FILED
10:34 am, Mar 09, 2022
MISSOURI COURT OF APPEALS
WESTERN DISTRICT

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IN THE MISSOURI COURT OF APPEALS
WESTERN DISTRICT

Appeal No. WD84816

Cynthia M. Franklin,

Respondent,

v.

Lexington Insurance Company,

Appellant.

Appeal from the Circuit Court of Jackson County, Missouri
The Honorable S. Margene Burnett
Case Number 1816-CV04397

BRIEF OF AMICUS CURIAE UNITED POLICYHOLDERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES 3
STATEMENT OF INTEREST OF *AMICUS CURIAE* 5
INTRODUCTION 7
ARGUMENT 9
I. THE MEANINGS OF THE TERMS ACTUAL CASH VALUE, REPLACEMENT COST VALUE, AND DEPRECIATION. 9
Actual Cash Value 9
Replacement Cost Value 10
Depreciation 11
Methods of determining actual cash value 11
II. DEPRECIATION OF LABOR IS DIRECTLY CONTRARY TO THE CONCEPT OF INDEMNITY. 13
III. THE QUESTION OF WHETHER LABOR SHOULD BE DEPRECIATED IS A MATTER OF CONTRACT INTERPRETATION AND SHOULD BE DECIDED AS A MATTER OF LAW. 16
IV. A REASONABLE CONSTRUCTION OF THE INSURANCE POLICIES AT ISSUE IS THAT LABOR SHOULD NOT BE DEPRECIATED. 17
V. TO THE EXTENT THE POLICY TERMS “ACTUAL CASH VALUE” AND “DEPRECIATION” ARE SUBJECT TO MORE THAN ONE REASONABLE INTERPRETATION, THE POLICY MUST BE INTERPRETED IN FAVOR OF THE POLICYHOLDERS. 21
CONCLUSION 28
CERTIFICATE OF COMPLIANCE 30
CERTIFICATE OF SERVICE 30

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

TABLE OF AUTHORITIES

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Allstate Prop. & Cas. Ins. Co. v. Wolfe, 629 Pa. 444 (2014) 5
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Coppins v. Allstate Indem. Co., 359 N.W.2d 896 (Wis. Ct. App. 2014)............ 9
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Gen. Cas. Co. of Wis. v. Hills, 561 N.W.2d 718 (Wis. 1997) 24
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SYMPOSIUM ON SUPREME COURT ADVOCACY: EFFECTIVE AMICUS BRIEFS., 33 Cath. U.L. Rev. 603 6

Valuation and Measure of Recovery Under Fire Insurance Policies, 49 Colum. L. Rev. 818 (1949) 12

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

STATEMENT OF INTEREST OF *AMICUS CURIAE*

United Policyholders ("UP") is a non-profit organization whose mission is to serve as an effective voice and source of information and guidance for insurance commercial and personal lines around the country. UP is funded by donations and grants. It does not sell insurance or accept money from insurance companies. Unlike insurers, individual policyholders are not repeat players on insurance coverage issues. UP works to provide an intellectual counterweight to the claims of the insurance industry in order to help facilitate the evenhanded development of insurance law. Indeed, the Illinois Supreme Court recently favorably cited a UP *amicus curiae* brief on the labor depreciation issue that is before this Court. *See Sproull v. State Farm Fire & Cas. Co.*, 2021 IL 126446 ¶ 53 (Ill. 2021). Multiple state supreme courts, as well as the U.S. Supreme Court, have similarly cited UP briefs with approval on other subjects.[1]

UP seeks to fulfill the classic role of amicus curiae by supplementing the efforts of counsel and drawing the court's attention to law that may have escaped consideration. As commentators have stressed, an amicus is often in a superior position to focus the court's attention on the broad implications of various possible rulings. *See* R. Stern, E. Greggman & S. Shapiro, Supreme Court Practice, 570-71 (1986) (quoting SYMPOSIUM ON

[1] *See*, *e.g.*, *Humana Inc. v. Forsyth*, 525 U.S. 299, 314 (1999); *Cont'l Ins. Co. v. Honeywell Int'l, Inc.*, 234 N.J. 23, 64 (2018); *Allstate Prop. & Cas. Ins. Co. v. Wolfe*, 629 Pa. 444, 452–53 (2014); *Julian v. Hartford Underwriters Ins. Co.*, 45 Cal. 4th 747, 760 (2005).

SUPREME COURT ADVOCACY: EFFECTIVE AMICUS BRIEFS., 33 Cath. U.L. Rev. 603, 608).

