



Mike Kreidler- Insurance commissioner

As required by

The Washington State Administrative Procedures Act

Chapter 34.05 RCW

Matter No. **R 2021-04**

**CONCISE EXPLANATORY STATEMENT; RESPONSIVENESS
SUMMARY; RULE DEVELOPMENT PROCESS; AND
IMPLEMENTATION PLAN**

Relating to the adoption of

Prohibiting depreciation of labor on property claims

November 10, 2021

TABLE OF CONTENTS

Section 1	Introduction	pg. 3
Section 2	Reasons for adopting the rule	pg. 3
Section 3	Rule development process	pg. 3
Section 4	Differences between proposed and final rule	pg. 4
Section 5	Responsiveness summary	pg. 4
Section 6	Implementation plan	pg. 7
Appendix A	Hearing Summary	pg. 9

Section 1: Introduction

Revised Code of Washington (RCW) 34.05.325 (6) requires the Office of Insurance Commissioner (OIC) to prepare a “concise explanatory statement” (CES) prior to filing a rule for permanent adoption. The CES shall:

1. Identify the Commissioner's reason's for adopting the rule;
2. Describe differences between the proposed rule and the final rule (other than editing changes) and the reasons for the differences; and
3. Summarize and respond to all comments received regarding the proposed rule during the official public comment period, indicating whether or not the comment resulted in a change to the final rule, or the Commissioner's reasoning in not incorporating the change requested by the comment; and
4. Be distributed to all persons who commented on the rule during the official public comment period and to any person who requests it.

Section 2: Reasons for Adopting the Rule

When a homeowner has property damage covered under their homeowners insurance policy, the insurance company investigates the loss, values the damage, and then issues an Actual Cash Value (ACV) payment. The ACV payment is replacement cost less depreciation. After the repairs are fully completed, the insurance company releases the withheld depreciation to the insured to fulfil their obligation to cover the replacement cost as defined in the policy. Besides applying depreciation to the loss of value due wear and tear, deterioration, and obsolesce to physical material items, some insurance companies are applying depreciation to the labor costs associated with the repair process.

The practice of depreciating labor costs on initial insurance payments for replacement cost property damage claims floats a significant part of the labor repair costs to the consumer and their repair contractor. This unfairly shifts a burden to the consumer during the repair process and is likely against the principle of indemnity. The Commissioner has seen a steady rise of policy forms that are writing this practice into their definition of Actual Cash Value.

Section 3: Rule Development Process

On June 22, 2021, the Commissioner filed a CR-101 pre-proposal public notice of intent to adopt rules. The comment period was open through July 31, 2021. One comment was received.

On June 23, 2021, the Commissioner issued a working draft of the amended rules relating to prohibiting the depreciation of labor on property damage claims. The comment period was open through July 15, 2021. Three comments were received.

On September 1, 2021, the Commissioner filed a CR-102 proposed rule making. The comment period was open through October 12, 2021. Two comments were received.

On October 13, 2021, the Commissioner held a public hearing to hear testimony on the proposed rule. Fifteen people attended the public hearing and some testimony was provided. The hearing summary is in Appendix A.

The responsiveness summary chart included in Section 5 addresses the comments received.

Section 4: Differences Between Proposed and Final Rule
None.

Section 5: Responsiveness Summary

Comment	Response
Multiple comments offering support	We appreciate the review of the stakeholder draft and the submitter’s effort to provide supporting comments.
The rulemaking exceeds the authority of the Insurance Commissioner.	As listed in WSR 21-13-134 and WSR 21-18-093, RCW 48.02.060, 48.27.020, 48.18.120 provides authority for the rulemaking. The Commissioner has considered this comment and not made any changes to the rule language.
The Commissioner must provide narrative reasoning on the CR 102 of why he believes he can use the authority he provided. It is not sufficient to only cite the statutes.	The Commissioner has followed the statutory requirements when presenting the CR 102 Proposed Rule Making documents. The Commissioner has considered this comment and not made any changes to the proposed rule language.
The rulemaking is contrary to the generally accepted understanding of how Actual Cash Value payments are calculated and violates the principle of indemnity.	The principle of indemnity is the basis of the Actual Cash Value (ACV) payment. The basic objective of the principle of indemnity in property insurance is to restore an insured to the same financial position after the loss as they were prior to the damaging event. This means the cost to

