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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
The Honorable J. Michelle Childs, United States District Judge

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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

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RESPONDENTS' BRIEF

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INTRODUCTION

This case is one of numerous putative class action lawsuits filed across the country involving the application of depreciation in estimating "actual cash value" (ACV) under homeowners and commercial property insurance policies. Since the 19th century, insurance policies have provided for payment of the ACV of covered damage to structures. Today, most policies provide coverage on an ACV basis unless and until the insured repairs or replaces the damaged property. After repair or replacement is completed, a supplemental payment is made so that the total amount paid is the full cost of repair or replacement of covered damage (subject to the deductible and any other applicable provisions of the policy). If, however, the insured declines to make the repairs or fails to demonstrate that he or she spent more than the ACV in making repairs, the policy provides coverage only on an ACV basis.

For decades, courts across the country, including this Court, have interpreted "actual cash value" in accordance with its ordinary, common sense meaning, i.e., the actual value in cash or, in other words, the actual (i.e., true and accurate) economic value of the damaged property. One of the well-established methods used for estimating ACV involves estimating the replacement cost value (RCV) of the damage and then subtracting depreciation. This approach to property valuation is used not only for insurance purposes, but also for property tax assessments, real estate appraisals and other purposes. When this approach is used to estimate ACV, depreciation is properly applied to the full RCV, not merely a portion of that cost.

In recent years, plaintiffs' attorneys across the country have attempted to create a legal fiction, under which the ACV of damaged property would *not* be the actual value in cash of the property. These plaintiffs' attorneys contend that, where an insurance policy provides for payment of ACV, the policyholder is entitled, as a matter of law, to be paid an amount calculated by

estimating the RCV of the damage and subtracting only the *portion* of the depreciation attributable to the cost of materials. The argument made is that only the cost of the building materials depreciates, not the cost of labor to install them. But this proposed interpretation of ACV makes no economic sense, is contrary to the plain and ordinary meaning of the words "actual cash value," and contrary to court decisions and insurance industry practices stretching back many decades.

Plaintiffs do not even attempt to demonstrate that their proposed rule of law, under which ACV would be determined by estimating RCV and applying depreciation only to the cost of materials, is an *accurate* method of valuing a structure, or any portion thereof. It is not. Common sense dictates that it is the value of the roof of a structure that depreciates, for example, not merely the cost of the shingles and nails.

Conspicuously absent from Plaintiffs' Brief is *any* citation to or even acknowledgement of the most recent state supreme court decision to address the same issue presented here, which happens to be from this Court's closest neighbor. In *Accardi v. Hartford Underwriter Ins. Co.*, 838 S.E.2d 454 (N.C. 2020), the North Carolina Supreme Court held:

> The policy language provides no justification for differentiating between labor and materials when calculating depreciation, and to do so makes little sense. The value of a house is determined by considering it as a fully assembled whole, not as the simple sum of its material components. To conclude that labor is not depreciable in this case would "impose liability upon the company which it did not assume," and provide a benefit to plaintiff for which he did not pay. *Wachovia*, 276 N.C. at 354, 172 S.E.2d at 522. We will not do so.

Id. at 457-58 (emphasis added). *Accardi* is concise and well-reasoned. There is no reason why the rule of law on the certified question presented here should differ based on which side of the North/South Carolina border a property is on.[1] This Court should follow its sister court in North

[1] *See* Richard Stradling, "The border between North and South Carolina is officially settled," *Charlotte Observer* (Dec. 9, 2016) (reporting an agreement to slightly modify the state borders in

Carolina and rule that ACV should be calculated by applying depreciation properly to the full RCV of the damaged property, including both materials and embedded labor components. In the alternative, this Court should adopt the position of the Minnesota Supreme Court that the question of how to properly determine ACV in the context of a particular loss is not a question of law, but instead a case-by-case determination for a finder of fact (with the aid of expert testimony) or appraisal panel.

STATEMENT OF ISSUE ON APPEAL

The certified question is:

> 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

This lawsuit was filed in the U.S. District Court for the District of South Carolina on September 16, 2019. (Dkt. 1.[2]) Plaintiffs filed a First Amended Complaint on October 11, 2019. (Dkt. 13.) As described in further detail below, the First Amended Complaint alleged claims for breach of contract and declaratory judgment under homeowners' insurance policies issued by Defendants, alleging that Defendants improperly applied depreciation in estimating the ACV of the covered damage to their property. Plaintiffs also sought certification of a proposed statewide class. On November 4, 2019, Defendants filed a motion to dismiss the First Amended Complaint,

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certain areas) (available at https://www.charlotteobserver.com/news/politics-government/article120032668.html).

[2] Because a record on appeal in this Court is not prepared when this Court accepts a certified question, as Plaintiffs have done, Defendants cite to the federal district court record, which is publicly available at https://ecf.scd.uscourts.gov, under case number 3:19-cv-02621. "Dkt." refers to the docket entry number, and the page numbers herein are the page numbers assigned by the federal district court's electronic filing system, which appear at the top of each page.

pursuant to Fed. R. Civ. P. 12(b)(6). (Dkt. 16.) The parties completed briefing on that motion, and later supplemented that briefing with new decisions issued in various jurisdictions involving the same "labor depreciation" issue that has been the subject of extensive putative class action litigation across the country. (Dkt. 22, 26, 29-49.) On September 26, 2020, the federal district court, after reviewing the parties' briefs on Defendants' motion to dismiss, issued an order certifying the question set forth above to this Court. (Dkt. 40.) On October 16, 2020, this Court issued an order accepting the certified question.

STATEMENT OF FACTS

The federal district court certified the question presented after reviewing the parties' briefing on Defendants' motion to dismiss under Fed. R. Civ. P. 12(b)(6). Accordingly, as the federal district court noted, the relevant "facts" are the facts alleged in the First Amended Complaint, along with the insurance policy provisions at issue. (Order and Opinion Certifying Question ("Certification Order"), p. 2 fn. 1.) Defendants summarize the relevant allegations and quote the applicable policy provisions below.

A. The Butler Loss

Plaintiff Miriam Butler alleges that she owns residential property in Columbia, South Carolina (the "Butler Property") that was damaged by fire on October 6, 2016 (the "Butler Loss"). (Dkt. 13 ¶¶ 1, 15.) At the time of the Butler Loss, the Butler Property was insured by a homeowners' insurance policy (the "Butler Policy") issued by one of the Defendants, The Travelers Home and Marine Insurance Company ("Travelers"). (*Id.*, ¶ 11.) Butler submitted a claim to Travelers under the Butler Policy. (*Id.*, ¶ 17.) The Butler Policy provides, in pertinent part, as follows with respect to how covered property losses are settled:

> **3. Loss Settlement.** . . . Covered property losses are settled as follows:
>
> . . .

b. Buildings covered under Coverage A or B at replacement cost without deduction for depreciation, subject to the following:

(1) If, at the time of loss, the amount of insurance in this policy on the damaged building is 80% or more of the full replacement cost of the building immediately before the loss, we will pay the cost to repair or replace, after application of any deductible and without deduction for depreciation, but not more than the least of the following amounts:

(a) The limit of liability under this policy that applies to the building;

(b) The replacement cost of that part of the building damaged with material of like kind and quality and for like use; or

(c) The necessary amount actually spent to repair or replace the damaged building.

. . .

(4) We will pay no more than the actual cash value of the damage until actual repair or replacement is complete. Once actual repair or replacement is complete, we will settle the loss as noted in **b.(1)** and **b.(2)** above.

However, if the cost to repair or replace the damage is less than $2,500, we will settle the loss as noted in **b.(1)** and **b.(2)** above whether or not actual repair or replacement is complete.

(5) You may disregard the replacement cost loss settlement provisions and make claim under this policy for loss to buildings on an actual cash value basis. You may then make claim for any additional liability according to the provisions of this Condition **3.** Loss Settlement, provided you notify us of your intent to do so within 180 days after the date of loss.

(Dkt. 16-2, pp. 27-28 of 44 (emphasis added).) As quoted above, the Butler Policy provides for payment of the ACV of the damage unless and until repair or replacement of the damaged property is complete.

Butler alleges that Travelers estimated that the replacement cost of the damage to her home was $111,442.76, and deducted depreciation of $59,763.41.[3] After subtracting the deductible of

[3] Plaintiffs incorrectly suggest that Defendants "surreptitiously depreciate labor costs," and that this "allows Travelers to take unfair advantage of its consumers without their knowledge." (Plaintiffs' Br. at 13.) Contrary to Plaintiffs' assertions, Defendants' estimates readily demonstrate that depreciation is not limited to the cost of materials. The first substantive page of the Butler estimate, for example, includes a line item for "Paint door or window opening – 2 coats (per side)" with an RCV of $118.71 and depreciation applied of $106.84. (Dkt. 13-1, p. 3 of 55.) Any homeowner who has ever purchased paint or hired a painter would understand that depreciation is not being applied only to the cost of the paint.

$1,500, Travelers issued an ACV payment in the amount of $50,179.35. (Dkt. 13, ¶ 34.) Butler does not allege that she has completed the repair or replacement of the Butler Property.[4] She alleges that she is entitled to be paid the ACV of the damage to her property. (*Id.*, ¶¶ 106-107.)

B. The Stewart Loss

Plaintiff Evelyn Stewart alleges that she is the personal representative of the estate of her deceased father, Joseph Stewart, who owned residential property in Columbia, South Carolina (the "Stewart Property") that was damaged by fire on September 17, 2016 (the "Stewart Loss"). (*Id.* ¶¶ 2, 23.) At the time of the Stewart Loss, the Stewart Property was insured by a homeowners' insurance policy (the "Stewart Policy") issued by Defendant The Standard Fire Insurance Company ("Standard Fire"), an affiliate of Travelers. (*Id.*, ¶ 19.) Joseph Stewart submitted a claim to Standard Fire under the Stewart Policy. (*Id.*, ¶ 25.) The Stewart Policy provides, in pertinent part, as follows with respect to how covered property losses are settled:

> **3. Loss Settlement.** Covered property losses are settled as follows:
>
> . . .
>
> **c.** BUILDINGS UNDER COVERAGE A OR B AT REPLACEMENT COST WITHOUT DEDUCTION FOR DEPRECIATION, SUBJECT TO THE FOLLOWING:
>
> **(1)** IF AT THE TIME OF LOSS THE AMOUNT OF INSURANCE IN THIS POLICY ON THE DAMAGED BUILDING IS 80% OR MORE OF THE FULL REPLACEMENT COST OF THE BUILDING IMMEDIATELY PRIOR TO THE LOSS, WE WILL PAY THE COST OF REPAIR OR REPLACEMENT, WITHOUT DEDUCTION FOR DEPRECIATION, BUT NOT EXCEEDING THE SMALLEST OF THE FOLLOWING AMOUNTS:
>
> **(a)** THE LIMIT OF LIABILITY UNDER THIS POLICY APPLYING TO THE BUILDING;
>
> **(b)** THE REPLACEMENT COST OF THAT PART OF THE BUILDING DAMAGED FOR EQUIVALENT CONSTRUCTION AND USE ON THE SAME PREMISES; OR

[4] In fact, although this is not alleged in the complaint, as Defendants noted in their memorandum of law in the federal district court, Butler has completed a portion of the repairs to the Butler Property, and Travelers has paid for that portion of the repairs on an RCV basis by paying some of the amounts previously withheld as depreciation.

> (c) THE AMOUNT ACTUALLY AND NECESSARILY SPENT TO REPAIR OR REPLACE THE DAMAGED BUILDING.
>
> . . .
>
> (4) We will pay no more than the actual cash value of the damage until actual repair or replacement is complete. Once actual repair is complete, we will settle the loss according to the provisions of **c.(1)** and **c.(2)** above.
> However, if the cost to repair or replace is less than $2,500 we will settle the loss according to the provisions of **c.(1)** and **c.(2)** above, whether or not actual repair or replacement is complete.
>
> (5) YOU MAY DISREGARD THE REPLACEMENT COST LOSS SETTLEMENT PROVISIONS AND MAKE CLAIM UNDER THIS POLICY FOR LOSS OR DAMAGE TO BUILDINGS ON AN ACTUAL CASH VALUE BASIS AND THEN MAKE CLAIM WITHIN 180 DAYS AFTER LOSS FOR ANY ADDITIONAL LIABILITY ON A REPLACEMENT COST BASIS.

