



July 15, 2021

Submitted via www.rulescoordinator@oic.wa.gov

Mike Kreidler
Washington State Insurance Commissioner
P.O. Box 40255
Olympia, WA 98504-0255

Re: Prohibiting depreciation of labor on property claims (R 2021-04)

Dear Commissioner Kreidler:

Thank you for the opportunity to comment on the first stakeholder draft of a regulation prohibiting the depreciation of labor on property claims (R 2021-04).

United Policyholders (“UP”). UP is a non-profit, tax-exempt, charitable organization founded in 1991 that is a source of information and guidance and a respected voice for policyholders throughout the nation. UP helps preserve the integrity of the insurance system by advocating for fair sales and claim practices. Through a Roadmap to Recovery program we provide technical guidance and support to disaster-impacted property owners at no charge through an extensive website library, public workshops, clinics and webinars in coordination with public agencies and partners. Grants, donations, and volunteers support the organization’s work.

Excessive and improper depreciation by insurance company adjusters is an all too common unfair claim practice that interferes with loss indemnification. We commend your agency for issuing the proposed regulation. It is important and much needed.

A diverse range of individual and commercial policyholders throughout the United States 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 numerous briefs across the country in which we specifically address the topic of labor depreciation in the calculation of “actual cash value” or “ACV” under standard form property insurance policies.

Specifically, 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 these issues go to the very heart of Washington 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.¹

In providing these comments, UP would like to specifically address the following concerns all of which support the proposed rulemaking to prohibit the depreciation of labor on property claims in Washington State:

1. The traditional industry approach was not to depreciate labor when calculating a policyholder's ACV payment.
2. All commercially available, electronic claims-estimating software programs allow for the depreciation of materials and sales tax *only* to the exclusion of labor costs.
3. Insurers' aggressive expansion of what comprises "depreciation" coupled with policy deductibles and the requirement that a policyholder must first incur repair or replacement costs in order to obtain "replacement cost coverage" or "RCV," effectively leaves policyholders paying premiums for RCV coverage but not being able to afford to make the repairs necessary to obtain said coverage.
4. While approximately half of property insurance carriers do not depreciate labor, many major insurers do, including some of those with the largest market share in Washington. Those insurers that depreciate labor do not inform the consuming public of what labor depreciation is or how it operates to significantly lower claim payments. As a result, insurance consumers do not know what type of insurance coverage they have purchased until *after* they have suffered a loss.

Overview of Industry Practice and Commercial Claims Estimating Software

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"). This was the traditional approach of the industry prior to the advent of computerized property insurance claims estimating software. *See Don Wood et al., Insurance Recovery After Hurricane Sandy: Correcting the Improper Depreciation of Intangibles Under Property Insurance Policies*, 42 TORTS, INS. & COMPENSATION L.J. 19, 24 (Winter 2013); Chip Merlin, *Few Judges and Insurance Regulators Worked In Property Claims: Understanding New Insurance Rulings*, PROP. INS. COV. LAW BLOG (August 16, 2017).

In contrast to the traditional property insurance industry approach, and over the past ten to fifteen years, commercially available, electronic claims-estimating software programs (*e.g.*, Xactimate® and Symbility) began to provide a property insurer with the option to withhold—or not withhold—a portion of the labor needed to repair a structure as "depreciation" at the same time the program calculated the depreciation arising from the physical deterioration of building materials. The new option was created as property insurers realized that withholding labor as "depreciation" could dramatically lower ACV payments, and the software ensured that said option was simply a "mouse-

¹ *See, e.g.*, "Depreciation Basics" at <https://www.uphelp.org/pubs/depreciation-basics>.

click away.” *Hicks v. State Farm Fire & Cas. Co.*, 965 F.3d 452, 456-57, 465 (6th Cir. 2020) (recognizing insurer can “make simple changes to the parameters in Xactimate to calculate the ACV ... and to assure that labor depreciation would not be subtracted ...”); *Arnold v. State Farm Fire & Cas. Co.*, No. 17-00148, 2020 WL 6879271, at *2 (S.D. Ala. Nov. 23, 2020) (“Xactimate software enables labor depreciation to be calculated or not calculated by merely selecting it as an option with a click of a button.”).