When insurers reduce actual cash value claim payouts by depreciating labor, they are failing to meet their duty to indemnify insureds for the 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 Missouri 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 topics of both proper and improper depreciation. *See*, *e.g.*, "Depreciation Basics" <available at https://www.uphelp.org/pubs/depreciation-basics>

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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, and labor—*logically and by its very nature*—cannot depreciate in value over time the way materials can.

Fortunately, approximately fifty percent of insurance carriers *do not* engage in the practice of depreciating labor costs. *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 depreciate labor costs, many have filed and use coverage forms expressly authorizing the practice so that the policyholders ostensibly know what they are buying. *See 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"). Expressly disclosing the practice of depreciating labor in an insurance policy creates clarity and transparency, as policyholders clearly know what they are purchasing and how a claim will be calculated.

This case deals with a practice that the *minority* of insurance companies engage in: depreciating labor costs without any authorization in the policy form. Lexington Insurance

Company ("Lexington") is well- aware of the controversy of depreciating labor costs, as it has been a topic of much litigation around the country in the past decade. Indeed, as detailed below, numerous state supreme courts, federal district courts, and federal circuit courts of appeal have opined on the topic, with the majority concluding that depreciating labor costs without a policy expressly authorizing it is unlawful. Rather than being transparent with Missouri policyholders by expressly disclosing that it was depreciating labor costs when calculating claims, Lexington engaged in this practice without informing its policyholders.

Ultimately, the question of whether labor should be depreciated in calculating actual cash value ("ACV") requires interpretation of the insurance contracts themselves. As such, the issue is a question of law for this Court.

Missouri 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, labor costs should not be depreciated. Depreciation of labor results in policyholders not receiving the full amount that they reasonably are entitled to under their ACV coverage. It also often results in policyholders being unable to collect replacement cost value ("RCV") benefits for which they have paid an additional premium. That can lead to a life-changing loss for policyholders—and a windfall for the insurer.

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

ARGUMENT

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

Determining whether labor should be depreciated depends on the evaluation 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 ACV is at the heart of this dispute. Generally, 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). ACV 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. The obvious corollary to this principle is that the ACV approach should never 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 Indem. Co.*, 359 N.W.2d 896, 905 (Wis. Ct. App. 2014). A policyholder should reasonably expect that ACV 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, ACV would be the price of providing the policyholder a ten-year-old roof that was not destroyed by hail. Disputes arise, as here, 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.

Replacement Cost Value

In contrast to ACV (which provides enough money to return damaged property to the same condition it was in immediately before a casualty), RCV 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, 3 INS. CLAIMS AND DISPUTES § 11:35 (6th ed. Mar. 2021 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 RCV coverage 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 ACV and RCV payments differs. ACV benefits are paid as soon after the loss as the amount owed by the insurance company is determined. In contrast, RCV

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benefits 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 Plitt, *et al.*, COUCH ON INSURANCE §176:56 (3d ed. Dec. 2021 Update). As the recovery of RCV benefits requires an insured to take additional steps, insurers may try to allocate as much of the loss as possible into replacement cost coverage rather than ACV to make it less likely the insurer will have to pay any replacement costs.

<u>Depreciation</u>

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*.'" Richard J. Cohen, et al., 5 NEW APPLEMAN ON INS. LAW LIBRARY ED. §47.04[2][a] (2021) (emphasis added); *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.

<u>Methods of determining actual cash value</u>

UP understands that the parties in this case agreed to calculate the ACV of the

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covered losses at issue by first calculating RCV and then deducting depreciation.[2] Indeed, it was on this core foundation that Lexington calculated the depreciation to be subtracted from Plaintiff's payment. UP agrees that the insurance policy at issue in this case requires this methodology. 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.

Another method to calculate ACV is market value. Logically, market value cannot be the only factor because it is impossible to determine the value of a roof or a deck except as a component of the house or other building to which it is attached; and the market value of that house or other building is itself determined in part by the property on which it sits. *Travelers Indem. Co.*, 442 N.E.2d at 355 (citing Note, *Valuation and Measure of Recovery Under Fire Insurance Policies*, 49 Colum. L. Rev. 818, 820 (1949)).

The fallacy of utilizing market value to measure actual cash value after a structural loss is shown by a hypothetical that a roof might have deteriorated to the point that it has no value. In that situation, an insurer might argue that labor to install the roof has been reduced to no value. Although a worn roof might not have any *market value*, it certainly has some value to those whom the roof protects from the weather. Those are the same

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[2] Alternative methods of calculating actual cash value are the broad evidence rule and fair market value approaches. The broad evidence 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*, where the replacement cost less depreciation methodology is used, "'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.