(Dkt. 16-3, pp. 22-23 of 50, as modified by p. 39 of 50 (emphasis added).) As quoted above, the Stewart Policy provides for payment of the ACV of the damage unless and until repair or replacement of the damaged property is complete.

Stewart alleges that Standard Fire estimated that the replacement cost of the damage to the Stewart Property was $2,617.26, and deducted depreciation of $1,017.79. After subtracting the deductible of $1,000, Standard Fire issued an ACV payment in the amount of $599.47. (Dkt. 13, ¶¶ 45-46.) Stewart does not allege that her father or the estate completed the repair or replacement of the Stewart Property. She alleges that she is entitled to be paid the ACV of the damage to the Stewart Property. (*Id.*, ¶¶ 106-107.)

C. Plaintiffs' Alleged Causes of Action

Butler and Stewart allege that Travelers and Standard Fire, respectively, paid them less than they were entitled to be paid under their policies (the "Policies") for ACV, as a matter of law. Specifically, Plaintiffs maintain that Defendants, in estimating the ACV of Plaintiffs' losses, improperly calculated the depreciation deductions based on both the material cost and labor cost components of the estimated RCV of the damage. Plaintiffs claim that Defendants, in estimating

the depreciation, should have applied depreciation only to the estimated cost of materials, and not to the estimated cost of labor. (*Id.*, ¶¶ 37, 49, 107, 110.) Plaintiffs contend that there should be a rule of law that in *all circumstances*, Defendants' "property insurance contracts prohibit the withholding of [a portion of] labor costs as depreciation . . . ." (*Id.*, ¶ 116.)

The First Amended Complaint alleges claims for breach of contract and declaratory relief. The breach of contract claim (Count I) alleges that "Travelers[5] 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.) Plaintiffs seek "damages sufficient to make them whole for all amounts Travelers unlawfully withheld or delayed from its ACV payments as labor cost depreciation, including unrecovered depreciated labor costs and interest on any withheld or delayed labor cost depreciation withholdings." (*Id.*, ¶ 110.) The declaratory judgment claim (Count II) seeks "a declaration that Travelers' property insurance contracts prohibit the withholding of labor costs as depreciation when adjusting partial losses under the methodology employed here." (*Id.*, ¶ 116.)

STANDARD OF REVIEW

In answering certified questions from federal courts regarding insurance policy interpretation, this Court applies its well-settled principles of contract interpretation. *Century Indem. Co. v. Golden Hills Builders, Inc.*, 348 S.C. 559, 565, 561 S.E.2d 355, 358 (S.C. 2002), *overruled on other grounds by Crossmann Communities of N. Carolina, Inc. v. Harleysville Mut. Ins. Co.*, 395 S.C. 40, 717 S.E.2d 589 (S.C. 2011). "Insurance policies are subject to the general rules of contract construction." *B.L.G. Enterprises, Inc. v. First Fin. Ins. Co.*, 334 S.C. 529, 535, 514 S.E.2d 327, 330 (S.C. 1999). "This Court must give policy language its plain, ordinary, and

[5] In the First Amended Complaint, the term "Travelers" is defined to include both defendants. (Dkt., ¶ 5.)

popular meaning." *Id.* "When a contract is unambiguous, clear, and explicit, it must be construed according to the terms the parties have used." *Id.* "The court's duty is limited to the interpretation of the contract made by the parties themselves regardless of its wisdom or folly, apparent unreasonableness, or failure [of the parties] to guard their interests carefully." *Id.* (bracket in original; internal quotations and citation omitted). "[I]nsurers have the right to limit their liability and to impose conditions on their obligations provided they are not in contravention of public policy or a statutory prohibition." *Id.* at 535-36, 514 S.E.2d at 330.

Here, the parties' dispute focuses on the meaning of the term "actual cash value," which is not defined by the Policies. As this Court has explained, an insurance policy provision is "not ambiguous merely because its terms are undefined in the policy." *Bardsley v. Gov't Employees Ins. Co.*, 405 S.C. 68, 76, 747 S.E.2d 436, 440 (S.C. 2013). Rather, "[i]t is a well-settled principle of contract interpretation that absent a contractual definition to the contrary, contract language is given its ordinary and plain meaning." *Id.* This is because:

> If policy language was rendered ambiguous simply because it was not defined, insurance policies would need to contain definitions for every word in order to avoid ambiguity, a requirement which would be absurd. To say that any word that is not defined is ambiguous is to ignore the utility of human language. We use words because they have commonly accepted meanings, and it is only when they are subject to more than one meaning as used in a particular policy that they may become ambiguous.

Id.; *see also Beaufort Cty. Sch. Dist. v. United Nat. Ins. Co.*, 392 S.C. 506, 518, 709 S.E.2d 85, 91 (S.C. Ct. App. 2011) ("The term 'series' is not defined in the endorsements, so it must be defined according to the usual understanding of the ordinary person."); *Ex parte United Servs. Auto. Ass'n*, 365 S.C. 50, 55, 614 S.E.2d 652, 654 (S.C. Ct. App. 2005) ("Where a term is not defined in a policy, it is to be defined according to the usual understanding of the term's significance to the ordinary person.") (internal quotations omitted).

ARGUMENT

I. THE ORDINARY MEANING OF "ACTUAL CASH VALUE" DEMONSTRATES THAT DEFENDANTS' POSITION IS CORRECT

There is no dispute that, under the terms of the Policies, Plaintiffs were entitled to be paid the ACV of the damage to their property. The Policies provide that Defendants "will pay no more than the actual cash value of the damage until actual repair or replacement is complete." (Dkt. 16-2, pp. 27-28 of 44; Dkt. 16-3, pp. 22-23 of 50, as modified by p. 39 of 50.) The Policies further provide that "[y]ou [i.e., Plaintiffs] may disregard the replacement cost loss settlement provisions and make claim under this policy for loss to buildings on an actual cash value basis." (*Id.*) Neither Butler nor Stewart alleges that repair or replacement was completed with respect to the covered damage to the insured property. Accordingly, based on Plaintiffs' allegations, Defendants' obligations under the Policies therefore were limited to paying the ACV of the covered damage.

Under this Court's well-settled principles of insurance policy construction, where the words "actual cash value" are not further defined by the Policies, those words must be given their "ordinary and plain meaning," *Bardsley*, 747 S.E.2d at 440, in other words, "the usual understanding of the ordinary person." *Beaufort Cty.*, 709 S.E.2d at 91; *see also Ex parte United Servs. Auto. Ass'n*, 614 S.E.2d at 654 (undefined term must be given "the usual understanding of the term's significance to the ordinary person"). This is the same rule the North Carolina Supreme Court applied in recently deciding the same issue presented here. *See Accardi*, 838 S.E.2d at 457 ("if the policy fails to define a term, the court must define the term in a manner that is consistent with the context in which the term is used, and the meaning accorded to it in ordinary speech").

The ordinary, plain meaning of the words "actual cash value" is the actual value, in cash, of the damaged property, or in other words, its actual economic value. This Court has rarely addressed the meaning of ACV, but in doing so stated similarly that "[t]o sum up, 'actual cash

value' means the actual value expressed in terms of money of the thing for the purpose for which it was used; in other words, the real value to replace." *S.C. Elec. & Gas Co. v. Aetna Ins. Co.*, 238 S.C. 248, 262, 120 S.E.2d 111, 118 (S.C. 1961) (emphasis added); *see also Columbia College v. Pennsylvania Ins. Co.*, 250 S.C. 237, 250, 157 S.E.2d 416, 423 (S.C. 1967) (describing ACV as the "actual value" of a building, which could be "worth only one-half of its replacement cost," or, in other words, the "value of a used building"). This is consistent with a seminal case nationally on ACV insurance, *McAnarney v. Newark Fire Ins. Co.*, 159 N.E. 902 (N.Y. 1928), in which the New York Court of Appeals explained that "[w]e interpret 'actual cash value' to have no other significance than 'actual value' expressed in terms of money." *Id.* at 903 (emphasis added). The Nebraska Supreme Court similarly explained, in deciding the same issue presented here, that "actual cash value must . . . be measured as an economic unit, i.e., related to what, in terms of value, one could receive for his or her property." *Henn v. American Family Mutual Ins. Co.*, 894 N.W.2d 179, 185 (Neb. 2017) (quoting *Erin Rancho Motels, Inc. v. United States Fid. & Guar. Co.*, 352 N.W.2d 561, 565 (Neb. 1984); *see also Lampe Mkt. Co. v. Alliance Ins. Co.*, 22 N.W.2d 427, 428-29 (S.D. 1946) (ACV means "'actual value' expressed in terms of money"); *Tyler v. Shelter Mut. Ins. Co.*, 184 P.3d 496, 501 (Okla. 2008) (ACV means "the actual value of property expressed in terms of money").

ACV is frequently estimated by starting with the estimated RCV and subtracting depreciation. *See, e.g., Accardi*, 838 S.E.2d at 456. When applying depreciation, what the certified question here describes as "embedded labor components" must not be ignored. As the North Carolina Supreme Court explained in *Accardi*, "[t]he policy language provides no justification for differentiating between labor and materials when calculating depreciation, and to do so makes little sense." *Id.* at 457. This because "[t]he value of a house is determined by considering it as a fully

assembled whole, not as the simple sum of its material components." *Id.* A properly-applied deduction for depreciation ensures that the insured receives the actual economic value of the damaged property, and does not receive the economic, financial benefit that accrues from, for example, replacing an old roof with a brand new one that will last 30 years, or replacing 30-year-old kitchen cabinets with brand new ones. It is common sense that a prospective house buyer pays more for a house with a brand-new roof or new kitchen than an old roof or an old kitchen. This is consistent with Plaintiffs' definition of depreciation—Plaintiffs recognize that "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." (Plaintiffs' Br. at 15 (quoting Richard J. Cohen, et al., 5 New Appleman on Ins. Law Library Ed. § 47.04[2][a] (2020).)

To illustrate this with a concrete example, assume that a roof is damaged by a hailstorm and requires complete replacement. The estimated replacement cost (the cost of a brand-new roof) is $10,000, $4,000 of which represents the cost of materials and $6,000 of which represents the cost of labor. Because the roof was 18 years old when the damage occurred and was expected to last a total of 20 years, assume that the appropriate depreciation is 90% (i.e., 18 divided by 20). Here is how Plaintiffs' position regarding the economic value of what was damaged (an 18-year-old roof) compares to Defendants' position:

	Plaintiffs' Position	Defendants' Position
Estimated Labor	$6,000	$6,000
Estimated Materials	$4,000	$4,000
Estimated Replacement Cost of the Roof	$10,000	$10,000
Estimated Depreciation	-$3,600 (90% applied to materials only)	-$9,000 (90% applied to estimated replacement cost)
Estimated Actual Cash Value of the Roof	$6,400	$1,000

Defendants' position is the correct measure of the ACV of the roof because it measures the actual economic value of the 18-year-old roof.[6] Given that a brand-new roof would cost approximately $10,000, and the old roof had only 10% of its useful life remaining, the actual economic value of the old roof to a reasonable, knowledgeable person interested in buying the house prior to the loss would have been $1,000. Such a buyer would have recognized that the roof would have to be replaced very soon, and would have taken that into account in deciding how much to offer in buying the house. In contrast, Plaintiffs' proposed calculation reaches a result ($6,400) that is more than six times the actual economic value of the roof prior to the loss. A reasonable person, familiar with the condition of the roof and the cost of roof replacement, buying the house the day before the loss occurred, would not pay $6,400 in value for a roof that was near the end of its life expectancy and would cost $10,000 to replace within the next two years. Yet, under Plaintiffs' proposed legal valuation rule, the insurer would be required to pay $6,400 for a roof that a reasonable buyer would value at only $1,000. Put another way, Plaintiffs' proposed legal valuation rule would require the insurer to indemnify the insured, at the initial, ACV stage of the claim, for more than the actual economic loss sustained.[7]

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[6] Plaintiffs incorrectly suggest that Defendants seek to withhold an "arbitrary amount" of depreciation as applied to the embedded labor component of estimated RCV. (Plaintiffs' Br. at 1.) Defendants seek to apply economically *accurate* depreciation, consistent with how depreciation has been applied for decades not only in the insurance context but also other relevant contexts. *See* Sections II and VI below. It is Plaintiffs' approach of applying only partial depreciation that would be arbitrary and inconsistent with the economic value of the damaged property.