	<p>repair or replace the damaged property with material of like kind and quality that was damaged. With replacement cost coverage, because the replacement cost amount includes new material costs, it is appropriate to depreciate the new material to represent the condition of the damaged material prior to the loss. Depreciation is the reduction in value or price because of a physical decline in the material's condition. Labor does not physically deteriorate.</p> <p>Furthermore, labor is required to restore an insured to the same financial position after the loss as they were prior to the loss. For example, an insured has 8-year-old cabinets damaged in a loss. A way to restore the insured to their pre-loss condition would be to install the same 8-year-old cabinet material. It is highly unlikely to find the exact 8-year-old cabinets, so under replacement cost coverage to find the ACV payment, the cost of new cabinets would be depreciated to represent the condition of the 8-year-old cabinets. Whether installing 8-year-old cabinets or installing new cabinets, the expense of labor is the same. Depreciating labor would not place the insured to their pre-loss condition. The Commissioner has considered this comment and not made any changes to the rule language.</p>
<p>The rulemaking would discourage consumers from repairing damaged property.</p>	<p>There was no data provided to support this allegation and the argument that depreciating labor encourages homeowners to complete repairs is speculative. The Commissioner has considered this comment and not made any changes to the rule language.</p>
<p>The Commissioner has already approved policy forms that allow for depreciation of labor.</p>	<p>Previously approved filings will need to be refiled with language that is compliant with this rule.</p>

<p>The proposed rule conflicts with the Washington Supreme Court ruling in Holden v Farmers Insurance Co. of Washington.</p>	<p>The question in Holden v Farmers related to ambiguous policy language in a renter's policy and whether sales tax should be included in an ACV payment for personal property loss. Furthermore, Farmers disclosed they used various methods to determine ACV and included sales tax when calculating the replacement cost valuation. The Court determined taking sales tax into account did not result in the insured reaping a windfall. The Commissioner has considered this comment and not made any changes to the rule language.</p>
<p>An insured who enjoys the benefit of a 20-year roof for 15 years before sustaining hail damage has not been deprived of 5 years of materials and 20 years of labor. The insured has lost only one roof, and that roof could have reasonably been expected to provide only 5 more years of use before requiring replacement anyway (25% of the economic expectation). To provide more than 25% of the estimated repair cost (representing the insured's actual lost use) would result in a windfall.</p>	<p>Labor is not a tangible depreciable item that loses value over 20 years. It does not lose value caused by age, or wear & tear, or obsolesce. It is a one-time expense that is required regardless of installing new or old material. The full cost of labor is required to make an insured whole. Making an insured whole is the principle of indemnity and does not create any windfall profit to them. The Commissioner has considered this comment and not made any changes to the rule language.</p>
<p>State Farm will often release the withheld depreciation of labor if the insured provides a signed repair contract.</p>	<p>The Commissioner applauds releasing the unnecessary withholding of the depreciation of labor, but notes it is not in State Farm's policy language and can be subjectively applied. The Commissioner also notes that State Farm reported they will not depreciate for labor on cleaning and other restorative labor costs. This business practice is also not in the insurance policy, but simply volunteered by the company. This uneven application of withholding the depreciation of labor demonstrates how arbitrary it can be.</p>
<p>This rule will cause insurance rates to increase for all Washington state consumers.</p>	<p>Most insurance companies in Washington state do not appear to depreciate for labor within their actual cash value definition in their policy. At least one company that</p>

	does has reported a subjective application of their business practice to waive it. Rates are closely tied to the expected cost of claims. Since this rule does not affect the overall claim payout on replacement cost policies, it is unlikely to affect ratemaking. Furthermore, the uneven application of depreciation of labor across the insurance market does not create a general condition for all consumers. The commissioner has considered this comment and not made any changes to the proposed rule language.
This rule improperly interferes between parties entering into a contract.	Statutes and regulations often intercede on conditions found within contracts. This is the proper regulatory venue to conduct this action. The commissioner has considered this comment and not made any changes to the proposed rule language.

