THE STATE OF SOUTH CAROLINA
In The Supreme Court

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

J. Michelle Childs, United States District Judge

Appellate Case No. 2020-001285

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S.C. SUPREME COURT

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.

BRIEF OF UNITED POLICYHOLDERS AS *AMICUS CURIAE*

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STATEMENT OF CERTIFIED QUESTION PRESENTED FOR REVIEW

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 INTEREST OF *AMICUS CURIAE*

United Policyholders ("UP") is a non-profit 501(c)(3) organization whose mission is to be a trustworthy and useful information resource and an effective voice for consumers of all types of insurance in all fifty states. Much of UP's work is aimed at helping insured individuals and businesses successfully navigate the claim process and reach full, fair and timely settlements so that they can restore or replace assets that have been damaged or destroyed. UP assists South Carolina residents through a "Roadmap to Recovery" program that focuses on hurricane and flood recovery, and an online publication library. UP maintains communication with the SC Director of Insurance through the proceedings of the National Association of Insurance Commissioners, wherein UP is an official consumer representative.

Insurer formulas and policy language related to actual cash value, replacement value and recoverable and non-recoverable depreciation are a primary cause of claim delays and underpayments that defeat the indemnity purpose of property insurance. Because insurers' inconsistent approaches to applying depreciation is such a chronic source of conflict and consumer frustration, United Policyholders strives to educate insureds on this important topic.

One way UP seeks to assist individual and business policyholders to successfully navigate the claim process is by advocating for greater transparency by insurance companies in the claim process. In other words, UP advocates to require insurance companies to clearly disclose how they

calculate what they owe on a claim. We also advocate for preventing insurers from minimizing claim payments by depreciating items that should not rightly be subject to depreciation. Labor is a primary example.

UP conducts and publishes the results of surveys related to property insurance payouts. Consumer confusion and frustration related to depreciation and replacement value calculations are a growing obstacle to disaster recovery. UP hosts a library of publications for consumers on depreciation and related topics on its website at www.uphelp.org.

In addition to the disaster victims UP serves, UP hears regularly from a diverse range of individual and commercial policyholders throughout the United States. This input allows UP to submit informed *amicus curiae* briefs to assist state and federal courts in deciding cases involving important insurance principles. UP has filed *amicus curiae* briefs in approximately 450 cases throughout the United States since the organization's founding in 1991. Arguments from UP's *amicus curiae* briefs have been cited with approval by numerous state and federal appellate courts, including the United States Supreme Court.

Because the issues in this case go to the very heart of South Carolina insurance consumers' rights, they fall squarely within UP's advocacy interests. UP's library of publications, tools and guidance includes many publications that address the topic of proper and improper depreciation. *See, e.g.,* "Depreciation Basics" at https://www.uphelp.org/pubs/depreciation-basics.

INTRODUCTION

Building owners purchase property insurance to protect themselves if their property is damaged by fire, hail, hurricanes, or other catastrophic events. Adequate payment of insurance policy benefits is what often stands between homeowners and homelessness after a disaster. Insurers have been known to use various strategies to minimize benefit payments after a loss, even though they accepted the policyholder's premium payments. The wrongful depreciation of labor costs is one of those strategies.

Approximately fifty percent of insurance carriers *do not* engage in the practice of depreciating labor costs. *See Arnold v. State Farm Fire and Cas. Co*., 268 F.Supp.3d 1297, 1312 n.23 (S.D. Ala. 2017) ("some adjusters believe only the material and not the labor should be depreciated"). Of the approximately fifty percent of the carriers engaging in the practice, many have filed and use coverage forms expressly authorizing the practice. *Hicks v. State Farm Fire & Cas. Co.*, 751 F. App'x. 703, 709 (6th Cir. Oct. 15, 2018), *reh'g denied* (Nov. 21, 2018) ("State Farm reworded its standard homeowner's insurance policies in Arkansas to expressly depreciate labor and material cost, consistent with Arkansas law") Expressly disclosing the practice of depreciating labor in an insurance policy creates clarity and transparency as policyholders clearly know what they are purchasing and how a claim will be calculated.

This case deals with a practice that the *minority* of insurance companies engage in: depreciating labor costs without a policy that expressly authorizes the practice. Travelers and Standard Fire are well aware of the controversy of depreciating labor costs as they have been parties to similar cases around the country. Rather than being transparent with policyholders by expressly telling its policyholders that they were depreciating labor costs when calculating claims, Travelers and Standard Fire engaged in this practice without informing its policyholders.