[7] Significantly, the fact that, at the initial ACV stage of the claim, the insured would be entitled to only the actual value of the lost 18-year-old roof does ***not*** mean that the insured would not be able to recover the cost of replacing the 18-year-old roof with a brand new roof ($10,000) minus the applicable deductible. Rather, under Plaintiffs' Policies, Plaintiffs would be able to recover on a RCV basis, and thereby receive an economic gain, simply by making the repairs or entering into a contract to do so. (Defendants do not require policyholders to fund the full cost before receiving RCV payment, and the ACV is usually more than sufficient to provide a deposit for a contractor to commence work.)

Plaintiffs do not even attempt to demonstrate that their proposed rule of law, under which ACV always would be determined by estimating RCV and applying partial depreciation (applied only to the cost of materials), is an *accurate* method of valuing a structure, or any portion thereof. It is not. Plaintiffs maintain that the "actual cash value" of 25-year-old siding with a replacement cost of $30,000 and a normal life span of 50 years is $22,500, i.e., 75% of the cost of brand-new siding. (Plaintiffs' Br. at 15-17.) An ordinary South Carolinian would never reach that conclusion. He or she would not expect the actual value, in cash, of 25-year-old siding to be 75% of the value of brand-new siding. That is illogical and contrary to the plain meaning of ACV, as well-reasoned opinions have repeatedly held. *See, e.g., Accardi*, 838 S.E.2d at 457 ("The policy language provides no justification for differentiating between labor and materials when calculating depreciation, and to do so makes little sense. The value of a house is determined by considering it as a fully assembled whole, not as the simple sum of its material components"); *Graves v. Am. Family Mut. Ins. Co.*, 686 Fed. Appx. 536, 540 (10th Cir. 2017) ("a reasonably prudent insured would not expect the insurer to apply such an unorthodox depreciation method [advocated by plaintiffs] when determining actual cash value"; rather, "a reasonably prudent insured would understand 'depreciation' to mean a decline in an asset's overall value"); *Basham v. United Servs. Auto. Ass'n*, No. 16-CV-03057-RBJ, 2017 WL 3217768, at *4 (D. Colo. July 28, 2017) ("Given the specific policy language here and background insurance principles, 'a reasonably prudent insured would understand 'depreciation' to mean a decline in an asset's overall value'") (quoting *Graves*).[8]

[8] Plaintiffs further maintain that Defendants should have adopted policy language apparently used by two other insurers expressly stating that depreciation will be applied to labor costs. (Plaintiffs' Br. at 10.) Defendants were not required to adopt another insurer's language, especially where the majority rule in state supreme courts nationwide supports Defendants' position. In any event, this argument must be disregarded because, under South Carolina law, "[e]xtrinsic evidence may not

The error in Plaintiffs' position is further demonstrated by the fact that what is insured by the Policies are Plaintiffs' *dwellings*, not merely the building materials (which are covered separately only if they are stored on site for the purpose of future construction or repairs). As the Policies provide in "COVERAGE A – DWELLING":

> **1.** We cover:
>
> **a.** The dwelling on the "residence premises" shown in the Declarations, including structures attached to the dwelling; and
>
> **b.** Materials and supplies located on or next to the "residence premises," used to construct, alter or repair the dwelling or other structures on the "residence premises".

(Dkt. 16-2, at p. 15 of 44; Dkt. 16-3, at p. 12 of 50.) The Policies further provide that "We insure against risk of direct physical loss to *property* described in Coverages A and B." (Dkt. 16-2, at p. 15 of 44 (emphasis added); *see also* Dkt. 16-3, at p. 17 of 40.) As one court persuasively explained, "[t]o adopt plaintiffs' view that 'property'—as used in step one of the Policy—equates to 'all *physical* materials required to produce the covered building but *nothing else*' strains reason. The ordinary meaning of 'property' is 'any external thing over which the rights of possession, use, and enjoyment are exercised.' The property owner exercises the right to possess, use, and enjoy the *outcome* of combining labor, tax costs, and materials—*i.e.*, the property itself in its finished form. In the same sense, defendant indemnified plaintiffs at step one of the Policy against the loss of the value of the *outcome* of combining labor, tax costs, and materials—*i.e.*, the covered property itself." *Papurello v. State Farm Fire & Cas. Co.*, 144 F. Supp. 3d 746, 770 (W.D. Pa. 2015) (emphasis in original; citations omitted).

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be used to create an ambiguity in an otherwise unambiguous policy." *Beaufort Cty. Sch. Dist.*, 392 S.C. at 525-26, 709 S.E.2d at 95-96; *see also In re Katrina Canal Breaches Litig.*, 495 F.3d 191, 210 (5th Cir. 2007) (rejecting argument that "the policies before us are ambiguous in light of more specific language used in other policies" because court must focus on the policy language before it).

Other courts that have held that depreciation may properly be applied to embedded labor components have emphasized that the Policies insure Plaintiffs' dwellings as a whole; they do not provide separate insurance for the materials and for labor. *See Redcorn v. State Farm Fire & Cas. Co.*, 55 P.3d 1017, 1021 (Okla. 2002) (explaining that policyholder "insured a roof surface, not two components, material and labor"; "[h]e did not pay for a hybrid policy of actual cash value for roofing materials and replacement costs for labor"); *Henn*, 894 N.W.2d at 190 ("The policy does not state that the insured will receive the actual cash value of the materials and the replacement cost value of the labor. As in *Redcorn*, [plaintiff] did not purchase a 'hybrid policy' that would allow for this distinction. The policy does not distinguish between materials and labor, and we refuse to read that distinction into the policy.").

Plaintiffs incorrectly suggest that Defendants, in applying depreciation to the full RCV including embedded labor components, are seeking to depreciate not merely the buildings that are insured by the Policies but also "intangible labor services." (Plaintiffs' Br. at 28.) What Defendants' position seeks to achieve is simply the *accurate* valuation of the buildings that are insured. As *Accardi*, *Henn* and *Redcorn* recognized, the value of insured buildings is *not* limited to the value of the materials that were used to build them (or are used to replace them). The Butler Policy, for example, has a Coverage A (Dwelling) limit of $123,000. (Dkt. 16-2, p. 2 of 44.) Under South Carolina law, this limit must not be more than "the value of the property to be insured," and the limit is the amount that must be paid for a total loss by fire. S.C. Stat. Ann. § 38-75-20. This amount, assuming it is accurate, is plainly not limited to the value of the materials that were used to build the house, or that would be used to rebuild it. It makes no sense to apply depreciation only to the portion of the value of the dwelling that is attributable to the cost of the materials.

Defendants' position is further supported by how the South Carolina Department of Insurance explained ACV when it published a "Post-Disaster Claims Guide."[9] This guide uses an example in which the cost to replace a roof is valued at $15,000 and the roof is ten years old, such that depreciation could be applied at a rate of $1,000 per year for ten years, resulting in a payment of $4,000 under ACV coverage (after subtraction of a $1,000 deductible) versus $14,000 under replacement cost coverage. (Dkt. 16-4, p. 12 of 24.) The Department of Insurance further explains that if a roof has an expected useful life of 25 years, and the roof is 20 years old, "an ACV policy may pay as little as 20% of the cost to replace the roof[.]" (*Id.*, p. 13 of 24.) This calculation applies straight-line depreciation (i.e., 20/25 = 80% depreciation) to the full RCV of the roof. In accordance with the ordinary meaning of ACV and the North Carolina Supreme Court's decision in *Accardi*, the South Carolina Department of Insurance's example does not segregate materials from labor in applying depreciation. *Both* examples published by the South Carolina Department of Insurance are squarely inconsistent with Plaintiffs' proposed approach of depreciating only the cost of materials.

II. PLAINTIFFS' PROPOSED INTERPRETATION OF "ACTUAL CASH VALUE" IS CONTRARY TO THE HISTORY AND PURPOSE OF ACV INSURANCE

While the ordinary meaning of "actual cash value" and the arguments set forth above are sufficient for this Court to answer the certified question in favor of Defendants' position, this Court may also find helpful some further background on the history and purpose of ACV insurance, which further supports Defendants' position.

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[9] In *Accardi*, the North Carolina Supreme Court cited a similar consumer guide published by the North Carolina Department of Insurance. *See Accardi*, 838 S.E.2d at 455 (citing N.C. Dep't of Ins., *A Consumer's Guide to Homeowner's Insurance* (2010), https://files.nc.gov/doi/documents/consumer/publications/consumer-guide-to-homeowners-insurance_cho1.pdf). The Nebraska Supreme Court also cited a similar brochure from the Nebraska Department of Insurance as supportive of the court's ruling that depreciation may be applied to the embedded labor component of RCV. *Henn*, 894 N.W.2d at 189.

A. Background on the History and Purpose of ACV Insurance

The issues presented here regarding ACV insurance coverage are not new, but rather have been created in recent years as a result of an inventive argument that plaintiffs' lawyers have been pursuing in putative class action litigation around the country. Insurers have been writing property insurance policies providing ACV coverage in South Carolina since at least 1892, and in the United States since at least the 1840s. *See, e.g., Stickley v. Mobile Ins. Co.*, 37 S.C. 56, 16 S.E. 280, 284 (S.C. 1892) (quoting insurance policy provision in use at that time providing for "the loss or damage to be estimated according to the actual cash value of the property at the time of the loss"); *Ulmer v. Phoenix Fire Ins. Co.*, 61 S.C. 459, 39 S.E. 712, 712 (S.C. 1901) (quoting standard policy providing that "the loss or damage shall be ascertained or estimated according to such actual cash value, with proper deduction for depreciation, however caused"); *Mutual Safety Ins. Co. v. Hone*, 2 N.Y. 235, 243 (1849) (quoting insurance policy providing for "the loss or damage to be estimated according to the true and actual cash value of the said property at the time the same shall happen").

Since at least the mid-20th century, insurers have provided two distinct types of casualty protection for buildings. "One insures to the extent of the 'actual cash value,' i.e., the diminution in value; and the other insures to the extent of 'the full cost of repair or replacement without deduction for depreciation . . . .'" *Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349, 352 (Ind. 1982); *see also In re State Farm Fire & Cas. Co. ("Labrier")*, 872 F.3d 567, 575 (8th Cir. 2017) (describing post-World War II advent of replacement cost coverage). As this Court has explained, replacement cost insurance was "previously called depreciation insurance." *Columbia College*, 250 S.C. at 250, 157 S.E.2d at 423. "If one is paid actual cash value for the destruction of a building which is, by reason of depreciation, worth only one-half of its replacement cost, the insured is in no financial condition to replace the building. Replacement cost insurance was devised to provide money for reconstruction. In effect, the insurer, under this plan, agrees to pay not only actual value

but also the difference between actual cash value and full replacement cost." *Id.* Replacement cost coverage "is obviously held out to the insurance buyer as an increased benefit to *bridge the gap between the* ***value of a used building*** *and the cost of replacing the same.*" *Id.* at 254, 157 S.E.2d at 425 (emphasis added).

Today, the predominant form of property insurance coverage provides combined coverage, in the sense that coverage is provided on an ACV basis unless and until the insured repairs or replaces the damaged property (or enters into a contract to do so).[10] After repair or replacement is completed, a supplemental payment is made so that the total amount paid is the full cost of repair or replacement of covered damage (subject to the deductible and any other applicable provisions of the policy). *See Nat'l Sec. Fire & Cas. Co. v. DeWitt*, 85 So. 3d 355, 374 (Ala. 2011). This is the type of policy that Plaintiffs purchased from Defendants in this case, as explained above.

