No. 126446

IN THE SUPREME COURT OF ILLINOIS

JARRET SPROULL, Individually and on behalf of others similarly situated, Plaintiff-Appellee, v. STATE FARM FIRE and CASUALTY COMPANY, Defendant-Appellant.	)	Appeal from the Appellate Court of Illinois, Fifth District Case No. 5-18-0577 Third Judicial Circuit, Madison County, Illinois Law. No. 16-L-1341 Honorable William A. Mudge, Judge Presiding

BRIEF OF *AMICUS CURIAE* UNITED POLICYHOLDERS

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POINTS AND AUTHORITIES

STATEMENT OF INTEREST OF *AMICUS CURIAE*

Amicus Curiae United Policyholders ("UP") submits this brief in support of the position of Plaintiff, Jarret Sproull ("Sproull"), the insured under a property insurance policy issued by State Farm Fire and Casualty Company ("State Farm"). Counsel hopes that its efforts will assist both the attorneys and this Court, by focusing on public policy considerations that should prevent insurance adjusters from reducing benefit payments to loss victims by depreciating the cost of the labor that will be required to complete repairs or replacement of an insured asset.

UP is a non-profit public interest consumer advocacy organization dedicated to helping preserve the integrity of the insurance system. UP is a voice and source of help for insurance consumers throughout the United States. 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 insured individuals and businesses successfully navigate the claim process so they can restore or replace assets that have been damaged or destroyed. As part of that work, 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.

UP's Executive Director has been an official consumer representative to the National Association of Insurance Commissioners for over a decade where she

communicates regularly with various states' departments of insurance staff and Commissioners during the organization's tri-annual meetings and interim proceedings.

In addition to the disaster victims UP serves, we hear from a diverse range of individual and commercial policyholders throughout the U.S. This input allows UP to submit informed amicus curiae briefs to assist state and federal courts decide 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. *See* https://www.uphelp.org/resources/amicus-briefs. UP briefs have also been received by the Supreme Court of Illinois in *Avery et al. v. State Farm*, 216 Ill. 2d 100, 835 N.E.2d 801 (2005) and *Country Mutual Ins. Co. v. Livorsi Marine, Inc.*, 222 Ill. 2d 303, 856 N.E.2d 338 (2006).

When insurers reduce actual cash value claim payouts by depreciating labor, they are failing to meet their duty to indemnify insureds for a necessary cost of restoring insured assets to pre-loss condition. Improper depreciation of labor by insurance companies creates shortfalls in repair and rebuilding financing for property owners *and* negatively impacts the local, state and federal government entities that have an interest in communities' successful economic recovery and the restoration of property tax bases. Because the issues in this case go to the very heart of Illinois 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.

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)).

UP files simultaneously with this brief, a motion pursuant to Supreme Court Rule 345 for leave to file this brief.

INTRODUCTION

Building owners purchase property insurance to protect themselves if their property is damaged by fire, hail, tornadoes, or other often catastrophic events. In the case of homeowners, adequate payment of insurance policy benefits is often what stands between them 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 is one of those strategies.

Fortunately, a large percentage of insurance companies do not engage in the practice of depreciating labor. *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"). For those carriers that do engage in the practice, many have filed and use coverage forms authorizing the practice so that the policyholders ostensibly know what they are buying. *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"); *Shelter Mutual Ins. Co. v. Goodner*, 477 S.W.3d 512 (Ark. 2015).

This case deals with the shrinking practice that unfortunately State Farm engaged in here—depreciating labor without any authorization in the policy form. In the court record below, State Farm never answered the simple question—if State Farm knew it was going to be one of the few carriers that still depreciate labor, why didn't its policy form say so?

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

Illinois law honors and enforces the principle that insurance policies should be interpreted to effectuate indemnity and uphold policyholders' reasonable expectations of coverage. Consistent with those principles, the cost of labor should not be depreciated. Depreciation of labor results in policyholders not receiving the full amount that they reasonably are entitled to under their actual cash value coverage, and it often results in policyholders also being unable to collect replacement cost value benefits for which they have paid an additional premium. That is an often life-changing loss for policyholders and provides a windfall to the insurer.