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

people who Lexington now asserts should not receive any of the insurance coverage for which they have paid.

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, ACV puts the policyholder in the same condition as before the loss. Because physical material depreciation is withheld to determine the ACV (as both parties agree can and should be done), the policyholder bears 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.

If additional amounts are withheld as depreciation for labor costs, the policyholder does not get ACV coverage because he or she is not restored to his or her pre-loss condition. He or she is no longer receiving ACV coverage, but rather, something less.

A basic example illustrates the differences between RCV and ACV, the interplay between ACV and RCV, and the role of depreciation and its impact on labor. Assume a residential home that has a ten-year-old shingled roof with a normal life span of twenty years is destroyed in a hurricane. Further assume that all of the shingles were properly installed at the time the policyholder buys ACV coverage.

Determining the replacement cost value is simple—it is the cost to replace all damaged components of the roof with brand new materials. Assume that the undisputed replacement cost of the damaged roof in our hypothetical is $30,000. To arrive at an actual

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cash value amount, 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 his or her pre-loss condition. To do this, the goal must be to give the insured what he or she had before the loss—a ten-year-old, properly installed roof. ACV, therefore, requires payment of the value of ten-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 must be removed and disposed of, and that labor cost must be ascertained. Then the diminished value of ten-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 (*i.e.*, 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 difference between ten-year-old shingles and brand-new shingles and the deductible. The physical depreciation fairly penalized the policyholder for the roof's pre-loss wear and tear.

Practically, there is no market for ten-year-old shingles and no store sells "used" ten-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

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($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 he or she can afford to pay the difference between the worn, ten-year-old shingles and brand-new shingles out-of-pocket, the ACV payment does not enable the insured to remove the damaged shingles and reinstall the shingles paid for. This double deduction does not accomplish indemnity and is the ultimate reason why Lexington's logic and arguments fail. Lexington's theory leaves the insured in a worse condition than before the loss, thus not resulting in indemnity.

Adoption of a "market value" ACV valuation method in the context of partial structural losses would similarly result in injustice and underpayment of valid claims. Because there is no readily available or definable market for worn shingles, used nails, 10 year old HVAC ductwork, or the like, application of a market value approach to calculating ACV would render ACV coverage practically illusory, and it would leave policyholders with little more than pittance after catastrophic events, a result that certainly does not meet the reasonable expectations of any layperson purchasing property insurance. This is particularly true when the policy itself contains no reference to market value whatsoever.

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III. THE QUESTION OF WHETHER LABOR SHOULD BE DEPRECIATED IS A MATTER OF CONTRACT INTERPRETATION AND SHOULD BE DECIDED AS A MATTER OF LAW.

Insurance policies are interpreted as a matter of law and are subject to the general rules of contract construction. *See Standard Artificial Limb v. Allianz Ins. Co.*, 895 S.W.2d 205, 209 (Mo. Ct. App. 1995) ("The interpretation of the meaning of an insurance policy is a question of law."). The resolution of whether labor costs should be depreciated is not a question of fact, but a question of law appropriate for a court's independent determination.

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 to policyholders. The harmful effect is that factfinders could render differing awards to policyholders in identical situations, resulting in *different* ACV benefits. For example, consider respective owners of two identical houses, who purchased identical insurance policies from the same carriers, 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, all dependent on the question of whether the particular adjuster, appraiser, judge, or jury decided to depreciate labor.

Worse, some insurers might insist on depreciating labor across the board 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 to provide certainty and clarity to policyholders *and* insurers.

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IV. A REASONABLE CONSTRUCTION OF THE INSURANCE POLICIES AT ISSUE IS THAT LABOR SHOULD NOT BE DEPRECIATED.

Under Missouri law, an insurance policy must be construed giving the policy language its plain meaning or that which would be attached to it by an ordinary purchaser of insurance. *See Doe Run Res. Corp. v. Am. Guar. & Liab. Ins.*, 531 S.W.3d 508, 511 (Mo. 2017). However, any ambiguity must be construed in favor of the insured. *See Owners Ins. Co. v. Craig*, 514 S.W.3d 614, 617 (Mo. 2017). A reasonable construction of the insurance policies in this case is that labor is *not* included in depreciation. Not only would depreciating labor costs require ignoring the definition of common words, doing so would also fail to effectuate the purpose of actual cash value coverage of indemnifying the policyholders for their losses.