Ultimately, the question of whether labor should be depreciated in determining actual cash value ("ACV") requires interpretation of the insurance contracts themselves. As such, the issue is a question of law that should be decided by the Court.

South Carolina law honors and enforces the principle that insurance policies should be interpreted to effectuate indemnity and uphold policyholders' reasonable expectations of coverage. *See Greenville Cnty. v. Ins. Reserve Fund*, 313 S.C. 546-47, 443 S.E.2d 552-53 (1994) (policies with more than one reasonable interpretation will be construed in a manner "most favorable to the insured."). Consistent with those principles, labor costs should not be depreciated. Depreciation of labor results in policyholders not receiving the full amount that they reasonably are entitled to under their ACV coverage. It also often results in policyholders being unable to collect replacement cost value ("RCV") benefits for which they have paid an additional premium. That can lead to a life-changing loss for the policyholders, and a windfall for the insurer.

ARGUMENT

I. MEANING OF THE TERMS ACTUAL CASH VALUE, REPLACEMENT COST VALUE, AND DEPRECIATION.

Determining whether labor should be depreciated depends on the evaluation of unique property insurance concepts and coverages, such as those contained in Plaintiffs' policies at issue in this case.

Actual Cash Value

The precise interpretation of ACV is at the heart of this dispute. Generally speaking, ACV is the amount required to put a policyholder back to where he or she was before the loss. *Hicks*, 751 F. App'x. at 706-07 (explaining ACV coverage). ACV coverage is "pure indemnity coverage." *Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349, 352 (Ind. 1982). To indemnify "means simply to place the insured back in the position she enjoyed prior to the loss." Johnny

Parker, *Replacement Cost Coverage: A Legal Primer*, 34 WAKE FOREST L. REV. 295, 296 (1999). Its purpose "is to make the insured whole but never to benefit him because a [loss] occurred." *Armstrong,* 442 N.E.2d at 352. The obvious corollary to this principle is that the ACV approach should never be employed to underpay a claim by providing less than indemnity.

"'[A]ctual cash value' does not mean that the determination is some sort of free-for-all" where the adjuster chooses "any calculation of his or her choosing based on nothing more than feelings. If that were the case, it would be difficult to understand why any reasonable person would buy insurance." *Coppins v. Allstate Indem. Co.*, 359 N.W.2d 896, 905 (Wis. Ct. App. 2014). A homeowner policyholder should reasonably expect that ACV provides enough money to return a destroyed structure to a reasonable standard of livability.

For example, if a policyholder owned a house with a ten-year-old roof destroyed by hail, ACV would be the price of providing the policyholder a ten-year-old roof that was not destroyed by hail. Disputes arise, as here, because it is not possible to buy a ten-year-old roof (or ten-year-old roofing materials) to install on an existing building. This dilemma has led to various methods of attempting to value the cost of putting policyholders back in the position they were in prior to the loss.

Replacement Cost Value

In contrast to ACV (which provides enough money to return damaged property to the same condition it was in immediately before a casualty), replacement cost coverage allows a policyholder to recover full repair costs with all new construction materials. "Replacement cost coverage, therefore, in contravention of the general rule that an insured cannot profit through insurance, *results in the insured being better off than he or she was prior to the loss, since the insured ends up with a more valuable property*." Allan D. Windt, INSURANCE CLAIMS AND

DISPUTES § 11:35 (6th ed., Apr. 2020 Update) (emphasis added).

In other words, using the above example of a ten-year-old roof, replacement cost coverage will pay for the cost of a *new* roof, as opposed to the ten-year-old roof destroyed by hail. Because RCV coverage places policyholders in a *better* position than before the loss (they now have a new roof rather than a ten-year-old roof), it is not indemnity coverage. Policyholders must pay an additional premium for replacement cost coverage.

The timing of ACV and RCV payments differs. ACV benefits are paid as soon after the loss as the amount owed by the insurance company is determined. In contrast, RCV benefits are typically reimbursed to the policyholder *if and when* repairs have been substantially completed and paid for by the policyholder, and only if the repairs are completed within a specified period of time after the loss. Steven Pitt, COUCH ON INSURANCE § 176:56 (3rd ed., Dec. 2018 Update). As the recovery of RCV benefits requires an insured to take additional steps, insurers may try to allocate as much of the loss as possible into replacement cost coverage rather than ACV to make it less likely the insurer will have to pay any replacement cost coverage.

