ambiguity by simply writing its policies to expressly include labor depreciation when calculating ACV.' But it didn't, and under Ohio law, an ambiguous policy with competing reasonable interpretations must be construed in favor of the insured." (internal citation omitted)); *Hicks*, 751 Fed. App'x. at 709 ("State Farm could have removed any ambiguity by simply writing its policies to expressly include labor depreciation when calculating ACV. In other states, State Farm has done just this.").

South Carolina law is in accord. If Travelers wished to withhold labor costs as "depreciation" in calculating ACV payments, it "had both the means and the responsibility" to draft explicit language to that effect. *Super Duper Inc. v. Penn. Nat. Mut. Cas. Ins. Co.*, 385 S.C. 201, 210, 683 S.E.2d 792, 796 (2009) ("If Travelers intended to restrict its exposure solely to the common law tort of misappropriation, then Travelers had both the means and the responsibility to use restrictive language in the contract instead of the general term 'misappropriation.'"). The fact that Travelers elected not to do so requires the Court to construe the ambiguous policy terms against them and in favor of Plaintiffs. *See id.*; *see also Auto Owners Ins. Co. v. Benjamin*, 415 S.C. 137, 150, 781 S.E.2d 137, 143-44 (Ct. App. 2015) (holding that a circuit court properly construed endorsement in favor of coverage "[b]ecause the burden rests with the insurer to clearly enumerate the terms in its policy—and ambiguous terms are to be construed strictly against the insurer"); *Canal Ins. Co. v. Nat'l House Movers, LLC*, 414 S.C.255, 265, 777 S.E.2d 418, 421, 424 (Ct. App. 2015) (holding that, "as the drafter, [the insurer] had an obligation of specifying who needed to furnish the temporary worker if it wished to include such language in its policy" (citations omitted)).

Travelers' policy interpretation also fails because it "argues for a technical definition of depreciation that is not evident on the face of either policy. Taking the term in its ordinary sense,

it applies to physical deterioration, which is the meaning attributed to it by the homeowners…. [C]onstruing the policy language in favor of the insured, depreciation can only be applied to the cost of materials, not to labor costs." *Lammert*, 572 S.W.3d at 179; *see also Hicks*, 751 Fed. App'x. at 709 ("A reasonable construction of the insurance policies in this case is that labor is not included in depreciation. *Black's Law Dictionary* (10th ed. 2014), defines depreciation as '[a] reduction in the value or price of something; specif., a decline in an asset's value because of use, wear, obsolescence, or age.'"); *Sproull*, 2020 WL 4251702, at *7 (holding "the plain, common, and ordinary meaning of depreciation is a reduction in value of a property because of aging and wear and tear to the physical structure of that property"); APPLEMAN, *supra*, §47.04[2][a] and [b][iii] (recognizing that "courts use the term 'depreciation' as synonymous with physical deterioration under the replacement cost less depreciation approach."). Simply put, "with the insured's interpretation controlling, labor may not be depreciated when the insurance company calculates the [ACV] of a property using the replacement cost less depreciation method." *Lammert*, 572 S.W.3d at 179.

To avoid the ordinary meaning of depreciation, given the absence of a definition contained in Travelers' policies, Travelers will likely urge the Court to consider how depreciation is applied in other unrelated circumstances such as property tax assessments, eminent domain, and other valuations of property. (*See* Dkt. 16-1, at 28-32). However, South Carolina law *requires* that the Court's policy interpretation be guided by the "plain, ordinary and popular meaning" of the words in the policies as opposed to technical definitions that might be used by accountants, real estate appraisers, insurance adjusters, or tax preparers. *Helena Chem. Co. v. Allianz Underwriters Ins. Co.*, 357 S.C. 631, 638, 594 S.E.2d 455, 458 (2004) (refusing to give insurance policy language

"a narrow, technical meaning" because doing so "goes against South Carolina precedent which holds that this Court must give policy language its plain, ordinary, and popular meaning").

