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

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S.C. SUPREME COURT

Appellate Case No. 2020-001285

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

v.

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

BRIEF OF AMICUS CURIAE AMERICAN PROPERTY CASUALTY INSURANCE ASSOCIATION AND NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Thomas C. Salane (SC Bar # 4815)
R. Hawthorne Barrett (SC Bar # 16973)
Turner Padget Graham & Laney, P.A.
P.O. Box 1473
Columbia, SC 29202
(803) 254-2200
tsalane@turnerpadget.com
tbarrett@turnerpadget.com

Attorneys for Amicus Curiae American Property Casualty Insurance Association & National Association of Mutual Insurance Companies

TABLE OF CONTENTS

Table of Authorities.....ii

Statement of the Issue on Appeal.....1

Amicus Curiae Parties.....1

Statement of the Case.....2

Standard of Review.....2

Argument.....2

(A) The Claim Adjustment Process.....2

(B) The Plaintiffs' Position, If Accepted, Would Change A Longstanding Industry Practice That Other Courts Have Approved.....6

(C) Subsequent Events In One State That Adopted The Plaintiffs' Proposed Approach Demonstrate The Practice Problems It Creates.....11

(D) There Is No Support For The Assertion That The Policies In Question Give The Defendants An Advantage In The Market.....14

Conclusion.....16

TABLE OF AUTHORITIES

(A) CASES

Accardi v. Hartford Underwriter Ins. Co.,
838 S.E.2d 454 (N.C. 2020).....7-8

Adams v. Cameron Mutual Ins. Co.,
430 S.W.3d 675 (Ark. 2013).....12-13

Henn v. American Family Mut. Ins. Co.,
894 N.W.2d 179 (Neb. 2017).....7

Redcorn v. State Farm Fire & Cas. Co.,
55 P.3d 1017 (Okla. 2002).....7

Shelter Mut. Ins. Co. v. Goodner,
477 S.W.3d 512 (Ark. 2015).....12

Wilcox v. State Farm Fire & Cas. Co.,
874 N.W.2d 780 (Minn. 2016).....7

(B) STUDY

National Association of Insurance Commissioners, Dwelling
Fire, Homeowners Owner-Occupied, and Homeowners
Tenant and Condominium/Cooperative Unit Owners Insurance:
Data for 2013-2016, Table 4.....13-14

STATEMENT OF THE ISSUE ON APPEAL

The United States District Court for the District of South Carolina has requested that this Court answer the following certified question:

> 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?

AMICUS CURIAE PARTIES

The American Property Casualty Insurance Association ("APCIA") is the primary national trade association for home, auto and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members represent all sizes, structures and regions – protecting families, communities and businesses in the United States and across the globe. On issues of importance to the property and casualty insurance industry and marketplace, APCIA advocates sound public policies on behalf of its members in legislative and regulatory forums and the state and federal levels and files amicus curiae briefs in significant cases before federal and state courts.

The National Association of Mutual Insurance Companies ("NAMIC") is the largest property/casualty insurance trade group with a diverse membership of more than 1,400 local, regional and national member companies. This membership includes seven of the top ten property/casualty insurers in the United States. NAMIC members lead the personal lines sector, representing sixty-six percent of the homeowner's insurance market and fifty-three percent of the auto market. Through its advocacy programs NAMIC promotes public policy solutions that benefit NAMIC's member companies and the

policyholders they serve and foster greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

STATEMENT OF THE CASE

APCIA and NAMIC agree and concur with the Statement of the Case set forth in the Respondents' Brief submitted by the defendants The Travelers Home and Marine Insurance Company and The Standard Fire Insurance Company.

STANDARD OF REVIEW

APCIA and NAMIC also agree and concur with the Standard of Review stated in the Respondents' Brief submitted by the defendants The Travelers Home and Marine Insurance Company and The Standard Fire Insurance Company.

ARGUMENT

In this brief, APCIA and NAMIC will provide background information regarding the manner in which the property insurance claim adjustment process usually proceeds. Fully understanding that process, which the parties' briefs do not address in detail, will give the Court the proper context for evaluating the question presented. APCIA and NAMIC will also add to the defendants' arguments that the result sought by the plaintiffs would disturb longstanding and established principles and industry practices. Finally, this brief will also inform the Court of problems that arose in another state when its highest court accepted the same argument asserted by the plaintiffs in this case.