Depreciation

Depreciation is "the amount an item has lessened in value since it was purchased, taking into account age, wear and tear, market conditions, and obsolescence. Although depreciation has been defined in several ways, *the principal definition attributable to that term refers to 'physical deterioration*.'" 5-47 NEW APPLEMAN ON INS. LAW LIBRARY ED. §47.04[2][a] (2020) (emphasis added); *Black's Law Dictionary* (10th ed., 2014) (depreciation is "[a] reduction in the value or price of something; specif., a decline in an asset's value because of use, wear, obsolescence, or age"). "Physical depreciation is a visible condition." National Committee on Property Insurance, *Actual Cash Value Guidelines: Buildings, Personal Property* (1982). Thus, the concept of

depreciation considers that a ten-year-old roof is not valued the same as a new roof.

Common law and policy methods of determining actual cash value

UP understands that the parties in this case agreed to calculate the ACV of the covered losses at issue by calculating RCV and deducting depreciation.[1] The question that remains, however, is *what* should be depreciated in order to accomplish the intended purpose of indemnity under the replacement cost less depreciation methodology.

II. DEPRECIATION OF LABOR IS DIRECTLY CONTRARY TO THE CONCEPT OF INDEMNITY.

Under a replacement cost policy, the property is fully repaired with brand new materials and without any out-of-pocket loss by the insured except the deductible. In contrast, ACV puts the policyholder in the same condition as before the loss. Once physical material depreciation is withheld to determine the ACV (as both parties agree can and should be done), this forces the policyholder to bear all of the costs and expenses associated with all of the pre-loss physical wear and tear to the materials and leaves the policyholder as she was before the loss, no better and no worse – less the applicable deductible. A policyholder that receives a property claim payment that withholds physical materials depreciation is never receiving replacement cost value coverage.

If additional amounts are withheld as depreciation for labor costs, the policyholder can never even get ACV coverage because he or she is not restored to his or her pre-loss condition. He or she is no longer receiving ACV coverage, but something less.

[1] Alternative methods of calculating actual cash value are the broad evidence rule and fair market value approaches. The broad evidence rule allows the fact-finder to consider any relevant factor to establish a correct estimate of the value of the damaged or destroyed property. *Hicks*, 751 F. App'x. at 706. As the Sixth Circuit explained in *Hicks*, where the replacement cost less depreciation methodology is used, "'the instructive precedents [addressing labor depreciation] are not those from states that reject reproduction cost, but those that define actual cash value as replacement cost less depreciation, like Illinois, Ohio, and Alabama.'" *Id*. at 711.

A basic example illustrates the differences between RCV and ACV, the interplay between ACV and RCV, and the role of depreciation and its impact on labor. Assume a residential home has a ten-year-old shingled roof with a normal life span of twenty years is destroyed in a hurricane. Further assume that all of the shingles were properly installed at the time the policyholder buys ACV coverage.

Determining the replacement cost value is simple – it is the cost to replace all damaged components of the roof with brand new materials. Assume that the undisputed replacement cost of the damaged roof in our hypothetical is $30,000. To arrive at an actual cash value amount, the next step is to determine the proper depreciation. When determining the appropriate deduction for depreciation, it is critical to keep the goal of indemnity at the heart of the calculation, i.e., to restore the insured to his or her pre-loss condition. To do this, the goal must be to give the insured what he or she had before the loss — a ten-year-old properly installed roof. ACV therefore requires payment of the value of ten-year-old shingles already properly installed on the roof, because the policyholder's shingles were already installed on the roof at the time of the loss. The shingles were not sitting in a garage.

So how is this accomplished? First, the damaged ten-year-old shingles have to be removed and disposed of, and that labor cost must be ascertained. Then the diminished value of ten-year-old shingles at the time of the loss must be determined. Finally, the labor cost of re-installing shingles back to the same way they were installed before the loss must be calculated. This calculation puts the insured right back where she was before the loss (a residential home with installed shingles minus the full cost of the pre-loss wear and tear of the shingles). The policyholder in this hypothetical is not receiving replacement cost coverage or a windfall because he or she must fully pay, out of his or her own pocket, the difference between ten-year-old shingles

and brand-new shingles and the deductible. The concept of physical depreciation therefore fairly penalized the policyholder for all of the roof's pre-loss wear and tear.