ARGUMENT

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

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

Actual cash value

The precise interpretation of actual cash value is at the heart of this dispute. Generally speaking, actual cash value (often referred to as "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). Actual cash value 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. Obviously, the 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 Indemnity Co*., 359 N.W.2d 896, 905 (Wis. Ct. App. 2014). A homeowner policyholder should reasonably expect that actual cash value 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, actual cash value would be the price of providing the policyholder a ten-year old roof that was not destroyed by hail. Disputes arise 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. To determine actual cash value, Illinois law requires insurers to first calculate the replacement cost value of the loss and then deduct deprecation.

Replacement cost value

In contrast to actual cash value (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., March 2018 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 replacement cost value coverage (often referred to as "RCV") 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 actual cash value and replacement cost value payments differs. Actual cash value benefits are paid as soon after the loss as the amount owed by the insurance company is determined. Replacement cost value benefits, in contrast, 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). For this reason, insurers may try to allocate as much of the loss as possible into replacement cost coverage rather than actual cash value so it is less likely that the insurer will ever 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] (2016); *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

United Policyholders agrees with Plaintiff and State Farm that the appropriate method for determining actual cash value here is replacement cost value with deduction for depreciation. This is consistent with 50 Ill. Admin. Code § 919.80(d)(8)(A). It also is consistent with Illinois case law since 1920.[1] *See Smith v. Allemannia Fire Ins. Co. of Pittsburgh*, 219 Ill. App. 506 (5th Dist. 1920); *C. L. Maddox, Inc. v. Royal Ins. Co. of America*, 208 Ill. App. 3d 1042 (5th Dist. 1991); *General Cas. Co. v. Tracer Industries, Inc.*, 285 Ill. App. 3d 418 (4th Dist. 1996); *Cary v. Am. Family Brokerage, Inc.*, 391 Ill. App. 3d 273 (1st Dist. 2009).

Here, State Farm acknowledged at the lower courts that it determines ACV by

[1] An alternative method of calculating actual cash value is the so-called broad evidence rule, which was not used here and is not contemplated by Illinois law. That 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*, in a state like Illinois that requires use of the replacement cost less depreciation, "'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.

calculating the repair or replacement cost of the damaged part of the property less depreciation and deductible. Thus, the parties agree that the appropriate methodology to determine actual cash value is replacement cost minus depreciation. 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, actual cash value puts the policyholder in the same condition as before the loss. Once physical material depreciation is withheld to determine the actual cash value (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 further amounts are also withheld relating to labor, the policyholder can never even get actual cash value coverage because he or she is not restored to his or her pre-loss condition. He or she is no longer receiving actual cash value coverage.

An example can illustrate the differences between replacement cost value and actual cash value, the interplay between the two, and the role of depreciation and its impact on labor. Assume a residential home has a 10-year-old shingled roof (with a normal life span of 20 years). Further assume that all of the shingles were properly

installed at the time the policyholder buys actual cash value coverage. Then, all of the properly-installed shingles are totally destroyed in a hail storm.

Determining the replacement cost value is simple, i.e., the cost to replace all damaged components of the roof with brand new materials. For purposes of our hypothetical, we will assume that replacement cost to be an undisputed $30,000. To arrive at an actual cash value, the next step is to determine the proper depreciation. When determining the appropriate deduction for depreciation, it is critical to keep the goal of indemnity at the heart of the calculation, i.e., to restore the insured to her pre-loss condition. To do this, the goal of course must be to give the insured what she had before the loss, which was a 10-year old properly installed roof. Actual cash value therefore requires payment of the value of 10-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 10-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 delta between 10-year old shingles and brand-new shingles as well as the deductible. The concept of physical depreciation therefore fairly penalized the

policyholder for all of the roof's pre-loss wear and tear.

In the real world, there is no market for 10-year old shingles and there is no store that a person can visit to purchase "used" 10-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 she can afford to pay the difference between the worn 10-year old shingles and brand-new shingles out-of-pocket, the ACV payment does not enable her to remove the damaged shingles and then reinstall the shingles she just paid for. This double deduction is unfair. It does not accomplish indemnity and is the ultimate reason why State Farm's logic and arguments fail. State Farm's theory leaves the insured in a worse condition than before the loss. Such a result is the opposite 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.