Further, an identical argument has been repeatedly rejected in the labor depreciation context. As one court succinctly explained:

> The defendant insists that depreciation of labor costs occurs in other contexts—including tax law, maritime law and appraisals—and under various state statutes and regulations. A reasonable insured, however, is not charged with knowledge of these usages, and the defendant has failed to explain how they could negate the reasonableness of construing the Policy as not providing for depreciation of labor costs.

Arnold, 268 F. Supp. 3d at 1312, n.24; *accord Lammert*, 572 S.W.3d at 179 (refusing to apply technical definition of depreciation in construing undefined ACV policy term); *McLaughlin* Order at 12 (applying ordinary meaning of "depreciation" "as found in dictionaries and common usage (as opposed to technical definitions that may be used by accountants, insurance adjusters, or tax preparers) nothing suggests the depreciation of labor costs in the context of 'replacement cost of property'"); Robert Eurich, INSURANCE AND LOSS PREVENTION §7.4.1 (2011) ("The asset records will reflect acquisition costs less book depreciation, which should not be the basis for insurable values. Book depreciation may or may not equal physical depreciation because the rate of depreciation for accounting purposes generally reflects tax considerations rather than actual diminution in physical value.").

Other courts have stated that "[i]t is not reasonable to believe that an average homeowner would consider labor to be a tangible asset included within the definition of depreciation." *Sproull*, 2020 WL 4251702, at *9; *see also Hicks*, 751 Fed. App'x. at 709 ("A layperson confronted with State Farm's policy could reasonably interpret the term depreciation to include only the cost of materials."). Notably, "[n]othing in the ordinary definitions [of depreciation] refers to or includes diminished value of labor costs connected with property." *McLaughlin* Order at 13. In light of this

Court's relatively recent holding that insurance policies should be interpreted in a fashion that is consistent with the reasonable expectations of the insured unless contrary to the plain language of the policy, the same result should be reached here. *See Bell v. Progressive Direct Ins. Co.*, 407 S.C. 565, 581, 757 S.E.2d 399, 407 (2014).

Travelers' position also ignores that the subject policies "insure against risk of direct physical loss to *property* described in Coverages A and B," and further define "property damage" as "physical injury to, destruction of, or loss of use of *tangible property*." (Dkt. 16-2, at pp. 15 and 22 of 44 (emphasis added); Dkt. 16-3, at pp. 11 and 17 of 50). The loss settlement provisions of the policies repeatedly reference depreciation as it relates to the "buildings," "damaged building," and "damage to buildings." (Dkt. 16-2, at p. 27 of 44; Dkt. 16-3, at p. 22 of 50). Given this language, an ordinary layperson could reasonably interpret the undefined term "depreciation" within the policies to only apply to tangible materials rather than intangible labor services. Indeed, that is the only rational "reasonable expectation" of an average consumer absent a contrary indication within the policy.

For example, under similar policy language, the Illinois Court of Appeals recently held that only the property structure and materials are subject to reasonable depreciation, and depreciation may *not* be applied to the intangible labor component, explaining:

> According to the dictionary definitions, property refers to something tangible, something that is owned, or possessed…. Thus, it is clear, **based upon the plain language of the State Farm policy at issue** and the language of the Code that **"actual cash value" refers to real property—an asset that can lose value over time due to wear and deterioration, resulting from use or the elements, and does not refer to services, such as labor**. We note that this definition of "property" is further supported by the language of State Farm's own policy. The subject policy defines "property damage" as "physical damage to or destruction of *tangible* property, including loss of use" of that property. Thus, **an ordinary layperson may reasonably interpret "depreciation, if any," to describe the depreciation of physical, tangible materials, particularly where the language follows the word "property."**

Sproull, 2020 WL 4251702, at *8 (italics in original; bold emphasis added). The *Sproull* court's reasoning applies with equal force here where the word "depreciation" follows the words "property" as well as "buildings," "damaged building," and "damage to buildings." (Dkt. 16-2, at pp. 15, 22, and 27 of 44; Dkt. 16-3, at pp. 11, 17 and 222 of 50).