Practically, there is no market for ten-year-old shingles and no store sells "used" ten-year-old shingles. As a result, the concept of depreciation was born to hypothetically determine what the cost of those materials would be. In the above hypothetical, if we simplistically assumed the cost of the $30,000 roof was half labor ($15,000) and half materials ($15,000), then the proper ACV payment would be 100% of the labor costs ($15,000) and half of the material costs due to the 50% depreciation of the shingles ($7,500), resulting in a total ACV payment of $22,500.

In contrast, if labor was also depreciated by 50%, the ACV payment would decrease to $15,000. The policyholder would not have enough money to return the property to pre-loss condition. *See Lammert v. Auto-Owners (Mut.) Ins. Co.*, 572 S.W.3d 170, 175 (Tenn. 2019) (using a similar "hypothetical [to] illustrate[] the dilemma").

Furthermore, if the labor for removing the damaged shingles and re-installing replacement shingles is also withheld in part, this leaves the policyholder in a worse position because even if he or she can afford to pay the difference between the worn ten-year-old shingles and brand-new shingles out-of-pocket, the ACV payment does not enable the insured to remove the damaged shingles and reinstall the shingles paid for. This double deduction is unfair. It does not accomplish indemnity and is the ultimate reason why Travelers and Standard Fire's logic and arguments fail. Travelers and Standard Fire's theory leaves the insured in a worse condition than before the loss. Such a result directly contradicts the fundamental principle of indemnity.

III. THE QUESTION OF WHETHER LABOR SHOULD BE DEPRECIATED IS A MATTER OF CONTRACT INTERPRETATION AND SHOULD BE DECIDED AS A MATTER OF LAW.

Insurance policies are interpreted as a matter of law and are subject to the "general rules of contract construction." *Whitlock v. Stewart Title Guar. Co.*, 399 S.C. 610, 614, 732 S.E.2d 626, 628 (2012). The resolution of whether labor costs should be depreciated is not a question of fact, but a question of law appropriate for a court's independent determination. There is no dispute in this case that the Court can determine whether insurers in this state can depreciate labor costs from an ACV payment when ACV is not defined in the applicable insurance policy.

Even if the depreciation of labor question could be determined as a matter of fact instead of a matter of law, this may have profound and adverse consequences upon policyholders. The harmful effect is that factfinders could render opposite awards to policyholders in identical situations. For example, consider respective owners of two *identical* houses, who purchased identical insurance policies from the same carrier, and have houses that were built side-by-side by the *same* builder at the *same* time, and with the *same* roof damage from the *same* hurricane. They could receive *different* ACV benefits. When policyholders and their insurers disagree regarding the amount of loss, an insurer may seek to resolve the dispute through appraisal by having a panel that would decide as a matter of fact whether labor should be depreciated. If the depreciation of labor issue is decided as a question of fact, it is possible that one owner's appraiser could determine that labor *should* be depreciated, while the other owner's appraiser could determine that labor *should not* be depreciated.

Worse, some insurers might across the board insist on depreciating labor when making a settlement offer. Many homeowners do not have the knowledge or resources to argue that doing so is incorrect. Thus, this issue should be decided as a matter of law. This provides certainty and

clarity to policyholders *and* insurers.

IV. A REASONABLE CONSTRUCTION OF THE INSURANCE POLICIES AT ISSUE IS THAT LABOR SHOULD NOT BE DEPRECIATED.

Under South Carolina Law, an insurance policy that is ambiguous must be construed in a manner "most favorable to the insured." *Whitlock*, 399 S.C. at 613, 732 S.E.2d at 627. A reasonable construction of the insurance policies in this case is that labor is not included in depreciation. Not only would depreciating labor costs require ignoring the definition of common words, doing so would also fail to effectuate the purpose of actual cash value coverage of indemnifying the policyholders for their loss.

Depreciation is defined by insurance law hornbooks, and *Black's Law Dictionary*, as a decrease in value because of factors including age, wear and tear, market conditions or value, and obsolescence. 5-47 NEW APPLEMAN ON INS. LAW LIBRARY ED. §47.04[2][a] (2020); *Black's Law Dictionary* (10th ed. 2014). The principal definition of depreciation "refers to 'physical deterioration.'" 5-47 NEW APPLEMAN ON INS. LAW LIBRARY ED. §47.04[2][a] (2020) (emphasis added). *Depreciation* is the "reduction in value of *tangible* property." Robert J. Prahl, *Introduction to Claims*, 87 (1988) (emphasis added).

The depreciation factors of age, wear and tear, market conditions or value, and obsolescence can only apply to material, not labor. To the extent that labor is subject to market conditions, its value generally rises as wages go up. Labor is not a physical thing that can deteriorate.