"The construction of an insurance policy [] is a question of law…." *Cent. Ill.*

Light Co. v. Home Ins. Co., 213 Ill. 2d 141, 153 (2004). The resolution of whether labor should be depreciated is not a question of fact, but a question of law and policy language interpretation appropriate for a court's independent determination. There is not a dispute in this case whether a court can determine this meaning.

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*** hailstorm. They could receive ***different*** actual cash value 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.

IV. A REASONABLE CONSTRUCTION OF THE SUBJECT INSURANCE POLICY IS THAT LABOR SHOULD NOT BE DEPRECIATED.

Under Illinois law, "if the words used in the [insurance] policy are reasonably susceptible to more than one meaning, they are ambiguous and will be strictly construed

against the drafter." *Cent. Ill. Light Co.*, 213 Ill. 2d at 153. A reasonable construction of the insurance policies in this case is that labor is not included in depreciation. Not only would depreciating labor require ignoring the definition of common words, it 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] (2016); *Black's Law Dictionary* (10th ed. 2014), *supra* at 6). The principal definition of depreciation "refers to 'physical deterioration.'" New Appleman on Ins. Law Library Ed., *supra* at 6.

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. Courts, likewise, refer to FC & S bulletins when interpreting insurance policy provisions. *See, e.g., U.S. Fire Ins. Co. v. J.S.U.B., Inc*., 979 So. 2d 871, 895 (Fla. 2007). 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).

State Farm and other insurance carriers should not be allowed to reap the benefit of a term that it chose not to define in its 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, has explained that if an insurance company wants its own interpretation to apply, it can define that term in its own policy. 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).

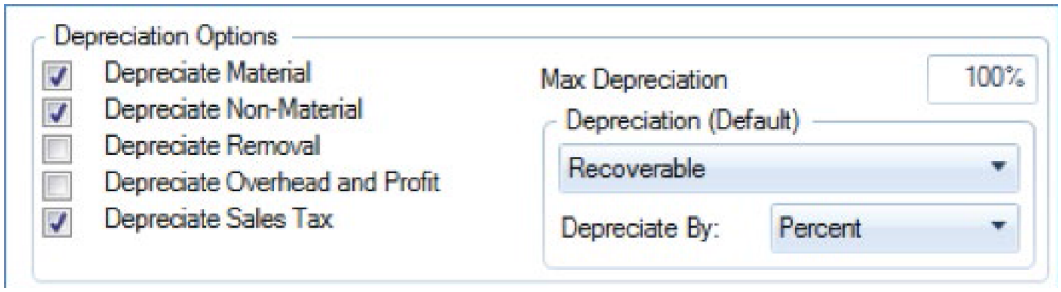
In this case, State Farm could have easily defined actual cash value to include depreciation of labor, as it did after the Plaintiff's wind loss, but it chose not to. State Farm should not now get the benefit of its decision not to define actual cash value in its

policy. Many carriers, in fact, do define actual cash value to include depreciation of labor. *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"); *Goodner*, 477 S.W.3d at 513 (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.

The claims adjusting software that is almost universally used by insurance carriers also demonstrate that there are at least two approaches to whether labor should be depreciated, thus further demonstrating the reasonableness of Plaintiff's interpretations that under State Farm's policy labor costs are not properly subject to depreciation. Indeed, 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 actual cash value.

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. [including State Farm] and 10 of the top 10 Canadian insurers use Xactware property insurance claims tools."[2] The below 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:

[2] *See* https://www.xactware.com/en-us/company/about/ (last visited February 21, 2021).



http://xactimate.xactware.help/help_baggage/2015_WhitePaper_CalculatingDepreciationForStructuralPropLines.pdf (last visited February 21, 2021). 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, State Farm cannot credibly argue that Plaintiff's policy interpretation is not reasonable.

To illustrate how labor depreciation settings change a policyholder's recovery, the following is an example of an Xactimate calculation in which labor is not depreciated. This hypothetical involves a common small property claim: a laminate wood floor contaminated and destroyed by a basement sewage backup. The laminate floor has two-thirds of its useful life remaining.

