

No. 19-5719

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT
ELECTRONICALLY FILED

SUSAN HICKS and DON WILLIAMS,
Plaintiffs-Appellees,
v.
STATE FARM FIRE AND CASUALTY COMPANY,
Defendant-Appellant.

On Appeal from the United States District Court
for the Eastern District of Kentucky, Ashland Division
Case No. 0:14-cv-00053-HRW

AMICUS CURIAE BRIEF OF UNITED POLICYHOLDERS

J. Brandon McWherter
McWherter Scott Bobbitt PLC
341 Cool Springs Blvd., Suite 230
Franklin, Tennessee 37067
(615) 354-1144
bmcwherter@gilbertfirm.com

*Attorneys of record for Amicus Curiae
United Policyholders*

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INTRODUCTION

This lawsuit only concerns deficient actual cash value (“ACV”) payments for dwellings and buildings. United Policyholders (“UP”) seeks to comment upon three issues: (1) “costs of repair” in State Farm’s ACV loss settlement sections of its homeowner’s policy form; (2) property insurance claims estimating software, and how a property insurer’s labor depreciation withholdings can be easily determined without disturbing any of the field claims adjuster’s determinations concerning the damaged property he or she observed; and (3) why State Farm is properly tasked with incurring the full cost of properly recalculating its erroneous ACV payments so policyholders can be paid for all previously withheld amounts.

First and most importantly, State Farm’s coverage arguments address the “not to exceed the cost to repair or replace” language contained in two separate provisions of its standard-form homeowner’s policy’s ACV loss settlement provisions. State Farm erroneously equates “costs of repair” to the “actual cost of repairs,” and therefore argues “State Farm never owes more than the policyholder’s actual cost to repair.” SF Br. at 13. Significantly for policyholders, State Farm contends it can “claw back” ACV payments from policyholders if it turns out the policyholders’ actual costs of repairs, regardless of the type or kind of repair, were less than the ACV payment. State Farm’s interpretation, if adopted, would reflect a dangerous sea change in property insurance claims adjusting.

State Farm's simplistic analysis of its policy is contrary to industry standards and is wrong. ACV is based upon estimated and theoretical costs of repair. Here, State Farm's standard-form homeowner's policy provides two different standards for calculating the "costs of repair" for ACV payments, dependent upon the coverage purchased: (1) the "common construction" cost of repair standard (A2 coverage); or (2) the "similar construction" cost of repair standard (A1 coverage). *See generally Bernert v. State Farm Fire and Cas. Co.*, No. 10-12359, 2012 WL 1060089 at *3-6 (E.D. Mich. Mar. 29, 2012) (describing the differences between "common construction" and "similar construction" cost of repairs standards in State Farm's homeowners' policy). Both standards use estimated and theoretical standards, and neither utilizes the "actual cost" of repairs when determining ACV.

Second, State Farm uses the word "individualized" 42 times in its brief, in an effort to suggest to this Court that recalculating the amounts of withholdings through third-party claims estimating software is burdensome. UP will provide the Court with an overview of the third-party claims estimating software programs used by property insurers in the United States today, including the software program at issue here, Xactimate®, and describe their functions. UP will explain how these third-party software programs allow a property insurer to withhold labor as depreciation, or conversely not withhold labor as depreciation, without altering any of the field claims adjuster's determinations and conclusions concerning the damaged property.

Finally, UP addresses the issue of loss adjustment expenses. In comparison to most class actions arising outside the insurance context, the policyholders here already paid substantial premiums to State Farm for the property adjustment and calculation of their ACV payments. State Farm should not be allowed to leverage class certification procedural arguments to be relieved from properly recalculating ACV payments—a task for which it has already been paid.

IDENTITY AND INTEREST OF AMICUS CURIAE

UP is a non-profit public interest consumer advocacy organization dedicated to helping preserve the integrity of the insurance system. UP serves as a voice and an information resource for consumers in all 50 states and is based in San Francisco, California. UP was founded in 1991 to assist homeowners with coverage and claim problems. UP's work is supported by donations, grants, and volunteer labor. UP does not sell insurance or accept funding from insurance companies.

Much of UP's work is aimed at helping individuals and businesses navigate the claims process after disasters to finance repairs and rebuilding. UP engages with local governments, stakeholders, and other advocates to provide insurance claim and coverage guidance for victims of natural disasters, including recent fires in California. UP hosts a library of publications for consumers on its website at www.uphelp.org. Through its Advocacy and Action Program, UP engages with regulators, including Commissioners of Insurance, legislators, academics, and

various stakeholders in connection with legal and marketplace developments relevant to all policyholders and all lines of insurance with a special emphasis on lessons learned in disaster areas. UP conducts and publishes the result of surveys related to property insurance payouts. Consumer confusion and frustration related to depreciation and replacement value calculations is a growing obstacle to disaster recovery. UP hosts a library of publications for consumers on its website at www.uphelp.org.