Material is defined as: "1. A solid substance such as wood, plastic, metal, or paper. 2. The things that are used for making or doing something." *Black's Law Dictionary* (10th ed. 2014). Labor is "[w]ork of any type." *Id.* As the United States District Court for the Northern District of Mississippi explained in *Titan Exteriors, Inc. v. Certain Underwriters at Lloyd's, London*, 297 F.

Supp.3d 628, 634 (N.D. Miss. 2018), "Labor does not suffer use, wear, or obsolescence. It does not physically deteriorate." Thus, it is difficult to envision any scenario in which labor would depreciate since it is not susceptible to aging or wear.

The National Underwriter Company publishes, under the name "FC & S", or Fire, Casualty & Surety, a comprehensive library of reference books for insurance professionals. FC & S also provides online bulletins in which its experts respond to questions from insurance professionals. The bulletin is used by insurance agents and brokers to interpret standard insurance policy provisions. FC & S has stated its position is that depreciation should not apply to labor unless a policy explicitly states that it should. FC & S Bulletin, *Should depreciation be applied to demolition, cleaning, and odor control costs following a fire loss?* (Nat'l Underwriter Co. December 5, 2014).

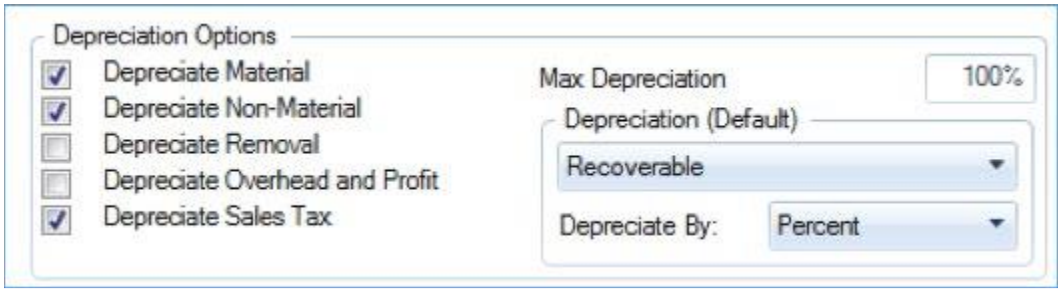
Travelers, Standard Fire, and other insurance carriers should not be allowed to reap the benefit of a term that it chose not to define in their policies. Even the International Risk Management Institute ("IRMI"), an independent insurance industry entity that provides instruction to risk management and insurance industry professionals concerning the application of policy provisions, agrees. The IRMI has explained that if an insurance company wants its own interpretation of ACV to apply, it can simply define ACV in its own policy. *See* Mike McCracken, International Risk Management Institute, Inc., *What Exactly is Actual Cash Value? Better Yet, How Do You Calculate It?* available at https://www.irmi.com/articles/expert-commentary/what-exactly-is-actual-cash-value (Dec. 2007).

Travelers and Standard Fire could have easily defined ACV to include the depreciation of labor. They chose not to do so. Travelers and Standard Fire should not now get the benefit of its affirmative decision not to not define ACV in its policy. Many insurers have taken the simple step

of defining ACV to include depreciation of labor costs. *See, e.g.*, *Hicks*, 751 F. App'x. at 709 ("State Farm reworded its standard homeowner's insurance policies in Arkansas to expressly depreciate labor and material cost, consistent with Arkansas law"); *Shelter Mutual Ins. Co. v. Goodner*, 477 S.W.3d 512 (Ark. 2015) defining depreciation to "include the depreciation of the materials, the labor, and the tax attributable to each part which must be replaced to allow for replacement of the damaged part"). Many carriers also choose not to depreciate labor costs.

Tellingly, the claims adjusting software that is almost universally used by insurance carriers further demonstrates that it is reasonable for an insurer to expect labor costs will not be depreciated. The top four software packages used by insurance companies to adjust structural damage claims all allow the insurance company to select whether or not to depreciate labor costs when calculating ACV.