Section 6: Implementation Plan

A. Implementation and enforcement of the rule.

After the permanent rule is filed and adopted with the Office of the Code Reviser:

- Policy staff will distribute copies of the final rule and the Concise Explanatory Statement to all interested parties through the State's Govdelivery email system.
- The CR 103 documents and adopted rule will be posted on the Office of the Insurance Commissioner's website.
- Questions will be addressed by Office of the Insurance Commissioner's staff as follows:

Type of Inquiry	Division
Consumer assistance	Consumer Protection
Rule Content	Policy
Authority for rules	Policy
Enforcement of rule	Legal Affairs
Market Compliance	Company Supervision

B. How the Agency intends to inform and educate affected persons about the rule.

- The agency will meet with and provide assistance to any affected property insurer.
- Policy staff will distribute copies of the final rule and the Concise Explanatory Statement to all interested parties through the State's Govdelivery email system.
- The CR 103 documents and adopted rule will be posted on the Office of the Insurance Commissioner's website

C. How the Agency intends to promote and assist voluntary compliance for this rule.

- The agency will meet with and provide assistance to any affected property insurer.
- Policy staff will distribute copies of the final rule and the Concise Explanatory Statement to all interested parties through the State's Govdelivery email system.
- The CR 103 documents and adopted rule will be posted on the Office of the Insurance Commissioner's website

D. How the Agency intends to evaluate whether the rule achieves the purpose for which it was adopted.

The agency will monitor the market to better understand the impacts of this rulemaking on the insurance repair process.

Appendix A

CR-102 Hearing Summary

Summarizing Memorandum

**To: Mike Kreidler
Insurance Commissioner**

**From: David Forte
Presiding Official, Hearing on Rule-making**

Matter No. R 2021-04

Topic of Rule-making: Prohibiting depreciation of labor on property claims

This memorandum summarizes the hearing on the above-named rule making, held on October 13 at 9:00AM on Zoom meeting ID# 872 0410 6563 over which I presided in your stead.

The following agency personnel were present: Dennis Godwin, Amy Teshera

In attendance and testifying:

Christian Rataj
Mel Sorenson
Kenton Brine

In attendance:

Christine Barlow, Jean Leonard, Katie Kolan, Kellee Gunn, Victoria Kidman, Mark Skelton, Austin Laney, JuliaAnna Anastassatos, Luke Salzwedel, Veronica Vanslyke.

Contents of the presentations made at hearing:

Christian Rataj testified representing the National Association of Mutual Insurance Companies and asked the Commissioner to withdraw the rule. He testified that the proposed rulemaking prohibits the fundamental freedom of parties to enter into contracts and alleging the Commissioner failed to properly cite authority enabling this type of rulemaking. Furthermore, Mr. Rataj testified the rule fails to meet a reasonable standard, inconsistent with Washington state case law, and conceptually inaccurate. Finally, Mr. Rataj testified that if the rule goes into effect, it creates an economic windfall for insureds if they do not replace the covered damage.

Mel Sorenson testified representing the American Property Casualty Insurance

Association and asked the Commissioner to withdraw the rule. He testified the rule will negatively impact anyone who buys an ACV only policy and exceeds the authority of the Commissioner. Mr. Sorenson further testified the rule is against Washington state case law and will discourage homeowners from properly maintaining their home.

Kenton Brine testified representing the NW Insurance Council and asked the Commissioner to withdraw the rule. He testified the rule is outside the Commissioner's authority and would be administrative burdensome for companies to implement. Mr. Brine opined that disclosure to the insured is a better pathway, so consumers may have options in insurance products to choose from. Mr. Brine also offered to help fight against contractor fraud.

The hearing was adjourned.

SIGNED this 13th day of October, 2021



David Forte, Presiding Official