ACV coverage is based on the principle of indemnity, that is, "[t]he insured who suffers a covered loss is entitled to receive full, but not more than full, value for the loss suffered, to be made whole but not be put in a better position than before the loss." *Labrier*, 872 F.3d at 573; *see also Joseph v. Sears Roebuck & Co.*, 224 S.C. 105, 113-14, 77 S.E.2d 583, 587 (S.C. 1953) ("An insurance contract is likewise a contract of indemnity. The insurer undertakes to indemnify another against loss, damage or liability arising from an unknown or contingent event."). "The limitation of property loss coverage to the insured's actual loss serves the public policy of preventing over-insurance, which can be an 'inducement to destroy property in order to procure the insurance upon it.'" *Labrier*, 872 F.3d at 573 (quoting *Daggs v. Orient Ins. Co. of Hartford*, 38 S.W. 85, 87 (Mo. 1896), *aff'd*, 172 U.S. 557 (1899); *see also D & S Realty, Inc. v. Markel Ins. Co.*, 816 N.W.2d 1,

[10] Part of the ACV payment is typically used to pay a deposit to a contractor to start the repairs. Defendants do not require policyholders to pay the additional cost to complete repairs out of pocket if the policyholder enters into a contract for the repairs.

12 (Neb. 2012); *Higgins v. Insurance Co. of N. Am.*, 469 P.2d 766, 773 (Or. 1970). As the Eighth Circuit has explained, "[b]y adhering to the core principle of indemnity," ACV coverage "limits the insured's covered loss to the *value of the damaged asset* at the time of the loss[.]" *Labrier*, 872 F.3d at 575 (emphasis added). Thus, "the insured, not the insurer, is responsible for the cash difference necessary to replace the old property with new property." *D & S Realty*, 816 N.W.2d at 11.

If insureds purchase replacement cost policies, however, as Plaintiffs did here, they can receive a supplemental payment to cover the full cost of replacing old property with new property (and thereby receive an economic gain) simply by making the repairs and submitting a supplemental claim to the insurer. It appears there would be no dispute here if Plaintiffs had simply completed the repairs to their properties and made such supplemental claims. *See Graves*, 686 Fed. Appx. at 539 ("Had [plaintiff] wanted to recover the full replacement cost under her policy she should have had the repairs completed by the one-year deadline.").

B. Court Decisions and Insurance Adjustment Manuals Have Long Recognized That Depreciation is Properly Applied to the Full Cost of Repair or Replacement

Courts have long recognized—since the 19th century—that in estimating ACV, depreciation is properly applied to the full cost of repair or replacement of damaged property (including embedded labor components), not merely to one component of value (such as the cost of materials). Back in 1886, in *Commercial Fire Ins. Co. v. Allen*, 1 So. 202 (Ala. 1887), the Alabama Supreme Court explained that "[i]f property had been destroyed which, from use or otherwise, had become less valuable than when new, then *the cost of repairing it, less the percentage of depreciation of the destroyed article* by such use, will determine the extent of the damages." *Id.* at 208 (emphasis added); *see also Providence Washington Ins. Co. v. Gulinson*, 215 P. 154, 155 (Colo. 1923) ("If $3016 was the cost of repairs it should have been reduced for

depreciation at something like the same rate as the cost of the whole reconstruction, 50 per cent."); *Boise Ass'n of Credit Men v. United States Fire Ins. Co.*, 256 P. 523, 527 (Idaho 1927) (determining lowest permissible valuation of building based on the evidence of replacement cost and percentage of depreciation per year applied thereto); *Wisconsin Screw Co. v. Fireman's Fund Ins. Co.*, 297 F.2d 697, 701 (7th Cir. 1962) (affirming district court judgment determining ACV as replacement cost less 50% depreciation); *Knuppel v. American Ins. Co.*, 269 F.2d 163, 166 (7th Cir. 1959) (affirming district court judgment determining ACV based on testimony regarding replacement cost less depreciation of 2% per year of the building's age); *Svea Fire & Life Ins. Co. v. State Sav. & Loan Ass'n*, 19 F.2d 134, 136 (8th Cir. 1927) (under Oklahoma law, affirming jury verdict that was consistent with testimony regarding cost of repair less 25% depreciation); *Real Asset Management v. Lloyd's of London*, 61 F.3d 1223, 1230 (5th Cir. 1995) (recognizing that ACV was properly determined by applying a depreciation percentage to full replacement cost).

Insurance adjusting manuals dating back many years confirm that depreciation was applied at that time, as it is today, as a percentage of the RCV (including embedded labor components), not based on the cost of the materials only. In one handbook from 1924, the author describes a straight-line method of depreciation that applies as a percentage of the full replacement cost: "Suppose half a dozen good contractors agree that it would cost $100,000 to reproduce a certain building at current rates, but that it was 20 years old, how much would it be worth? Three of them might set a life-time at 40 years, and the other three at 50. In the one case there would be an annual depreciation of 2 ½ per cent to deduct, and in the other 2 [percent]." William Arthur, APPRAISERS' AND ADJUSTERS' HANDBOOK 36 (1924) (Dkt. 16-5, p. 5 of 8). Nothing in this handbook indicates that adjusters were ever instructed to apply depreciation only to the materials portion of the RCV. *Id.* at 34-37, 47-48; *see also* Prentiss B. Reed, ADJUSTMENT OF FIRE LOSSES 58-62 (1929) (Dkt.

16-6). Another handbook from 1982 describes how depreciation is applied to the full RCV of a damaged roof, not merely to the cost of the shingles:

> On a partial loss to a structure, depreciation is based on the life span of each item in the building that is damaged. A four-year-old hail-damaged roof with a life expectancy of 20 years, for example, which costs $5,000 to replace, would be depreciated 20 percent (1/5 of $5,000 or $1,000) even though the dwelling may be 65 years old.

Robert J. Prahl, CPCU, INTRODUCTION TO CLAIMS 88 (Insurance Institute of America 1988) (Dkt. 16-7, p. 10 of 11).

Plaintiffs incorrectly suggest that the advent of claims estimating software resulted in insurers beginning to apply "depreciation" to labor costs. (Plaintiffs' Br. at 7.) To the contrary, as demonstrated by the historical handbooks cited above, for decades, insurers applied depreciation, in an appropriate percentage, to the full estimated RCV of a damaged roof, for example, not merely to the cost of the materials. The advent of claims estimating software has led to inventive arguments by plaintiffs' attorneys that the value of individuals' labor is what is being "depreciated" when in fact it is the actual economic value of an aged roof that is being estimated by applying depreciation to the RCV of the roof in essentially the same manner as was done decades ago when property insurance adjusters were doing the calculations by hand or with a calculator rather than using software.[11]

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[11] Plaintiffs cite two articles that they contend suggest that depreciation was traditionally applied only to the materials component of RCV. (Plaintiffs' Br. at 6-7.) Neither of these articles is an insurance adjustment manual or other document created by an insurance industry source. The first article is written by two public insurance adjusters, who represent insureds in pursuing insurance claims, in exchange for a percentage of the amount recovered. *See* https://suncoastclaims.com/about/. The article argues that "courts have erred in including labor in depreciation calculations." Don Wood et al., "Insurance Recovery After Hurricane Sandy: Correcting the Improper Depreciation of Intangibles Under Property Insurance Policies," N.Y. State Bar Ass'n Torts, Insurance & Compensation Law Section Journal, vol. 42 no.1, at 22 (Winter 2013). The second article is a blog post written by a plaintiffs' attorney who specializes in suing insurance companies (describing himself as "The Policyholder's Advocate"), and acknowledges

III. *S.C. ELECTRIC* DOES NOT SUPPORT PLAINTIFFS' POSITION

Plaintiffs focus heavily on *S.C. Elec. & Gas Co. v. Aetna Ins. Co.*, 238 S.C. 248, 120 S.E.2d 111 (S.C. 1961), even asserting that in this 1961 case this Court reached a "holding that repair labor is undepreciable when calculating ACV[.]" (Plaintiffs' Br. at 21.) To the contrary, as the federal district court's Certification Order correctly recognized, "it appears the Supreme Court simply examined a hypothetical ACV calculation and mentioned that labor was not depreciated," and "it does not appear labor depreciation was at issue" in the case. (Certification Order, p. 9.) The Certification Order further noted that *S.C. Elec. & Gas Co.* has been cited only a few times since 1961, none of which involved the application of depreciation.[12] (*Id.*) The federal district court's reading of *S.C. Elec. & Gas Co.* was correct, and Plaintiffs' position should be rejected.

S.C. Elec. & Gas Co. involved an insurance claim under fire insurance policies for damage to an electrical generator. Due to a fire, all of the stator coils had to be rewound and replaced. *S.C. Elec. & Gas Co.*, 238 S.C. at 258, 120 S.E.2d at 116. The policy provided coverage "to the extent of the actual cash value of the property at the time of loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality within a reasonable time after such loss." *Id.* The case was tried to a jury, which awarded the plaintiffs $87,000. There was evidence presented at trial that the "[t]he total cost of repairs was $132,181,

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that courts have reached conflicting results on the "labor depreciation" issue. Chip Merlin, "Few Judges and Insurance Regulators Worked in Property Claims: Understanding New Depreciation Rulings," Property Insurance Coverage Law Blog (Aug. 16, 2017).

[12] *S.C. Elec. & Gas* has been cited only three times, and only once by a South Carolina court. *See Smith v. Winningham*, 166 S.E.2d 825, 829 (S.C. 1969) (citing *S.C. Elec. & Gas* only for proposition that jury charge "must be considered as a whole"); *Aetna Ins. Co. v. Getchell Steel Treating Co.*, 395 F.2d 12, 17 (8th Cir. 1968) (rejecting part of jury charge in *S.C. Elec. & Gas.* addressing meaning of "ensuing fire"). The only citation relevant here is that *S.C. Elec. & Gas* was cited by the Oklahoma Supreme Court for the proposition that "the term 'actual value' means nothing more than an expression of the actual value of property in terms of cash." *Tyler v. Shelter Mut. Ins. Co.*, 184 P.3d 496, 497 & n.5, n.22 (Okla. 2008). That citation is consistent with Defendants' position here.

of which $90,300 represented the cost of the new coils and rewinding material, and between $15,000 and $16,000 the cost of labor furnished by the manufacturer. The cost of the new coils, installed, exclusive of certain expenses of removal and maintenance, was approximately $112,000." *Id.* at 258, 120 S.E.2d at 116. On post-trial motions, the trial court ordered a new trial unless the plaintiffs remitted the portion of the verdict that exceeded $67,200 plus interest. *Id.* at 255, 120 S.E.2d at 114. The plaintiffs agreed to that remittitur, and the defendants appealed. *Id.* at 255, 120 S.E.2d at 115.

On appeal, the defendants maintained that the jury charge on ACV was erroneous because recovery should have been limited to the ACV of the coils that were destroyed or damaged, not the entire stator. The defendants also claimed there was no evidence introduced of the ACV of the stator, which was not destroyed. *Id.* at 259, 120 S.E.2d at 116-17. The trial court had charged the jury that "the maximum amount to which the plaintiffs could be entitled under the contract was the 'actual cash value of the stator, installed in the generator, before the occurrence on June 27, 1950, taking into account its age and condition and the period beyond that date during which its useful economic life might reasonably be expected to have extended.'" *Id.* at 259, 120 S.E.2d at 116. This Court concluded that, although the references to the ACV of the stator may have been incorrect, it was clear from the verdict that the jury had disregarded that instruction. This Court concluded that the following portion of the jury charge was adequate and correct: "[t]he measure of damages under the loss may be arrived at by determining the difference between the value of the damaged property immediately before and immediately after the fire." *Id.* at 259, 120 S.E.2d at 117. The jury instruction went on to explain ACV and depreciation as follows:

> I charge you further, as to the measure of damages, the fire insurance policies provide that the fire insurers will pay 'the actual cash value of the property at the time of the loss, but not exceeding the amount which it would cost to repair or replace the property with material of like kind and quality'; and in connection

> therewith I charge you that cost of replacement and repairs is not conclusive as to this actual value but is evidence of the value and may be considered by you along with the other evidence in determining the amount of damages, if any . . .
>
> I charge you further that the property which was destroyed or damaged on June 27, 1950, had been in use since 1930. Therefore, in determining the actual value in 1950, you may consider the new value or cost thereof and take into consideration ***any depreciation of the property*** between 1930 and 1950 to be deducted from the new value or cost. In other words, Mr. Foreman and gentlemen, I charge you that that is one thing that you may consider in arriving at damages. It's not the only rule, it's nothing final or conclusive, but it's one rule that you may follow, if you find that the plaintiffs are entitled to recover.