(A) THE CLAIM ADJUSTMENT PROCESS

The evaluation of a property insurance claim is replete with individualized factual assessments on a wide array of factors. Those factors include the nature of any damage, the cause of that damage, the estimated cost of repair or replacement work, and the

amount by which the property's value had depreciated prior to the loss. Determining the amount of depreciation requires an adjuster to investigate things such as the age of the property and its condition prior to the damage. Only then can the adjuster accurately calculate the true "actual cash value" of a covered loss.[1]

As an example, suppose a policy holder makes an insurance claim following a windstorm. An adjuster comes to the premises and finds several missing roof shingles, a dislodged gutter, and an old fence that is down. After noting those conditions, the adjuster must first determine whether the storm caused each of them, or whether any of them were preexisting problems. In this example, the adjuster concludes that the missing roof shingles and the dislodged gutter were the result of the storm and are, therefore, covered under the policy. But the adjuster also determines that the fence had already been down before the storm and that its condition was the result of owner neglect, which is not covered under the applicable policy. Thus, the adjuster's analysis only proceeds to the next step for the roof shingles and the gutter. The adjuster then must decide whether the covered damages can be repaired, or whether replacement is necessary. In our hypothetical, the adjuster finds that although the gutter can simply be reattached, the roof shingles must be replaced.

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[1] The plaintiffs argue several times that consumers should be able to know all the intricacies of how depreciation will be applied when they first purchase a homeowner's insurance policy. In practice, most consumers do not consider or contemplate how actual cash value ("ACV") will be calculated in the event of a loss when they obtain homeowner's insurance. Consumers would only expect ACV to be interpreted in accordance with its plain meaning and the manner in which depreciation is generally applied in property valuation. However, for the relatively few consumers who consider that issue and have questions about it, they always have access to insurance agents, who are licensed and trained to answer such questions, as well as to the Department of Insurance.

The applicable policy in this example, like those widely used in the industry (and those involved in the case at bar), provides for a two-step process for payment of losses. Initially, the insured is only entitled to receive a payment for the ACV of the covered loss. If the insured proceeds to have the repair or replacement work performed, the insurer makes a supplemental payment so that the full repair or replacement cost is reimbursed, minus the deductible. This system prevents the insured from receiving advance payment for repairs or replacements that are never actually done.

The established method for setting the amount due at the ACV stage is to estimate the replacement cost and then subtract the estimated pre-loss depreciation. Adjusters often use computer software to determine the estimated cost to repair or replace the damaged item. The software bases the estimates on pricing within a given market or geographic area. However, the estimated repair or replacement cost might wind up being higher or lower than the amount that one or more local contractors would actually charge to perform the work.

After a repair or replacement cost estimate is in place, the adjuster must come up with the amount of depreciation to be deducted. When creating an estimate of how much the value of the property had depreciated prior to the loss, the adjuster considers factors such as the property's age and its pre-loss condition, including the extent of the wear and tear it had experienced. In some situations, "straight-line depreciation," which is calculated based primarily on the remaining useful lifespan of the item, might be appropriate. But in other cases, such as ones involving an item that was in unusually good or bad condition for its age before the loss, straight-line depreciation might not lead to a correct result. For example, an item that had been in very poor condition before the loss

would involve higher depreciation than an item of the same type and age that had been in extremely good condition, and vice versa. The adjuster considers all of those factors while trying to reach a depreciation amount that is as accurate as possible.

It is significant to note that the established industry standard is to include labor costs in the calculation of depreciation. Recall that it is the repair or replacement cost that is subject to a reduction for depreciation. Whether an item is being repaired or replaced, there is necessarily a labor component to the cost of achieving that result. For instance, in the hypothetical set forth above, the replacement cost for the missing roof shingles would not simply be the price of new shingles. It also has to include the fees of the contractor who will install those new shingles on the roof. Both components of the replacement cost would logically be reduced for depreciation. After all, it is a damaged roof, not merely individual shingles, that is being replaced or repaired.

Of course, determining the amount of depreciation to complete the estimate provided to the insured cannot possibly be an exact science, and disagreements between the insured and the insurer can arise. For that reason, there are commonly used practices in the industry through which an insured can challenge estimates and attempt to resolve disputes with the insurer. If an insured reviews an estimate and believes it is based on incomplete data, she can provide additional information and request that the adjuster consider modifying the estimate. Alternatively, an insured can obtain a different estimate from a contractor and provide it to the adjuster. In that scenario, the adjuster would likely discuss that estimate with the contractor and, if appropriate, revise the adjuster's estimate based on those discussions.