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. APPLEMAN §47.04[2][a]; *Black's Law Dictionary* (10th ed. 2014). The principal definition of depreciation "refers to 'physical deterioration.'" APPLEMAN §47.04[2][a]. *Depreciation* is the "reduction in value of *tangible* property." Robert J. Prahl, *Introduction to Claims,* 87 (1988) (emphasis added). 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. Quite simply, 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 court explained in *Titan Exteriors, Inc. v. Certain Underwriters at Lloyd's, London*, 297 F. Supp.3d 628, 634 (N.D. Miss. 2018), "[l]abor does not suffer use, wear, or obsolescence. It does not physically deteriorate." *Id.* Thus, it is difficult to envision a scenario where labor would depreciate since it is not susceptible to aging or wear.

The National Underwriter Company publishes, under the name "FC & S", 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. 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, *Depreciation of Labor* (Nat'l Underwriting Co. Dec. 3, 2014).

Lexington 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 the insurance industry concerning the application of policy provisions, agrees. It has explained that if an insurance company wants its own interpretation of ACV to apply, it can simply define ACV in its own policy. *See* Mike McCracken, International Risk Management Institute, Inc. Expert Commentary, *What Exactly is Actual Cash Value? Better Yet, How Do You Calculate It?* (Sept. 2018), *available at*: https://www.irmi.com/articles/expert-commentary/what-exactly-is-actual-cash-value (last visited Feb. 19, 2022).

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

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Here, Lexington could have easily defined ACV to include the depreciation of labor. It chose not to do so. Lexington should not now get the benefit of its affirmative decision not to define ACV in its policy. Many insurers have taken the simple step of defining ACV to include depreciation of labor costs. *See, e.g.*, *Hicks*, 751 F. App'x. at 709. Many carriers also simply choose not to depreciate labor costs.

Tellingly, the claims adjusting software that is almost universally used by insurance carriers further demonstrates that it is reasonable for an insured to expect that labor costs will not be depreciated. 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 ACV.

For example, Xactimate® by Xactware is a software program for estimating construction and repair costs that is widely used by "22 of the top 25 property insurance companies in the U.S. and 10 of the top 10 Canadian insurers …"[3] The below Xactimate® screenshot shows that an insurer can choose to select or de-select "Depreciate Non-Material" or "Depreciate Removal," both of which are labor items:

Depreciation Options
☑ Depreciate Material
☑ Depreciate Non-Material
☐ Depreciate Removal
☐ Depreciate Overhead and Profit
☑ Depreciate Sales Tax
Max Depreciation 100%
Depreciation (Default)
Recoverable
Depreciate By: Percent

http://xactimate.xactware.help/help_baggage/2015_WhitePaper_CalculatingDepreciation

[3] *See* https://www.xactware.com/en-us/company/about/# (last visited February 19, 2022).

ForStructuralPropLines.pdf (last visited February 19, 2022). Given that insurance companies' own valuation software allows for the depreciation of labor costs or not, Lexington cannot credibly argue that Plaintiff's policy interpretation is unreasonable. *See Sproull*, 2021 IL 126446, ¶¶ 52-53 (distinguishing cases that failed to recognize both industry practice and standard software allow insurance companies to decide whether or not to depreciate labor).

To create certainty and clarity in the insurance marketplace for insurers and policyholders, some states and courts have sought to require insurers to specify that they will depreciate labor costs in calculating ACV. For example, in 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."[4] 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. To the extent this Court determines that an insurer may depreciate labor costs when calculating ACV in Missouri, the Court should, at a minimum, require insurers to specifically disclose in their policies that labor will be subject to depreciation.

Insurance companies like Lexington should not benefit by deducting labor from policyholders' ACV payments. As explained below, even if the term is subject to more

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[4] *See* https://www.mid.ms.gov/legal/bulletins/20178bul.pdf (last visited February 19, 2022).

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than one reasonable interpretation, rules of construction favor the policyholders' position.

Finally, depreciating labor would not effectuate the purpose of ACV coverage, *i.e.,* indemnity, or placing policyholders back in the position they enjoyed prior to the loss. While ACV coverage can never return the policyholders to the *precise* position they were in prior to the loss, insureds need enough money to repair or replace the damaged property, including removal and installation labor.

Consider again the policyholders in the earlier example with a ten-year-old roof that was destroyed by a storm. 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, however, is not feasible. Therefore, ACV benefits 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, 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 POLICY 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

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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.