Id. at 260, 120 S.E.2d at 117 (emphasis added). This Court further stated: "To sum up, 'actual cash value' means the actual value expressed in terms of money of the thing for the purpose for which it was used; in other words, the real value to replace." *Id.* at 262, 120 S.E.2d at 118 (emphasis added). These statements are consistent with the decisions cited above, under which ACV is the actual economic value of the damaged property, and when the replacement-cost-less-depreciation method is used for estimating ACV, it must be applied in a manner that is consistent with the true and accurate value of property. *See, e.g., Henn*, 894 N.W.2d at 875 ("an insured is properly indemnified when the amount calculated for actual cash value equals the depreciated value of the property just prior to the loss, which includes both materials and labor"). This is also consistent with how this Court later described the difference between ACV and RCV coverage in *Columbia College*, 250 S.C. at 250, 254, 157 S.E.2d at 423, 425 (ACV coverage is intended to insure "the value of a used building"), and with the South Carolina Department of Insurance's "Post-Disaster Claims Guide," as discussed above.[13]

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[13] *S.C. Elec. & Gas Co.* also contains a somewhat confusing discussion of the Pennsylvania Supreme Court's decision in *Fedas v. Ins. Co. of State of Pa.*, 151 A.285 (Pa. 1930), which held, under a 1930s policy that provided ACV coverage without any replacement cost coverage option, that the insured was nevertheless entitled to full replacement cost without *any* deduction for depreciation. *See Fedas*, 151 A. at 287-88. That was not the conclusion of this Court in *S.C. Elec. & Gas Co.*, and is not Plaintiffs' position here. More recent Pennsylvania appellate authority holds

Plaintiffs focus heavily on a statement by this Court in *S.C. Elec. & Gas Co.* that "[t]here 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." *S.C. Elec. & Gas Co.*, 238 S.C. at 262, 120 S.E.2d at 118; Plaintiffs' Br. at 19. This Court went on to perform hypothetical calculations of depreciation that yielded alternative calculations that potentially reached or exceed the jury's verdict, and substantially exceeded the amount that plaintiffs accepted after remittitur. *S.C. Elec. & Gas Co.*, 238 S.C. at 262-63, 120 S.E.2d at 118-19.[14]

S.C. Elec. & Gas Co. must be read in the context of the legal standard for an excessive verdict applicable at that time. As this Court had explained two years earlier, "[w]e cannot reduce the verdict and can reverse for excessiveness only when the verdict is so out of proportion to the

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that depreciation may be deducted in estimating ACV under policies that, like the Policies at issue here, provide for a "two-step" process under which the insured received an initial ACV payment, and then must complete the repairs or replacement to receive payment on a RCV basis. *See Kane v. State Farm Fire & Cas. Co.*, 841 A.2d 1038, 1050 (Pa. Super. Ct. 2003). A Pennsylvania federal court, after extensively analyzing *Fedas*, *Kane* and other relevant authority, dismissed a putative class action involving the same issue presented here. *Papurello*, 144 F. Supp. 3d at 770.

[14] Plaintiffs filed into the federal district court's record the entire appellate record from the *S.C. Elec. & Gas Co.* case. That record reflects that there was no testimony about depreciation, only testimony about the replacement costs, and the useful life of the equipment. (Dkt. 22-5, at p. 108 (useful life approximately 40 years); *id.* at 125 (cost of repair); *id.* at p. 130 (useful life ranged from 20 to 50 years); Dkt. 22-6, at p. 148 (remaining useful life 20 years); *id.* at p. 154 (cost of repairs).) After the jury awarded $87,000, the trial court ordered a new trial unless the plaintiffs accepted a reduced verdict in the amount of $67,200. (Dkt. 22-8, at pp. 311-12.) The trial court calculated this amount based on its conclusion that the damaged coils had 60% of their useful life remaining and their replacement cost (*including installation*) was $112,000. (*Id.* at p. 303.) That reduced amount was accepted by the plaintiffs. (Dkt. 22-9, at p. 18 of 27.) On appeal, the defendants-appellants' position was that they should have been granted a directed verdict because the damaged coils were worthless. (*Id.* at p. 5 of 27.) Their alternative position was that they should only be required to pay for a small portion of the repairs that were done, because only a small number of coils were damaged. (*Id.* at pp. 6-7 of 27.) The plaintiffs-respondents argued that it was necessary to replace all the coils, and that they were entitled to up to the full cost of repairs (which was more than the verdict). (*Id.* at pp. 21-23 of 27.)

evidence that it clearly indicates that it was influenced by partiality, prejudice, passion, caprice, or other considerations not founded upon the evidence." *Peagler v. Atl. Coast Line R. Co.*, 234 S.C. 140, 159, 107 S.E.2d 15, 25 (S.C. 1959); *see also Newman v. Brown*, 228 S.C. 472, 475, 90 S.E.2d 649, 651 (S.C. 1955) (applying same standard). In describing potential methods by which the jury theoretically could have applied depreciation in *S.C. Elec. & Gas Co.*, this Court was simply deciding that the verdict was not "out of proportion to the evidence," not that the jury (or the insurer) was *required* to determine ACV by using a specific method of calculation. To read *S.C. Elec. & Gas Co.* as Plaintiffs advocate—as setting forth a rule of *law* that depreciation may *never* be applied to embedded labor costs—would be squarely contrary to this Court's statements that ""[t]he measure of damages under the loss may be arrived at by determining the difference between the value of the damaged property immediately before and immediately after the fire," and "[t]o sum up, 'actual cash value' means the actual value expressed in terms of money of the thing for the purpose for which it was used; in other words, the real value to replace." *S.C. Elec. & Gas Co.*, 238 S.C. at 259, 262, 120 S.E.2d at 117-18 (emphasis added). The actual value in money of a damaged roof, for example, cannot be determined by estimating the RCV and applying depreciation only to the cost of the shingles, ignoring embedded labor costs.

As the Certification Order noted, Plaintiffs appear to be the first litigants to have ever suggested that *S.C. Elec. & Gas Co.* mandates the result they now seek, nearly six decades later. For Plaintiffs to suggest that *S.C. Elec. & Gas Co.* mandates that ACV be calculated in a manner contrary to the actual value of a building is a complete misreading of the decision, and unsupported by any decision in South Carolina in the last 60 years.

V. A MAJORITY OF STATE SUPREME COURT DECISIONS ON POINT SUPPORT DEFENDANTS' POSITION

On insurance coverage issues on which there is a split of authority nationwide, this Court has customarily followed the majority rule. *See L-J, Inc. v. Bituminous Fire & Marine Ins. Co.*, 366 S.C. 117, 121 & n.3, 621 S.E.2d 33, 35 & n.3 (S.C. 2005) (agreeing with majority view on insurance coverage issue, declining to adopt minority view); *Concrete Servs., Inc. v. U.S. Fid. & Guar. Co.*, 331 S.C. 506, 509-11, 498 S.E.2d 865, 866-67 (S.C. 1998) (finding policy language unambiguous, agreeing with majority of other jurisdictions and declining to adopt minority view).[15] Here, this Court should follow the well-reasoned majority of decisions in other state supreme courts, which have agreed with Defendants' position.

The supreme courts of Oklahoma, Nebraska, Minnesota and North Carolina have all ruled in favor of insurers on the same issue presented here, rejecting Plaintiffs' position. The first of these decisions was *Redcorn v. State Farm Fire & Casualty Co.*, 55 P.3d 1017 (Okla. 2002), which answered a certified question from a federal district court regarding whether, in determining ACV using a replacement-cost-less-depreciation method, depreciation may be applied to the full RCV, including embedded labor costs. The Oklahoma Supreme Court noted that it had previously followed the "broad evidence rule," under which the determination of ACV is "a matter of fact to be determined by a consideration of all relevant factors and circumstances existing at the time of loss." *Id.* at 1020. The court also noted that insurance law is based on the principle of indemnity,

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[15] Plaintiffs maintain that the split of authority in other jurisdictions weighs in favor of finding the policy language ambiguous, but in the cases they cite, as in *L-J* and *Concrete Servs.*, this Court chose to follow the majority rule. *See Helena Chem. Co. v. Allianz Underwriters Ins. Co.*, 357 S.C. 631, 641, 594 S.E.2d 455, 460 & n.5 (S.C. 2004) (where split of authority existed, this Court "align[ed] South Carolina with the majority of jurisdictions"; court also recognized a split of authority on whether insured bears the burden of proof on exception to exclusion, and followed majority rule that insured bears burden of proof); *Greenville Cty. v. Ins. Reserve Fund, a Div. of S.C. Budget & Control Bd.*, 313 S.C. 546, 548, 443 S.E.2d 552, 553 (S.C. 1994) (following approach taken in "numerous jurisdictions").

and "[t]he goal of indemnity is to place the insured in as good a condition, so far as practicable, as he would have been if no fire had occurred." *Id.* As Plaintiffs do here, the insured argued that depreciation should not be applied to the embedded labor cost component of RCV because "if it were possible to purchase depreciated shingles, the cost of the labor to install them would be the same as the cost of installing new shingles." *Id.* The Oklahoma Supreme Court rejected this argument, explaining that "[a] roof does not have a separate market value from the building it covers," and "[a] building is the product of both materials and labor." *Id.* The court further reasoned that the policy "insured a roof surface, not two components, material and labor," the plaintiff "did not pay for a hybrid policy of actual cash value for roofing materials and replacement costs for labor," and "[t]o construe the policy in such a manner would unjustly enrich the policy holder." *Id.* at 1021.[16]

The Minnesota Supreme Court addressed the same issue in *Wilcox v. State Farm Fire & Cas. Co.*, 874 N.W.2d 780 (Minn. 2016), in answering a certified question from a federal district court essentially the same as the one presented here.[17] The Minnesota Supreme Court concluded that "[t]he term 'actual cash value' is not ambiguous," and "'actual cash value' is a legal term of art that refers to the 'actual loss' sustained by the insured." *Id.* at 784. The court further concluded that the plaintiffs "do not advance a reasonable interpretation of the phrase 'actual cash value' that would categorically exclude embedded-labor-cost depreciation under every circumstance." *Id.* The court noted that it had previously followed the "broad evidence rule" with respect to ACV,

[16] A dissenting opinion in *Redcorn* concluded that "[a] roof is not a unified product but a combination of a product (shingles) and a service (labor to install the shingles)," and that it would be "illogical" to apply depreciation to labor. *Id.* at 1022 (Boudreau, J., dissenting). Several other courts have disagreed with this reasoning as contrary to the manner in which property is accurately valued. *See, e.g.*, *Henn*, 894 N.W.2d at 873 (discussed further below).