In the relatively small number of instances in which those types of discussions do not resolve the dispute over an estimate, many policies allow an insured to request an appraisal, in which a panel of appraisers provides a resolution. This is also a well-established part of the industry standards and practices for adjusting property damage claims.

At the end of the adjusting process, the insurer issues a payment to the insured for the ACV of the covered loss. Under most policies, such as the ones at issue in the present case, the amounts withheld at the ACV stage of the claim become payable when the repair or replacement work has been completed. In fact, some policies actually permit the supplemental payment to be made as soon as the insured has signed a contract for the work to be performed. Either way, the key is an act by the insured that demonstrates the work actually has been done, or that it will be done. This protects the insurer from paying for repair or replacement work that is never undertaken or completed.

(B) THE PLAINTIFFS' POSITION, IF ACCEPTED, WOULD CHANGE A LONGSTANDING INDUSTRY PRACTICE THAT OTHER COURTS HAVE APPROVED.

The plaintiffs ask this Court to rule that the ACV of real property should always be calculated as replacement cost minus *partial* depreciation – i.e. depreciation of only the cost of materials involved. This is not a recognized method of determining property value in any context. Rather, it is an invented and erroneous attempt to alter the well-established method by which ACV is determined for purposes of property loss claims.

As the Respondents' Brief makes clear, ACV in the context of property losses has typically meant the repair or replacement cost less depreciation. Indeed, even the plaintiffs acknowledge that basic definition. But the plaintiffs wrongly proceed to claim

that the standard and widely accepted policy language involved in this dispute is somehow unclear or ambiguous as to whether or not depreciation includes solely the cost of materials, or also the cost of the labor necessary to perform the repair or replacement work. In making that assertion, the plaintiffs overlook an industry practice that has been in place, without issue, for nearly a century. Depreciation in this context has *always* included both materials and labor costs. Despite the plaintiffs' suggestions to the contrary, the practice challenged in this case is not new. The only "new" thing in this case is the attempt to manufacture a controversy regarding that long-established standard.

The Supreme Courts of North Carolina, Nebraska, Minnesota and Oklahoma have squarely rejected identical attempts in recent years. *See Accardi v. Hartford Underwriter Ins. Co.*, 838 S.E.2d 454 (N.C. 2020); *Henn v. American Family Mut. Ins. Co.*, 894 N.W.2d 179 (Neb. 2017); *Wilcox v. State Farm Fire & Cas. Co.*, 874 N.W.2d 780 (Minn. 2016); *Redcorn v. State Farm Fire & Cas. Co.*, 55 P.3d 1017 (Okla. 2002). APCIA and NAMIC will not discuss all those decisions in detail, as the defendants have fully provided that analysis in their Respondents' Brief. However, APCIA and NAMIC do want to emphasize the basis for the Supreme Court of North Carolina's decision in *Accardi*, which is the most recent pronouncement on this issue by the highest appellate court of a sister state.[2]

After rejecting the claim that the term "depreciation" in the applicable policy language was ambiguous, the North Carolina Court explained:

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[2] The plaintiffs argue that this Court has no practice of following North Carolina law in matters concerning insurance. Yet, there is also no practice of this Court following the law of the states in which the cases relied upon by the plaintiffs were decided. Thus, there is no reason for this Court not to consider carefully the North Carolina Supreme Court's well-reasoned decision and to view it as persuasive authority.

> 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 the plaintiff for which he did not pay. ... We will not do so.