Finally, "the split of authority amongst the other courts that have addressed this issue militates in favor of a finding of ambiguity and an interpretation in favor of the insured." *Helena Chem*, 357 S.C. at 639 (citing *Greenville Cty.*, 313 S.C. at 547-48)). If intelligent jurists trained in the law cannot agree on whether labor may or may not be depreciated, Plaintiffs' interpretation is certainly reasonable. *See Mitchell*, 954 F.3d at 707 (holding insurer's interpretation of ACV that views "depreciation" as a reduction in market value "is not so singularly compelling as to make [policyholder's] definition of ACV unreasonable. We resolve this dispute in favor of [the policyholder] under the canon that 'ambiguity and doubt in an insurance policy must be resolved in favor of the insured."). Numerous courts have noted that the existing conflict between jurists concerning labor depreciation sufficiently demonstrates policy ambiguity. *See, e.g.*, *Arnold*, 268 F. Supp. 3d at 1311 ("Again, however, the question is whether the plaintiff's construction is also reasonable. The jurists in the plaintiff's cases have all thought so."); *Titan Exteriors*, 297 F. Supp. 3d at 634 (discussing conflicting labor depreciation case law and stating "[t]he Court need not decide which of these interpretations is correct. It needs [sic] only find that each is reasonable, and the Court so finds that 'actual cash value' when defined as 'replacement cost less depreciation' is subject to more than one reasonable interpretation").[9]

[9] *Arnold* also noted that, in addition to the divergent judicial positions, the insurance industry itself has different practices. "[T]he fact remains that [State Farm] has confirmed that some percentage of insurance adjusters, like some percentage of jurists, share the plaintiff's understanding." *Arnold*, 268 F. Supp. 3d at 1312, n.23.

In sum, all ambiguities must be construed in favor of the insured, and because Travelers' policies do not define the term "actual cash value" or otherwise unambiguously provide for labor depreciation in the calculation of ACV payments, Travelers may not do so as a matter of law. *See Whitlock*, 399 S.C. at 613, 615-16 ("Where, as here, the insurance contract does not unambiguously identify a date for measuring the diminution in value of the insured property or otherwise unambiguously provide for the method of valuation as a result of the title defect, such ambiguity requires a construction allowing for the measure of damages most favorable to the insured."). The answer to the district court's certified question should therefore be answered in the negative—that is, "Defendants cannot withhold a portion of the labor costs as depreciation under either policy." *Lammert*, 572 S.W.3d at 179.

C. Labor Cannot Be Withheld As Depreciation In The Absence Of A Labor Permissive Form Where, As Here, The Parties Agreed On And Travelers, In Fact, Utilized The "Replacement Cost Less Depreciation" Methodology To Calculate ACV

Courts have adopted three different methods to determine ACV: (1) "replacement cost less depreciation"; (2) market value; and (3) broad evidence. *See* Steven Plitt *et al*., COUCH ON INSURANCE §§ 177:24-177:28 (3rd ed. June 2020); Steven Plitt *et al*., CATASTROPHE CLAIMS: INSURANCE COVERAGE FOR NATURAL AND MAN-MADE DISASTERS § 6:14 (Nov. 2020); APPLEMAN, *supra*, § 47.04[1]. As discussed below, when a "replacement cost less depreciation" methodology is used by the insurer to calculate ACV—*as Travelers did here*—courts are near unanimous in disallowing the withholding of labor as depreciation in the absence of express policy language authorizing the practice.

The First Amended Complaint alleges that Travelers "affirmatively and unilaterally chose to use a 'replacement cost less depreciation' methodology" when calculating and issuing Plaintiffs' ACV payments. (Dkt. 13, ¶¶ 28, 40). Travelers did *not* use any "market value" methodology when

calculating and making Plaintiffs' ACV payments. (Dkt. 13, ¶¶ 29, 41). Plaintiffs each agreed with, and do not dispute, Travelers' decision to use a "replacement cost less depreciation" methodology to calculate ACV. (*Id.* ¶¶ 30, 42).