[17] The federal district court's certified question here is modeled on the question as reformulated by the Minnesota Supreme Court in *Wilcox*.

concluding that "under the broad evidence rule, embedded-labor-cost depreciation is one factor that the trier of fact may *consider* and weigh among other factors to determine the actual cash value of the damaged property." *Id.* at 785. The court held that "whether embedded-labor-cost depreciation is logical or helpful to the trier of fact is ultimately a question of fact, not law," and "[w]hen a homeowner's insurance policy does not define the term 'actual cash value' or otherwise state whether embedded labor costs are depreciable for the purpose of calculating actual cash value, the trier of fact may consider embedded-labor-cost depreciation when such evidence logically tends to establish the actual cash value of a covered loss." *Id.*

The Nebraska Supreme Court answered a similar certified question in *Henn v. American Family Mut. Ins. Co.*, 894 N.W.2d 179 (Neb. 2017). The court explained that "it is a well-accepted principle that '[a]ctual cash value is the value of the property in its depreciated condition.'" *Id.* at 186. The court further explained that ACV is "a representation of the depreciated value of the property immediately prior to damages." *Id.* at 189. The court agreed with the majority in *Redcorn* that "both materials and labor constitute relevant facts to consider when establishing the value of the property immediately prior to the loss," and "absent specific language in the policy, the insured does 'not pay for a hybrid policy of actual cash value for roofing materials and replacement costs for labor," further noting that "[t]he property is a product of both materials and labor." *Id.* at 189. The court held that "[t]he unambiguous definition of actual cash value is a depreciation of the whole," and "an insured is properly indemnified when the amount calculated for actual cash value equals the depreciated value of the property just prior to the loss, which includes both materials and labor." *Id.* at 190. The court further reasoned that "[t]he policy does not distinguish between materials and labor, and we refuse to read that distinction into the policy." *Id.*

The most recent state supreme court to address the issue presented here is the North Carolina Supreme Court, which followed the majority rule, holding earlier this year in *Accardi* that "the term 'ACV' is not susceptible to more than one meaning and unambiguously includes the depreciation of labor[.]" *Accardi*, 373 N.C. at 293, 838 S.E.2d at 455. As here, the policy at issue provided for an initial payment of ACV and then, after the item was repaired or replaced, "defendant would reimburse plaintiff for any extra money paid to repair or replace the item, up to the RCV." *Id.* The base policy form did not define ACV, although an endorsement applicable only to roof damage explained (consistent with Plaintiffs' position in this case and how Plaintiffs' own claims were adjusted) that ACV would be determined by estimating RCV and subtracting depreciation. *Id.* at 293-94, 838 S.E.2d at 455-56. As here, the policy did not define depreciation or address "labor depreciation" specifically. *Id.* The North Carolina Supreme Court explained that, as in South Carolina, "if the policy fails to define a term, the court must define the term in a manner that is consistent with the context in which the term is used, and the meaning accorded it in ordinary speech." *Id.* at 295, 838 S.E.2d at 457. The court concluded that "'[a]ctual cash value,' as used in the policy, is not susceptible to more than one reasonable interpretation and the term unambiguously includes costs for the depreciation of labor." *Id.* at 296, 838 S.E.2d at 457. The court noted that the policy's definition of ACV as RCV minus depreciation in the roof coverage endorsement was sufficient,[18] and that:

> Neither is the term "depreciation" ambiguous. The policy language provides no justification for differentiating between labor and materials when calculating depreciation, and to do so makes little sense. The value of a house is determined by considering it as a fully assembled whole, not as the simple sum of its material

[18] Plaintiffs cannot credibly claim that the definition of ACV in the roof coverage endorsement in *Accardi* makes that decision distinguishable from this case where Plaintiffs repeatedly assert, from the first page of their brief onward, that "ACV should be calculated by first determining the replacement cost of the damaged property and then subtracting depreciation." (Plaintiffs' Br. at 1.)

> components. To conclude that labor is not depreciable in this case would "impose liability upon the company which it did not assume," and provide a benefit to plaintiff for which he did not pay. *Wachovia*, 276 N.C. at 354, 172 S.E.2d at 522. We will not do so.
>
> Because we hold that the insurance policy at issue unambiguously allows for depreciation of the costs of labor and materials, we affirm the decision of the Business Court.

Id. at 296-97, 838 S.E.2d at 457-58 (emphasis added).

While there are two state supreme courts that have ruled in favor of Plaintiffs' position, they should not be followed by this Court.[19] In *Adams v. Cameron Mut. Ins. Co.*, 430 S.W.3d 675 (Ark. 2013), a majority of the Arkansas Supreme Court summarily reached the conclusion that the term "actual cash value" was ambiguous, without considering the ordinary, plain meaning of "actual cash value," i.e., actual value in cash, or any of the history of the use of that phrase in insurance policies or even in that court's own prior jurisprudence. *Id.* at 678. The Arkansas majority then agreed with the dissent in *Redcorn* that an insured should not sustain a "significant out-of-pocket loss" in an ACV calculation, *Adams*, 430 S.W.3d at 678-79, disregarding the longstanding principle that under ACV coverage, "the insured, not the insurer, is responsible for

[19] Plaintiffs also suggest that the Mississippi Supreme Court has ruled in their favor (Plaintiffs' Br. at 6 n.6), but it has not decided the issue. *Bellefonte Ins. Co. v. Griffin*, 358 So. 2d 387 (Miss. 1978) is readily distinguishable from the issue presented here. It involved automobile insurance coverage, and the court concluded that an insurer was not entitled to a "double deduction," in that "[w]hen an automobile is replaced with another of like kind and quality, then the replacement is already depreciated to the extent of the original vehicle." *Id.* at 390. Applying additional depreciation, the court concluded, would not yield the correct valuation of the automobile in that case. *Id.* In the context of structural damage to buildings, in contrast, an insurer estimates the cost of replacing an old, damaged roof, for example, with a new roof, and then deducts depreciation based on the age and condition of the roof. That would be comparable to replacing a damaged vehicle with a brand new one, and then deducting for the depreciation. The Fifth Circuit, when attempting to predict Mississippi law on the issue presented here, concluded that *Bellefonte* was *not* on point because it involved different policy language and a different context (auto insurance). *Mitchell v. State Farm Fire & Cas. Co.*, 954 F.3d 700, 708 n.10 (5th Cir. 2020).

the cash difference necessary to replace the old property with new property." *D & S Realty*, 816 N.W.2d at 11. The Arkansas Supreme Court also relied upon an Arkansas Insurance Department bulletin prohibiting depreciation of labor costs. *Adams*, 430 S.W.3d at 679.[20] The Arkansas legislature subsequently repudiated *Adams* and *Goodner* by enacting a statute expressly permitting depreciation of the full RCV, including the embedded labor component thereof, with the use of a notice to policyholders to be approved by the state insurance department. Ark. Code Ann. § 23-88-106.

In *Lammert v. Auto-Owners (Mut.) Ins. Co.*, 572 S.W.3d 170 (Tenn. 2019), the Tennessee Supreme Court expressly declined to follow the majority rule. The court recognized that "[t]he generally accepted definition of 'actual cash value' is 'actual value expressed in terms of money,'" but did not analyze how the actual value in cash of damaged property is accurately determined. *Id.* at 174. The court explained that "Black's Law Dictionary defines depreciation as '[a] reduction in the value or price of something; specif[ically] a decline in an asset's value because of use, wear, obsolescence, or age,'" and depreciation is "the actual deterioration of a structure by reason of age, and physical wear and tear, computed at the time of loss." *Id.* at 174-75 (quoting *Black's Law Dictionary* (10th ed. 2014) and *Redcorn*, 55 P.3d at 1020). The court failed, however, to analyze how depreciation in the value of an asset is accurately determined. Rather, it concluded that the plaintiffs' interpretation was "reasonable" without explaining how that interpretation would yield a plausibly *accurate* valuation of a damaged structure or component thereof (such as a roof). *Lammert*, 572 S.W.3d at 178. The court further concluded that "an insured should not have to

[20] In a subsequent decision, a majority of the Arkansas Supreme Court further concluded that as a matter of public policy, in estimating ACV, depreciation could never be applied to the embedded labor cost component of RCV, even where the insurance policy expressly so provided. *Shelter Mut. Ins. Co. v. Goodner*, 477 S.W.3d 512, 515-16 (Ark. 2015). No other court has reached such an outcome.

consult a long line of case law or law review articles and treatises" to determine coverage; that the insurer "argue[d] for a technical definition of depreciation"; and that "[t]herefore, construing the policy language in favor of the insured, depreciation can only be applied to the cost of materials, not to labor costs." *Id.* at 179 (quoting *Harrell v. Minn. Mut. Life Ins. Co.*, 937 S.W.2d 809, 814 (Tenn. 1996)).

Lammert should not be followed by this Court because it poorly reasoned and inconsistent with the plain and ordinary meaning of ACV and depreciation, as discussed above and as applied in numerous other contexts (as discussed further below). *Lammert* is inconsistent with the basic principle of South Carolina law that ACV must be given its "ordinary and plain meaning." *Bardsley*, 747 S.E.2d at 440. The *Lammert* court provided no support for the proposition that applying partial depreciation (only to the cost of materials) yields an *accurate* valuation of a structure, and there is none. Contrary to the *Lammert* court's reasoning, a homeowner desiring to ascertain how depreciation works would not have to consult case law or law review articles, but merely consult the South Carolina Department of Insurance consumer guide discussed above, or a basic example of how depreciation is applied to a structure in determining ACV. *See, e.g.*, Actual Cash Value Calculator available at https://www.miniwebtool.com/actual-cash-value-calculator/ (visited Dec. 8, 2020). *Lammert* also erroneously suggests that depreciation in insurance policies is intended to be different from how depreciation is applied in other property valuation contexts, when the opposite is true (as demonstrated below).[21]

[21] Plaintiffs also cite a recent Illinois Appellate Court decision that is currently being reviewed by the Illinois Supreme Court, and thus it is unclear whether this intermediate appellate decision correctly reflects the law of Illinois. *Sproull v. State Farm Fire & Cas. Co.*, 2020 WL 4251702 (Ill. App. Ct. July 24, 2020), *pet. for leave to appeal allowed*, 2020 WL 6886446 (Ill. Nov. 18, 2020). The *Sproull* intermediate appellate court appeared to conclude that, based on an Illinois regulation and prior Illinois decisions, an RCV-less-depreciation estimate of ACV should *not* be based on accurate depreciation, and should reach an outcome that does *not* accurately reflect true

VI. FEDERAL COURTS' "*ERIE* GUESSES" ON THE ISSUE PRESENTED ARE OF LIMITED VALUE TO THIS COURT'S ANALYSIS

Plaintiffs focus heavily on several federal court of appeals decisions addressing the "labor depreciation" issue under the law of various states, some of which ruled in favor of Plaintiffs' position. *Mitchell v. State Farm Fire & Cas. Co.*, 954 F.3d 700 (5th Cir. 2020); *Cranfield v. State Farm Fire & Cas. Co.*, 798 Fed. App'x 929 (6th Cir. 2020); *Perry v. Allstate Indem. Co.*, 953 F.3d 417 (6th Cir. 2020); *Hicks v. State Farm Fire & Cas. Co.*, 751 Fed. App'x 703 (6th Cir. 2018); *but see In re State Farm Fire & Cas. Co. ("Labrier")*, 872 F.3d 567 (8th Cir. 2017); *Graves v. Am. Family Mut. Ins. Co.*, 686 Fed. Appx. 536, 540 (10th Cir. 2017). In the absence of a state supreme court decision on point, a federal court of appeals must "make an *Erie* guess as to how the [State] Supreme Court would decide the question," and "[w]hen making an *Erie* guess, [the federal court's] task is to attempt to predict state law, not to create or modify it." *Keen v. Miller Envtl.*

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market value of damaged property. *Sproull* explained that, since 1920, the Illinois Appellate Court had followed a rule under which "'actual cash value' means 'reproduction value less depreciation for age and not market value.'" *Sproull*, 2020 WL 4251702, at *8 (quoting *Smith v. Allemannia Fire Ins. Co. of Pittsburgh*, 219 Ill. App. 506, 512-13 (1920)) (emphasis added). The court further explained how two subsequent decisions of that court had followed what it described as the "*Smith* rule," and one of those decisions had again rejected market value as even a relevant consideration in determining ACV. *Id.* (citing *C.L. Maddox, Inc. v. Royal Ins. Co. of Am.*, 208 Ill. App. 3d 1042, 1055 (1991)). South Carolina law is the *opposite* of Illinois law on this point. As this Court explained in *S.C. Elec. & Gas Co.*, a jury instruction on ACV should direct a jury to determine "the difference between the value of the damaged property immediately before and immediately after the fire," because "'actual cash value' means the actual value expressed in terms of money of the thing for the purpose for which it was used; in other words, the real value to replace." *S.C. Elec. & Gas Co.*, 238 S.C. at 259, 262, 120 S.E.2d at 117-18 (emphasis added). Thus, under South Carolina law, as with the majority of jurisdictions, "actual cash value" must yield a true and accurate valuation of property in money. This can be accomplished by estimating RCV and applying true and accurate depreciation (including embedded labor cost components). It is Plaintiffs' proposed version of the RCV-less-depreciation measure of ACV that is inconsistent with the market value of property. As explained further below, Plaintiffs repeatedly suggest, erroneously, that RCV-less-depreciation and market value are inconsistent methods of estimating ACV. Estimating RCV and applying depreciation is a method of estimating market value. The approaches are fundamentally inconsistent only when one adopts Plaintiffs' proposed approach of applying only partial depreciation (to the cost of materials only).