Using the traditional insurance industry methodology to indemnify the policyholder, the insured is indemnified for the cost to remove and dispose of the flooring, and then reinstall materials of like-kind and quality. The replacement cost value (full replacement with brand new flooring) is $9,100.50. Only the tangible laminate

flooring is depreciated (recall that one-third of the flooring material's useful life is gone), and therefore the ACV payment for the wood floor is $7,566.00:

Dwelling - Raw Sewage Example

DESCRIPTION	QUANTITY	UNIT PRICE	TAX	RCV	DEPREC.	ACV
1a. Remove Laminate - simulated wood flooring	1,500.00 SF	0.93	0.00	1,395.00	<0.00>	1,395.00
1b. Replace Laminate - simulated wood flooring	1,500.00 SF	4.92	325.50	7,705.50	<1,534.50>	6,171.00
Totals: Dwelling - Raw Sewage Example			**325.50**	**9,100.50**	**1,534.50**	**7,566.00**

This ACV payment provides the policyholder with just enough money to return the basement flooring to its pre-loss condition.

However, in this same hypothetical, if the flooring contractor's *reinstallation* labor is also depreciated (by clicking the box to "Depreciate Non-Material"), the ACV payment is decreased by over $900 to $6,665.10:

Dwelling - Raw Sewage Example

DESCRIPTION	QUANTITY	UNIT PRICE	TAX	RCV	DEPREC.	ACV
1a. Remove Laminate - simulated wood flooring	1,500.00 SF	0.93	0.00	1,395.00	<0.00>	1,395.00
1b. Replace Laminate - simulated wood flooring	1,500.00 SF	4.92	325.50	7,705.50	<2,435.40>	5,270.10
Totals: Dwelling - Raw Sewage Example			**325.50**	**9,100.50**	**2,435.40**	**6,665.10**

Now, the policyholder is deprived of benefits needed to return his flooring to its pre-loss condition.

Finally, if an insurer depreciates *both removal* labor and *reinstallation* labor, the ACV further decreases to $6,204.75, despite the fact that this is the identical loss for the identical property adjusted with the same commercial software program on the same date and location:

Dwelling - Raw Sewage Example

DESCRIPTION	QUANTITY	UNIT PRICE	TAX	RCV	DEPREC.	ACV
1. R&R Laminate - simulated wood flooring	1,500.00 SF	5.85	325.50	9,100.50	<2,895.75>	6,204.75
Totals: Dwelling - Raw Sewage Example			**325.50**	**9,100.50**	**2,895.75**	**6,204.75**

To create certainty and clarity in the insurance marketplace—for both insurers and policyholders—some states and courts have sought to require insurers to specify that they will depreciate labor costs in calculating actual cash value. 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." https://www.mid.ms.gov/legal/bulletins/20178bul.pdf (last visited February 21, 2021). 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. After the *Hicks* decision, the Kentucky Department of Insurance issued an advisory opinion stating, "[i]f the policy defines in a clear and unambiguous manner the practice of withholding labor depreciation in the adjudication of a property claim payment, then the Kentucky Insurance Code does not prohibit it." Advisory Opinion 2020-01, KY. DEP'T OF INS. (Feb. 7, 2020), *available at* https://insurance.ky.gov/ppc/Documents/AdvisoryOpinion2020-01.pdf (last visited February 21, 2021. To the extent the Court determines that an insurer may depreciate labor costs when calculating ACV, the Court should, at a minimum, require insurers to specifically disclose in their policies that labor will be subject to depreciation.

State Farm should not benefit by deducting labor from the policyholder's actual

cash value 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.

Moreover, depreciating labor would not effectuate the purpose of actual cash value coverage, which is indemnity, or placing the policyholders back in the position they enjoyed prior to the loss. Of course, ACV coverage can never put the policyholders back in the *precise* position they were in prior to the loss. In the example previously discussed, the policyholders had a ten-year old roof that was destroyed by hail. 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 is not feasible as you cannot buy and install a used roof or used roofing material. Therefore, actual cash value benefits will 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, the 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.

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, 13-14 (Fall 1992) (footnotes omitted).

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"). Illinois law is in accord. *See, e.g.*, *Cent. Ill. Light*, 213 Ill. 2d at 153.

The same principles apply to the question of whether labor should be depreciated. Recently, in *Lammert*, the Tennessee Supreme Court held that actual cash value, 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*.