Travelers, in turn, affirmed that it utilized the "replacement cost less depreciation" methodology in calculating Plaintiffs' ACV payments. (Dkt. 16-1, at 1). The estimate worksheets Travelers provided Plaintiffs in connection with their property losses further demonstrate that this is the methodology, in fact, utilized by Travelers when calculating Plaintiffs' ACV payments. (Dkts. 13-1 and 13-2). Finally, the district court's Certification Order likewise recognized that the "replacement cost less depreciation" methodology "is the methodology used in [Plaintiffs'] policies." (Dkt. 40, at 6).

This method is consistent with South Carolina Department of Insurance Bulletin Number 2014-18, issued July 26, 2014, which requires calculation of ACV by first determining RCV, and then deducting depreciation. *See* Dkt. 22-10. The Bulletin's sample notice states: "*Actual cash value* is the amount needed to repair or replace the damage minus a deduction for depreciation." (*Id.* at p. 16 out of 17 (emphasis in original)). Thereafter, on September 14, 2014, Travelers filed with the South Carolina Department of Insurance its form notice to all homeowners policyholders for all Travelers affiliates using the Department of Insurance's sample language. (Dkt. 22-11).[10]

[10] This filing was obtained from the South Carolina Department of Insurance public filing system SERFF. https://filingaccess.serff.com/sfa/home/sc. This Court may properly take judicial notice of matters of public record, including agency records made available on government websites. *Wingfield v. South Carolina Tax Com.*, 147, S.C. 116, 127, 166 (1928); *see also Phillips v. Pitt County Memorial Hosp.*, 572 F.3d 176, 180 (4th Cir. 2009) (citing *Hall v. Virginia*, 385 F.3d 421, 424 (4th Cir. 2004) (noting it was proper to consider "publicly available [statistics] on the official redistricting website of the Virginia Division of Legislative Services.")); *see also McFadden v. Fuller*, No. 13-2290, 2014 WL 3671336, at *6 n.3 (D.S.C. July 22, 2014) (collecting cases "indicating that federal courts may take judicial notice of governmental websites" and "that postings on government websites are inherently authentic or self-authenticating"); *Miller v. Vocational Rehabilitation Workshop, Inc.*, No. 09-39, 2009 WL 482349, at *3, n.3 (D.S.C. Feb.

Accordingly, as a matter of fact, it cannot be seriously disputed that the only methodology at issue here is the "replacement cost less depreciation" methodology. Travelers' utilization of the "replacement cost less depreciation" methodology, and Plaintiffs' agreement as to that methodology, should render any discussion about whether South Carolina should allow depreciation of labor under a methodology other than "replacement cost less depreciation" wholly irrelevant, academic and hypothetical.

Nevertheless, before the district court, Travelers argued that South Carolina courts should allow a property insurer to use a "market value" methodology when calculating ACV. Dkt. 16-1, at 1, 9-10. This argument must fail, however, because it is premised upon a non-existent fact pattern as plainly demonstrated by Travelers' own estimates. (Dkts. 13-1 and 13-2).

Where the parties have agreed to use a "replacement cost less depreciation" methodology, it is irrelevant whether labor is hypothetically depreciable under a different methodology never actually utilized by the insurer. This same issue recently arose before the Tennessee Supreme Court, wherein a property insurer agreed to calculate ACV under a "replacement cost less depreciation" methodology. When it was subsequently sued for withholding labor as depreciation, the property insurer argued that Tennessee was a "broad evidence" state, thereby allowing the insurer to withhold labor. The Tennessee Supreme Court rejected the property insurer's argument in *Lammert*, stating:

> Auto-Owners argues that Tennessee is a broad evidence state and that this court should follow other broad evidence states in concluding that labor is depreciable…. *[W]hether Tennessee is a broad evidence state is not at issue because in this case, as the homeowners point out, the parties agreed that the actual cash value was to be calculated based on the replacement cost method*.