Xactimate® by Xactware, is a computer software program for estimating construction and repair costs that is widely used by insurance companies. "Today 22 of the top 25 property insurance companies in the U.S. and 10 of the top 10 Canadian insurers use Xactware property insurance claims tools."[2] The following screenshot from the Xactimate® program shows that an insurer can choose to select or de-select "Depreciate Non-Material" and "Depreciate Removal," both of which are labor items:



http://xactimate.xactware.help/help_baggage/2015_WhitePaper_CalculatingDepreciationForStru

[2] *See* https://www.xactware.com/en-us/company/about/# (last visited July 31, 2019).

cturalPropLines.pdf (last visited August 1, 2019). Appendix A51-A53 includes similar screenshots from the other primary valuation software platforms: Powerclaim, Simsol, and Symbility. Like Xactimate, each allow the insurance company user the option to choose whether or not to depreciate labor costs. In fact, Powerclaim states that "Tax and Labor can be optionally depreciated. Choose the appropriate setting for defaults." *Id*. Given that insurance companies' own valuation software allows for the depreciation of labor costs or not, Travelers and Standard Fire cannot credibly argue that Plaintiffs' policy interpretation is unreasonable.

To create certainty and clarity in the insurance marketplace for insurers and policyholders, some states and courts have sought to require insurers to specify that they will depreciate labor costs in calculating ACV. For example, on August 4, 2017, the Mississippi Commissioner of Insurance issued a bulletin instructing insurers to, among other things, "clearly provide for the depreciation of labor in the insurance policy."[3] Similarly, after determining that State Farm's Kentucky homeowner's policy did not allow State Farm to depreciate labor costs, the Sixth Circuit explained that "following [its] decision, State Farm can ensure that the wording of any new homeowner's insurance policy it offers in Kentucky defines ACV depreciation to include both labor and materials." *Hicks*, 751 F. App'x. at 709. To the extent this Court determines that an insurer may depreciate labor costs when calculating ACV in South Carolina, the Court should, at a minimum, require insurers to specifically disclose in their policies that labor will be subject to depreciation.

Travelers and Standard Fire should not benefit by deducting labor from the policyholder's ACV payment. As explained below, even if the term is subject to more than one reasonable interpretation, traditional rules of contract construction would favor the policyholders' position.

[3] *See* https://www.mid.ms.gov/legal/bulletins/20178bul.pdf (last visited August 1, 2019).

Finally, depreciating labor would not effectuate the purpose of ACV coverage, i.e. indemnity, or placing policyholders back in the position they enjoyed prior to the loss. While ACV coverage can never put the policyholders back in the *precise* position they were in prior to the loss, insureds need enough money to repair or replace the damaged property, to include installation.

Consider again the policyholders in the earlier example with a ten-year-old roof that was destroyed by a hurricane. The only way to return the policyholders back to the exact position they were in before the loss would be to install a ten-year-old roof. That, however, is not feasible. Therefore, ACV benefits provide the policyholders the cost of a new roof, depreciated by the amount that their roof has deteriorated. But if the insurer also depreciates the cost of labor, insureds will not receive enough money to install the roof. Before the loss, the insureds had a ten-year-old roof that was *installed* on the house. To be made whole, the insurer must pay enough money to *install* a ten-year-old roof on the insured's house. Whether installing a new roof or a ten-year-old roof, the price of labor is the same. Depreciating labor will not make the policyholder whole and will frustrate the indemnity purpose of the actual cash value coverage: indemnification.

V. TO THE EXTENT THE POLICY TERMS "ACTUAL CASH VALUE" AND "DEPRECIATION" ARE SUBJECT TO MORE THAN ONE REASONABLE INTERPRETATION, THE POLICIES MUST BE INTERPRETED IN FAVOR OF THE POLICYHOLDERS.

The rule requiring that ambiguous clauses in insurance policies be interpreted in favor of a policyholder has grown out of a centuries-long history of insurers attempting to wrongfully deny or minimize coverage despite the vital role that insurance coverage plays in society:

> [T]he insurance industry plays a very important institutional role by providing the level of predictability requisite for the planning and execution that leads to further development. Without effective planning and execution, a society cannot progress.

….

> Insurance is purchased routinely and has become pervasive in our society. It protects against losses that otherwise would disrupt our lives, individually and collectively. The public interest, as well as the individual interests of millions of insureds, is at stake. This is the foundation for the general judicial conclusion that the business of insurance is cloaked with a public purpose or interest.

Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transaction: Refining the Standard of Culpability and Reformulating the Remedies By Statute,* 26 U. of Mich. J. L. Ref. 1, 9-11 (Fall 1992) (footnotes omitted).