Depreciation of Labor is Directly Contrary to the Concept of Indemnity and Results in a Windfall to Insurers

Allowing insurers to depreciate labor is contrary to both the concept of indemnity and the reasonable expectations of their customers and tends to cause policyholders significant financial harm. If post-loss labor costs—needed to both remove and dispose of damaged construction materials and then to re-install replacement materials—are withheld, the policyholder is left in a worse position than before the loss. Under that scenario, the policyholder would be forced to not only pay the out-of-pocket delta between worn building materials and brand-new building materials (in addition to the deductible), but would also be forced to fund the removal and reinstallation of the building materials (which he or she just paid for) to return the property to its pre-loss condition. Such a result is illogical and antagonistic to the goal of indemnity—*i.e.*, to return the insured to his or her *status quo ante*. Steven Plitt, *et al.*, COUCH ON INSURANCE §175.5 (3d ed. 2020) (describing purpose of indemnity is “to place him or her in the same financial condition” as if there had been no casualty).

Further, the reasonable expectation of the policyholders is that the indemnity policy they purchased will provide coverage sufficient to actually indemnify them or put them back in the position they were in prior to the loss. If the policyholders’ property had a roof before the loss, indemnity requires that they be paid the depreciated value of the roofing materials and the cost of installing those depreciated materials. Otherwise, they will be left with less than the benefit of their bargain.

When an insurer depreciates labor it generally means the insurer *never* pays the true cost of the labor their policyholders must pay to construction professionals which means the purpose of insurance - indemnity in case of loss -is defeated.

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

Standard property insurance policies provide that RCV coverage is not paid until the repairs are actually incurred. 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 RCV 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 RCV 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 (*e.g.*, to pay their contractors).

The Office's Notice of the first stakeholder draft for R2021-04 thus correctly observes that the practice of depreciating labor costs on insurance payments for property damage claims "floats a significant part of the labor repair costs to the consumer ..., unfairly shifting a burden to the consumer during the repair process"—irrespective of whether the consumer has purchased ACV or RCV coverage. The proposed rule will ensure that policyholders have sufficient funds for the labor necessary to restore insured assets to their pre-loss condition.

Insurance Consumers Have a Right to Know What Type of Insurance Coverage They Are Purchasing

Approximately 50% of property insurance carriers depreciate labor in calculating ACV payments to their insureds, whereas the other 50% do not—yet, no carrier advertises on its website or in its marketing materials what labor depreciation is or how it operates to significantly lower claim payments. When shopping for homeowners' coverage, then, how are consumers to know what type of ACV insurance they are considering purchasing?

The answer to this fundamental question is clear and supports the proposed rulemaking here: because of the dramatic impact of withholding labor as depreciation—coupled with the diametrically opposed approaches to withholding labor within the homeowners' insurance market, policyholders do not know what coverage they have purchased until *after* a claim arises. The clarity provided by R2021-04 ensures that policyholders will know precisely what they are buying in an insurance policy *at the time they are purchasing it*.

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 employ unfair business practices when adjusting claims in order to bolster their bottom line. Depreciating labor when calculating ACV benefits payable is an unethical and unfair. Depreciation of labor is contrary to the policies insurers have issued and the purpose of insurance: effecting indemnity in case of loss. Accordingly, I urge the Washington State Office of the Insurance Commissioner to closely examine the important benefits that the proposed rule will afford to Washington insurance consumers and consider the points made in these comments.

Thank you for providing the opportunity to present these comments on the first stakeholder draft for prohibiting the depreciation of labor on property claims (R 2021-04). We are available for further dialogue or to answer questions.

Sincerely,

A handwritten signature in black ink that reads "Amy Bach". The signature is written in a cursive style with a long horizontal line extending from the end of the name.

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