25, 2009) ("The court may take judicial notice of factual information located in postings on government websites." (citing cases)).

Lammert, 572 S.W.3d at 178 (emphasis added).[11] The parties' agreement is factually dispositive of Travelers' market value methodology argument. Consequently, whether labor is depreciable under a "market value" approach is not at issue in this case.

Even if the parties had not agreed to use the "replacement cost less depreciation" methodology (which they did), Travelers argument would still fail for additional reasons. First, Travelers' argument ignores that this Court itself, in *S.C. Elec.*, previously applied the "replacement cost less depreciation" methodology—and *not* market value or the broad evidence rule—to determine the ACV of the loss. 238 S.C. at 261-63. This Court's decision in *S.C. Elec.* fully supports Plaintiffs' position here.

Second, Travelers errantly argued before the District Court that "the strong weight of well-reasoned appellate authority on point" hold that insurance policies like Travelers' permit depreciation of labor when calculating ACV. (Dkt. 16-1, at 17-21). However, the cases upon which Travelers relies are not "on point," because courts almost universally *preclude* labor depreciation where: (1) the policies at issue do *not* expressly permit labor depreciation; and (2) the property insurer agreed that ACV payments were to be calculated under the "replacement cost less depreciation" methodology *or* state law required the use of the "replacement cost less depreciation" methodology.

[11] Prior to the Tennessee Supreme Court decision in *Lammert*, other federal courts similarly found that the parties' agreement on methodology precludes disputes concerning other methodologies. *See, e.g., Stuart v. State Farm Fire & Casualty Co.*, 910 F.3d 371, 376 (8th Cir. 2018) ("*the parties agreed on a methodology* and the only dispute is over including labor depreciation in the calculation" (emphasis added)), *reh'g and reh'g en banc denied* (8th Cir. Jan. 29, 2019); *Brown v. Travelers Casualty Insurance Co. of America*, No. 15-50, 2016 WL 1644342, at *5 (E.D. Ky. Apr. 25, 2016) ("Here, the parties have agreed that actual cash value is replacement cost less depreciation.").

The foreign authority split can be largely harmonized by looking at whether the dispute in question is governed by the "replacement cost less depreciation" methodology or the "broad evidence rule." In *Hicks v. State Farm Fire & Cas. Co.*, the Sixth Circuit provided a simple analysis harmonizing the existing case law from throughout the United States. The court found:

- Kentucky is a "replacement cost less depreciation" state;
- The insurer's supporting case law was *not* from "replacement cost less depreciation" states; and
- Authority from "replacement cost less depreciation" states favors policyholders.

751 Fed. Appx. at 708-11. Specifically, the Sixth Circuit stated that the identical authority relied upon by Travelers here is distinguishable because it comes from broad evidence jurisdictions, *not* "replacement cost less depreciation" jurisdictions:

> [T]he cases on which [the insurer] relies—*Redcorn*, *Henn*, *Wilcox*, *LaBrier*, and *Graves*—*come primarily from states where the broad evidence rule applies* or where the policies at issue expressly define ACV. On the other hand, courts that have endorsed the minority position come from states with laws or regulations like Kentucky, *which prescribe a replacement cost less depreciation formula*.

Id. at 710-11 (holding insurer cannot depreciate labor costs when calculating ACV pursuant to the replacement cost less depreciation methodology (emphasis added)).

Travelers' reliance on the identical set of decisions in this case is misplaced for the same reason. Such decisions do *not* involve the circumstances found here—*i.e.*, where the parties expressly agreed prior to suit that ACV would be calculated by estimating the cost to repair or replace the property, less depreciation, and the policyholders simply dispute whether labor costs can be withheld as depreciation.