UP's Executive Director is an official consumer representative to the National Association of Insurance Commissioners for over a decade where she communicates regularly with various state department of insurance staff and commissioners.

A diverse range of individual and commercial policyholders throughout the U.S. regularly communicate their insurance concerns to UP which allows UP to submit *amicus curiae* briefs to assist state and federal courts decide cases involving important insurance principles. UP has filed *amicus curiae* briefs in more than 450 cases throughout the United States since the organization's founding in 1991. UP's *amicus curiae* arguments have been cited with approval by numerous state and federal appellate courts. See <https://www.uphelp.org/amicus-briefs>

UP considers this case to be of special significance because a policyholder's contractual right to be fully and accurately paid ACV after a structural loss is critical to disaster recovery and also to further the goal of an ACV payment - - indemnity.

Improper depreciation of labor by insurance companies results in underpayments to building owners and impedes the process of restoration and rebuilding. It also impacts local, state, and federal government entities that have an interest in communities' successful economic recovery. Because the issues in this case go to the very heart of insurance consumers' rights, they fall squarely within UP's advocacy interests.

In this brief, UP seeks to fulfill the "classic role of amicus curiae by assisting in a case of general public interest, supplementing the efforts of counsel, and drawing the court's attention to law that escaped consideration." *Miller-Wohl Co., Inc. v. Comm'r. of Labor & Indus.*, 694 F.2d 203, 204 (8th Cir. 1982). This is an appropriate role for amicus curiae. As commentators have stressed, an *amicus curiae* is often in a superior position to "focus the court's attention on the broad implications of various possible rulings." (R. Stern, E. Greggman & S. Shapiro, *Supreme Court Practice*, 570-71 (1986) (quoting Ennis, *Effective Amicus Briefs*, 33 *Cath. U.L. Rev.* 603 (1984)).

Pursuant to Rule 29(a)(4), UP affirms that no party's counsel authored this brief, that no party or party's counsel contributed money to UP that was intended to fund preparing or submitting the brief, and no person contributed money that was intended to fund preparing or submitting the brief.

ARGUMENT

A. **“Costs Of Repair Or Replacement” In The ACV Loss Settlement Provisions Of The State Farm Policy Refers Only To Estimated Costs Of Repair Under Either A “Common Construction” Or “Similar Construction” Theoretical Standard – Not The Actual Costs of Repair**

1. ACV Payments Are Prospective (Before Actual Repairs), While RCV Payments Are Retrospective (After Actual Repairs)

The fundamental differences between ACV coverage and RCV coverage are dispositive of State Farm’s erroneous “costs of repair” policy interpretation. As discussed in this section, ACV payments are made before repairs (which do not even have to be undertaken), and therefore must be based upon estimated costs of repair. On the other hand, RCV payments are always made after repairs are complete. Second, as discussed in the next section, ACV payments are based upon theoretical costs of repair, while RCV payments are based upon actual costs of repair.

The first distinction is temporal, as ACV payments are made before repairs are undertaken. Because ACV coverage is paid before repairs, ACV is logically calculated based solely upon *estimated* repair costs – not actual repair costs as suggested by State Farm. *See Johnson v. Hartford Cas. Ins. Co.*, No. 15-04138, 2017 WL 2224828, at *5 (N.D. Cal. May 22, 2017) (“In other words, the ACV is determined prospectively at the time of the loss as an estimate of what it would cost to repair—that is, what it would cost to return the structure to its state prior to the

loss. This is distinct from the RCV, which is determined retrospectively, and is paid subsequent to the completion of repairs, in the amount of the actual cost of repairs.”).

The most widely used property forms are those provided by the Insurance Services Office, or “ISO” for short. ISO property forms serve as the “benchmarks for analyzing and comparing policies” developed by individual insurers, because most insurers use ISO language “as is” or as a combination of ISO language and proprietary language.¹ ISO forms also follow the temporal distinction between ACV and RCV coverages. *E.g.*, HO-3² (“We will pay no more than the actual cash value of the damage until actual repair or replacement is complete.”)

State Farm’s policies also follow ISO’s bright line, temporal distinction. ACV is only paid “until actual repair or replacement is completed,” while RCV coverage is only paid “when the repair or replacement is actually completed.” Dkt. 129-2, PageID.5554; Dkt. 130-5, PageID.6567.

Because ACV payments are always prospective under State Farm’s policy form, they must be based solely on estimated costs. Before suit, State Farm similarly

¹ See generally Marianne Bonner, *Insurance Services Office (ISO)*, The Balance (May 16, 2019) (available at <https://www.thebalancesmb.com/insurance-services-office-iso-462706>).