The field of insurance is different from any other business involving commercial contracts, based on its high degree of interaction with a potentially vulnerable portion of the consuming public. As explained in an insurance industry treatise, *The Legal Environment of Insurance* in its chapters on Insurance Contract Law:

> The insurance contract has the same basic requisites as other contracts. There is a need for an agreement, competent parties, consideration, and a legal purpose. However, the insurance contract also has other distinctive features. Insurance contracts cover fortuitous events, are contracts of adhesion and indemnity, must have the public interest in mind, require the utmost good faith, are executory and conditional, and must honor reasonable expectations.

James J. Lorimer, et al., *The Legal Environment of Insurance* 176 (American Institute for Charter Property Casualty Underwriter, 4th ed. 1993). A particularly scholarly discussion explaining why insurance is treated differently by courts is found in an article written by Professor Henderson of the University of Arizona College of Law, which includes the following discourse:

> In order to purchase a home or a car, or commercial property, most people had to borrow money, and loans were not obtainable unless the property was insured. . . . The purchase of insurance was no longer a matter of prudence; it was a necessity. Then losses occurred and the inevitable disputes arose. These disputes, however, were not about an even exchange in value. Rather, they were about something quite different.

> Insureds bought insurance to avoid the possibility of unaffordable losses, but all too often they found themselves embroiled in an argument over that very possibility. Disputes over the allocation of the underlying loss worsened the insureds' predicament. In most instances, insureds were seriously disadvantaged because of the uncompensated loss; after all, the insured would not have insured against this peril unless it presented a serious risk of disruption in the first place. The prospect of paying attorneys' fees and other litigation expenses, in addition to the burden of collecting from the insurer, with no assurance of recovery, only aggravated the situation.
>
> These additional expenses could prove to be a formidable deterrent to the average insured. For most insureds, unlike insurers, such expenses were not an anticipated cost of doing business. Insureds did not plan for litigation as an institutional litigant would. Insurers, on the other hand, built the anticipated costs of litigation into the premium rate structure. In effect, insureds, by paying premiums, financed the insurers' ability to resist claims. Insureds, as a group, were therefore peculiarly vulnerable to insurers who, as a group, were inclined to pay nothing if they could get away with it, and, in any event, to pay as little as possible. Insurance had become big business.

Henderson, *The Tort of Bad Faith in First-Party Insurance Transaction: Refining the Standard of Culpability and Reformulating the Remedies By Statute,* 26 U. of Mich. J. L. Ref. at 13-14.

Against this background, to protect policyholders and create consistency, comprehensive rules of policy interpretation have developed. They boil down to this:

> [w]hen interpreting insurance policies, as a matter of public policy, ambiguities are generally construed in favor of the insured and against the insurer. Thus, where the policy is found to be unclear and ambiguous, the court's construction of an insurance policy will be guided by the reasonable expectations of the insured.

Ponder v. State Farm Mut. Auto. Ins. Co., 12 P.3d 960, 967 (N.M. 2000) (internal quotation omitted); *see also Gen. Cas. Co. of Wis. v. Hills*, 561 N.W.2d 718, 722 (Wis. 1997) ("[o]f primary importance is that the language of an insurance policy should be interpreted to mean what a reasonable person in the position of the insured would have understood the words to mean"). South

Carolina law is in accord. *See generally Whitlock*, 399 S.C. at 613, 732 S.E.2d at 627.

The same principles apply to the question of whether labor should be depreciated. For example, the Tennessee Supreme Court in *Lammert* held that ACV, when defined in the policy as "the cost to replace damaged property with new property of similar quality and features reduced by the amount of depreciation applicable to the damaged property immediately prior to the loss," is subject to more than one reasonable interpretation. *Lammert* 572 S.W.3d at 173, 179. Thus, the court found that the policy was ambiguous and "strictly construed against the insurance companies and in favor of the insured." *Id.* Accordingly, the court held that "labor may not be depreciated when the insurance company calculates the actual cash value of a property using the replacement cost less depreciation method." *Id.*

Similarly, in *Hicks*, the Sixth Circuit was faced with a policy that defined ACV as replacement cost less depreciation. *Hicks*, 751 F. App'x. at 711. The court determined that a "layperson confronted with [this] policy could reasonably interpret the term depreciation to include only the cost of materials" and thus held that the policy did not allow State Farm to depreciate labor costs. *Id.* at 709. Other courts around the country have ruled similarly. *E.g.*, *Lains v. American Family Ins. Co.*, Case No. 14-1982, 2016 WL 4533075 (W.D. Wash. Feb. 9, 2016) ("T]he question here is 'what is depreciation?' … The policy does not define depreciation … the language is ambiguous"); *Arnold*, 268 F.Supp.3d at 1309 ("a reasonable insured in the plaintiff's position, not possessing specialized knowledge or expertise about such matters and knowing only the Policy language and the common, everyday meaning of the language employed, could reasonably understand that ACV does not include depreciation of labor").