838 S.E.2d at 457-58 (internal citation omitted). This analysis succinctly demonstrates the vital point that the plaintiffs fail to grasp: The property's value comes from its status as a completed and assembled whole. Thus, any concept of depreciation that includes only the component parts, and not the labor required to make them part of the whole structure, has no basis in logic.[3]

The decision in *Accardi*, as well as those in Nebraska, Minnesota and Oklahoma, did not create some new legal principle. As a practical matter, those decisions simply acknowledged the manner in which the insurance industry has operated for decades upon decades. Insurers have issued property insurance policies throughout the United States providing for payment of the ACV of covered losses for nearly two hundred years. In all that time, courts have given the words ACV their plain and ordinary meaning – the actual economic value, in cash, of the damaged property. Stated another way, a property's ACV is its actual economic value just prior to the loss occurring. Since the late 1800s, insurers have consistently determined the ACV by estimating the replacement cost of the damage

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[3] In their Reply Brief, the plaintiffs attempt to distinguish *Accardi* by arguing that North Carolina is a "broad evidence rule" jurisdiction, in which insurers consider market value rather than reproduction cost. However, the *Accardi* Court makes no reference to the "broad evidence rule" or to "fair market value." The Court simply concluded that the plaintiffs' proposed interpretation was unreasonable and defied common sense with respect to the ACV of the property. Thus, whether North Carolina is or is not a "broad evidence rule" jurisdiction is irrelevant for present purposes.

and applying an appropriate depreciation percentage to the *total* estimated replacement cost, which necessarily included the labor component. This practice, generally called the "cost approach," has also been used to value property in other contexts.[4]

As fully explained in the Respondents' Brief, this "cost approach" is the only method for determining ACV that prevents an insured from gaining a windfall at the ACV stage – i.e. being paid more than what the damaged property was worth prior to the loss.[5] At the same time, however, the insured is not at any disadvantage because he or she receives a supplemental reimbursement payment when the repair or replacement work has been finished, or an advance payment when the insured signs a contract for the work to be done. In this way, the insured is made whole, while the insurer provides only the bargained-for coverage. The insurance industry has used this method of adjusting property damage claims for countless years, and the plaintiffs have failed to present any compelling reason to alter it.

Similarly, there is no merit to the plaintiff's argument that insurers such as the defendants should have to change the wording of their policies to include labor costs in depreciation for determining ACV. According to the plaintiffs' position, the term ACV, which has been used in insurance policies for decades and has an accepted legal definition, must nevertheless be suddenly redefined in those types of policies. Accepting that position would open the door for several significant problems.

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[4] For some of those other contexts in South Carolina, APCIA and NAMIC respectfully direct the Court's attention to section VII of the Respondents' Brief, which identifies and discusses property tax assessments, eminent domain values, and other real estate valuations.

[5] See the hypothetical set forth on pages 12 through 14 of the Respondents' Brief.

First, it would impose an unfair burden on insurers by forcing them to rewrite standard policy language and terms that have been accepted and undisturbed for years. This would be a time-consuming, costly process, and it would result in increased insured losses that would need to be accounted for in future premiums. In the meantime, until the insurers could complete the lengthy process of seeking and obtaining approval for new forms and policy language, they would be forced to bear losses that were never contemplated in calculating premiums for in-force policies.

Second, the plaintiffs' position would create needless uncertainty in an industry that relies upon predictability. The insurance industry requires the use of standard policy language and forms. It is neither possible nor desirable to craft tailored language for each individual insured. Thus, in most circumstances, insurers submit proposed policy language or forms to regulatory bodies within a given jurisdiction for approval. That process allows insurers to calculate accurate premiums and operate within a given jurisdiction with the requisite business confidence. Requiring changes to that status quo, suddenly and without warning, would negatively impact the insurance industry. This is especially true in South Carolina, where the Department of Insurance has never taken the plaintiffs' position on the current issue, unlike other states referenced in the plaintiffs' Reply Brief.

The third problem is related to the first two. If the plaintiffs succeed in their attempt to manufacture a controversy about this longstanding, accepted policy term, the odds of it being the last invented problem are minimal. The forces behind the current nationwide rash of lawsuits on the depreciation of labor issue will then search for other standard policy terms to deem ambiguous. This would mean a new wave of lawsuits that

would eventually reach South Carolina, accompanied by the repetition of the problems discussed above. While allowing the established definition of ACV to stand will not guarantee that no future "invented crises" will arise in this State, adopting the plaintiffs' position will extend an invitation for them.

Finally, the plaintiffs' argument attempts to force insurers into a position where they must implicitly concede that the old language and the new language mean different things. If the insurers are required to rewrite their policy language, those changes could only take effect in future policies. Existing policies would remain the same, and the insureds with those policies could wind up with an advantage over holders of the later, amended policies. The insureds with the old policy could argue that the changes were evidence of problems or ambiguities in the original language. As a result, those insureds could claim entitlement to coverage they never actually bargained or paid for, whereas insureds with the new policies could not. Although such a change might benefit some insureds, it would wind up harming the homeowners' insurance marketplace as a whole.