² According to the International Risk Management Institute (“IRMI”), ISO’s HO-3 Special Form (most current version HO 00 03005 11) is the most widely used homeowners form in the United States. ISO’s HO3 form is available at <https://www.propertyinsurancecoveragelaw.com/files/2018/09/HO-00-03-05-11-1.pdf>.

interpreted its ACV provision as requiring ACV to be calculated based upon estimated costs. For example, in Hicks’ “Explanation of Building Replacement Cost Benefits,” State Farm advised Hicks in a pre-printed form communication: “We determined actual cash value by deducting depreciation from the *estimated* repair or replacement cost.”³ Dkt. 30-2, PageID.927.

“Costs of repair” are therefore estimated and not actual costs. This important distinction is the first reason State Farm’s “actual cost” argument fails.

2. *The Repair And Replacement Language In State Farm’s ACV Loss Settlement Provisions Refers To The Theoretical Costs To Repair Or Replace With Either Common Construction or Similar Construction Standards On The Date Of Loss – Not To The Actual Costs To Repair*

Not only is ACV based upon the estimated costs of repair because ACV benefits are paid prospectively, but ACV payments are also based upon theoretical standards, and not actual costs. *See Salesin v. State Farm Fire and Cas. Co.*, 581 N.W.2d 781, 791 (Mich. Ct. App. 1998) (“the original estimate of actual cash value

³ Further, in State Farm’s new ACV definition (in national policy form FE-3650, which is used in Kentucky), State Farm clarifies that ACV is based solely upon estimated costs and never actual costs: “Actual cash value means the value of the damaged part of the property at the time of loss, calculated as the *estimated* cost to repair or replace such property, less a deduction to account for pre-loss depreciation.” The FE-3650 form is available at: http://doi.nv.gov/uploadedFiles/doinvgov/_publicdocuments/Consumers/Home/State_Farm/FE-3650.pdf

of the damage under the State Farm insurance policy in force in Michigan is entirely theoretical and is therefore not limited by the lack of actual expenditures”).

When ACV is defined as replacement cost less depreciation, replacement cost must be ascertained. For purposes of this equation, the calculation of replacement cost is based on what it would cost to repair or replace the item in question; it is not based on actual repair costs. Until the insured actually makes the replacement, all components of replacement cost used to calculate ACV are theoretical.

This theoretical measurement must be based on the date of loss, even if actual repair or replacement is made months or even years later. *E.g., O’Hara v. Travelers*, No. 11-208, 2012 WL 3062300, at *10 (S.D. Miss. July 26, 2012) (excluding expert witness opinion as to ACV on relevance grounds because opinion did not opine on ACV “immediately after the loss”); COUCH ON INSURANCE 3D § 175.19 (June 2015) (“What constitutes actual cash value in a fire policy ... depends upon the nature of the property insured, its condition, and other circumstances existing *at the time of the loss.*” (emphasis added)).

Here, for example, State Farm’s ACV loss settlement provisions expressly required ACV to be calculated solely “at the time of the loss” regardless of whether actual repair or replacement occurs much later. Dkt. 129-2, PageID.5554; Dkt. 130-5, PageID.6567. Because cost of repair for ACV must be theoretically calculated as

of the date of loss regardless of date of repair, ACV cannot be based upon actual costs.

Second, the cost to repair used to calculate ACV is further based upon a theoretical standard, sometimes set forth in the policy, concerning the type of repair or replacement. For example, while there are myriads of ways to “repair” damaged property, one would not expect a claims adjuster to argue that the theoretical cost to repair a hole in a roof is simply to lay a temporary tarp over the hole. *Coppins v. Allstate Indemnity Co.*, 359 N.W.2d 896, 905 (Wis. Ct. App. 2014) (“[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 but insurance.”).

State Farm’s standard homeowners’ policy provides two different theoretical standards for the types of repair dependent upon what coverage is purchased: (1) the “common construction” standard; and (2) the “similar construction” standard. Dkt. 129-2, PageID.5554; Dkt. 130-5, PageID.6567. Coverage under State Farm’s “common construction” standard is cheaper than the standard “similar construction” standard. *Bernert*, 2012 WL 10060089 at *7.

First, under the State Farm policy’s cheaper, “common construction” standard for calculating the cost of repairs for RCV and ACV coverage, the theoretical cost

of repairs is based upon the use of “common construction” techniques and materials, even if those techniques and materials are *not* like kind and quality, and regardless of the actual type of repairs ultimately chosen. The “common construction” loss settlement provision states:

2. A2 - Replacement Cost Loss Settlement - Common Construction.

a. We will pay *the cost to repair or replace with common construction* and for the same use on the premises shown in the Declarations, the damaged part of the property covered under SECTION I -COVERAGES, COVERAGE A - DWELLING, except for wood fences, subject to the following:

(1) we will pay only for repair or replacement of the damaged part of the property with common construction techniques and materials commonly used by the building trades in standard new construction. We will not pay the cost to repair or replace obsolete, antique or custom construction with like kind and quality;

(2) until actual repair or replacement is completed, we will pay only the actual cash value at the time of the loss of the damaged part of the property, up to the applicable limit of liability shown in the Declarations, *not to exceed the cost to repair or replace the damaged part of the property as described in a.(1) above;*

Dkt. 129-2, PageID.5554; Dkt. 130-5, PageID.6567 (emphasis added).