In 2020, the Sixth Circuit was faced with a policy that incorporated an Ohio

insurance regulation that—much like the Illinois regulation here—defined ACV as replacement cost less depreciation. *Perry v. Allstate Indem. Co.*, 953 F.3d 417, 422 (6th Cir. 2020). The Court noted the policyholder's "interpretation—that in calculating ACV depreciation does not include labor costs—has been recognized as reasonable by numerous state and federal courts, including our own, because depreciation traditionally refers to value lost from physical wear and tear." *Id*. at 423. Accordingly, the court held that since the policyholder's "interpretation of 'depreciation' [as not including labor] is a fair reading of an ambiguous term, her interpretation prevails against the insurer." *Id*. Immediately after issuing its *Perry* decision, the Sixth Circuit held that "[b]ecause [the policyholder's] policy with State Farm did not expressly provide for labor-cost depreciation deductions," State could not depreciate labor costs. *Cranfield v. State Farm Fire & Cas. Co.*, 798 F. App'x 929, 930 (6th Cir. 2020).

Previously, the Sixth Circuit addressed another State Farm policy that incorporated a Kentucky insurance regulation that—again, much like the Illinois regulation here—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.

In 2020, the Fifth Circuit similarly was tasked with interpreting another State Farm policy that did not define ACV. *Mitchell v. State Farm Fire & Cas. Co.*, 954 F.3d 700, 705 (5th Cir. 2020). There, the court determined that the policyholder's interpretation was "reasonable, because it restores an insured to her status at the moment before the damage occurred." *Id*. at 706. The court noted that "[p]lacing a homeowner in

a position identical to the one she was in before the damage to her property accords with Mississippi's definition of Actual Cash Value[— again, much like the Illinois regulation here— 'the cost of replacing damaged or destroyed property with comparable new property, minus depreciation and obsolescence.'" *Id*.

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, Illinois law directs that the ambiguity be construed against State Farm and in favor of the Plaintiff.

It is illogical to assume that insureds, such as the Plaintiff in this case, would be able to infer that labor would depreciate from an ACV coverage policy when the term "actual cash value" possesses no definition. *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 in favor of State

Farm would place a burden on the insureds, which unjustly benefits State Farm. *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. *See Cummins v. Country Mutual Insurance Co.*, 178 Ill. 2d 474, 485, 687 N.E.2d 1021 (1997 ("this court can also consider a policyholder's reasonable expectations and the coverage intended by the insurance policy"). 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. *See Mitchell*, 954 F.3d at 706-07 (policyholder's "definition, which results in paying the costs necessary to place a homeowner in the status quo ante, is reasonable"). 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 do not include replacement cost coverage. Depreciating labor 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 replacement cost value 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 actual cash value 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. Further, 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 life-altering catastrophes affecting their persons and property.

Unfortunately, some insurance companies are tempted to obtain an "edge" when it comes to claims payment, to bolster their bottom line. Depreciating labor when calculating actual cash value benefits payable is an example of unethical conduct. Depreciation of labor is contrary to the policies insurers have issued and the purpose of insurance: effecting indemnity in case of loss. Even where policies are ambiguous, they must be interpreted in favor of coverage. Allowing insurers to depreciate labor 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 submits that the Court affirm the trial court's and appellate court's decisions below and find labor costs should not be depreciated under the subject State Farm policy.

Dated: February __, 2021.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of this brief, excluding the pages contained in the Rule 341(d) cover, the Rule 341(h)(1) statement of points and authorities, the Rule 341(c) certificate of compliance, the certificate of service, and those matters to be appended to the brief under Rule 342(a), is __ pages.

/s/ Edward Eshoo, Jr.
Edward Eshooo, Jr.

CERTIFICATE OF FILING AND PROOF OF SERVICE

I certify that on August 5, 2019, I electronically filed and transmitted the foregoing **BRIEF OF AMICUS CURIAE UNITED POLICYHOLDERS** with the Clerk of the Court, Fifth Appellate District by using the Odyssey eFileIL system.

I further certify that the other individuals in this case, named below have been served by transmitted a copy via electronic mail to all email addresses designated by those individuals, as follows:

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Under penalties as provided by law pursuant to section 1-109 of the Illinois Code of Civil Procedure [735 ILCS 5/1-109], I certify that the statements set forth in this **Certificate of Filing and Proof of Service** are true and correct, except as to matters therein stated to be on information and belief and as to such matters I certify as aforesaid that I verily believe the same to be true.

/s/ Edward Eshoo, Jr.
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