(C) SUBSEQUENT EVENTS IN ONE STATE THAT ADOPTED THE PLAINTIFFS' PROPOSED APPROACH DEMONSTRATE THE PRACTICAL PROBLEMS IT CREATES.

The Respondents' Brief identifies and distinguishes two decisions in other states that adopted the position the plaintiffs assert in the present case. The aftermath in one of those states serves as a cautionary tale, as it reveals the damaging impact that decision had on the homeowners' insurance marketplace. This Court should prevent a similar result in South Carolina by rejecting the plaintiffs' assertion.

In 2013, the Arkansas Supreme Court concluded that the term ACV was ambiguous and found that, for purposes of that term, depreciation applied only to

materials, not to embedded labor costs. *Adams v. Cameron Mutual Ins. Co.*, 430 S.W.3d 675 (Ark. 2013). Two years later, the Arkansas Court went a step beyond *Adams* and held that depreciation could *never* apply to embedded labor costs in an ACV determination, even if the applicable policy allowed for it. *Shelter Mut. Ins. Co. v. Goodner*, 477 S.W.3d 512 (Ark. 2015).

Adams created a radical change in the law in Arkansas. Insurers that had been adjusting property damage claims in the long-established manner (i.e. depreciating the costs of both materials and embedded labor) were suddenly faced with greatly expanded exposure. In short, the change created a liability for which homeowners' insurers doing business in Arkansas had not bargained and to which they had not agreed. As one would expect, those insurers had to react accordingly.

Insurers must seek to change their rates periodically, so that the rates are adequate and do not violate any actuarial principles or practices. One factor to be considered in that process is loss experience, which includes amounts paid on the relevant types of claims. When the loss experience increases, rates typically must rise in response. Although that is a normal and necessary part of the business, the end result is that consumers wind up paying more for coverage.

This is exactly what happened in Arkansas following its Supreme Court's decision in *Adams*. According to the National Association of Insurance Commissioners, the premiums for homeowners' insurance in Arkansas increased by 5.4% in 2014, the year after *Adams* was decided. Homeowners' insurance premiums then went up another 4.7% in 2015. *See* National Association of Insurance Commissioners, Dwelling Fire,

Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owners Insurance: Data for 2013-2016, Table 4.

After seeing homeowners' insurance premiums rise by more than 10% in just two years, the Arkansas General Assembly felt compelled to intervene. In 2017, the legislature did just that by enacting a statute that repudiated *Adams* and permitted depreciation of the full replacement cost value, including the embedded labor component. Ark. Code Ann. §23-88-106. The enactment of that statute put an end to the disturbance in the homeowners' insurance marketplace in Arkansas that *Adams* had begun four years earlier.

Of course, the South Carolina General Assembly has the power to enact a similar statute in this state, but that "solution" is neither necessary nor entirely sufficient. It is not necessary because this Court can, and should, align South Carolina with the other jurisdictions that have rejected the plaintiffs' arguments. It is not entirely sufficient because a legislative enactment in this scenario is necessarily reactive and, thus, not timely.

If this Court were to accept the plaintiffs' position, the General Assembly *could* take up the issue, but that legislative process would take time. If homeowners' insurance premiums were to spike as they did in Arkansas during the time it would take the General Assembly to act, the harm to the homeowners' insurance marketplace would already be done by the time legislative relief arrived. This Court should prevent that scenario from occurring by accepting the long-established position espoused by the defendants.

(D) THERE IS NO SUPPORT FOR THE ASSERTION THAT THE POLICIES IN QUESTION GIVE THE DEFENDANTS AN ADVANTAGE IN THE MARKET.

The plaintiffs argue that the defendants have attempted "to obtain an advantage over their competitors and policy holders" by not proposing new endorsements that expressly provide for depreciation of labor costs, even though two other insurers have done so. (Plaintiffs' Opening Brief, p. 10.) Yet, the plaintiffs provide no real facts to support that claim. They rely solely on speculation.