The italicized language above shows that the ACV payment is based upon the depreciated value of *common construction* repairs. Therefore, under the common construction standard, costs of repairs for both ACV and RCV coverage is limited to the theoretical cost to repair or replace, on the date of loss, with common construction techniques and materials used by the building trades in standard new

construction, without payment for antique materials or custom construction techniques. For example, if a policyholder had exotic teak wood flooring and custom plaster and paneling, ACV would be calculated based upon the cost to install oak flooring and regular drywall, less depreciation. *Bernert*, 2012 WL 10060089 at *3.

Second, under the more expensive “similar construction” coverage, “costs of repair” is based upon the theoretical cost of repair using of similar construction and materials as found in the original structure:

1. A 1 - Replacement Cost Loss Settlement - Similar Construction.

We will pay *the cost to repair or replace with similar construction and for the same use* on the premises shown in the **Declarations**, the damaged part of the property covered under **SECTION I COVERAGES, COVERAGE A - DWELLING**, except for wood fences, subject to the following:

(1) until actual repair or replacement is completed, we will pay only the actual cash value at the time of the loss of the damaged part of the property, up to the applicable limit of liability shown in the *Declarations*, *not to exceed the cost to repair or replace the damaged part of the property*;

Dkt. 129-2, PageID.5554; Dkt. 130-5, PageID.6567. Under this provision, the ACV is calculated by the State Farm’s adjuster using the theoretical cost to repair or replace, on the date of loss, with the *similar* construction techniques and like kind materials at issue in the damaged building.

As a result, State Farm’s “actual cost” argument makes little sense. If a policyholder purchases the more expensive “similar construction” coverage, but

actually repairs his property using “common construction” techniques, State Farm’s argument would result in the policyholder forfeiting his more expensive “similar construction” ACV coverage. This argument is illogical.

For this reason, the State Farm and ISO forms *never* refer to “actual costs” when addressing the appropriate measurement for calculating ACV. Rather, the State Farm and ISO forms always use the “actual cost” cap language *only* within the RCV loss settlement terms. In State Farm’s forms, State Farm uses the phrases the “amount you actually and necessarily spend” or the “amount you actually spend” only in relationship to RCV benefits. Dkt. 129-2, PageID.5554; Dkt. 130-5, PageID.6567. This is identical to ISO’s HO3 form, wherein RCV coverage is limited to the “necessary amount actually spent.” “Actually spent” or similar cap language is only found in the RCV coverage terms of property policies.

3. State Farm’s Strained “Actual Cost of Repair” Interpretation, If Adopted, Would Allow State Farm To Sue To Recover Previously Paid ACV Payments And Willfully Delay And Underpay Claims

UP encourages the Court to consider the adverse impact to tens of thousands of policyholders if State Farm’s strained “actual cost” interpretation was adopted. First, every time a policyholder chose to make repairs to his or her own structure with their own time and labor, State Farm could later sue the policyholders to recover most if not all of the policyholder’s prior ACV payment by simply claiming that the policyholder did not incur any actual costs of repair, or at least did not incur costs of

repair in excess of the initial ACV payment. Policyholders who made substandard repairs—such as a policyholder choosing to replace a damaged cedar shake roof with a shingled roof—would be in the same position. State Farm could make claims for (or as in this case, take credit against) the return of prior amounts paid or owed as ACV. Nowhere in any judicial, administrative or secondary source has State Farm ever provided an example in which a property insurer was entitled to make such a claim against its customer to recover a prior ACV payment.

Second, even if State Farm did not sue for prior ACV payments, State Farm would be granted license to purposely delay and underpay future ACV claims. Why would State Farm (or any other property insurer) immediately pay full value for any ACV claim in Kentucky in the future, when State Farm can defend against any future suit by simply alleging it is waiting to see if the policyholder ultimately chooses to repair his or her property, and if so, whether the actual costs of repair equal the amounts already paid? State Farm's tortured interpretation would result in a sea change in how residential and commercial property insurance claims are handled in Kentucky and elsewhere.