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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

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

> 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"). Missouri law is in accord. *See*, *e.g.*, *Seeck v. Geico Ins. Co.*, 212 S.W.3d 129, 132 (Mo. 2017) (noting courts are to construe policies with "the meaning which would be attached by an ordinary person of average understanding if purchasing insurance" and to "resolve[] ambiguities in favor of the insured.")

Because the policy terms ACV and depreciation are subject to more than one reasonable interpretation, the terms must be construed in favor of the policyholder. Courts across the country have reached this result and found that insurers may not depreciate labor

when their policies do not specify that such is allowed. For example, in 2019, the Tennessee Supreme Court addressed an insurance policy very similar to the one here—*i.e.*, the policy did "not define actual cash value but states that actual cash value includes a deduction for depreciation." *Lammert*, 572 S.W.3d at 173. The court held this language is subject to more than one reasonable interpretation. *Lammert*, 572 S.W.3d at 173, 179. Thus, the court "strictly construed [it] against the insurance companies and in favor of the insured[]" and 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.* at 179.

Similarly, in *Sproull*, the Illinois Supreme Court held that a policy that failed to define ACV or depreciation was ambiguous, and did not allow depreciation of labor costs. *Sproull*, 2021 IL 126446, ¶ 54. In *Hicks*, the Sixth Circuit was faced with a policy that defined ACV as replacement cost less depreciation. *Hicks*, 751 F. App'x. at 711. Applying Kentucky law, 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. Other courts are in accord. *See*, *e.g*., *Perry v. Allstate Indem. Co.*, 953 F.3d 417, 422 (6th Cir. (Ohio) 2020) (holding that because the policyholder's "interpretation of 'depreciation' [as not including labor] is a fair reading of an ambiguous term, her interpretation prevails against the insurer."); *Lains v. American Family Ins. Co.*, 2016 WL 4533075 (W.D. Wash. Feb. 9, 2016) ("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

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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, Missouri law directs that the ambiguity be construed against Lexington and in favor of the Plaintiff.

It is unreasonable to assume insureds would be able to infer that labor would depreciate from an ACV coverage policy when the terms "actual cash value" and "depreciation" are not defined. *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). As a result, allowing labor depreciation under these circumstances would place an unfair burden on the insureds, and as a result, would unjustly enrich insurers.

Moreover, allowing insurers to depreciate labor is contrary to the reasonable expectations of their customers and tends to cause them significant financial harm. The reasonable expectation of layperson 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 v. State Farm Fire & Cas. Co.*, 954 F.3d 700, 706-07 (5th Cir. 2020) (policyholder's "definition, which results

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

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 with respect to policies that only provide ACV coverage, and do not include RCV coverage. Depreciating labor costs means that insurers will *never* pay the cost of labor, and policyholders will never receive that portion of their loss.

Many insurance policies also include RCV coverage, for which policyholders pay an additional premium. Even when RCV 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 ACV coverage. In fact, where the policyholders have paid for replacement cost coverage, depreciating labor in the calculation of ACV will often result in an even bigger windfall for the insurer than where there is no RCV coverage. Furthermore, 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 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 ACV, or RCV 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 policyholder contracted and paid.

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

The insurer receives a windfall, and the policyholder remains without a roof.

Even if policyholders manage to save enough money to make repairs and eventually receive replacement cost value benefits from the insurers, in the interim, the insurers have earned income on the withheld depreciation. 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 ACV benefits payable is an example of such improper conduct, particularly when the policy is silent on the topic. 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 requests that the Court affirm the trial court's decisions below and find labor costs should not be depreciated under the subject policy.

Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

Dated: March 4, 2022.

Respectfully submitted,

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Electronically Filed - WESTERN DISTRICT CT OF APPEALS - March 04, 2022 - 09:33 AM

CERTIFICATE OF COMPLIANCE

This brief contains all of the information required by Missouri Supreme Court Rule 55.03 and complies with the requirements of Rule 84.06(b). The brief contains 6508 words. Counsel has relied upon the word-counting utility of Microsoft Word in making this certification.

/s/ Neil Chanter

CERTIFICATE OF SERVICE

I hereby certify that on March 4, 2022, a copy of the foregoing was submitted to the Court's electronic filing system to be served upon all counsel of record pursuant to Rule 103.08. A courtesy copy of this filing was also sent to all counsel via e-mail. The undersigned is informed and believes that Appellant's counsel of record is a registered user of the electronic filing system.

/s/ Neil Chanter