Any ambiguity must be resolved in favor of the policyholders. Where the language of an insurance policy is fairly susceptible of more than one meaning, as here, South Carolina law directs

that the ambiguity be construed against the insurer and in favor of the insured.

It is unreasonable to assume that insureds, like Plaintiffs, would be able to infer that labor would depreciate from an ACV coverage policy when the term "actual cash value" is not defined. *See* Adam J. Babinat, *Ensuring Indemnity: Why Insurers Should Cease The Practice of Depreciating Labor*, 22 DRAKE J. AGRIC. L. 65, 78, 85 (Spring 2017) (to protect farmers, recommending that Iowa adopt a regulation similar to California that the expense of labor to repair, build or replace damaged property is not a component of physical depreciation). Here, holding for Travelers and Standard Fire would place an unfair burden on the insureds, and enrich Travelers and Standard Fire. *Id.* at 78.

Moreover, allowing insurers to depreciate labor is contrary to the reasonable expectations of their customers and tends to cause them significant financial harm. The reasonable expectation of the policyholders is that the indemnity policy they purchased will provide coverage sufficient to actually indemnify them or put them back in the position they were in prior to the loss. If the policyholders' property had a roof before the loss, indemnity requires that they be paid the depreciated value of the roofing materials and the cost of installing those depreciated materials. Otherwise, they will be left with less than the benefit of their bargain.

The harm to policyholders and the windfall to insurers from depreciating labor is obvious on its face with respect to policies that only provide ACV coverage, and do not include replacement cost coverage. Depreciating labor costs means that insurers will *never* pay the cost of labor, and policyholders will never receive that portion of their loss.

Many property insurance policies also include RCV coverage, for which policyholders pay an additional premium. Even when replacement cost value coverage exists, it is not as simple as the insurer paying whatever amount it has calculated as depreciation on labor as replacement cost

coverage rather than ACV coverage. In fact, where the policyholders have paid for replacement cost coverage, depreciating labor will often result in an even bigger windfall for the insurer than where there is no replacement cost coverage. Furthermore, the insurer has received the extra premium without paying the benefit to the insured.

Standard property insurance policies provide that replacement cost coverage is not paid until the repairs have actually been made. Moreover, those repairs must be completed within a specified time, in some cases as little as 180 days after payment of the actual cash value, or replacement cost coverage is forfeited. *See Sher v. Allstate Ins. Co.*, 947 F. Supp. 2d 370 (S.D.N.Y. 2013).

When an insurer retains amounts for depreciation of labor and pays less in ACV coverage, it is likely the policyholder will not have enough funds to rebuild the damaged property within the policy's required time period, or at all. In that instance, the insurer *never pays* the replacement cost coverage for which the policyholders contracted and paid. The insurer receives a windfall. The policyholders remain without a roof.

Even if the policyholders do manage to save enough money to make repairs and eventually receive replacement cost value benefits from the insurer, in the interim, the insurer has earned income on the depreciation holdback amount. Meanwhile, the policyholders have been denied the use of those funds when they may need them the most (to pay their contractors.)

CONCLUSION

UP recognizes and appreciates the extremely important role insurance companies play in modern society. Profitable and financially stable insurance companies promote a healthy society, allowing risk of loss to be spread widely and fairly. When the system works, prompt and proper payment goes to those who have suffered catastrophes affecting their persons and property.

Unfortunately, some insurance companies are tempted to obtain an "edge" when it comes to claims payment, in order to bolster their bottom line. Depreciating labor when calculating ACV benefits payable is an example of unethical conduct. Depreciating labor costs is contrary to the policies insurers like Travelers and Standard Fire have issued and the purpose of insurance: effecting indemnity in case of loss.

Where policies are ambiguous, they must be interpreted in favor of coverage. Allowing insurers to depreciate labor in the absence of express, lawful policy language to that effect would result in the policyholders not receiving the coverage they reasonably believed they purchased and creates a windfall for insurers.

For the foregoing reasons, United Policyholders respectfully requests that the Court answer the certified question in a manner that does not permit Travelers, Standard Fire, or other insurers to depreciate labor costs from ACV payments when the policy does not expressly authorize it.

Respectfully submitted,

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