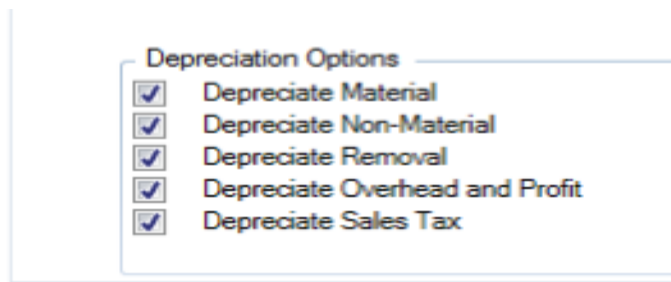
B. Property Insurance Claims Estimating Software Programs Allow Insurers To Depreciate Labor, Or Recalculate Depreciation Without Depreciating Labor, Without Altering Any Of The Claims Adjuster's Determinations And Conclusions

Today, property insurance companies calculate ACV through third-party property insurance claims estimating software programs. The programs all calculate

ACV through the replacement cost less depreciation methodology. The most prevalent program in use in the United States is Xactimate® by Xactware Solutions, Inc. Other popular third-party claims estimating software programs are PowerClaim® by Hawkins Research, Simsol® by Simultaneous Solutions and Symbility® by CoreLogic.

These third-party claims estimating software programs prompt claims adjusters in the field to obtain and input factual information regarding the damaged physical property they inspect, such as measurement (*e.g.*, lengths and widths), condition (*e.g.*, new, below average), and age determinations (*e.g.*, year of installation). Once this information is inputted in response to the programs' prompts, the programs will calculate RCV, depreciation and ACV based upon proprietary geographic and temporal pricing data for labor and materials.

The field adjusters' inputs concerning the damaged property are wholly independent of the software users' decision whether or not to withhold labor as "depreciation." For example, State Farm uses the Xactimate® software product. When calculating ACV, the default settings for Xactimate® do not depreciate labor. However, by mouse-click, the insurance company can depreciate labor for any claim by toggling the "depreciate non-material" or "depreciate removal" boxes as reflected in the screenshot below:



Most insurance companies, like State Farm, set the depreciation option settings at the corporate management level, are state specific, and do not permit the claim adjuster to undo the depreciation option settings.

The software programs' prompts for the depreciation option settings are independent of the programs' prompts concerning the damaged property. In other words, once the adjuster completes the task of inputting factual information concerning the damaged property, the software can estimate depreciation and ACV values with or without withholding labor as depreciation by toggling on or off the depreciation option setting prompts.

Amici estimates that approximately one-half of property insurers today will require their claims adjusters to depreciate labor. Consistent with this divergence in practice, all claims software programs allow the property insurance company to depreciate or not depreciate labor on a given claim, all by toggling on or off simplistic check boxes, and without changing any determinations made by the claims adjuster. Specifically, PowerClaim® has a "Depreciate Labor" checkbox, Simsol® has a checkbox to depreciate "Materials Only," and Symbility® allows or prohibits

labor depreciation through “Unit Price” versus “Materials Only” check boxes.

Screenshots reflecting these checkbox settings are set forth below:

The screenshot displays a settings interface with three main sections: Tax Options, Overhead & Profit Options, and Depreciation Options. The Depreciation Options section is highlighted with a red border.

Tax Options

- Include tax in estimates
- Material Rate: %
- Labor Rate: %
- Equip Rate: %

Regional Cost Adjustment

Base (No adjustment)

- Material: 100%
- Labor: 100%
- Equip: 100%

Overhead & Profit Options

- Add O & P to estimate
- Overhead: %
- Profit: %
- Non-cumulative O & P
- Depreciate O & P
- Add O & P to each line item cost
- Show O & P in coverage totals

Depreciation Options

- Depreciate Tax
- Depreciate Labor
- Default Item Depreciation: %

Local Depreciation Table Editor

Changing the Default Estimate Economic Age will not update your current repair items. **Economic Age must be addressed**