Grp., Inc., 702 F.3d 239, 243 (5th Cir. 2012); *see also Erie R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938). Thus, a federal court of appeals may lack the discretion to reach what the panel might believe is the correct result on an issue on which existing state law precedent is lacking—the panel might conclude that to reach that result it would have to create or modify existing state law. Given that none of the federal court of appeals decisions relied on by Plaintiffs have been subsequently reviewed by the applicable state supreme court, it remains uncertain whether they correctly reflect state law.

In deciding the certified question here, this Court should decline to follow the "*Erie* guesses" that Plaintiffs rely upon. In *Hicks v. State Farm Fire & Cas. Co.*, 751 Fed. App'x 703 (6th Cir. 2018) (unpublished), the majority concluded that "the contract is ambiguous because it relies on a [Kentucky] regulation that is subject to multiple reasonable interpretations," and "[i]n the insurance context, Kentucky applies the reasonable expectations doctrine which interprets ambiguous terms 'in favor of the insured's reasonable expectations.'" *Id.* at 708-09 (quoting *True v. Raines*, 99 S.W.3d 439, 443 (Ky. 2003)). Here, in contrast, the South Carolina Department of Insurance has agreed with Defendants' position,[22] and in South Carolina, the reasonable

[22] As noted above, in explaining how depreciation is calculated, the Department of Insurance has agreed with Defendants' position. (Dkt. 16-4, p. 12 of 24.) Plaintiffs cite South Carolina Department of Insurance Bulletin No. 2014-08, which implements a statute requiring insurers to provide policyholders with a summary of coverage explaining that ACV reflects depreciation, while RCV coverage does not deduct for depreciation. While that is not a disputed point, the relevant statute states that: "Any disclosure provided pursuant to this section shall be for informational purposes only and shall not amend, extend, or alter coverage provided in a policy. Any notice or disclosure provided shall not be admissible in any action brought concerning a policy except for the sole purpose of showing that the notice was or was not provided pursuant to this section." S.C. Stat. § 38-75-755(B)(3). The summary of coverage contains a heading with a similar statement. (Dkt. 22-10, p. 15 of 17.) Plaintiffs improperly rely on a document that is expressly inadmissible under the governing statute, and in any event does not address the issue of embedded labor costs that is presented by the certified question, which is addressed in the Department of Insurance's consumer guide. (Dkt. 16-4.)

expectations doctrine "cannot be used to alter the plain terms of an insurance policy." *Bell v. Progressive Direct Ins. Co.*, 407 S.C. 565, 581, 757 S.E.2d 399, 407 (S.C. 2014).

The *Hicks* majority further concluded that the majority rule, followed in *Henn*, *Wilcox*, *Labrier* and *Graves*, stems from states that "still employ the broad evidence rule, or some form of fair market valuation" in determining ACV, and that this was somehow contrary to a RCV-less-depreciation approach. *Id.* at 710. As discussed above, South Carolina law provides for ACV to be *consistent* with market value and "actual value expressed in terms of money" of the property. *S.C. Elec. & Gas Co.*, 238 S.C. at 259, 262, 120 S.E.2d at 117-18; *see also Columbia College*, 250 S.C. at 254, 157 S.E.2d at 425 (describing difference between replacement cost coverage and ACV coverage, and explaining that ACV is based on "the value of a used building"). In any event, as the dissent correctly explained in *Hicks*, the majority's attempt to distinguish states following the "broad evidence rule" from other states was "a distinction without a difference" because "Kentucky's replacement cost minus depreciation formula is the *method to calculate the economic value* of damaged property at the time it was damaged." *Hicks*, 751 Fed. App'x at 714 (Griffin, J., dissenting) (emphasis added). In other words (and as explained further below), RCV-less-depreciation is simply a method of estimating market value; the *Hicks* majority misunderstood that. The dissent found the majority rule nationwide to be consistent with how "Kentucky law provides that the purpose of insurance is to place the insured back in a position to where she was, no better and no worse," and further noted that consumer guidance provided by the Kentucky Department of Insurance demonstrated that depreciation would apply to the full cost of replacement, not merely the embedded materials component thereof. *Id.* at 712-13.

Moreover, the rationale of the several decisions that the *Hicks* majority declined to follow was *not* limited to the broad evidence rule or fair market value standards, but rather was also based

on the plain language of the policy and common sense. *See Henn*, 894 N.W.2d at 189 (explaining that "absent specific language in the policy, the insured does 'not pay for a hybrid policy of actual cash value for roofing materials and replacement costs for labor," and "[t]he property is a product of both materials and labor"); *Wilcox*, 874 N.W.2d at 784 (plaintiffs "do not advance a reasonable interpretation of the phrase 'actual cash value' that would categorically exclude embedded-labor-cost depreciation under every circumstance"); *Labrier*, 872 F.3d at 574 (explaining that depreciation has a "well understood meaning," and that dictionary definitions of depreciation consistently "deduct depreciation from the initial full cost of the damaged asset, because that was the insured's investment"); *Graves*, 686 Fed. App'x at 540 (court made no reference to broad evidence rule or market value; court reasoned that "*Black's Law Dictionary* describes ten different depreciation methods, none of which involves distinguishing materials from labor costs. Rather, its descriptions focus on the asset itself and various approaches to determining its value as a whole. Based on the plain and ordinary meaning of 'depreciation,' a reasonably prudent insured would not expect the insurer to apply such an unorthodox depreciation method when determining actual cash value.").

Perry, decided by the same federal circuit that decided *Hicks*, essentially adopted *Hicks* and *Lammert* in making an "*Erie* guess" about Ohio law, with little further analysis, after finding "no clear answer" in Ohio decisions, and acknowledging that "a slim majority of courts may have gone the other way[.]" *Perry*, 953 F.3d at 421-23. The concurring/dissenting opinion in *Perry* would have remanded the case for further proceedings because "Ohio law affords parties to an insurance coverage dispute the opportunity to present extrinsic evidence of custom and usage, industry practice, and the like, any of which may inform the ultimate interpretive question," and that "[e]vidence developed in discovery may allow Allstate to resolve any ambiguity in the policy

language." *Id.* at 425-26 (Readler, J., concurring in part and dissenting in part). This would be the correct outcome if an ambiguity were found under South Carolina law (although this Court should not find ambiguity).[23]

Cranfield adds nothing to the analysis because the Sixth Circuit panel in *Cranfield* was bound to follow the then-recent decision in *Perry*. The panel noted that the North Carolina Supreme Court had recently reached the opposite result in *Accardi*, and that the district court had "[a]gree[d] with the majority of courts to address the issue" in dismissing the plaintiff's complaint. *Cranfield*, 798 Fed. App'x at 930.

In *Mitchell*, the Fifth Circuit made another "*Erie* guess" regarding Mississippi law, essentially adopting the rationale in *Hicks*. *Mitchell*, 954 F.3d at 706-07 & n.5. The court noted that "State Farm's definition of ACV instead views 'depreciation' as the reduction in the *appraised* or *market value* of the roof prior to the damage," and "[t]his definition may be reasonable as well. But it is not so singularly compelling as to make [plaintiff's] definition of ACV unreasonable." *Id.* at 707. Unlike Mississippi law as interpreted by the Fifth Circuit, South Carolina law provides for actual cash value to *accurately* reflect the value of property. *S.C. Elec. & Gas Co.*, 238 S.C. at 259, 262, 120 S.E.2d at 117-18. The Fifth Circuit also used a hypothetical example, *id.* at 706, that is expressly contrary to the South Carolina Department of Insurance's Post-Disaster Claims Guide. (Dkt. 16-4, at 11-12.)

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[23] *See Beaufort Cty. Sch. Dist.*, 392 S.C. at 525-26, 709 S.E.2d at 95-96 (explaining that, under South Carolina law, "[e]xtrinsic evidence may not be used to create an ambiguity in an otherwise unambiguous policy," but may be considered in the event of a latent ambiguity, and typically "[i]nterpretation of a policy with a latent ambiguity is for the jury"); *Williams v. Gov't Employees Ins. Co. (GEICO)*, 409 S.C. 586, 594, 762 S.E.2d 705, 710 (S.C. 2014) ("If the court decides the language [in an insurance policy] is ambiguous, however, evidence may be admitted to show the intent of the parties, and the determination of the parties' intent becomes a question of fact for the fact-finder."); *Canal Ins. Co. v. Nat'l House Movers, LLC*, 414 S.C. 255, 260, 777 S.E.2d 418, 421 (S.C. Ct. App. 2015) (same).

None of these federal court decisions, which may not accurately reflect state law, provide useful guidance for this Court in applying South Carolina law on ACV. This Court should follow *Accardi* and the majority rule adopted by other state supreme courts nationwide.

VII. IN OTHER RELEVANT CONTEXTS, DEPRECIATION IS APPLIED TO THE FULL VALUE OF A BUILDING, INCLUDING BOTH LABOR AND MATERIALS

This Court should also take into account how depreciation is applied in other contexts in which the actual economic value of a building (or portion thereof) is determined, including property tax assessments, eminent domain, and other valuations of real property. In those contexts, when the "cost approach" (RCV-less-depreciation) is used to estimate market value, labor costs are *not* segregated from materials costs for purposes of calculating depreciation and determining actual economic value. Rather, depreciation is applied to the total estimated RCV. To achieve consistency in South Carolina law, properties should be valued for ACV insurance purposes consistently with how the same properties are valued for other purposes when a RCV-less-depreciation method is used in valuing property. There are no circumstances in which professionals in property valuation depreciate only the portion of replacement cost that is attributable to the cost of materials.

A. Property Tax Assessments

The cost approach to valuation—i.e., RCV-less-depreciation, the same method often used for estimating ACV for insurance purposes—is one of the methods used to estimate the fair market value of buildings for property tax assessment purposes. The South Carolina Constitution requires that real property be assessed for tax purposes at a specified percentage of its fair market value. S.C. Const. art. X, sec. 1. South Carolina law further requires that "[a]ll property must be valued for taxation at its true value in money which in all cases is the price which the property would bring following reasonable exposure to the market, where both the seller and the buyer are willing,

are not acting under compulsion, and are reasonably well informed of the uses and purposes for which it is adapted and for which it is capable of being used." S.C. Code Ann. § 12-37-930 (emphasis added). One of the approaches used to determine the "true value in money" of real estate for property tax purposes, in some circumstances, is the cost approach, which involves estimating replacement cost and subtracting depreciation from the full replacement cost (without segregating embedded labor costs from materials costs for purposes of depreciation, as Plaintiffs advocate). *See, e.g., Hull v. Spartanburg Cty. Assessor*, 372 S.C. 420, 425, 641 S.E.2d 909, 911 (S.C. Ct. App. 2007) ("At least four methods exist for determining fair market value of property for taxation purposes: analysis of comparable sales, capitalization of gross income, capitalization of net income, and reproduction cost less depreciation and obsolescence.") (quoting 72 Am.Jur.2d State and Local Taxation § 669 (2001)).