For example, Travelers relies upon *In re State Farm Fire & Cas. Co.*, 872 F.3d 567 (8th Cir. 2017) ("*LaBrier*"), to argue that ACV must be interpreted in this case to mean fair market value. (Dkt. 16-1, at 17-18). *LaBrier* is distinguishable because it was decided in the context of an

insurer and insured *not* agreeing on the methodology by which the insurer calculates ACV. *LaBrier*, 872 F.3d at 576 ("An equally significant error was to ignore the fact that, while the policy's replacement cost coverage obligated State Farm to estimate actual cash value and replacement cost and make an initial actual cash value payment, these estimates *were not agreed to by LaBrier* …." (emphasis added)). In contrast, all the parties in the instant case agreed that ACV is calculated using the replacement cost less depreciation methodology, consistent with South Carolina Department of Insurance Bulletin Number 2014-18.

Additionally, in *Stuart v. State Farm Fire & Casualty Co.*, the Eighth Circuit subsequently limited the scope of *LaBrier*, confining it to the facts of that case and a unique Missouri statutory ACV definition not at issue here. 910 F.3d 371, 376 (8th Cir. 2018) (holding whether State Farm was in breach for depreciating labor would depend on whether its methodology produced a reasonable estimate of ACV, as provided by Missouri law, which defined ACV as "the difference between the reasonable value of the property immediately before and immediately after the loss"), *reh'g and reh'g en banc denied* (8th Cir. Jan. 29, 2019). In fact, in *Stuart*, the Eighth Circuit upheld class certification of a labor depreciation class precisely because "Arkansas law … differs from Missouri law in that it explicitly prohibited insurers from depreciating the costs of labor when using this [replacement cost less depreciation] formula." *Id.* In doing so, the Eighth Circuit recognized that "[t]here is no need for a jury to evaluate conflicting estimates based on different methodologies; *the parties agreed on a methodology and the only dispute is over including labor depreciation in the calculation*, which is a discrete portion of the formula that is easily segregated and quantified." *Id.* (emphasis added).

"Accordingly, … the instructive precedents are not those from states that reject reproduction cost, but those that define actual cash value as replacement cost less depreciation,"

Hicks, 751 Fed. App'x. at 711 (internal quotation marks removed), *or where the parties expressly agreed on the method of calculating the loss*. *Stuart*, 910 F.3d at 376; *Lammert*, 572 S.W.3d at 178.

This year alone, at least seven decisions from "replacement cost less depreciation" jurisdictions have precluded labor depreciation under policies like Travelers', which do not expressly address the practice. *See, supra*, at 21-22, n.7. Further, in addition to this Court's decision in *S.C. Elec.*, discussed *supra*, there are three state supreme courts from "replacement cost less depreciation" jurisdictions (or where the parties have agreed to that methodology) that have addressed labor depreciation in some fashion—*e.g.*, Arkansas, Mississippi, and Tennessee. In all three cases, the state supreme courts found that labor is *not* depreciable when ACV is calculated by applying the "replacement cost less depreciation" methodology. *See Adams*, 430 S.W.3d at 678 ("We … simply cannot say that labor falls within that which can be depreciable."); *Bellefonte Ins. Co. v. Griffen*, 358 So.2d 387, 389-90 (Miss. 1978) (policy term allowing "deduction for depreciation" is ambiguous because it "does not specifically prohibit or allow depreciation on the cost of labor"); *Lammert*, 572 S.W.3d at 179 ("labor may not be depreciated when the insurance company calculates the actual cash value of a property using the replacement cost less depreciation method.").

Accordingly, even if this Court's decision in *S.C. Elec*. did not compel a ruling in favor of Plaintiffs (which Plaintiffs believe it does), the parties' agreement on methodology, coupled with the Sixth Circuit's analysis in *Hicks* and the growing number of labor depreciation decisions from "replacement cost less depreciation" jurisdictions, provide an independent basis for ruling against Travelers. The "replacement cost less depreciation" methodology is focused entirely on allowing enough money for repairs to return a building to its *status quo ante*. If the insurer withholds labor

from the ACV payment by expanding the concept of depreciation to include market value concepts, the policyholder cannot return the property to its pre-loss condition.