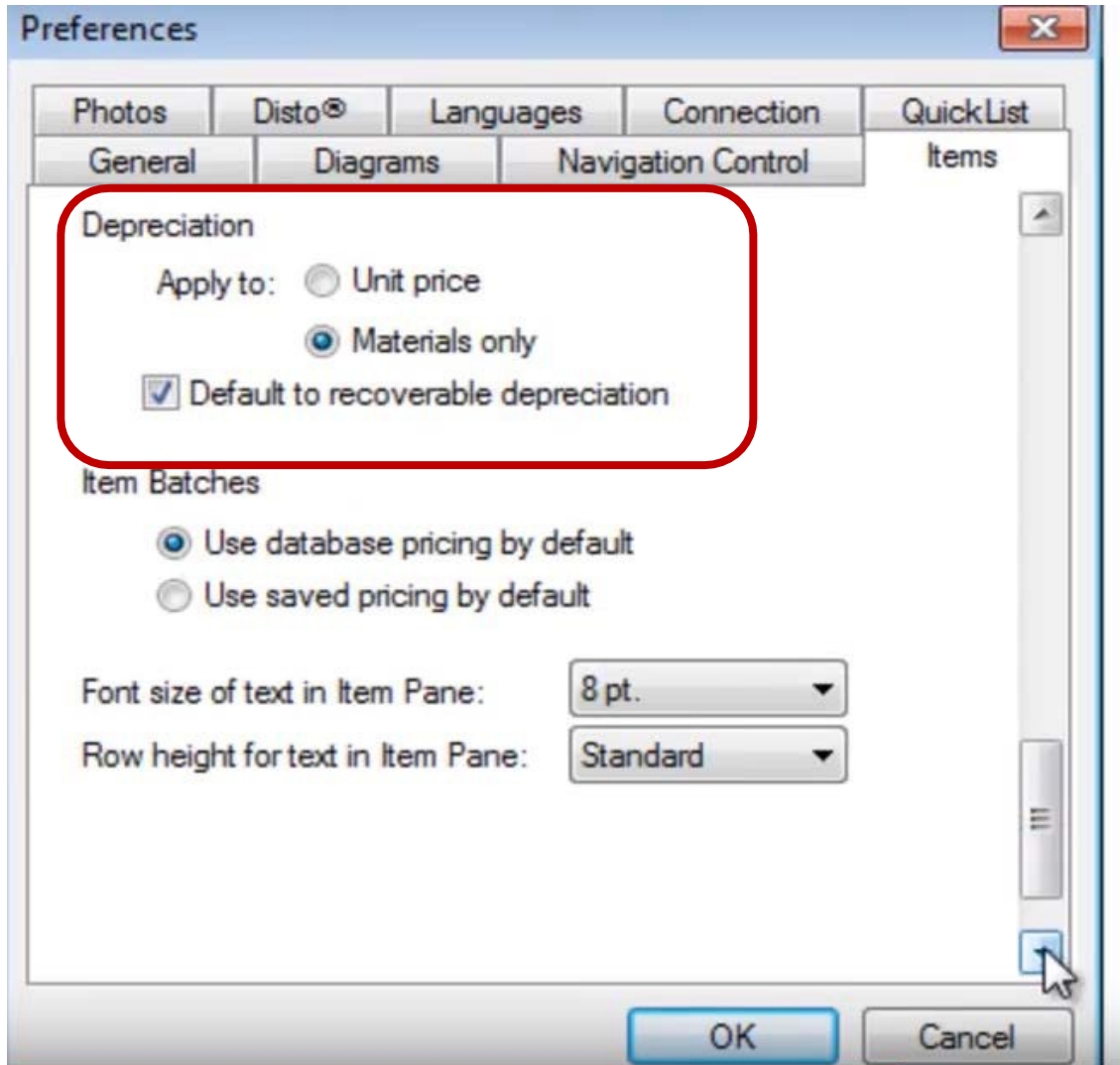
Accept New Factors and Exit
 Update All Line Items in This Estimate and Exit
 Update All Items, Prompt For Overridden Items and Exit
 Update Only Line Items Not Overridden and Exit

Depreciation Method
 None
 Scope
 Trade
 Scope w/Age
 Trade w/Age
 Materials Only

Major Trade/Classification
 MOISTURE PROTECTION

Subtrade/Category	1st Year %	Add'l Year %	Max %
▶ WATERPROOFING	5	5	50
INSULATION	1	1	50
ROOFING	5	5	50
ROOF ACCESORIES	5	5	50
SKYLIGHTS / VENTS	5	5	50
EXTERIOR SIDING	4	4	50
GUTTERS	4	4	50
AWNINGS	4	4	50
CAULKING / SEALANTS	0	0	50
MISCELLANEOUS PROTECTION	0	0	50
FLASHINGS	5	5	50

Economic Age: Yrs



Because these third-party claims estimating software programs uniformly allow or disallow the depreciation of labor through simple “check box” depreciation option settings, which are independent of the field adjusters’ determinations and conclusions, rerunning an estimate without depreciating labor is a task that is easy and almost instantaneous. The only task is to simply pull up the electronic estimate file into the software program (akin to loading a .doc file in Microsoft Word® or an .xls file in Microsoft Excel®) and then uncheck the relevant check boxes.

While a property insurer may contend the process is overly complicated to oppose class certification, in truth, recalculating ACV without withholding labor as depreciation is that simple. State Farm's internal process to recalculate an estimate without withholding labor as depreciation was recently disclosed in federal court in the Southern District of Alabama. The steps are identical to those set forth above, as reflected in the document:

If the Depreciation Options are shown as below an adjust is necessary.

Depreciation Options:

- Depreciate Material
- Depreciate Non-Material
- Depreciate Removal
- Depreciate Overhead and Profit
- Depreciate Sales Tax

Max Depreciation: 80%

Depreciation (Default): Recoverable

Depreciate By: Age/Condition

1. Note the Net Actual Cash Value Payment at the time of settlement.
2. Uncheck Depreciate Non-Material and/or Depreciate Removal.
3. Take the difference between the two.
4. Issue supplemental payment and document the file accordingly.

See *Arnold v. State Farm Fire and Cas. Co.*, Case No. 2:17-CV-148 (S.D. Ala.), PageID.7628.