The leading treatise on property tax assessment, entitled PROPERTY ASSESSMENT VALUATION, is published by the International Association of Assessing Officers. Here is an example from that treatise regarding calculation of depreciation when using the cost approach:

> $\frac{\text{Effective age}}{\text{Total economic life}}$ = Depreciation
> (effective age + remaining economic life)
>
> By using the [above] formula for depreciation, what is the depreciation suffered by the following single-family residence and its corresponding improvement value if the cost new of the residence is $400,000? The total economic life of the residence is estimated to be 50 years, and the appraiser has determined that 5 years is the effective age for the residence.
>
Effective age	5 years
Divided by total economic life	50 years
Equals depreciation	**10%**
Cost new	$400,000
Less depreciation	**$40,000**
Improvement value	$360,000

Garth E. Thimgan, CAE et al., PROPERTY ASSESSMENT VALUATION (International Ass'n of Assessing Officers 3d ed.) at 273 (emphasis added).

The example could not be clearer: when using the cost approach to calculate property value, depreciation is applied to the *entire* RCV. There is no reason why the cost approach to valuation should be applied in a fundamentally different manner for ACV insurance purposes than the cost approach is applied for property tax valuation purposes.

Plaintiffs repeatedly try to suggest that "market value" approaches are fundamentally different from RCV-less-depreciation. (*See, e.g.*, Plaintiffs' Br. at 20, 30-33.) Plaintiffs' position is incorrect because the RCV-minus-depreciation approach is a *method* used by property valuation professionals for *estimating market value* of real property (which may be more or less accurate than other approaches for estimating market value, depending on the specific factual circumstances). As the Nebraska Supreme Court explained, "[d]epreciating the whole is merely one way to arrive at a value that represents the depreciated value of the property to which the insured is entitled." *Henn*, 894 N.W.2d at 185; *see also Labrier*, 872 F.3d at 574 ("A 'depreciation' deduction is the most common, but not the only acceptable *method of estimating the reduced fair market value* of damaged property.") (emphasis added); *Hicks*, 751 F. App'x at 714 (Griffin, J., dissenting) (explaining that majority's attempt to distinguish cases in other jurisdictions based on broad evidence rule was a "distinction without a difference" because "Kentucky's replacement cost minus depreciation formula is the *method to calculate the economic value* of damaged property at the time it was damaged") (emphasis added).

B. Eminent Domain and Other Real Estate Valuations

In the context of valuing property being taken by eminent domain, under South Carolina law, a property owner is "entitled to the fair market value of her property at the time of the taking," which is the "price which a willing buyer will pay a willing seller, neither being under compulsion

to buy or sell and both being fully informed of all uses to which the property is adopted and for which it is capable of being used." *Hous. Auth. of City of Charleston v. Olasov*, 282 S.C. 603, 608, 320 S.E.2d 478, 481 (S.C. Ct. App. 1984). Eminent domain proceedings typically involve the testimony of licensed appraisers. Persons seeking to be licensed as real estate appraisers by the South Carolina Real Estate Appraisers Board are required to learn the cost approach along with other methods of property valuation. *See* S.C. Code § 40-60-30 et seq.; S.C. Code of Regs. R. 137-100.02(C), (D), (E), 137-900.05(C), (D), (E). Licensed appraisers are also required to complete continuing education requirements. S.C. Code § 40-60-35. One of the approved course providers is the Appraisal Institute. *See* https://llr.sc.gov/appr/PDF/Forms/Doc400.pdf. The leading appraisal treatise, entitled THE APPRAISAL OF REAL ESTATE, is published by the Appraisal Institute. Here is an example from that treatise regarding calculation of depreciation when using the cost approach to determine the value of property:

> The total percentage of depreciation (36%) is determined by dividing the estimated effective age of 18 years by the total economic life expectancy of 50 years (Step 2). Thus, the economic age-life formula indicates total depreciation of 36%. When this rate is applied to the cost of $668,175, the total depreciation is $240,543 (Step 3). The cost approach is applied as follows:
>
> | | |
> |---|---|
> | Total [replacement] cost | $668,175 |
> | Less total depreciation | - 240,543 |
> | Depreciated cost | $427,632 |
> | Plus land value | +180,000 |
> | Indicated value by the cost approach | $607,632 |

Appraisal Institute, THE APPRAISAL OF REAL ESTATE 386 (13th ed. 2008).

This example further demonstrates that, when using the cost approach to calculate market value, depreciation is applied to the entire RCV of the structure (including embedded labor costs). This is fully consistent with how the RCV-less-depreciation methodology has been utilized for purposes of real estate assessments, eminent domain valuations, insurance adjustments and other

purposes for decades. South Carolina statutes and regulations require this type of depreciation methodology to be used for various purposes. *See* S.C. Code Ann. § 58-31-350 (requiring that electrical utility property be valued for "just compensation" purposes based on "[r]eproduction cost, new, of the facilities being acquired, less depreciation on a straight line basis"); S.C. Code Ann. § 58-27-1360 (similar); S.C. Code Regs. R. 19-410.3 (requiring that certain state buildings be depreciated based on "amount of expiration of the useful life of the buildings using the straight-line method with a twenty year base").

Applying depreciation only to the materials portion of RCV would be contrary to how depreciation is applied in the context of property tax assessments and basic principles of real estate appraisal. This would mean that the same South Carolina court, when applying the same approach for estimating market value (i.e., RCV-less-depreciation), would value the same property in fundamentally inconsistent and conflicting ways, depending on whether the valuation is for purposes of a property tax assessment, real estate appraisal, or ACV insurance purposes. That would be an inefficient and nonsensical approach, and should be rejected.[24]

VIII. IN THE ALTERNATIVE, THIS COURT SHOULD ADOPT THE MINNESOTA SUPREME COURT'S APPROACH

While Defendants maintain that this Court should conclude that applying depreciation to the labor cost component of RCV in determining ACV is permissible as a matter of law, as the North Carolina Supreme Court held in *Accardi*, if this Court does not reach that result, it should,

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[24] Plaintiffs argue that how depreciation is applied in property tax assessments, eminent domain and other property valuations should be irrelevant because "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[.]" (Plaintiffs' Br. at 26.) Contrary to Plaintiffs' position, where the plain and ordinary meaning of the words is "the actual value expressed in terms of money of the thing for the purpose for which it was used," *S.C. Elec. & Gas Co.*, 238 S.C. at 262, 120 S.E.2d at 118, how that monetary value is determined in related contexts is highly relevant. *See also Wilcox*, 874 N.W.2d at 785 (citing Appraisal Institute, *The Appraisal of Real Estate* (14th ed. 2013).

at a minimum, conclude that Plaintiffs are incorrect that there are *no* circumstances under which depreciation can *ever* properly be applied to labor costs. If this Court does not follow *Accardi* and the other state supreme courts that have concluded that application of depreciation to the full RCV, including embedded labor costs, is proper as a matter of law, this Court should conclude, as the Minnesota Supreme Court held, that the question of how to properly determine ACV in the context of a particular loss is not a question of law, but instead a case-by-case determination for a finder of fact (with the aid of expert testimony) or appraisal panel.[25] This would be consistent with *S.C. Elec. & Gas Co.* to the extent that the determination of ACV in that case was left to the jury with an appropriate charge on the meaning of ACV, and the verdict was ultimately found to be within the range of reasonableness based on the evidence admitted. At a minimum, Defendants should be permitted to argue to a trier of fact that depreciation may be applied to labor costs in the factual circumstances of Plaintiffs' individual insurance claims.

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[25] Appraisal is an alternative dispute resolution mechanism provided for in the insurance policies at issue. The appraisal provision states: "If you and we fail to agree on the amount of loss, either may demand an appraisal of the loss." (Dkt. 16-2, p. 28 of 44.) A three-member panel is appointed and ultimately "[a] decision agreed to by any two will set the amount of loss." (*Id.*) Plaintiffs argue that on the type of issue presented in this case there would be nothing to appraise (Plaintiffs' Br. at 37), but the dispute is plainly over the "amount of loss," i.e., the ACV. South Carolina law is consistent with Minnesota law on this point. *See, e.g., Hendricks v. Am. Fire & Cas. Co.*, 247 S.C. 479, 485, 148 S.E.2d 162, 165 (S.C. 1966) ("[T]he overwhelming weight of authority sustains the validity of a stipulation in an insurance policy requiring that *any difference of opinion as to the amount of loss*, shall be submitted to appraisers to be chosen in accordance with the policy provisions. Such stipulation, not ousting the jurisdiction of the courts, but leaving the general question of liability for loss to be judicially determined, and simply providing a reasonable method of estimating and ascertaining the amount of the loss, is valid.") (emphasis added); *Miller v. British Am. Assur. Co.*, 238 S.C. 94, 100, 119 S.E.2d 527, 531 (S.C. 1961) ("Since the [insurer] admits liability to the [insureds] for the damage to their cabin cruiser, and the parties have failed to agree as to the amount of the loss, it was proper for this question to be referred to appraisers to determine such, provided demand for such appraisal had been made in accordance with the provision of the appraisal clause of the policy."). Defendants do not contend that Plaintiffs' claims should be subject to appraisal in this case, in which no appraisal has been requested. Defendants provide this background so that the Court understands how the issue presented here could be determined by an appraisal panel in other cases.

The Minnesota Supreme Court concluded that "[t]he appraisal of real estate includes elements of both art and science," "whether embedded-labor-cost depreciation is logical or helpful to the trier of fact is ultimately a question of fact, not law," and "arguments about whether labor-cost depreciation is 'logical' according to accepted methods of appraisal in a given case are best presented to an appraisal panel or via expert testimony before a jury." *Wilcox*, 874 N.W.2d at 785. The court further explained that "[e]mbedded-labor-cost depreciation . . . is only one of many factors to be considered by the trier of fact; and its relevance depends on the facts and circumstances of the particular case." *Id.*; *see also Labrier*, 872 F.3d at 576-77 (predicting that Missouri Supreme Court would adopt *Wilcox* approach, explaining that "this issue may only be determined based on all the facts surrounding a particular insured's partial loss"); *Brown v. Travelers Cas. Ins. Co. of Am.*, No. 15-50-ART, 2016 WL 1644342, at *3-4 (E.D. Ky. Apr. 25, 2016) (reaching similar result).

Plaintiffs incorrectly suggest that *Wilcox* is distinguishable because "Minnesota case law allows appraisers to resolve questions of law." (Plaintiffs' Br. at 37-38.) To the contrary, the Minnesota Supreme Court has held that "appraisers have authority to decide the 'amount of loss' but may *not* construe the policy or decide whether the insurer should pay." *Quade v. Secura Ins.*, 814 N.W.2d 703, 706 (Minn. 2012) (emphasis added). Rather, Minnesota law "reserves to the courts the authority to decide coverage questions." *Id.* at 708. Thus, in *Wilcox*, the Minnesota Supreme Court decided the meaning of ACV as a matter of law, and then left it to a jury or appraisal panel to apply that definition of ACV to the specific facts and circumstances of the plaintiffs' loss. If this Court does not follow *Accardi*, the *Wilcox* approach would be consistent with what the trial court did in *S.C. Elec. & Gas Co.*, and this Court approved of in that case. The *Wilcox* approach would also be consistent with the approach this Court has taken to valuation of property rights

under title insurance policies. *Stanley v. Atl. Title Ins. Co.*, 377 S.C. 405, 411, 661 S.E.2d 62, 65 (S.C. 2008) ("Depending on the circumstances, the loss of a title's value can be measured in a variety of ways. For instance, an owner's loss can be the fair market value of a portion of property which has proven completely unmarketable; the cost of removing the defect from the property; or the difference in the values of the property with and without the defect.").[26]

CONCLUSION

This Court should answer the certified question in the affirmative, and rule that Defendants may apply depreciation to the full estimated replacement cost value, including embedded labor costs, 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. In the alternative, this Court should adopt the approach of the Minnesota Supreme Court in *Wilcox* and rule that whether embedded-labor-cost depreciation is appropriate is a question of fact to be determined by the trier of fact or appraisal panel, based on the facts and circumstances of each insurance claim.

Respectfully submitted,

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[26] Plaintiffs repeatedly cite *Whitlock v. Stewart Title Guar. Co.*, 399 S.C. 610, 732 S.E.2d 626 (S.C. 2012), another title insurance case, but that case involved the applicable *date* for valuation, not the valuation itself, which is governed by *Stanley* and is more analogous to the issue presented here.

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