The Plaintiffs' Opening Brief does not cite or discuss any data that would show the defendants have obtained an unfair advantage in the homeowners' insurance marketplace in South Carolina. The plaintiffs do identify two other insurers that have proposed the kinds of endorsements the plaintiffs believe should be required – Foremost Insurance Company and State Farm Fire and Casualty Company. But the plaintiffs do not even argue, let alone demonstrate, that proposing or using those endorsements resulted in decreased market share for those insurers. To the contrary, the plaintiffs refer to State Farm Fire and Casualty Company as the largest homeowners' insurance carrier in South Carolina by market share, and the plaintiffs give no information indicating that State Farm's status has changed in that regard.

The plaintiffs also fail to support their suggestion that the defendants' market share has increased during the relevant time period. Presumably, if data showing an increased market share for the defendants existed, the plaintiffs would have made the Court aware of it in their brief. Thus, the absence of such information is telling. In addition, APCIA and NAMIC are not aware of any data that would demonstrate

increased market share for the defendants in South Carolina due to their continuing use of their long-established policy language.

The defendants also have not attempted to gain any advantage over their policy holders, as they appear to be adjusting claims in the same manner as they have consistently done for decades. Furthermore, as previously discussed, the supplemental payments made upon completion of the actual repairs, or the signing of a contract for that work, make the insureds whole. There are no negative consequences for the insureds who arrange to have repairs or replacement work done. For this reason, it is difficult to discern how the defendants would have any unfair advantage over their insureds, who receive exactly what the policies state they should. Again, the plaintiffs' argument to the contrary is based on nothing more than speculation.

It is worth noting, however, that the negative effects on insureds stemming from the plaintiffs' position is *not* a matter of conjecture. As explained above, insureds in Arkansas saw their homeowners' insurance premiums spike more than 10% in the two years after the judicial decision that adopted the plaintiffs' position. There is no reason to believe a similar harmful outcome would not occur in South Carolina. The same market adjustments by insurers would be necessary to collect premiums for losses not previously recognized or anticipated. This very real threat of harm to the homeowners' insurance market in this State outweighs the plaintiffs' speculative assertions about unfair competitive advantages for the defendants.

Adopting the plaintiffs' position would also create a competitive *disadvantage* for insurers such as the defendants, which rely on the standard policy language regarding the calculation of ACV. As previously noted, a sudden change in the widely accepted

meaning of that policy language would force those insurers to either rewrite their policies, or extend additional coverage, *gratis*, that the insurers and the policyholders never bargained for or anticipated. Changing the policy language and getting the new wording and forms approved would take time, and during that interval, a repetition of the troubling Arkansas situation would appear to be a likely, if not inevitable, outcome. This would put those insurers at a competitive disadvantage, as would the alternative of simply paying losses that were never contemplated.

In both of those scenarios, the insurers would be punished for the supposed "crime" of relying upon and using a policy term and definition that have been widespread and standard in the industry for scores of years. The insurance industry obviously wants to avoid and prevent that kind of upheaval, which would harm not just the insurers, but eventually their policyholders as well. Again, the Court need only look to the adverse experience in Arkansas to see where a decision in the plaintiffs' favor would lead.

CONCLUSION

Adopting the plaintiffs' position would benefit the plaintiffs personally, but it would detrimentally affect the homeowners' insurance industry in South Carolina. Insurers like the defendants would have to begin a timely and costly process of rewriting policies. Based on historical precedent, premiums for homeowners' insurance policies would be adversely impacted, to the detriment of residents of this State seeking to obtain and maintain the coverage they need. That situation has happened before in Arkansas, and there is every reason it will happen here as well if the plaintiffs prevail.

Fortunately, to prevent that harmful scenario, this Court need not adopt any unorthodox or unsupported reading of the challenged policy language. The Court would

only need to join its sister jurisdictions, like North Carolina, in allowing a longstanding, well-established insurance definition and practice to remain in place. This is the reasonable request the defendants are making to the Court. APCIA and NAMIC respectfully urge the Court to grant that request and to answer the certified question accordingly.

Respectfully submitted,

s/ Thomas C. Salane
Thomas C. Salane (SC Bar # 4815)
R. Hawthorne Barrett (SC Bar # 16973)
Turner Padget Graham & Laney, P.A.
P.O. Box 1473
Columbia, SC 29202
(803) 254-2200
tsalane@turnerpadget.com
tbarrett@turnerpadget.com

Attorneys for Amicus Curiae American Property Casualty Insurance Association & National Association of Mutual Insurance Companies