In a published decision from the Northern District of Mississippi, State Farm estimated the time to determine class members' damages averages 15-20 minutes per claim:

Plaintiff's expert, Toby Jerrell Johnson, reported that "determining the amount of still withheld non-material depreciation on a property damage claim through Xactimate is *simple*" and the amount of withheld non-material depreciation could be determined on a property claim

within 2-3 minutes—less complex cases may take 1 minute and more complex cases may take 3-4 minutes. Johnson further reports that the process would require the “simple function of toggling the check-box” in each members' claim and comparing the difference in the amounts of withheld depreciation. However, *even if it were to take the 15-20 minutes per claim, or the expected 3000 hours, as calculated by State Farm's expert O'Connor*, this court finds that neither method preclude class certification.

Mitchell v. State Farm Fire and Cas. Co., 327 F.R.D. 552, 564 (N.D. Miss. 2018)

(emphasis added), *appeal pending*. While State Farm’s time estimate is certainly longer than one would reasonably estimate to untoggle a depreciation option setting as reflected in the above-depicted screens shots, this time period is extremely modest in comparison to more complex damages administration models for class actions.

1. Because State Farm Has Breached Its Contracts of Insurance by Withholding Labor As Depreciation, It Is Contractually Obligated To Pay For The Cost to Recalculate ACV

In State Farm’s and insurance industry amici’s appellate briefs, the insurers continually suggest that State Farm should be relieved from recalculating amounts withheld as labor depreciation because of the need for “individualized” or “manual” review of claims and software data. They also claim that the Xactimate® machinations need to identify class members are not administratively feasible.

State Farm itself previously raised administrative feasibility arguments against a policyholder class action in *Young v. Nationwide Mut. Ins. Co.*, 693 F.3d 532 (6th Cir. 2012). In *Young*, State Farm was one of several insurer defendants, and a class of State Farm policyholders sought overstated premium charges based

upon the insurers' erroneous inclusion of local government premiums taxes. Kentucky allows local governments to impose taxes on the insurers for the premiums they collect, and there were 391 separate local taxing jurisdictions in the state.

This Court's opinion noted that State Farm had over seven million insurance premium transactions at issue. *Id.* at 539, n.3. The State Farm policyholders proposed to determine class membership by marrying State Farm's insurance policy records with geocoding software to identify the precise location of the insured property, which would then be used to determine the appropriate local-tax-jurisdiction. While this process would assist in identifying potential class members, damages would be determined by manual data review.

In its appellate brief to this Court in *Young*, State Farm made eerily-similar arguments as it presents here – albeit in a far more administratively burdensome situation. State Farm argued that an overwhelming manual review would be required to identify all class members and overcharges due to the inadequate state of State Farm's electronic record-keeping.⁴ In its appellate brief, State Farm addressed what it called a “massive manual review,” arguing that potential class members could not be ascertained:

⁴ As in this case, State Farm also attacked the policyholder's expert witness' opinions concerning administrative feasibility under *Daubert*. State Farm Aplt. Br., *Dyas v. State Farm Fire and Cas. Ins. Co.*, No. 11-5018, 2011 WL 2191629, at *32-38 (6th Cir. Mar. 2, 2011).

While the District Court was not troubled by this massive manual review, it overlooked that all seven million State Farm policy transactions must be reviewed to determine those that are incorrectly assigned a taxing jurisdiction by geocoding. Identifying class members would require millions of separate factual inquiries into the circumstances of *each* tax jurisdiction assignment, for each insured, for each policy renewal period, for each jurisdictional boundary shift, and for each of the 391 local governments. Determining the actual physical location of a risk address individually by manual review of multiple third-party resources, at multiple points in time, for over seven million policy transactions is not, in any sense of the phrase, an administratively feasible method of identifying class members. Therefore, the Court's conclusion that class members could be identified in an administratively feasible manner was an abuse of discretion.

State Farm Aplt. Br., *Dyas v. State Farm Fire and Cas. Ins. Co.*, No. 11-5018, 2011 WL 2191629, at *53-54 (6th Cir. Mar. 2, 2011) (emphasis in original/citations omitted).

This Court rejected State Farm's arguments:

Equally – if not more – persuasive is the district court's practical rationale: “[T]he need to manually review files is not dispositive. If it were, defendants against whom claims of wrongful conduct have been made could escape class-wide review due solely to the size of their business or the manner in which their business records were maintained.” We find this reason compelling. It is often the case that class action litigation grows out of systemic failures of administrative, policy application, or records management that result in small monetary loss to large numbers of people. To allow the systemic failure to defeat class certification would undermine the very purpose of class action remedies. We reject Defendants' attacks on administrative feasibility based on the number of insurance policies at issue... [I]t is difficult to understand why Defendants should be able to escape a class suit even if Plaintiffs did not offer a means to escape the burden of identifying class members.