This Court should thus hold that where the parties agree to application of the "replacement cost less depreciation" methodology as they did here, labor cannot be withheld as depreciation. Travelers cannot escape its pre-suit decision to exclusively use a "replacement cost less depreciation" methodology when calculating ACV payments. The inapposite cases relied upon by Travelers simply do not address these undisputed facts.

D. The Certified Question Presents A Question Of Law For The Court And Is Not Subject To Appraisal

Finally, as this Court considers the certified question, it may question whether the issue presented is more appropriately resolved by an appraisal panel as opposed to a court. It is not. The certified question presents a question of law for the Court and not a question for appraisal.

As alleged factually, Plaintiffs agree with *all* of Travelers' valuations of the amount of labor and materials necessary to return their properties to their pre-loss condition. (Dkt. 13, ¶¶ 36, 48). Similarly, Plaintiffs do not dispute *any* of Travelers' valuations as to the depreciated values of the tangible property that was damaged. (*Id.* ¶¶ 36, 48). Instead of a dispute over any valuations, the dispute here is only whether the policy forms allow Travelers to withhold portions of the agreed-to amounts of intangible labor as "depreciation." (*Id.* ¶¶ 37, 49). If the parties submitted this dispute to appraisal, there would be nothing to appraise because there is no dispute over valuations.

In one of the decisions heavily cited by Travelers before the District Court, the Minnesota Supreme Court admittedly held that whether labor can be withheld as depreciation under a property policy is a question for an appraisal panel to decide. *Wilcox v. State Farm Fire & Cas. Co.*, 874 N.W.2d 780 (Minn. 2016). However, unlike South Carolina and most states' law, Minnesota case

law allows appraisers to resolve questions of law. *Compare Harwell v. Home Mutual Fire Ins. Co.*, 91 S.E.2d 273, 275 (S.C. 1956) ("An agreement to submit to [appraisal] all questions of law and fact that may arise under a contract is contrary to the public policy and void, and an attempt to oust courts of their jurisdiction"), *with American Cent. Ins. Co. v. District Court*, 147 N.W. 242, 244 (Minn. 1914) ("the appraisers must determine … questions, both of law and fact, upon which the parties may differ."). For this reason, *Wilcox* is an outlier, contrary to most decisions that hold that whether labor can be withheld as depreciation is question of law. *See Lammert*, 572 S.W.3d at 176 ("The Minnesota Supreme Court took a third approach to answering the question by determining that the depreciation of labor costs is an issue of fact rather than law.").

The instant case is like that presented in *Stuart*, *supra*, wherein the Eighth Circuit affirmed certification of a labor depreciation class because "[t]here is no need for a jury to evaluate conflicting estimates based on different methodologies; the parties agreed on a methodology and the only dispute is over including labor depreciation in the calculation, which is a discrete portion of the formula that is easily segregated and quantified." *Stuart*, 910 F.3d at 376.

In short, only this Court can determine whether undisputed amounts of labor can be withheld as depreciation under the terms of the insurance policy, including whether the insurance policy is ambiguous. In other words, "[i]t is a question of law for the court whether the language of a contract is ambiguous." *Whitlock,* 399 S.C. at 614 (internal quotation marks and citations omitted). Similarly, "[w]hen the language of a contract is clear and unambiguous, the determination of the parties' intent is a question of law for the court." *West Anderson Water Dist. v. City of Anderson,* 790 S.E.2d 204, 207 (S.C. Ct. App. 2016). In South Carolina, only the courts can resolve the policy interpretation issue presented in the certified question.

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court answer the certified question posed by Judge Childs in the negative, holding that labor may not be depreciated when the insurance company calculates the ACV of property damage using the replacement cost less depreciation method.

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