693 F.3d at 540-41.

The burdens needed to determine labor withholdings obviously pale in comparison to the process State Farm described in its appellate brief in *Young*. The action to determine labor withholding – toggling on or off a software prompt – are of common experience. Common sense dictates that such data manipulations should be deemed *de minimis* in time. See *Mitchell v. JCG Indus., Inc.*, 745 F.3d 837, 842 (7th Cir. 2014) (resolving parties’ competing time estimates, between 2-3 minutes on the one hand, versus 10 to 15 on the other hand, as a matter of “common sense intuition”).

But even if determining claim withholding information takes 15-20 minutes per claim as State Farm argues (although it is far from clear why it would take so long), it would not matter for another critical reason: property insurance policies require an insurer to pay for the costs to adjust claims, even if the cost of adjustment exceeds the value of the claim. For example, if a claim payout would only equal \$50, a property insurer cannot refuse to adjust the claim on the grounds that the cost of adjustment would exceed \$100.

The cost of adjustment is referred to in the insurance industry as a loss adjustment expenses, or LAE. LAEs include the costs of adjusters and any other fees or expenses attributable to a claim. While some commercial liability policies

require policyholders to pay for loss adjustment expenses,⁵ property insurance policies do not.

In simple terms, an insurer's LAE, along with its loss experience, are periodically reported to state regulators, who oversee and approve premium rates and rate increases. In other words, property policyholders pay their property insurers "up front" for all LAE costs within their annual premiums. The putative class has expressly paid premiums to State Farm for State Farm to "manually" or "individually" calculate the amount it owes for ACV. Allowing State Farm to underpay ACV claims by improperly withholding labor depreciation from claims, and then to further allow State Farm to avoid paying the costs to properly recalculate the correct withholdings when it errs, would result in a second breach of the property policies issued to the Kentucky policyholders at issue. Under *Young*, and under the policy terms at issue, State Farm must properly calculate depreciation for its ACV payments.

⁵ *E.g., Nordby Const., Inc. v. Am. Safety Indemnity Co.*, 2015 WL 17376454 (N.D. Cal. April 14, 2015).

CONCLUSION

UP recognizes and appreciates the extremely important role insurance companies play in modern society. When those companies follow the law as interpreted by the courts, prompt and proper payment goes to those who suffer life-altering catastrophes affecting their persons and property.

This Court, consistent with other courts from “replacement cost less depreciation jurisdictions,” has now held that State Farm should not have withheld labor as depreciation in calculating ACV payments. State Farm is now obligated to make correct payments, and should not be heard to claim that, in lieu of the correctly-calculated ACV, State Farm can now pay the class members a potentially lesser amount—the “actual costs of repair.” Such an interpretation would treat the class members differently than all other State Farm policyholders and allow State Farm in the future to sue policyholders for the return of ACV payments in Kentucky and elsewhere. This interpretation would also incentivize State Farm into underpaying ACV claims going forward.

Finally, allowing State Farm to escape its obligation to pay in accordance with this Court’s prior decision, based upon State Farm’s arguments that there is too great of an “individualized” or “manual” administrative cost to properly adjust claims, again breaches the property policies at issue, which require State Farm to incur the costs of proper claims adjustment.

For all the foregoing reasons, UP respectfully submits that the Court should affirm the district court's class certification decision.

Respectfully submitted,

s/J. Brandon McWherter
J. Brandon McWherter (TN Bar #21600)
McWherter Scott Bobbitt PLC
341 Cool Springs Blvd, #230
Franklin, Tennessee 37067
(615) 354-1144
bmcwherter@gilbertfirm.com

*Attorney of record for Amicus Curiae
United Policyholders*

Certificate of Compliance

Pursuant to Federal Rule of Appellate Procedure 29(a)(4)(G) and Sixth Circuit Rule 32(a) and (b), I hereby certify that according to the word count of the word-processing system used to prepare the brief, this *Amicus Curiae* brief contains 5762 words, exclusive of cover page, the table of contents, table of authorities, certificates of counsel, signature block, and proof of service. I further certify this has been prepared in a proportionally spaced typeface using Microsoft Word in 14 point characters with Times New Roman font.

Dated: January 31, 2020

s/ J. Brandon McWherter
J. Brandon McWherter

Corporate Disclosure Statement

Pursuant to Rules 26 and 29(a)(4)(A), UP states that it is a non-profit 501(c)(3) consumer organization, that it does not have a parent corporation, and that no publicly held corporation owns 10% or more of its stock.

Dated: January 31, 2020

s/ J. Brandon McWherter
J. Brandon McWherter

Certificate of Service

I hereby certify that on January 31, 2020, I electronically filed the foregoing with the Clerk of the Court by using the CM/ECF system, which will send a notice of electronic filing to all counsel of record.

s/ J. Brandon McWherter
J. Brandon McWherter